



Fiscal Year 2008 United States Army Annual Financial Statement
Financing America's Army: The Strength of the Nation

2008

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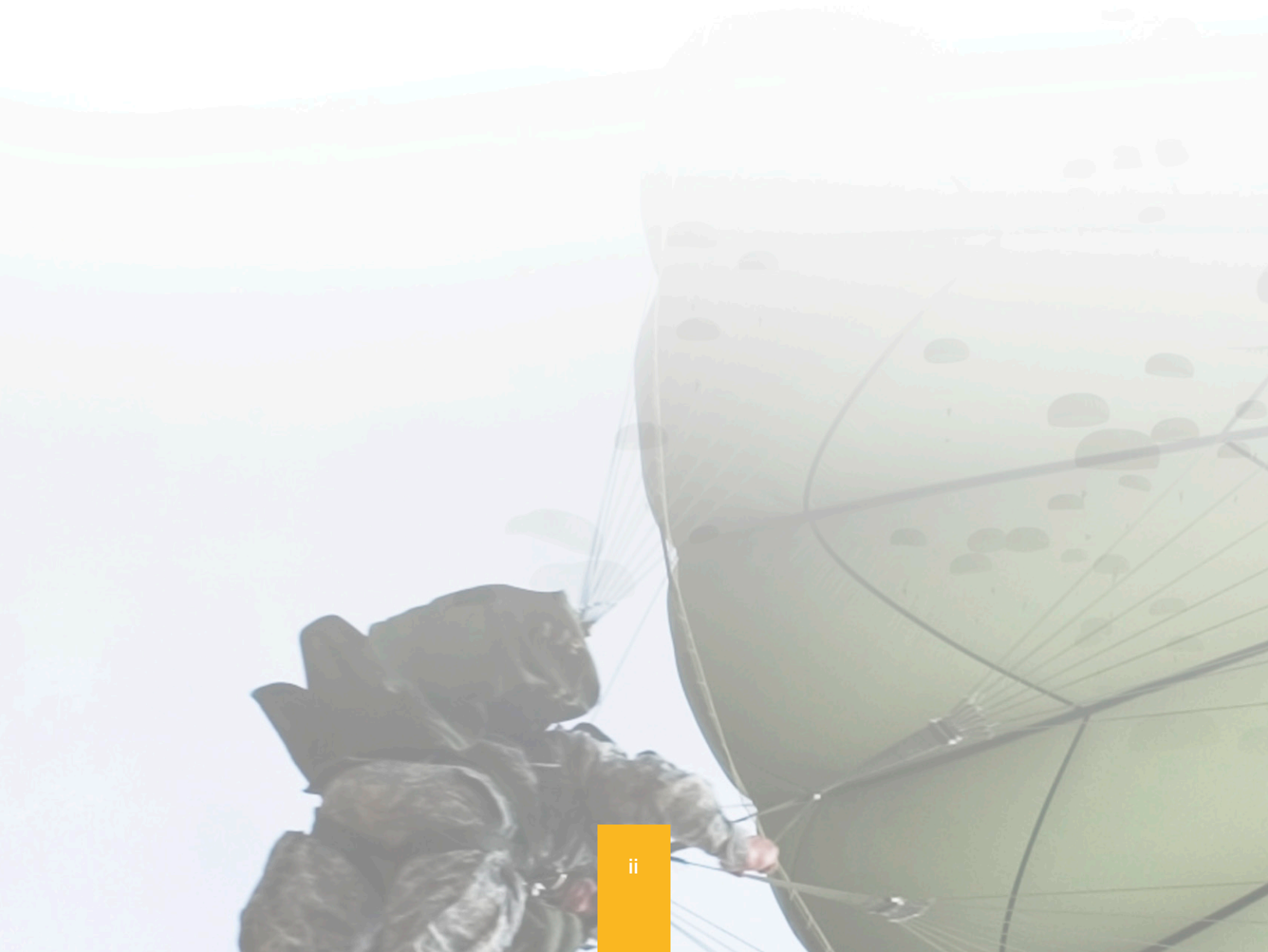
A U.S. Army military policeman gives a high five to a young Iraqi girl. (U.S. Air Force photo by Tech Sgt. Cohen A. Young/Released)

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The Honorable
Pete Geren
Secretary of the Army



The seven years since 9/11 have been years of radical transformation. The Army of 2008 does not look like the Army of 2001. Our Soldiers are trained, equipped and led differently. They have adapted to the evolving threats of an asymmetric battlefield with innovation, resiliency and resoluteness of purpose. And they are battle-hardened and combat-proven throughout the ranks.

Many of the challenges of the past remain the challenges for our future. They include ensuring that we have full spectrum readiness, adapting to shifting current and future threats, and providing a quality of life for our Army Families equal to their extraordinary service.

Over the last year, with Congressional and budgetary support, the Army has made progress in rebalancing its force while simultaneously fighting two wars. Spin-off technologies from our Future Combat System are being implemented now, helping to both sustain and prepare our Soldiers as we transform our Army to meet present and future challenges. This continued Army growth – and the necessary funding for it – remains vital.

Just as we have adapted to evolving threats on the battlefield, our support for Army Families must adapt to their changed circumstances – the increasing physical and emotional demands of an Army long at war. In this past year, communities across the Nation have embraced our Community Covenants – and pledged to work collaboratively with our military Families. Using appropriated resources, we have improved housing, built child development centers and restructured the support system for our returning Wounded Warriors. These are all laudable initiatives – but they are not complete. We must continue to provide the financial resources that will guarantee that our support of Army Families and Soldiers is second to none.

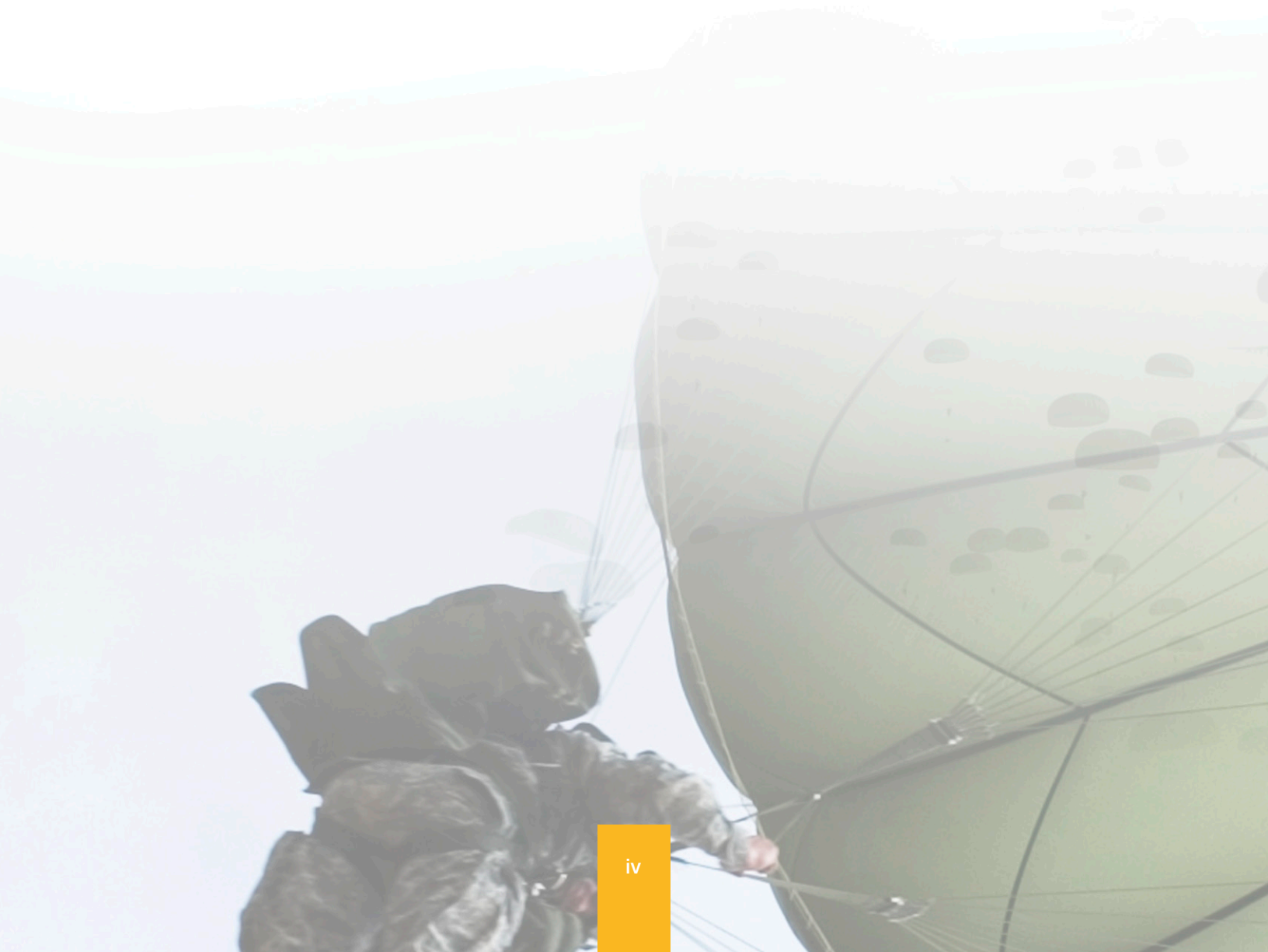
We have made great progress in this past year – but more work lies ahead. With your support and partnership, we will continue to build an Army that will meet the threats, challenges and opportunities of the 21st Century.



Pete Geren
Secretary of the Army

Peter E. Kunkel

*Acting Assistant Secretary of the Army
(Financial Management and Comptroller)*



In FY 2008, the Army continued to transform its warfighting forces with the most sweeping changes undertaken since World War II. From the division-centric, forward-deployed force that served us well for many years, we are transitioning to the brigade-centric, expeditionary Army that is needed to meet the national security demands of the 21st century. We are simultaneously growing the Army by more than 74,000 Soldiers, restationing our warfighting and supporting forces in the U. S. and overseas and conducting combat operations against a highly capable enemy. If the Army is to successfully accomplish this challenging array of tasks with limited resources, it is essential that all Army organizations operate more effectively and efficiently.

To that end, Army financial management has continued to adapt and integrate cost management into the Army culture – to ensure that cost implications are factored into decision-making at all levels of the organization. Through education and training, new processes and procedures, cost and performance metrics and new systems, we are pressing on to “run the Army” just as effectively and efficiently as we “fight the Army.”

The centerpiece of our efforts is the General Fund Enterprise Business System (GFEBS), which will link financial accounting, funds control, asset accounting and cost management information across the Army. GFEBS will provide the information and analytical tools needed by executives, operational leaders and resource managers to make informed decisions. GFEBS continues to be on schedule and on budget. In March 2008, GFEBS successfully completed a critical acquisition milestone requirement and began implementation at our test site at Fort Jackson, SC, in October 2008. The system will “go live” in waves across the Army, beginning in FY 2009.

Going forward, we will develop a series of initiatives to make cost management an integral part of senior leader decision making. We are examining the workforce changes required to effectively field GFEBS and to provide expertise Army-wide to capitalize on its full range of capabilities. We will also renew our focus on a federated approach to enterprise resource planning as we integrate GFEBS with other systems in the logistics enterprise.

In FY 2008, we steadily progressed in process and systems improvements, making Army financial transformation a permanent element of the Army’s broader and ongoing transformation. FY 2009 holds the opportunity to continue that momentum through additional investments in our people and our systems. We are looking forward to it.



Peter E. Kunkel
Acting Assistant Secretary of the Army
(Financial Management and Comptroller)



“We have magnificent Soldiers, leaders and civilians. They are ordinary people who are doing extraordinary things for our country.”

General George Casey, Chief of Staff of the Army



Soldiers hold onto Static lines while training for their next airborne operation at the United States Army Special Operations Command mock trainer in Fort Bragg, North Carolina.

Overview

The last seven years have been years of radical transformation. The Army of 2008 does not look like the Army of 2001. Soldiers are trained, equipped and led differently. They are battle-hardened and combat-proven throughout the ranks. But many of the challenges of the past remain the challenges for our future.

We are halfway through the largest transformation since World War II and this effort impacts everything we do. Our Army is changing, becoming more lethal, sustainable and versatile. While executing this transformation, the Army is adding more than 74,000 Soldiers to the active and reserve forces, a process that will be completed in 2013. The Army also is in the midst of a mass repositioning of forces worldwide. Plans for resetting equipment and units to full capacity through Army Force Generation are in full swing.

Last year, we reported that the Army, while a committed, resilient and combat-seasoned force, was out of balance. The demand for our forces exceeded the sustainable supply, and we had gone to 15-month deployments. Consumed with meeting the requirements of the current fight, we lacked sufficient strategic flexibility and operational depth to respond to other contingencies. We were unable to provide a predictable, sustainable tempo of deployments for our Soldiers and their Families. Support systems designed for the pre-September 11 peacetime Army were stretched and stressed by the demands of lengthy and repeated deployments with insufficient recovery time. Overall, our readiness was being consumed as fast as we could build it.

In 2008, we initiated a plan founded on four imperatives to restore balance. We said we would sustain the Army's Soldiers, Families and civilians; continue to prepare forces for success in the current conflict; reset returning units to rebuild the readiness consumed in operations and to prepare for future deployments and contingencies; and transform to meet the demands of the 21st century. At the time, we acknowledged that implementing these imperatives would require several years, considerable resources and sustained national commitment. By 2011, we expect to: grow the Army to 1.1 million; establish acceptable balance between deployments and time spent at home; achieve substantial progress in modular transformation and rebalancing initiatives; complete Base Realignment and Closure and associated restationing; and fully implement the Army Force Generation model, all while sustaining the all-volunteer force and setting conditions for the future.

Mission, Vision and Organization of the Army

The Army’s mission is to support the National Military Strategy by providing well-trained, well-led and well-equipped forces to the combatant commanders. This mission has remained constant throughout the 233-year life of the Army; however, the environment and nature of conflict have changed dramatically over that same time, especially in the context of today’s Global War on Terrorism (GWOT). New adversaries and the growth in asymmetric warfare have compelled the Army to transform how it trains and equips its Soldiers, how those Soldiers are organized and how they fight.

The Army is committed to remaining the world’s preeminent land power – relevant and ready at all times to serve the nation and to support our allies. The Army will continue to supply U.S. combatant commanders with the forces necessary to defeat any adversary, in any situation, at any time. The Army, therefore, must fully train and appropriately organize its forces; develop innovative and adaptive leaders; and design support structures that are appropriate for the new global security environment.

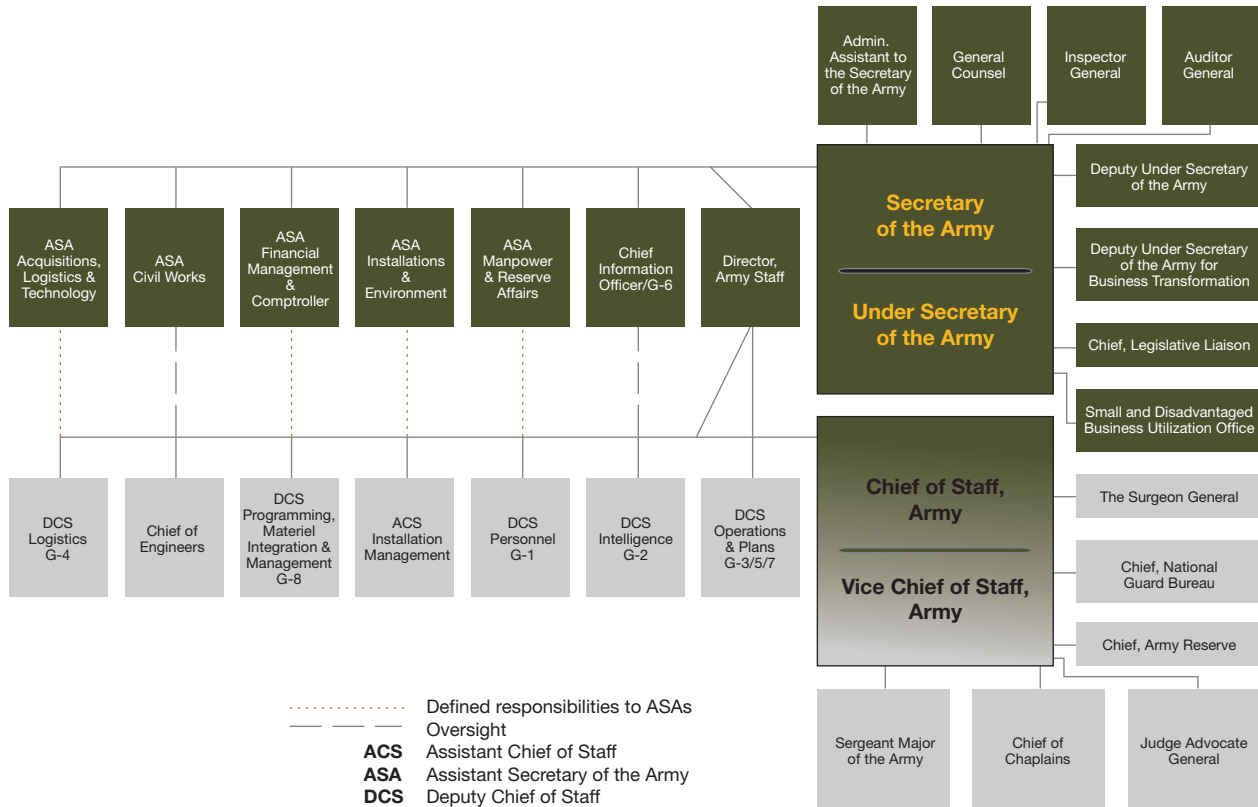
Figure 1 – Army Vision



The Army is a large and complex organization, with more than 543,000 active duty Soldiers and approximately 250,000 active and reserve component Soldiers deployed or forward-stationed in nearly 80 countries overseas. They are supported by nearly 290,000 Army civilians, who are critical members of the institution at every level.

The Army is organized with the primary objective of supporting and sustaining the mobilization, training and deployment of its Soldiers anywhere in the world. The Headquarters, Department of the Army (HQDA) (Figure 2), under the direction of the Secretary of the Army and the Chief of Staff, leads and manages the entire Army.

Figure 2 – Headquarters, Department of the Army (HQDA)



The Army’s organizational structure consists of two interdependent pieces: (1) the warfighting, operational Army; and (2) the institutional Army, which supports the operational force by providing the training, facilities and equipment necessary to prepare and to sustain Soldiers.

The operational Army provides the land-power capabilities for the combatant commander. Within the operational Army, the transition from a division-centric warfighting force to a brigade-centric force continues. At the heart of this change is the modularization and standardization of Army brigade combat teams (BCTs), a process that is essential to the development of a more rapidly deployable, flexible and powerful force.

Viewed by its constituent elements, the Army can be separated into the active and reserve components. The active component consists of full-time Soldiers assigned to the operational and institutional organizations that perform day-to-day Army missions. The Congress annually reviews and mandates the number of Soldiers that the Army may maintain. The reserve component consists of the Army National Guard (ARNG) and the U.S. Army Reserve (USAR).

The ARNG has two missions: federal and state. Its federal mission is to provide trained and ready forces for wartime, national emergencies and other requirements, as necessary. Its state mission is to train for, and respond to, domestic emergencies and other missions as required by state law. Unless federally mobilized, ARNG units are commanded by their state executive, usually the governor.

The USAR is the primary federal reserve force of the Army. The USAR provides specialized units and resources to support the deployment and sustainment of Army forces around the globe. In addition, the USAR is the main source of individual Soldiers to augment headquarters staff and to fill vacancies in the active component.

Performance Goals, Objectives and Results

Our country has been at war since the September 11, 2001, attacks on New York City and the Pentagon. The Army is a leader in this war and in the liberation of 50 million people from tyranny and oppression. It is also fully engaged in the difficult process of consolidating success, building stability and providing assistance in the development of local security forces and governance capacity. Over time, these operations have expanded in scope and duration, and have stretched and stressed our all-volunteer force.

As a result, the Army is out of balance. The demand for forces in Iraq and Afghanistan has exceeded the sustainable supply and limited our ability to provide ready forces for other contingencies. The Army's overall posture is further affected by the extraordinary requirement for counterinsurgency training, insufficient time between deployments and the extreme wear and tear on equipment. In addition, while the Reserve Components are performing magnificently, many reserve component (RC) units have found themselves assigned missions for which they were not originally intended nor adequately resourced.

The Honorable Pete Geren, Secretary of the Army, and General George Casey, Chief of Staff of the Army, have identified four critical Army imperatives necessary to restore balance and, based upon these imperatives, have initiated a plan to restore balance by 2011. These four imperatives will sustain our Soldiers, Families and civilians; prepare Soldiers for success in current operations; reset units to restore readiness and depth for future operations; and transform the Army into the force the nation needs today and in the future. These are not easy tasks and they require the full support of the Congress and the American people. While we have achieved much, more remains to be done.

In FY 2008, the Army refined the Cost of the Army model using newer data and methods to validate the cost of the force structure associated with accomplishing the missions set forth by Office of the Secretary of Defense (OSD). Factoring the costs associated with full implementation of the President's Grow the Army plan (an increase of 74,200 active and reserve component Soldiers), along with the associated recruiting and retention programs, resulted in an annual estimate of \$173 billion in FY 2010 dollars once the Army reaches the steady-state force structure levels approved by OSD in a peacetime operational status. We continue to refine our methodology and resourcing strategy so that we produce the leanest possible estimate, while accurately articulating the cost of the Army and its operational capabilities to the Congress and the American people.

The following sections discuss the four imperatives, goals and program performance results.



U.S. Army recruits wait in line for their initial haircut while still partially dressed in their civilian clothes during basic combat training at Fort Jackson, S.C., January 16, 2008. (U.S. Air Force photo by Senior Airman Micky M. Bazaldua) (www.army.mil)



Sustain

To sustain Soldiers, Families and Army civilians in an era of persistent conflict, the Army must maintain the quality and viability of the all-volunteer force and the many capabilities it provides the nation. Sustain ensures that Soldiers and their Families have the quality of life they deserve, which helps to improve retention rates.

Manning the Force – Recruiting and Retaining Soldiers

While the recruiting environment is challenging, the Army remains committed to bringing only the very best into our ranks. Our goal is for Tier 1 Educational Credential Holders (e.g., those with high school diplomas and college degrees) to comprise no less than 90 percent of new recruits. Typically, Tier 1 recruits are a lower risk for attrition and, therefore, are the most desirable group from which to draw. While the Army achieved 83 percent Tier 1 recruits in FY 2008, first-term attrition declined and training base attrition was at a historic low. Both are positive signs that we are recruiting, training and retaining a highly qualified force.

Table 1 – Quality – Percent Tier 1 Educational Credential Holders

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Tier 1 Goal	90	90	90	90	90
Tier 1 Actual	92	87	83	79	83

Though FY 2008 presented a challenging recruiting environment, the Army was able to meet its recruiting mission in all components. Several initiatives were implemented, such as Active First, the Army Prep School and the Army Advantage Fund, which helped the Army achieve its goals. FY 2009 is also expected to be a challenging recruiting year and we will continue to utilize these initiatives to attract high-quality recruits.

Table 2 – Recruiting

	FY 2005 Actual	FY 2006 Actual	FY 2007 Goal	FY 2007 Actual	FY 2008 Goal	FY 2008 Actual
Active Army	73,373	80,635	80,000	80,407	80,000	80,517
Army Reserve	19,400	25,378	26,500	27,004	26,500	26,945
Army National Guard	50,219	69,042	65,115	66,652	60,600	62,397

Due to the Global War on Terrorism, several special skills are in high demand. To fill them, it has been necessary to augment recruiting and retention incentives. The Army instituted a Critical Skills Retention and Accession Bonus (CSRB) to attract and to retain personnel in specific skills areas, including Special Forces, Criminal Investigations, Military Intelligence and Field Artillery. Further, medical-related CSRBs have been offered to physician’s assistants and maxillofacial/oral surgeons.

Table 3 – Active Component End Strength Within 2%

	FY 2005	FY 2006	FY 2007	FY 2008
Goal	502,400	502,400	518,400	529,191
Congressional Baseline	512,400	512,400	518,400	525,400
Actual	492,728	505,402	522,017	543,645
% Delta	-2.0%	+0.6%	+0.7%	+3.5%*

Performance Measure: The number of Soldiers on active duty at the end of the year. *When the President declares a State of National Emergency, end strength limits can be waived. The Army is trying to grow as fast as possible to relieve stress on the force and increase time between deployments.

Table 4 – Reserve (USAR and ARNG) End Strength Within 2%

	FY 2005	FY 2006	FY 2007	FY 2008
Goal	555,000	555,000	550,000	556,300
Actual	522,182	536,263	542,589	557,375
% Delta	-5.9%	-3.4%	-1.3%	+0.2%

Performance Measure: The number of Soldiers in the USAR and ARNG at the end-of-month (EOM) August 2008.

The Army has boosted reenlistment bonuses to a maximum of \$33,500 for high-demand specialties. These bonuses, which are a vital tool in keeping Soldiers who possess valuable combat experience, have helped the Army to exceed its retention goal for FY 2008. Careful and deliberate adjustments to bonuses, including which critical skills are targeted, will be made in order to retain the correct Soldiers.

Table 5 – Active and Reserve Component Retention

	FY 2005 Actual	FY 2006 Actual	FY 2007 Goal	FY 2007 Actual	FY 2008 Goal	FY 2008 Actual
Active Army	69,512	67,307	62,200	69,777	65,000	73,913
Army Reserve	16,485	18,223	16,571	19,761	14,946	16,523
Army National Guard	33,804	41,083	37,578	37,718	31,889	29,618

Performance Measure: Measures the number of Soldiers reenlisted during a given fiscal year against the published goals. The AC and USAR have achieved their recruiting mission for FY 2008 as of EOM September. The ARNG is considered successful as they have exceeded their end-strength requirements.

Recruiting and retaining Soldiers who are confident, adaptive, competent and able to handle the full complexity of 21st century warfare in this combined, joint, expeditionary environment is a highly competitive endeavor. The Army will continue to develop and to implement programs to address this challenge.

Improving the Quality of Life for Soldiers and Their Families

To retain Soldiers and meet the needs of their Families, the Army must care for them by providing exceptional programs and services that support their well-being. The Army is committed to attaining a quality of life for active, Guard and Reserve Soldiers and their Families that matches the quality of their service. Senior leaders across the Army signed an Army Family Covenant to demonstrate this commitment. To better fulfill this promise during war, the Army initiated programs to improve spouse employment, to ease the transition of high school students during moves and to extend in-state college tuition rates to military Families. In addition, there is an on-going effort to improve access to and availability of health care, child care, youth programs, schools and facilities. The Army also is concerned about our Soldiers' financial health and continued a multiyear initiative to eliminate Soldiers' out-of-pocket housing expenses.

To improve unit cohesion and readiness while reducing unit turbulence and uncertainty for Families, the Army is changing how units are manned. Under Force Stabilization, the Army plans to keep Soldiers in each assignment longer and will synchronize their assignments to brigade combat team (BCT) rotational schedules. Stabilization will create more deployable, combat-capable units while improving predictability and quality of life for Soldiers and their Families. They, in turn, will be able to build deeper roots in their communities and will have better opportunities for spouse employment, continuity of health care and schooling, and access to stronger support networks that enhance well-being.

Improving Soldier and Family Housing

Housing programs are essential for demonstrating our concern for Soldiers and their Families. In concert with the private sector, the Army continues to focus a considerable amount of effort on the Residential Communities Initiative and the Barracks Modernization Program. Congressional support for these initiatives has had a dramatic effect on improving the quality of life for our Soldiers and their Families.

Our programs are on track to eliminate the original inventory of inadequate family housing worldwide by FY 2009, through privatization, construction and divestiture of excess units. Additional inventory at Baumholder, recently reclassified as enduring, will be fully adequate by 2015. In FY 2008, 2,301 homes were privatized, bringing the total to 78,743. In addition, 2,179 homes were renovated and 5,052 homes were constructed using appropriated funds as equity contributions.

The Army's permanent-party, single-Soldier barracks requirement is 169,977 spaces. In FY 2008, the Army built or modernized 15,150 barracks spaces for about \$2.14 billion, bringing the total spaces built or modernized to 85.6 percent of the Army's requirement.

The Army has a training barracks requirement for 115,413 Soldiers but only has 92,833 spaces available. Installation Status Report ratings for almost all training barracks showed facility condition deficiencies that impair the capability of, or present significant obstacles to, the tenant organizations' accomplishment of required missions. In FY 2008, the Army built or modernized 14,356 training barracks spaces for \$1.27 billion.

The First Sergeant Barracks Initiative (FSBI) is being implemented across the Army and will provide centralized barracks management, similar to Family Housing management, for single Soldiers. The FSBI will encompass all aspects of asset management, to include Housing Operations Management System software modules designed specifically for barracks management.

The Army also is executing limited Unaccompanied Personnel Housing privatization projects for staff sergeants and above at Forts Irwin, Drum, Bragg, Bliss and Stewart. Together, these facilities will provide 1,396 apartments (1,804 bedrooms) in areas that have limited available rental properties for these grades.



A Soldier secures an area of a market development project in New Baghdad, Iraq, during a dismounted tour of the area January 27, 2008. (U.S. Army photo by Spc. Nicholas Hernandez) (www.army.mil)

Prepare

To prepare Soldiers, units and equipment, the Army must maintain a high level of readiness for the current operational environments, especially in Iraq and Afghanistan, while taking into consideration potential future conflicts. The Army is continually adapting training and materiel to keep pace with an evolving enemy. We remain committed to providing our deploying Soldiers with the best available equipment so that they can maintain a technological advantage over any enemy they may face.

Providing Support for Operational Requirements

The pace of operations in the new security environment presents a number of significant force management challenges to the Army. As a result of the Army's global commitments, approximately 250,000 Soldiers are deployed or forward-stationed in nearly 80 countries overseas. As of October 2008, approximately 543,000 personnel were serving in the active component, and approximately 76,000 reserve-component Soldiers were on mobilization orders.

Repeated deployments affect recruiting and retention, and have a very real impact on our ability to care for Soldiers and their Families. To meet today's challenges, and to better position troops for the future, the Army is pursuing numerous initiatives that will reduce force-management risk. By developing the Army Modular Force, we will significantly increase the pool of rotating units and, by employing the Army Force Generation Model (ARFORGEN), we will reduce the stress on the force. The results will be greater stability, unit cohesion and readiness, and less uncertainty for Families.

The ARFORGEN process leverages modular unit designs and the operational cycle to create a sustainable deployment posture with units that are ready in predictable patterns and with the capacity to surge combat power for major operations. When fully operational, ARFORGEN will enable the Army to schedule effectively and efficiently fully ready units for deployment, which will:

- (1) Reduce uncertainty for Soldiers, Families and the communities that support installations;
- (2) Improve the availability of forces for combatant commanders;

- (3) Generate a continuous number of available brigade combat teams (BCTs), augmented by all required supporting organizations (given appropriate mobilization authority); and
- (4) Enable the Army to surge additional BCTs augmented by all required supporting organizations (given appropriate mobilization authority).

Training Soldiers

Initial Entry Training increases the Soldier’s warfighting capability through individual warrior tasks and battle drills. Every six months, the Army reviews and updates these tasks and drills to ensure that training is relevant to today’s environment. During FY 2008, the Army’s training centers and schools increased student throughput by 10.3 percent compared to the program baseline. This increase was tied to the Grow the Army initiative to achieve an active component (AC) end strength of 547,000.

The Army continues to augment its ability to conduct irregular warfare through several functional courses that build on language and cultural competencies and improve Soldiers’ and civilians’ knowledge of, and capabilities in, electronic warfare, red teaming (opposing forces), counterterrorism, weapons of mass destruction, civil affairs, information operations, counter-explosive hazards and operational law.

Table 6 – Individual Training

	Basic Combat Training	One Station Unit Training	Advanced Individual Training	Basic Officer Leader Course	Officer Candidate School	Warrant Officer Entry Course	Initial Entry Rotary Wing
2007 Trained (reported)	65,098	22,644	70,219	13,043	1,337	2,666	N/A
2007 Trained (actual)	76,166	31,414	93,888	15,214	1,756	2,667	967
2008 Trained (interim)	65,262	21,252	74,041	13,594	1,518	2,606	653

This data represents active Army, ARNG and USAR students graduating from active component schools. All data is based on start date (i.e., if a class starts in FY 2007 and graduates in FY 2008 it is counted in the FY 2007 data). 2008 Trained (interim) data is as of October 15, 2008.

Training Units

In FY 2008, the Army provided trained and ready forces to commanders around the globe in addition to meeting critical homeland defense missions. To make sure Soldiers were combat-ready in FY 2008, they engaged in an appropriate mix of live, virtual and constructive training. The AC and RC fully executed their ground and air training plans, which included actual miles driven and hours flown as well as virtual miles associated with the use of simulators. In FY 2008, home-station training miles execution was impacted by the limited dwell times between rotations and the surge of units into theater.

Table 7 – Ground and Air Operational Tempo (OPTEMPO)

	FY 2005	FY 2006	FY 2007	FY 2008 Goal	FY 2008 Actual
AC Ground OPTEMPO (Mileage)	708	666	729	459	500
AC Air OPTEMPO (Flight Hours)	12.2	12.6	12.8	11.6	12.4
ARNG Ground OPTEMPO	176	139	127	129	150
ARNG Air OPTEMPO	7.5	4.7	10.1	6.5	9.7
USAR Ground OPTEMPO	213	169	138	152	152
USAR Air OPTEMPO	8.0	8.7	9.7	6.4	8.1

NOTE: FY 2005 through FY 2007 reflects home-station execution only. FY 2008 amounts are estimates based on execution as of August 2008.

Training Support Systems

The Army's Training Support Systems enable the execution of training at home stations, the combat training centers, and at Training and Doctrine Command schools by creating realistic conditions that reflect the operational environment. These critical training enablers include ranges and targets; live-virtual-constructive and gaming training aids, devices, simulations and simulators; instrumentation systems; training facilities; and training support operations.

Table 8 – Military Construction (MILCON) Range Projects

	FY 2005	FY 2006	FY 2007	FY 2008
Range Construction Projects	17	30	37	26

The Army is adapting the Training Support Systems to support ARFORGEN training requirements and lessons learned from current operations. At home station, training must expose Soldiers, leaders and units to the full spectrum of possible conflict under realistic conditions. Ranges are being modernized to integrate digital systems that allow crews and platoons to train as they fight. New ranges are being built to support gunnery requirements in accordance with the Army Campaign Plan; and Urban Operations Training Facilities are being constructed and fielded to provide units a complex urban-area training capability. This live training environment will be further enhanced with a Home Station Instrumentation Training System that links ranges, urban complexes and training areas.

New and improved live-virtual-constructive and gaming training aids, devices, simulations and simulators are being fielded to augment training against improvised explosive devices (IEDs). Virtual simulators, IED simulators, gaming simulations and convoy live-fire systems provide a complete package for battle drills, learning tactical techniques and procedures, and generally raising IED situational awareness.

The Army also is modernizing the Battle Command Training Centers (BCTCs) and training simulations to increase leader and battle-staff training and to improve mission-rehearsal capabilities for deploying units. The BCTCs provide units the ability to train and to sustain critical individual/operator and battle-staff skills on digital command, control, communications, computer, intelligence, surveillance and reconnaissance systems. The BCTCs will also network with other installations and simulations to support joint training exercises.

Army training modernization must continue to keep pace with equipment modernization and Army transformation in order to meet expeditionary readiness requirements.

Adapting Training

In FY 2008, the Army conducted 24 rotations at Combat Training Centers (CTCs). The CTCs provide realistic joint and combined-arms training that approximates actual combat according to Army and joint doctrine. The CTCs are at the core of the Army's collective training strategy and have dedicated resources beyond those available at home-station training sites. Training is specifically tailored to prepare units for the conditions in the theater to which they will deploy. While the CTCs have retained the capability for high-intensity unit training needed for other potential theaters of war and the new modular brigades, the current focus is counter-insurgency operations and lessons from combat in Iraq and Afghanistan. The training environment emphasizes rapid change and adaptation to current activities, and uses improved facilities, civilians on the battlefield and realistic scenarios. The complex, event-driven scenarios challenge the BCT to execute multiple, simultaneous missions that include integrated enablers from the Army and the joint community.

Combat Training Center modernization lags behind Army modernization. CTC commanders are using supplemental funds to improve their centers and provide conditions that reflect the current operational environment.



“Military success in this war is tied to the capabilities of our leaders and Soldiers, and we will not fail to prepare them for success.”

— General George Casey, Chief of Staff of the Army

Growing Adaptive Leaders

The current operational environment proves that leaders must possess skills beyond those of pure tactical war fighting. It instead demands leaders who have developed non-lethal skills in such disciplines as irregular warfare, information operations, negotiation, cultural awareness, stability and reconstruction operations and foreign language proficiency – without losing their warfighting focus. The Army initiated and will continue to:

- (1) Incorporate cultural awareness training and education into all levels of Professional Military Education (PME);
- (2) Develop expertise in irregular warfare and full-spectrum operations for Soldiers and leaders from the tactical to strategic levels, emphasizing multinational, interagency and joint operations; and
- (3) Encourage language training and cultural education throughout the Army – in schools, through self-development, online and in training at CTCs.

Due to the current high operational demand, many of our leaders are unable to attend their PME at the optimal time in their career. As a result, the Army has a large backlog at nearly all educational levels in both the active and reserve components. To slow the growth of the backlog, the Army employed mobile training teams for Noncommissioned Officer (NCO) Education System courses and increased use of distributed learning to facilitate conducting PME within the constraints of ARFORGEN. As mission requirements change, the Army expects the availability of leaders to attend PME to increase sufficiently to begin reducing the backlog.

Table 9 – Professional Development (AC Schools Only)

	Warrior Leader Course	Basic NCO Course	Advanced NCO Course	Sergeants Major Course	Intermediate Level Education	Senior Service College
2008 Trained	26,457	10,817	9,792	0/779	0/508	609/474

These data represent active Army, ARNG and USAR students graduating from active component schools. The FY 2008 resident Sergeants Major Course does not graduate until May 2009. The FY 2008 Resident Intermediate Level Education classes do not graduate until December 2008 and June 2009. All data is based on start date (i.e. if a class starts in FY 2007 and graduates in FY 2008 it is counted in the FY 2007 data). FY 2008 Trained data are as of October 15, 2008. For the Sergeants Major, Intermediate Level and Senior Service College courses, the number to the left of the diagonal represents the number of FY 2008 entrants graduating as of October 15, 2008. The number to the right of the diagonal represents FY 2008 entrants who remain enrolled in the course as of October 15, 2008.

The Civilian Education System (CES) will meet the Secretary of the Army’s mandate that leaders of tomorrow be “adaptable and multi-skilled.” This requires a new paradigm and a centralized development program for training and educating the Army’s future leaders, “who will serve in both operational and institutional capacities in order to operate, and win, in this new environment.”

The Army is keenly aware of the valuable contributions of its Civilian Corps in supporting the National Military Strategy. The Army must provide its civilians training, education and operational experiences that develop leader competencies and enhance their ability to support Soldiers, the Army and the nation. To accomplish this, the Civilian Leader Development Program has been revamped into a training and education system, the CES, that is similar to the military leader development system.

Table 10 – Civilian Professional Development

	Senior Service College	Senior Fellowship Program	National War College	Industrial College of Armed Forces (ICAF)	NATO Staff Orientation Course
2008 Trained	42	1	56	111	10

All data is based on start date (i.e., if a class starts in FY 2007 and graduates in FY 2008 it is counted in the FY 2007 data). FY 2008 Trained data are as of October 15, 2008.

The CES uses leadership competencies derived from those set by the Office of Personnel Management and those identified by the Center for Army Leadership. These courses provide leader development training and education that support civilian leaders’ career path requirements and professional development, and promote lifelong learning and self-development.

In October 2008, CES will complete its first full year. The training is producing adaptive, multi-skilled and innovative leaders, who are proficient in all disciplines – not just those disciplines in which they specialize. Looking toward FY 2009 and beyond, CES will provide the training and education underpinnings of the new holistic Enterprise Civilian Human Capital Lifecycle Management System, which will manage the workforce across the lifecycle from an enterprise perspective to efficiently meet national security and enterprise needs.

Modernizing and Equipping the Army to Increase Strategic Depth


The Army’s Soldiers and commanders rely on and deserve the very best equipment that can be provided, and they play a large role in setting Army requirements. Since 2002, the Army has shifted resources in response to the many lessons learned from Operations Iraqi Freedom and Enduring Freedom. Force protection, communications, surveillance and weapon systems programs were accelerated to meet Soldiers’ urgent needs. To modernize the force, the Army invested in a variety of new equipment to replace the outdated and expensive-to-maintain, including trucks and aircraft. For example, the Army expects to divest its 2.5 ton M35 series trucks over the next five years, replacing them with both armored and un-armored variants of medium tactical vehicles.

The Army also has accelerated the fielding of the M4 Carbine and Enhanced Night Vision Devices, and continued efforts to provide Soldiers the very best body armor. To address a unique operational requirement, the Army invested in the Mine Resistant Ambush Protected (MRAP) vehicle. The Army’s aviation fleet was significantly modernized through procurements of UH-60M Black Hawk, CH-47F Chinook and AH-64D Apache helicopters. The Army is accelerating development of Future Combat Systems spin-out technologies as well, in order to give today’s Soldiers the most advanced systems possible.

The Rapid Fielding Initiative was initiated to enhance warfighting capabilities through commercial-off-the-shelf technology, rather than waiting for acquisition programs, to address Soldier requirements and shortfalls. Twenty-four brigade combat teams and other Army units comprising 196,229 Soldiers were fielded Rapid Fielding Initiative equipment during FY 2008. The focus of this program continues to be providing the latest equipment to Soldiers as they prepare for deployments.

Units returning from theater enter a RESET phase of ARFORGEN focused on repairing and modernizing their equipment. RESET extends the life of vital systems and platforms in order to reduce the need to procure new equipment and, in certain cases, to introduce new technologies during the maintenance and repair process.

The Army continues to invest in the Army National Guard and Army Reserve to enhance their mission capabilities and to ready forces entering the ARFORGEN cycle for deployment. The fleet age of trucks, combat vehicles, communications systems and Soldier weapons continues to decline as new equipment is fielded to the reserve component. Army National Guard and Army Reserve forces preparing to deploy are fielded with the very best equipment, reducing the disparity in modernization between the active and reserve components – a critical goal in the effort to create strategic depth.



A Soldier works with Australian combat engineers as they align two sections of a bridge. Photo by Capt. James Reid, Combined Task Force Castle

Reset

To reset the force, the Army must prepare Soldiers, units and equipment for future deployments and other contingencies. Since FY 2003, equipment has been used at unprecedented rates in harsh and demanding desert and mountain environments. In addition to fixing, replacing and upgrading equipment, and retraining for future missions, the Army must also revitalize Soldiers and their Families by providing them the time and the opportunity to recover from the cumulative effects of sustained operations.

Reset and Repair Army Units and Equipment

Upon return from deployment, Army units and equipment must be reset to ensure full readiness for future operations. In FY 2008, the Reset program was highly successful despite a dynamic strategic environment. For the fiscal year, the Army received \$16 billion in supplemental funding from the Congress. The Army aggressively executed this funding to restore units' equipment readiness. The Army obligates the majority of procurement funding within 90 days of receipt, while Operation and Maintenance, Army (OMA) obligations occur throughout the fiscal year as equipment returns. The Army completed resetting 23 brigades' worth of equipment during the fiscal year and began resetting 12 more brigades' worth of equipment as surge forces started to return.

A fully-funded Army Reset program ensures that equipment is operationally ready for use by combat forces in Iraq, Afghanistan and other potential contingencies, and by forces that are training prior to deployment. Reset program funding should match Reset requirements, and should be provided in a timely manner at the beginning of each fiscal year to promote cost efficiencies and process effectiveness, while ensuring the timely return of equipment to support training and future deployments.

Enhancing Logistics Readiness

Accomplishing logistics information technology transformation objectives is paramount to modernizing the force and supporting the warfighter. The Army also must ensure that logistics information systems seamlessly interoperate with associated systems in other functional areas, such as finance, personnel, medical, transportation and command/control.

The Army has a three-tiered strategy: 1) continue support to legacy systems still in the field; 2) replace legacy systems with modernized bridging systems, as required; and 3) implement Enterprise Resource Planning solutions, the Logistics Modernization Program (LMP), the Global Combat Support System – Army (GCSS-Army) and Product Lifecycle Management Plus. The following are key accomplishments during FY 2008:

- GCSS-Army completed a successful operational assessment of the supply module at the National Training Center.
- GCSS-Army received Milestone B approval from the Under Secretary of Defense (Acquisition, Technology and Logistics) and began developing maintenance, ammunition and property-book functionality.
- LMP prepared for enterprise expansion to the Army Aviation and Missile Life Cycle Management Command and Corpus Christi Army Depot.
- Bridging systems were fielded to 90 percent of the total Army and are on track to complete fielding by end of FY 2009.

Together, these initiatives provide more effective support for Soldiers on the front lines of the GWOT, put logistics management practices in line with world-class businesses, and provide the Army the tools necessary to manage one of the most valuable, complex logistics systems in the world.

In FY 2008, more than 110,000 items were repaired at depot facilities. This includes, for example, more than 2,000 tracked vehicles (e.g., Abrams tanks, Bradley Fighting Vehicles, M88 Recovery Vehicles), more than 12,000 wheeled vehicles (e.g., HMMWVs, Medium and Heavy Tactical Vehicles), more than 20,000 small arms (e.g., rifles, pistols, machine guns), more than 30,000 communications-electronics items and more than 80 aircraft.



A Soldier prepares to fire an M2 .50-caliber machine gun during mobilization training. (U.S. Army photo by Staff Sgt. Russell Lee Klika) (www.army.mil)



Transform

To transform itself, the Army must continuously improve its ability to meet the combatant commanders' needs in a changing 21st century security environment. Transformation is a holistic effort to adapt how we fight, train, modernize, develop leaders, base our forces and support our Soldiers, Families and civilians. Transformation is a journey, not a destination.

Developing Force Generation Platforms in Support of ARFORGEN

One deployment infrastructure project was executed in FY 2008 at Fort Lewis, Washington, to support the "Flagships of Readiness" concept using Grow the Army funding. This project will improve rail out-loading of vehicles, ammunition and other cargo. The upgrade at the rail interchange yard will increase throughput of Army equipment and cargo from 180 railcars to 240 railcars per day. This growth will facilitate meeting deployment timelines to Europe, Africa and the Middle East when ship loading occurs at Fort Lewis' designated secondary seaport of embarkation, Norfolk, Virginia. Also included in this project is the construction of an engine house, which will facilitate repair and maintenance of the locomotives operating at Fort Lewis. The contract was awarded on June 30, 2008. The beneficial occupancy date is scheduled for April 2010.

Growing and Modularizing the Army

The Global War on Terrorism and the requirement to maintain a forward presence, have created both the necessity and the opportunity to accelerate change from the current to the future force. The Army's conversion to a modular force that is carefully balanced between the active and reserve components is well under way. Modularity is intertwined throughout the force to the point that it is now indistinguishable as a separate effort. As a result, the Army is more lethal, flexible, deployable and sustainable.

The Army Modular Force reorganizes the operational Army into Army Service Component Commands, theater support structures, corps and division headquarters, BCTs, and multi-functional and functional support brigades, all based on standardized organizational designs across the three components. The intent of this transformation is to:

- (1) Increase the number of available BCTs to meet operational requirements;
- (2) Create brigade-size combat support and combat service support formations of common organizational designs; and
- (3) Redesign organizations to perform as integral parts of the joint force, making them more effective across the range of military operations and enhancing their ability to contribute to joint, interagency and multinational efforts.

The Army is increasing its operational end strength in order to man the modular force. The Congress has authorized the Army to add a total of 74,200 spaces, growing the AC from 482,400 to 547,400; the ARNG from 350,000 to 358,200; and the USAR from 205,000 to 206,000.

As part of the modular conversion, the Army is rebalancing capability within and among its three components to provide a force capable of meeting current operational demands with the strategic depth to meet the security challenges of the future. The AC and RC rebalancing initiative is an incremental process and it continues to evolve. The major tenets of this initiative include:

- (1) Increasing capabilities to relieve stress on units with persistent shortfalls;
- (2) Eliminating demand for RC forces during the initial phase of an operational deployment; and
- (3) Rebalancing structure to maximize readiness and rotational availability while preserving homeland defense and homeland security capabilities.

The Army also is re-designating military positions in the institutional force as civilian slots, where appropriate, freeing uniformed personnel for the operating force. Already, since FY 2003, 14,000 Soldiers have been returned to the operational structure. In addition, the Army has been able to improve the individual Soldier assignment process and thereby ensure full manning of operational units and command posts.

Of the 43 AC maneuver brigades programmed for the end FY 2008, the Army finished converting 38 to the modular design and was in the process of converting another two. The conversion process can take up to 12 months for an active component Heavy Brigade Combat Team and Infantry Brigade Combat Team, and as long as 24 months for a Stryker Brigade Combat Team.

The ARNG began transforming in FY 2005 with an accelerated plan allowing early reorganization, manning and training under the new BCT designs. Transformation for an ARNG BCT can take as long as 48 months. At the end of FY 2008, the ARNG was in the process of transforming 28 BCTs. The ARNG will fully convert seven BCTs by the end of FY 2009 and will complete another seven by the end of FY 2010.

The overall transformation plan is on track to achieve a combined total of 76 BCTs: 48 in the active component and 28 in the ARNG. Initial transformation covers training, manning and organization only; equipment transformation will occur over time. Table 11 provides a summary of BCT transformation.

Table 11 – BCT Transformation Summary

	FY 2006	FY 2007	FY 2008
AC Transformed	31	35	38
ARNG Transformed	0	0	0
Total Transformed	31	35	38
AC Transforming	4	4	2
ARNG Transforming	16	26	28
Total Transforming	20	30	30
Total Transformation	51	65	68

Transformed means the unit has completed its initial reorganization and re-equipping to a modular design within resource constraints, is participating in the ARFORGEN process, and may be used against a requirement. Transforming means the unit is still undergoing initial reorganization and re-equipping to a modular design within resource constraints.

Restructuring Army Aviation

The Army continues to transform its aviation structure as part of its efforts to develop modular, capabilities-based forces that are optimized to operate in a joint and expeditionary environment. Over the next six years, the Army plans to accelerate the modernization of the rotary- and fixed-wing aircraft fleets, using the funds made available through termination of the Comanche program. The Army will also modernize aircraft sensors, execute safety and reliability modifications, and procure the best available aircraft survivability equipment. This will reduce maintenance costs, increase survivability and improve readiness rates. Key components of the aviation modernization plan include accelerating modernization of RC aviation and unmanned aerial vehicle programs, as well as pushing forward the development of a common cockpit for cargo and utility aircraft.

Table 12 – Restructuring Army Aviation

	FY 2007 Delivered	FY 2008 Goals	FY 2008 Delivered
# of Aircraft Reset (Mix of Operation Enduring Freedom and Operation Iraqi Freedom Returning Fixed/Rotary-Wing Aircraft)	526	401	392
UH-60 Recapitalization	27	38	29
UH-60M Produced	14	56	50
MH-47G Produced	4	6	6
CH-47 Recapitalization	3	4	4
CH-47F Produced	25	26	26
AH-64 Recapitalization	80	96	82
AH-64D Produced (Wartime Replacements)	13	2	2
UH-72A Produced	8	33	31

Developing and Fielding FCS and FCS Spin-Outs

The Future Combat Systems (FCS) is the cornerstone of Army Modernization. FCS embodies the Army’s promise to provide Soldiers the best equipment and technology available as soon as practical. FCS is not just a technology development program; it is the development of new Brigade Combat Teams. These new brigades, with more infantry Soldiers, better equipment, and unmatched situational awareness and communications, will enable complete domination in asymmetric



“We’re ultimately working toward an agile, globally responsive Army that’s enhanced by modern networks, surveillance sensors, precision weapons and platforms that are lighter, less logistics-dependent and less manpower-intensive. It’s a truly 21st century force.”

— General George Casey, Chief of Staff of the Army

ground warfare and will produce a force that can sustain itself in remote areas. In addition to forming these new FCS brigades, starting in 2011, early FCS capabilities will be provided to Soldiers in active and National Guard Infantry Brigade Combat Teams. The FCS program consists of eight new manned ground vehicles, a family of unmanned air and ground vehicles, the Non-Line-of-Sight Launch System, and advanced tactical and urban sensors that are all connected by a state-of-the-art network. Working together, these systems will help Soldiers share real-time information across the battlefield. Overall, FCS will provide Soldiers vastly increased situational awareness, survivability and lethality, ensuring that they can take the fight to the enemy before the enemy has time to react.

Developing LandWarNet Operational Capabilities

LandWarNet is a capability-focused, orders-based system of systems that is derived from the Army’s Battle Command and Global Information Grid. It is an integral part of the decision-support process, and enables information-based joint, interagency, multinational, civil defense, warfighting and support operations, regardless of Joint Operational Phase, operational urgency or the battlespace circumstances of its authorized users. LandWarNet also provides warfighters the capability to “train as they fight” and is necessary to creating a global collaborative environment. The transformation of LandWarNet into an Army enterprise activity within the joint enterprise construct will not only enable network-dependent capabilities but it will dramatically improve the computer network defense and information assurance posture.

In FY 2008, the Army pursued integration of architectures for the Future Combat Systems network, with communications spin-outs scheduled for delivery in FY 2010. The Army also continued fielding the Warfighter Information Network-Tactical Increment 1 (WIN-T Inc 1) and added Ka satellite band upgrades that will leverage the Wideband Global Satellite constellation. In addition, the Army continued to field the Army Battle Command Systems to units deploying into operational theaters.

HQDA, in coordination with the Training and Doctrine Command and the WIN-T program manager, restructured the High Capacity Communications Capability (HC3) satellite terminal program, pending an HC3 program review. The restructuring ensures that ground combatants will be able to maintain the current AN/TSC-93 and Phoenix satellite terminals, with life extension upgrades through FY 2020.

Developing LandWarNet Institutional Infrastructure

The objective of transformation for the institutional Army is to achieve joint, standardized data collection processes, effective communication linkages and efficient information sharing among stakeholders. The Installation Information Infrastructure Modernization Program is providing necessary infrastructure upgrades, with the goal of making Army installations “docking stations” that allow Soldiers to train as they will fight, with the same equipment and capabilities in garrison as they use during operational deployments. In FY 2008, the Army modernized information technology infrastructure at an additional two installations and refreshed four more installations that previously were upgraded.

In addition, the Army continued to apply its defense-in-depth strategy through networkiness certification and authorization. The Army implemented financial data collection within the mission areas and domains as part of the Army information technology portfolio management process. The Army completed the Service Migration Plan for the transition of Army Knowledge On-Line (AKO) to Defense Knowledge Online (DKO), with continued support to AKO services. Also, the Army established within the G-6 a chief data officer position to oversee data transformation and a general officer billet to oversee cyber operations.

Implementing Base Realignment and Closure

The Army Base Realignment and Closure (BRAC) 2005 strategy established a streamlined portfolio of installations with optimized military value and a significantly reduced cost of ownership, which facilitates transformation, joint operations and joint business functions. The BRAC accommodates the rebasing of overseas units within the Integrated Global Presence and Basing Strategy, and divests an accumulation of installations that are no longer relevant and are less effective in supporting a joint and expeditionary Army.

The Army partnered with the other Services to seek joint training, deployment and operational opportunities and efficiencies in common business functions, as well as to transform reserve component infrastructure. The Army selected the optimum locations for units returning from overseas, locating modular brigades to ensure that they have the capability to train and to deploy, and to take care of Families and Soldiers when at home.

The Army BRAC 2005 program is more than three-times larger than the four previous Army BRAC rounds combined, and represents 53 percent of the entire DoD program. This effort is made more complex by the need to synchronize it with other Army initiatives and the Global War on Terrorism. The Army will close 13 active component installations, 387 reserve component installations and eight leased facilities in this round. It realigns 53 installations and functions, and creates 125 multi-component Armed Forces Reserve Centers.

The Army developed 102 business plans to further define the BRAC 2005 recommendations into a list of more than 1,100 actions. These plans represent Army BRAC requirements and collectively provide the budget input, as well as the means for measuring the cost and savings associated with each recommendation and achieving full implementation by September 15, 2011.

A majority of the BRAC 2005 actions are dependent on construction at gaining installations, with fully 75 percent of the total program dedicated to funding 330 major construction projects. FY 2008 was the third year of the six-year BRAC execution window. In FY 2008, the Army awarded 77 construction projects, valued at \$3.4 billion, adding to the 71 already awarded in FYs 2006 and 2007. To date, the Army has completed seven of these projects. The Army also completed 75 National Environmental Policy Act actions, closed one active installation and nine U.S. Army Reserve Centers, and disposed of 1,133 excess acres from BRAC 2005 properties.

The program remains fully funded and on track to meet the September 2011 deadline. However, with more than 180 construction projects still to be awarded, and more than 800 unit/activity moves remaining, timely receipt of funding in the remaining years of the program will be critical to successful execution of an already significantly compressed implementation schedule.

Implementing the National Security Personnel System

As a result of the Global War on Terrorism, the role of the Army's civilian workforce is expanding to include more significant participation in combat support functions. This growth allows military personnel to focus on warfighting duties.

More generally, civilian personnel are vital to maintaining institutional knowledge in the face of frequent rotations of military personnel. Since the end of the Cold War, the civilian workforce has experienced substantial changes resulting from downsizing, base realignments and closures, and competitive sourcing initiatives. Considering the Army's aging workforce and the "baby bust" anticipated by Bureau of Labor Statistics analyses, the Army's institutional knowledge and its future ability to acquire skilled personnel is at risk. In order for the Army to meet present and future mission requirements, action must be taken to mitigate this risk.

The National Security Personnel System (NSPS) allows DoD to manage civilian personnel with more flexibility and in a manner that is consistent with the human capital management strategy. NSPS also allows the Army to be a more competitive and progressive employer at a time when national security demands a highly responsive civilian personnel management system. It links personnel management to the Army's overarching goals and enables the Army to rapidly adapt its civilian workforce composition to meet changes in mission requirements. NSPS was designed to create an environment in which all employees can excel, be challenged with meaningful work and can be recognized for their contributions. By the end of FY 2008, the Army had 73,000 civilian employees in NSPS, representing 42 percent of those eligible to transition to NSPS.

Implementing Business Transformation Initiatives

The Army advanced its journey of Business Transformation (BT) in FY 2008, literally touching or impacting everyone in and every facet of the Army. The BT initiatives continue to focus on three areas: continuous process improvement (CPI), organizational analysis and design (OA&D) and situational awareness.

The Army chose Lean Six Sigma (LSS) as its CPI methodology. Lean focuses on removing waste while Six Sigma reduces variation and produces a consistently reliable product, thereby increasing quality. The Army selected LSS because its methodology is applicable to the vast majority of Army process improvement opportunities. LSS also provides a common business lexicon that both increases the business acumen of the workforce and creates a common framework in which to discuss, report and approach process improvement. This commonality is critical to leveraging and replicating work done by one individual or an entire organization. Progress in FY 2008 validated the Army's approach to CPI.

In FY 2008, the spearhead for LSS was transitioned to the Army's Enterprise Task Force to ensure strategic alignment, continuity of effort and enterprise prioritization. The Army has worked aggressively to institutionalize LSS, including fostering a culture of continuous improvement and producing the first Army certified LSS Master Black Belts. These Black Belts are the internal experts who will train, teach, coach and mentor, thereby creating a self-generating LSS capability and decreasing reliance on external support. The Army also continued to train Green Belts, who executed thousands of projects in vital areas that need reformation, such as force generation, health care and operational capabilities.

OA&D is designed to identify and to fix typical organizational pathologies, such as ill-defined roles and accountability, excessive overhead and permanent "temporary" task forces. OA&D looks at organizations from the customer's viewpoint, with an understanding that real organizational change and reform need to be catalyzed by external evaluation. OA&D efforts continued in the Office of the Administrative Assistant and the Installation Management Command (IMCOM), and were also under way in the Training and Doctrine Command, the Office of the Chief Information Officer and the Office of the Assistant Secretary for Acquisition, Logistics and Technology.

The Army continues to field a robust solution of systems and software controls to streamline the Army business enterprise's accounting and financial processes. The General Fund Enterprise Business System (GFEBS) is the centerpiece of this effort,

and remains on schedule and on budget. On October 1, 2008, the Army successfully implemented Release 1.2 of GFEBS at the Fort Jackson garrison, along with seven other organizations, including the Installation Management Command headquarters and the Defense Finance and Accounting Service. Army-wide implementation of GFEBS will improve financial, asset and real-property management and is scheduled to be completed in FY 2011.

Conclusion

The Army is involved in a difficult but essential transformation. We are simultaneously and significantly increasing our permanent end strength, accelerating formation of new BCTs, converting the remaining legacy force to modular designs, modernizing equipment, including fielding improved weapons systems, and carrying out the most significant restationing in decades. To support these efforts, the Army's financial managers are balancing resources among a myriad of competing but critical demands. Clearly, the challenges we face are significant. The degree of difficulty has increased as a result of the requirement for financial managers to develop and execute simultaneously the largest base and supplemental budgets in the Army's history while at war. Implementing the Chief of Staff's four imperatives to bring the Army back into balance will take several years, considerable resources, and the continued support of the Congress and the American people.



Analysis of Financial Statements and Stewardship Information

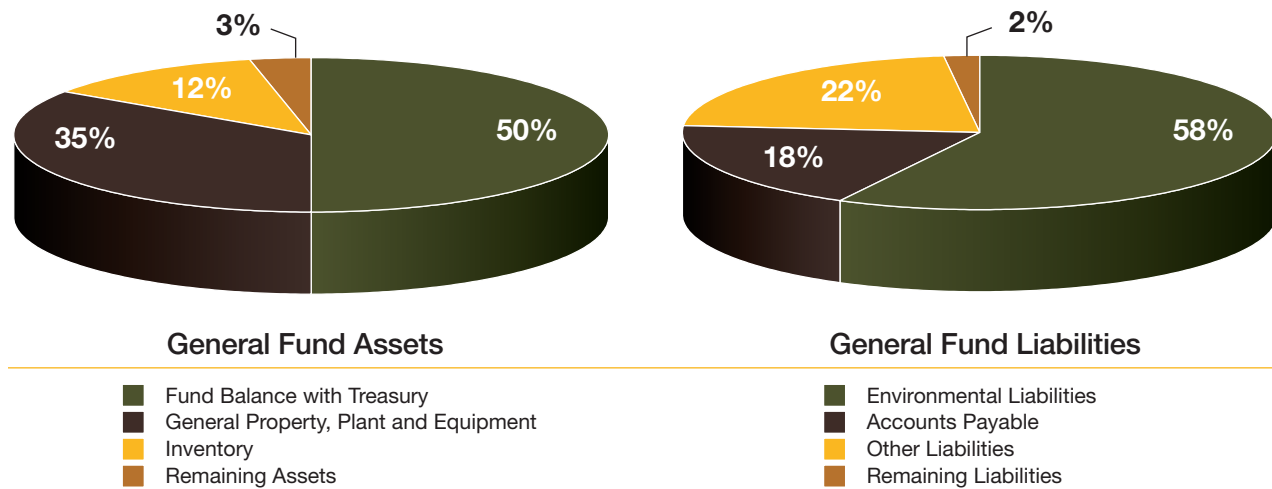
As discussed in the accompanying independent auditor’s report, longstanding financial management challenges prevent the Army’s producing auditable financial statements for the Army General Fund and the Army Working Capital Fund. The Army, however, continues to work with DoD to develop sustainable business practices and enhanced internal controls that will improve financial management processes and produce quality financial management information. These processes must be supported by compliant business systems and an effective set of management controls.

General Fund Financial Results and Balance Sheet

The Army General Fund balance sheet includes total assets that exceed \$325 billion. Two asset categories, Fund Balance with Treasury and General Property, Plant and Equipment (GPP&E), comprise 85 percent of total assets, with values of \$163.3 billion and \$111.9 billion, respectively.

Liabilities primarily consist of \$42.5 billion in Environmental Liabilities and \$13.5 billion in Accounts Payable.

Figure 2 – Composition of General Fund Assets and Liabilities



Fund Balance with Treasury grew by \$34.0 billion in FY 2008 due to an increase in Army appropriations received for GWOT requirements. GPP&E increased \$20.9 billion due to continued deliveries of and upgrades for High Mobility Multipurpose Wheeled Vehicles, Bradley combat vehicles and Abrams tanks.

Table 13 – Select General Fund Assets and Liabilities

(Amounts in billions)

Asset Type	FY 2008	FY 2007	Change	Percentage of FY 2008 Assets
Fund Balance with Treasury	\$163.3	\$129.3	\$34.0	50%
General Property, Plant and Equipment	111.9	91.0	20.9	35%
Inventory	40.1	33.9	6.2	12%
Remaining Assets	10.5	10.3	0.2	3%
Total Assets	\$325.8	\$264.5	\$61.3	100%

Liability Type	FY 2008	FY 2007	Change	Percentage of FY 2008 Liabilities
Environmental Liabilities	\$42.5	\$45.7	(\$3.2)	58%
Accounts Payable	13.5	10.8	2.7	18%
Other Liabilities	15.9	13.5	2.4	22%
Remaining Liabilities	1.5	1.5	0.0	2%
Total Liabilities	\$73.4	\$71.5	\$1.9	100%

Amounts may not sum due to rounding

Army Working Capital Fund Financial Results

Army Working Capital Fund (AWCF) activities maintain the Army’s combat readiness by providing supplies, equipment and ordnance necessary to prepare, sustain and reset our forces in the most efficient and cost-effective manner possible. In performing this mission, AWCF activities are obligated to control and minimize costs. Financial performance is measured through cash management, net operating result (NOR) and accumulated operating results (AOR). Operational performance is measured by carryover, stock availability and production.

Cash Management

Managing the cash balance is dependent on setting rates to recover full costs, including any prior-year losses, projecting accurate workload and achieving established operational goals. The AWCF must maintain a sufficient cash balance at the U.S. Treasury to pay liabilities when due. The AWCF forecasts monthly collections and disbursements to ensure sufficient funds are available.

The AWCF ended FY 2008 with a cash balance of \$2,571.4 million, \$1,868.5 million above the 10-day cash level of \$702.9 million. The AWCF cash balance will return to a balance closer to the 10-day level when operations in Iraq and Afghanistan decline and payments associated with the delivery of replacement stocks and repair of spares are higher than inventory sales.

Table 14 shows an overall growth in cash from both operations and direct appropriations offset by transfers out. The AWCF received direct appropriations for war reserve materiel, inventory augmentation, replacement of inventory combat losses and higher fuel costs. Transfers were made to several appropriations in support of urgent, unfunded combat requirements. At some point, part or all of the transfers will require repayment to ensure that the fund has sufficient cash on hand.

Table 14 – AWCF Cash

<i>Cash (Amounts in millions)</i>	FY 2006	FY 2007	FY 2008
Collections	\$14,053.4	\$15,256.7	\$16,352.9
Disbursements	14,260.8	14,335.0	15,934.9
Cash from Operations	(207.5)	921.7	418.0
Appropriations Received	459.5	627.8	1,324.3
Transfers Out	0	145.7	1,450.0
Net Outlays	252.1	1,403.8	292.3
Cash Balance	\$875.3	\$2,279.1	\$2,571.4

Net Operating Result and Accumulated Operating Results

The NOR represents the difference between revenues and costs within a fiscal year. AOR represent the aggregate of all recoverable net earnings, including prior-year adjustments, since inception of the working capital fund. The goal of the AWCF is to establish rates that will bring the AOR to zero in the budget year. An activity group’s financial performance is measured by comparing actual results to the budget’s NOR and AOR.

Supply Management AOR was reduced by \$920 million in FY 2008, reflecting a reprogramming of AWCF cash to the Operation and Maintenance, Army appropriation. Reprogrammed cash is not available for return to customers through reduced rates.

Table 15 – Net and Accumulated Operating Results by Activity Group

<i>Operating Results (Amounts in millions)</i>	FY 2006	FY 2007	FY 2008
Industrial Operations NOR	(\$209.3)	(\$117.7)	\$158.8
Industrial Operations AOR*	\$437.8	\$324.7	\$481.5
Supply Management NOR	\$5.5	\$489.3	\$411.0
Supply Management AOR	(\$36.7)	\$452.6	(\$56.4)

* Includes prior-period AOR adjustments.

Carryover

Carryover is the dollar amount of orders accepted from customers that have not been completed by the end of a fiscal year. It is a normal part of doing business; these orders enable the industrial workforce to maintain continuity in production operations. The Army expects carryover for FY 2008 to be less than the allowable amount.

Table 16 – AWCF Carryover

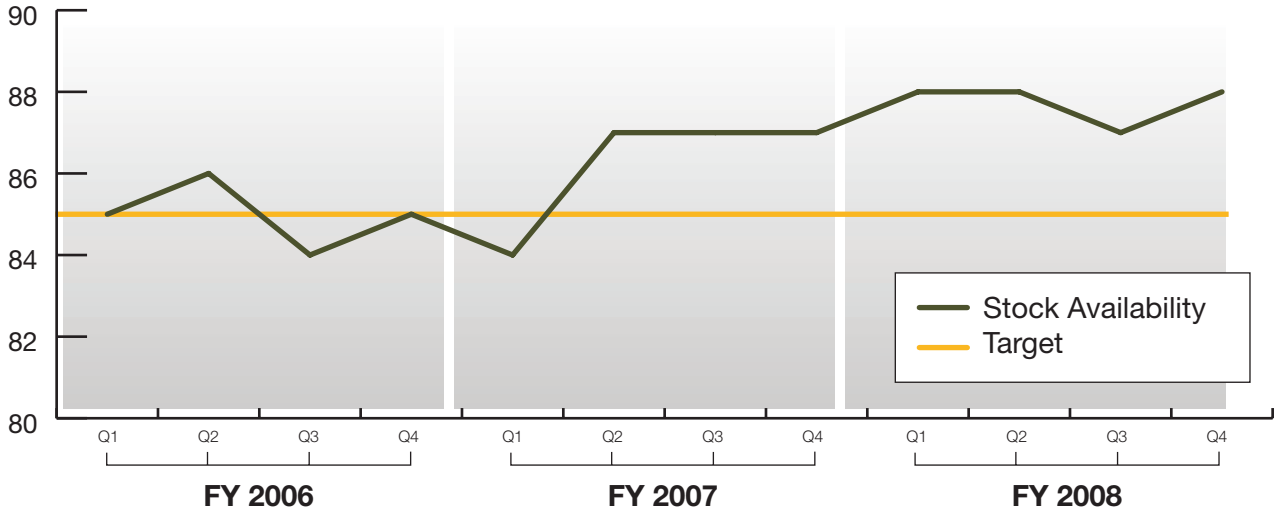
<i>(Amounts in millions)</i>	FY 2006	FY 2007	FY 2008
New Orders	\$5,425.2	\$6,850.3	\$6,990.6
Allowable Carryover	\$2,115.1	\$2,752.4	*
Carryover	\$2,141.3	\$3,029.5	*

* Amounts not available at time of printing

Stock Availability

Stock availability measures the percentage of requisitions filled within established timeframes. DoD and the Army have set a target of 85 percent stock availability. Since FY 2005, stock availability has remained high due to sufficient hardware funding levels, more accurate customer-demand forecasts and inventory levels built to support combat operations.

Figure 3 – Stock Availability (percentage)



Production

Although the Industrial Operations activity group is comprised of 13 activities, the preponderance of workload is performed at the five hard-iron maintenance depots. Major operations in Iraq and Afghanistan are placing tremendous demands on equipment. As a result of higher operating tempo, rough desert environments and limited depot maintenance available in theater, operational fleets are aging at a far greater pace than expected. To counter this, the Army established a Reset program designed to reverse the effects of combat stress on equipment and to prepare equipment for future missions. Industrial Operations received \$2.3 billion in Reset orders, representing one-third of FY 2008 new orders.

The Army's depots and their efforts to partner with industry are critical to the entire Reset effort. These repair programs must continue through the end of the current conflict and for at least an additional two to three years afterward to completely reconstitute equipment. Due to actions taken in support of wartime requirements, the Industrial Operations activity group has dramatically increased depot production over pre-war levels, as illustrated below:

Table 17 – Annual Production Throughput*

	Pre-War	FY 2006	FY 2007	FY 2008
Aircraft	4	46	66	82
Helicopter Engines	<200	>700	>750	781
Bradleys	144	600	>850	1,038
HMMWVs	<100	7,398	9,344	9,471
Firefinder Radars	<1	57	49	50
Track Shoes	120,000	400,000	141,000	250,660

* Throughput is the number of weapon systems completed for any given year.

AWCF Balance Sheet

The AWCF balance sheet shows assets exceeding \$24.8 billion, primarily in Inventory and Fund Balance with Treasury. Liabilities consist of Accounts Payable and Other Liabilities, which includes payroll, benefits, accrued annual leave and workman’s compensation.

Figure 4 – AWCF Assets and Liabilities

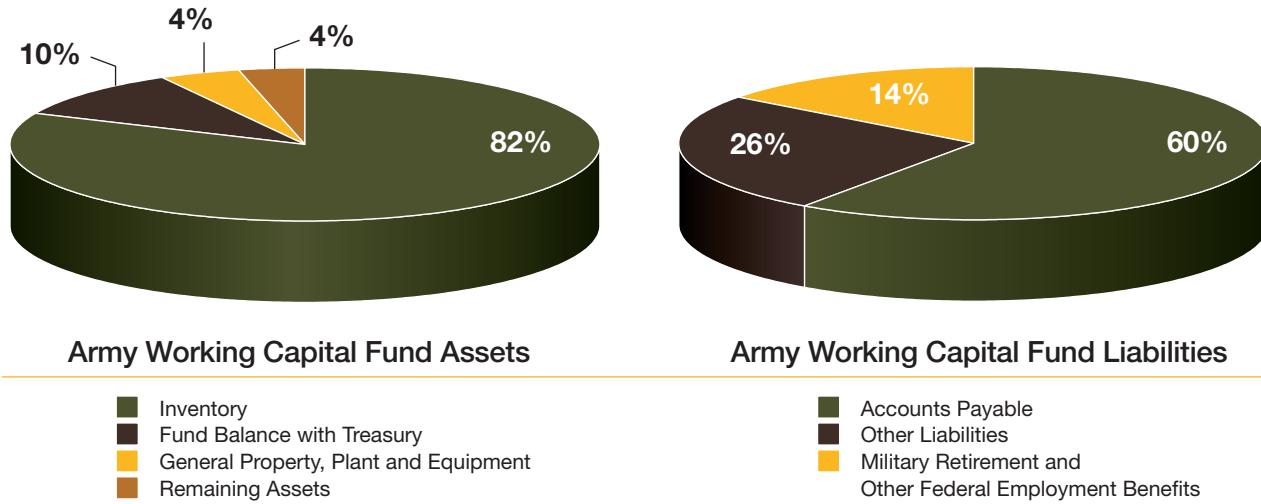


Table 18 – AWCF Assets and Liabilities

(Amounts in millions)

Asset Type	FY 2008	FY 2007	Change	Percentage of FY 2008 Assets
Inventory	\$20,279.7	\$19,728.7	\$551.0	82%
Fund Balance with Treasury	2,571.4	2,279.1	292.3	10%
General Property, Plant and Equipment	1,097.7	996.9	100.8	4%
Remaining Assets	876.3	712.1	164.2	4%
Total Assets	\$24,825.1	\$23,716.8	\$1,108.3	100%

Liability Type	FY 2008	FY 2007	Change	Percentage of FY 2008 Liabilities
Accounts Payable	\$1,031.5	\$1,120.3	(\$88.8)	60%
Other Liabilities	443.0	459.5	(16.5)	26%
Military Retirement and Other Federal Employment Benefits	254.5	243.1	11.4	14%
Total Liabilities	\$1,729.0	\$1,822.9	(\$93.9)	100%

Amounts may not sum due to rounding



Limitations

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of Title 31, United States Code, section 3515(b).

While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity.



CONSOLIDATED BALANCE SHEET

<i>As of September 30, 2008 and 2007 (Amounts in thousands)</i>	2008 Consolidated	Restated 2007 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 163,322,471	\$ 129,263,268
Investments (Note 4)	3,532	3,448
Accounts Receivable (Note 5)	499,668	420,417
Other Assets (Note 6)	430,932	514,835
Total Intragovernmental Assets	\$ 164,256,603	\$ 130,201,968
Cash and Other Monetary Assets (Note 7)	\$ 2,418,049	\$ 2,183,051
Accounts Receivable, Net (Note 5)	619,471	576,533
Loans Receivable (Note 8)	0	67
Inventory and Related Property, Net (Note 9)	40,134,982	33,938,649
General Property, Plant and Equipment, Net (Note 10)	111,908,995	90,968,019
Other Assets (Note 6)	6,495,961	6,607,587
TOTAL ASSETS	\$ 325,834,061	\$ 264,475,874
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 1,563,994	\$ 1,729,905
Debt (Note 13)	833	26,706
Other Liabilities (Note 15 & 16)	3,647,103	3,085,453
Total Intragovernmental Liabilities	\$ 5,211,930	\$ 4,842,064
Accounts Payable (Note 12)	\$ 11,956,805	\$ 9,108,551
Military Retirement and Other Federal Employment Benefits (Note 17)	1,472,383	1,483,177
Environmental and Disposal Liabilities (Note 14)	42,475,466	45,698,351
Loan Guarantee Liability (Note 8)	2,337	290
Other Liabilities (Note 15 and Note 16)	12,240,852	10,374,078
TOTAL LIABILITIES	\$ 73,359,773	\$ 71,506,511
NET POSITION		
Unexpended Appropriations - Other Funds	\$ 153,860,352	\$ 124,485,255
Cumulative Results of Operations - Earmarked Funds	52,946	24,620
Cumulative Results of Operations - Other Funds	98,560,990	68,459,488
TOTAL NET POSITION	\$ 252,474,288	\$ 192,969,363
TOTAL LIABILITIES AND NET POSITION	\$ 325,834,061	\$ 264,475,874

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF NET COST

As of September 30, 2008 and 2007 (Amounts in thousands)

	2008 Consolidated		2007 Consolidated	
Program Costs				
Gross Costs	\$	200,428,354	\$	178,746,856
(Less: Earned Revenue)		(9,927,425)		(9,823,195)
Net Program Costs	\$	190,500,929	\$	168,923,661
Net Cost of Operations	\$	190,500,929	\$	168,923,661

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

<i>As of September 30, 2008 and 2007 (Amounts in thousands)</i>	2008 Earmarked Funds	2008 All Other Funds	2008 Eliminations	2008 Consolidated
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances	\$ 24,621	\$ 68,459,488	\$ 0	\$ 68,484,109
Prior Period Adjustments:				
Changes in accounting principles (+/-)	0	0	0	0
Beginning balances, as adjusted	\$ 24,621	\$ 68,459,488	\$ 0	\$ 68,484,109
Budgetary Financing Sources:				
Appropriations used	0	212,944,662	0	212,944,662
Nonexchange revenue	10,843	0	0	10,843
Donations and forfeitures of cash and cash equivalents	7,325	0	0	7,325
Transfers-in/out without reimbursement	0	1,450,000	0	1,450,000
Other Financing Sources:				
Transfers-in/out without reimbursement (+/-)	0	2,578,457	0	2,578,457
Imputed financing from costs absorbed by others	0	948,408	0	948,408
Other (+/-)	26,346	2,664,715	0	2,691,061
Total Financing Sources	\$ 44,514	\$ 220,586,242	\$ 0	\$ 220,630,756
Net Cost of Operations (+/-)	16,189	190,484,740	0	190,500,929
Net Change	\$ 28,325	\$ 30,101,502	\$ 0	\$ 30,129,827
Cumulative Results of Operations	\$ 52,946	\$ 98,560,990	\$ 0	\$ 98,613,936
UNEXPENDED APPROPRIATIONS				
Beginning Balances	\$ 0	\$ 124,485,255	\$ 0	\$ 124,485,255
Prior Period Adjustments:				
Changes in accounting principles	0	0	0	0
Beginning balances, as adjusted	\$ 0	\$ 124,485,255	\$ 0	\$ 124,485,255
Budgetary Financing Sources:				
Appropriations received	0	231,149,155	0	231,149,155
Appropriations transferred-in/out	0	14,645,498	0	14,645,498
Other adjustments (rescissions, etc)	0	(3,474,894)	0	(3,474,894)
Appropriations used	0	(212,944,662)	0	(212,944,662)
Total Budgetary Financing Sources	\$ 0	\$ 29,375,097	\$ 0	\$ 29,375,097
Unexpended Appropriations	0	153,860,352	0	153,860,352
Net Position	\$ 52,946	\$ 252,421,342	\$ 0	\$ 252,474,288

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

<i>As of September 30, 2008 and 2007 (Amounts in thousands)</i>	2007 Earmarked Funds	2007 All Other Funds	2007 Eliminations	2007 Consolidated
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances	\$ 42,792	\$ 71,228,205	\$ 0	\$ 71,270,997
Prior Period Adjustments:				
Changes in accounting principles (+/-)	0	(3,780,694)	0	(3,780,694)
Beginning balances, as adjusted	\$ 42,792	\$ 67,447,511	\$ 0	\$ 67,490,303
Budgetary Financing Sources:				
Appropriations used	0	179,732,087	0	179,732,087
Nonexchange revenue	145	0	0	145
Donations and forfeitures of cash and cash equivalents	5,761	0	0	5,761
Transfers-in/out without reimbursement	(6,903)	38,700	0	31,797
Other Financing Sources:				
Transfers-in/out without reimbursement (+/-)	0	1,689,316	0	1,689,316
Imputed financing from costs absorbed by others	0	954,983	0	954,983
Other (+/-)	155	(12,496,778)	0	(12,496,623)
Total Financing Sources	\$ (842)	\$ 169,918,308	\$ 0	\$ 169,917,466
Net Cost of Operations (+/-)	17,330	168,906,331	0	168,923,661
Net Change	\$ (18,172)	\$ 1,011,977	\$ 0	\$ 993,805
Cumulative Results of Operations	\$ 24,620	\$ 68,459,488	\$ 0	\$ 68,484,108
UNEXPENDED APPROPRIATIONS				
Beginning Balances	\$ 0	\$ 85,045,798	\$ 0	\$ 85,045,798
Prior Period Adjustments:				
Changes in accounting principles	0	3,780,694	0	3,780,694
Beginning balances, as adjusted	\$ 0	\$ 88,826,492	\$ 0	\$ 88,826,492
Budgetary Financing Sources:				
Appropriations received	0	214,837,314	0	214,837,314
Appropriations transferred-in/out	0	1,600,147	0	1,600,147
Other adjustments (rescissions, etc)	0	(1,046,611)	0	(1,046,611)
Appropriations used	0	(179,732,087)	0	(179,732,087)
Total Budgetary Financing Sources	\$ 0	\$ 35,658,763	\$ 0	\$ 35,658,763
Unexpended Appropriations	0	124,485,255	0	124,485,255
Net Position	\$ 24,620	\$ 192,944,743	\$ 0	\$ 192,969,363

The accompanying notes are an integral part of these financial statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

As of September 30, 2008 and 2007 (Amounts in thousands)	Budgetary Financing Accounts		Non-Budgetary Financing Accounts	
	2008 Combined	Restated 2007 Combined	2008 Combined	2007 Combined
BUDGETARY RESOURCES				
Unobligated balance, brought forward, October 1	\$ 32,258,188	\$ 17,409,234	\$ 590	\$ 1,292
Recoveries of prior year unpaid obligations	16,325,368	17,827,086	0	0
Budget authority				
Appropriation	231,167,292	214,853,089	0	0
Borrowing authority	0	0	590	15,500
Spending authority from offsetting collections				
Earned				
Collected	22,642,208	21,615,878	27,256	285
Change in receivables from Federal sources	90,385	77,579	0	0
Change in unfilled customer orders				
Advance received	246,196	199,782	0	0
Without advance from Federal sources	2,836,858	2,430,565	0	0
Subtotal	\$ 256,982,939	\$ 239,176,893	\$ 27,846	\$ 15,785
Nonexpenditure transfers, net, anticipated and actual	16,095,498	1,638,847	0	0
Permanently not available	(3,474,895)	(1,046,610)	(26,628)	0
Total Budgetary Resources	\$ 318,187,098	\$ 275,005,450	\$ 1,808	\$ 17,077
Status of Budgetary Resources:				
Obligations incurred:				
Direct	\$ 249,952,967	\$ 217,025,713	\$ 1,491	\$ 16,487
Reimbursable	27,681,171	25,721,549	0	0
Subtotal	\$ 277,634,138	\$ 242,747,262	\$ 1,491	\$ 16,487
Unobligated balance:				
Apportioned	36,283,194	28,970,760	318	187
Exempt from apportionment	125	0	0	0
Subtotal	\$ 36,283,319	\$ 28,970,760	\$ 318	\$ 187
Unobligated balance not available	4,269,641	3,287,428	(1)	403
Total status of budgetary resources	\$ 318,187,098	\$ 275,005,450	\$ 1,808	\$ 17,077
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	\$ 116,374,290	\$ 93,609,036	\$ 0	\$ 0
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(19,644,700)	(17,136,557)	0	0
Total unpaid obligated balance	\$ 96,729,590	\$ 76,472,479	\$ 0	\$ 0
Obligations incurred net (+/-)	\$ 277,634,138	\$ 242,747,262	\$ 1,491	\$ 16,487
Less: Gross outlays	(233,290,781)	(202,154,922)	(1,491)	(16,487)
Obligated balance transferred, net				
Less: Recoveries of prior year unpaid obligations, actual	\$ (16,325,368)	\$ (17,827,086)	\$ 0	\$ 0
Change in uncollected customer payments from Federal sources (+/-)	(2,927,244)	(2,508,143)	0	0
Obligated balance, net, end of period				
Unpaid obligations	144,392,278	116,374,290	0	0
Less: Uncollected customer payments (+/-) from Federal sources (-)	(22,571,943)	(19,644,700)	0	0
Total, unpaid obligated balance, net, end of period	\$ 121,820,335	\$ 96,729,590	\$ 0	\$ 0
Net Outlays				
Net Outlays:				
Gross outlays	\$ 233,290,781	\$ 202,154,922	\$ 1,491	\$ 16,487
Less: Offsetting collections	(22,888,403)	(21,815,661)	(27,257)	(284)
Less: Distributed Offsetting receipts	(674,720)	807,967	0	0
Net Outlays	\$ 209,727,658	\$ 181,147,228	\$ (25,766)	\$ 16,203

The accompanying notes are an integral part of these financial statements.

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Army General Fund, as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the Army General Fund in accordance with the Department of Defense (DoD), Financial Management Regulation (FMR), the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Army General Fund is responsible, unless otherwise noted. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernable.

The Army General Fund is unable to fully implement all elements of GAAP and the OMB Circular A-136 due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The Army General Fund derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The Army General Fund continues to implement process and system improvements addressing these limitations.

The Army General Fund currently has 14 auditor identified financial statement material weaknesses: (1) Financial Management Systems; (2) Fund Balance With Treasury; (3) Accounts Receivable; (4) Inventory; (5) General Property, Plant, and Equipment; (6) Accounts Payable; (7) Environmental Liabilities; (8) Statement of Net Cost; (9) Statement of Budgetary Resources; (10) Intragovernmental Eliminations; (11) Accounting Adjustments; (12) Abnormal Account Balances; (13) Reconciliation of Net Cost of Operations to Budget; and (14) Contingency Payment Audit Trails.

1.B. Mission of the Reporting Entity

The Army mission is to support the National Security and Defense Strategies by providing well-trained, well-led, and well-equipped forces to the combatant commanders. This mission encompasses the intent of the Congress, as defined in Title 10 of the U.S. Code, to preserve the peace and security, and provide for the defense of the United States, the Territories, Commonwealths, and Possessions of the United States, and any areas occupied by the United States; support national policies; implement national objectives; and overcome any nations responsible for aggressive acts that imperil the peace and security of the United States.

This mission has been unchanged for the 233-year life of the Army, but the environment and nature of conflict have undergone many changes over that same time, especially with the Global War on Terrorism. This has required that the Army simultaneously transform the way that it fights, trains, and equips its soldiers. This transformation is progressing rapidly, but it must be taken to its full conclusion if the Army is to continue to meet the Nation's domestic and international security obligations today and into the future.

1.C. Appropriations and Funds

The Army General Fund receives its appropriations and funds as general, trust, special, and deposit funds. The Army General Fund uses appropriations and funds to execute its missions and subsequently report on resource usage.

General funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction accounts.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. Certain trust and special funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish them from general revenues.

Special fund accounts are used to record government receipts reserved for a specific purpose.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. The Army General Fund is acting as an agent or a custodian for funds awaiting distribution.

The Army General Fund is a party to allocation transfers with other federal agencies as a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one agency of its authority to obligate budget authority and outlay funds for another agency. Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity. Exceptions to this general rule apply to specific funds for which the OMB has directed that all activity be reported in the financial statements of the child entity. Exceptions include all Treasury-Managed Trust Funds, Executive Office of the President (EOP), and all other funds specifically designated by OMB. The Army General Fund is a party to other allocation transfers as the child for the following funds meeting the OMB exception and all related activity is thus included in our financial statements: the Executive Office of the President (EOP).

The Army General Fund is a party to allocation transfers as the child for the following agencies: Federal Highway Administration and the U.S. Forestry Service.

The Army General Fund allocates funds, as the parent, to the Department of Agriculture and the Department of Transportation for Active Army and Army National Guard.

1.D. Basis of Accounting

For FY 2008, the Army General Fund's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Army General Fund's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the Army General Fund's financial and nonfinancial legacy systems were designed to record information on a budgetary basis.

The DoD has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until all of the Army General Fund's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the Army General Fund's financial data will be derived from budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and accruals made of major items such as payroll expenses, accounts payable, and environmental liabilities.

1.E. Revenues and Other Financing Sources

The Army General Fund receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The Army General Fund recognizes revenue as a result of costs incurred for goods or services provided

to other federal agencies and the public. Full cost pricing is the Army General Fund's standard policy for services provided as required by OMB Circular A-25, Transmittal Memorandum #1, User Charges. The Army General Fund recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The Army General Fund does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Note 21, "Reconciliation of Net Cost of Operations to Budget." The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Army General Fund's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. Operating Materials and Supplies (OM&S) consist of tangible personal property consumed in normal operations, and they are generally recognized as expenses when the items are purchased. Efforts are underway to transition towards the consumption method for recognizing OM&S expenses.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, the Army General Fund cannot accurately eliminate intragovernmental transactions by customer because the Army General Fund's systems do not track buyer and seller data at the transaction level. Generally, seller entities within the DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. IntraDoD balances are then eliminated. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements to ensure accurate intragovernmental information, to include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government," and the U.S. Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. While the DoD is unable to fully reconcile intragovernmental transactions with all federal partners, the Army General Fund is able to reconcile balances pertaining to investments in federal securities, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the U.S. Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the Army General Fund sells defense articles and services to foreign governments and international organizations under the provisions of the “Arms Export Control Act of 1976.” Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the U.S. Government. Payment in U.S. dollars is required in advance.

1.I. Funds with the U.S. Treasury

The Army General Fund’s monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U.S. Army Corps of Engineers (USACE), and the Department of State’s financial service centers process the majority of the Army General Fund’s cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. The Army General Fund’s recorded balance in the FBWT accounts and U.S. Treasury’s FBWT accounts must reconcile monthly.

1.J. Foreign Currency

Cash is the total of cash resources under the control of DoD, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts.

The majority of cash and all foreign currency is classified as nonentity and is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the restoration of Iraq.

The Army General Fund conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations: operations and maintenance, military personnel, military construction, family housing operations and maintenance, and family housing construction. The gains and losses are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Army General Fund does not separately identify currency fluctuation transactions.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based on the estimate of uncollectible accounts receivable from the public on a percentage of aged receivables by category. The allowance is calculated by using 50 percent of aged receivables in the 180-day to 2-year category and 100 percent of aged receivables in the greater than 2-year category. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual.

1.L. Direct Loans and Loan Guarantees

The Army General Fund operates a loan guarantee program designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

The “Federal Credit Reform Act of 1990” governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

1.M. Inventories and Related Property

The Army General Fund manages only military or government specific materiel under normal conditions. “Materiel” is a unique term that relates to military force management, and includes all items (including ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment, but excluding real property, installations, and utilities) necessary to equip, operate, maintain, and support military activities without distinction as to its application for administrative or combat purposes. Items commonly used in and available from the commercial sector are not managed in the Army General Fund materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The Army General Fund holds materiel based on military need and support for contingencies. The DoD does not attempt to account separately for “inventory held for sale” and “inventory held in reserve for future sale” based on SFFAS No. 3 definitions, unless otherwise noted.

Related property includes Operating Materials and Supplies (OM&S). The OM&S, including munitions not held for sale, are valued at standard purchase price. The Army General Fund uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Army General Fund uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2008, the Army General Fund expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

The Army General Fund determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high dollar items, such as aircraft engines, are categorized as OM&S rather than military equipment.

The Army General Fund recognizes condemned materiel as “Excess, Obsolete, and Unserviceable.” The cost of disposal is greater than the potential scrap value, therefore, the net value of condemned materiel is zero. Potentially redistributed materiel, presented in previous years as “Excess, Obsolete, and Unserviceable,” is included in the “Held for Use” or “Held for Repair” categories according to its condition.

1.N. Investments in U.S. Treasury Securities

The Army General Fund reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investment using the effective interest rate method or another method obtaining similar results. The Army General Fund’s intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The Army General Fund invests in nonmarketable market-based U.S. Treasury securities. These are U.S. Treasury securities that are issued by the Bureau of Public Debt to federal agencies. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

1.O. General Property, Plant and Equipment

The Army General Fund uses the estimated historical cost for valuing military equipment. The DoD identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, program acquisitions, and disposals to establish a baseline. The military equipment baseline is updated using expenditure, acquisition and disposals information.

The DoD's General Property, Plant & Equipment (General PP&E) capitalization threshold is \$100,000 except for real property which is \$20,000. The Army General Fund has not implemented the threshold for real property but expects to be fully compliant by FY 2009. Army General Fund is currently using the capitalization threshold of \$100,000 for all General PP&E.

General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed DoD capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

General PP&E previously capitalized at amounts below \$100,000 was written off the Army General Fund financial statements in FY 1998.

When it is in the best interest of the government, the Army General Fund provides government property to contractors to complete contract work. The Army General Fund either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, Federal accounting standards require that it be reported on the Army General Fund's Balance Sheet.

The DoD is developing new policies and a contractor reporting process for Government Furnished Equipment that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Army General Fund reports only government property in the possession of contractors that is maintained in Army General Fund's property systems. The DoD has issued new property accountability and reporting requirements that require the Army General Fund to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, the DoD policy is to record advances and prepayments in accordance with GAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The Army General Fund has not implemented this policy primarily due to system limitations.

1.Q. Leases

Lease payments for the rental of operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), Army General Fund records the applicable asset and liability if the value equals or exceeds the current capitalization threshold. The Army General Fund records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value

calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The Army General Fund as the lessee receives the use and possession of leased property, for example, real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space and leases entered into by Army General Fund in support of contingency operations are the largest component of operating leases. These costs were gathered from existing leases, General Services Administration bills, and Interservice Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases. The Army General fund will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on Army General Fund's Balance Sheet.

The Army General Fund conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, Army General Fund may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction In Progress. It is DoD policy to record certain contract financing payments as Other Assets.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The Army General Fund recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending, or threatened litigation, and possible claims and assessments. The Army General Fund's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for Army General Fund's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service.

Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon DoD's policy, which is consistent with SFFAS No. 5 "Accounting for Liabilities of Federal Government." The DoD recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily identifiable from, environmental disposal costs.

1.T. *Accrued Leave*

The Army General Fund reports as liabilities military leave and civilian earned leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. *Net Position*

Net Position consists of Unexpended Appropriations and Cumulative Results of Operations.

Unexpended Appropriations represent the amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfers in and out of assets that were not reimbursed.

1.V. *Treaties for Use of Foreign Bases*

The DoD has the use of the land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The Army General Fund purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the Army General Fund continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any nonretrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

1.W. *Comparative Data*

The Army General Fund's financial statements and notes are presented on a comparative basis.

1.X. *Unexpended Obligations*

The Army General Fund obligates funds to provide goods and services for outstanding orders not yet delivered. Unless the title has passed, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations includes both obligations for which goods and services have been delivered (title passed) and a liability recognized, and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources, and is referred to as "Total, unpaid obligated balances, net, end of period."

1.Y. *Undistributed Disbursements and Collections*

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the monthly accounting

reports. In transit payments are those payments that have been made, but have not been recorded in the fund holder's accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities.

1.Z. Significant Events

No significant events noted.

Note 2. Nonentity Assets

As of September 30	2008		2007	
<i>(Amounts in thousands)</i>				
1. Intragovernmental Assets				
A. Fund Balance with Treasury	\$	816,703	\$	663,415
B. Accounts Receivable		0		0
C. Total Intragovernmental Assets	\$	816,703	\$	663,415
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	\$	2,418,049	\$	2,183,050
B. Accounts Receivable		14,136		16,752
C. Other Assets		0		0
D. Total Nonfederal Assets	\$	2,432,185	\$	2,199,802
3. Total Nonentity Assets	\$	3,248,888	\$	2,863,217
4. Total Entity Assets	\$	322,585,173	\$	261,612,657
5. Total Assets	\$	325,834,061	\$	264,475,874

Definitions

Nonentity assets are assets for which the Army General Fund maintains stewardship accountability and responsibility to report, but are not available for the Army General Fund's operations.

Nonentity Fund Balance with Treasury consists of deposit funds for humanitarian relief and reconstruction, seized Iraqi cash, and Development Fund Iraq (DFI). Deposit funds are generally used to record amounts held temporarily until paid to the appropriate government or public entity. Humanitarian relief and reconstruction deposit funds are funds held for expenditures on behalf of the Iraqi people. Seized Iraqi cash is former Iraqi regime monies confiscated by coalition forces. The DFI consists of proceeds from Iraqi oil sales, repatriated assets from the United States and other nations, and deposits from unencumbered oil-for-food program funds. The deposit funds for seized Iraqi cash and DFI consist of residual amounts only. The Nonentity Fund Balance with Treasury consists primarily of humanitarian relief and reconstruction funds held for expenditures on behalf of the Iraqi people.

Nonentity Cash and Other Monetary Assets consist of cash held by disbursing officers to carry out their paying and collecting missions, and foreign currency accommodation exchange primarily consisting of the burden sharing for the Republic of Korea. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

Nonentity Nonfederal Accounts Receivables are primarily from canceled year appropriations. These receivables will be returned to the U.S. Treasury as miscellaneous receipts once collected.

Note 3. Fund Balance with Treasury

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Fund Balances		
A. Appropriated Funds	\$ 162,453,643	\$ 128,544,970
B. Revolving Funds	4,286	6,992
C. Trust Funds	1,674	976
D. Special Funds	46,165	46,915
E. Other Fund Types	816,703	663,415
F. Total Fund Balances	\$ 163,322,471	\$ 129,263,268
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	\$ 164,616,052	\$ 128,737,334
B. Fund Balance per Army	163,322,471	129,263,269
3. Reconciling Amount	\$ 1,293,581	\$ (525,934)

Other Fund Types

Other Fund Types consists of deposit funds, clearing accounts, unavailable receipt accounts, Seized Iraqi Cash, and the Development Fund Iraq (DFI). Deposit funds are generally used to record amounts held temporarily until paid to the appropriate government or public entity. Clearing accounts are used as a temporary suspense account until later paid by or refunded into another account or when the Government acts as a banker or agent for others. Unavailable receipt accounts are credited with all collections not earmarked by law for a specific purpose. These include: taxes, customs duties, and miscellaneous receipts. Seized Iraqi cash is former Iraqi regime monies confiscated by coalition forces. The DFI consists of proceeds from Iraqi oil sales, repatriated assets from the United States and other nations, and deposits from unencumbered oil-for-food program funds.

Reconciling Amount

The U.S. Treasury reported an additional \$1.3 billion in Fund Balance with Treasury than reported by the Army General Fund. This includes \$1.2 billion in canceling year authority, \$145.0 million in unavailable receipts and (\$14.6) million in net differences due to the U.S. Treasury treatment of allocation transfers.

Status of Fund Balance with Treasury

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Unobligated Balance		
A. Available	\$ 36,283,637	\$ 28,970,947
B. Unavailable	4,269,641	3,287,831
2. Obligated Balance not yet Disbursed	144,392,279	116,374,288
3. Nonbudgetary FBWT	952,390	278,513
4. Non-FBWT Budgetary Accounts	(22,575,476)	(19,648,311)
5. Total	\$ 163,322,471	\$ 129,263,268

Definitions

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support the FBWT.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed. Unobligated Balance Unavailable consists of unobligated or unapportioned authority that has expired, which restricts the ability to incur new obligations.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represent adjustments that do not have budgetary authority, such as unavailable receipt accounts, clearing accounts, deposit accounts and Iraqi custodial accounts.

Non-FBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT, such as contract authority, borrowing authority and investment accounts, accounts receivable, as well as unfilled orders without advance from customers. This category reduces the Status of FBWT.

Note 4. Investments and Related Interest

		2008				
As of September 30		Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
<i>(Amounts in thousands)</i>						
1. Intragovernmental Securities						
A. Nonmarketable, Market-Based						
1. Military Retirement Fund		\$ 0		\$ 0	\$ 0	\$ 0
2. Medicare Eligible Retiree Health Care Fund		0		0	0	0
3. US Army Corps of Engineers		0		0	0	0
4. Other Funds		3,449	Effective Interest	51	3,500	3,530
5. Total Nonmarketable, Market-Based		\$ 3,449		\$ 51	\$ 3,500	\$ 3,530
B. Accrued Interest		32			32	32
C. Total Intragovernmental Securities		\$ 3,481		\$ 51	\$ 3,532	\$ 3,562
2. Other Investments						
A. Total Other Investments		\$ 0		\$ 0	\$ 0	N/A
		2007				
As of September 30		Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
<i>(Amounts in thousands)</i>						
3. Intragovernmental Securities						
A. Nonmarketable, Market-Based						
1. Military Retirement Fund		\$ 0		\$ 0	\$ 0	\$ 0
2. Medicare Eligible Retiree Health Care Fund		0		0	0	0
3. US Army Corps of Engineers		0		0	0	0
4. Other Funds		3,384	Effective Interest	30	3,414	3,257
5. Total Nonmarketable, Market-Based		\$ 3,384		\$ 30	\$ 3,414	\$ 3,257
B. Accrued Interest		34			34	34
C. Total Intragovernmental Securities		\$ 3,418		\$ 30	\$ 3,448	\$ 3,291
4. Other Investments						
A. Total Other Investments		\$ 0		\$ 0	\$ 0	N/A

The Other Funds include the Army Gift Fund. The Army Gift Fund was established to control and account for the disbursement and use of monies donated to the Army General Fund along with the interest received from the investment of such donations. The related earnings are allocated to appropriate Army General Fund activities to be used in accordance with the directions of the donor. These funds are recorded as Nonmarketable Market-Based U.S. Treasury Securities, which are not traded on any securities exchange, but mirror the prices of marketable securities with similar terms.

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general government purposes. U.S. Treasury securities are issued to the Army General Fund as evidence of its deposits. U.S. Treasury securities are an asset to the Army General Fund and a liability to the U.S. Treasury. Because the Army General Fund and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S.

Governmentwide financial statements. The U.S. Treasury securities provide the Army General Fund with authority to draw upon the U.S. Treasury to make expenditures. When the Army General Fund requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Note 5. Accounts Receivable

As of September 30 <i>(Amounts in thousands)</i>	2008			2007
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
1. Intragovernmental Receivables	\$ 499,668	N/A	\$ 499,668	\$ 420,417
2. Nonfederal Receivables (From the Public)	729,785	\$ (110,314)	619,471	576,533
3. Total Accounts Receivable	\$ 1,229,453	\$ (110,314)	\$ 1,119,139	\$ 996,950

Note 6. Other Assets

As of September 30 <i>(Amounts in thousands)</i>	2008	2007
1. Intragovernmental Other Assets		
A. Advances and Prepayments	\$ 430,932	\$ 514,835
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	\$ 430,932	\$ 514,835
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	\$ 6,469,032	\$ 6,011,028
B. Advances and Prepayments on behalf of Foreign Governments	0	0
C. Advances and Prepayments	26,929	596,559
D. Other Assets (With the Public)	0	0
E. Total Nonfederal Other Assets	\$ 6,495,961	\$ 6,607,587
3. Total Other Assets	\$ 6,926,893	\$ 7,122,422

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Army General Fund that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the Army General Fund is not obligated to make payment to the contractor until delivery and acceptance.

The Outstanding Contract Financing Payment balance of \$6.5 billion is comprised of \$6.1 billion in contract financing payments and an additional \$421.1 million in estimated future payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. See additional discussion in Note 15, Other Liabilities.

Note 7. Cash and Other Monetary Assets

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Cash	\$ 1,088,505	\$ 1,101,981
2. Foreign Currency	1,329,544	1,081,070
3. Other Monetary Assets	0	0
4. Total Cash, Foreign Currency, & Other Monetary Assets	\$ 2,418,049	\$ 2,183,051

Other Information Related to Cash and Other Monetary Assets

Cash consists primarily of cash held by disbursing officers to carry out their paying and collecting mission. Foreign currency consists primarily of burden sharing funds from the Republic of Korea.

Foreign currency is valued using the U.S. Treasury Prevailing Rate of Exchange. This rate is the most favorable rate that would legally be available to the U.S. Government's acquisition of foreign currency for its official disbursements and accommodation of exchange transactions. All the Army General Fund cash and foreign currency is nonentity and is, therefore, restricted.

Note 8. Direct Loan and Loan Guarantees

As of September 30

Direct Loan and/or Loan Guarantee Programs

The Army General Fund operates a loan guarantee program, the Armament Retooling & Manufacturing Support (ARMS) Initiative Loan Guarantee Program, designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

The "Federal Credit Reform Act of 1990" governs all loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees. The Army General Fund does not operate a direct loan program.

Loan guarantee liabilities are reported at the net present value. The cost of the loan guarantee is the net present value of the following estimated projected cash flows:

- Payments by the Army General Fund to cover defaults and delinquencies, interest subsidies, or other payments; offset by
- Payments to the Army General Fund including origination and other fees, penalties, and recoveries.

Armament Retooling and Manufacturing Support Initiative

The ARMS Initiative, Title 10 United States Code 4551-4555, is a Loan Guarantee Program designed to encourage commercial use of the Army General Fund's Inactive Ammunition Plants through many incentives for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements; however, this capacity may be needed by the military in the future. The revenues from the property rental are used to pay for the operation, maintenance and environmental cleanup at the facilities. The resulting savings in

overhead costs lower the production cost of the goods manufactured and fund environmental cleanup at no cost to the government.

The Army General Fund, by means of ARMS Initiative legislation, established a loan guarantee program to facilitate commercial firms' use of specified ammunition manufacturing facilities. The Army and U.S. Department of Agriculture (USDA) Rural Business-Cooperative Service (RBS) established a memorandum of understanding for the RBS to administer the ARMS Initiative loan guarantee program.

Loan Guarantees

In an effort to preclude additional Army General Fund loan liability, the Assistant Secretary of the Army (Acquisition, Logistics and Technology) instituted an ARMS loan guarantee moratorium in 2004. The Army General Fund continues to operate under the moratorium, and does not anticipate initiating new loan guarantees.

Summary of Direct Loans and Loan Guarantees

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
Loans Receivable		
Direct Loans		
1. Foreign Military Loan Liquidating Account	\$ 0	\$ 0
2. Military Housing Privatization Initiative	0	0
3. Foreign Military Financing Account	0	0
4. Military Debt Reduction Financing Account	0	0
5. Total Direct Loans	\$ 0	\$ 0
Defaulted Loan Guarantees		
6. A. Foreign Military Financing Account	\$ 0	\$ 0
B. Military Housing Privatization Initiative	0	0
C. Armament Retooling & Manufacturing Support Initiative	0	67
7. Total Default Loan Guarantees	\$ 0	\$ 67
8. Total Loans Receivable	\$ 0	\$ 67
Loan Guarantee Liability		
1. Foreign Military Liquidating Account	\$ 0	\$ 0
2. Military Housing Privatization Initiative	0	0
3. Armament Retooling & Manufacturing Support Initiative	2,337	290
4. Total Loan Guarantee Liability	\$ 2,337	\$ 290

The Loan Guarantee Liability represents the present value of the estimated cash inflows less cash outflows of non-acquired loan guarantees. The \$2.3 million in loan guarantee liability represents the estimated long-term cost of the currently performing loans to the U.S. Government for the ARMS Initiative Loan Guarantee Program.

Direct Loans Obligated

The Army General Fund does not operate direct loan programs; therefore, this schedule is not applicable.

Total Amount of Direct Loans Disbursed

The Army General Fund does not operate direct loan programs; therefore, this schedule is not applicable.

Subsidy Expense for Direct Loan by Program

Not applicable.

Subsidy Rate for Direct Loans by Program

The Army General Fund does not operate direct loan programs; therefore, this schedule is not applicable.

Schedule for Reconciling Subsidy Cost Allowance Balances for Post FY1991 Direct Loans

The Army General Fund does not operate direct loan programs; therefore, this schedule is not applicable.

Defaulted Guaranteed Loans

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
Defaulted Guaranteed Loans from Pre-FY 1992 Guarantees (Allowance for Loss Method):		
1. Foreign Military Loan Liquidating Account		
A. Defaulted Guaranteed Loans Receivable, Gross	\$ 0	\$ 0
B. Interest Receivable	0	0
C. Foreclosed Property	0	0
D. Allowance for Loan Losses	0	0
E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	\$ 0	\$ 0
Defaulted Guaranteed Loans from Post-FY 1991 Guarantees (Present Value Method):		
2. Military Housing Privatization Initiative		
A. Defaulted Guaranteed Loans Receivable, Gross	\$ 0	\$ 0
B. Interest Receivable	0	0
C. Foreclosed Property	0	0
D. Allowance for Subsidy Cost (Present Value)	0	0
E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	\$ 0	\$ 0
3. Armament Retooling & Manufacturing Support Initiative		
A. Defaulted Guaranteed Loans Receivable, Gross	\$ 15,142	\$ 14,407
B. Interest Receivable	0	0
C. Foreclosed Property	0	0
D. Allowance for Subsidy Cost (Present Value)	(15,142)	(14,340)
E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	\$ 0	\$ 67
4. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable	\$ 0	\$ 67

Guaranteed Loans Outstanding

As of September 30 <i>(Amounts in thousands)</i>	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding		
1. Military Housing Privatization Initiative	\$ 0	\$ 0
2. Armament Retooling & Manufacturing Support Initiative	3,079	2,617
3. Foreign Military Liquidating Account	0	0
4. Total	\$ 3,079	\$ 2,617
2008		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	\$ 0	\$ 0
2. Armament Retooling & Manufacturing Support Initiative	0	0
4. Total	\$ 0	\$ 0
2007		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	\$ 0	\$ 0
2. Armament Retooling & Manufacturing Support Initiative	0	0
4. Total	\$ 0	\$ 0

Outstanding Principal of Guaranteed Loans, Face Value is the principal amount of loans disbursed by third parties and guaranteed by the Army General Fund. The face value does not include any interest that is due to be paid on the debt instruments.

Amount of Outstanding Principal Guaranteed is the principal amount of loans disbursed by third parties and guaranteed by the Army General Fund less borrower collateral. The net amount represents the loan amount guaranteed by the Army General Fund. One performing loan remains.

Liabilities for Loan Guarantees

As of September 30 <i>(Amounts in thousands)</i>	2008	2007
Liabilities for Losses on Loan Guarantee from Pre 1992 (Allowance for Loss):		
1. Foreign Military Liquidating Account	\$ 0	\$ 0
2. Total Loan Guarantee Liability (Pre-FY 1992)	\$ 0	\$ 0
Liabilities for Loan Guarantee from Post 1991 (Present Value):		
3. Military Housing Privatization Initiative	\$ 0	\$ 0
4. Armament Retooling & Manufacturing Support Initiative	2,337	290
5. Total Loan Guarantee Liability (Post-FY 1991)	\$ 2,337	\$ 290
6. Total Loan Guarantee Liability	\$ 2,337	\$ 290

Liabilities for Loan Guarantee Programs Post-FY 1991 represent the present value of the estimated cash inflows less cash outflows of non-acquired loan guarantees. The \$2.3 million in loan guarantee liability represents the estimated long-term cost of the currently performing loan to the U. S. Government for the ARMS Initiative Loan Guarantee Program.

Subsidy Expense for Loan Guarantees by Program

As of September 30

(Amounts in thousands)

2008	Interest Differential	Defaults	Fees	Other	Total
1. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Armament Retooling & Manufacturing Support Initiative	0	0	0	0	0
Total	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

2007	Interest Differential	Defaults	Fees	Other	Total
2. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Armament Retooling & Manufacturing Support Initiative	0	0	0	0	0
Total	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

2008	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Modifications and Reestimates:					
Military Housing Privatization Initiative	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Armament Retooling & Manufacturing Support Initiative	0	409	1,651	2,060	2,060
Total	\$ 0	\$ 409	\$ 1,651	\$ 2,060	\$ 2,060

2007	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Modifications and Reestimates:					
Military Housing Privatization Initiative	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Armament Retooling & Manufacturing Support Initiative	0	2,202	(1,088)	1,114	1,114
Total	\$ 0	\$ 2,202	\$ (1,088)	\$ 1,114	\$ 1,114

	2008	2007
5. Total Loan Guarantee:		
Military Housing Privatization Initiative	\$ 0	\$ 0
Armament Retooling & Manufacturing Support Initiative	2,060	1,114
Total	\$ 2,060	\$ 1,114

In an effort to preclude additional Army General Fund loan liability, the Assistant Secretary of the Army (Acquisition, Logistics and Technology) instituted an ARMS loan guarantee moratorium in 2004. The Army General Fund continues to operate under the moratorium, and does not anticipate initiating new loan guarantees.

Subsidy Rates for Loan Guarantees by Program

The Subsidy Rates for Loan Guarantees table displays subsidy rates applied to new guaranteed loans. Since no new loan guarantees for the ARMS Initiative Program originated in FY 2008 or FY 2007, the table properly presents zero percent subsidy rates.

Schedule for Reconciling Loan Guarantee Liability Balances for Post-FY 1991 Loan Guarantees

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
Beginning Balance, Changes, and Ending Balance:		
1. Beginning Balance of the Loan Guarantee Liability	\$ 290	\$ 12,853
2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
A. Interest Supplement Costs	\$ 0	\$ 0
B. Default Costs (Net of Recoveries)	0	0
C. Fees and Other Collections	0	0
D. Other Subsidy Costs	0	0
E. Total of the above Subsidy Expense Components	\$ 0	\$ 0
3. Adjustments		
A. Loan Guarantee Modifications	\$ 0	\$ 0
B. Fees Received	0	0
C. Interest Supplements Paid	0	0
D. Foreclosed Property and Loans Acquired	746	2,290
E. Claim Payments to Lenders	(767)	(15,310)
F. Interest Accumulation on the Liability Balance	8	(657)
G. Other	0	0
H. Total of the above Adjustments	\$ (13)	\$ (13,677)
4. Ending Balance of the Loan Guarantee Liability before Reestimates	\$ 277	\$ (824)
5. Add or Subtract Subsidy Reestimates by Component		
A. Interest Rate Reestimate	409	2,202
B. Technical/default Reestimate	1,651	(1,088)
C. Total of the above Reestimate Components	\$ 2,060	\$ 1,114
6. Ending Balance of the Loan Guarantee Liability	\$ 2,337	\$ 290

The loan guarantee reconciliation displays the calculation for the ending balance of the loan guarantee liability. Foreclosed Property and Loans Acquired of \$746,100 relates to the net present value of the loan acquired this year. The interest accumulation on the liability balance represents the amount of interest income attributable to the one remaining performing loan. This process will occur for the first three quarters of the fiscal year until the fourth quarter at which time actual values will be recorded.

Administrative Expenses

Administrative expense of \$16,000 is an annual amount for salary and expense which normally occurs during the last quarter of the fiscal year.

Note 9. Inventory and Related Property

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Inventory, Net	\$ 0	\$ 0
2. Operating Materials & Supplies, Net	40,134,982	33,938,649
3. Stockpile Materiel, Net	0	0
4. Total	\$ 40,134,982	\$ 33,938,649

Inventory, Net

Not applicable.

Operating Materials and Supplies, Net

As of September 30	2008			2007		Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net		
1. OM&S Categories						
A. Held for Use	\$ 40,134,982	\$ 0	\$ 40,134,982	\$ 33,938,649		SP, LAC, MAC
B. Held for Repair	0	0	0	0		SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable	737,202	(737,202)	0	0		NRV
D. Total	\$ 40,872,184	\$ (737,202)	\$ 40,134,982	\$ 33,938,649		

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
 SP = Standard Price
 AC = Actual Cost

NRV = Net Realizable Value
 O = Other
 MAC = Moving Average Cost

Operating Materials and Supplies (OM&S) includes ammunition, tactical missiles, and related spare and repair parts. The category, Held for Use, includes all materiel able to be issued. Economically repairable materiel is categorized as held for repair.

Managers determine which items are more costly to repair than to replace. Items retained for management purposes are coded condemned. The net value of these items is zero, and is shown as Excess, Obsolete, and Unserviceable.

The Army General Fund establishes an allowance for excess, obsolete, and unserviceable OM&S and inventory at 100 percent of the carrying amount in accordance with DoD policy.

The value of the Army's Government Furnished Materiel and Contractor Acquired Materiel in the hands of contractors is normally not included in the OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information in other existing logistics systems.

Stockpile Materiel, Net

Not applicable

Note 10. General PP&E, Net

As of September 30 (Amounts in thousands)	2008					2007
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
1. Major Asset Classes						
A. Land	N/A	N/A	\$ 522,002	N/A	\$ 522,002	\$ 523,766
B. Buildings, Structures, and Facilities	S/L	20 Or 40	51,373,867	\$ (32,075,265)	19,298,602	18,181,710
C. Leasehold Improvements	S/L	lease term	15,035	(12,029)	3,006	12,510
D. Software	S/L	2-5 Or 10	501,718	(193,255)	308,463	356,789
E. General Equipment	S/L	5 or 10	4,008,979	(1,766,039)	2,242,940	2,114,575
F. Military Equipment	S/L	Various	121,904,581	(42,280,951)	79,623,630	62,707,236
G. Assets Under Capital Lease	S/L	lease term	166,617	(157,777)	8,840	12,393
H. Construction-in- Progress	N/A	N/A	9,881,429	N/A	9,881,429	7,033,929
I. Other			20,083	0	20,083	25,111
J. Total General PP&E			\$ 188,394,311	\$ (76,485,316)	\$ 111,908,995	\$ 90,968,019

¹Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

S/L = Straight Line

N/A = Not Applicable

Information Related to Heritage Assets and Stewardship Land

The mission of the Department of Defense, including the Army, is to provide the military forces needed to deter war and protect the security of the United States by organizing, training, supplying, equipping, and mobilizing forces for assignment in support of that mission. Executing this mission requires efficient and effective use of resources in a manner that ensures operational and environmental sustainability, while respecting the history and heritage that reflect and support the military mission. The Army has stewardship responsibilities for heritage assets that date not only from the military history of the land, but from prior historic occupations. The Army relies upon heritage assets, such as historic buildings and stewardship land for daily use in administration, housing, and training soldiers. Those heritage assets not currently employed as “multi-use,” such as archeological collections or museum collections, are items that embody the multi-faceted history of the land, the military, the local communities, and the nation, that is the heritage that the Department of Defense defends.

The Army’s policies for managing cultural resources and heritage assets is published in Army Regulations 200-4 and 870-20. These policies provide in-depth procedures for managing the Army’s cultural resources and museum collections. The Army Regulations take into account the Army’s responsibilities under various legal compliance requirements such as the National Historic Preservation Act, the Native American Graves Protection and Repatriation Act, the National Environmental Policy Act, and the Archeological Resources Protection Act, among others. The regulations provide guidance to all active Army, Army Reserves, and National Guard units and installations as to the appropriate policies, responsibilities, procedures, and requirements affecting heritage assets. These policies are designed to ensure that Army installations and commanders make informed decisions regarding the cultural resources under their stewardship in compliance with public laws, in support of the military mission, and consistent with sound principles of cultural resource management.

Heritage assets are items that are distinguished by one or more of the following characteristics:

1. Historical or natural significance;
2. Cultural, educational, or artistic importance; or
3. Significant architectural characteristics.

Heritage assets are expected to be preserved. The DoD policy requires that heritage assets be reported within the following categories:

Buildings and Structures: Includes buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-use Heritage Assets. Includes National Historic Landmarks; buildings or structures that are contributing elements to districts listed on or eligible for the National Register of Historic Places or a National Historic Landmark District; and buildings and structures designated eligible in the National Register of Historic Places for purposes of Program Alternatives.

Museums: Buildings that house collection type items including artwork, archeological artifacts, archival materials, and other historical artifacts. The primary use of such buildings shall be the preservation, maintenance, and display of the collection type Heritage Assets.

Archeological Sites: Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Register of Historic Places.

Assets Under Capital Lease

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	\$ 166,071	\$ 166,071
B. Equipment	546	546
C. Accumulated Amortization	(157,777)	(154,223)
D. Total Capital Leases	\$ 8,840	\$ 12,394

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Intragovernmental Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	2,804,367	459,482
D. Total Intragovernmental Liabilities	\$ 2,804,367	\$ 459,482
2. Nonfederal Liabilities		
A. Accounts Payable	\$ 192,963	\$ 196,499
B. Military Retirement and Other Federal Employment Benefits	1,472,383	1,483,177
C. Environmental Liabilities	39,702,096	43,302,064
D. Other Liabilities	5,819,091	4,911,900
E. Total Nonfederal Liabilities	\$ 47,186,533	\$ 49,893,640
3. Total Liabilities Not Covered by Budgetary Resources	\$ 49,990,900	\$ 50,353,121
4. Total Liabilities Covered by Budgetary Resources	23,368,873	21,153,389
5. Total Liabilities	\$ 73,359,773	\$ 71,506,511

Intragovernmental Liabilities, Other primarily consists of disbursing officers custodial liability.

Nonfederal Other Liabilities, Other consists of Unfunded Annual Leave and Conventional Munitions Disposals.

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources is comprised of various employee actuarial liabilities. These liabilities are primarily comprised of Federal Employee Compensation Act benefits liability of \$1.5 billion. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Liabilities not covered by budgetary resources are liabilities for which congressional action is needed before budgetary resources can be provided.

Liabilities such as Environmental Liabilities, Military Retirement and Other Federal Employment Benefits, Accounts Payable, and Debt are not covered by budgetary resources due to being classified as noncurrent. Congressional action will not be taken to cover these liabilities until classified as current.

Other Intragovernmental Liabilities include liabilities for non-entity assets, such as disbursing officers cash, that are held in the Army General Fund to be transferred to other entities and therefore not covered by budgetary resources. Unfunded Annual Leave is leave an employee is entitled to upon separation and funded with future years' appropriations and thus not covered by budgetary resources in the current fiscal year.

Note 12. Accounts Payable

As of September 30 <i>(Amounts in thousands)</i>	2008			2007	
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total	
1. Intragovernmental Payables	\$ 1,563,994	\$ N/A	\$ 1,563,994	\$ 1,729,905	
2. Nonfederal Payables (to the Public)	11,956,805	0	11,956,805	9,108,551	
3. Total	\$ 13,520,799	\$ 0	\$ 13,520,799	\$ 10,838,456	

Other Information Related to Accounts Payable

The Army General Fund systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts payable were adjusted by reclassifying between federal and nonfederal accounts payable.

In FY 2007, the Department recognized accounts payable balances of the Mechanization of Contract Administration Services (MOCAS) system at gross value without reductions for partial payments, progress payments, and non-accounts payable records overstating accounts payable and expenses. The overstated balances for FY 2007 were undeterminable due to system limitations; therefore, no corrections have been made. Balances at FY 2008 are properly reported net of non-accounts payable records, partial and progress payments of \$339.4 million.

Note 13. Debt

As of September 30 <i>(Amounts in thousands)</i>	2008			2007	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
1. Agency Debt (Intragovernmental)					
A. Debt to the Treasury	\$ 26,706	\$ (25,873)	\$ 833	\$ 15,302	\$ 26,706
B. Debt to the Federal Financing Bank	0	0	0	0	0
C. Total Agency Debt	\$ 26,706	\$ (25,873)	\$ 833	\$ 15,302	\$ 26,706
2. Total Debt	\$ 26,706	\$ (25,873)	\$ 833	\$ 15,302	\$ 26,706

The Army General Fund, by means of Armament Retooling and Manufacturing Support (ARMS) Initiative legislation, established a loan guarantee program to facilitate commercial firms' use of specified ammunition manufacturing facilities. When a borrower defaults on a guaranteed loan, the Army General Fund executes borrowing authority with the U.S. Treasury to pay the lender the guaranteed outstanding principal resulting in a debt with the U.S. Treasury. The total debt of \$832,800 consists of interest and principal payments due to the U.S. Treasury for two ARMS loan defaults. During 3rd Quarter, FY 2008, the Army General Fund made a \$26.6 million payment to the U.S. Treasury for two defaulted loans related to the ARMS Initiative legislation.

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30 <i>(Amounts in thousands)</i>	2008			2007
	Current Liability	Noncurrent Liability	Total	Total
1. Environmental Liabilities--Nonfederal				
A. Accrued Environmental Restoration Liabilities				
1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	\$ 381,303	\$ 2,286,566	\$ 2,667,869	\$ 2,876,537
2. Active Installations—Military Munitions Response Program (MMRP)	45,323	2,697,323	2,742,646	3,227,899
3. Formerly Used Defense Sites—IRP and BD/DR	168,975	3,064,204	3,233,179	3,813,999
4. Formerly Used Defense Sites--MMRP	100,898	14,758,142	14,859,040	14,696,788
B. Other Accrued Environmental Liabilities—Non-BRAC				
1. Environmental Corrective Action	43,844	356,897	400,741	568,623
2. Environmental Closure Requirements	2,759	94,088	96,847	192,477
3. Environmental Response at Operational Ranges	19,275	144,469	163,744	183,068
4. Asbestos	0	0	0	0
5. Non-Military Equipment	0	0	0	0
6. Other	0	33,874	33,874	46,557
C. Base Realignment and Closure Installations				
1. Installation Restoration Program	197,231	572,006	769,237	794,255
2. Military Munitions Response Program	52,927	888,232	941,159	876,410
3. Environmental Corrective Action / Closure Requirements	8,930	287,274	296,204	113,094
4. Asbestos	0	0	0	0
5. Non-Military Equipment	0	0	0	0
6. Other	0	0	0	0
D. Environmental Disposal for Military Equipment / Weapons Programs				
1. Nuclear Powered Military Equipment / Spent Nuclear Fuel	0	0	0	0
2. Non-Nuclear Powered Military Equipment	0	0	0	0
3. Other National Defense Weapons Systems	0	0	0	0
4. Other	0	0	0	0
E. Chemical Weapons Disposal Program				
1. Chemical Agents and Munitions Destruction (CAMD)	1,242,560	9,394,093	10,636,653	18,308,644
2. CAMD Assembled Chemical Weapons Assessment (ACWA)	509,344	5,124,929	5,634,273	0
3. Other	0	0	0	0
2. Total Environmental Liabilities	\$ 2,773,369	\$ 39,702,097	\$ 42,475,466	\$ 45,698,351

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Environmental Disclosures

Applicable Laws and Regulations

The Army General Fund is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activity prior to 1986 from hazardous substances and wastes that created a public health or environmental risk and prior to FY 2003 from unexploded ordnance (UXO), discarded military munitions, and munitions constituents at other than operational ranges under the Defense Environmental Restoration Program (DERP), established by Section 211 of the Superfund Amendments and Reauthorization Act of 1986 codified in Title 10 of the United States Code 2701. The Army General Fund is also required to clean up contamination resulting from waste disposal practices, leaks, spills, and other activity after 1986 from hazardous substances and wastes and after FY 2003 from UXO, discarded military munitions, and munitions constituents migrating from an operational range under the Army Compliance Cleanup Program.

The Army is required to destroy the chemical stockpile and nonstockpile as part of the Chemical Demilitarization Program. The 1986 Defense Authorization Act (Public Law (PL) 99-145, as amended by subsequent acts) directed the DoD to destroy the unitary chemical stockpile while providing for maximum protection of the environment, public, and personnel involved in the destruction effort. The 1993 Defense Authorization Act (PL 102-484) required the establishment of the NonStockpile Chemical Material Project to safely dispose of all nonstockpile chemical material. The destruction operations being carried out using the facilities and equipment developed and fielded as part of the program are also subject to numerous federal and state environmental regulations.

Applicable laws are as follows for the DERP, NonDERP, Low Level Radioactive Waste, and the BRAC programs:

- Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
- Superfund Amendments and Reauthorization Act (SARA)
- Clean Water Act
- Safe Drinking Water Act
- Clean Air Act
- Resource Conservation and Recovery Act (RCRA)
- Toxic Substances Control Act (TSCA)
- Medical Waste Tracking Act
- Atomic Energy Act
- Nuclear Waste Policy Act
- Low Level Radioactive Waste Policy Amendments Act
- National Defense Authorization Acts

Types of Environmental Liabilities and Disposal Liabilities Identified

The Army General Fund has environmental cleanup requirements for the DERP sites at active installations, Base Realignment and Closure (BRAC) installations, Formerly Used Defense Sites (FUDS), NonDERP sites at active installations, weapon systems programs, and chemical weapons disposal programs. The DERP and NonDERP sites are required to clean up contamination in coordination with regulatory agencies, other responsible parties, and current property owners. Environmental disposal for weapons systems programs consists of chemical weapons disposal, including the destruction of the entire U.S. stockpile of chemical agents and munitions and disposal of nonstockpile chemical material. This includes binary chemical weapons, old chemical weapons recovered as part of remediation and recovery

operations, and miscellaneous materiel associated with chemical weapon production, storage, testing, maintenance, and disposal. The weapons systems program also consists of nuclear-powered aircraft carriers, nuclear powered submarines, and other nuclear ships. All clean-up is done in coordination with regulatory agencies, other responsible parties, and current property owners.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating Periods

The Army General Fund uses engineering estimates and independently validated models to estimate environmental liabilities. The models are contained within the Remedial Action Cost Engineering Requirements and the Normalization of Data System. The Department validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Army General Fund primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

Once the environmental cost estimates are complete, Army General Fund complies with accounting standards to assign costs to current operating periods. Army General Fund has already expensed the costs for cleanup associated with General PP&E placed into service prior to October 1, 1997, unless the costs are intended to be recovered through user charges. If the costs are recovered through user charges, then Army General Fund expensed that portion of the asset that has passed since General PP&E was placed into service and is systematically recognizing the remaining cost over the life of the assets.

For General PP&E placed into service after September 30, 1997, the Army General Fund expenses the associated environmental costs systematically over the life of the asset. Army General Fund expenses the full cost to clean up contamination for Stewardship PP&E at the time the asset is placed into service.

Army General Fund uses two methods for systematic recognition: physical capacity for operating landfills, and life expectancy in years for all other assets.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to Inflation, Deflation, Technology, or Applicable Laws and Regulations

The Army General Fund had changes in estimates resulting from overlooked or previously unknown contaminants, better site characterization with sampling, reestimation based on different assumptions, and lessons learned. Environmental liabilities can also change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

Uncertainty Regarding the Accounting Estimates used to Calculate the Reported Environmental Liabilities

The environmental liabilities for the Army General Fund are based on accounting estimates, which require certain judgments and assumptions that are believed to be reasonable based upon information available to us at the time of calculating the estimates. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. The liabilities can be further impacted if further investigation of the environmental sites discloses contamination different than known at the time of the estimates.

For the environmental liability associated with the destruction of chemical weapons, the schedules and cost estimates in the approved baseline are based on the best information available and have been through the formal Acquisition Program Baseline approval process at the time of report submission. It should be noted that they are subject to fact of life changes

and impacts from program risks and uncertainties inherent to the task of chemical demilitarization and the political sensitivity of the program. These risks may include processing changes required to meet the operational schedules due to the deteriorating condition of the stockpile and additional schedule time and/or cost to address changes in environmental laws or congressional requirements.

The Army has a liability to take environmental restoration/corrective action for buried chemical munitions and agents, which it is unable to estimate at this time because the extent of the buried chemical munitions and agents is unknown. The Department is also unable to provide a complete estimate for Formerly Utilized Sites Remedial Action Plan (FUSRAP). The Department has ongoing studies and will update its estimate as additional liabilities are identified. In addition, not all components of the Department recognize environmental liabilities associated with General PP&E due to process and system limitations.

In addition to the liabilities reported above, the Army General Fund is uncertain regarding the extent of the liabilities at installations that are realigning or closing as a result of the FY 2005 BRAC round. The Army General Fund is in the process of determining the extent of environmental liabilities at bases due to realign or close; in particular those liabilities associated with unexploded ordnance on training ranges that are due to realign or close.

The Army General Fund is also uncertain regarding the extent of NonDERP closure environmental liabilities at Active installations. The Army General Fund is in the process of determining the extent of environmental liabilities associated with NonDERP closure requirements.

In addition, the Army General Fund reports the costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The Army General Fund is currently unable to provide a reasonable estimate because the extent of restoration required is not known.

Other Accrued Environmental Costs, Other consists of Low Level Radioactive Waste

The Army General Fund reports zero balances in the Environmental Disclosure table. The Army General Fund is unable to systematically report and gather information for items presented above. These reporting deficiencies result from system and internal control weaknesses. The Army General Fund will continue coordination with the Office of the Under Secretary of Defense (Comptroller) to address these deficiencies and additionally outline specific tasks and milestones in the Army Chief Financial Officers Strategic Plan by 4th Quarter, FY 2010.

Note 15. Other Liabilities

As of September 30 <i>(Amounts in thousands)</i>	2008			2007
	Current Liability	Noncurrent Liability	Total	Total
1. Intragovernmental				
A. Advances from Others	\$ 67,973	\$ 0	\$ 67,973	\$ 134,514
B. Deposit Funds and Suspense Account Liabilities	673,433	0	673,433	243,120
C. Disbursing Officer Cash	2,419,223	0	2,419,223	2,183,051
D. Judgment Fund Liabilities	0	0	0	90
E. FECA Reimbursement to the Department of Labor	97,292	180,621	277,913	279,701
F. Custodial Liabilities	7,066	0	7,066	71,960
G. Employer Contribution and Payroll Taxes Payable	100,481	0	100,481	64,182
H. Other Liabilities	101,014	0	101,014	108,835
I. Total Intragovernmental Other Liabilities	\$ 3,466,482	\$ 180,621	\$ 3,647,103	\$ 3,085,453
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	\$ 2,619,264	\$ 0	\$ 2,619,264	\$ 2,539,715
B. Advances from Others	1,740,233	0	1,740,233	1,405,272
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	279,248	0	279,248	(2)
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	2,042,986	2,042,986	1,284,052
G. Accrued Unfunded Annual Leave	3,342,808	0	3,342,808	3,277,006
H. Capital Lease Liability	3,793	11,062	14,855	20,668
I. Contract Holdbacks	201,343	0	201,343	329,983
J. Employer Contribution and Payroll Taxes Payable	1,036,996	0	1,036,996	583,791
K. Contingent Liabilities	112,415	848,660	961,075	895,761
L. Other Liabilities	2,044	0	2,044	37,832
M. Total Nonfederal Other Liabilities	\$ 9,338,144	\$ 2,902,708	\$ 12,240,852	\$ 10,374,078
3. Total Other Liabilities	\$ 12,804,626	\$ 3,083,329	\$ 15,887,955	\$ 13,459,531

Intragovernmental – Other Liabilities

Intragovernmental Other Liabilities, Other consists of accrued unfunded annual leave, education benefits trust liability, and unemployment compensation liability.

Nonfederal – Other Liabilities

Nonfederal Other Liabilities, Other consists of miscellaneous liabilities submitted by the U.S. Army Corps of Engineers.

Estimated Future Contract Financing Payments

Contingent Liabilities includes \$421.1 million in estimated future contract financing payments that will be paid to the contractors upon delivery and Government acceptance. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. Army General Fund is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to Army General Fund and the amount of potential future payments is estimable; the Army General Fund has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

Capital Lease Liability

As of September 30	2008				2007	
	Asset Category					
	Land and Buildings	Equipment	Other	Total	Total	
<i>(Amounts in thousands)</i>						
1. Future Payments Due						
A. 2008	\$ 0	\$ 0	\$ 0	\$ 0	\$	8,685
B. 2009	5,376	93	0	5,469		5,469
C. 2010	5,376	0	0	5,376		5,376
D. 2011	4,510	0	0	4,510		4,510
E. 2012	2,413	0	0	2,413		2,413
F. 2013	1,612	0	0	1,612		0
G. After 5 Years	148	0	0	148		1,759
H. Total Future Lease Payments Due	\$ 19,435	\$ 93	\$ 0	\$ 19,528	\$	28,212
I. Less: Imputed Interest Executory Costs	4,652	20	0	4,672		7,543
J. Net Capital Lease Liability	\$ 14,783	\$ 73	\$ 0	\$ 14,856	\$	20,669
2. Capital Lease Liabilities Covered by Budgetary Resources				\$ 11,146	\$	14,976
3. Capital Lease Liabilities Not Covered by Budgetary Resources				\$ 3,708	\$	5,692

Note 16. Commitments and Contingencies

The Army General Fund is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests.

The Army General Fund has accrued contingent liabilities for legal actions where our Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The Army General Fund records Judgment Fund liabilities in Note 12, Accounts Payable, and Note 15, Other Liabilities.

Nature of Contingency

The FY 2008 Army Legal Representation Letter outlines claims against the Army General Fund totaling \$2.3 trillion for which the Army Office of General Counsel is unable to express an opinion. The historical payout percentage for these cases is less than 1 percent. To determine the historical payout, the Army Office of General Counsel divides the total amount reported as a payout in the fiscal year by the total amount claimed in the Army Legal Representation Letter.

The Army General Fund has other contingent liabilities for which the possibility of loss is considered reasonable. These liabilities are not accrued in the Army General Fund's financial statements nor reported in the FY 2008 Army Legal Representation Letter. As of September 30, 2008, the Army General Fund had \$571.5 million in claims considered reasonably possible. These contingent liabilities and estimates are presented in the following table. Estimates for litigations, claims and assessments are required to be fully supported. Additionally, the Army General Fund has coordinated with Army Office of General Counsel to ensure that estimates agree with the legal representation letters and management summary schedule.

(Amounts in thousands)

Title of Contingent Liabilities	Estimate
Army Environmental Law Division	\$293,171
Army Contract Appeals	108,172
U.S. Army Claims Service	86,123
Litigation Division	84,036
Total	\$571,502

Other Information Pertaining to Commitments

The Army General Fund has entered into contractual commitments that require future use of financial resources. It has significant amounts of long-term lease obligations, undelivered orders, and cancelled accounts payable. The amount of contractual commitments for 2nd Quarter, FY 2008 is presented in the following schedule.

(Amounts in thousands)

Title of Contractual Commitments	
Long-term lease obligations	\$14,854
Undelivered orders	\$133,049,497
Cancelled accounts payable	\$192,963

The Army General Fund is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, the Army General Fund does not have an automated system by which it captures or assesses these potential contingent liabilities; therefore, the amounts reported may not fairly present the Army General Fund's contingent liabilities.

Contingencies that are considered both measurable and probable have been recognized as liabilities. Refer to Note 15, Other Liabilities, for further details.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30 <i>(Amounts in thousands)</i>	2008				2007	
	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities	Liabilities	
1. Pension and Health Actuarial Benefits						
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0	\$ 0	0
B. Military Retirement Health Benefits	0		0	0	0	0
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0	0
D. Total Pension and Health Actuarial Benefits	\$ 0		\$ 0	\$ 0	\$ 0	0
2. Other Actuarial Benefits						
A. FECA	\$ 1,472,383	4.368	\$ 0	\$ 1,472,383	\$ 1,483,177	
B. Voluntary Separation Incentive Programs	0		0	0	0	0
C. DoD Education Benefits Fund	0		0	0	0	0
D. Total Other Actuarial Benefits	\$ 1,472,383		\$ 1,472,383	\$ 1,483,177	\$ 1,483,177	
3. Other Federal Employment Benefits	0		0	0	0	0
4. Total Military Retirement and Other Federal Employment Benefits:	\$ 1,472,383		\$ 0	\$ 1,472,383	\$ 1,483,177	

Federal Employees Compensation Act (FECA)

Actuarial Cost Method Used: The Army's actuarial liability for Workers' Compensation benefits is developed by the Department of Labor and provided to the Army General Fund each fiscal year end. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments.

Assumptions: The projected annual benefit payments are discounted to the present value using the Office of Management and Budget's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost of living adjustments and medical inflation factors provided by the Department of Labor are also applied to the calculation of projected future benefits. The estimated actuarial liability is updated only at the end of each fiscal year.

Note 18. General Disclosures Related to the Statement of Net Cost

As of September 30 <i>(Amounts in thousands)</i>	2008		2007	
Intragovernmental Costs and Exchange Revenue				
1. Intragovernmental Costs	\$ 51,475,585	\$	46,435,946	
2. Public Costs	148,952,769		132,310,910	
3. Total Costs	\$ 200,428,354	\$	178,746,856	
4. Intragovernmental Earned Revenue	\$ (8,204,813)	\$	(8,139,817)	
5. Public Earned Revenue	(1,722,612)		(1,683,378)	
6. Total Earned Revenue	\$ (9,927,425)	\$	(9,823,195)	
7. Net Cost of Operations	\$ 190,500,929	\$	168,923,661	

Definitions

Intragovernmental costs and revenue are related to transactions made between two reporting entities within the Federal government.

Public costs and revenue are exchange transactions made between the reporting entity and a nonfederal entity.

Other Information Regarding Costs

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department's current process and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The Department is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government".

The amounts presented in the Consolidated Statement of Net Cost are based on funding, obligation, accrual, and disbursing transactions, which are not always recorded using accrual accounting. The Army General Fund's systems do not always record the transactions on an accrual basis as is required by the generally accepted accounting principles. The information presented also includes data from nonfinancial feeder systems to capture all cost and financing sources for the Army General Fund.

Additional Disclosures

The Army General Fund systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue. Expenses were adjusted by reclassifying amounts between federal and nonfederal expenses.

The Army General Fund accounting system does not capture information relative to Heritage Assets separately and distinctly from normal operations. The Army General Fund is not able to separately identify the costs of acquiring, constructing, improving, reconstructing or renovating heritage assets. The Army Chief Financial Officers Strategic Plan outlines tasks to separately identify and report costs associated with Heritage Assets by 1st Quarter, FY 2010.

Note 19. Disclosures Related to the Statement of Changes in Net Position

Restatements

During 3rd Quarter, FY 2008, an accounting error impacting the prior year was discovered. As a result, prior year changes have been made retrospectively in accordance with generally accepted accounting principles (GAAP).

Correction of an Accounting Error

On September 30, 2007, the military payroll due for disbursement on October 1st was processed one day early resulting in the funds being decremented at the U.S. Treasury one day early. The payroll was not actually paid to the soldiers until October 1st. Since the processing of the payroll and the actual outlays for the payroll crossed over two fiscal years, the outlays in both fiscal years were incorrectly stated (overstated in FY 2007 and understated in FY 2008) and required correction. The restated amount of \$ 1.3 billion impacted the Balance Sheet and Statement of Budgetary Resources.

Per OMB Circular A-136 Section II.4.5.4, errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. Prior period financial statements should be restated for corrections of errors that would have caused any statements presented to be materially misstated, consistent with Statement of Federal Financial Accounting Standards No. 21, "Reporting Corrections of Errors and Changes in Accounting Principles."

Other

Other Financing Sources (Other) primarily consists of gains and losses that resulted from adjustments necessary to balance the Army General Fund's feeder systems with DoD's financial reporting system. Also represented are adjustments to bring the proprietary accounts into agreement with the budgetary accounts. These adjustments are necessary to correct inherent limitations of the current financial systems.

Appropriations Received

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with the Appropriations Received on the Statement of Budgetary Resources. The total difference is \$18.1 million and is due to additional resources included in the Appropriation Received on the Statement of Budgetary Resources. Refer to Note 20, Disclosures Related to the Statement of Budgetary Resources, for additional details.

Eliminations

In the SCNP, all offsetting balances (i.e. transfers-in and transfers-out, revenues, and expenses) for intraDoD activity between earmarked and other (non earmarked) funds are reported on the same lines. This results in an eliminations column, which appears to contain no balances. In reality, the column contains all appropriate elimination entries, but all net to zero within each respective line, except for intraentity imputed financing costs.

Earmarked

Earmarked Cumulative Results of Operations ending balance on the SCNP does not agree with the Earmarked Cumulative Results reported on the Balance Sheet because the cumulative results on the Balance Sheet are presented net of eliminations.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 133,049,497	\$ 108,380,690
2. Available Borrowing and Contract Authority at the End of the Period	0	0

Undelivered Orders

Undelivered Orders presented in the Statement of Budgetary Resources includes Undelivered Orders-Unpaid for both direct and reimbursable funds.

Reporting of Appropriations Received

Appropriations received on the Statement of Budgetary Resources do not agree with appropriations received on the Statements of Changes in Net Position because of differences between proprietary and budgetary accounting concepts and reporting requirements. The differences are made up of the recording of receipts for trust and special funds and the appropriations anticipated indefinite accounts.

Presentation of Statement of Budgetary Resources

The Statement of Budgetary Resources includes intraentity transactions because the statements are presented as combined.

Breakdown of Apportionment Categories

Office of Management and Budget Circular A-136 specifically requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under Category A (apportioned by fiscal quarter), Category B (apportioned by project or activity), and Exempt from Apportionment.

Budgetary	Direct	Reimbursable
Category A	\$244.2 billion	\$20.6 billion
Category B	\$5.7 billion	\$7.1 billion
Total	\$249.9 billion	\$27.7 billion
Non-Budgetary		
Category A	\$1.5 million	

This disclosure agrees with the aggregate of the related information as reported on the Budgetary Execution Report and Obligations Incurred on the Statement of Budgetary Resources.

Terms of Borrowing Authority

Borrowing authority is used for guaranteed loan defaults relating to the Armament Retooling and Manufacturing Support (ARMS) Initiative. This initiative is designed to encourage commercial use of inactive Army General Fund ammunition plants through many incentives for businesses willing to locate to a government ammunition production facility. The Army General Fund, by means of ARMS Initiative legislation, established a loan guarantee program to facilitate commercial firms' use of specified ammunition manufacturing facilities. The Army General Fund and Department of Agriculture Rural Business-Cooperative Service (RBS) established a Memorandum of Understanding for the RBS to administer the ARMS Initiative Loan Guarantee Program.

Available Borrowing Authority as of September 30, 2008, is \$590,000.

Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	\$ 277,635,629	\$ 242,763,749
2. Less: Spending authority from offsetting collections and recoveries (-)	(42,168,271)	(42,151,175)
3. Obligations net of offsetting collections and recoveries	\$ 235,467,358	\$ 200,612,574
4. Less: Offsetting receipts (-)	(674,720)	807,967
5. Net obligations	\$ 234,792,638	\$ 201,420,541
Other Resources:		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	2,578,457	1,689,316
8. Imputed financing from costs absorbed by others	948,408	954,983
9. Other (+/-)	2,691,061	(12,496,622)
10. Net other resources used to finance activities	\$ 6,217,926	\$ (9,852,323)
11. Total resources used to finance activities	\$ 241,010,564	\$ 191,568,218
Resources Used to Finance Items not Part of the Net Cost of Operations:		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:		
12a. Undelivered Orders (-)	\$ (24,668,808)	\$ (24,007,538)
12b. Unfilled Customer Orders	3,083,054	2,630,346
13. Resources that fund expenses recognized in prior Periods (-)	(3,492,658)	(61,901)
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	701,976	(807,682)
15. Resources that finance the acquisition of assets (-)	(30,240,386)	(15,269,738)
16. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	0	0
16b. Other (+/-)	(5,269,518)	10,807,307
17. Total resources used to finance items not part of the Net Cost of Operations	\$ (59,886,340)	\$ (26,709,206)
18. Total resources used to finance the Net Cost of Operations	\$ 181,124,224	\$ 164,859,012

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
19. Increase in annual leave liability	\$ 319,243	\$ 0
20. Increase in environmental and disposal liability	0	723,114
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the public (-)	0	0
23. Other (+/-)	874,211	590,195
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ 1,193,454	\$ 1,313,309
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	\$ 10,787,640	\$ 3,970,548
26. Revaluation of assets or liabilities (+/-)	30	49,629
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	0	0
27c. Operating Material and Supplies Used	0	0
27d. Other	(2,604,419)	(1,268,837)
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ 8,183,251	\$ 2,751,340
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	\$ 9,376,705	\$ 4,064,649
30. Net Cost of Operations	\$ 190,500,929	\$ 168,923,661

The Reconciliation of Net Cost of Operations to Budget is intended to explain and define the relationship between net obligations from budgetary accounting and net cost of operations from proprietary accounting. The following Reconciliation of Net Cost of Operations to Budget lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Due to Army General Fund's financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data is a previously identified deficiency.

Other Resources – Other, and Other resources or adjustments to net obligated resources that do not affect net cost of operations – Other include Other Gains and Losses, which represents adjustments to bring the proprietary accounts into agreement with the budgetary accounts. Due to system deficiencies, there are unreconciled differences between the budgetary and proprietary trial balances. In addition, Other resources or adjustments to net obligated resources that do not affect net cost of operations – Other includes transfers in and out without reimbursement.

Other Components Requiring or Generating Resources in Future Period represents increases in future funded expense for Future Funded Expenses for Conventional Disposal costs and Contingent liabilities for contract appeals and tort claims.

Other Components not Requiring or Generating Resources is comprised of Other Expenses not Requiring Budgetary Resources for the Iraqi Relief and Reconstruction Fund. The Iraqi Relief and Reconstruction Fund is a transfer fund where the Army General Fund executes the funding on behalf of the Executive Office of the President. The U.S. Treasury requires that the execution for this type of transfer is presented on the Army General Fund financial statements.

Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

Note 23. Earmarked Funds

BALANCE SHEET As of September 30 <i>(Amounts in thousands)</i>	2008				
	Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
ASSETS					
Fund balance with Treasury	\$ 0	\$ 0	\$ 48,123	\$ 0	\$ 48,123
Investments	0	0	2,597	0	2,597
Accounts and Interest Receivable	0	0	2,886	(2,886)	0
Other Assets	0	0	935	0	935
Total Assets	\$ 0	\$ 0	\$ 54,541	\$ (2,886)	\$ 51,655
LIABILITIES and NET POSITION					
Military Retirement Benefits and Other Federal Employment Benefits	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other Liabilities	0	0	1,595	0	1,595
Total Liabilities	\$ 0	\$ 0	\$ 1,595	\$ 0	\$ 1,595
Unexpended Appropriations	0	0	0	0	0
Cumulative Results of Operations	0	0	52,946	0	52,946
Total Liabilities and Net Position	\$ 0	\$ 0	\$ 54,541	\$ 0	\$ 54,541
STATEMENT OF NET COST For the period ended September 30					
Program Costs	\$ 0	\$ 0	\$ 17,405	\$ 0	\$ 17,405
Less Earned Revenue	0	0	(1,216)	0	(1,216)
Net Program Costs	\$ 0	\$ 0	\$ 16,189	\$ 0	\$ 16,189
Less Earned Revenues Not Attributable to Programs	0	0	0	0	0
Net Cost of Operations	\$ 0	\$ 0	\$ 16,189	\$ 0	\$ 16,189
STATEMENT OF CHANGES IN NET POSITION For the period ended September 30					
Net Position Beginning of the Period	\$ 0	\$ 0	\$ 24,621	\$ 0	\$ 24,621
Net Cost of Operations	0	0	16,189	0	16,189
Budgetary Financing Sources	0	0	18,168	0	18,168
Other Financing Sources	0	0	26,346	0	26,346
Change in Net Position	\$ 0	\$ 0	\$ 28,325	\$ 0	\$ 28,325
Net Position End of Period	\$ 0	\$ 0	\$ 52,946	\$ 0	\$ 52,946

Earmarked Funds

Earmarked Funds represent funds received from outside sources for specific purposes. The Army General Fund receives earmarked funds for the following appropriations:

- Sale of Hunting and Fishing Permits. Fees are received from individuals for the issuance of special hunting and fishing permits. The funds for this account are used for wildlife, fish, and game conservation and rehabilitation on military reservations. Title 10, United States Code (USC) 670b gives the authority to collect funds for this purpose and distribute the funds for the intended purposes.

- Restoration of Rocky Mountain Arsenal. Funds are received from private industry for the cleanup of contamination areas of Rocky Mountain Arsenal. Public Law (PL) 99 661, Section 1367 provides the authority for this explicit use.
- Royalties for Use of DoD-Military Insignia and Trademarks. Funds are received from the sale of commemorative memorabilia, trademarks, and licensing activities. The funds are used to replenish inventory stock for such items and other related Commemorative Program expenses. The authority to create expenditures originates from PL 102 484, Section 378.
- Forest and Wildlife Conservation, Military Reservations. These funds are produced from the sale of forest products that are in excess of operation and maintenance expenses at fiscal year-end for the payment of entitlements to states. The authority and directive for this fund originates from Title 10, USC 2665.
- National Science Center. Funds received from the collection of fees for the use of the National Science Center and use for the operation and maintenance of the National Science Center as authorized under PL 99-145, Defense Authorization Act, 1986, Section 1459.
- Department of the Army General Gift Fund. Funds are received from private parties and estates and used for various purposes. Title 10, USC 2601 establishes the authority governing the use of this fund.

The Total Earmarked Funds column is shown as consolidated and relates only to Earmarked Funds. The elimination column on this note includes only eliminations associated with Earmarked Funds and excludes the offsetting eliminations from All Other Funds. This exclusion causes assets to not equal liabilities and net position in the note. However, the amounts in the total column equal the amounts reported for Earmarked Funds on the Balance Sheet.

BALANCE SHEET
As of September 30

(Amounts in thousands)

	2007				
	Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
ASSETS					
Fund balance with Treasury	\$ 0	\$ 0	\$ 48,282	\$ 0	\$ 48,282
Investments	0	0	2,545	0	2,545
Accounts and Interest Receivable	0	0	26,695	(26,628)	67
Other Assets	0	0	903	0	903
Total Assets	\$ 0	\$ 0	\$ 78,425	\$ (26,628)	\$ 51,797
LIABILITIES and NET POSITION					
Military Retirement Benefits and Other Federal Employment Benefits	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Other Liabilities	0	0	53,804	(26,628)	27,176
Total Liabilities	\$ 0	\$ 0	\$ 53,804	\$ (26,628)	\$ 27,176
Unexpended Appropriations	0	0	0	0	0
Cumulative Results of Operations	0	0	24,621	0	24,621
Total Liabilities and Net Position	\$ 0	\$ 0	\$ 78,425	\$ (26,628)	\$ 51,797
STATEMENT OF NET COST For the period ended September 30					
Program Costs	\$ 0	\$ 0	\$ 19,657	\$ 0	\$ 19,657
Less Earned Revenue	0	0	(2,326)	0	(2,326)
Net Program Costs	\$ 0	\$ 0	\$ 17,331	\$ 0	\$ 17,331
Less Earned Revenues Not Attributable to Programs	0	0	0	0	0
Net Cost of Operations	\$ 0	\$ 0	\$ 17,331	\$ 0	\$ 17,331
STATEMENT OF CHANGES IN NET POSITION For the period ended September 30					
Net Position Beginning of the Period	\$ 0	\$ 0	\$ 42,792	\$ 0	\$ 42,792
Net Cost of Operations	0	0	17,330	0	17,330
Budgetary Financing Sources	0	0	(995)	0	(995)
Other Financing Sources	0	0	155	0	155
Change in Net Position	\$ 0	\$ 0	\$ (18,170)	\$ 0	\$ (18,170)
Net Position End of Period	\$ 0	\$ 0	\$ 24,622	\$ 0	\$ 24,622

Note 24. Other Disclosures

As of September 30 <i>(Amounts in thousands)</i>	2008 Asset Category			
	Land and Buildings	Equipment	Other	Total
1. ENTITY AS LESSEE-Operating Leases				
Future Payments Due				
Fiscal Year				
2009	\$ 3,794	\$ 0	\$ 0	\$ 3,794
2010	2,118	0	0	2,118
2011	67	0	0	67
2012	67	0	0	67
2013	67	0	0	67
After 5 Years	15,350	0	0	15,350
Total Future Lease Payments Due	\$ 21,463	\$ 0	\$ 0	\$ 21,463

Note 25. Restatements

During 3rd Quarter, FY 2008, an accounting error was discovered. As a result, prior year changes have been made retrospectively in accordance with generally accepted accounting principles (GAAP).

Correction of an Accounting Error

On September 30, 2007, the military payroll due for disbursement on October 1st was processed one day early, resulting in the funds being decremented at the U.S. Treasury one day early. The payroll was not actually paid to the soldiers until October 1st. Since the processing of the payroll and the actual outlays for the payroll crossed over two fiscal years, the outlays in both fiscal years were incorrectly stated (overstated in FY 2007 and understated in FY 2008) and required correction. The restated amount of \$1.3 billion impacted the Balance Sheet and Statement of Budgetary Resources.

Per OMB Circular A-136 Section II.4.5.4, errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. Prior period financial statements should be restated for corrections of errors that would have caused any statements presented to be materially misstated, consistent with Statement of Federal Financial Accounting Standards No. 21, "Reporting Corrections of Errors and Changes in Accounting Principles."

Balance Sheet <i>(Amounts in thousands)</i>	Beginning Balance Change for FY 2008
Fund Balance with Treasury	\$1,281,537
Payroll Liability	(\$1,281,537)
Statement of Budgetary Resources	
Unpaid Obligations, brought forward	\$1,281,537

The adjustment to correct the beginning balance of Total Actual Resources increases Unpaid Obligations, brought forward. Since the supplemental Treasury 224 entry allowed Treasury to correct the beginning balance and repost the disbursements in FY 2008, the proprietary balances are in agreement with Treasury. A comparative account adjustment has been prepared in 4th Quarter, FY 2008 to correct the FY 2007 Fund Balance with Treasury and Payroll Liability accounts.

FY 2008 Required Supplementary Stewardship Information (RSSI)

The following summarizes Nonfederal Physical Property. Investments in Non-federal Physical Property refers to those expenses incurred by the Army for the purchase, construction, or major renovation of physical property owned by State and Local Governments, including major additions, alterations and replacements; the purchase of major equipment; and the purchase of improvement of other physical assets. A schedule of estimated investments value of state-owned properties that are used by the Federal Government is shown below.

Non-federal Physical Property
Yearly Investment in State and Local Governments
For Fiscal Years FY 2004 through FY 2008
(Amounts in millions)

(a)	(b)	(c)	(d)	(e)	(f)
Categories	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
Transferred Assets:					
1. National Defense Mission Related	\$34.2	\$23.0	\$66.5	\$70.7	\$54.7
Funded Assets:					
2. National Defense Mission Related	0	0	0	0	0
Total	\$34.2	\$23.0	\$66.5	\$70.7	\$54.7

The Army General Fund incurs investments in Nonfederal Physical Property for the purchase, construction, or major renovation of physical property owned by state and local governments, including major additions, alterations, and replacements, the purchases of major equipment, and the purchases or improvement of other nonfederal assets. In addition, Nonfederal Physical Property Investments include federally-owned physical property transferred to state and local governments.

Investment values included in this report are based on Nonfederal Physical Property outlays (expenditures). Outlays are used because current Department accounting systems are unable to capture and summarize costs in accordance with federal accounting standards.

The following summarizes Basic Research, Applied Research, and Development Investments and provides examples of each.

Investments in Research and Development
Yearly Investment in Research and Development
For Fiscal Years FY 2004 through FY 2008
(Amounts in millions)

(a)	(b)	(c)	(d)	(e)	(f)
Categories	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
Basic Research	\$345.9	\$348.9	\$355.4	\$360.0	\$291.6
Applied Research	1,147.4	1,115.2	1,006.8	995.1	886.8
Development					
Advanced Technology Development	1,336.5	1,576.2	1,369.3	1,185.8	1,010.4
Advanced Component Development and Prototypes	719.8	585.3	659.7	830.3	767.7
Systems Development and Demonstration	4,981.4	5,026.1	4,963.5	4,309.4	3,288.3
Research, Development, Test and Evaluation Management Support	1,317.1	1,336.7	1,287.5	1,157.3	1,069.8
Operational Systems Development	\$1,459.2	\$1,380.5	\$1,218.7	\$1,156.7	\$929.8
Total	\$11,307.3	\$11,368.9	\$10,860.9	\$9,994.6	\$8,244.4

Narrative Statement:

Investment values included in this report are based on Research and Development outlays (expenditures). Outlays are used because current Department accounting systems are unable to capture and summarize costs in accordance with federal accounting standards. Research and Development (R&D) programs are classified in the following categories: Basic Research, Applied Research and Development. The definition for each type of Research and Development Category and subcategories are explained below:

Basic Research is the systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

The following are two representative program examples for each of the major categories:

Defense Research Sciences (PE 0601102A): This program fosters fundamental scientific knowledge and contributes to the sustainment of U.S. Army scientific and technological superiority in land warfighting capability, provides new concepts and technologies for the Army's Future Force, and provides the means to exploit scientific breakthroughs and avoid technological surprises. It fosters innovation in Army niche areas (such as lightweight armor, energetic materials, night vision) and where the commercial incentive to invest is lacking due to limited markets (e.g., vaccines for tropical diseases). It also focuses university single investigators on research areas of Army interest, such as high-density compact power and novel sensor phenomenologies. The in-house portion of the program capitalizes on the Army's scientific talent and specialized facilities to expeditiously transition knowledge and technology into the appropriate developmental activities. The extramural program leverages the research efforts of other government agencies, academia, and industry. This translates to a coherent, well-integrated program which is executed by four primary contributors: 1) the Army Research, Development, and Engineering Command (RDECOM); 2) the U.S. Army Engineer Research and Development Center (ERDC); 3) the Army Medical Research and Materiel Command (MRMC) laboratories; and 4) the Army Research Institute for Behavioral and Social Sciences (ARI). The basic research program is coordinated with the other Services via Defense Science and Technology Reliance (Defense Basic Research Advisory Group), and other inter-service working groups. This program responds to the scientific and technological requirements of the Department of Defense Basic Research Plan by enabling technologies that can significantly improve joint war fighting capabilities. The projects in this program involve basic research efforts directed toward providing fundamental knowledge that will contribute to the solution of military problems related to long-term national security needs.

University and Industry Research Centers (PE 0601104A): A significant portion of the work performed within this program directly supports Future Force requirements by providing research that supports enabling technologies for Future Force capabilities. Broadly, the work in this project falls into three categories: Collaborative Technology Alliances (CTAs), University Centers of Excellence (COE), and paradigm-shifting centers - University-Affiliated Research Centers (UARCs). The Army has formed CTAs to leverage large investments by the commercial sector in basic research areas that are of great interest to the Army. CTAs involve partnerships between industry, academia, and the Army Research Laboratory to incorporate the practicality of industry, the expansion of the boundaries of knowledge from universities, and Army scientist to shape, mature and transition technology. CTAs have been competitively established in the areas of Advanced Sensors, Advanced Decision Architecture, Communications and Networks, Power and Energy, and Robotics. This program element (PE) includes the Army's COE, which focus on expanding the frontiers of knowledge in research areas where the Army has enduring needs, such as rotorcraft, automotive, microelectronics, materials, and information sciences. COEs couple state-of-the-art research programs at academic institutions with broad-based graduate education programs to increase the supply of scientists and engineers in information sciences, materials science, electronics, automotive, and rotary wing technology. Also included is eCYBERMISSION, the Army's national web-based competition to stimulate interest in science, math, and technology among middle and high school students. This program also includes the four Army UARCs, which have

been created to exploit opportunities to advance new capabilities through a sustained long-term multidisciplinary effort. The Institute of Advanced Technology funds basic research in electromagnetics and hypervelocity physics. The Institute for Soldier Nanotechnologies focuses on Soldier protection by emphasizing revolutionary materials research for advanced Soldier protection and survivability. The Institute for Collaborative Biotechnologies, focusing on enabling network centric technologies, will broaden the Army's use of biotechnology for the development of bio-inspired materials, sensors, and information processing. The Institute for Creative Technologies is a partnership with academia and the entertainment and gaming industries to leverage innovative research and concepts for training and simulation.

Applied Research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is the practical application of such knowledge or understanding for the purpose of meeting a recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs are scientific studies, investigations, and research papers, hardware components, software codes, and limited construction of, or part of, a weapon system to include nonsystem specific development efforts.

The following are two representative program examples for this category:

Materials Technology (PE 0602105A): This program funds research and evaluation of materials technologies for armor and armaments that will significantly enhance the survivability and lethality of Future Force systems and where feasible, can be exploited to enhance the Current Force. This program builds on materials research transitioned from Defense Research Sciences Materials and Mechanics project and applies it to specific Army platforms and the individual Soldier. This program is directed toward developing materials technology that contributes to making heavy forces lighter and more deployable and light forces more lethal and survivable. The program provides the technology base required for solving materials-related problems in individual Soldier support equipment, armor, armaments, aircraft, ground and combat vehicles, and combat support. This program also funds collaborative research efforts in nanomaterials technology between the Army Research Laboratory (ARL) and the Institute for Soldier Nanotechnologies (ISN) at the Massachusetts Institute of Technology and the ISN industry partners. The effort is focused specifically on the improvement in individual Soldier protection.

Combat Vehicle and Automotive Technology (PE 0602601A): This program researches, investigates, and applies combat vehicle and automotive component technologies that enhance survivability, mobility, sustainability, and maintainability of Army ground combat and tactical vehicles. As combat vehicle systems become smaller and lighter, and tactical vehicles are more often exposed to combat conditions, one of the greatest technological and operational challenges is providing adequate crew protection without reliance on heavy passive armor. This challenge will be met using a layered approach, including long-range situational awareness, advanced lightweight opaque and transparent armors, Active Protection Systems (APS), and multi-spectral signature reduction. This program focuses on designing, fabricating, and evaluating performance of integrated and add-on lightweight armor packages needed to provide lightweight combat vehicles protection against Chemical Energy (CE) and Kinetic Energy (KE) threats with less than one fourth the weight of conventional heavy armor. This program also designs, fabricates, and evaluates structural and add-on armors for tactical vehicles. This program funds the National Automotive Center (NAC). The goal of the NAC is to leverage large commercial investments in automotive technology, research, and development by pursuing automotive-oriented technology programs that have potential benefit to military ground vehicles. This program researches and investigates a variety of enabling technologies in the areas of hybrid electric propulsion, mobility, thermal management, intelligent systems, vehicle diagnostics, fuels/lubricants, and water purification. Future Force vehicles and new tactical vehicles are being designed with hybrid electric architectures, advanced high power density engines, and auxiliary power units that provide power for propulsion, control systems, communications, life support systems, electromagnetic (EM) armor, Soldier battery charging, and export to other systems.

Development takes what has been discovered or learned from basic and applied research and uses it to establish

technological feasibility, assessment of operability, and production capability. Development is comprised of five stages defined below:

1. **Advanced Technology Development** is the systematic use of the knowledge or understanding gained from research directed toward proof of technological feasibility and assessment of operational and productivity rather than the development of hardware for service use. Employs demonstration activities intended to prove or test a technology or method.
2. **Advanced Component Development and Prototypes (ACD&P)** evaluates integrated technologies in as realistic an operating environment as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components, or complete weapon systems, ready for operational and developmental testing and field use.
3. **System Development and Demonstration** concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapons systems finalized for complete operational and developmental testing.
4. **Research, Development, Test & Evaluation Management Support** is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the R&D program.
5. **Operational Systems Development** is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development, which have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

The following are five representative program examples of development:

Electronic Warfare Advanced Technology (PE 0603008A): The goal of this program is to provide enabling technologies for a secure, mobile, wireless network that will operate reliably in diverse and complex terrain, in all environments for the Army's Future Force and, where feasible, exploit opportunities to enhance Current Force capabilities. Technologies will be matured and demonstrated to address this challenge with distributed, mobile, secure, self-organizing communications networks. A key objective is to demonstrate seamlessly integrated communications technologies across all network tiers, ranging from unattended networks and sensors through maneuver elements and airborne/space assets. To accomplish the goal this program will investigate and leverage external communication technologies and combine technology options in a series of Command, Control, Communications, and Computers Intelligence, Surveillance, and Reconnaissance (C4ISR) On-The-Move (OTM) experiments to measure the battlefield effectiveness for the Future Force. This program also provides: protection technologies for tactical wireless networks against modern network attacks; smart communication technologies to network and control unmanned systems anywhere on the battlefield enabling timely sensor-decider-engagement linkage to defeat critical targets; advanced antenna technologies for greater communications mobility, range and throughput; and automated network management aids.

Aviation - Advanced Development (PE 0603801A): This program provides advanced development aviation support of tactical programs associated with air mobility, advanced maintenance concepts and equipment, and Aircrew Integrated Systems. This program demonstrates the feasibility and maturity of new technology and gains understanding in order to evaluate utility of this technology to expedite delivery of new capabilities for Army Aviation rotary wing assets. Additionally, the Aviation Ground Support Equipment assets enhance the functionality of current and future aircraft by improving the effectiveness of maintenance and servicing operations through validating new maintenance concepts to

improve man and machine interfaces, improve aircraft maintenance processes, reduce Operation and Support costs and insert diagnostics technologies to replace obsolete and unsupportable equipment.

Patriot/MEADS Combined Aggregate Program (CAP) (PE 0604869A): The Medium Extended Air Defense System (MEADS) program is a tri-national co-development program between the United States, Germany, and Italy to replace the U.S. Patriot air defense systems, Patriot and Hawk systems in Germany, and NIKE Hercules systems in Italy. The NATO MEADS Management Agency (NAMEADSMA) is the NATO contracting authority providing management of the MEADS program on behalf of the participating nations and is responsible for managing the system acquisition. Within the Patriot/MEADS CAP there are two synergistic efforts: an international MEADS development effort managed by NAMEADSMA, and a U.S. effort to inject U.S.-specific capability requirements into the MEADS Major End Items.

MEADS will provide joint and coalition forces, critical asset and defended area protection against multiple and simultaneous attacks by short to medium range ballistic missiles, cruise missiles, unmanned aerial vehicles and tactical air-to-surface missiles. The Missile Segment Enhancement missile has been accepted as the baseline missile for MEADS. It is being developed by the U.S. for Patriot to meet U.S. operational requirements. MSE will provide a more agile and lethal interceptor that increases the engagement envelope/defended area of Patriot and the MEADS systems. The PAC-3 MSE improves upon the current PAC-3 missile capability with a higher performance solid rocket motor, modified lethality enhancer, more responsive control surfaces, upgraded guidance software, and insensitive munitions improvements.

Army Test Ranges and Facilities (0605601A): This program funds the indirect test costs associated with rapidly testing field systems and equipment needed in support of the Global War on Terrorism such as individual soldier protection equipment and Counter Measures for Improvised Explosive Devices and up-armoring the Army's wheeled vehicle fleet. This project sustains the developmental Test and Evaluation capability required to support Army as well as joint Service or other Service systems, hardware, and technologies. Unclassified systems scheduled for developmental testing encompass the entire spectrum of weapons systems such as: up-armoring vehicle ballistic protection on the Buffalo, Cougar, Family of Medium Tactical Vehicles Long Term Armor Strategy, and Joint Light Tactical Vehicle; Stryker upgrades; armor gun shields for tactical vehicles; reactive and active armor on the Stryker; Personnel Screening Systems; the Mine Resistant Ambush Protected Vehicles; Intelligence Surveillance and Reconnaissance; Electronic Countermeasure Devices; body armor; High Mobility Multipurpose Wheeled Vehicle; Aviation Transformation; aviation protection systems; missile defense; and Unmanned Systems. Capabilities are also required to support System-of-Systems and network centric systems to include Future Combat System (FCS) testing.

This project provides the institutional funding required to operate the developmental test activities required by Department of Defense (DoD) Program Executive Officers, Program and Product Managers, and Research, Development, and Engineering Centers. This project provides resources to operate four DoD Major Range and Test Facility Bases: White Sands Missile Range, NM; Aberdeen Test Center, MD; Electronic Proving Ground, AZ; and Yuma Proving Ground, AZ (to include management of Army natural environmental testing at Cold Regions Test Center, Fort Greely and Fort Wainwright, AK, and Tropic Regions Test Center at various locations). This project also funds the Army's developmental test capability at Aviation Technical Test Center, AL; and Redstone Technical Test Center, AL. Test planning and safety verification at Headquarters, U.S. Army Developmental Test Command (DTC), MD is also supported by this program.

Information Systems Security Program (0303140A): The Communications Security Equipment Program develops Information Systems Security (ISS) equipment and techniques required to combat threat Signal Intelligence capabilities and to insure the integrity of data networks. The Army's RDTE ISS program objective is to implement National Security Agency (NSA) developed security technology in Army information systems. Communications Security Equipment (COMSEC) technology ensures total signal and data security for all Army information systems to include any operational enhancement and specialized Army configurations.

FY 2008 Required Supplementary Information (RSI)

National Defense Property, Plant, and Equipment

The Federal Accounting Standards Advisory Board (FASAB) revised the Statement of Federal Financial Accounting Standards No. 6 to require the capitalization and depreciation of military equipment (formerly National Defense Property, Plant and Equipment/ND PP&E) for fiscal years (FY) 2003 and beyond, and encouraged early implementation.

Heritage Assets For Fiscal Year Ended September 30, 2008

(a)	(b)	(c)	(d)	(e)	(f)
	Measurement / Quantity	As of 10/1/07	Additions	Deletions	As of 9/30/08
Buildings & Structures	Each	9,508	1,051	598	9,961
Museums	Each	59	0	0	59
Archeological Sites	Sites	7,648	465	1,140	6,973

Narrative Statement:

In most cases, the additions/deletions are the result of sites/installations: (a) identifying cemeteries and historical facilities; (b) disposing of BRAC Closure property or excess installations; and (c) privatization/RCI program. BRAC Mission Closure installations/sites are included in this report.

Heritage Assets are items of historical, natural, cultural, educational, or artistic significance (e.g., aesthetic) or items with significant architectural characteristics. Heritage Assets are expected to be preserved indefinitely.

The fiscal year 2008 categories are defined as follows:

Notes:

1. Historical Buildings and Structures: Buildings and structures designated as historical includes museums, monuments, and memorials were reported separately in FY 2007. The number of Buildings and Structures increased as a result of the following initiatives:
 - Installations conducting real property surveys and making adjustments according to their findings;
 - Active installations now reporting previously omitted National Guard Bureau buildings and structures designated as heritage assets; and
 - Both National Guard and Reserve are now reporting new buildings and structures designated as heritage assets.
2. Museums: The Army Museum System consists of 59 museums and museum activities in the active Army and Army Reserve. There are a relatively small number of federally owned artifacts in National Guard Museum activities, which are primarily state entities. In addition, there is historical property displayed in numerous regimental rooms, trophy rooms, officer's clubs, visitor's centers, chapels, and headquarters building elements that are not individually recognized by the Department of the Army as museums or museum activities. Solely for reporting purposes, we have consolidated all of these separate and smaller collections during this reporting period.

3. Archeological Sites: The Army reports Archeological Sites in per the amended DOD 7000.14-R, Volume 6B, Chapter 12. Only those archeological sites that have been determined eligible for the National Register of Historic Places (NR) or are listed on the NR are reported in the Heritage Assets table. These archeological sites which have been through a formal evaluation process and are either eligible for, or listed on, the National Register of Historic Places.

This is the first year that the Army is reporting only those archeological sites on the National Register of Historic Places and those which are eligible for listing based on the new FMR above. The actual number of recorded archeological sites that can be found on Army installations is 74,728, a net increase of 4,731 from last year's report. The Army does not generally acquire or remove new archeological sites annually but instead identifies new sites on existing Army land or evaluates existing sites during the course of the financial year. Installations reported 465 additions and 1,140 deletions; however the installations are still adjusting their numbers to remove duplicate entries, old entries that have already been deleted, etc. Additions of archeological sites reflect the Army's policy to identify and evaluate historic properties in accordance with Sections 106 and 110 of the National Historic Preservation Act. As more land is surveyed, more archeological sites are identified. Some deletions reflect changes to the status of a recorded archeological site that may have been determined ineligible for listing or may be evidence of an accounting correction due to installations' continued improvement of data quality. In some cases, an archeological site may appear as a deletion if it was mitigated or destroyed or if multiple sites previously counted as individual sites were found to have only one official trinomial number. However, the majority of deletions in both categories is not due to any physical changes to these sites, but instead reflects improvements in accountability of actual sites recorded.

The conditions of archeological sites across the Army remain varied from poor to excellent based on a number of factors including the environmental setting, the type of the site, and impacts from Army activities. If an Army activity has the potential to adversely impact an archeological site eligible for the National Register of Historic Places, the installation's Installation Cultural Resource Management Plan (ICRMP) contains provisions for how the installation would proceed to mitigate those impacts. ICRMPs are the plan that installations use to manage their cultural resources including archeological sites in compliance with federal requirements. These plans provide for site protection, site conditions monitoring, and mitigation procedures for adverse impacts to sites. Overall, the conditions of sites on Army installations are fair based on the Army's cultural resource management procedures.

The following summarizes Stewardship Land. Additions/deletions are the result of: (a) acquiring additional land through donation or withdrawal from public domain; (b) identification of missing land records; and (c) disposal of Base Realignment and Closure (BRAC) sites or transfer of land to another DOD agency. BRAC Mission Closure installations and sites are included in this report.

**Army General Fund - Consolidated Report
Stewardship Land
For Fiscal Year Ended September 30, 2008
(Acres in thousands)**

Facility Code	Facility Title	As of 10/01/07	Additions	Deletions	As of 9/30/2008
9110	Government-Owned Land	5,192	14	4	5,202
9111	State-Owned Land	N/A	N/A	N/A	N/A
9120	Withdrawn Public Land	6,506	0	0	6,506
9130	Licensed and Permitted Land	1,862	0.3	0.1	1,863
9140	Public Land	11	0	0	11
9210	Land Easement	219	0.1	0.1	219
9220	In-leased Land	290	1	1	290
9230	Foreign Land	169	2	4	167

GRAND TOTAL **14,257**
TOTAL – All Lands **7,740**
TOTAL – Stewardship Lands **6,517**

**Department of the Army
General Property, Plant, and Equipment
Real Property Deferred Maintenance Amounts
As of September 30, 2008
(Amounts in thousands)**

Property Type	Current Fiscal Year (CFY)		
	1. Plant Replacement Value	2. Required Work (deferred maintenance)	3. Percentage
Category 1	\$151,286,805	\$20,323,573	13%
Category 2	\$26,984,522	\$7,266,358	27%
Category 3	\$224,074	\$0	0%

Narrative Statement:

The deferred maintenance estimates are based on the facility Q-ratings found in the Army's real property inventory. For FY 2008, the Q-rating values range from 0 to 100. Deferred maintenance is calculated as follows:

$$\text{Deferred Maintenance} = (100 - \text{Q-rating}) \times 0.01 \times \text{plant replacement value (PRV)}.$$

Q-ratings are determined by the Installation Status Report (ISR) for the majority of facilities, and by business rule for the remaining facilities. During ISR data collection, facility occupants evaluate the condition of each facility against published standards. The inspection generates a quality improvement cost estimate for each facility based on the condition rating of each component of the facility, and the component improvement cost factor. Improvement cost factors are developed using industry standards for each facility component within each facility type. The business rule assignment of Q-ratings is as follows: 95 if the facility is no more than 5 years old; 70 if the facility is permanent construction and more than 5 years old; 40 if the facility is temporary construction and more than 5 years old; 95 if the asset is a lease. Acceptable operating condition represents facilities with no deferred maintenance.

Facility Categories are as follows:

- Category 1: Buildings, Structures, and Utilities that are enduring and required to support an ongoing mission including multi-use Heritage Assets
- Category 2: Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal including multi-use Heritage Assets
- Category 3: Buildings, Structures, and Utilities that are Heritage Assets

**Military Equipment Deferred Maintenance
For Fiscal Year Ended September 30, 2008**
(Amounts in thousands)

Major Categories	
1. Aircraft	\$427,909
2. Automotive Equipment	\$0
3. Combat Vehicles	\$252,505
4. Construction Equipment	\$17,312
5. Electronics and Communications Systems	\$383,660
6. Missiles	\$149,020
7. Ships	\$5,460
8. Ordnance Weapons and Munitions	\$31,051
9. General Purpose Equipment	\$48,288
10. All Other Items	\$39,840
Total	\$1,355,045

The Op-30 from the FY2008 President Budget was used to compile the deferred depot level maintenance. Depot Maintenance Operations and Planning System (DMOPS). DMOPS is the automated system for capturing depot-level deferred maintenance data.





INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
200 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

November 8, 2008

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT AND
COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Army General Fund FY 2008 and FY 2007 Basic Financial Statements
(Report No. D-2009-018)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Army General Fund Consolidated Balance Sheets as of September 30, 2008 and 2007, and the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, the Statement of Custodial Activity, and related notes for the fiscal years then ended. The financial statements are the responsibility of Army management. The Army is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Army General Fund FY 2008 and FY 2007 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Army (Financial Management and Comptroller) acknowledged to us that the Army General Fund FY 2008 and FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that Army financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2008. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended,¹ to determine whether material amounts on the financial statements were fairly presented. Prior audits have identified, and the Army has also acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the

¹ OMB Memorandum M-08-24, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," August 25, 2008.

basic financial statements.² Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on Management’s Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information presented with the basic financial statements. Accordingly, we express no opinion on that information.

OMB Circular A-136, “Financial Reporting Requirements,” states that prior-period financial statements should be restated for corrections of errors that would have caused any statements presented to be materially misstated. On September 30, 2007, the military payroll scheduled for disbursement on October 1, 2007, was misreported to the Department of the Treasury as a September disbursement. The actual payroll was not paid to the soldiers until October 1, 2007. As a result of this error, the Army General Fund had a prior-period adjustment to increase Fund Balance With Treasury by \$1.3 billion and to decrease Payroll Liability by the same amount. This is discussed in detail in Notes 19 and 25.

Summary of Internal Control

In planning our work, we considered Army internal controls over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continued to exist in the following areas:

- Financial Management Systems
- Fund Balance With Treasury
- Accounts Receivable
- Inventory
- General Property, Plant, and Equipment
- Accounts Payable
- Environmental Liabilities
- Statement of Net Cost
- Statement of Budgetary Resources
- Intragovernmental Eliminations
- Accounting Adjustments
- Abnormal Account Balances
- Reconciliation of Net Cost of Operations to Budget

² The annual financial statements include the basic financial statements, Management’s Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

We identified the following additional material weakness in FY 2008:

- Contingency Payment Audit Trails

A material weakness is a significant deficiency, or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.³

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP. Significant deficiencies result in more than a remote likelihood that a misstatement of an entity's financial statements that is more than inconsequential will not be prevented or detected. The following is the significant deficiency identified:

- Legal Representation Process

Internal control work that we conducted as part of our prior audits would not necessarily disclose all significant deficiencies. The Attachment offers additional details on significant deficiencies, most of which we consider to be material internal control weaknesses.

The Army reported the above weaknesses in its 2008 Statement of Assurance on Internal Controls.

Summary of Compliance with Laws and Regulations

We limited our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting because management acknowledged that instances of noncompliance identified in prior audits continued to exist. The Assistant Secretary of the Army (Financial Management and Comptroller) acknowledged to us that Army financial management systems do not substantially comply with Federal financial management system requirements, GAAP, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether the Army complied with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

Management's Responsibilities

Management is responsible for:

- preparing the financial statements in conformity with GAAP;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.

³ The term "remote" is defined as when the chance of a future event or events occurring is slight. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.

We provided a draft of this report to the Office of the Deputy Secretary of the Army (Financial Operations), who provided technical comments, which have been incorporated as appropriate. Army officials expressed their continuing commitment to address the problems this report outlines.



Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; that the requirements of applicable laws and regulations are met; and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses that could adversely affect the Army General Fund financial management operations.

Previously Identified Material Weaknesses. Management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

Financial Management Systems. Army accounting systems lacked a single, standard, transaction-driven general ledger. The Army also needed to upgrade or replace many of its nonfinancial feeder systems so that financial statement reporting requirements could be met. The lack of a single, standard, transaction-driven general ledger will continue to prevent the Army from preparing auditable financial statements.

The Army has acknowledged that its financial management systems were unable to provide adequate evidence supporting various material amounts on the financial statements and did not comply with Federal financial management system requirements, GAAP, and the U.S. Government Standard General Ledger at the transaction level. Until the Army's systems and processes are updated to comply with GAAP, the Army's financial data will be based on budgetary transactions, nonfinancial feeder systems transactions, and adjustments for known accruals of major items. The Army derives its reported values and information for major asset and liability accounts from nonfinancial feeder systems, such as inventory and logistics systems. (Major assets include General Property, Plant, and Equipment and Inventory and Related Property.) In addition, budgetary transactions were recorded in line items such as Fund Balance With Treasury, Accounts Receivable, Accounts Payable, Gross Costs, and Earned Revenue.

Fund Balance With Treasury. DoD and its Components, including the Army, have had long-standing problems with reconciling transaction activity in their Fund Balance With Treasury accounts. Appropriation balances recorded in the accounting records do not agree with balances held at the Department of the Treasury. Therefore, the Defense Finance and Accounting Service, Indianapolis Operations (DFAS Indianapolis) made unsupported adjustments that had a net effect of \$18 billion on the three Fund Balance With Treasury line items.

Accounts Receivable. The Army has acknowledged weaknesses in its accounts receivable management. The weaknesses are considered to be DoD-wide and apply to both public and intragovernmental receivables at the Army General Fund level. Weaknesses include:

- noncompliance with policies and procedures regarding referrals to the Debt Management Office and the Department of the Treasury and for write-offs of 2-year-old debt;
- a lack of controls to ensure that all entitlement system receivables (vendor pay, civilian pay, and interest) are recorded in the accounting systems; and
- a lack of controls to ensure that accounts receivable balances are supportable at the transaction level.

Attachment

As a result, DFAS Indianapolis made \$2.2 billion in unsupported adjustments for FY 2008.

Inventory. Inventories are valued and reported at approximate historical cost, using latest-acquisition-cost adjusted for holding gains and losses. The systems do not maintain historical cost data necessary to comply with Statement of Financial Accounting Standards No. 3, “Accounting for Inventory and Related Property.” The systems are also unable to produce financial transactions using the U.S. Government Standard General Ledger. Statement of Federal Financial Accounting Standards No. 3 states that Operating Materials and Supplies must be expensed when the items are consumed. However, the Army has acknowledged that significant amounts of Operating Materials and Supplies were expensed when they were purchased, instead of when they were consumed.

General Property, Plant, and Equipment. Statement of Federal Financial Accounting Standards No. 6, “Accounting for Property, Plant, and Equipment,” requires that all General Property, Plant, and Equipment be recorded at cost, and that depreciation expense be recognized on all General Property, Plant, and Equipment. The Army has acknowledged that real property and military equipment were not recorded at acquisition or historical cost and did not include all costs needed to bring these assets to a form and location suitable for their intended use. Also, the Army could not support the reported cost of military equipment in accordance with Statement of Federal Financial Accounting Standards No. 6. The Army also lacks financial accountability systems that comply with the Federal Financial Management Improvement Act of 1996 for its Military Table of Equipment unit property books.

Accounts Payable. The Army is unable to properly account for and report Accounts Payable. DFAS Indianapolis made \$2.2 billion in unsupported adjustments for FY 2008. In addition, the Army accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations for intra-agency sales. Therefore, the Army has acknowledged that it was unable to reconcile intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payables.

Environmental Liabilities. The Army has not properly estimated and reported its environmental liabilities. For example, the processes used to report environmental liabilities for the Defense Environmental Restoration Program, Base Realignment and Closure, and the Non-Defense Environmental Restoration Program on the financial statements were not adequate to establish or maintain sufficient documentation and audit trails. Although estimators were properly qualified to perform estimates, the Army did not document supervisory reviews of estimates and did not have adequate quality control programs in place to ensure the reliability of data.

Statement of Net Cost. The financial information contained in the Statement of Net Cost is not presented by program, in alignment with major goals and outputs described in the DoD strategic and performance plans required by the Government Performance and Results Act. Because financial processes and systems do not correlate costs with performance measures, revenues and expenses are reported by appropriation category. Because Army systems do not always record the transactions on an accrual basis, as required by GAAP, the amounts presented in the Statement of Net Cost are based on funding, obligation, and disbursing transactions. To capture all cost and financing sources for the Army, the information presented also includes data from nonfinancial feeder systems. In addition, Army General Fund budgetary and proprietary data do not correlate. As a result, DFAS Indianapolis made \$1.2 billion in unsupported adjustments to force costs to agree with obligation information.

Statement of Budgetary Resources. Army accounting systems do not provide or capture data needed for obligations incurred or prior-year obligations recovered, as required by OMB Circular No. A-111, “Preparation,

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Submission, and Execution of the Budget Requirements.” Although the Army developed an alternative methodology to calculate these items, the amount of distortion cannot be reliably determined. The Statement of Budgetary Resources does not include eliminating entries and, therefore, a Disaggregated Statement of Budgetary Resources is included in the Required Supplementary Information section of the financial statements. The Army uses budget execution data, which is composed of transaction report codes, to prepare the monthly Standard Form 133, “Report on Budget Execution and Budgetary Resources,” and the quarterly Federal Agencies Centralized Trial Balance System II budgetary general ledger accounts. DFAS Indianapolis personnel then use the Federal Agencies Centralized Trial Balance System II data to prepare the Statement of Budgetary Resources. Because both the Standard Form 133 and the Statement of Budgetary Resources are prepared using budget execution data, there is no true reconciliation between the two reports. According to OMB Circular No. A-136, “Financial Reporting Requirements,” the Statement of Budgetary Resources should be predominantly derived from an entity’s budgetary general ledger, instead of being based on budget execution data. In FY 2008, DFAS Indianapolis prepared \$4 billion in unsupported adjustments that affected general ledger accounts used in the Statement of Budgetary Resources.

DFAS Indianapolis reported budget execution data to the Department of the Treasury that did not agree with the data reported on the Army financial statements. The differences between the amounts reported on the Standard Form 133 provided to OMB and the Army General Fund Statement of Budgetary Resources (and its related footnote) totaled \$190.8 billion for fourth quarter FY 2008. This occurred because DFAS Indianapolis did not perform an effective reconciliation among Federal Agencies Centralized Trial Balance System II data, the Army General Fund Statement of Budgetary Resources, and the Standard Form 133 prepared for the Army. As a result, DFAS Indianapolis used one set of budget execution data to manage Army funds, but provided the Department of the Treasury a different set of budget execution data for the OMB’s use. Also, DFAS Indianapolis reported inaccurate and misleading budget execution data on the Army Standard Form 133, on the Army Statement of Budgetary Resources (and the related footnote), and to the Department of the Treasury for the OMB Standard Form 133. In addition, DFAS Indianapolis will perpetuate these material differences in the newly fielded accounting system if the differences are not corrected.

Intragovernmental Eliminations. DoD is unable to collect, exchange, and reconcile buyer and seller intragovernmental transactions, resulting in adjustments that cannot be verified. This is primarily because of systems limitations, as the majority of the systems currently used within DoD do not allow the capture of buyer-side information for use in reconciliations and eliminations. DoD and Army accounting systems were unable to capture trading partner data at the transaction level to facilitate required trading partner eliminations, and DoD guidance did not require adequate support for eliminations. In addition, DoD procedures required that buyer-side transaction data be forced to agree with seller-side transaction data without performing proper reconciliations. Therefore, DFAS Indianapolis made \$38.6 billion in unsupported adjustments to intragovernmental accounts to force the accounts to agree with the records of Army’s trading partners.

Accounting Adjustments. Because of inadequate financial management systems and processes, DFAS Indianapolis used journal voucher adjustments and data calls to prepare the Army General Fund financial statements. DFAS Indianapolis did not adequately support \$595.8 billion in journal voucher adjustments used to prepare the Army General Fund financial statements. Specifically, DFAS Indianapolis made:

- \$151.5 billion in unsupported adjustments to force amounts to agree with other sources of information and records or financial statement lines,
- \$38.6 billion in unsupported adjustments to intragovernmental accounts to force the accounts to agree with

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the records of the Army's trading partners,

- \$292.7 billion in unsupported adjustments to correct errors and reclassify amounts to other accounts, and
- \$113 billion in unsupported adjustments to force the general ledger account to agree with status of appropriations data (or ending balance adjustments) without reconciling the differences or determining which data source was correct.

Abnormal Account Balances. DFAS Indianapolis did not detect, report, or take action to eliminate abnormal balances included in the Army General Fund accounting records. The FY 2008 trial balance data for the Army General Fund included 143 general ledger accounts, with \$36 billion in unresolved abnormal balances for proprietary accounts used by DFAS Indianapolis as part of the compilation of the Army General Fund financial statements. The FY 2008 trial balance data for the Army General Fund included an additional \$261.3 billion in abnormal balances in 53 budgetary general ledger accounts that were not used in compiling the Army General Fund financial statements. DFAS Indianapolis considers this budgetary data so unreliable that the trial balance for budgetary accounts must be constructed from other budgetary reports.

In response to DoD Office of the Inspector General Report No. D-2004-118, "Army General Fund Controls Over Abnormal Balance for Field Accounting Services," September 28, 2004, DFAS Indianapolis stated that the Defense Departmental Reporting System-Budgetary Module (Budgetary Module) would significantly reduce abnormal balances in accounting records. However, the implementation of the Budgetary Module has been delayed until FY 2009. The DoD Financial Management Regulation has not been revised to require the disclosure of unresolved abnormal balances for all financial statement lines affected in the notes to the financial statements. Although the Army reported abnormal balances as an area of concern in its FY 2006 Annual Statement of Assurance, it did not disclose abnormal balances in the financial statement footnotes. Abnormal balances not only distort the Army General Fund financial statements, but also indicate internal control and operational deficiencies and may conceal instances of fraud.

Reconciliation of Net Cost of Operations to Budget. The Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources," requires a reconciliation of proprietary and budgetary information to assist users in understanding the relationship of the data. During FY 2007, OMB rescinded the requirement to report this reconciliation as a Statement of Financing and now requires the disclosure of the information as a note to the financial statements. The Army General Fund is unable to represent the relationship between budgetary obligations incurred and its Statement of Net Costs without preparing \$1.2 billion in unsupported adjustments to the general ledger accounts to force costs to match obligation information.

Material Weakness Identified During FY 2008. As a result of our financial-related work during FY 2008, we identified a significant deficiency that is material.

Contingency Payment Audit Trails. During FY 2007, we reported inadequate controls over out-of-country payments as a significant deficiency. The Army identified contingency audit trails as a material weakness in the FY 2008 Army Statement of Assurance Over Internal Controls, acknowledging that the maintenance of substantiating documents by certifying and entitlement activities creates significant challenges in tracing audit trails for support of financial statements. DoD Office of the Inspector General Report No. D-2008-098, "Internal Controls Over Payments Made in Iraq, Kuwait, and Egypt," May 22, 2008, determined that the Army made \$1.4 billion in commercial payments that lacked the minimum supporting documentation and information for a valid payment. (Minimum support would include documents such as certified vouchers, proper receiving reports, and

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invoices.) In addition, we estimated that \$6.3 billion of commercial payments contained the minimum supporting documentation but did not comply with other statutory and regulatory requirements. Payments that are not properly supported do not provide the necessary assurance that funds were used as intended.

Other Significant Deficiencies. During prior years, as part of our financial-related audits, we noted a deficiency related to contingent legal liabilities.

Legal Representation Process. The Army legal representation process did not provide meaningful assessments of potential liabilities and was not linked to the Army process for reporting and disclosing contingent legal liabilities on the financial statements. The legal representation letter from the Army Office of General Counsel and its attached management schedule did not corroborate either the \$540 million reported on the Balance Sheet as part of Non-Federal Other Liabilities or the \$571.5 million disclosed as contingent legal liabilities on Note 16 in the FY 2008 Army General Fund Financial Statements.

These financial management deficiencies may cause inaccurate management information. As a result, Army management decisions based in whole or in part on this information may be adversely affected. Financial information reported by DoD may also contain misstatements resulting from these deficiencies.

Compliance with Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. We limited our work to determine compliance with selected provisions of the applicable laws and regulations because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Army was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on overall compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996. The Federal Financial Management Improvement Act of 1996 requires the Army to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2008, the Army did not fully comply with the Federal Financial Management Improvement Act of 1996. The Army acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2008.

Government Performance and Results Act. Congress enacted the Government Performance and Results Act of 1993 (GPRA) to establish strategic planning and performance measurement in the Federal Government. Strategic plans, annual performance plans, and annual program performance reports comprise the main elements of GPRA. Although the Army has established a strategic plan as a blueprint for achieving auditable financial statements, it is not supported by evidence of actions taken, completed, or needed to meet the milestones. Further, there are no uniform methods or procedures to report percent-completion and start/finish dates of tasks, and not all system implementation dates were aligned with milestones in the plan. Additionally, the Army did not comply with GPRA because it did not have cost accounting systems in place to collect, process, and report operating costs. This resulted in the Army General Fund Statement of Net Cost being unable to provide cost-of-operations data that were consistent with the GPRA goals and measures.

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Antideficiency Act. Section 1341, title 31, United States Code (31 U.S.C. 1341) limits the Army and its agents to making or authorizing only expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Army or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. According to 31 U.S.C. 1351, if an officer or employee of an executive agency violates the Antideficiency Act, the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2008, the Army reported nine cases of violation of the Antideficiency Act. Therefore, the Army did not comply with 31 U.S.C. 1341.

Audit Disclosures

The Assistant Secretary of the Army (Financial Management and Comptroller) acknowledged to us on March 17, 2008, that the Army financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, and previously identified material weaknesses continue to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Federal Credit Reform Act of 1990; Pay and Allowance System for Civilian Employees; Prompt Payment Act; Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act of 1996).

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance with laws and regulations because previous audit reports contained recommendations for corrective actions or because audit projects currently in progress will include appropriate recommendations.

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Limitations

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of Title 31, United States Code, section 3515(b).

While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity.



CONSOLIDATED BALANCE SHEET*As of September 30, 2008 and 2007 (Amounts in thousands)***2008 Consolidated 2007 Consolidated****ASSETS (Note 2)**

Intragovernmental:

Fund Balance with Treasury (Note 3)	\$	2,571,441	\$	2,279,084
Accounts Receivable (Note 5)		297,458		325,168
Other Assets (Note 6)		1,879		3,002
Total Intragovernmental Assets	\$	2,870,778	\$	2,607,254

Accounts Receivable, Net (Note 5)	\$	16,972	\$	16,466
Inventory and Related Property, Net (Note 9)		20,279,681		19,728,687
General Property, Plant and Equipment, Net (Note 10)		1,097,692		996,885
Other Assets (Note 6)		559,932		367,391
TOTAL ASSETS	\$	24,825,055	\$	23,716,683

LIABILITIES (Note 11)

Intragovernmental:

Accounts Payable (Note 12)	\$	85,510	\$	96,452
Other Liabilities (Note 15 & 16)		60,493		55,229
Total Intragovernmental Liabilities	\$	146,003	\$	151,681

Accounts Payable (Note 12)	\$	946,005	\$	1,023,839
Military Retirement and Other Federal Employment Benefits (Note 17)		254,518		243,112
Other Liabilities (Note 15 and Note 16)		382,465		404,317
TOTAL LIABILITIES	\$	1,728,991	\$	1,822,949

NET POSITION

Unexpended Appropriations - Other Funds	\$	719,900	\$	0
Cumulative Results of Operations - Other Funds		22,376,164		21,893,734
TOTAL NET POSITION	\$	23,096,064	\$	21,893,734

TOTAL LIABILITIES AND NET POSITION	\$	24,825,055	\$	23,716,683
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The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF NET COST

As of September 30, 2008 and 2007 (Amounts in thousands)

	2008 Consolidated	2007 Consolidated
Program Costs		
Gross Costs	\$ 19,466,040	\$ 16,159,985
(Less: Earned Revenue)	(20,370,296)	(18,682,923)
Net Program Costs	\$ (904,256)	\$ (2,522,938)
Net Cost of Operations	\$ (904,256)	\$ (2,522,938)

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

<i>As of September 30, 2008 and 2007 (Amounts in thousands)</i>	2008 Earmarked Funds	2008 All Other Funds	2008 Eliminations	2008 Consolidated
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances	\$ 0	\$ 21,893,734	\$ 0	\$ 21,893,734
Beginning balances, as adjusted	\$ 0	\$ 21,893,734	\$ 0	\$ 21,893,734
Budgetary Financing Sources:				
Appropriations used	0	604,496	0	604,496
Transfers-in/out without reimbursement	0	(1,450,000)	0	(1,450,000)
Other Financing Sources:				
Transfers-in/out without reimbursement (+/-)	0	(272,573)	0	(272,573)
Imputed financing from costs absorbed by others	0	155,381	0	155,381
Other (+/-)	0	540,870	0	540,870
Total Financing Sources	\$ 0	\$ (421,826)	\$ 0	\$ (421,826)
Net Cost of Operations (+/-)	0	(904,256)	0	(904,256)
Net Change	\$ 0	\$ 482,430	\$ 0	\$ 482,430
Cumulative Results of Operations	\$ 0	\$ 22,376,164	\$ 0	\$ 22,376,164
UNEXPENDED APPROPRIATIONS				
Budgetary Financing Sources:				
Appropriations received	\$ 0	\$ 1,375,471	\$ 0	\$ 1,375,471
Other adjustments (rescissions, etc)	0	(51,075)	0	(51,075)
Appropriations used	0	(604,496)	0	(604,496)
Total Budgetary Financing Sources	\$ 0	\$ 719,900	\$ 0	\$ 719,900
Unexpended Appropriations	0	719,900	0	719,900
Net Position	\$ 0	\$ 23,096,064	\$ 0	\$ 23,096,064

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

<i>As of September 30, 2008 and 2007 (Amounts in thousands)</i>	2007 Earmarked Funds		2007 All Other Funds		2007 Eliminations		2007 Consolidated	
CUMULATIVE RESULTS OF OPERATIONS								
Beginning Balances	\$	0	\$	19,316,705	\$	0	\$	19,316,705
Beginning balances, as adjusted	\$	0	\$	19,316,705	\$	0	\$	19,316,705
Budgetary Financing Sources:								
Appropriations used		0		627,790		0		627,790
Transfers-in/out without reimbursement		0		(145,700)		0		(145,700)
Other Financing Sources:								
Transfers-in/out without reimbursement (+/-)		0		(345,832)		0		(345,832)
Imputed financing from costs absorbed by others		0		163,133		0		163,133
Other (+/-)		0		(245,301)		0		(245,300)
Total Financing Sources	\$	0	\$	54,090	\$	0	\$	54,091
Net Cost of Operations (+/-)		0		(2,522,938)		0		(2,522,938)
Net Change	\$	0	\$	2,577,028	\$	0	\$	2,577,029
Cumulative Results of Operations	\$	0	\$	21,893,733	\$	0	\$	21,893,734
UNEXPENDED APPROPRIATIONS								
Budgetary Financing Sources:								
Appropriations received	\$	0	\$	627,854	\$	0	\$	627,854
Other adjustments (rescissions, etc)		0		(64)		0		(64)
Appropriations used		0		(627,790)		0		(627,790)
Total Budgetary Financing Sources	\$	0	\$	0	\$	0	\$	0
Unexpended Appropriations		0		0		0		0
Net Position	\$	0	\$	21,893,733	\$	0	\$	21,893,734

The accompanying notes are an integral part of these financial statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

As of September 30, 2008 and 2007 (Amounts in thousands)	Budgetary Financing Accounts		Non-Budgetary Financing Accounts	
	2008 Combined	2007 Combined	2008 Combined	2007 Combined
BUDGETARY RESOURCES				
Unobligated balance, brought forward, October 1	\$ 2,516,314	\$ 1,791,465	\$ 0	\$ 0
Recoveries of prior year unpaid obligations	800,094	1,130,769	0	0
Budget authority				
Appropriation	1,375,471	627,854	0	0
Contract authority	12,348,540	10,715,333	0	0
Spending authority from offsetting collections				
Earned				
Collected	16,375,333	15,227,289	0	0
Change in receivables from Federal sources	8,923	103,333	0	0
Change in unfilled customer orders				
Advance received	(22,477)	29,395	0	0
Without advance from Federal sources	390,797	1,336,140	0	0
Subtotal	\$ 30,476,587	\$ 28,039,344	\$ 0	\$ 0
Nonexpenditure transfers, net, anticipated and actual	(1,450,000)	(145,700)	0	0
Permanently not available	(10,164,456)	(11,534,744)	0	0
Total Budgetary Resources	\$ 22,178,539	\$ 19,281,134	\$ 0	\$ 0
Status of Budgetary Resources:				
Obligations incurred:				
Reimbursable	\$ 18,818,961	\$ 16,764,820	\$ 0	\$ 0
Subtotal	\$ 18,818,961	\$ 16,764,820	\$ 0	\$ 0
Unobligated balance:				
Apportioned	3,359,578	2,516,314	0	0
Subtotal	\$ 3,359,578	\$ 2,516,314	\$ 0	\$ 0
Total status of budgetary resources	\$ 22,178,539	\$ 19,281,134	\$ 0	\$ 0
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	\$ 10,854,914	\$ 9,555,896	\$ 0	\$ 0
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(5,537,453)	(4,097,980)	0	0
Total unpaid obligated balance	\$ 5,317,461	\$ 5,457,916	\$ 0	\$ 0
Obligations incurred, net (+/-)	\$ 18,818,961	\$ 16,764,820	\$ 0	\$ 0
Less: Gross outlays	(15,934,896)	(14,335,033)	0	0
Less: Recoveries of prior year unpaid obligations, actual	\$ (800,094)	\$ (1,130,769)	\$ 0	\$ 0
Change in uncollected customer payments from Federal sources (+/-)	(399,720)	(1,439,473)	0	0
Obligated balance, net, end of period				
Unpaid obligations	12,938,885	10,854,914	0	0
Less: Uncollected customer payments (+/-) from Federal sources (-)	(5,937,173)	(5,537,453)	0	0
Total, unpaid obligated balance, net, end of period	\$ 7,001,712	\$ 5,317,461	\$ 0	\$ 0
Net Outlays				
Net Outlays:				
Gross outlays	\$ 15,934,896	\$ 14,335,033	\$ 0	\$ 0
Less: Offsetting collections	(16,352,856)	(15,256,685)	0	0
Net Outlays	\$ (417,960)	\$ (921,652)	\$ 0	\$ 0

The accompanying notes are an integral part of these financial statements.

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Army Working Capital Fund (AWCF), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the AWCF in accordance with the Department of Defense (DoD) Financial Management Regulation (FMR), the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible, generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the AWCF is responsible unless otherwise noted.

The AWCF is unable to fully implement all elements of GAAP and OMB Circular A-136 due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The AWCF derives its reported values and information for major asset and liability categories largely from nonfinancial feeder systems, such as inventory and logistics systems. These systems were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The AWCF continues to implement processes and system improvements addressing these limitations.

The AWCF currently has nine auditor identified financial statement material weaknesses: (1) Financial Management Systems; (2) Inventory; (3) General Property, Plant, and Equipment; (4) Accounts Payable; (5) Statement of Net Cost; (6) Intragovernmental Eliminations; (7) Other Accounting Entries; (8) Reconciliation of Net Cost of Operations to Budget; and (9) Abnormal Account Balances.

1.B. Mission of the Reporting Entity

The AWCF is part of the Defense Working Capital Fund, and is divided into two separate business areas: Supply Management and Industrial Operations. These business areas ensure delivery of critical items, such as petroleum products, repair parts, consumable supplies, depot maintenance services, munitions, and weapons to support the deployment and projection of lethal force as and when required by the nation.

1.C. Appropriations and Funds

Working capital funds (revolving funds) receive funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations and transactions that flow through the fund. Financial resources to replenish the corpus, and to permit continuing operations, are generated by the acceptance of customer orders and additional appropriations. The AWCF operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision-making process. The activities provide goods and services on a reimbursable basis. Receipts derived from operations generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

1.D. Basis of Accounting

The AWCF generally records transactions on an accrual accounting basis as is required by GAAP. For FY 2008, AWCF financial management systems are unable to meet all of the requirements for full accrual accounting. Many AWCF financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP.

The DoD has undertaken efforts to determine the actions required to bring all of its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). At this time, not all AWCF accounting systems are USSGL compliant. However, the Army has implemented the Logistics Modernization Program (LMP) at Tobyhanna Army Depot, Communications Electronics Life Cycle Management Center Command, and other Army Materiel Command activities. The LMP is substantially compliant with the Federal Financial Management Integrity Act (FFMIA) as determined by the Army Audit Agency (AAA). Until LMP is fully implemented and all of the processes are updated to collect and report financial information as required by GAAP, some of the AWCF financial data will be derived from budgetary (obligations, disbursements and collections) transactions from nonfinancial feeder systems, and accruals made of major items such as payroll expenses and accounts payable.

1.E. Revenues and Other Financing Sources

The AWCF Industrial Operations activities recognize revenue according to the percentage-of-completion method. Supply Management activities recognize revenue when an inventory item is sold. Prices set for products and services offered through the AWCF are intended to recover the full costs (cost plus administrative fees) incurred by these activities. Unearned revenue is recorded as deferred revenue until earned.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because AWCF financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable and unbilled revenue.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, the AWCF cannot accurately eliminate intragovernmental transactions by customer because the AWCF systems do not track at the transaction level. Generally, seller entities within the DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, where the amounts do not match, buyer-side records are adjusted to agree with DoD seller-side balances. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements that will ensure intragovernmental information is accurate and will include sufficient edits and controls to eliminate the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the DoD and other federal agencies. The U.S. Treasury Financial Manual, Part 2 – chapter 4700, “Agency Reporting Requirements for the Financial Report of the United States Government” and the U.S. Treasury’s “Federal Intragovernmental Transactions Accounting Policy Guide,” provide guidance for reporting and reconciling intragovernmental balances. While the AWCF is unable to fully reconcile intragovernmental transactions with all federal partners, the AWCF is able to reconcile balances pertaining to Federal Employees’ Compensation Act transactions with the Department of Labor (DOL) and benefit program transactions with the Office of Personnel Management (OPM).

The DoD proportionate share of public debt and related expenses of the Federal Government is not included. Debt issued by the Federal Government and the related costs are not apportioned to Federal agencies. The DoD financial statements, therefore, do not report any portion of the public debt or interest, nor do the financial statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the U.S. Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the AWCF sells defense items and services to foreign governments and international organizations under the provisions of the “Arms Export Control Act of 1976.” Under the provisions of the Act, DoD has the authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the U.S. government. Payments in U.S. dollars are required in advance and are booked as liabilities until such time as the goods are delivered.

1.I. Funds with the U.S. Treasury

The U.S. Treasury maintains AWCF monetary financial resources. The DFAS, Military Services, U.S. Army Corps of Engineers (USACE) disbursing stations, as well as the Department of State financial service centers process the majority of cash collections, disbursements, and adjustments for the AWCF. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the U.S. Treasury’s system. Differences between the AWCF and the U.S. Treasury’s records sometime result and are subsequently reconciled.

1.J. Foreign Currency

Not applicable.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes three categories: accounts receivable, claims, and refunds from other federal agencies and the public. Federal accounts receivable arise generally from the provision of goods and services to other federal agencies and, with the exception of occasional billing disputes, are considered to be fully collectible. Receivables from the public generally arise from the provision of goods and services to state, local, and foreign governments. Refunds receivable are overpayments by the Federal Government in the process of being collected.

An allowance for estimated uncollectibles is established for reporting purposes based on past experience in the collection of accounts receivable and analysis of outstanding balances by fund type. The AWCF bases the estimate of uncollectible accounts receivable from the public on a percentage of aged receivables by category. The allowance is calculated by using 50 percent of aged receivables in the 180-day to 2-year category and 100 percent of aged receivables in the greater than 2-year category. This excludes foreign debt and debt as reported in the Defense Debt Management System. The allowance is updated annually based on the aged accounts receivable at the end of the 2nd Quarter. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are resolved between the agencies in accordance with dispute resolution procedures in the Intragovernmental Business Rules published in the Treasury Financial Manual.

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

The AWCF values approximately 17 percent of resale inventory using the moving average cost method. The AWCF reports the remaining 83 percent of resale inventories at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the AWCF is continuing to transition the balance of the inventories to the moving average cost method. However, since the on-hand balances which were transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS No. 3 and GAAP.

The AWCF manages only military or government-specific materiel under normal conditions. "Materiel" is a unique term that relates to military force management, and includes all items (such as tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment, but excluding real property, installations, and utilities) necessary to equip, operate, maintain, and support military activities without distinction as to its application for administrative or combat purposes. Items commonly used in and available from the commercial sector are generally not managed in the AWCF materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The AWCF holds materiel based on military need and support for contingencies.

There are new DoD accounting and reporting requirements for inventory held in reserve for future sale and for inventory held for repair. Items in excess of the Approved Acquisition Objective (AAO), plus items suspended from current sale (such as items suspended due to litigation), should be accounted for as inventory held in reserve for future sale. The AWCF will begin making the required disclosures for future sale balances in 1st Quarter, FY 2009, in accordance with available information in the inventory feeder systems. Additionally, new accounting policy now defines inventory held for repair and future resale as "inventory held for remanufacture." Inventory held for remanufacture capitalizes repair and rebuild costs, values unrepaired carcasses at cost, and provides for exchange pricing concepts for customer returns. AWCF is unable to comply with the accounting requirements for remanufacturing until such time as LMP is fully implemented and all inventory related tasks in the Army Financial Improvement Plan have been addressed, to include logistics interfaces.

The AWCF accounts for condemned materiel as excess, obsolete, and unserviceable. The net value of this type of condemned materiel is zero, because the costs of disposal are greater than the potential scrap value.

Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the AWCF. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It may be more economical to repair than to procure these inventory items. The DoD often relies on weapon systems and machinery no longer in production. As a result, the AWCF supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Work in process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

1.N. Investments in U.S. Treasury Securities

Not applicable.

1.O. General Property, Plant and Equipment

The AWCF's General Property, Plant and Equipment (GPP&E) capitalization threshold is \$100,000, except for real property, which is \$20,000. The AWCF has not implemented this threshold for real property. The AWCF is currently using the capitalization threshold of \$100,000 for all GPP&E. The Army is executing the Real Property Audit Readiness Plan. The target completion date for audit readiness, which includes substantiation of real property values, is FY 2009.

The AWCF capitalizes all General PP&E used in the performance of their mission. These capitalized assets are categorized as General PP&E, whether or not they meet the definition of any other General PP&E categories.

When it is in the best interest of the government, the AWCF provides government property to contractors to complete contract work. The AWCF either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured GPP&E exceeds the DoD capitalization threshold, Federal accounting standards require that it be reported on the AWCF Balance Sheet.

The DoD is developing new policies and a contractor reporting process that will provide appropriate GPP&E information for future financial statement reporting purposes. Accordingly, the AWCF reports only government property in the possession of contractors that is maintained in AWCF property systems. The DoD has issued new property accountability and reporting requirements that require the AWCF to maintain, in their property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards.

1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, the DoD's policy is to record advances and prepayments in accordance with GAAP. Payments made in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The DoD policy is to expense and/or properly classify assets when the related goods and services are received. The AWCF has implemented this policy for advances identified in contract feeder systems, but has not fully implemented the policy for all business events primarily due to system limitations.

1.Q. Leases

Not applicable.

1.R. Other Assets

Other assets includes those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments, that are not reported elsewhere on the AWCF Balance Sheet.

The AWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the AWCF may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property are reported as Construction in Progress in Note 10. It is DoD policy to record certain contract financing payments as Other Assets.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the AWCF. The uncertainty will be resolved when one or more future events occur or fail to occur. The AWCF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to only disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The AWCF risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft and vehicle accidents; property or environmental damages; and contract disputes.

1.T. Accrued Leave

The AWCF reports as liabilities earned civilian annual leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Cumulative results of operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfers in and out of assets without reimbursement. Unexpended appropriations represent the amounts of authority that are unobligated and have not been rescinded or withdrawn.

1.V. Treaties for Use of Foreign Bases

Not applicable.

1.W. Comparative Data

The AWCF financial statements and notes are presented on a comparative basis.

1.X. Unexpended Obligations

The AWCF obligates funds to provide goods and services for outstanding orders not yet delivered. Unless title has passed, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations include both obligations for which goods and services have been delivered and a liability recognized and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources and is referred to as "Total, unpaid obligated balances, net, end of period."

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the monthly accounting reports. In-transit payments are those payments that have been made, but have not been recorded in the fund holder’s accounting records. These payments are applied to the entities’ outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities’ accounts receivable balance.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. The AWCF does not follow this procedure for collections since all AWCF undistributed collections are derived from interfund transactions which processes automatic collections from federal sources only. Undistributed disbursements are allocated between federal and nonfederal based on disbursement history accumulated fiscal year to date. The AWCF records unsupported undistributed disbursements in accounts payable and unsupported undistributed collections in other liabilities.

1.Z. Significant Events

In the FY 2008 Bridge Supplemental, the AWCF received \$719.9 million in appropriated funds for war reserves and spares augmentation. These funds were appropriated with a three year designation, which differs from the normal no-year designation of funds for a revolving fund. These funds are available for obligation from FY 2008 to FY 2010.

Note 2. Nonentity Assets

As of September 30	2008		2007	
<i>(Amounts in thousands)</i>				
1. Intragovernmental Assets				
A. Fund Balance with Treasury	\$	0	\$	0
B. Accounts Receivable		0		0
C. Total Intragovernmental Assets	\$	0	\$	0
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	\$	0	\$	0
B. Accounts Receivable		0		0
C. Other Assets		0		0
D. Total Nonfederal Assets	\$	0	\$	0
3. Total Nonentity Assets	\$	0	\$	0
4. Total Entity Assets	\$	24,825,055	\$	23,716,683
5. Total Assets	\$	24,825,055	\$	23,716,683

Nonentity assets are assets for which the reporting entity maintains stewardship accountability and responsibility to report, but are not available for the reporting entity’s operations.

Note 3. Fund Balance with Treasury

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Fund Balances		
A. Appropriated Funds	\$ 719,900	\$ 0
B. Revolving Funds	1,851,541	2,279,084
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	<u>\$ 2,571,441</u>	<u>\$ 2,279,084</u>
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	\$ 2,571,441	\$ 2,279,084
B. Fund Balance per	2,571,441	2,279,084
3. Reconciling Amount	<u>\$ 0</u>	<u>\$ 0</u>

Status of Fund Balance with Treasury

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Unobligated Balance		
A. Available	\$ 3,359,578	\$ 2,516,314
B. Unavailable	0	0
2. Obligated Balance not yet Disbursed	12,938,885	10,854,914
3. Nonbudgetary FBWT	0	0
4. Non-FBWT Budgetary Accounts	(13,727,022)	(11,092,144)
5. Total	<u>\$ 2,571,441</u>	<u>\$ 2,279,084</u>

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support the FBWT.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with contract authority and customer orders. There are no restrictions on the Unobligated Balance.

Obligated Balance not yet disbursed represents funds that have been obligated for goods that have not been received, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represent adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT. For the AWCF, this consists of unfilled orders, reimbursements earned and contract authority.

Note 4. Investments and Related Interest

Not applicable.

Note 5. Accounts Receivable

As of September 30 <i>(Amounts in thousands)</i>	2008			2007	
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net	
1. Intragovernmental Receivables	\$ 297,458	N/A	\$ 297,458	\$ 325,168	
2. Nonfederal Receivables (From the Public)	21,346	\$ (4,374)	16,972	16,466	
3. Total Accounts Receivable	\$ 318,804	\$ (4,374)	\$ 314,430	\$ 341,634	

Note 6. Other Assets

As of September 30 <i>(Amounts in thousands)</i>	2008		2007	
1. Intragovernmental Other Assets				
A. Advances and Prepayments	\$	1,879	\$	3,002
B. Other Assets		0		0
C. Total Intragovernmental Other Assets	\$	1,879	\$	3,002
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	\$	555,275	\$	367,020
B. Advances and Prepayments		719		368
C. Other Assets (With the Public)		3,938		3
D. Total Nonfederal Other Assets	\$	559,932	\$	367,391
3. Total Other Assets	\$	561,811	\$	370,393

Other Assets (With the Public) consists of travel advances and prepaid expenses.

Contract terms and conditions for certain types of contract financing payments convey certain rights to AWCF that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the AWCF is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

The Contract Financing Payment balance of \$555.3 million is comprised of \$508.1 million in contract financing payments and an additional \$47.2 million in estimated future payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

Note 7. Cash and Other Monetary Assets

Not applicable.

Note 8. Direct Loan and Loan Guarantees

Not applicable.

Note 9. Inventory and Related Property

As of September 30	2008		2007	
<i>(Amounts in thousands)</i>				
1. Inventory, Net	\$	20,279,681	\$	19,728,687
2. Operating Materiel & Supplies, Net		0		0
3. Stockpile Materiel, Net		0		0
4. Total	\$	20,279,681	\$	19,728,687

Inventory, Net

As of September 30	2008			2007		Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net		
<i>(Amounts in thousands)</i>						
1. Inventory Categories						
A. Available and Purchased for Resale	\$ 24,260,857	\$ (7,796,050)	\$ 16,464,807	\$ 15,894,145		LAC, MAC
B. Held for Repair	5,569,787	(2,025,250)	3,544,537	3,735,314		LAC, MAC
C. Excess, Obsolete, and Unserviceable	546,527	(546,527)	0	0		NRV
D. Raw Materiel	103,529	0	103,529	99,228		MAC, SP, LAC
E. Work in Process	166,808	0	166,808	0		AC
F. Total	\$ 30,647,508	\$ (10,367,827)	\$ 20,279,681	\$ 19,728,687		

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

O = Other

MAC = Moving Average Cost

Restrictions of Inventory Use, Sale, or Disposition:

There are restrictions on the use, sale, and disposition of inventory classified as war reserve materiel of \$1.8 billion which includes petroleum products, subsistence items, spare parts, and medical materiel.

Other Information:

The categories listed below comprise Inventory, Net. The AWCF assigns Inventory items to a category based upon the type and condition of the asset. Inventory Available and Purchased for Resale includes spare and repair parts, clothing and textiles, and petroleum products. Inventory Held for Repair consists of damaged materiel held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable Inventory consists of scrap materiel or items that cannot be economically repaired and are awaiting disposal. Raw Materiels consists of items consumed in the production of goods for sale or in the provision of services for a fee.

Work in process includes costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including amounts withheld from payment to ensure

performance, and amounts paid to other government plants for accrued costs of end items of materiel ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

Operating Materiels and Supplies, Net

Not applicable.

Stockpile Materiel, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30 <i>(Amounts in thousands)</i>	2008					2007
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
1. Major Asset Classes						
A. Land	N/A	N/A	\$ 0	N/A	\$ 0	\$ 0
B. Buildings, Structures, and Facilities	S/L	20 Or 40	1,894,335	\$ (1,472,075)	422,260	438,707
C. Leasehold Improvements	S/L	lease term	96,629	(84,084)	12,545	15,000
D. Software	S/L	2-5 Or 10	585,063	(290,881)	294,182	216,686
E. General Equipment	S/L	5 or 10	1,570,476	(1,249,718)	320,758	282,807
F. Military Equipment	S/L	Various	0	0	0	0
G. Assets Under Capital Lease	S/L	lease term	0	0	0	0
H. Construction-in-Progress	N/A	N/A	47,947	N/A	47,947	43,685
I. Other			0	0	0	0
J. Total General PP&E			\$ 4,194,450	\$ (3,096,758)	\$ 1,097,692	\$ 996,885

¹Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

S/L = Straight Line

N/A = Not Applicable

Assets Under Capital Lease

Not applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2008		2007	
<i>(Amounts in thousands)</i>				
1. Intragovernmental Liabilities				
A. Accounts Payable	\$	0	\$	0
B. Debt		0		0
C. Other		47,102		45,410
D. Total Intragovernmental Liabilities	\$	47,102	\$	45,410
2. Nonfederal Liabilities				
A. Accounts Payable	\$	0	\$	0
B. Military Retirement and Other Federal Employment Benefits		254,518		243,112
C. Environmental Liabilities		0		0
D. Other Liabilities		0		0
E. Total Nonfederal Liabilities	\$	254,518	\$	243,112
3. Total Liabilities Not Covered by Budgetary Resources	\$	301,620	\$	288,522
4. Total Liabilities Covered by Budgetary Resources		1,427,371		1,534,427
5. Total Liabilities	\$	1,728,991	\$	1,822,949

Liabilities not Covered by Budgetary Resources are liabilities for which congressional action is needed before budgetary resources can be provided.

Intragovernmental Other Liabilities represents future funded Federal Employees Compensation Act (FECA) liabilities billed to AWCF by the Department of Labor (DOL) for payments made by DOL to Army's beneficiaries. The current portion of this bill, \$20.9 million, is due in FY 2009 and the remainder is due in the following fiscal years.

Military Retirement and Other Federal Employment benefits not covered by budgetary resources are comprised of various FECA actuarial liabilities not due and payable during the current fiscal year. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Note 12. Accounts Payable

As of September 30	2008			2007	
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total	
<i>(Amounts in thousands)</i>					
1. Intragovernmental Payables	\$ 85,510	\$ N/A	\$ 85,510	\$	96,452
2. Nonfederal Payables (to the Public)	946,005	0	946,005		1,023,839
3. Total	\$ 1,031,515	\$ 0	\$ 1,031,515	\$	1,120,291

The AWCF systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts payable were adjusted by reclassifying amounts between federal and nonfederal accounts payable.

The department recognized accounts payable balances of the Mechanization of Contract Administration Services (MOCAS) system at gross value without reductions for partial, progress payments, and non-accounts payable records overstating accounts payable and expenses. The overstated balances for FY 2007 were undeterminable due to system limitations;

therefore, no corrections have been made. Balances at FY 2008 are properly reported net of non-accounts payable records, partial and progress payments of \$165.6 million.

Note 13. Debt

Not applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

Not applicable.

Note 15. Other Liabilities

As of September 30 <i>(Amounts in thousands)</i>	2008			2007
	Current Liability	Noncurrent Liability	Total	Total
1. Intragovernmental				
A. Advances from Others	\$ 0	\$ 0	\$ 0	\$ 0
B. Deposit Funds and Suspense Account Liabilities	0	0	0	0
C. Disbursing Officer Cash	0	0	0	0
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	20,934	26,167	47,101	45,411
F. Custodial Liabilities	0	0	0	0
G. Employer Contribution and Payroll Taxes Payable	13,392	0	13,392	9,818
H. Other Liabilities	0	0	0	0
I. Total Intragovernmental Other Liabilities	\$ 34,326	\$ 26,167	\$ 60,493	\$ 55,229
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	\$ 104,104	\$ 0	\$ 104,104	\$ 80,675
B. Advances from Others	105,491	0	105,491	103,101
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	(41,154)	0	(41,154)	(895)
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	96,446	0	96,446	100,635
H. Capital Lease Liability	0	0	0	0
I. Contract Holdbacks	48,274	0	48,274	34,000
J. Employer Contribution and Payroll Taxes Payable	22,139	0	22,139	55,179
K. Contingent Liabilities	25	47,140	47,165	31,622
L. Other Liabilities	0	0	0	0
M. Total Nonfederal Other Liabilities	\$ 335,325	\$ 47,140	\$ 382,465	\$ 404,317
3. Total Other Liabilities	\$ 369,651	\$ 73,307	\$ 442,958	\$ 459,546

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Contingent Liabilities includes \$47.2 million in estimated future contract financing payments to be paid upon delivery and Government acceptance of a satisfactory product. In accordance with contract terms, when a specific type of contract financing payments are made, specific rights to the contractor's work vests with the Government. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The AWCF is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to the AWCF and the amount of potential future payments is estimable, the AWCF has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance of a satisfactory product.

Note 16. Commitments and Contingencies

The AWCF is a party in various administrative proceedings and legal actions, with claims, including environmental damage claims, equal opportunity matters, and contractual bid protests. The AWCF has accrued contingent liabilities for legal actions where the Army's Office of the General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. The AWCF records Judgment Fund liabilities in Note 12, "Accounts Payable," and Note 15, "Other Liabilities."

Nature of Contingency

The FY 2008 Legal Representation Letter for the Army Working Capital Fund outlines two claims against AWCF totaling \$498.3 million for which the Army Office of General Counsel is unable to express an opinion.

Other Information Pertaining to Commitments

The AWCF does not have open contracts citing canceled appropriations.

Contingencies that are considered both measurable and probable have been recognized as liabilities. Refer to Note 15, Other Liabilities, for further details.

The AWCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, AWCF does not have a systematic process by which it captures or assesses these potential contingent liabilities; therefore, no associated liabilities are recognized or disclosed.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30 <i>(Amounts in thousands)</i>	2008			2007	
	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities	Liabilities
1. Pension and Health Actuarial Benefits					
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0	\$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Actuarial Benefits	\$ 0		\$ 0	\$ 0	\$ 0
2. Other Actuarial Benefits					
A. FECA	\$ 254,518	4.368	\$ 0	\$ 254,518	\$ 243,112
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	\$ 254,518		\$ 0	\$ 254,518	\$ 243,112
3. Other Federal Employment Benefits	0		0	0	0
4. Total Military Retirement and Other Federal Employment Benefits:	\$ 254,518		\$ 0	\$ 254,518	\$ 243,112

Federal Employees Compensation Act (FECA)

The AWCF actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to AWCF at the end of each fiscal year. The liability includes the estimated liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments. The projected annual benefit payments are discounted to present value using the Office of Management and Budget's (OMB's) economic assumptions for 10-year Treasury notes and bonds. Cost of living adjustments (COLAs) and consumer price index medical (CPIM) factors are applied to the calculation of projected future benefits.

The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefits payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

2008

4.368% in Year 1
4.770% in Year 2
And thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (COLAs) and medical inflation factors (CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2008 are used to adjust the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPIM
2008	3.03%	4.71%
2009	3.87%	4.01%
2010	2.73%	3.86%
2011	2.20%	3.87%
2012	2.23%	3.93%
2013+	2.30%	3.93%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions; (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments; (3) a comparison of the incremental paid loses per case (a measure of case-severity) in CBY 2008 to the average pattern observed during the most current three charge back years; and (4) a comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections of the most recent three years.

Other Disclosures

The AWCF actuarial liabilities increased \$11.4 million since the previous calculation at the end of FY 2007.

Actuarial liabilities are computed for employee compensation benefits as mandated by the Federal Employment Compensation Act (FECA). The Office of Personnel Management provides updated Army actuarial liabilities during the 4th Quarter of each fiscal year. The AWCF computes its portion of the total Army actuarial liability based on the percentage of AWCF FECA expense to the total Army FECA expense.

Note 18. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue				
As of September 30	2008		2007	
<i>(Amounts in thousands)</i>				
1. Intragovernmental Costs	\$	3,787,660	\$	3,231,526
2. Public Costs		15,678,380		12,928,459
3. Total Costs	\$	19,466,040	\$	16,159,985
4. Intragovernmental Earned Revenue	\$	(13,880,795)	\$	(12,590,913)
5. Public Earned Revenue		(6,489,501)		(6,092,010)
6. Total Earned Revenue	\$	(20,370,296)	\$	(18,682,923)
7. Net Cost of Operations	\$	(904,256)	\$	(2,522,938)

Intragovernmental costs and revenue are transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The AWCF systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue. Expenses were adjusted by reclassifying amounts between federal and nonfederal expenses.

The Statement of Net Cost is unique because its principles are driven by understanding the net cost of programs and/or organizations that the Federal Government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

While AWCF activities generally record transactions on an accrual basis, as is required by federal generally accepted accounting principles, the systems do not always capture actual costs. Some of the information presented on the Consolidated Statement of Net Cost is based on non-financial feeder systems, including property accountability and logistics systems. The AWCF is in the process of upgrading its financial and logistical feeder systems to the Logistics Modernization Program to address this issue.

Note 19. Disclosures Related to the Statement of Changes in Net Position

Other Financing Sources, Other on the Statement Changes in Net Position consists of other gains and other losses from non exchange activity primarily attributable to intragovernmental transfers-in/out for which trading partners could not be identified and the correction of prior period adjustments that did not meet the materiality thresholds.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 12,237,211	\$ 9,950,750
2. Available Borrowing and Contract Authority at the End of the Period	0	0

All AWCF obligations represent reimbursable obligations in apportionment category B.

The AWCF Statement of Budgetary Resources includes intraentity transactions because the statements are presented as combined.

At the end of the fiscal year, all unused contract authority is withdrawn.

There are no legal arrangements affecting the use of unobligated balances of budgetary authority.

Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	\$ 18,818,961	\$ 16,764,820
2. Less: Spending authority from offsetting collections and recoveries (-)	(17,552,670)	(17,826,926)
3. Obligations net of offsetting collections and recoveries	\$ 1,266,291	\$ (1,062,106)
4. Less: Offsetting receipts (-)	0	0
5. Net obligations	\$ 1,266,291	\$ (1,062,106)
Other Resources:		
6. Donations and forfeitures of property	0	0
7. Transfers in/out without reimbursement (+/-)	(272,573)	(345,832)
8. Imputed financing from costs absorbed by others	155,381	163,133
9. Other (+/-)	540,870	(245,300)
10. Net other resources used to finance activities	\$ 423,678	\$ (427,999)
11. Total resources used to finance activities	\$ 1,689,969	\$ (1,490,105)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:		
12a. Undelivered Orders (-)	\$ (2,286,461)	\$ (948,969)
12b. Unfilled Customer Orders	368,319	1,365,535
13. Resources that fund expenses recognized in prior Periods (-)	(13,886)	(25,497)
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0
15. Resources that finance the acquisition of assets (-)	(8,176,389)	(8,180,607)
16. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	0	0
16b. Other (+/-)	(268,298)	591,131
17. Total resources used to finance items not part of the Net Cost of Operations	\$ (10,376,715)	\$ (7,198,407)
18. Total resources used to finance the Net Cost of Operations	\$ (8,686,746)	\$ (8,688,512)

As of September 30	2008	2007
<i>(Amounts in thousands)</i>		
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
19. Increase in annual leave liability	\$ 9,697	\$ 2,576
20. Increase in environmental and disposal liability	0	0
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
22. Increase in exchange revenue receivable from the public (-)	0	0
23. Other (+/-)	13,096	25
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	\$ 22,793	\$ 2,601
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	\$ 61,145	\$ 57,291
26. Revaluation of assets or liabilities (+/-)	2,433,172	1,515,071
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0	0
27b. Cost of Goods Sold	6,126,441	5,249,313
27c. Operating Material and Supplies Used	0	0
27d. Other	(861,061)	(658,702)
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ 7,759,697	\$ 6,162,973
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	\$ 7,782,490	\$ 6,165,574
30. Net Cost of Operations	\$ (904,256)	\$ (2,522,938)

Due to AWCF's financial systems limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data is a previously identified deficiency.

Resources that Finance the Acquisition of Assets were adjusted by \$384.3 million to bring the note schedule into agreement with the Statement of Net Cost.

The following Reconciliation of Net Cost of Operations to Budget lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Resources, Other consists of other gains and other losses from non exchange activity primarily attributable to intragovernmental transfers-in/out for which trading partners could not be identified and the correction of prior period adjustments that did not meet the materiality thresholds.

Other Resources or adjustments to net obligated resources that do not affect Net Cost of Operations, Other consists of other gains and losses from non exchange activity primarily attributable to intragovernmental transfers-in/out for which trading partners could not be identified and the correction of prior period adjustments that did not meet the materiality thresholds.

Components Requiring or Generating resources in a Future Period, Other consists of the unfunded Federal Employee Compensation Act (FECA) expense and the change in the related actuarial liability.

Components not Requiring or Generating Resources Other, Other consists of cost capitalization offsets. Agencies must first record all expenses to Operating Expenses/Program Costs. These expenses are then offset using the Cost Capitalization Offset account when the costs are capitalized to the appropriate “in-process type” account.

Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

Note 23. Earmarked Funds

Not applicable.

Note 24. Other Disclosures

Not applicable.

Note 25. Restatements

Not applicable.





INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
200 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

November 8, 2008

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Army Working Capital Fund FY 2008 and FY 2007 Basic Financial Statements (Report No. D-2009-020)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Army Working Capital Fund Consolidated Balance Sheets as of September 30, 2008 and 2007, and the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of Army management. The Army is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Army Working Capital Fund FY 2008 and FY 2007 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Army (Financial Management and Comptroller) acknowledged to us that the Army Working Capital Fund FY 2008 and FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that Army financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2008. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended,¹ to determine whether material amounts on the financial statements were fairly presented. Prior audits have identified, and the Army has acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses affect the reliability of

¹ OMB Memorandum M-08-24, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," August 25, 2008.

certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.² Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on Management’s Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information presented with the basic financial statements. Accordingly, we express no opinion on that information.

Summary of Internal Control

In planning our work, we considered Army internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continued to exist in the following areas:

- Financial Management Systems
- Inventory
- General Property, Plant, and Equipment
- Accounts Payable
- Statement of Net Cost
- Intragovernmental Eliminations
- Other Accounting Entries
- Reconciliation of Net Cost of Operations to Budget

We identified the following additional material weakness in FY 2008:

- Abnormal Account Balances

A material weakness is a significant deficiency, or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.³

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP. Significant deficiencies result in more than a remote likelihood that a misstatement of an entity’s financial statements that is more than inconsequential will not be prevented or detected.

² The annual financial statements include the basic financial statements, Management’s Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information.

³ The term “remote” is defined as when the chance of a future event or events occurring is slight. Therefore, the likelihood of an event is “more than remote” when it is at least reasonably possible.

We identified the following significant deficiency in FY 2007. It remains a significant deficiency in FY 2008.

- Statement of Budgetary Resources

Internal control work that we conducted as part of our prior audits would not necessarily disclose all significant deficiencies. The Attachment offers additional details on significant deficiencies, most of which we consider to be material internal control weaknesses.

Summary of Compliance with Laws and Regulations

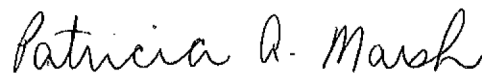
We limited our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting because management acknowledged that instances of noncompliance identified in prior audits continued to exist. The Assistant Secretary of the Army (Financial Management and Comptroller) acknowledged to us that Army financial management systems do not substantially comply with Federal financial management system requirements, GAAP, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether the Army Working Capital Fund complied with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

Management's Responsibilities

Management is responsible for:

- preparing the financial statements in conformity with GAAP;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.

We provided a draft of this report to the Office of the Deputy Assistant Secretary of the Army (Financial Operations), who provided technical comments, which have been incorporated as appropriate. Army officials expressed their continuing commitment to address the problems this report outlines.



Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated



Report on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; that the requirements of applicable laws and regulations are met; and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses and significant deficiency that could adversely affect the Army financial management operations.

Previously Identified Material Weaknesses. Management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

Financial Management Systems. Army Working Capital Fund systems do not meet the requirements for full accrual accounting. The systems do not collect and record financial information as required by GAAP. Financial and nonfinancial feeder systems do not contain the required system integration to provide a transaction-level audit trail for the amounts reported in the proprietary and budgetary general ledger accounts. The Army Working Capital Fund derives a majority of its financial information from noncompliant financial systems, such as the Commodity Command Standard System and the Standard Industrial Funds System.

In FY 2003, the Army began deploying the Logistics Modernization Program system as its Army Working Capital Fund core accounting system. However, implementation problems at the initially deployed field locations and the system's inability to produce auditable outputs and achieve compliance with the Federal Financial Management Improvement Act prevented further system deployment. The Government Accountability Office and DoD Office of Inspector General have issued audit reports that identify data integrity and system integration problems, questioning whether the Logistics Modernization Program system correctly records transactions. The Army has developed a Compliance Management Plan to achieve and maintain Federal Financial Management Improvement Act compliance and address auditor-identified deficiencies. The Army plans to deploy the Logistics Modernization Program system to the Aviation and Missile Life Cycle Management Command and subordinate organizations in FY 2009. The Army is planning full operational capability of the Logistics Modernization Program in FY 2010.

Inventory. The inventory valuation method used for most Army Working Capital Fund inventory does not produce an auditable approximation of historical cost. In FY 2008, the Army reported that the Army Working Capital Fund can only value 17 percent of its inventory at moving average cost. The Army Working Capital Fund uses the latest acquisition cost method of valuing most inventory because the Army designed legacy inventory systems for materiel management, rather than for accounting in conformance with GAAP. The systems provide accountability and visibility for inventory items but do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property." In addition, the systems are unable to produce financial transactions using the U.S. Government Standard General Ledger accounts, and neither the Defense Finance and Accounting Service nor the Army reconciled all differences between the accounting records and the logistical records. Instead, they accepted the data from the logistical records and adjusted the accounting records by \$3.7 billion.

The Army Working Capital Fund does not adequately report inventory items in excess of their approved acquisition objective and inventory items suspended from current sales as inventory held for future sale, both of

Attachment

which are DoD accounting requirements. In FY 2009, the Army plans to take steps to identify and report the value of inventory held for future sale. In addition, Note 9 does not adequately disclose the amount of inventory held for remanufacture, because the Army Working Capital Fund systems are unable to determine the value of remanufactured inventory. The Army will not properly disclose this amount until full operational capability of the Logistics Modernization Program occurs.

General Property, Plant, and Equipment. The reported value of Army Working Capital Fund General Property, Plant, and Equipment is unreliable because the Army lacked the documentation needed to support the historical acquisition costs of its assets. The Army has not established and implemented a methodology to baseline acquisition costs for all property, plant, and equipment. Also, the Army Working Capital Fund organizations sometimes recorded the acquisition date and cost incorrectly or received incorrect information from the feeder systems. During FY 2008, the Army did not implement the DoD capitalization threshold for real property assets, as required by DoD policy.

The DoD Office of Inspector General completed an audit to evaluate controls over real property and found that the Army Working Capital Fund did not have adequate controls over the addition, disposal, and improvement transactions entered into the Integrated Facilities System to maintain accurate account balances. During FY 2008, the Army began implementing the guidance contained in its Real Property Audit Preparation Handbook. The Assistant Chief of Staff for Installation Management required that each Army installation inventory all real property and establish auditable documentation records for all real property assets. When fully implemented, these audit readiness procedures will address most of the control weaknesses identified during the audit. In September 2009, when Army Working Capital Fund organizations complete their real property validations and the Army implements the DoD capitalization threshold, the Army should be able to develop an auditable baseline for all of its real property assets. However, the reported value of General Property, Plant, and Equipment may continue to be unreliable until the Army also implements: (1) a methodology to baseline the acquisition costs of the other categories of property and equipment, and (2) internal control measures to ensure that Army Working Capital Fund organizations maintain accurate balances.

Accounts Payable. DFAS Indianapolis adjusted accounts payable balances to derive the reported balances. DFAS Indianapolis adjusted Accounts Payable with the Public upward by \$128 million for undistributed disbursements. Also, Army Working Capital Fund systems cannot reconcile accounts payable with the corresponding intragovernmental accounts receivable that generated the payables. As a result, DFAS Indianapolis made \$307.7 million in unsupported adjustments to decrease intragovernmental accounts payable to force the amounts to agree with Army Working Capital Fund trading partners. In addition, the Supply Management, Army activity group does not establish accounts payable in accordance with Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," which requires the Army to establish an account payable when it accepts title to goods or services.

Statement of Net Cost. The Army Working Capital Fund does not present its Statement of Net Cost by responsibility segments. The Army Working Capital Fund accounting systems did not accurately capture costs for Army Working Capital Fund programs or properly account for intragovernmental transactions and related eliminations. In addition, the Army Working Capital Fund used budgetary obligation, collection, and disbursement data to present some of the information reported on the Statement of Net Cost.

Intragovernmental Eliminations. DoD is unable to collect, exchange, and reconcile buyer and seller intragovernmental transactions, resulting in adjustments that are not verifiable. DoD and Army Working Capital Fund systems do not capture the trading partner financial data at the transaction level needed to

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facilitate reconciling and eliminating intragovernmental transactions. DoD procedures require that the Army Working Capital Fund adjust its buyer-side transaction data to agree with seller-side transaction data from other Government entities without the entities performing proper reconciliations. As a result, Defense Finance and Accounting Service (DFAS) Indianapolis made \$10.2 billion in adjustments to Army Working Capital Fund accounts to force the accounts to agree with the corresponding records of intragovernmental trading partners.

Other Accounting Entries. DFAS Indianapolis did not adequately support \$4.6 billion in journal vouchers used to prepare the Army Working Capital Fund financial statements. DFAS Indianapolis made the unsupported adjustments to force amounts to agree with other sources of information and records used in preparing the FY 2008 Army Working Capital Fund Financial Statements. In addition, DFAS Indianapolis did not always follow the established minimum requirements for documenting the analytical process used to develop the journal vouchers and support adjusting accounting entries made to the general ledger accounts. The resulting unsupported accounting adjustments presented a material uncertainty regarding the line item balances on the FY 2008 Army Working Capital Fund Financial Statements.

Reconciliation of Net Cost of Operations to Budget. Statement of Federal Financial Accounting Standards No. 7, "Revenues and Other Financing Sources," requires a reconciliation of proprietary and budgetary information to assist users in understanding the relationship of the data. The Army Working Capital Fund is unable to reconcile budgetary obligations incurred and its Statement of Net Cost without preparing \$384 million in unsupported adjustments to the general ledger accounts to force costs to match obligation information.

Material Weaknesses Identified During FY 2008. As a result of our financial-related work during FY 2008, we identified a significant deficiency that we consider to be material.

Abnormal Account Balances. During FY 2007, we reported abnormal account balances as a significant deficiency. During FY 2008, we reviewed the compilation of the quarterly Army Working Capital Fund financial statements and found that Army managers and DFAS Indianapolis personnel had not detected and reported, or taken action to eliminate, abnormal balances reported by Army Working Capital Fund field-level organizations. The Army Working Capital Fund organizations reported 57 abnormal account balances (at the limit level), valued at \$753.7 million. Nineteen of the 57 abnormal account balances, valued at \$51.6 million, were from the Logistics Modernization Program system. The Army and DFAS Indianapolis used the 57 abnormal balances to compile the amounts reported on the Balance Sheet for: Intragovernmental Accounts Receivable, Inventory, Intragovernmental Accounts Payable, Accounts Payable, and Other Liabilities.

Other Significant Deficiencies. Management acknowledged that a previously identified significant deficiency continued to exist in the following area.

Statement of Budgetary Resources. The Army Working Capital Fund did not use data from Army Working Capital Fund budgetary general ledger accounts to populate the Statement of Budgetary Resources. Instead, DFAS Indianapolis used budget execution data. OMB Circular No. A 136, "Financial Reporting Requirements," June 3, 2008, states that the reporting entity should derive the Statement of Budgetary Resources predominantly from the general ledger accounts, not from budget execution data.

These financial management deficiencies may cause inaccurate management information. As a result, Army management decisions based in whole or in part on this information may be adversely affected. Financial information reported by DoD may also contain misstatements resulting from these deficiencies.

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Compliance with Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. We limited our work to determine compliance with selected provisions of the applicable laws and regulations because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Army Working Capital Fund was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on overall compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996. The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2008, the Army Working Capital Fund did not fully comply with the Federal Financial Management Improvement Act of 1996. The Army acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2008.

Government Performance and Results Act. Congress enacted the Government Performance and Results Act of 1993 to establish strategic planning and performance measurement in the Federal Government. Strategic plans, annual performance plans, and annual program performance reports comprise the main elements of the Government Performance and Results Act. Although the Army has established a comprehensive strategic plan as a blueprint for achieving auditable financial statements, Army managers have not fully supported the strategic plan with the tactical plans required to complete the actions and meet the milestones. Further, there are no uniform methods or procedures to report percent completion and start and finish dates of tasks, and not all system implementation dates were aligned with milestones in the plan.

Antideficiency Act. Section 1341, title 31, United States Code (31 U.S.C. 1341) limits the Army Working Capital Fund and its agents to making or authorizing only expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Army Working Capital Fund or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. According to 31 U.S.C. 1351, if an officer or employee of an executive agency violates the Antideficiency Act, the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2008, the Army Working Capital Fund reported no potential Antideficiency Act violations.

Audit Disclosures

The Deputy Assistant Secretary of the Army (Financial Operations) acknowledged to us on March 17, 2008, that the Army financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, and previously identified material weaknesses continue to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, Prompt Payment Act, and Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act of 1996).

This report does not include recommendations to correct the material internal control weaknesses, significant deficiency, and instances of noncompliance with laws and regulations, because previous audit reports contained recommendations for corrective actions or because audit projects currently in progress or planned will include appropriate recommendations.

Attachment



We are interested in your feedback regarding the content of this report.
Please feel free to e-mail your comments to AAFS@hqda.army.mil or write to:

Department of the Army

Office of the Deputy Assistant Secretary of the Army
(Financial Management and Comptroller)
Office of the Financial Reporting Directorate
Room 3A312, 109 Army Pentagon
Washington, DC 20310-0109

Additional copies of this report can be obtained by sending a written request to
the e-mail or mailing address listed above.

You may also view this document at: <http://www.asafm.army.mil/fo/fod/cfo/cfo.asp>



The Soldier's Creed

I am an American Soldier.
I am a Warrior and a member of a team.
I serve the people of the United States and live the Army Values.

I will always place the mission first.
I will never accept defeat.
I will never quit.
I will never leave a fallen comrade.

I am disciplined, physically and mentally tough,
trained and proficient in my warrior tasks
and drills. I always maintain my arms,
my equipment and myself.

I am an expert and I am a professional.

I stand ready to deploy, engage, and
destroy the enemies of the United States
of America in close combat.

I am a guardian of freedom and the
American way of life.

I am an American Soldier.