

**Notes to the Financial Statements**

**Fiscal Year 2002**

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## **Note 1. Significant Accounting Policies**

### **A. Basis of Presentation**

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the “Chief Financial Officers (CFO) Act of 1990,” expanded by the “Government Management Reform Act (GMRA) of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with the “DoD Financial Management Regulation,” Office of Management and Budget (OMB) Bulletin No. 01-09, “Form and Content of Agency Financial Statements,” and to the extent possible Federal generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the Department is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The DoD’s financial statements are in addition to the financial reports also prepared by the Department pursuant to OMB directives that are used to monitor and control the DoD’s use of budgetary resources.

The Department is unable to fully implement all elements of Federal GAAP and OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. The Department derives its reported values and information for major asset and liability categories largely from nonfinancial feeder systems, such as inventory systems and logistic systems. These 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 Federal GAAP. As a result, the Department cannot currently implement every aspect of Federal GAAP and OMB Bulletin No. 01-09. The Department continues to implement process and system improvements addressing the limitations of its financial and nonfinancial feeder systems. The Department provides a more detailed explanation of these financial statement elements in the applicable footnote.

### **B. Mission of the Reporting Entity**

The National Security Act of 1947 created The Department of Defense (DoD) on September 18, 1947. The overall mission of the Department is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies. Fiscal year (FY) 2003 is the seventh year that the Department has prepared audited DoD Agency-wide financial statements required by the CFO Act and GMRA. The reporting entities within the Department changed to facilitate this reporting requirement. Auditors will be issuing opinions on the financial statements of the following stand-alone reporting entities: (1) Army General Fund, (2) Army Working Capital Fund, (3) Navy General Fund, (4) Navy Working Capital Fund, (5) Air Force General Fund, (6) Air Force Working Capital Fund, (7) Military Retirement Fund, and (8) U.S. Army Corps of Engineers (Civil Works).

In addition to the eight stand-alone reporting entities, separate columns in the combining/consolidating statements are included with the financial information of the “Other Defense Organizations General Funds” or “Other Defense Organizations Working Capital Funds.” The Office of the Inspector General will not issue separate audit opinions on the statements of the Other Defense Organizations; instead the financial statements and records of those organizations will be included in the audit performed to support the opinion issued on the DoD Agency-wide financial statements.

Also, the Department requires the following Defense Agencies to prepare internal stand-alone annual financial statements to be audited by certified public accounting firms: (1) Defense Logistics Agency, (2) Defense Finance and Accounting Service (DFAS), (3) Defense Information Systems Agency, (4) Defense Contract Audit Agency, (5) Defense Commissary Agency, (6) Defense Security Service, and (7) Defense Threat Reduction Agency.

### C. Appropriations and Funds

The Department receives its appropriations as general, working capital (revolving funds), trust, special, and deposit funds. The Components use these appropriations and funds to execute their missions and report on resource usage.

- General funds are used for financial transactions arising under congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and construction accounts.
- Trust funds represent the receipt and expenditure 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.
- Special funds are accounts for government receipts earmarked for a specific purpose.
- Deposit funds generally are used to: (1) hold assets for which the Department is acting as an agent or a custodian or whose distribution awaits legal determination, or (2) account for unidentified remittances.
- Working Capital funds (WCF) (revolving funds) receive their initial working capital through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders. The Defense Working Capital Fund 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.

## **D. Basis of Accounting**

The Department generally records transactions on a budgetary basis and not an accrual accounting basis as is required by Federal GAAP. For FY 2002, the Department's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP for federal agencies and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP.

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

In addition, the Department identifies programs based upon the major appropriation groups provided by Congress. The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

## **E. Revenues and Other Financing Sources**

The Department receives congressional appropriations as financing sources for general funds (annual and a multiyear basis). When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The Department recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Under the reimbursable order process, the Department recognizes revenue when earned.

Depot Maintenance and Ordnance Working Capital Funds (WCF) recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items.

Other financing sources reported by Department do not include non-monetary support provided by U.S. Allies for common defense and mutual security. The U.S. has agreements with foreign countries that include both direct and indirect sharing of costs that each country incurs in support of the same general purpose. 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. DoD is reviewing these types of financing and cost reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the Department's financial statements in accordance with generally accepted accounting principles. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

## **F. Recognition of Expenses**

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the Department's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and environmental liabilities. The Department's expenditures for capital and other long-term assets are not recognized as operating expenses until depreciated in the case of Property, Plant and Equipment (PP&E) or consumed in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made. The Departments adjust operating expenses as a result of the elimination of balances between DoD Components. See Note 19.I, Intragovernmental Expenses and Revenue for disclosure of adjustment amounts.

## **G. Accounting for Intragovernmental Activities**

The Department as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Department as though the agency was a stand-alone entity.

- Public Debt

The Department's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debts 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 budget 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 Department of the Treasury does not allocate such interest costs to the benefiting agencies.

- Civilian/ Military Retirement Systems

The Department's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) while the Military Retirement System (MRS) covers military personnel. Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The Department funds a portion of the civilian and military pensions. Reporting civilian pensions under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The Department recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the Statement of Net Cost; and recognizes corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

- Actuarial Liability

The Department reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the DoD financial statements. The Department recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization General Fund column of the DoD Agency-wide consolidating/combining statements.

- Inter/Intra Governmental Elimination

Preparation of reliable financial statements requires the elimination of transactions occurring between entities within the Department or between two or more federal agencies. However, the Department, as well as the rest of the federal government, cannot accurately identify all Intragovernmental transactions by customer. For FY 1999 and beyond seller entities within the Department provided 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 have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD Intragovernmental balances were then eliminated.

The Department of the Treasury, Financial Management Service (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In September 2000, the FMS issued the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide." The Department was not able to fully implement the policies and procedures in this guide related to reconciling Intragovernmental assets, liabilities, revenues, and expenses for non-fiduciary transactions. The Department, however, was able to implement the policies and procedures contained in the "Intragovernmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide," for reconciling Intragovernmental transactions pertaining to investments in federal securities, borrowings from the United States (U.S.) Treasury and

the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the OPM.

## **H. Transactions with Foreign Governments and International Organizations**

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the Department 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. Customers may be required to make payments in advance.

## **I. Funds with the U.S. Treasury**

The Department's financial resources are maintained in U.S. Treasury accounts. DFAS, Military Services, U.S. Army Corps of Engineers (USACE) disbursing stations, and the Department of State financial service centers process the majority of cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the Department's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. See Note 3, Fund Balance with Treasury for material disclosure. Differences between accounting offices' detail-level records and Treasury's FBWT accounts are disclosed in Note 21.B, specifically, differences caused by in-transit disbursements and unmatched disbursements (which are not recorded in the accounting offices' detail-level records).

## **J. Foreign Currency**

The Department 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 (operation and maintenance, military personnel, military construction, family housing operation 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 Department does not separately identify currency fluctuations.



## **K. Accounts Receivable**

As presented in the Balance Sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department 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. See Note 5, Accounts Receivable for material disclosure.

## **L. Loans Receivable**

The Department of Defense operates a loan guarantee program authorized by the National Defense Authorization Act for FY 1996, Public Law 104-106 Statute 186 Section 2801, that includes a series of authorities that allow the Department to work with the private sector to renovate military housing. The Department's goals are to: obtain private capital to leverage government dollars, make efficient use of limited resources, and use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually, or in combination. They include: guarantees, both loan and rental, conveyance/leasing of existing property and facilities, differential lease payments, investments, both limited partnerships and stock/bond ownership and direct loans. In addition, 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.

## **M. Inventories and Related Property**

Inventories are reported at approximate historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses.

The Department uses the LAC method because its inventory systems were designed for material management rather than accounting. The systems provide accountability and visibility over inventory items. They do not maintain the historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Neither can they directly produce financial transactions using the United States Government Standard General Ledger (USSGL), as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208).

The law distinguishes between "Inventory held for sale" and "Inventory held in reserve for future sale." There is no management or valuation difference between the two USSGL accounts. Further, the DoD manages only military or government-specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD material management activities. Operational cycles are irregular,

and the military risks associated with stock-out positions have no commercial parallel. The Department holds material based on military need and support for contingencies. Therefore, the Department does not attempt to account separately for items held for “current” or “future” sale.

Related property includes Operating Materials and Supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses the consumption method of accounting for OM&S, for the most part, expensing material when it is issued to the end user. Where current systems cannot fully support the consumption method, the Department uses the purchase method - that is, expensed when purchased. For FY 2002, the Department reported significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item is in the hands of the end user.

The Department implemented new policy in FY 2002 to account for condemned material (only) as “Excess, Obsolete, and Unserviceable.” The net value of condemned material is zero, because the costs of disposal are greater than the potential scrap value. Potentially redistributable material, presented in previous years as “Excess, Obsolete, and Unserviceable,” is included in “Held for Use” or “Held for Repair” categories according to its condition.

In addition, past audit results identified uncertainties about the completeness and existence of quantities used to produce the reported values. Material disclosures related to inventory and related property are provided at Note 9.

## **N. Investments in U.S. Treasury Securities**

The Department reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts amortize into interest income over the term of the investment using the effective interest rate method or another method obtaining similar results. The Department 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 Department invests in both marketable and non-marketable securities. Marketable securities are investments trading on a public market. The two types of non-marketable securities are par value and market based Intragovernmental securities. The Bureau of Public Debt issues non-marketable Par Value Intragovernmental Securities. Non-marketable, Market Based Intragovernmental Securities mimic marketable securities, but are not traded publicly. See Note 4 for material disclosures.

## **O. General Property, Plant and Equipment**

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of \$100,000. Also, DoD requires

capitalization of improvement costs over the DoD capitalization threshold of \$100,000 for General PP&E. The Department depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E with an acquisition cost of \$15,000, \$25,000, and \$50,000 for FYs 1993, 1994, and 1995 respectively, and an estimated useful life of two or more years was capitalized. These assets remain capitalized and reported on WCF financial statements. General PP&E previously capitalized at amounts below \$100,000 were written off General Fund financial statements in FY 1998. See Note 10, General PP&E, Net for material disclosures.

- Government Equipment in the Hands of Contractors

When it is in the best interest of the government, the Department provides to contractors government property necessary to complete contract work. The Department 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, such PP&E is required to be included in the value of General PP&E reported on the Department's Balance Sheet.

The Department completed a study that indicates that the value of General PP&E above the DoD capitalization threshold and not older than the DoD Standard Recovery Periods for depreciation, and that is presently in the possession of contractors, is not material to the Department's financial statements. Regardless, the Department is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the Department currently reports only government property, maintained in the DoD's property systems, in the possession of contractors.

To bring the DOD into fuller compliance with federal accounting standards, the Department has issued new property accountability and reporting regulations that require the DoD Components to maintain, in DoD Component 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.

## **P. Advances and Prepayments**

The Department records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. In addition, when the department receives the related goods and services it recognizes advances and prepayments as expenditures and expenses.

## **Q. Leases**

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) the department records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The Departments 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 value. The Department deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest was necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases. In addition, the Department classifies leases that do not transfer substantially all of the benefits or risks of ownership as operating leases and records payment expenses over the lease term.

## **R. Other Assets**

The Department 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 Department provides financing payments. One type of financing payment that the Department makes, for real property, is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in Note 10, General PP&E, Net.

In addition, the Federal Acquisition Regulations allow the Department to make financing payments under fixed price contracts that are not based on a percentage of completion. The Department reports these financing payments as advances or prepayments in the "Other Assets" line item. The Department treats these payments as advances or prepayments because the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the advance.

The Department has completed its review of all applicable federal accounting standards; applicable public laws on contract financing; Federal Acquisition Regulation Parts 32, 49, and 52; and the OMB guidance in 5 CFR Part 1315, "Prompt Payment." The Department concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering appropriate actions.

## **S. Contingencies and Other Liabilities**

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the Department. The uncertainty will be resolved when one or more future events occur or fail to occur. The DoD recognizes contingencies as

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, possible claims and assessments. The Department's loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur 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 the Department'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 commences when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of an asset based upon the Department's policy, which is consistent with SFFAS No. 5 "Accounting for Liabilities of Federal Government". The Department agrees to the recognition of nonenvironmental disposal liability for National Defense PP&E nuclear powered assets when placed into service. Such amounts are developed in conjunction with, and not easily separately identifiable from, environmental disposal costs. See Notes 14 and 15 for material disclosures.

#### **T. Accrued Leave**

The Department reports civilian annual leave and military leave that has been accrued and not used as of the balance sheet date as liabilities. The liability reported at the end of the fiscal year reflects the current pay rates.

#### **U. Net Position**

Net Position consists of unexpended appropriations and cumulative results of operations.

- Unexpended Appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn. It also represents amounts obligated for which legal liabilities for payments have not been incurred
- Cumulative Results of Operations represents the difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, this included the cumulative amount of donations and transfers of assets in and out without reimbursement.

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

The DoD Components have the use of land, buildings, and other facilities, which are located overseas obtained through various international treaties and agreements negotiated by the

Department of State. DoD purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. The DoD's fixed assets decrease by not renewing a treaty or not reaching agreements. Therefore, 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 non-retrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

## **W. Comparative Data**

In FY 2002, the Department modified the financial statement presentation for the Statements of Net Cost, Changes in Net Position, and Financing. As a result, the Department's statements during this reporting period may not always lend themselves to comparative analysis. In some instances, amounts on the statements were reported on one financial line in FY 2001 and split into multiple financial lines for FY 2002, in accordance with OMB's guidance.

## **X. Unexpended Obligations**

The Department obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods/services not yet delivered.

## Note 2. Nonentity and Entity Assets

As of September 30, (Amounts in millions)	2002			2001
	Nonentity	Entity	Total	Total
<b>Intra-governmental Assets</b>				
Fund Balance with Treasury	\$ 537.3	\$ 205,278.9	\$ 205,816.2	\$ 190,129.1
Investments		180,804.5	180,804.5	173,288.2
Accounts Receivable	5.4	1,116.5	1,121.9	1,064.2
Other Assets		0.1	0.1	4.2
<b>Total Intra-governmental Assets</b>	<b>\$ 542.7</b>	<b>\$ 387,200.0</b>	<b>\$ 387,742.7</b>	<b>\$ 364,485.7</b>
<b>Nonfederal Assets</b>				
Cash and Other Monetary Assets	\$ 578.2	\$ 164.5	\$ 742.7	\$ 1,014.1
Accounts Receivable	4,139.9	2,202.0	6,341.9	4,613.8
Loans Receivable		44.2	44.2	0.0
Inventory & Related Property		146,198.6	146,198.6	205,406.2
General PP&E		122,338.1	122,338.1	113,826.8
Other Assets	125.0	18,120.8	18,245.8	17,834.4
<b>Total Non-Federal Assets</b>	<b>\$ 4,843.1</b>	<b>\$ 289,068.2</b>	<b>\$ 293,911.3</b>	<b>\$ 342,695.3</b>
<b>Total Assets</b>	<b>\$ 5,385.8</b>	<b>\$ 676,268.2</b>	<b>\$ 681,654.0</b>	<b>\$ 707,181.0</b>

### Other Information Related to Nonentity and Entity Assets

#### Relevant Information for Comprehension

- Assets are categorized as:
  - Entity assets consist of resources that the Department has the authority to use, or where management is legally obligated to use funds to meet entity obligations.
  - Nonentity assets are assets held by an entity, but are not available for use in the operations of the entity.
- Other Information

The purpose of this note is to disclose the \$5.4 billion of nonentity assets that are not available for use by the Department in its day-to-day operations, but for which the Department maintains stewardship accountability and responsibility to report.

- Fund Balance With Treasury

NonEntity Assets -- Fund Balance With Treasury is comprised of other entity funds which can include disbursing officers' deposits and suspense accounts. The \$537.3 million balance consists of \$375.0 million in deposit and suspense accounts and \$162.3 million from Foreign Military Sales.

- Non-Federal Assets

The Department is currently holding Nonentity Cash and Other Monetary Assets as follows: (in millions)

<u>Type</u>	<u>Army GF</u>	<u>Navy GF</u>	<u>Air Force GF</u>	<u>USACE</u>	<u>ODO WCF</u>	<u>Total</u> <u>(\$ in millions)</u>
Disbursing Officer Cash	\$ 178.1	\$ 130.2	\$ 116.3	\$ .6	\$ 4.4	\$ 429.6
Foreign Currency	123.6	.5	24.4	.2		\$ 148.7
<b>Total</b>	<b>\$ 301.7</b>	<b>\$ 130.7</b>	<b>\$ 140.7</b>	<b>\$ .8</b>	<b>\$ 4.4</b>	<b>\$ 578.3</b>

- Non-Federal Accounts Receivable

The Department is reporting accounts receivables of \$5,004.0 million, interest of \$1,332.8 million, and fines and penalties of \$5.1 million. These Non-Federal receivables are related to aged Navy contract receivables for unliquidated progress payments made for the cancelled A-12 aircraft program and receivables related to litigation surrounding Air Force contracts. These contracts are in litigation and once settled the Department's collected sum will be deposited into the Department of Treasury Miscellaneous Receipt Accounts. The Department derived nor receives any benefit from these collections but incurs the cost of administering them.

- Loans Receivable

Loans Receivable of \$44.2 million reported in 2002 are attributable to a Military Housing Privatization Initiative reported by the Other Defense Organization General Fund. There were no Loans Receivable reported in 2001.

- **Note Reference**

- For Additional Line Item discussion, see:
  - Note 3, Fund Balance with Treasury
  - Note 4, Investments
  - Note 5, Accounts Receivable
  - Note 6, Other Assets



### Note 3. Fund Balance with Treasury

As of September 30, (Amounts in millions)	2002	2001
<b>Fund Balances</b>		
Appropriated Funds	\$ 195,621.4	\$ 182,437.9
Revolving Funds	7,823.4	5,327.0
Trust Funds	809.6	556.3
Other Fund Types	1,561.8	1,807.9
<b>Total Fund Balances</b>	<b>\$ 205,816.2</b>	<b>\$ 190,129.1</b>
<b>Fund Balances Per Treasury Versus Agency</b>		
Fund Balance per Treasury	\$ 204,945.0	\$ 187,673.7
Fund Balance per The Department of Defense	205,816.2	190,129.1
<b>Reconciling Amount</b>	<b>\$ (871.2)</b>	<b>\$ (2,455.4)</b>

#### Explanation of Reconciliation Amount

Reporting Entity (Amounts in millions)	Fund Balance with Treasury FY 2002	Fund Balance per Entity Books FY 2002	Reconciling Amount FY 2002	Reconciling Amount FY 2001
Navy GF	\$ 68,250	\$ 68,250	\$ 0	\$ 0
Air Force GF	47,943	47,943		
Army GF	39,510	39,510		
ODO GF	42,193	43,006	(813)	(2,812)
Corps of Engineers	2,485	2,544	(59)	(5)
MRF	19	19		
Air Force WCF	1,323	463	860	362
Army WCF	251	251		
ODO WCF	1,261	2,120	(859)	
Navy WCF	1,710	1,710		
<b>Total</b>	<b>\$ 204,945</b>	<b>\$ 205,816</b>	<b>\$ (871)</b>	<b>\$ (2,455)</b>

#### Analysis of Reconciling Amounts

Currently, the Department of Treasury reports fund balances at the appropriation basic symbol level. The Department of the Defense, Central Sites' adjust their funds to agree with the official DoD cash figures shown in each entity's expenditure system:

- Data Element Management/Accounting Reporting System: (DELMAR) for Army,
- Centralized Expenditure and Reimbursement Processing System (CERPS) for Navy, and
- Merged Accounting and Fund Reporting System (MAFR) for Air Force.

For the Defense Agencies, the Department of the Defense reconciles at the highest level, since Defense Treasury Index 97 funds allotted at limit level preclude individual entity reporting compliance. The Department continues to improve internal methodology to properly account for their funds at the lowest level.

As of September 30, 2002, the Department of the Defense shows a reconciling net difference of (\$871) million with the Department of Treasury, which comprises of:

- (\$813) million undistributed collections and disbursements reported at the departmental level for the ODO General Fund but not yet recorded by the applicable agency;
- (\$859) million for ODO Working Capital Fund is a combination of two differences. The first is the result of an offsetting plus/minus reporting requirement of \$860 million between the Department of Treasury and AFS reporting for the United States Transportation Command (USTRANSCOM). The Department of Treasury reports USTRANSCOM cash as part of Air Force Working Capital Fund; however, the reporting entity's fund balance is picked up in the ODO Working Capital Fund's footnote. The second adjustment reflects the reconciled DeCA FBWT as of September 30, 2001, with the final FY 2001 DeCA Audited Financial Statements (AFS), (i.e. DeCA's Version 3.5). In FY 2002, the disbursements and collections cash amounts have been adjusted to reflect the new Fund Balance and adjusted undistributed amounts.
- (\$59) million in cash is reported by Department Treasury in the Fund Balance of U.S. Army Corp of Engineers (USACE) for the Inland Waterways and Harbor Maintenance Trust Funds. USACE is identified as the lead agency for the reporting of these fund; and,

### **Fluctuations and/or Abnormalities**

- Total Fund Balance

Fund Balance increased, between fiscal years 2002 and 2001, primarily as a result of additional funding from the Defense Emergency Response Fund (DERF) for fighting terrorism throughout the World. The Department of Defense received approximately \$14,472 million in DERF funding for fiscal year 2002/2003 with additional transfer of approximately \$8,901 million in no-year DERF funding in late fiscal year 2001.

- Unused Funds and Expired Appropriations Returned

The aggregate amount of unused funds and expired appropriations returned to Treasury totaled \$2,701 million, comprising of \$820 million for the Department of the Air Force, \$669 million for the Defense Agencies, \$658 million for the Department of the Navy, and \$554 million for the Department of the Army.

## Other Information Related to Fund Balance with Treasury:

### Relevant Information for Comprehension

- Accounting Adjustments to Canceled Appropriations

The aggregate balance of accounting adjustments to canceled appropriations for fiscal year 96 and prior is \$83 million. Balances related to these funds have no effect on these financial statements and have been disclosed for information purposes only.

- Check Issue Discrepancy

The Department of Defense is in the process of collecting information for all check issue discrepancy data that are unsupported because: (1) records have been lost during deactivation of disbursing offices, (2) the Department of the Treasury may not assist in research efforts for transactions over 1-year old, or (3) corrections were processed for transactions that the Department of the Treasury had removed from the check comparison report. Transactions that have no supporting documentation due to one of the preceding situations shall be provided to the Department of the Treasury with a request to remove them from the Treasury Check Comparison Report. The vast majority of the remaining check issue discrepancies are a result of timing differences between the Department of Defense and the Department of Treasury for processing checks. Currently, the Department is not requesting the Department of Treasury to remove any dollars from the check issue comparison report.

- Intragovernmental Payment and Collection (IPAC)

The Intragovernmental Payment and Collection (IPAC) differences are reconcilable differences that represent amounts recorded by Treasury but not reported by the organization. As of September 30, 2001 and 2002 there were \$1 million and \$17 million respectively of IPAC differences greater than 180-days old reported by the DFAS Sites'. Automated reconciliation tools implemented during fiscal year 2001 and used throughout fiscal year 2002 virtually eliminated existing differences for the Department of the Army, and the Department of the Air Force. However, the Department of the Navy reported \$1 million and \$17 million as of September 30, 2001, and 2002. A majority of the differences represent internal DoD transactions and therefore do not affect the Fund Balance with Treasury (FBWT) at the DoD consolidated level. For individual entity level statements, however, these differences would affect the amount reported for the FBWT. The Department continues to work with its DFAS sites and the Department of the Treasury in reconciling the Treasury's Statement of Differences and to establish better internal controls over the IPAC process.

- Deposit Differences

The deposit differences are reconcilable differences that represent deposit amounts reported by the Department of Treasury or the organization. As of September 30, 2002 and 2001,

there were \$5 million and \$1 million, respectively, of deposit differences greater than 180-days old reported by the Department of the Army. The difference is due to an electronic funds transfer (EFT) voucher reported incorrectly by the Federal Reserve Bank of Atlanta. All other reported deposit differences greater than 180-days were of minimal value; i.e. less than \$5 thousand.

- **Note Reference**

- See Note Disclosure 1. I. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Funds with the U.S. Treasury.
- See Footnote 2 and Footnote 21B for further discussions on Other Fund Balance Types (e.g., Suspense, Budget Clearing, Special and Deposit, etc.)

**Note 4. Investments**

**As of September 30,**  
(Amounts in millions)

	2002				2001
	Cost	Amortization Method	Amortized (Premium)/Discount	Investments Net	Market Value Disclosure
<b>Intra-governmental Securities</b>					
Marketable	\$ 120.9	Effective Interest	\$	\$ 120.9	\$ 16.5
Nonmarketable, Par Value					0.0
Nonmarketable, Market-Based	187,674.7	Effective Interest	(11,226.8)	176,447.9	168,451.0
Subtotal	187,795.6		(11,226.8)	176,568.8	168,467.5
Accrued Interest	4,235.7			4,235.7	4,820.7
<b>Total Intra-governmental Securities</b>	<b>\$ 192,031.3</b>		<b>\$ (11,226.8)</b>	<b>\$ 180,804.5</b>	<b>\$ 173,288.2</b>

## Other Information Related to Investments

### Relevant Information For Comprehension

- Marketable Securities

The \$120.9 million on Line 1A, Marketable Intragovernmental Securities, represents investments for limited partnerships which have been entered into on behalf of the U.S. Government by the Department of the Navy in support of the Military Housing Privatization Initiative as signed into Public Law 104-106 110 Stat 186 on February 11, 1996. This investment relates to limited partnerships that do not require Market Value Disclosure. The increase is the result of limited partnerships initiated during FY 2002 (see Table below). The limited partnerships support military housing at the following sites:

<b>Installation</b>	<b>Amount Invested</b>	<b>Month Invested</b>
Everett NAS, Washington	\$ 12,176.6	December 2000
Kingsville NAS, Texas	4,300.0	December 2000
New Orleans Naval Complex, Louisiana	23,100.0	October 2001
Ft. Hood, Texas	52,000.0	November 2001
South Texas, Texas	29,400.0	November 2001
<b>Total</b>	<b>\$ 120,976.6</b>	

- Other Department of Defense Disclosures

Investments in U.S. Treasury securities are reported at cost, net of amortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment using the effective interest rate method or other method if similar results are obtained. The DoD'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.

- Investments, Net

Department of Defense Net Investments are supported by various Trust Funds in each of the reporting entities. These Trust Funds are comprised of military retirement contributions, donations (Gift Funds) and amounts reported by the Corps of Engineers.

<u>Reporting Entities</u>	<u>Amounts (in millions)</u>
<u>Military Retirement Fund (MRF)</u>	
Bonds	\$ 79,812
Notes	76,584
1-Day Certificates	6,000
<b>Total MRF</b>	<b>\$ 162,396</b>
<u>U.S. Army Corps of Engineers (USACE)</u>	
Inland Waterways	406
Harbor Maintenance	1,821
SD Terrestrial Wildlife Habitat Restoration Trust Funds	42
<b>Total USACE</b>	<b>2,269</b>
<b>Total of All Other Agencies</b>	<b>11,904</b>
<b>Subtotal</b>	<b>\$ 176,569</b>
Accrued Interest	4,236
<b>Total Investments</b>	<b>\$ 180,805</b>

- Investment Bid Price

The Department of Defense uses the "bid" price, shown in the Wall Street Journal on September 30, 2002 (the last trading day in the Department of Defense fiscal year), to provide the Market Value Disclosure column for securities values.

- **Note Reference**

- See Note Disclosure 1.N. – Investments in U. S. Treasury for additional DoD policies governing Investments in U.S. Treasury Securities.

## Note 5. Accounts Receivable

As of September 30, (Amounts in millions)	2002			2001
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
Intra-governmental Receivables	\$ 1,121.9	N/A	\$ 1,121.9	\$ 1,064.2
Nonfederal Receivables (From the Public)	6,838.1	(496.2)	6,341.9	4,613.8
<b>Total Accounts Receivable</b>	<b>\$ 7,960.0</b>	<b>\$ (496.2)</b>	<b>\$ 7,463.8</b>	<b>\$ 5,678.0</b>

### Fluctuations and/or Abnormalities

- Accounts Receivable

Total Accounts Receivable, Net increased by \$1,785.8 million or 31.5 percent between FY 2001 and FY 2002. The increase was largely attributable to an increase in Non-Federal Receivables (From the Public), Net of \$1,728.1 million or 37.5 percent. The major contributors to the increase in Non-Federal Receivables (From the Public), Net:

<u>Reporting Activities</u>	<u>Amounts (in millions)</u>
Army General Fund	\$205.4
Navy General Fund	\$1,019.0
Air Force General Fund	\$456.1
Other Defense Organizations General Fund	\$160.0
Army Corps of Engineers	(\$105.4)
Misc. Reporting Activities	(\$7.0)
<b>Total</b>	<b>\$1,728.1</b>

The large net increase was primarily reported by Navy General Funds as they recorded interest receivable in the amount of \$1,019.0 million for unliquidated progress payments of \$1,333.5 million made for the A-12 aircraft program that was subsequently cancelled and remains in litigation. The entire amount is reported in accordance with a 1994 General Accounting Office audit recommendation. The Air Force General Fund increases were primarily attributable to newly identified contractor debts and to the Air Force's portion of the General Electric litigation debt of \$316 million plus related interest. The Army General



Fund's increase was the result of the recording of Foreign Military Sales public receivables for \$138.8 million. Partially off-setting the increases in Non-Federal Receivables, Net was a decrease of \$105.4 million reported by the US Army Corps of Engineers.

## **Other Information Related to Accounts Receivable**

### **Relevant Information for Comprehension**

- Allowance Methods

DoD Components used a variety of techniques for estimating the allowance for uncollectible accounts receivable from the public. While the exact details differed among the Components, estimates were usually based on either a percentage of actual prior-year write-offs or a percentage of aged receivables from the public. The difference in the size of the percentages used in either method was generally associated with each DoD Component's experience in bad debt collection. Following are major DoD Components and a brief description of the allowance methods used by each.

- Army General Fund used a three-year average of actual write-offs.
- Army Working Capital Fund used actual write-offs over the last five years.
- Navy General Fund used a percentage of accounts receivable write-offs over the preceding three years.
- The Air Force estimated allowances by using 50 percent of the closed years receivables.
- The Defense Commissary Agency General Fund allowance varies based on a percentage applied to each aging category.
- The Defense Commissary Agency Working Capital Fund used 10 percent of the receivables over 180 days old on Resale Stock.
- The US Army Corps of Engineers based the allowance for estimated uncollectibles by aging receivables and based the percentages of write-offs by using prior year public receivables.

- Elimination Adjustments

The Department's accounting systems do not capture trading partner data for purchases at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the Department was unable to reconcile Intragovernmental accounts receivable balances with its trading partners. Through the ongoing Financial Management Enterprise Architecture (FMEA) Program, the Department intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of Intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished with the existing or foreseeable resources.

- **Note Reference**

- See Note Disclosure 1.K. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Accounts Receivable.

## Note 6. Other Assets

As of September 30, (Amounts in millions)	2002	2001
<b>Intra-governmental Other Assets</b>		
Advances and Prepayments	\$ 0.1	\$ 4.2
Other Assets		0.0
<b>Total Intra-governmental Other Assets</b>	<b>\$ 0.1</b>	<b>\$ 4.2</b>
<b>Non-Federal Other Assets</b>		
Outstanding Contract Financing Payments	\$ 15,227.2	\$ 14,757.3
Other Assets (With the Public)	3,018.6	3,077.1
<b>Total Non-Federal Other Assets</b>	<b>\$ 18,245.8</b>	<b>\$ 17,834.4</b>
<b>Total Other Assets</b>	<b>\$ 18,245.9</b>	<b>\$ 17,838.6</b>

### Other Information Related to Other Assets

#### Relevant Information For Comprehension

- Intragovernmental Other Assets
  - Advances and Prepayments

In accordance with the elimination guidance, buyer-side “advances to others” balances were adjusted to agree with the seller-side “advances from others” to the financial records of other DoD reporting entities. Additionally, the buyer-side prepayment balances were adjusted to agree with seller-side deferred credits to the financial records of other DoD reporting entities. The majority of the Advances and Prepayments were within the DoD, and were eliminated in the preparation of these statements. The \$.1 million represents the fiscal year 2002 advances and prepayment activity between the Department and other federal agencies compared to \$4.1 million in similar activity in fiscal year 2001. This reduction is consistent with the overall downward trend in Intragovernmental advances and prepayments.

- **Non-Federal Other Assets**

- **Outstanding Contract Financing Payments (OCFP)**

The Department has reported outstanding financing payments for fixed price contracts that are not based on percentage or stage of completion as an advance and prepayment. This is because, under the contract terms the Department becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the Department is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the Department for the full amount of the outstanding contract financing payments.

The \$15.2 billion in the OCFP consists mainly of:

- \$4.6 billion from the Navy GF - For the Navy GF, the \$1.3 billion decrease (from \$5.9 to \$4.6 billion) is due to the completion of active contracts, for which prepayments were no longer required.
- \$7.3 billion from the Air Force GF - For the Air Force GF, the \$1.9 billion increase (from \$5.4 to \$7.3 billion) is mostly attributable to the start-up cost of the C-17 and F-22 aircraft programs.
- \$3.1 billion from Army GF – Army balances did not experience a material fluctuation in the year.

- **Other Nonfederal Assets Disclosure**

<u>Type of Asset</u>	<u>FY 2002</u> <u>(in millions)</u>
<b>Non-Federal</b>	
<b>Other Contract Financing Payments</b>	
Army GF	\$ 3,109.6
Navy GF	4,609.3
Air Force GF	7,275.9
Other Agencies	232.4
<b>Total Other Contract Financing Payments</b>	<b>\$ <u>15,227.2</u></b>
<b>Other Assets With The Public</b>	
<u>Army</u>	
Advances to Others	\$ 418.7
MILCON Construction, Missile and Ammunition Procurement, RDT&E and Family Housing	54.5
Travel Advances, Contractor Advances, and Prepayments	18.8
<u>Navy</u>	
Advances to Others	\$ 181.9
Prepayments	110.7
Other Assets	1,019.3

<u>Air Force</u>		
Advances to Contractors and Non-Federal Advances	\$	260.1
Advances and Prepayments SMAG		122.5
Advances and Prepayments DMAG		53.1
SMAG Deliveries suspense and pending vendor credit		354.7
<u>DLA</u>		
Payments to Contractors and Misc. Advances		225.6
<u>Other Agencies</u>		
Advances to Contractors and Non Federal Advances	\$	56.9
Prepayments		99.9
Other Assets from Multiple Reporting Entities		41.9
<b>Total Other Assets With the Public</b>	<b>\$</b>	<b><u>3,018.6</u></b>

- **Note Reference**

- See Note Disclosure 1. R. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Other Assets.

## Note 7. Cash and Other Monetary Assets

As of September 30, (Amounts in millions)	2002	2001
Cash	\$ 573.2	\$ 924.3
Foreign Currency (non-purchased)	148.6	68.9
Other Monetary Assets	20.9	20.9
<b>Total Cash, Foreign Currency, &amp; Other Monetary Assets</b>	<b>\$ 742.7</b>	<b>\$ 1,014.1</b>

### Definitions

- Cash and Foreign Currency – Cash is the total of cash resources under the control of the Department of Defense, which includes coin, paper currency, negotiable instruments, and amounts on deposit in banks and other financial institutions. Cash available for agency use includes petty cash funds and cash held in revolving funds which will not be transferred into the U.S. Government General Fund. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts. Non-purchased foreign currency is limited to the Treasury Index 97X7000 fund account (formerly called FT accounts). There is a very limited dollar amount for non-purchased foreign currency. Non-purchased foreign currencies are acquired under the provisions of foreign assistance or foreign agricultural development programs.
- Other Monetary Assets - includes gold, special drawing rights, and U.S. Reserves in the International Monetary Fund. This category is principally for use by the Department of the Treasury.

### Fluctuation and/or Abnormalities

Foreign currency, including currency to pay foreign vendors, increased approximately \$80 million primarily in support of contingency mission Operation Enduring Freedom during FY 2002.

Cash decreased by \$351.1 million primarily resulting from the correction of an error in the Air Force General Fund (AFGF) which resulted in removing cash of \$378.7 million. This total consisted of \$182.6 million of Foreign Military Sales deposits and \$196.1 million of Foreign Military Sales undeposited collections that were erroneously included in Cash in FY 2001. The remaining \$27.6 million increase is composed of DoD Components that individually make up less than 10 percent of the total variance. The Balance Sheet prior period Cash column has been restated to \$545.6 million to incorporate the AFGF correction.

## Other Information Related to Cash and Other Monetary Assets

### Relevant Information for Comprehension

- Cash and Foreign Currency

Cash and foreign currency reported consists primarily of cash held by Disbursing Officers to carry out their paying, collecting and foreign currency accommodation exchange missions. The primary source of the amounts reported for cash and purchased foreign currency is the Standard Form 1219, Statement of Accountability. The non-purchased foreign currency, if there is any, is reported on the monthly DD Form 1363 (Statement of Transactions and Accountability (FT Accounts)). Foreign currency is valued using the Department of 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 exchange transactions.

- **Note Reference**

- See Note Disclosure 1. J. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Foreign Currency.

## Note 8.A. Direct Loans and Loans Guarantees Assets

### Other Information Related to Direct Loan and/or Loan Guarantee Programs

#### Relevant Information For Comprehension.

- **Military Housing Privatization Initiative**

The Military Housing Privatization Initiative (MHPI) fosters a mutually beneficial relationship between the DoD and the private sector. For the DoD, the MHPI results in the construction of more housing built to market standards, at a lower cost than through the military construction process. Commercial construction (Private Sector) is faster and less costly than military construction and significantly stretches and leverages the DoD's limited housing funds. The MHPI also provides protection against specific risks, such as base closure or member deployment, for the private sector partner.

An analysis of loans receivable, loan guarantees, the liability for loan guarantees, and the nature and amounts of the subsidy and administrative costs associated with the direct loans and loan guarantees is provided in the following sections of this note.

The Department of Defense operates a loan guarantee program authorized by the National Defense Authorization Act for FY 1996, Public Law 104-106 Stat. 186 Section 2801, includes a series of powerful authorities that allow the Department to work with the private sector to renovate military housing. The Department's goals are to:

- obtain private capital to leverage government dollars,
- make efficient use of limited resources, and
- use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually, or in combination. They include:

- guarantees, both loan and rental
- conveyance/leasing of existing property and facilities
- differential lease payments
- investments, both limited partnerships and stock/bond ownership
- direct loans

In addition, 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.

- Direct loans - are reported net of allowance for subsidy at present value, and
  - Loan Guarantee Liabilities - are reported at present value.
- Armament Retooling and Manufacturing Support Initiative

The Armament Retooling and Manufacturing Support Initiative (ARMS), Title 10 U.S.C. 4551-4555, is designed to encourage commercial use of the Army's Inactive Ammunition Plants through many incentives for businesses willing to locate to a government ammunition production facility. These facilities' production capacity is greater than the current military requirements, however this capacity could be needed in the event of another major war. The revenues from the property rental are used to pay for the operation, maintenance and environmental clean up at the facilities. This savings in overhead cost lowers the production cost of the goods manufactured, and funds the environmental clean up at no cost to the government.

The US Department of Agriculture Rural Business-Cooperative Service (RBS) and the United States Army established a Memorandum of Understanding (MOU) to furnish services to the Army in connection with the ARMS Initiative Loan Guarantee Program (AILG) pursuant to section 195 of the Armament Retooling and Manufacturing Support Act of 1992, as amended (10 U.S.C. 2501 note). The MOU is entered into pursuant to section 195 and 31 U.S.C. 1535.

The Army, by means of the ARMS Initiative legislation, has been authorized to establish a loan guarantee program to facilitate commercial firms' use of specified ammunition manufacturing facilities. Army is authorized by Public Law 103-337, the National Defense Authorization Act for Fiscal Year 1995, to enter into this agreement with RBS. RBS has the needed programmatic and administrative services necessary and convenient to process applications for loan guarantees, guarantee repayment for the loans, and to provide other services required to administer the AILG Program. Therefore, in order to ensure service to the public and for protection of the federal interests and rights, it is necessary for Army to obtain services from RBS.



## Note 8.B Direct Loans Obligated after FY 1991

As of September 30, (Amounts in millions)	2002	2001
<b>Loan Programs</b>		
<b>Military Housing Privatization Initiative</b>		
Loans Receivable Gross	\$ 92.6	\$ 0
Interest Receivable		
Foreclosed Property		
Allowance for Subsidy Cost (Present Value)	(48.4)	
<b>Value of Assets Related to Direct Loans</b>	<b>\$ 44.2</b>	<b>\$ 0</b>
<b>Total Loans Receivable</b>	<b>\$ 44.2</b>	<b>\$ 0</b>

### Other Information Related to Direct Loans Obligated after FY 1991

#### Relevant Information For Comprehension

- Military Housing Privatization Initiative

FY 2002 was the first year Direct Loans were disbursed. The Direct Loans were for Housing at Elmendorf, Alaska; Lackland Air Force Base, Texas; and Robbins Airforce Base, Georgia.

## Note 8.C Total Amount of Direct Loans Disbursed

As of September 30, (Amounts in millions)	2002	2001
<b>Direct Loan Programs</b>		
Military Housing Privatization Initiative:	\$ 92.6	\$ 0
<b>Total</b>	<b>\$ 92.6</b>	<b>\$ 0</b>

### Other Information Related to Total Amount of Direct Loans Disbursed

#### Relevant Information For Comprehension

- Military Housing Privatization Initiative

FY 2002 was the first year for Direct Loans in the Military Housing Privatization Initiative.

**Note 8.D. Subsidy Expense for Post- FY 1991 Direct Loans**

As of September 30,  
(Amounts in millions)

Subsidy Expense for New Direct Loans Disbursed		Interest Differential	Defaults	Fees	Other	Total
Military Housing Privatization Initiative						
FY 2002	\$	34.6	\$ 7.2	\$	\$	\$ 41.8
FY 2001	\$	\$	\$	\$	\$	\$ 0
Direct Loan Modifications and Re-estimates:		Modifications	Interest Rate Re-estimates	Technical Re-estimates	Total Re-estimates	Total
Military Housing Privatization Initiative						
FY 2002	\$	\$	\$	\$	\$	\$ 0
FY 2001	\$	\$	\$	\$	\$	\$ 0
<b>5. Total Direct Loan Subsidy Expense:</b>		<b>2002</b>	<b>2001</b>			
Military Housing Privatization Initiative		41.8	0			
<b>Total</b>		<b>\$ 41.8</b>	<b>\$ 0</b>			

**Other Information Related to Total Amount of Direct Loans Disbursed**

**Relevant Information For Comprehension**

- Military Housing Privatization Initiative

Subsidy Expense is based on the total direct loans disbursed in relationship to the subsidy rate for Direct Loans.

- **Note Reference**

- See Note 8.E. – Subsidy Rate for Direct Loans

**Note 8.E. Subsidy Rate for Direct Loans**

As of September 30,	Interest Supplements	Defaults	Fees and other Collections	Other	Total
<b>Direct Loan Programs</b>					
Military Housing Privatization Initiative	37%	8%			45%

**Other Information Related to Direct Loan Programs**

**Relevant Information For Comprehension**

The subsidy rates disclosed pertain only to the current year’s cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes modifications and re-estimates.

These rates are obtained from the following web site:

[http://www.whitehouse.gov/omb/budget/fy2003/pdf/cr\\_supp.pdf](http://www.whitehouse.gov/omb/budget/fy2003/pdf/cr_supp.pdf).

The FY 2003 Federal Credit Supplement provides summary information about Federal direct loan and loan guarantee programs subject to the Federal Credit Reform Act (FCRA) of 1990, as amended by the Balanced Budget Act of 1997. The data is based on legislation enacted for FY 2002 and the proposals contained in the President’s 2003 Budget.

**Note 8.F. Schedule for Reconciling Subsidy Cost Allowance Balance for Post – 1991 Direct Loans**

<i>As of September 30,</i> (Amounts in millions)	2002
Beginning balance of the subsidy cost allowance	\$ 0
<b>Add: Subsidy Expense For Direct Loans Disbursed During The Reporting Years By Component</b>	
Interest Rate Differential Costs	\$ 34.6
Default Costs (Net Of Recoveries)	7.2
Fees And Other Collections	
Other Subsidy Costs	
<b>Total Of The Above Subsidy Expense Components</b>	<b>\$ 41.8</b>
<b>Adjustments</b>	
Loan Modifications	\$ 0
Fees Received	
Foreclosed Property Acquired	
Loans Written Off	
Subsidy Allowance Amortization	
Other	
<b>Total Of The Above Adjustment Components</b>	<b>\$ 0</b>
<b>Ending Balance Of The Subsidy Cost Allowance Before Re-Estimates</b>	<b>\$ 41.8</b>
<b>Add Or Subtract Subsidy Re-Estimates By Component</b>	
Interest Rate Re-Estimate	\$ 0
Technical/Default Re-Estimate	
<b>Total Of The Above Re-Estimate Components</b>	<b>\$ 0</b>
<b>Ending Balance Of The Subsidy Cost Allowance</b>	<b>\$ 41.8</b>

**Note 8.G. Defaulted Guaranteed Loans from Post – 1991 Guarantees**

**Other Information Related to Defaulted Guaranteed Loans from Post – 1991 Guarantees**

**Relevant Information For Comprehension**

There were no Defaulted Guaranteed Loans from Post-1991 Guarantees for FY 2002.

## Note 8.H Guaranteed Loans Outstanding

As of September 30, (Amounts in millions)	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Loan Guarantee Program Title		
<b>2002</b>		
Military Housing Privatization Initiative	\$ 75.0	\$ 75.0
Armament Retooling and Manufacturing Support Initiative	8.6	7.7
<b>Total</b>	<b>\$ 83.6</b>	<b>\$ 82.7</b>
<b>2001</b>		
Military Housing Privatization Initiative	\$ 45.6	\$ 45.6
<b>Total</b>	<b>\$ 45.6</b>	<b>\$ 45.6</b>

### Other Information Related to Guarantees Loans Outstanding

#### Relevant Information For Comprehension

- Armament Retooling and manufacturing Support Initiative (ARMS), Army

This is a joint program with USDA. Prior to FY 2002 the USDA was required to include this program in USDA's financial statements. In FY 2002, the USDA is not required to include this program and Army reported the balance. This complies with the Office of Management and Budget (OMB) Bulletin No. 01-09, Note 36

## Note 8.I. Liabilities for Post – 1991 Loan Guarantees, Present Value

As of September 30, (Amounts in millions)	2002	2001
Loan Guarantee Program(s)		
Military Housing Privatization Initiative	10.1	3.3
Armament Retooling and Manufacturing Support Initiative	0.7	
<b>Total</b>	<b>\$ 10.8</b>	<b>\$ 3.3</b>

**Note 8.J. Subsidy Expense for Post FY 1991 Loan Guarantees**

As of September 30,  
(Amounts in millions)

Subsidy Expense for New Direct Loans Disbursed		Defaults	Fees	Interest	Other	Total
Military Housing Privatization Initiative						
FY 2002	\$	10.1	\$	\$	\$	\$ 10.1
FY 2001	\$		\$	\$	\$	\$ 0
<b>Subsidy Expense for New Loans Guarantees Disbursed</b>						
Military Housing Privatization Initiative						
FY 2002	\$		\$	\$	\$	\$ 0
FY 2001	\$	1.1	\$	\$	\$	\$ 1.1
<b>Loan Modifications and Re-estimates</b>						
Military Housing Privatization Initiative						
FY 2002	\$		\$	Technical Re-estimates	Total Re-estimates	Total
FY 2001	\$		\$	\$	\$	\$ 0
<b>Total Direct Loan Subsidy Expense</b>						
		2002	2001			
Military Housing Privatization Initiative		\$ 10.1	\$ 1.1			
<b>Total</b>		<b>\$ 10.1</b>	<b>\$ 1.1</b>			

**Other Information Related to Subsidy Expense for Post-1991 Loan Guarantees**

**Relevant Information for Comprehension**

- Armament Retooling and Manufacturing Support Initiative (ARMS), Army

Other Information consists of prepayments, losses other than default, and outflow other than disbursements

**Note 8.K. Subsidy Rate for Loan Guarantees**

As of September 30,	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantees					
Military Housing Privatization Initiative	%	6%	%	%	6%
Armament Retooling and Manufacturing Support Initiative		5%	-2%		3%

**Other Information Related to Subsidy Rate for Loan Guarantees**

**Relevant Information for Comprehension**

- Military Housing Privatization Initiative

- Subsidy Rates

The subsidy rates disclosed pertain only to the current year’s cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense for new loans reported in the current year could result from disbursements of loans from both current year cohorts and prior year(s) cohorts. The subsidy expense reported in the current year also includes modifications and re-estimates.

These rates are obtained from the following web site:

[http://www.whitehouse.gov/omb/budget/fy2003/pdf/cr\\_supp.pdf](http://www.whitehouse.gov/omb/budget/fy2003/pdf/cr_supp.pdf).

The FY 2003 Federal Credit Supplement provides summary information about Federal direct loan and loan guarantee programs subject to the Federal Credit Reform Act (FCRA) of 1990, as amended by the Balanced Budget Act of 1997. The data is based on

legislation enacted for FY 2002 and the proposals contained in the President's 2003 Budget.

- Armament Retooling and Manufacturing Support Initiative (ARMS), Army

Fees are collected from the borrower in order to partially offset subsidy cost.



**Note 8.L. Schedule for Reconciling Loan Guarantee Liability Balances  
for Post – 1991 for Loan Guarantees**

as of September 30, (Amounts in millions)	2002
Beginning Balance Of The Subsidy Cost Allowance	\$ 3.3
<b>Add: Subsidy Expense For Direct Loans Disbursed During The Reporting Years By Component</b>	
Interest Rate Supplemental Costs	\$ 0
Default Costs (Net Of Recoveries)	10.1
Fees And Other Collections	
Other Subsidy Costs	
Total Subsidy Expense Components	<u>\$ 10.1</u>
<b>Adjustments</b>	
Loan Modifications	\$
Fees Received	
Interest Supplements Paid	
Foreclosed Property And Loans Acquired	
Claims Payments To Lenders	
Interest Accumulation On The Liability Balance	
Other	0.7
Total Of The Above Adjustment	<u>\$ 0.7</u>
<b>Ending Balance Of The Subsidy Cost Allowance Before Re-Estimates</b>	<b>\$ 14.1</b>
<b>Add Or Subtract Subsidy Re-Estimates By Component</b>	
Interest Rate Re-Estimate	\$
Technical/Default Re-Estimate	
Total Of The Above Re-Estimate Components	<u>\$ 0</u>
<b>Ending Balance Of The Subsidy Cost Allowance</b>	<b><u>\$ 14.1</u></b>

## Note 8.M. Administrative Expense

As of September 30, (Amounts in millions)	2002	2001
<b>Direct Loan</b>		
Military Housing Privatization Initiative	\$ 0	0
<b>Total</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Loan Guarantees</b>		
Military Housing Privatization Initiative	\$ 0	\$ 2.4
<b>Total</b>	<b>\$ 0</b>	<b>\$ 2.4</b>

### Other Information Related to the Schedule of Reconciling Loan Guarantee Liabilities

#### Relevant Information for Comprehension

- Armament Retooling and Manufacturing Support Initiative (ARMS), Army

This is a joint program with USDA. Prior to FY 2002 the USDA was required to include this program in USDA's financial statements. In FY 2002, the USDA was not required to include this program in its financial statements and Army reported the balance. This complies with OMB Bulletin No. 01-09, Note 36.

### Other Information Related to Administrative Expense

#### Relevant Information for Comprehension

Administrative Expense is limited to the separately identifiable expenses to administer the direct and guaranteed loans. DoD does not maintain a separate program account to administer the direct loans and loan guarantees. The program account contains the entire MHPI program.

**Note 9. Inventory and Related Property**

	2002	2001
<b>As of September 30,</b> (Amounts in millions)		
Inventory, Net (Note 9.A)	\$ 53,375.1	\$ 48,376.0
Operating Materials & Supplies, Net (Note 9.B)	90,715.4	154,636.9
Stockpile Materials, Net (Note 9.C)	2,108.1	2,393.3
Seized Property	0.0	0.0
Forfeited Property	0.0	0.0
Goods Held Under Price Support and Stabilization Programs	0.0	0.0
<b>Total</b>	<b>\$ 146,198.6</b>	<b>\$ 205,406.2</b>

**Note 9.A. Inventory, Net**

	2002			2001 Inventory Net	Valuation Method
	Inventory Gross Value	Revaluation Allowance	Inventory Net		
<b>As of September 30,</b> (Amounts in millions)					
<b>Inventory Categories</b>					
Available and Purchased for Resale	\$ 62,196.7	\$ (27,212.2)	\$ 34,984.5	\$ 31,206.3	LAC; MAC; AC
Held for Repair	28,508.7	(12,442.6)	16,066.1	14,446.5	LAC; O; MAC
Excess, Obsolete, and Unserviceable	4,484.1	(4,484.1)		344.6	LAC; AC; NRV; O
Raw Materials	2,324.5		2,324.5	0.0	MAC; LAC; SP
Work in Process				2,378.7	
<b>Total</b>	<b>\$ 97,514.0</b>	<b>\$ (44,138.9)</b>	<b>\$ 53,375.1</b>	<b>\$ 48,376.1</b>	
<b>Legend for Valuation Methods</b>					
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	

## Definitions

- **Inventory Available and Purchased for Resale** includes consumable spare and repair parts and repairable items owned and managed by the Department. Material available and purchased for resale includes material held due to a managerial determination that it should be retained to support military or national contingencies.
- **Inventory Held for Repair** is damaged inventory that requires repair to make suitable for sale. Many of the inventory items are more economical to repair than to procure. In addition, because the Department often relies on weapon systems and machinery no longer in production, the Department 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.
- **Excess, Obsolete, and Unserviceable** inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal. Potentially reusable material, presented in previous years as “Excess, Obsolete and Unserviceable” is included in “Held for Use” or “Held for Repair” categories according to its condition.
- **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 the amount withheld from payment to ensure performance, and the amount paid to other Government plants for accrued costs of end items of material ordered but not delivered.
- **General Composition of Inventory**

Inventory includes spare and repair parts, clothing and textiles, fuels, and ammunition. Inventory is tangible personal property that is:

- 1) Held for sale, or held for repair for eventual sale;
- 2) In the process of production for sale; or
- 3) To be consumed in the production of goods for sale or in the provision of services for a fee.

“Inventory held for repair” is damaged material that requires repair to make it usable. “Excess inventory” is condemned material that must be retained for management purposes. “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. The USSGL does not include a separate work in process account unrelated to sales.

- **Changes from Prior Year's Accounting Methods**

- Inventory Valuation

In a July 6, 2001 memo, the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) prescribed moving average cost as the inventory valuation method to provide the Department based on the Components' analyses of the Department's material management policies and processes. OUSD(C) also noted that the Department's legacy systems were not designed to maintain historical cost valuation for inventory held for sale and operating materials and supplies in compliance with GAAP. Therefore, alternative valuation methods were authorized for continued use for other functional requirements (e.g. logistics, procurement and budget) as deemed necessary. The alternative valuation methods authorized include LAC and standard price.

The LAC method, which approximates historical costs, applies the last representative invoice price to all like units held, including units acquired through donation, non-monetary exchange, and returns from end use or reutilization. Generally, LAC is determined by subtracting the appropriate surcharges from the standard cost to arrive at the price most recently paid for a carried item. The use of LAC requires these amounts be recognized only upon the sale or disposal of material, rather than as the price variance occurs. Therefore, an allowance account is established on the financial statements to display unrealized holding period gains and losses. This allowance account is not under general ledger control of the individual commodities, but is calculated and compiled on a spreadsheet application approved by the OUSD(C) and Defense Finance Accounting Service (DFAS). The purpose of the allowance account is to provide a representation of inventory at historical cost.

- **Restriction of Inventory Use, Sale or Disposition**

Generally, there are no restrictions on the use, sale, or disposition of inventory except in the following situations:

- Distributions without reimbursement are made when authorized by DoD directives;
- War reserve material includes fuels and subsistence items that are considered restricted; and
- Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with current policies and guidance or at the direction of the President.

- **Decision Criteria for Identifying the Category to Which Operating Materials and Supplies are Assigned**

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."

- **Changes in the Criteria for Identifying the Category to Which Inventory is Assigned**

The category “Held for Sale” includes all issuable material. The category “Held for Repair” includes all economically repairable material. Before FY 2002, the Department showed “Potentially redistributable” material, regardless of condition, as “Excess, Obsolete, and Unserviceable.”

**Fluctuations and/or Abnormalities**

- Prior Period Adjustments

In accordance with a memo from OUSD(C) dated August 12, 2002, a policy change was implemented which discontinued the adjustment for inventory valuation for the amount of excess, obsolete and unserviceable inventory. As a result of this policy change, \$5.8 billion of excess inventory which was recognized as expenses in prior years was reversed as a prior period adjustment. The inventory allowance account was decreased by this amount, which increased the overall value of inventory. Also, the inventory worksheet was adjusted to indicate the deletion of the excess expense, which increased the inventory amount and decreased cost of goods sold expense.

- Re-established Inventory

Effective for fiscal years ending on September 30, 2002, in accordance with an OUSD(C) memo dated August 12, 2002, the Department implemented the change in policy with regard to the accounting and classification of inventory as “Excess, Obsolete, and Unserviceable”. In the past, through the use of a stratification process, and using system-generated reports, excess inventories met the Department’s definition of potential excess and were written down to the net realizable value (NRV). As a result of the policy change, inventory amounts previously expensed have been reversed and re-established as inventory “Available and Purchased for Resale.” Based on this policy, the following inventories are presented by reporting entities:

<b>Inventory Categories (Amounts in millions)</b>	<u>Army WCF</u>	<u>Navy WCF</u>	<u>Air Force WCF</u>
Available and Purchased for Resale	\$ \$10,160.3	\$ \$ 4,456.2	\$ 8,455.2
Held for Repair	1,154.2	11,796.1	3,104.8
Excess, Obsolete, and Unserviceable			
Work in Process	4.8	760.3	1,286.8
<b>Total</b>	<b>\$ \$11,319.3</b>	<b>\$ 17,012.6</b>	<b>\$ 12,846.8</b>

Inventory Categories (Amounts in millions)	Defense		Total
	Logistics Agency WCF	Other Defense Agencies	
Available and Purchased for Resale	\$ 11,513.6	\$ 398.7	\$ 34,984.0
Held for Repair	11.4	0.0	16,066.5
Excess, Obsolete, and Unserviceable	0.1		.1
Work in Process	0.0	272.6	2,324.5
<b>Total</b>	<b>\$ 11,525.1</b>	<b>\$ 671.3</b>	<b>\$ 53,375.1</b>

- Redefinition of Operating Materials and Supplies (OM&S) as Inventory – Working Capital Funds (WCF)

- Army

The OUSD(C) issued guidance during FY 2002 directing the reported balance of material held by Depot Maintenance and Ordnance to be reported as inventory. In previous years this material was reported as OM&S. This change resulted in an increase in inventory of \$140.0 million. A direct appropriation of \$164.0 million and issued for the purpose of procuring additional inventory and a transfer-in of inventory from the Army General Fund (GF) of \$74.3 million also contributed to the increase.

- Navy

The policy change resulted in a restoration of approximately \$1.9 billion in inventory.

- Air Force

The policy change resulted in a restoration of approximately \$1.5 billion in inventory.

- Defense Logistics Agency (DLA)

Inventory “Available and Purchased for Resale” increased approximately \$2.1 billion over FY 2001. The increase is due mainly to the impact of the policy change, described above, resulting in the restoration of approximately \$1.5 billion in inventory previously expensed. The change positively impacted Accumulated Operating Results by approximately \$1.4 billion.

- **Note Reference**

- See Note Disclosure 1. M. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

**Note 9.B. Operating Materials and Supplies, Net**

As of September 30, (Amounts in millions)	2002		2001		Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S Net	
OM&S Categories Held for Use	\$ 79,979.4	\$ 0.0	\$ 79,979.4	\$ 141,469.4	MAC; LAC; SP; AC; O,
Held for Repair	13,516.4	(3,260.7)	10,255.7	11,434.4	MAC; LAC; SP; O,
Excess, Obsolete, and Unserviceable	1,943.6	(1,463.3)	480.3	1,733.1	AC; NRV; SP; O
<b>Total</b>	<b>\$ 95,439.4</b>	<b>\$ (4,724.0)</b>	<b>\$ 90,715.4</b>	<b>\$ 154,636.9</b>	

**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



- **General Composition of Operating Materials and Supplies**

Operating Materials and Supplies includes spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines.

- **Balances**

In addition to the account balances shown in Table 9.B., the Federal Accounting Standard requires disclosure of the amount of OM&S held for “future use.” The Department estimates that \$82,229.0 million of the OM&S held for use will be used more than 24 months after the end of FY 2002.

- **Decision Criteria For Identifying The Category To Which Operating Materials And Supplies Are Assigned**

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.”

- **Changes In The Criteria For Identifying The Category To Which Operating Materials And Supplies Are Assigned**

The category “Held for Use” includes all issuable material. The category “Held for Repair” includes all economically reparable material. Before FY 2002, the Department showed “Potentially re-distributable” material, regardless of condition, as “Excess, Obsolete, and Unserviceable.”

### Fluctuations and/or Abnormalities

- OM&S

From a fluctuation and analysis perspective, the Department’s consolidated balance did not change significantly. However, individually, the Air Force GF increased approximately \$5.6 billion and the Navy GF decreased approximately \$4.5 billion. The following table presents OM&S by reporting entities:

<b>OM&amp;S, Net Categories (Amounts in millions)</b>	<b><u>Navy GF</u></b>	<b><u>Air Force GF</u></b>	<b><u>Army GF</u></b>
Held for Use	\$ 27,307.2	\$ 23,779.7	\$ 26,964.9
Held for Repair	5,217.8	5,037.8	0.0
Excess, Obsolete, and Unserviceable	478.6	0.0	0.0
<b>Total</b>	<b>\$ <u>33,003.6</u></b>	<b>\$ <u>28,817.5</u></b>	<b>\$ <u>26,964.9</u></b>

<b>OM&amp;S, Net Categories (Amounts in millions)</b>	<b>Air Force WCF</b>	<b>Navy WCF</b>	<b>Other Defense Agencies</b>	<b>Total</b>
Held for Use	\$ 1,145.1	\$ 643.3	\$ 139.2	\$ 79,979.4
Held for Repair	0.0	0.0	0.0	10,255.6
Excess, Obsolete, and Unserviceable	0.0	0.0	1.7	480.3
<b>Total</b>	<b>\$ 1,145.1</b>	<b>\$ 643.3</b>	<b>\$ 140.9</b>	<b>\$ 90,715.3</b>

- Redefinition of Operating Materials and Supplies (OM&S) as Inventory

- Navy GF

Operating Materials & Supplies Held for Use, Net decreased from \$58,176.0 million in FY 2001 to \$27,307.2 million in FY 2002 (a total of decrease of \$30,868.8 million) due primarily to two audit adjustments. The first adjustment of (\$6,904.4) million was necessary to remove Mobile Facilities, Aviation Support Equipment, and Calibration Standards items erroneously included in the FY 2001 OM&S values. The second adjustment was to remove \$24,765.8 million of tactical missiles and torpedoes that were previously reported as ammunitions and munitions in FY 2001.

Operating Materials & Supplies Held for Repair, Net increased from \$1,210.4 million in FY 2001 to \$5,217.8 million in FY 2002 (a total increase of \$4,007.4 million) as a result of the Department's implementation of USD(C)'s policy regarding condition codes. Numerous condition codes reported as Excess, Obsolete, and Unserviceable in FY 2001 are being reported as "Held for Repair" in FY 2002. For FY 2001, the standard general ledger structure did not include an account for OM&S held for repair. Also, the Office of Management and Budget (OMB) Bulletin 01-09, "Form and Content of Agency Financial Statements" did not provide for specific footnote disclosure of the OM&S held for repair. Recognizing that the Department holds OM&S in need of repair, the USSGL Board approved for use, beginning in FY 2002, USSGL account 1514, OM&S Held for Repair.

Excess, Obsolete, and Unserviceable, Net decreased from \$1,675.3 million in FY 2001 to \$478.6 million in FY 2002, as a result of OUSD(C)'s memorandum "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies" dated August 12, 2002. The memo addresses the fact that the cost of disposal is greater than the potential scrap value, as such, all OM&S reported in this category has been revalued to zero. The residual balance of \$478.6 million reported represents a prior period adjustment that was booked to adjust the general ledger balance in line with current reporting requirements. The Department implemented new policy in FY 2002 to account for condemned material (only) as "Excess, Obsolete, and Unserviceable." Potentially re-distributable material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in "Held for Use" or "Held for Repair" categories according to its condition.

In addition to the account balances reported above, the Federal Accounting Standard requires disclosure of the amount of OM&S held for “future use.” This information was not captured by the current OM&S system. However, the Navy major commands reported approximately \$2,463.0 million the OM&S held for use that will not be used within the next fiscal year.

- Air Force GF

In FY 2002, several manually maintained accounts did not report any OM&S financial data for the Air Force financial statements even though values had been reported in prior years. Some of these accounts are automated and the Standard Base Supply System (SBSS) reported the retail inventory. However, the wholesale was not reported due to confusion of the account managers thinking the SBSS would report all materiel. To correct this reporting problem, a meeting was held with the Air Force Audit Agency (AFAA) in November and another meeting is scheduled for early December with the account managers to ensure all accounts properly report all inventory for the first quarter FY 2003 report. The Air Force instructed DFAS to use the wholesale prior year account balances for the FY 2002 financial statements to provide a more realistic picture of ending balances for OM&S. The prior year balance reported in the FY 2002 financial statements amounted to approximately \$613 million.

The Air Force provided only minimal accounting data that could be used in the financial statements at year-end for OM&S. The data provided consisted of only serviceable and unserviceable ending balances. Without the required additional data (beginning balances, acquisitions, transfers in, amounts used, transferred and etc.), DFAS could only report the “net change” between prior year’s ending balance and the values reported as current year ending balances. Although the required additional data is available in the Air Force systems, no electronic interface currently exists between the Air Force supply systems and DFAS accounting systems. To correct this problem, the Air Force and DFAS are working on a hard copy report to provide the additional data until the electronic interfaces can be developed.

Although, the Air Force OM&S systems in most cases capture trading partner data at the transaction level that identifies all items transferred out or in (to or from) other sources, there are no electronic interfaces between the Air Force supply systems and DFAS accounting systems. Consequently, Intragovernmental transactions (trading partner data) could not be reconciled. The Air Force is in the process of developing an electronic interface that will capture and report the required data to the General Accounting and Finance System – Rehost, a DFAS system currently under development.

The Federal Accounting Standards require disclosure of the amount of OM&S held for future use. Except for an immaterial amount of munitions, the Air Force does not have any items considered held for future use.

- Reversal of FY 2001 Early OM&S Implementation

In accordance with Inspector General, Department of Defense (IG, DoD) direction, FY 2002 and FY 2001 OM&S balances for retail and wholesale guided and tactical missiles, missile motors, aircraft engines and electronic pods totaling \$31,869.7 million were removed from the Balance Sheet. The IG, DoD opinion is that these items should not have been reclassified as OM&S from the National Defense Property, Plant and Equipment during FY 2001. A prior period adjustment was accomplished in FY 2002 and the FY 2001 prior year column was restated to reflect this adjustment.

- Army GF

In accordance with the IG, DoD directive to remove FY 2001 OM&S balances for retail and wholesale guided missiles, a prior period adjustment was prepared to remove \$7,114.2 million in FY 2001 OM&S and \$6,747.6 million in FY 2002 from the Balance Sheet. The IG, DoD opinion is that these items should not have been reclassified as OM&S from the National Defense Property, Plant and Equipment during FY 2001. A prior period adjustment was accomplished in FY 2002 and the FY 2001 prior year column was restated to reflect this adjustment.

## **Other Information Related to Operating Materials and Supplies, Net**

### **Relevant information for Comprehension**

- Government Furnished Material (GFM) and Contractor Acquired Material (CAM)

Generally, the value of the Department's GFM and CAM in the hands of contractors is 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 already in other existing logistics systems.

- Munitions

The total tonnage of munitions stock, to include chemical stocks, awaiting destruction for FY 2002 and out years is \$.4 million. Army owns \$5,000.0 million in ammunition that is under treaty agreements and is not intended for use by U. S. Forces. This ammunition is intended for use in defense of the host nation by the host nation.

- **Note Reference**

- See Note Disclosure 1.M – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Inventory and related Property

**Note 9.C. Stockpile Materials, Net**

**As of September 30,**  
(Amounts in millions)

	2002		2001		Valuation Method
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	
Stockpile Materials Categories					
Held for Sale	\$ 2,039.7	\$ 0.0	\$ 2,039.7	\$ 2,117.2	AC/LCM
Held in Reserve	68.4	0.0	68.4	276.1	AC/LCM
<b>Total</b>	<b>\$ 2,108.1</b>	<b>\$ 0.0</b>	<b>\$ 2,108.1</b>	<b>\$ 2,393.3</b>	

**Legend for Valuation Methods**

LAC = Latest Acquisition Cost  
SP = Standard Price

NRV = Net Realizable Value  
O = Other

AC = Actual Cost  
MAC = Moving Average Cost

- **General Composition of Stockpile Materials**

Stockpile materials are strategic and critical materials, held due to statutory requirements, for use in national defense, conservation or national emergencies. Required stockpile levels may only be changed by law through a presidential proposal in the Annual Material Plan submitted to Congress.

- **Restrictions On The Use Of Materials**

There are legal restrictions on the use of stockpile materials. Strategic and critical materials are stockpiled in the interest of national defense to preclude a dangerous and costly dependence on foreign sources of supply in times of a national emergency. Due to environmental considerations, there is a moratorium on the sale of mercury and thorium nitrate.

- **Decision Criteria For Categorizing Stockpiles Materials As “Held For Sale”**

Materials for which Congress has not authorized sale are classified as Materials Held in Reserve. The balance of the stockpile is available for sale on the open market. Disposals cannot be made from the stockpile except under the following situations: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained; and (4) as authorized by law.

- **Changes In The Criteria For Categorizing Stockpile Materials As “Held For Sale”**

All materials held by the Defense National Stockpile (DNS) are classified as Materials Held in Reserve until Congressional action declares the materials are no longer required to be stockpiled and are available for sale on the open market. Until DNS receives authorization to offer materials declared no longer needed and can be made available for sale. DNS then removes the materials from Material Held in Reserve and reclassifies them as Material Held for Sale.

### **Other Information Related to Stockpile Material, Net**

- **Note Reference**

- See Note Disclosure 1. M. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

**Note 10. General PP&E, Net**

As of September 30, (Amounts in millions)	2002				2001	
	Depreciation /Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
Major Asset Classes						
Land	N/A	N/A	\$ 9,560.0	N/A	\$ 9,560.0	\$ 9,359.9
Buildings, Structures and Facilities	S/L	20 or 40	151,787.8	(78,231.7)	73,556.1	70,190.8
Leasehold Improvements	S/L	Lease Term	188.8	(87.6)	101.2	78.1
Software	S/L	2-5 or 10	3,528.4	(2,136.6)	1,391.8	1,375.4
Equipment	S/L	5 or 10	33,375.8	(22,794.1)	10,581.7	7,897.5
Assets Under Capital Lease <sup>1</sup>	S/L	Lease Term	587.8	(323.4)	264.4	312.7
Construction-in-Progress	N/A	N/A	26,784.4	N/A	26,784.4	24,349.2
Other			98.5		98.5	263.1
<b>Total General PP&amp;E</b>			<b>\$ 225,911.5</b>	<b>\$ (103,573.4)</b>	<b>\$ 122,338.1</b>	<b>\$ 113,826.8</b>

<sup>1</sup>Note 15.B for additional information on Capital Leases.

Legend for Depreciation/Amortization Methods: S/L = Straight Line N/A = Not Applicable

## Fluctuations and /or Abnormalities

- Buildings and Structures

The \$3.4 billion increase in Buildings and Structures is attributable to the following reporting entities:

<b>Reporting Entity</b>	<b>Amounts (in millions)</b>
U.S. Army Corps of Engineers	\$ 808.7
Navy General Fund	766.8
Army General Fund	761.7
Air Force General Fund	697.0
Army Working Capital Fund	166.8
Navy Working Capital Fund	6.1
Air Force Working Capital Fund	(29.4)
Other Defense Organization Working Capital Fund	104.6
Other Defense Organization General Fund	83.0
<b>Total</b>	<b>\$ <u>3,388.6</u></b>

The Army General Fund increase was attributable to the Army National Guard properly reclassifying federal assets. These assets were previously reported by the Army National Guard as state assets. The remaining change in this account was primarily attributable to completed construction in process.

- Equipment

The \$2.7 billion increase in Equipment is reported primarily in Air Force General Fund (\$3.0 billion increase), Army Working Capital Fund, Navy Working Capital Fund, and Other Defense Organization General Fund each had a \$ .1 billion decrease in the equipment account.

The increase in Air Force General Fund is due to Air Force's extensive effort in FY 2001 to ensure completeness of reporting of equipment. In FY 2001 the costs of some items were estimated because historical cost or acquisition date was not readily available for FY 2001 reporting. In FY 2002, the estimates were reversed and historical cost reported. Additionally, the Air Force had new acquisitions that contributed to its \$3.0 billion increase.

- Construction In Process

The \$2.4 billion increase in Construction In Process is attributable to the following reporting entities:



<b>Reporting Entity</b>	<b>Amounts (in millions)</b>
U.S. Army Corps of Engineers (USACE)	\$ 998.8
Other Defense Organization General Fund	390.1
Navy General Fund	470.4
Army General Fund	234.5
Navy Working Capital Fund	168.3
Various Other Reporting Entities	173.1
<b>Total</b>	<b>\$ 2,435.2</b>

### **Other Information Related to General PP&E, Net**

- Major Asset Class, “Other” Components:

<b>Type of PP&amp;E</b>	<b>Amounts (in millions)</b>
Property Awaiting Sale or Disposition	\$ 53.2
Natural Resources (primarily the value of timber reserves)	20.5
Archeological and Cultural Resources (USACE)	11.7
Deferred and Undistributed Items (USACE)	7.3
Other assets not previously classified (USACE)	5.8
<b>Total</b>	<b>\$ 98.5</b>

No Accumulated Depreciation/Amortization is shown for Major Asset Class “Other” because current systems and related crosswalks do not provide for recording and presenting the acquisition cost, accumulated depreciation, and net book value of such items in accordance with DoDFMR, Volume 6B requirements. This limitation will be addressed as part of future DFAS efforts to record and report all General PP&E according to relevant standards and requirements.

- New Guidance for Reporting Military Equipment

In June 2002, the Federal Accounting Standards Advisory Board approved a standard entitled, “Eliminating the Category National Defense Property, Plant, and Equipment (ND PP&E).” In addition to eliminating the category ND PP&E, this standard rescinds Statement of Federal Financial Accounting Standards (SFFAS) No. 11, Amendment to Property, Plant, and Equipment – Definitional Changes; amends SFFAS No. 8, Supplementary Stewardship Reporting; and amends SFFAS No. 6, Accounting for Property, Plant, and Equipment. This standard is effective for years ending after September 30, 2002. The standard is currently sitting before Congress for a 45-day period in accordance with provisions of the Chief Financial Officers Act of 1990.

Prior standards provide for the expensing of ND PP&E when costs are incurred and the reporting of such costs as supplementary stewardship information. The Department of Defense has not reported the cost of ND PP&E in accordance with existing standards due to an absence of detailed cost information for property acquired over many decades.

The standard on eliminating the category of ND PP&E provides for the capitalization of property previously defined as ND PP&E and the reporting of such property as General Property, Plant, and Equipment. In recognition of the absence of detailed historical cost information, this standard provides that, "If obtaining initial historical cost is not practical, estimated historical cost may be used. Other information such as but not limited to budget, appropriation, or engineering documents and other reports reflecting amounts expended may be used as the basis for estimating historical cost." The standard acknowledges that imprecision may result from the use of estimates or other information.

Capitalization of property previously defined as ND PP&E will require extensive research to develop cost estimates for the property inventory. The Department initiated the valuation process this fiscal year by conducting detailed reviews of three selected "pilot" programs, the Paladin Mobile Howitzer, the DDG-51 Arleigh Burke class destroyer and the F-15 tactical fighter. The objective of this effort was the development of a valuation methodology and associated business rules, which the Department could use to value the balance of its military equipment.

- Military Equipment, Pilot Program Valuation Basis

The valuations are based on information derived from reports reflecting amounts expended on these programs.

- Included costs - The estimated total program costs include funds expended for procurement, research, development, test and evaluation, trainers and simulators, government furnished equipment, and other items included in the cost of the acquisition programs. The estimated portion of total program cost attributable to equipment under construction is reported as "work-in-process."
- Excluded costs - The cost of military construction (MILCON) has been excluded and will be reported as real property. In addition, where separately identifiable, the cost of initial spares has been excluded. Finally, the costs of modifications to the DDG-51 are not accounted for in the valuation for that program. The cost of DDG-51 modifications will be captured and reported separately in later phases of the implementation of this standard.
- Useful life and depreciation – The estimated useful lives used for these valuations are 20 years for the Paladin program, 35 years for the DDG-51 program and 20 years for the F-15 program. Depreciation is calculated on a group basis whereby the depreciation rate is applied to the estimated cumulative cost of the equipment "placed in service."

Estimated program costs, accumulated depreciation, and net book values for the foregoing programs are presented in the following table:

<b>Military Equipment (Amounts in millions)</b>	<b>Program Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
<b>Paladin Mobile Howitzer</b>			
Placed in Service	\$ 1,802.4	\$ (541.6)	\$ 1,260.8
Work in process	17.4		17.4
<b>DDG-51 Arleigh Burke Class of Destroyer</b>			
Placed in Service	32,991.1	(4,595.2)	28,395.9
Work in process	6,452.8		6,452.8
<b>F-15 Tactical Fighter</b>			
Placed in Service	23,077.3	(19,085.4)	3,991.9
Work in process	69.6		69.6
<b>Total</b>	<b>\$ <u>64,410.6</u></b>	<b>\$ <u>(24,222.2)</u></b>	<b>\$ <u>40,188.4</u></b>

- **Note Reference**

- See Note Disclosure 1. O. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing General Property, Plant and Equipment (PP&E)

## Note 10.A. Assets Under Capital Lease

As of September 30, (Amounts in millions)	2002	2001
<b>Entity as Lessee, Assets Under Capital Lease</b>		
Land and Buildings	\$ 576.3	\$ 555.7
Equipment	11.5	28.0
Other		0.0
Accumulated Amortization	(323.4)	(270.9)
<b>Total Capital Leases</b>	<b>\$ 264.4</b>	<b>\$ 312.8</b>

### Other Information Related to Assets under Capital Lease

The current portion of the liability, as shown on Note 15.A., is \$46.5 million and the noncurrent portion is \$320.7 million. Imputed interest was necessary to reduce net minimum lease payments to the present value calculated at the incremental borrowing rate at the inception of the leases. Assets Under Capital Lease decreased by \$48.4 million primarily due to straight-line depreciation of Leased Assets.

- **Note Reference**

- See Note Disclosure 1. Q. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Leases.

**Note 11. Liabilities Not Covered and Covered by Budgetary Resources**

As of September 30, (Amounts in millions)	2002			2001
	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	Total
<b>Intra-governmental Liabilities</b>				
Accounts Payable	\$ 78.8	\$ 6.9	\$ 85.7	\$ 124.4
Debt	808.7	65.6	874.3	986.2
Environmental Liabilities				0.0
Other	3,807.6	4,406.0	8,213.6	6,092.9
<b>Total Intra-governmental Liabilities</b>	<b>\$ 4,695.1</b>	<b>\$ 4,478.5</b>	<b>\$ 9,173.6</b>	<b>\$ 7,203.5</b>
<b>Nonfederal Liabilities</b>				
Accounts Payable	\$ 24,159.8	\$	\$ 24,159.8	\$ 22,707.5
Military Retirement Benefits and Other Employment- Related Actuarial Liabilities	171,053.0	1,157,773.5	1,328,826.5	1,296,210.7
Environmental Liabilities		59,353.1	59,353.1	63,293.8
Loan Guarantee Liability	10.8		10.8	
Other Liabilities	18,282.2	11,513.1	29,795.3	28,621.2
<b>Total Nonfederal Liabilities</b>	<b>\$ 213,505.8</b>	<b>\$ 1,228,639.7</b>	<b>\$ 1,442,145.5</b>	<b>\$ 1,410,833.5</b>
<b>Total Liabilities</b>	<b>\$ 218,200.9</b>	<b>\$ 1,233,118.2</b>	<b>\$ 1,451,319.1</b>	<b>\$ 1,418,037.0</b>

**Liabilities Not Covered and Covered by Budgetary Resources**

- Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date.
- Liabilities Covered by Budgetary Resources are those that are incurred by the reporting entity which are covered by realized budget resources as of the balance sheet date. Budgetary resources encompass not only new budget authority; but also other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include (1) new budget authority; (2) spending authority from offsetting collections (credited to an appropriation or fund account); (3) recoveries of unexpired budget authority

through downward adjustments of prior year obligations; (4) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year; and (5) permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

- Other Liabilities Disclosures

- Covered Intragovernmental

(Amounts in millions)	Army	Navy	Air Force	ODO	USACE	Total
Advances From Others	\$ 63	\$ 75	\$ 174	\$ 1	\$ 17	\$ 331
Deposit Funds, Clearing Accounts & Undeposited Collections Liabilities*	(1)	250	16	40	14	318
Disbursing Officers Cash	300	130	265	0	1	697
Employer Contributions	61	69	56	47	14	246
Employee Benefits	113	51	22	7	0	193
Future Contract Revenue	0	0	0	0	882	882
Resources Payable to Treasury	0	1	1,007	12	34	1,053
Subsidy Related to Undistributed Loans	0	0	0	87	0	87
<b>Total</b>	<b>\$ 536</b>	<b>\$ 576</b>	<b>\$ 1,540</b>	<b>\$ 194</b>	<b>\$ 962</b>	<b>\$ 3,808</b>

\* An EFT voucher incorrectly reported by the Federal Reserve Bank of Atlanta resulted in a \$1 million abnormal balance in Deposit Funds. This will be corrected in FY 2003.

- Not Covered Intragovernmental

(Amounts in millions)	Army	Navy	Air Force	ODO	USACE	Total
FECA	\$ 320	\$ 566	\$ 306	\$ 182	\$ 41	\$ 1,415
Judgment Fund	75	106	304	9	145	639
Treasury Liability	0	2,352	0	0	0	2,352
<b>Total</b>	<b>\$ 395</b>	<b>\$ 3,024</b>	<b>\$ 610</b>	<b>\$ 191</b>	<b>\$ 186</b>	<b>\$ 4,406</b>

- Covered Non-Federal

(Amounts in millions)	Air						Total
	Army	Navy	Force	ODO	USCOE	MRF	
Advances from Others	\$ 508	\$ 140	\$ 94	\$ 340	\$ 112	\$ 0	\$ 1,194
Accrued Payroll	2,168	1,722	1,315	389	388	0	5,982
Deferred Credits	0	0	0	6	0	0	6
Deposit Funds, Clearing Accounts, & Undeposited Collections	0	0	39	4	7	0	50
Capital Leases	82	0	216	4	0	0	302
Contract Holdbacks	638	94	0	82	42	0	856
FMS Trust Funds	0	0	0	594	0	0	594
Contingent Liabilities	304	1,351	92	0	42	0	1,789
Pension Benefits	0	0	0	0	0	3,135	3,135
Employer Contributions	257	0	0	432	0	0	689
Non-Environmental Disposal	1	0	0	26	0	0	27
Progress Payments <sup>1</sup>	0	(329)	951	0	0	0	622
Contract Services	0	1,979	0	0	0	0	1,979
Unearned Revenue	0	0	0	(1)	0	0	(1)
Receipt Accruals				100			100
Undistributed Disbursements	0	(1,045)	0	0	0	0	(1,045)
TERA	10	2	17	0	0	0	29
Withholding Pay	15	0	0	0	0	0	15
Work in Process (WIP)	0	0	1,959	0	0	0	1,959
<b>Total</b>	<b>\$ 3,982</b>	<b>\$ 3,915</b>	<b>\$ 4,683</b>	<b>\$ 1,976</b>	<b>\$ 591</b>	<b>\$ 3,135</b>	<b>\$ 18,282</b>

<sup>1</sup> Progress Payments – Navy WCF

A DFAS memorandum dated October 10, 1997, directed the allocation of undistributed disbursements to the DoD services from their DWCF corporate account. Since identifying transactional information does not support this allocation, it is still on the books. Navy WCF continues to work to obtain the necessary information. The abnormal Unearned Revenue is due to a system processing error that will be corrected in FY 2003.

- Not Covered Non-Federal

(Amounts in millions)	Army	Navy	Air Force	ODO	Total
Accrued Interest Liabilities	\$ 0	\$ 0	1	\$ 0	1
Annual Leave	2,786	2,032	1,674	441	6,933
Cancelled Appropriations	69	69	453	89	680
Capital Leases	0	1	63	1	65
Contingent Liabilities	960	0	201	4	1,165
Custodial Liability				162	162
Non-Environmental Disposal	1,424	899	63	0	2,386
Entitlement Expenses Due and Payable				8	8
Other Unfunded Employment Related				9	9
Unfunded Leave				26	26
Contract Incentives		78		0	78
<b>Total</b>	<b>\$ 5,239</b>	<b>\$ 3,079</b>	<b>\$ 2,455</b>	<b>\$ 740</b>	<b>\$ 11,513</b>

- **Note Reference**

- For Additional Line Item discussion, see:
  - Note 8, Direct Loans and/or Loan Guarantee Programs
  - Note 12, Accounts Payable
  - Note 13, Liabilities Not Covered and Covered by Budgetary Resources
  - Note 14, Environmental Restoration Liabilities, and Environmental Disposal Liabilities
  - Note 15, Other Liabilities
  - Note 16, Commitments and Contingencies
  - Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities



## Note 12. Accounts Payable

As of September 30, (Amounts in millions)	2002			2001
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
Intra-governmental Payables	\$ 85.7	N/A	\$ 85.7	\$ 124.4
Non-Federal Payables (to the Public)	\$ 24,159.8	\$ 0	\$ 24,159.8	\$ 22,707.5
<b>Total</b>	<b>\$ 24,245.5</b>	<b>\$ 0</b>	<b>\$ 24,245.5</b>	<b>\$ 22,831.9</b>

Intragovernmental Accounts Payable consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Interest, penalties and administrative fees are not applicable to Intragovernmental payables. Non-Federal Payables (to the public) are payments to non-federal government entities.

### Fluctuations and/or Abnormalities

- Intragovernmental Accounts Payable

Intragovernmental Accounts Payable for DoD decreased \$39.0 million between current year and prior year. The following reporting entities contributed to this decrease:

- Air Force General Fund outstanding payables decreased by \$11.7 million dollars.
- Other Defense Organizations (ODO) General Fund outstanding payables decreased by \$0.3 million dollars.
- ODO Working Capital Fund outstanding payables decreased by \$26.0 million dollars.
- Other agency increases and decreases accounted for the remaining net decrease of \$1.0 million dollars.

### Other Information Related To Accounts Payable

#### Relevant Information For Comprehension

- Undistributed disbursements

Undistributed disbursements are the difference between disbursements/collections recorded at the detailed level to a specific obligation, payable, or receivable in the activity field records versus those reported by the U.S. Treasury via the reconciled DD 1329 and DD1400.

This should agree with the undistributed amounts reported on the Departmental Accounting Reports. Intransit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities outstanding accounts payable balance at year-end. Accounts payable were adjusted downward in the amounts indicated below for these payments.

- Army Accounts Payable total amount of \$573.9 million was adjusted downward consisting of GF \$449.2 million and WCF \$124.7 million
- Air Force WCF Accounts Payable was adjusted downward by \$1,367.4 million.
- ODO GF Accounts Payable total amount of \$16.3 million was adjusted downward consisting of DeCA \$7.3 million and DCAA \$9.0 million
- ODO WCF Accounts Payable total amount of \$290.7 million was adjusted downward consisting of DLA \$263.7 million, DFAS \$5.0 million, DeCA \$20.2 million and DSS \$1.7 million.
- Navy WCF Accounts Payable total was adjusted downward by \$400.0 million.
- Intragovernmental Eliminations

The DoD summary level seller accounts receivable were compared to Agencies' accounts payable. An adjustment was posted to the Agencies' accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to the Agencies. Positive differences were treated as unrecognized accounts payable and in the case of the Agencies, accounts payable were adjusted upward in the amounts below:

- Army Accounts Payable total amount of \$901.1 million was adjusted upward consisting of GF \$839.1 million and WCF \$62.0 million.
- Air Force GF Accounts Payable was adjusted upward by \$219.0 million
- ODO GF Accounts Payable total amount of \$312.0 million was adjusted upward consisting of DISA \$308.0 million, DeCA \$4.0 million.
- ODO WCF Accounts Payable total amount of \$241.4 million was adjusted upward consisting of DLA \$209.4 million, DFAS \$28.0 million and DeCA \$4.0 million.
- **Note Reference**
  - See Note Disclosure 1.G. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing accounting for Intragovernmental Activities.

## Note 13. Debt

As of September 30, (Amounts in millions)	2002			2001
	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
<b>Public Debt</b>				
Held By the Government	\$ 0	\$ 0	\$ 0	\$ 0.0
Held by the Public				0.0
<b>Total Public Debt</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0.0</b>
<b>Agency Debt</b>				
Debt to the Treasury	\$ 30.6	\$ 50.9	\$ 81.5	\$ 30.5
Debt to the Federal Financing Bank	955.7	(162.9)	792.8	955.7
Debt to Other Federal Agencies	0.0	0.0	0.0	0.0
<b>Total Agency Debt</b>	<b>\$ 986.4</b>	<b>\$ (112.0)</b>	<b>\$ 874.3</b>	<b>\$ 986.2</b>
<b>Total Debt</b>	<b>\$ 986.4</b>	<b>\$ (112.0)</b>	<b>\$ 874.3</b>	<b>\$ 986.2</b>
<b>Classification of Debt</b>				
Intra-governmental Debt			\$ 874.3	\$ 986.2
Non-Federal Debt				N/A
<b>Total Debt</b>			<b>\$ 874.3</b>	<b>\$ 986.2</b>

### Fluctuation and/or Abnormalities

- Debt to the Treasury

The ending balance for FY 2002 reported to Treasury reflects an increase to direct loan subsidy cost payments of \$57.0 million from the Family Housing Improvement Fund. This includes funds borrowed from Treasury, interest and principal payments from borrowers, borrower fees, interest earned from Treasury, and proceeds from the sale of collateral. The additional increases and/or decreases are attributable to other multiple reporting entities.

## Other Information Related to Debt

### Relevant Information For Comprehension

- Debt to the Treasury

The Department of the Treasury provided funds to the U.S. Army Corps of Engineers for capital improvements to the Washington Aqueduct. Funding to repay the debt is being provided by Arlington County, Virginia; Falls Church, Virginia; and the District of Columbia. Actual draw-down of funds has been made from the Treasury of \$73.4 million with principal repayments totaling \$49.3 million. The ending balance for FY 2002 of \$24.7 million represents the difference between the draw-down and repayments plus accrued interest payable of \$.6 million.

- Debt to the Federal Financing Bank

- Navy WCF

Once approved by Congress the Afloat Prepositioning Force (APF-N) program provides ships for Time Charter, a specific Military Sealift Command (MSC) program, to meet transportation requirements not available in the marketplace. These ships are built or converted by private Interim Vessel Owners using private non-government financing obtained from various banking institutions. There were no payments made by the government during the building/conversion phase. The availability for the APF-N Time Charters is five years with four optional renewal periods of five years each, for a total of 25 years. When the contracts expire, the ships become the property of the vessel's owner.

The Federal Financing Bank (FFB) is one of the institutions that provides loans to the vessel owners. The FFB reported a debt for \$750.7 million that includes an outstanding principal balance of \$739.3 million and an accrued interest payable of \$11.4 million for the Transportation Activity. The debt for these loans should have been recorded as public debt owed by the private vessel owners, rather than Intragovernmental debt to the transportation activity group. To simplify the payments and to meet their reporting requirements, the FFB cross-disburses the semi-annual principal and interest payments directly from the NWCF. This method of financing was used vice having MSC make Capital Hire payments to the vessel owners, who would in turn make loan obligation payments to FFB. This methodology was used in prior fiscal years and was not unusual. The FFB agreed with the vessel owner to have the government make payments directly to a bank.

MSC recorded these payments as operating expense to comply with the established guidance published by OUSD(C) as January 22, 1999. However, the outstanding debt principal amount reported in the NWCF Balance Sheet as Other Assets in order to reconcile with the amount reported by the FFB through the trading partner elimination process. The misclassification by the FFB generated this long-standing reporting problem. See Note 6 for additional disclosures.

The DoD Appropriation Act passed in December 1985 required that ten percent of the fifth year termination value of the vessels be obligated against Operation and Maintenance, Navy funds. To comply as directed, this process was completed as each vessel was delivered.

On the Balance Sheet, the Intragovernmental Debt decreased considerably from FY 2001 to FY 2002 as a result of the FY 2002 reduction of outstanding debt principal amount reported for the Transportation Activity Group.

- ODO WCF

U. S. Transportation Command, Military Sealift Command (MSC), reported \$41.4 million in loans from the Federal Financing Bank to ship owners. These loans were made available to provide their vessels for time charter to meet requirements not available in the marketplace for MSC.

- **Note Reference**

- See Note Disclosure 1.G. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing accounting for Intragovernmental Activities Public Debt.

**Note 14. Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities**

As of September 30,  
(Amounts in millions)

	2002		2001
	Current Liability	Non-current Liability	Total
<b>Environmental Liabilities</b>			
<b>Non-Federal</b>			
Accrued Environmental Restoration (To be funded by the Defense Environmental Restoration Program (DERP)) Costs:			
Active Installations--Environmental Restoration (ER)	\$ 1,457.6	\$ 11,576.1	\$ 13,033.7
Active Installations--ER for Closed Ranges	31.5	1,673.6	1,705.1
Formerly Used Defense Sites (FUDS)--ER	281.4	4,023.4	4,304.8
FUDS--ER for Transferred Ranges	114.1	11,106.2	11,220.3
<b>Other Accrued Environmental Costs (Non-DERP funds)</b>			
Active Installations--Environmental Corrective Action	68.1	388.2	456.3
Active Installations--Environmental Closure Requirements	10.6	99.1	109.7
Active Installations--Environ. Response at Active Ranges	38.9	253.3	292.2
Other	17.2	14.5	31.7
<b>BRAC</b>			
BRAC Installations--Environmental Restoration (ER)	404.5	3,610.5	4,015.0
BRAC Installations--ER for Transferring Ranges	11.2	386.2	397.4
BRAC Installations--Environmental Corrective Action	25.4	183.2	208.6
Other	269.7	269.7	269.7
Environmental Disposal for Weapons Systems Programs			
Nuclear Powered Aircraft Carriers		4,890.0	4,890.0
Nuclear Powered Submarines	43.6	4,845.3	4,888.9
Other Nuclear Powered Ships		269.1	269.1
Other National Defense Weapon Systems	6.8	271.5	278.3
Chemical Weapons Disposal Programs	2,168.5	10,648.8	12,817.3
Other	165.1	165.1	111.5
<b>Total Non-Federal Environmental Liabilities:</b>	<b>\$ 5,114.2</b>	<b>\$ 54,238.9</b>	<b>\$ 59,353.1</b>
<b>Total Environmental Liabilities:</b>	<b>\$ 5,114.2</b>	<b>\$ 54,238.9</b>	<b>\$ 59,353.1</b>

The Department of Defense (DoD) is disclosing the following data related to environmental cost and its associated estimated liabilities for the period ending FY 2002. Each of the Department's major reporting entity are responsible to track and report all required environmental information related to environmental restorations, costs, disposal of weapons systems and any environmental cost related to the base realignment closure that have taken place in prior years. The Department fully supports the clean-up efforts as displayed in this disclosure.

DOD is required to cleanup contamination resulting from waste disposal practices, leaks, spills and other past activity, which has created a public health or environmental risk. The Department is required to cleanup certain contamination in coordination with regulatory agencies, their responsible parties and current property owners.

### **Other Information Related to Environmental Liabilities**

- Sources of Clean-up
  - Requirements Comprehensive Environment Response, Compensation Liability Act (CERCLA)
  - Superfund Amendment and Reauthorization Act (SARA)

The Department of Defense is required by law to adhere to the Comprehensive Environment Response, Compensation Liability Act (CERCLA) and Superfund Amendment and Reauthorization Act (SARA) to clean up contamination resulting from past waste disposal practices, leaks, spills, and other activities which have created a risk to public health or the environment. The Army is DoD Executive Agent for cleaning up contamination at sites formerly used by military departments and defense agencies. CERCLA requires the Army to clean-up contamination in coordination with regulatory agencies, other responsible parties, and current property owners. Failure to comply with agreements and legal mandates can put DoD at risk of fines and penalties.

### **Relevant Information for Comprehension**

- Accounting Standards

DoD's Feeder Systems are limited; however, DoD continues to report the Department estimated and reported its environmental liabilities. In some instances when the DoD Components' financial systems could not be used to estimate the liability, the DoD Components based the reported amount on estimates prepared for other purposes. The Department is currently using two independently validated estimating models. The validation was performed in accordance with DoD Instruction 5000.61. The models are the Remedial Action Cost Engineering Requirements (RACER) model and the Navy CTC system.

- Environmental Cost Liabilities

- The Department of Army's Defense Environmental Restoration Program (DERP) was established by Section 211 of the Superfund Amendments and Reauthorization Act of 1986 and codified in Title 10 of the United States Code 2701. To further define the programs see Title 10 of the United States Code, Sections 2701-2706 and 2810-2811. The Department of Army implemented the DERP in accordance with the Department of Defense (DoD) Directive 4715.1, Environmental Security, February 24, 1996, and DoD Instruction 4715.7, Environmental Restoration Program, April 22, 1996 and the Management Guidance for the Defense Environmental Restoration Program, as of September 28, 2001. Environmental liabilities for the Army DERP and the Base Realignment and Closure (BRAC) are prepared in accordance with the Management Guidance for the DERP and the DoD Financial Management Regulation (DoDFMR) 7000.14.
- The Department of Navy estimated and reported a value of \$3,871.0 million for Environmental Restoration (ER) liabilities FY 2002 under DERP as of 30 September 2002. This is comprised of \$3,520.8 million in Active Installations ER liabilities and \$350.0 million in Active Installations – ER for Closed Ranges liabilities which represents Unexploded Ordnance Cost (UXO) for 12 sites. The Department of Navy was not segregated and reported UXO prior to FY 2001 as part of the total amount disbursed. The DoD FMR, Volume 6B, Chapter 10 requires that “any estimate produced must be based on site specific information and use cost models validated in accordance with DoD Instruction 5000.61.” The Navy plans to support this requirement, continue validating its range inventory, and pursue the process of obtaining valid cost estimates for each range. Once this process is complete, the Navy plans to report the processed site liabilities. The increase in Active Installations – ER for Closed Ranges started in FY 2002 for the Munitions Response Program (MRP) for Navy.

- **Environmental Disposal Cost Liabilities (Non-DERP funded)**

- The Department of Navy reported an environmental disposal liability for Weapons Systems Programs valued at \$10,274.9 million in FY 2002. Additionally, the Navy reported Weapons Systems, which included nuclear powered aircraft carriers, nuclear powered submarines, other nuclear powered ships and other national defense weapons systems.

- **Range Characteristics**

The Department of Army estimated that its environmental liability for FY 2001 and FY 2002 at closed transferred and transferring ranges was \$16,684.3 million and \$12,237.3 million respectively. Currently, in the Army inventory database there are 430 sites at closed ranges, 1,650 properties at transferred ranges and 63 sites at transferring ranges.

- Closed Ranges

The Department of Army must expend \$649.4 million and the Department of Navy \$350.0 million respectively to characterize and to investigate closed ranges. The Navy



determined that it owned 12 closed ranges. Total environmental liabilities cannot be estimated for Army or Navy until this characterization is completed.

Closed ranges for Army and Navy were taken out of service as a range and re-classified as a new use because of incompatibility with range activities. They are not classified by the military as a potential range area.

- Transferring Ranges

The Department of Army site level investigations reveal that the total environmental liability for these types of ranges is valued at \$367.5 million. Transferring ranges are proposed for transfer and/or will be returned from DoD to another entity, including other federal entities.

- Transferred Ranges

The Department of Army completed 1,549 of 1,650 properties range inventories and the estimated amount of liability for those ranges is valued at \$11,220.3 million. These were properties formerly used as a military range that are no longer under military control and have been leased by DoD, transferred, or returned from the DoD to another entity, including federal entities.

- Active Ranges

The Department of Army is currently conducting only one active range investigation and characterization for Massachusetts Military Reservation at a cost of \$292.2 million. This pays for sampling and analysis, groundwater monitoring, feasibility studies, soil and groundwater cleanup, and UXO investigation and response. Currently, the Active ranges in service include military ranges still being regularly used, but still considered a potential range area by the cognizant Military Service. They have not been re-classified due to incompatibility with range activities.

- Methodology Used to Estimate Environmental Liabilities

The DoD guidance requires disposal costs for general PP&E to be amortized over the life of the asset.

The Department of Army uses the annual cost-to-complete estimate as the basis for the environmental liability calculation. The cost-to-complete estimate is prepared for each site in the DERP in accordance with the Management Guidance for the DERP and the DoD FMR 7000.14.

- Accrued Environmental Restoration (DERP Funded) Costs:

- The Department of Army captures the cost-to-complete estimate data in the Defense Site Environmental Restoration Tracking System (DSERTS) for Active installations. The

current liability number is based on FY 2003 allocation and unliquidated obligations (ULOs). The ULO data are pulled from preliminary FY 2002 year-end reports provided by DFAS. Non-current liabilities include the cost-to-complete estimates from FY 2004 through program completion in accordance with the Management Guidance for the DERP and the DoD FMR 7000.14.

All Formerly Used Defense Sites (FUDS) properties, cost-to-complete is captured in the FUDS Management Information System (FUDMIS). The current liability number is also based on FY 2003 allocation and ULOs. ULO data are obtained from the Corps of Engineers Financial Management System (CEFMS) for existing FUDS ULOs as of 30 Sep. Non-current liabilities include the cost-to-complete estimates from FY 2004 through program completion in accordance with the Management Guidance for the DERP and the DoD FMR 7000.14.

- The Department of the Navy liabilities (cleanup) for accrued restoration represents the cost to correct past environmental problems that are funded under the Defense Environmental Restoration Program (DERP) in accordance with “Management Guidance for the DERP,” and “Accrued Environmental Restoration (Cleanup) Liabilities,” Chapter 14 of Volume 4 of the DoDFMR. These liabilities relate to Property, Plant, and Equipment (PP&E), including acquired land and Stewardship Land. They fall in the major asset categories as described in Chapter 6 of Volume 4 of the DoD FMR. Environmental restoration activities are conducted at operating installations, at Formerly Used Defense Sites (FUDS), as Closed, Transferred, and Transferring Ranges. Environmental restoration measurements involve the use of cost estimates that consider, on a current cost basis, the anticipated costs of the level of effort required to effect the restoration, as well as applicable legal and/or regulatory requirements. Such cost estimates are based on the current technology available. Site inventory and estimated cost data prepared for the DERP was used by the Navy as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services) to report to the Congress. The Accrued Environmental Restoration (Cleanup) Costs did not include the costs of environmental compliance, pollution prevention, conservation activities, contamination or spills associated with current operations, or treaty obligations, all of which are accounted for as part of ongoing operations.
- Active Installations – Environmental Restoration for Closed Ranges.
  - The Department of Army is currently developing the requirement for non-current liability for ER for closed ranges based on the results of an Army-wide inventory of all ranges. The inventory for closed ranges is 30 percent complete. The estimated \$1,695.0 million non-current liability for ER at closed ranges is the low (most probable) cost and is based on a mix of site-level and general installation specific data collected using a survey. Once the inventory is complete, site-level cost data will be available for calculating closed range liability. Also, an estimated value of \$1,984.0 million was calculated for ER for closed ranges.

- The Department of Navy Active Installations ER represents the environmental liabilities associated with the identification, investigation and removal, and remedial actions to address environmental contamination at ranges that are closed or will be closed prior to September 30, 2002. The contamination may include munitions, chemical residues from military munitions and munitions scrap at ranges on active installations that pose a threat to human health or the environment. The amount reported for that portion of the liability was estimated based on site level investigations and characterizations. The estimate produced was based on site specific information and use cost models was validated in accordance with DoD Instruction 5000.61. Total liabilities (cost to complete) cannot be estimated until there is sufficient site specific data available to estimate the total liability.
- The Department of Air Force conducted an inventory of ranges for the Defense Environmental Restoration Program (DERP). Based on that inventory the Air Force identified 241 Sites that has an established liability of \$705.7 million. Currently no appropriation exists for these cleanup actions. Air Force does not expect any expenditures prior to FY 2004. This liability will increase as the Air Force continues to refine the inventory and expand investigation of potential sites.

Air Force's liability for environmental restoration on active installations increased by \$198.7 million or 3.94 percent during FY 2002. This basically reflects an inflationary increase. While the total liability increased by \$198.7 million, the liability increase from new sites and areas of concern added during the year totaled \$556.4 million or 28.4 percent of the increase in total liabilities. Total sites and areas of concern included in the FY 2002 estimate of environmental restoration increased by 127 on active installations. Therefore, a total of 6,483 active sites as of 30 September 2002 was reported. The Air Force achieved for FY 2002 over half of its projected site investigations primarily due to regulatory delays. The estimates include total costs for environmental restoration and non-operational ranges. Direct and indirect costs were captured because the programs are accounted for separately.

- FUDS – Environmental Restoration for Transferred Ranges.

The Department of Army non-current liability for ER for transferred ranges is based on results of an inventory of transferred ranges at 1,650 properties. Of the 1,650 properties inventoried of transferred ranges, 94 percent were completed based on data collected from the reported 1,549 properties.

- Other Accrued Environmental Costs (Non-DERP Funds)

The Department of Air Force reported a decline of \$71.1 million (28.9 percent) , during the fiscal year. The reduction is the result of reevaluations for solid waste management units at one installation. Reevaluation of the initially suspected contamination was substantially less than indicated through preliminary examinations of the sites. The estimates of non-DERP current liabilities were established the same as FY 2001.

The Department of the Navy (DON) developed guidance for the DON Major Commands to use as they begin to identify site data and develop estimates for DON's "ongoing" operations. The DON continued review of program areas such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retrofill, and/or disposal of PCB transformers and underground storage tank remedial investigation and closure.

- Active Installations – Environmental Corrective Action.

- The Department of Army reflects the total of active projects in the Fall 2001 Environmental Program Requirements (EPR) data base which are reported under the:
  - 1 Law/Reg RCRA-C with Environmental Category (ECAT) CORA (Corrective Action),
  2. Law/Reg RCRA-D with ECAT CORA,
  3. Law/Reg RCRA-I with ECAT USTR (Underground Storage Tanks), and
  4. Law/Reg SFND/CLNP (Superfund/Cleanup) with all ECATs (including those for Preliminary Assessments/Site Investigations, Remedial Action (CONUS Cleanup), and Removal Actions (Overseas Cleanup)).

The Current Liability total reflects costs recorded in the EPR for FY 2003, while the Noncurrent Liability total reflects total estimated costs for FY 2004 through FY 2015.

- Active Installations – Environmental Closure Requirements

- The Department of Army reflects the total of active projects in the Fall 2001 EPR data base which are reported under:
  1. Law/Reg RCRA-C with ECAT CPLN (Closure Plan), and
  2. RCRA-D with ECAT CPLN.

The Current Liability total reflects costs recorded in the EPR for FY 2003, while the Noncurrent Liability total reflects total estimated costs for FY 2004 through FY 2015.

- The Department of Air Force reported for the second year environmental disposal liabilities for Resource Conservation and Recovery Act (RCRA) regulated facilities. Facilities reported include landfills; treatment, storage and disposal facilities (TSDFs) for hazardous waste; and underground storage tanks (USTs). The total disposal liability increased \$3.6 million (6 percent), from September 30, 2001 to September 30, 2002. The significant change was lower than expected however, the individual areas showed a greater percentage change. Landfill liabilities increased \$4.5 million (37 percent) and USTs increased \$1.3 million (17 percent), but the TSDF liability declined \$2.1 million (5 percent). The

change in landfill liability reflects a greater number of landfills reported as of September 30, 2002 in comparison to September 30, 2001. Changes in TSDFs and USTs reflect changes in cost estimates, largely due to the increased use of the Remedial Action Cost Engineering Requirements (RACER) system. This system is used for all cost estimates for Air Force when there is not an actual bid and/or contract and to validate the Air Force estimates.

The Air Force's reporting of landfill liabilities is based on the proportion of the landfill used as of September 30, 2002 and includes the cost of capping the fill, as well as 30 years of monitoring as required by Federal regulations. The reported value of the total liability for closing landfills, without disclosure based on use, as of September 30, 2002 was \$80.0 million.

The Air Force TSDF closure liabilities are based on an assumed useful life of 30 years and two years of monitoring with closure costs estimated for a "clean close". "Clean close" is defined in the Federal regulations. The total closure liability for TSDF's reported \$226.1 million on an annual basis.

The Air Force UST closure liabilities are based on an assumed life of 20 years and two years of monitoring with closure costs estimated for a "clean close". The total closure liability for UST's reported \$75.3 million on an annual basis. Therefore, total closure liabilities on a current basis, without disclosure over time, was reported as \$381.4 million as of September 30, 2002.

The Air Force's reporting of landfill closure liability is not in compliance with the accounting standard. The standard would recognize all future costs regardless of timing. The Air Force recognizes only the initial closure. A landfill cap typically requires replacement every 20 to 40 years. An estimation of current costs based on all future costs, regardless of timing, would result in an infinite liability. This appears meaningless and not the intent of the standard. Therefore, the Air Force reports only the cost of the initial cap required to close a landfill. The Air Force believes this reporting is more meaningful. The present value of the future caps, those after the initial cap, would be negligible.

The Air Force's accounting methodology requires full cost be recognized for closure liability. Closure liabilities recognized by the Air Force cover only direct costs. There is no reliable cost accounting system to determine indirect closure costs. This is not considered material in the cost estimates because indirect costs incurred would not happen for at least 20 years and in many cases beyond 20 years. The present value of such costs would be negligible in recognition of the closure liabilities.

- Active Installations – Environmental Response at Active Ranges.

The Department of Army estimated total Non-DEIR liability for Environmental Response at Active Ranges reflects costs for the Massachusetts Military Reservation, broken out into current and non-current liabilities. This includes soils and groundwater cleanup and UXO detection and removal.

- Base Realignment and Closure (BRAC):

The Department of Army cost-to-complete estimate for BRAC installations are captured in the DSERTS. Because BRAC installations are funded separately using the Base Closure Account, restoration liabilities are reported as Environmental Restoration; unexploded ordnance liabilities are reported as Environmental Restoration for Transferring Ranges; and compliance liabilities are reported as Environmental Corrective Action. For current liabilities, the number is based on FY 2003 allocation and ULOs. Because prior year BRAC ULOs are not identified by individual program, BRAC ULOs for non-Federal liabilities are provided as “BRAC-Other”. Non-current liabilities include the cost-to-complete estimates from FY 2004 through program completion (collected in DSERTS) in accordance with the Management Guidance for the DEIR and the DoD FMR 7000.14.

- BRAC – Environmental Restoration for Transferring Ranges.

The Department of Army non-current liability for ER for transferring ranges is based on results of an inventory of transferring ranges at 63 properties. The inventory of transferring ranges is 99 percent complete with site-level cost data available for 62 of 63 properties.

- BRAC – Environmental Restoration/Environment Corrective Action.

The Department of Air Force estimated and reported its BRAC environmental future liabilities for FY 2002. The Air Force Base Conversion Agency (AFBCA) estimates a \$2.2 billion total environmental liability as of September 30, 2002. This amount includes all cleanup requirements to meet regulatory requirements and to transfer property (including the new radiological issues at McClellan and program increases at Chanute). However, this amount does not include potential future cost associated with long-term landfill management for which State laws probably will not relieve Air Force of their responsibility.

Currently, AFBCA is working to identify Military Munitions Response Program (MMRP) costs. AFBCA is in the process of identifying MMRP sites based on DEIR guidance, but has not been able to separate costs. Therefore, as of September 30, 2002 Air Force was unable to reasonably estimate MMRP costs separate from their ER and Closure costs.

- Environmental Disposal for Weapons Systems Programs

- The Department of Army reported \$12,817.3 million FY 2002 in comparison to \$14,252.5 million reported for FY 2001 based on the probable costs for the Program Manager for Chemical Demilitarization, the Chemical Stockpile Emergency Preparedness Project, and the Project Manager for the Assemble Chemical Weapons.

- The Department of Air Force reported environmental disposal liability value of \$51.3 million in Other National Defense Weapon Systems. This includes strategic, tactical, active, inactive missiles and missile motors as of 30 September 2002. The Air Force identified \$48.6 million in environmental liability for the disposal of Minuteman III and Peacekeeper strategic, inactive missile motors. The estimated environmental disposal liability for tactical, active, inactive missiles and missile motors is \$2.7 million.
- Year-to-Year Changes in the Liability Estimate

The Department of Army liability is \$6,019.5 million and \$4,818.0 million for FY 2001 and FY 2002 respectively for Environmental Restoration for FUDS (ER and ER for Closed Ranges). Currently the estimate reflects a decrease from the liability reported in the most recent prior fiscal year. Major factors contributing to the change includes increased QA/QC of program requirements. Non-current liability for ER for closed ranges is a developing requirement based on the results of an Army-wide inventory of all ranges.

The Department of Army reported totals of \$17,643.7 million and \$15,525.2 million for FY 2001 and 2002 for estimated total liability is FUDS for Environmental Restoration (ER and ERT for Transferred Ranges) respectively. Currently the estimate is a significant decrease from the prior fiscal year's liability. Major factors contributing to the changes include modifications to Remedial Action Cost Engineering Requirements (RACER) to account for varying ordnance densities at ranges (which decreased FUDS-ER Transferred Range estimate), increase in the number of HTRW projects, and review of all future cost-to-complete estimates (which increased FUDS-ER estimate).

The Department of Army estimated liability is \$72.3 million for FY 2002 and \$71.1 million for FY 2001 BRAC Installation – Environmental Corrective Action (includes current plus non-current liability). The current estimate is an increase from the liability reported in the most recent prior fiscal year. Major factors contributing to the change include refinement of cost estimates and identification of new requirements due to new characterization data and regulatory negotiations.

The Department of the Navy 296.62 percent increase in the environmental restoration for closed ranges at active installations is due to the fact that this is a new reporting requirement.

The Department of the Navy 100 percent increase for transferring ranges and Base Realignment and Closure is a result of a new reporting requirement. The DON is currently in the process of conducting Preliminary Assessment/Site Investigations (PA/SI) to determine the nature of the environmental restoration work that is actually at the ranges so estimates for cleanup can be completed. PA/SIs are expected to be completed by end of FY 2003.

- **Other Information**

- Others Category Disclosure Comparative Table for the Department of Army

<b>Types</b>	<b>FY2002</b> <b>(\$ in millions)</b>
Non-DERP – Other	
Low Level Radioactive Waste Clean up	\$ 15.1
Accrued Restoration Cost Other Defense Organization	\$ 16.5
 BRAC – Other	
Prior Year BRAC ULOs That Cannot Be Identified To A Specific Program	\$ 269.4
Low Level Radioactive Waste Clean up	\$ .2
 Environmental Disposal for Weapons Systems Programs	
<u>National Stockpile</u>	
Thorium Nitrate Disposal or Upgrade	\$ 60.0
Long Term Storage or Repackaging of Mercury	\$ 20.0
Cleanup Cost	\$ 25.0
Badalite Ore Disposal	\$ 6.0
<u>Other Defense Organization</u>	\$ 54.0

- Material Changes in Total Estimated Liability Costs Due to Changes in Laws, Technology, or Plans

Survey data of the Department of the Navy Environmental Restoration Program cost estimate changes, representing FY 2002 through completion changes between end of year 2001 and end of year 2002, for sites that had over 10 percent change or 500K indicates diverse reasons for change in estimates. Multiple reasons may apply both as plus-ups and deducts at any site. The reasons for changes are estimation changes (26 percent), regulatory changes (60 percent), and technical changes (15 percent). Reasons for changes in estimation are as follows: cost to complete (CTC) overlooked or previously unknown, better site characterization with sampling, cost avoidance rerun CTC, re-estimation based on different assumptions and/or escalation, and re-estimation of costs based on lessons learned. Reasons for changes in the area of regulatory are as follows: addition of range rule/munitions requirements, additional or extended long term monitoring requirements or 5 year reviews, no further action agreement with regulator, and risk based corrective action. Reasons for changes in the area of technical are as follows: additional contamination level reduction with sampling, additional or extended remedial action operation, additional sites and incomplete site data, and technical solution changed.



The Department of the Army does not have any unrecognized portion of the estimated total cleanup cost associated with general PP&E and there are no material changes in the total estimated liability due to changes in laws, technology, or plans. The major change in technology affecting the liability estimate was standardizing use of the estimating tools consistently across the Army programs.

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

The Department of the Army estimates used for environmental liability calculations are estimates of the cost to complete all activities at a site of environmental concern. The cost estimates are calculated at the site-level using a validated cost-estimating model or an engineered cost and entered into a database. There were no changes to the total liability cost due to inflation, deflation, technology, or applicable laws and regulations.

Service Component – Environmental Restoration (Cleanup) Liabilities and Environmental Disposal Liabilities (amounts in millions)	Army	Navy	Air Force	ODO
<b>Environmental Liabilities:</b>				
<b>Non-Federal</b>				
Accrued Environmental Restoration (To be funded by the Defense Environmental Restoration Program (DERP)) Costs:				
Active Installations--Environmental Restoration (ER)	\$ 4,168.5	\$ 3,521.0	\$ 5,237.4	\$ 106.8
Active Installation--ER for Closed Ranges	649.4	350.0	705.7	
Formerly Used Defense Sites (FUDS)--ER	4,304.9			
FUDS--ER for Transferred Ranges	11,220.3			
<b>Other Accrued Environmental Costs (Non-DERP funds)</b>				
Active Installations--Environmental Corrective Action	281.2		175.0	
Active Installations--Environmental Closure Requirements	44.6		65.2	
Active Installations--Environ. Response at Active Ranges	292.2			16.5
Other	15.2			
<b>BRAC</b>				
BRAC Installations--Environmental Restoration (ER)	575.2	1,293.3	2083.7	62.7
BRAC Installations--ER for Transferring Ranges	367.5	29.9		
BRAC Installations--Environmental Corrective Action	72.3		136.2	
Other	269.7			
<b>Environmental Disposal for Weapons Systems Programs</b>				
Nuclear Powered Aircraft Carriers		4,890.0		
Nuclear Powered Submarines		4,888.9		
Other Nuclear Powered Ships		269.0		
Other National Defense Weapon Systems		227.0	51.3	
Chemical Weapons Disposal Programs	12,817.3			
Other				165.1
<b>Total</b>	<b>\$ 35,078.3</b>	<b>\$ 15,469.1</b>	<b>\$ 8,454.6</b>	<b>\$ 351.1</b>

**Note 15.A. Other Liabilities**

As of September 30. (Amounts in millions)	2002			2001
	Current Liability	Non-current Liability	Total	Total
<b>Intra-governmental</b>				
Advances from Others	\$ 331.2	\$ 0	\$ 331.2	\$ 214.1
Deferred Credits				991.3
Deposit Funds and Suspense Account Liabilities	318.5		318.5	243.6
Resources Payable to Treasury	1,053.4		1,053.4	647.6
Disbursing Officer Cash	696.9		696.9	944.6
<b>Nonenvironmental Disposal Liabilities:</b>				
Military Equipment (Non-nuclear)				0.0
Excess/Obsolete Structures				0.0
Conventional Munitions Disposal				0.0
Other				0.0
Accounts Payable-Cancelled Appropriations				7.2
Judgment Fund Liabilities	349.4	288.8	638.2	729.9
FECA Reimbursement to the DoL	562.4	852.6	1,415.0	1,389.3
Capital Lease Liability				0.0
Other Liabilities	2,876.9	883.5	3,760.4	925.1
<b>Total Intra-governmental Other Liabilities</b>	<b>\$ 6,188.7</b>	<b>\$ 2,024.9</b>	<b>\$ 8,213.6</b>	<b>\$ 6,092.7</b>

As of September 30, (Amounts in millions)	2002			2001
	Current Liability	Non- current Liability	Total	Total
<b>Non-federal</b>				
Accrued Funded Payroll and Benefits	\$ 9,113.8	\$ 24.8	\$ 9,138.6	\$ 8,138.5
Advances from Others	1,194.0		1,194.0	939.4
Deferred Credits	6.4		6.4	1.9
Loan Guarantee Liability				0.0
Liability for Subsidy Related to Undisbursed Loans				0.0
Deposit Funds and Suspense Accounts	50.1		50.1	34.0
Temporary Early Retirement Authority	19.0	10.1	29.1	68.0
Nonenvironmental Disposal Liabilities:				
Military Equipment (Non-nuclear)	1.7	564.4	566.1	588.0
Excess/Obsolete Structures	89.2	305.9	395.1	210.0
Conventional Munitions Disposal		1,424.3	1,424.3	0.0
Other	27.0		27.0	0.5
Accounts Payable-Cancelled Appropriations	532.1	147.5	679.6	560.6
Accrued Unfunded Annual Leave	6,959.3		6,959.3	6,618.2
Accrued Entitlement Benefits for Military Retirees and Survivors				
Capital Lease Liability	46.5	320.7	367.2	572.2
Other Liabilities	8,222.3	736.2	8,958.5	10,890.0
<b>Total Non-Federal Other Liabilities</b>	<b>\$ 26,261.4</b>	<b>\$ 3,533.9</b>	<b>\$ 29,795.3</b>	<b>\$ 28,621.3</b>
<b>Total Other Liabilities</b>	<b>\$ 32,450.1</b>	<b>\$ 5,558.8</b>	<b>\$ 38,008.9</b>	<b>\$ 34,714.0</b>

### Fluctuations and/or Abnormalities-Intragovernmental Liabilities

For the Intragovernmental Other Liabilities, total amount has increased \$2,120.9 million (35 percent) from FY 2001 to FY 2002. The areas that have contributed the most to the increase include:

- Deferred Credits

Deferred Credits decreased \$991.3 million. The U.S. Army Corps of Engineers reclassified deferred credits in FY 2002 to Intragovernmental – Other Liabilities.

- Resources Payable to Treasury

Resources Payable to Treasury increased \$405.8 million in FY 2002. A comprehensive review of aged Accounts Receivable in FY 2002 resulted in the identification of many accounts receivable for cancelled appropriations that had been dropped from the DoD Statements. These receivables, along with interest were added in FY 2002, along with the associated liability to the Treasury.

- Intragovernmental Other

Intragovernmental Other increased \$2,835.3 million (134 percent) in FY 2002. The areas that contributed the most to the increase include:

- Army GF increased \$125.6 million due to increased Employer Contributions of \$12.4 million, increased Federal Employment Compensation Act (FECA) liabilities of \$24.0 million and Unemployment Compensation, not previously reported, of \$89.2 million.
- Navy GF increased \$2,403.9 million primarily as they recorded liabilities to Treasury to offset non-entity contract receivables for the Navy's A-12 aircraft program's unliquidated progress payments and associated accrued interest payments.
- ODO GF decreased \$575.3 million in FY 2002 as a result of National Defense Stockpile Transaction Fund sale of material authorized by Public Laws.
- Army Corps of Engineers increased \$895.6 million, due chiefly to a reclassification of deferred credits to Other liabilities for long term water storage contracts in accordance with DoD regulations.
- The remaining \$15.1 million decrease is attributable to various programs.
- Items Comprising more than 10 percent of Intragovernmental Other Liabilities (\$3,760.4 million):
  - Navy General Funds: Principal and interest on the A-12 aircraft program payable to the U.S. Treasury totals \$2,352 million (63 percent).
  - U.S. Army Corps of Engineers: The liability for long-term water storage and hydraulic mining contracts totals \$895.6 million (24 percent).

- Delinquent FECA Payments

The DoD-wide delinquency for FECA at fiscal year-end 2002 is \$25.5 million. Delinquencies by entity are:

- Department of the Army \$24.0 million
- DoD Dependent Schools \$00.7 million
- DoD Section 6 Education \$00.6 million
- U.S. University Health Sciences \$00.2 million

### **Fluctuations and/or Abnormalities-Non-Federal Liabilities**

The Non-Federal Other Liabilities Account increased by \$1,174.0 million (4 percent) from FY 2001 to FY 2002 due primarily to the following:

- Accrued Funded Payroll and Benefits

Accrued Funded Payroll and Benefits increased \$1,000.1 million.

- The Army GF increased \$610.1 million due to reclassification of amounts previously reported in Non-Federal Accounts Payable in FY 2001 to Accrued Funded Payroll and Benefits in FY 2002.
- The Air Force GF increased \$172.4 million due to the accrual of military payroll.
- The Military Retirement Fund increased \$128.3 million.
- The remaining difference of \$89.3 million is attributable to miscellaneous increases/decreases in the remaining programs.

- Advances from Others

Advances from Others increased \$254.6 million.

- DLA WCF increased \$120.3 million due to an increase in advance payments being held in reserve for future orders from civilian agencies for Supply Management Material and DRMS Unearned Revenue.
- Army Corps of Engineers increased \$34.9 million chiefly due to an increase in contributed funds from state and local municipalities for work to be done on a cost-share basis.
- Army GF increased \$43.6 million with the majority of the increase in Military Construction and Family Housing.
- Air Force GF increased \$34.8 million due to the timing of receipts and execution of orders.
- The remaining difference of \$21.0 million is attributable to miscellaneous increases/decreases in the remaining programs.

- Non-environmental Disposal Liabilities

Total Non-environmental Disposal Liabilities increased by \$1,614.0 million.

- The Department's Excess/Obsolete Structures increased \$185.2 million and Conventional Munitions Disposal increased \$1,424.3 million.
- The FY 2002 increase for Excess/Obsolete Structures relates to Navy GF for the preliminary cost estimate to complete the disposal or demolition of excess and/or obsolete real property and structures at active installations.
- Army GF reported the liability for Conventional Munitions Disposal for the first time in FY 2002 in response to direction from the Senate Armed Services Committee. Army is unable at this time to distinguish between current and non-current liability.

- Accounts Payable—Cancelled Appropriations

Accounts Payable-Cancelled Appropriations increased \$119.0 million.

- Army GF increased \$25.1 million due to reclassification from Intragovernmental to Non-Federal.
- Air Force GF increased \$372.2 million.
- Navy GF increased \$68.8 million. Cancelled year appropriations for FY 2001 and FY 2002 were reported in FY 2002.
- ODO GF decreased \$347.2 million due to reclassification of cancelled receivables to Other Liabilities.

- Accrued Unfunded Annual Leave

Accrued Unfunded Annual Leave increased by \$341.1 million.

- Capital Lease Liability

The following reporting entities contributed to the \$205.0 million decrease in Capital Lease Liability:

- Air Force General Funds capital leases decreased \$182.8 million.
- Army General Funds capital leases decreased \$9.9 million.
- Navy General Funds capital leases decreased \$9.2 million.

- Non-Federal Other Liabilities

The following reporting entities contributed to the \$1,931.5 million decrease in Non-Federal Other Liabilities:

- Army GF decreased \$296.7 million in the fiscal year. Contingent Liabilities decreased \$752.5 million, Contract Holdbacks increased \$277.7 million and Employer Contributions increased \$178.1 million.
- Navy WCF decreased \$1,233.0 million due to their allocation of undistributed disbursements. The remainder of the Other Liabilities consists primarily of Progress Payments and Property Furnished by Others Liability.
- Air Force GF decreased \$439.6 million due to the change in the number of pending claims and settlements.
- The remaining \$39.0 million increase is attributable to various programs.

## **Other Information Related to Other Liabilities**

### **Relevant Information for Comprehension**

- Non-environmental Disposal Liability for Nuclear Assets

The DoD has agreed to recognize the non-environmental liability for National Defense (ND) Property, Plant and Equipment (PP&E) nuclear powered assets when the asset is initially placed in service. The non-environmental costs are included with the environmental disposal cost and reported in Note 14.

- Intragovernmental Reconciliation for Fiduciary Transactions with the Department of Labor (DoL) and the Office of Personnel Management (OPM)

With respect to the major fiduciary balances with the DoL and OPM, the Department was able to reconcile. During the reconciliations, no material differences were identified as non-current liability.



## Note 15.B. Capital Lease Liability

As of September 30, (Amounts in millions)	2002				2001
	Asset Category				Total
	Land and Buildings	Equipment	Other	Total	Total
Future Payments Due:					
Fiscal Year 2003	\$ 66.5	\$ 3.1	\$ 0	\$ 69.6	\$ 78.0
Fiscal Year 2004	66.4	1.5		67.9	70.8
Fiscal Year 2005	66.4	0.7		67.1	68.0
Fiscal Year 2006	66.1			66.1	66.5
Fiscal Year 2007	60.2			60.2	66.2
After 5 Years	220.5			220.5	281.5
<b>Total Future Lease Payments Due</b>	<b>\$ 546.1</b>	<b>\$ 5.3</b>	<b>\$ 0</b>	<b>\$ 551.4</b>	<b>\$ 631.0</b>
Less: Imputed Interest Executory Costs	184.2			184.2	222.6
<b>Net Capital Lease Liability</b>	<b>\$ 361.9</b>	<b>\$ 5.3</b>	<b>\$ 0</b>	<b>\$ 367.2</b>	<b>\$ 408.4</b>
<b>Capital Lease Liabilities Covered by Budgetary Resources:</b>				<b>\$ 336.5</b>	<b>\$ 377.4</b>
<b>Capital Lease Liabilities Not Covered by Budgetary Resources:</b>				<b>\$ 165.2</b>	<b>\$ 191.6</b>

### Other Information Related to Capital Lease Liability

#### Relevant Information for Comprehension

- Capital Lease Liabilities Not Covered by Budgetary Resources

For the Department of Defense, all leases prior to FY 1992 are funded on a FY basis causing the non-current amounts to be shown as Not Covered by Budgetary Resources. All capital leases and lease purchases entered into after FY 1992 are funded in the first year of the lease.

- **Note Reference**

- See Note Disclosure I.Q. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Leases.

## Note 16. Commitments and Contingencies

### Disclosures Related to Commitments and Contingencies

- Nature of Contingency

The Department is subject to various claims that represent contingent liabilities for the United States Government. While no opinion has been expressed regarding the likely outcome or possible loss associated with specific claims, experience indicates that many claims are settled for less than sought, dismissed altogether, or the possibility of loss is remote. Liabilities considered remote are not accrued in the Department's financial statements.

In addition, the Department has other contingent liabilities in which the possibility of loss is considered reasonable. These liabilities are not accrued in the Department's financial statements. As of September 30, 2002, the Department has approximately \$13,308.4 million in claims considered reasonably possible. The Components reporting contingent liabilities and estimates follows:

- Estimate of the Possible Liability by Major Component

<u>Contingent Liabilities</u> (Amounts in millions)	<u>Army</u>	<u>Navy</u>	<u>Air Force</u>	<u>ODO WCF</u>	<u>USACOE</u>	<u>Total</u>
Chemical Demilitarization Stockpile Disposal	\$ 85.6	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0	\$ 85.6
Chemical Demilitarization Non-Stockpile Disposal	8,900.0					8,900.0
Contractual Actions	4.7	117.5	14.1	4.4 (DISA)		140.7
Tax Related Issues	.9					.9
Damage to Personal Effects	3.0					3.0
Employee Related Actions		6.8				6.8
Environmental Claims	40.0					40.0
Judgement Fund Liabilities	48.0					48.0
Claims & Litigation from Civil Law	2.5	139.4	271.5			413.4
Environmental Restoration	1,070.0			2,600.0 (DLA)		3,670.0
<b>Total</b>	<b>\$ 10,154.8</b>	<b>\$ 263.7</b>	<b>\$ 285.6</b>	<b>\$ 2,604.4</b>	<b>\$</b>	<b>\$ 13,308.4</b>

- **Note Reference**

- See Note Disclosure 1.S. – Significant Accounting Policies for additional discussion on financial reporting requirements and DOD policies governing Contingencies and Other Liabilities.

- Subsequent to the date of the financial statements, a payment was made for a previously unsettled claim in the amount of \$53.2 million that is not reflected in the contingent liabilities above. The DoD General Counsel was previously unable to express an opinion concerning the likely outcome of this case.

**Note 17. Military Retirement Benefits and Other Employment Related Actuarial Liabilities**

	2002			2001
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability
<b>Pension and Health Benefits</b>				
Military Retirement Pensions	\$ 726,915.4	6.25%	\$ (169,269.2)	\$ 543,839.3
Military Retirement Health Benefits	592,046.0	6.25%	592,046.0	580,881.0
<b>Total Pension and Health Benefits</b>	<u>\$ 1,318,961.4</u>		<u>\$ (169,269.2)</u>	<u>\$ 1,124,720.3</u>
<b>Other</b>				
Federal Employees Compensation Act	\$ 7,183.2	5.20%	\$	\$ 7,183.2
Voluntary Separation Incentive Programs	1,545.7		(782.4)	763.3
DoD Education Benefits Fund	1,136.2	6.00%	(1,001.4)	134.8
<b>Total Other</b>	<u>\$ 9,865.1</u>		<u>\$ (1,783.8)</u>	<u>\$ 8,341.3</u>
<b>Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities</b>	<u>\$ 1,328,826.5</u>		<u>\$ (171,053.0)</u>	<u>\$ 1,157,773.5</u>
				<u>\$ 1,133,061.6</u>

As of September 30,  
(Amounts in millions)

## Other Information Related to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

### Relevant Information for Comprehension

- Military Retirement Pensions:
  - Actuarial Cost Method Used:

#### **Net Pension and Health Benefit Expenses for the Years Ended September 30,**

	(Amount in millions)	
	2002	2001
Beginning of Year Accrued Liability	\$ 705,248.9	\$ 687,583.5
Normal Cost Liability	12,935.3	11,370.9
Plan Amendment Liability	5,563.5	3,058.2
Assumption Change Liability	(2,334.4)	(48.7)
Benefit Outlays	(35,187.8)	(34,205.9)
Interest on Pension Liability	43,393.2	42,271.2
Actuarial Loss (Gain)	(2,703.4)	(4,780.4)
End-of-Year Accrued Liability	726,915.4	705,248.9
<b>Net Change in Actuarial Liabilities</b>	<b><u>\$ 21,666.5</u></b>	<b><u>\$ 17,665.4</u></b>

- Assumptions

Each year the Accrued Liability is expected to increase with the normal cost, decrease with benefit outlays, and increase with the interest cost. In the absence of (1) actuarial gains or losses or (2) plan benefit changes, and (3) assumption changes, an increase of \$21.141 billion in the Accrued Liability was expected during FY 2002.

The September 30, 2002 Accrued Liability includes changes due to (1) new demographic assumptions, (2) benefit changes, and (3) an experience gain. The new assumptions include (a) non-disability retiree death and other loss rates, (b) retired pay adjustment factors, (c) first-year partial pay and benefit factors, and (d) enhancements to the reserve valuation model.

Changes in retirement benefits for FY 2002 are (a) reform of basic pay rates mandated by the FY 2002 DoD Authorization Act, and (b) giving the Survivor Benefit Plan (SBP) benefit for survivors of members who die on active duty with less than 20 years of service. The combined effect of the benefit changes is an increase in the September 30, 2002, Accrued Liability of \$5.564 billion. The combined effect of the actuarial assumption changes is a decrease in the September 30, 2002, Accrued Liability of \$2.334 billion. The decrease in Accrued Liability due to the net experience gain of \$2.703

billion reflects primarily the new population on which the September 30, 2001, roll forward is based.

The Military Retirement System is a single-employer, defined benefit plan. Administrative costs of the Fund are not ascertainable. Projected revenues deposited in the fund consist of three sources authorized by PL 98-94:

1. Interest earning on Fund assets,
2. Monthly DoD contributions - The monthly contributions are determined as a percentage (approved by the DoD Retirement board of Actuaries) of basic pay, and
3. Annual contributions from the Department of Treasury.

Treasury's contribution is paid at the beginning of each fiscal year and represents the amortization of the unfunded liability for service performed prior to October 1, 1984; as well as the amortization of actuarial gains and losses that have arisen since then. The Actuary Board determines Treasury's contribution while the Secretary of Defense directs the Secretary of Treasury to make payments.

For FY 2002 and FY 2001 valuations, the same long-term assumptions were used. Along with the 6.25 percent assumed annual interest rate, the long-term annual increase in the Consumer Price Index is assumed to be 3.0 percent. The long-term annual salary increase is assumed to be 3.5 percent. For FY 2002 and FY 2001, the actual inflation rates of 2.6 percent and 1.4 percent, and the actual salary increases of 4.6 percent and 4.1 percent were used. Other assumptions used to calculate the actuarial liabilities, such as mortality and retirement rates, were based on actual experience.

Because of reporting deadlines, the current year actuarial present value of projected plan benefits is rolled forward, using accepted actuarial methods, from the prior year's valuation results as reported in the DoD Office of the Actuary's valuation of the Military Retirement System. For purposes of the Fund's financial reporting, this process is applied annually.

The portion of the military retirement benefits actuarial liability applicable to the Department is reported on the financial statements of the Military Retirement Fund.

Market Value of Investments in Market-Based and Marketable Securities: \$192,218.4 million

- Military Retirement Health Benefits

- Actuarial Cost Method Used: Aggregate Entry-Age Normal
- Assumptions

Health benefits are funded centrally at the DoD level. As such the portion of the health benefits actuarial liability that is applicable to the Department is reported only on the DoD Agency-wide financial statements.

<b><u>Change in Military Retirement Health Benefits Liability</u></b>	<b><u>Amount</u></b> <b><u>(in millions)</u></b>
1. Reported Military Retirement Health Benefits Actuarial Liability as of 9/30/01	\$ 580,881
2. Change in actuarial liability due to NDAA '02 benefit decisions	(36,477)
3. Actuarial (Gains)/Losses Due to Changes in Population and Population Projections	68,403
4. Actuarial (Gains)/Losses Due to Changes in Claims and Expenses	(60,255)
5. Actuarial (Gains)/Losses Due to Change in Medical Trend Assumption	2,080
6. Actuarial Liability as of 9/30/01 (line 1+line 2+line 3+line 4+line 5)	<u>\$ 554,632</u>
7. Normal Cost for FY 2002	13,128
8. Benefit Payments for FY 2002	(10,461)
9. Interest Cost for FY 2002	<u>34,747</u>
10. Projected Actuarial Liability as of 9/30/02 (line 6+line 7-line 8+line 9)	<u>\$ 592,046</u>
11. Actuarial (Gains)/Losses Due to Change in Funding Method	
12. Actuarial (Gains)/Losses Due to Plan Amendments	
13. Net Change in Actuarial Liability (line 2+line 3+line 4+line 5+line 7+line 8+line 9+line 11+line 12)	11,165
14. Military Retirement Health Benefits Actuarial Liability as of 9/30/02 (line 1+line 13)	\$ 592,046

- Assumptions in Calculation of Military Retirement Health Benefits Actuarial Liability:

Interest Rate: 6.25%

Medical Trend:

<u>Type</u>	<u>FY 02 to 03</u>	<u>Ultimate Rate</u>
Medicare Inpatient	3.6%	6.25% in 2026
Medicare Outpatient	2.1%	6.25% in 2026
Medicare Prescriptions (Direct Care)	6.25%	6.25% in 2026
Medicare Prescriptions (Purchased Care)	16.73%	6.25% in 2026
Non-Medicare Inpatient	4.5%	6.25% in 2026
Non-Medicare Outpatient	9.7%	6.25% in 2026
Non-Medicare Prescriptions	13.9%	6.25% in 2026

- FECA

- Assumptions

The Department's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the Department at the end of each fiscal year. 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. The projected annual benefit payments are then discounted to the present value using the OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. Interest rate assumptions utilized for discounting were as follows:

2002  
5.20 percent in Year 1  
5.20 percent 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 (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. These factors were also 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:

<u>CBY</u>	<u>COLA</u>	<u>CPIM</u>
2003	1.80%	4.31%
2004	2.67%	4.01%
2005	2.40%	4.01%
2006+	2.40%	4.01%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection.



- Voluntary Separation Incentive Programs

- Assumptions:

The Voluntary Separation Incentive (VSI) Fund (recorded on the books of the U.S. Treasury) is used to accumulate funds to finance, on an actuarially sound basis, the liabilities of the DoD incurred under this program. The VSI benefit is an annual annuity paid to members who have separated under this program, and is paid for a period of time equal to twice the member's years of service. These benefits are paid by the VSI fund, which receives contributions from the services from their military personnel accounts. Contributions amounts are determined by the DoD, Office of the Actuary in conjunction with the USD(C), based on a comparison of liabilities to assets.

- Market Value of Investments in Market-Based and Marketable Securities: \$853.9 million

- DoD Education Benefits Fund

- Assumptions

The DoD Education Benefits Fund is designed to accumulate funds for the educational programs described under Title 10 United States Code, section 2006. This program promotes the recruitment and retention of members for the All-Volunteer Forces program and the Total Force Concept of the Armed Forces and aids in the readjustment of members of the Armed Forces to civilian life after separation from military service.

- Market Value of Investments in Market-Based and Marketable Securities: \$1,060.3 million

## Note 18 Unexpended Appropriations

As of September 30, (Amounts in millions)	2002	2001
<b>Unexpended Appropriations:</b>		
Unobligated, Available	\$ 30,115.5	\$ 32,532.5
Unobligated, Unavailable	4,551.8	4,793.7
Unexpended Obligations	142,615.3	125,864.4
<b>Total Unexpended Appropriations</b>	<b>\$ 177,282.6</b>	<b>\$ 163,190.6</b>

### Definitions

- Unexpended appropriations are the amount of budget authority remaining for disbursement against current or future obligations.
- Unobligated balances are classified as available or unavailable. Unobligated balances associated with appropriations expiring at fiscal year end remain available only for obligation adjustments until the account is closed.
- Unexpended obligations represent goods and services that have not yet been received/performed.

### Fluctuations/Abnormalities:

- Unexpended Obligations

The 13.2 percent increase in Unexpended Obligations is due primarily to increased funding for fighting terrorism throughout the world, the Defense Emergency Response Fund (DERF).

### Other Information Related to Unexpended Appropriations

#### Relevant Information for Comprehension:

- Unexpended Obligations

Unexpended Obligations reported as a component of Unexpended Appropriations include both Undelivered Orders-Unpaid and Undelivered Orders-Paid only by Direct Appropriated funds. This amount is distinct from Change in Amount of Goods, Services, and Benefits Ordered but Not Yet Provided of the Statement of Financing, which includes the change during the fiscal year in Unexpended Obligations against budget authority from all the Military Services.

## Note 19.A General Disclosures Related to the Statement of Net Cost

### Disclosures Related to the Statement of Net Cost

#### Relevant Information For Comprehension

The Consolidated Statement of Net Cost in the federal government is unique because its principles are driven on 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.

#### Reporting Entities

- General Fund

The amounts presented in the Statement of Net Cost (SoNC) are based on obligations and disbursements and therefore may not in all cases report actual accrued costs. The Department of Defense (DoD) generally records transactions on a cash basis and not an accrual basis as is required by generally accepted accounting principles. Therefore, the DoD accounting systems do not capture actual costs. The information presented in the SoNC is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems. Afterward, this information is adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

- Working Capital Fund

The Department of Defense Working Capital Funds (WCFs) generally record transactions on an accrual basis as required by generally accepted accounting principles however, the systems do not always capture actual costs. Information presented on the Statement of Net Cost (SoNC) is primarily based on budgetary obligation, disbursements, or collection transactions, as well as information from nonfinancial feeder systems.

**Note 19.B.**

**Gross Cost and Earned Revenue by Budget Functional Classification**

As of September 30, (Amounts in millions)	2002			2001
	Gross Cost	(Less: Earned Revenue)	Net Cost	Net Cost
<b>Budget Functional Classification</b>				
Department of Defense Military (051)	\$ 348,344.1	\$ (16,286.5)	\$ 332,057.6	\$ 691,927.1
Water Resources by U.S. Army Corps of Engineers (301)	4,227.2	(729.5)	3,497.7	3,983.5
Pollution Control and Abatement by US. Army Corps of Engineers (304)	149.6	(0.6)	149.0	152.3
Federal Employees Retirement and Disability, Department of Defense Military Retirement Fund (602)	56,855.8	(12,397.7)	44,458.1	38,689.2
Veterans Education, Training, and Rehabilitation by the Department of Defense Education Benefits Trust Fund (702)	303.2	(49.2)	254.0	263.1
<b>Total</b>	<b>\$ 409,879.9</b>	<b>\$ (29,463.5)</b>	<b>\$ 380,416.4</b>	<b>\$ 735,015.2</b>

**Other Information Related to Gross Cost and Earned Revenue by Functional Classification**

**Relevant Information for Comprehension**

- Military Retirement Health Benefits Liability (MRHB)

The large net cost decrease is due to the large net increase in the MRHB Actuarial Liability during FY 2001. The MRHB Actuarial Liability as of September 30, 2001, included the effect of Public Law No. 106-398 (the National Defense Authorization Act), which was signed into law on October 30, 2000. Under this legislation, TRICARE benefits were extended to military retirees and their beneficiaries eligible for Medicare, and a fund was established to pay these benefits. The Act also included a number of other enhanced medical benefits in addition to the specific Medicare-eligible benefits. (See notes 17 and 22 for additional details.)

- Other Decreases

- Working Capital Funds

- Air Force

A policy change for inventory valuation of excess, obsolete and unserviceable inventory resulted in a \$1.6 billion decrease in cost of goods sold expense. The Fuels Division of Supply Management was transferred to the Defense Energy Supply Center (DESC) which accounted for a decrease in net operating costs of \$2 billion. Depot Maintenance customer surcharge accounted for a \$1.1 billion decrease in net operating costs.

- Other Defense Organizations

Net costs decreased as a result of increased revenue generated from increased activity for Operation Enduring Freedom and the capitalization of worldwide fuel points.

**Note 19.C. Gross Cost to Generate Intragovernmental Revenue and Earned Revenue (Transactions with Other Federal—Non-DoD—Entities) by Budget Functional Classification**

The Department's accounting systems do not capture cost data in a manner that enables the Department to determine if the cost was incurred to generate Intragovernmental revenue. The Department is in the process of upgrading its financial and feeder systems and will be addressing this issue. Additionally, the identification of Intragovernmental revenue and expenses is a government-wide problem. The OMB and the Department of the Treasury have efforts underway to develop government-wide guidance to enable accurate reporting of Intragovernmental transactions.

## Note 19.D. Imputed Expenses

As of September 30, (Amounts in millions)	2002	2001
Civilian (e.g., CSRS/FERS) Retirement	\$ 1,340.1	\$ 1,312.6
Civilian Health	1,864.7	1,928.6
Civilian Life Insurance	20.6	6.3
Judgment Fund		
Military Retirement Pension		
Military Retirement Health	294.6	174.0
<b>Total Imputed Expenses</b>	<b>\$ 3,520.0</b>	<b>\$ 3,421.5</b>

## Note 19.E. Benefit Program Expenses

As of September 30, (Amounts in millions)	2002	2001
Service Cost	\$ 13,128.0	\$ 16,102.9
Period Interest on the Benefit Liability	34,747.0	53,879.2
Prior (or past) Service Cost	(36,477.0)	296,060.2
Period Actuarial Gains or (Losses)	8,148.0	(9,780.0)
Gains/Losses Due to Changes in Medical Inflation Rate Assumption	2,080.0	91,265.0
<b>Total Benefit Program Expense</b>	<b>\$ 21,626.0</b>	<b>\$ 447,527.3</b>

### Other Information Related to Benefit Program Expenses

#### Relevant Information For Comprehension

The Department of Defense is the administrating entity for the Military Retirement Fund and the Military Post Retirement Health Benefits Program. Employee benefits of military personnel include pensions and other post-employment and retirement benefits. The administrating entity is responsible for recognizing the benefit program expense. This expense is comprised of five elements identified above. (See Note 19B for fluctuation disclosure). The Office of Personnel Management is the administrating entity for programs related to civilian personnel and is responsible for reporting the associated benefit expense.

## **Note 19.F. Exchange Revenue**

Exchange Revenue arises when a Government entity provides goods and services to the public or to another Government entity for a price, - “earned revenue.” Exchange revenue includes most user charges other than taxes, i.e., regulatory user charges.

## **Note 19.G. Amounts for Foreign Military Sales (FMS) Program Procurements from Contractors**

The cost of items purchased by foreign governments under the Foreign Military Sales Program and provided directly to the foreign governments by contractors are not reported in the Statement of Net Cost. For FY 2002, we estimated these amounts to be \$9.0 billion, which is 80 percent of the disbursement during the fiscal year.

## **Note 19.H. Stewardship Assets**

Stewardship assets include Heritage Assets, Stewardship Land, Non-Federal Physical Property, and Investments in Research and Development. The current year cost of acquiring, constructing, improving, reconstructing, or renovating stewardship assets are included in the Statement of Net Cost. Material yearly investment amounts related to stewardship assets are provided in the Required Supplemental Stewardship Information section of this financial statement.

## **Note 19.I. Intragovernmental Revenue and Expense**

### **Other Information Related to Intragovernmental Revenue and Expenses**

- Revenue

The Department of Defense (DoD) accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the DoD was unable to reconcile Intragovernmental revenue balances with its trading partners. The Department intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of Intragovernmental transactions is so large that after-the-fact reconciliation can not be accomplished with the existing or foreseeable resources.

- Operating Expenses

The Department of Defense (DoD) operating expenses were adjusted based on a comparison between the Department’s accounts payable and the DoD summary level seller accounts receivable. An adjustment was posted to accounts payable and operating expenses to reflect unrecognized accounts payable and operating expenses. The operating expenses of the Department were adjusted upwards in the amount of 6.0 billion.

## Note 19.J. Suborganization Program Costs

### Other Information Related to Suborganization Program Costs

#### Relevant Information For Comprehension

- Programs and Major Appropriation Groups

The Department of Defense (DoD) identifies programs based on the nine major appropriation groups provided by Congress. The Department is in the process of reviewing available data and attempting to develop a cost reporting methodology that fulfills the need for cost information required by SFFAS No. 4 to keep the financial statements from becoming overly voluminous.

Until cost allocating processes and expanded intra-DoD eliminating capabilities are incorporated into the accounting processes, the usefulness of further suborganization-reported (major command) net costs is limited. This is the reason that no additional statements of suborganization cost at lower levels are presented with these statements.

The DoD is unable to accumulate costs for major programs based on performance measures identified under requirements of the Government Performance and Results Acts (GPRA) because current financial processes and systems do not capture and report this type of cost information. Until the processes and systems are upgraded, the DoD as a whole will break out programs by major appropriation groupings.

The Statement of Net Cost format requires reporting program costs by costs incurred with Intragovernmental and public entities. Although overall program costs are believed to be fairly stated, the cost allocations between Intragovernmental and public entities that were based on available vendor type data may not be totally accurate.



**Note 20.**

**Disclosures Related to the Statement of Changes in Net Position**

As of September 30, (Amount in millions)	Cumulative Results of Operations 2002	Unexpended Appropriations 2002	Cumulative Results of Operations 2001	Unexpended Appropriations 2001
<b>Prior Period Adjustments</b>				
<b>Increases (Decreases) to Net Position Beginning Balance</b>				
Changes in Accounting Standards	\$	\$	\$ 55,632.1	\$ 0
Errors and Omissions in Prior Year Accounting Reports	(63,388.8)	1,553.3	10,106.5	
Other Prior Period Adjustments	1,628.8		(4,804.3)	
<b>Total Prior Period Adjustments</b>	<b>\$ (61,760.0)</b>	<b>\$ 1,553.3</b>	<b>\$ 60,934.3</b>	<b>\$ 0</b>
<b>Imputed Financing</b>				
Civilian CSRS/FERS Retirement	1,340.1		1,312.6	
Civilian Health	1,864.7		1,928.6	
Civilian Life Insurance	20.6		6.3	
Judgment Fund				
Military Retirement Pension				
Military Retirement Health	294.6		174.0	
<b>Total Imputed Financing</b>	<b>\$ 3,520.0</b>		<b>\$ 3,421.5</b>	

**Fluctuations and/or Abnormalities**

- Errors and Omissions in Prior Year Accounting Reports

Prior period adjustments were reported for errors and omissions in prior-year accounting reports for both cumulative results of operations and for unexpended appropriations in the amounts of (\$63,388.8) million and \$1,553.3 million, respectively.

- Cumulative Results of Operations

Net position was affected by adjustments to Cumulative Results of Operations for the following prior period adjustments due to errors and/or omissions in prior years:

Reduced Operating Materials and Supplies (OM&S) accounts to remove items formerly classified as National Defense Plant, Property and Equipment. These items were added to the balance sheet in fiscal year 2001. This change is made at the direction of the Department of Defense Inspector General. Amounts by entity follow:

<u>Entity</u>		<u>Amounts in millions</u>
Army GF	\$	(7,114.2)
Air Force GF		(31,869.7)
Navy GF		(24,765.8)
<b>Total</b>	<b>\$</b>	<b><u>(63,749.7)</u></b>

Revaluation of Excess, Obsolete and Unserviceable (EOU) Inventory. EOU had previously been estimated based upon a percentage of inventory value. EOU is now identified based upon condition codes of specific inventory items. This change served to increase inventory values by entity as follows:

<u>Entity</u>		<u>Amounts in millions</u>
Navy WCF	\$	1,952.4
ODO WCF (DLA)		1,400.8
<b>Total</b>	<b>\$</b>	<b><u>3,353.2</u></b>

Correction of fiscal year 2001 errors made in the preparation of the Navy General Funds financial statements. Amounts that should have been applied to expenses in 2001 were erroneously applied to Unexpended Appropriations. These amounts were reclassified in fiscal year 2002 to Cumulative Results of Operations for a total of (\$3,036.7) million.

Miscellaneous other prior period adjustments affecting Cumulative Results of Operations totaled \$44.5 million

- Unexpended Appropriations

Net position was affected by adjustments to Unexpended Appropriations for the following prior-period adjustments due to errors and/or omissions in prior years:

- Correction of fiscal year 2001 errors made in the preparation of the Navy General Funds financial statements. Amounts that should have been applied to expenses in fiscal year 2001 were erroneously applied to Unexpended Appropriations. These amounts were reclassified in fiscal year 2002 to Cumulative Results of Operations for a total of \$3,036.7 million.
- Correction of a fiscal year 2001 error made in the preparation of the Navy General Funds financial statements. A-12 Program Accounts Receivable were established, however the offsetting entry was applied incorrectly to Unexpended Appropriations. The offset should have been to other liabilities. The correction totaled (\$1,483.4) million.

- Other Prior Period Adjustments

Other prior period adjustments were recorded in fiscal year 2002 affecting Cumulative Results of operations in the amount of \$1,628.8 million for the revaluation of Excess, Obsolete and Unserviceable (EOU) Inventory recorded by the Air Force Working Capital Funds. EOU had previously been estimated based upon a percentage of inventory value. EOU is now identified based upon condition codes of specific inventory items.

- Other General Fund Disclosures

- Imputed Financing:

Civilian life insurance increased by \$14.2 million or 225 percent between FY 2001 and FY 2002. The increase was attributable to a \$13.9 million entry for the component level of the Other Defense Organizations General Funds and the remaining \$0.3 million is attributable to other DoD Components that individually reported less than 10 percent of the total.

The amounts remitted to OPM by and for employees covered by CSRS, FERS, FEHB, and FEGLI do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employee contributions made by and for them by DFAS. The imputed financing cost factors are provided by the OPM to DFAS. The civilian employees' gross base pay and the number of employees electing health benefits are extracted directly from the Defense Civilian Pay System (DCPS) by reporting entity. The DFAS computes the imputed expenses for civilian employees' retirement and other benefits and provides such expenses to OUSD(P&R) for validation. Once OUSD (P&R) approves the imputed costs, DFAS provides amounts to the reporting components.

The Judgement Fund increased by \$120.6 million or 69.3 percent between FY 2001 and FY 2002. The increase was largely attributable to increases in the Air Force General Fund of \$46.5 million, the Navy General Fund of \$45.7 million and the Army General Fund of \$26.3 million. The imputed financing increase for the Air Force General Fund was due to the nature, size, dollar amount and number of previously pending claims settled that resulted in payments by the Department of the Treasury. The increase for the Navy General Fund was also due to the volume and outcome of settled claims as reported by the Department of the Treasury. The increase in imputed financing for the Army General Fund was due to an increase in payments to settle tort claims.

## Note 21.A. Disclosures Related to the Statement of Budgetary Resources

As of September 30, (Amount in millions)	2002	2001
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 183,957.7	\$ 155,604.5
Available Borrowing and Contract Authority at the End of the Period	\$ 20,165.4	\$ 18,288.5

### Fluctuations and/or Abnormalities

- Statement of Budgetary Resources

Fiscal year 2002, the Statement of Budgetary Resources presentation changed to closely follow the Report on Budget Execution (SF 133). Resources increased between Fiscal Year 2002 and fiscal year 2001 primarily as a result of additional funding from the Defense Emergency Response Fund (DERF) for fighting terrorism throughout the World.

- Accounting Standard U.S. Standard General Ledger

The Department of Defense has not fully implemented the U.S. Government Standard General Ledger (USSGL) in all operational accounting systems. Guidance from the Treasury Financial Manual, Part 2, Chap 4000, Federal Agencies' Centralized Trial Balance System II is used in the population of the Department's Statement of Budgetary Resources. However, some of the Department's entities still use proprietary accounts to produce their budgetary accounting data. The Department's accounting systems do not provide or capture data needed for obligations incurred and recoveries of prior year obligations in accordance with OMB Circular A-11, "Preparation, Submission, and Execution of the Budget" requirements. Although the Department of Defense developed an alternative methodology to calculate these items, the amount of distortion cannot be reliably determined, and may or may not be material.

- Statement Presentation

In fiscal year 2002, to facilitate the reconciliation of information between the Statement of Budgetary Resources, the following two enhancements were made to the Statement of Budgetary Resources, the budget execution reports (SF 133) and the Budget of the United States Government:

- Separate Column for Non-budgetary Credit Program Financing Accounts

This change allows for a clear distinction between budgetary and non-budgetary credit program financing account information. Non-budgetary credit financing accounts are reported separately from the budgetary totals in the Budget of the United States Government. Separate reporting on the Statement of Budgetary Resources enhances the reconciliation of the two sets of information.

- Offsetting Receipts Line

Offsetting Receipts are introduced as a new line item in the Statement of Budgetary Resources. These receipts are collections that are credited to the general, special or trust funds receipt accounts. In addition they represent offsetting receipts distributed to the Department of Defense. Offsetting receipts offset budget authority and outlays at the agency level in the Budget of the United States Government. Offsetting receipts must be included in the Statement of Budgetary Resources to reconcile it to information in the Budget of the United States Government.

## **Other Information Related to the Statement of Budgetary Resources**

### **Relevant Information For Comprehension**

- Intra-entity Transactions

The Statement of Budgetary Resources does not include intra-entity transactions because the statements are presented as combined and combining. As a result, a Disaggregated Statement of Budgetary Resources is presented in the Required Supplementary Information section of the financial statements.

- Apportionment Categories

OMB Bulletin No. 01-09 section 9.27 specifically requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B and exempt from apportionment. This disclosure should agree with the aggregate of the related information as reported on the agency's Budgetary Execution Report (SF 133) and lines 8A and 8B in the Statement of Budgetary Resources.

- Spending Authority from Offsetting Collections

Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available are not included in the "Spending Authority From Offsetting Collections" line on the Statement of Budgetary Resources or the "Spending Authority for Offsetting Collections and Recoveries" line on the Statement of Financing.

- **Undelivered Orders**

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

**Note 21.B. Disclosures Related to Problem Disbursements, In-transit Disbursements Suspense/Budget Clearing Accounts**

**1. Disclosures Related to Problem Disbursements, In-transit Disbursements**

As of September 30, (Amounts in millions)	Sept 2000	Sept 2001	Sept 2002	(Decrease)/ Increase from FY01 to FY02
<b>Total Problem Disbursements, <u>Absolute Value</u></b>				
Unmatched Disbursements (UMDs)	\$ 1,593.0	\$ 1,041.0	\$ 858.0	\$ (183.0)
Negative Unliquidated Obligations (NULOs)	\$ 1,179.0	\$ 205.0	\$ 122.0	\$ (83.0)
Total In-transit Disbursements, Net	\$ 6,171.0	\$ 6,240.0	\$ 4,550.0	\$ (1,690.0)

**Other Information Related to Problem Disbursements and In-transit Disbursements:**

For FY 2002 the DoD reports \$858 million in Unmatched Disbursements (UMDs) and \$122 million in Negative Unliquidated Obligations (NULOs). A UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. A NULO occurs when a payment is made against a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These problem disbursements represent the absolute value of disbursements of DoD funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. These payments have been made using available funds and based on valid receiving reports for goods and services delivered under valid contracts.

For FY 2002 the DoD reports \$4,550 million for In-Transits. The In-Transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity that has not been posted to the accounting system.

**Suspense/Budget Clearing Accounts, Net**

<u>Account</u>	<u>Sep 2000</u>	<u>Sep 2001</u>	<u>Sep 2002</u>	<u>(Decrease)/ Increase</u>
F3875	\$ 145.0	\$ 92.5	\$ 525.0	\$ 432.5
F3880	6.3	.3	2.5	2.2
F3882	0.0	0.0	23.2	23.2
F3885	136.6	350.5	258.7	(91.8)
F3886	(10.5)	5.2	6.3	1.1
<b>Total</b>	<b>\$ 277.4</b>	<b>\$ 448.5</b>	<b>\$ 815.7</b>	<b>\$ 367.2</b>

**Fluctuations and/or Abnormalities**

- Contributors to the Department of Defense Suspense/Budget Clearing Accounts, Net

<u>Reporting Entity (\$ in millions)</u>	<u>Army Sep 2002</u>	<u>Army (Decrease) /Increase</u>	<u>Air Force Sep 2002</u>	<u>Air Force (Decrease) /Increase</u>	<u>Navy Sep 2002</u>	<u>Navy (Decrease) /Increase</u>
F3875	\$ 0	\$ 0	\$ 398	\$ 367	\$ 113	\$ 69
F3880	0	(2)	0	0	2	4
F3882	(1)	(1)	0	0	24	24
F3885	0	0	(194)	284	446	(355)
F3886	6	1	0	0	1	1
<b>Total*</b>	<b>\$ 5</b>	<b>\$ (2)</b>	<b>\$ 204</b>	<b>\$ 651</b>	<b>\$ 586</b>	<b>\$ (257)</b>

\*rounding

<u>Reporting Entity (\$ in millions)</u>	<u>USACE Sep 2002</u>	<u>USACE (Decrease) /Increase</u>	<u>ODO Sep 2002</u>	<u>ODO (Decrease) /Increase</u>	<u>Total Sep 2002</u>	<u>Total (Decrease) /Increase</u>
F3875	\$ 14	\$ (3)	\$ 0	\$ (1)	\$ 525	\$ 433
F3880					2	2
F3882					23	23
F3885			6	(20)	258	(91)
F3886					6	1
<b>Total*</b>	<b>\$ 14</b>	<b>\$ (3)</b>	<b>\$ 6</b>	<b>\$ (21)</b>	<b>\$ 815</b>	<b>\$ 368</b>

\*rounding

Account F3882 (Uniformed Services Thrift Savings Plan), established in fiscal year 2002, will not have any trend information for Fiscal Year 2001 and prior. The two main contributors to the balance were the Department of the Navy \$24 million and the Department



of the Army (\$1) million. The Department is making every effort to establish policy and guidance to ensure a proper audit trail exists and that variances do not exist between collections and disbursements.

On September 30 of each fiscal year, most of the uncleared suspense/budget clearing account balances are reduced to zero (as required by the Department of the Treasury) by transferring the balances to proper appropriation accounts. On October 1 of the following year, the uncleared suspense/clearing account balances are reestablished.

### **Other Information Related to Suspense/Budget Clearing Accounts**

The Department of Defense has made a concerted effort to reduce balances in the suspense and budget/clearing accounts related to disbursements. Additionally, the Department of Defense established policies and procedures to ensure accurate and consistent use of these accounts.

- **Deposit Fund**

The Department of Defense has made a concerted effort to reduce balances in the deposit fund accounts (X6500, X6501, and X6276). Deposit fund accounts hold non-government monies for individual statutory authorizations or programs.

- **Note Reference**

- See Note 2 - Intragovernmental Assets - Fund Balance with Treasury for further explanation on deposits, suspense and budgetary clearing accounts.

## Note 22. Disclosures Related to the Statement of Financing

### Disclosures Related to the Statement of Financing

The statement of financing was expanded to further articulate and detail the relationship between net obligations from budgetary accounting and net cost of operation from proprietary accounting. Some items that were reported last year as a single line were subdivided to reflect its components. Several new line items were added to separately identify and further explain the use of resources to finance net obligations or net cost of operations. This change notes key differences between the net obligations and net cost of operations.

“Net Cost of Operations” in the 2001 column of the Statement of Financing shows \$730,112.2 million, compared to \$735,015.2 million in the Statement of Net Cost, and the amount reflected on the FY 2001 financial statements. Improper posting of the change in unfunded liability during preparation of the FY 2001 financial statements created a \$4,003 million difference. Incorrectly posting the change in FY 2001 of the actuarial liability contributed \$592 million to the difference. The remaining \$308 million difference is caused by miscellaneous other account mapping changes.

Budgetary data is not in agreement with Proprietary Expenses and Assets Capitalized. Differences between budgetary and proprietary data for Agency-wide are a previously identified deficiency. To bring the Statement of Financing into balance with the Statement of Net Cost, the following adjustments were made:

- Resources that Finance the Acquisition of Assets \$(5,276) million
- Revaluation of assets or liabilities \$(1,877) million
- Total components of Net Cost of Operations that will Require or Generate Resources in Future Periods \$ 3,073 million

The large decrease in Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period, Other (+/-) is due to the large net increase in the Military Retirement Health Benefits liability (MRHB) Actuarial Liability during fiscal year 2001. The MRHB Actuarial Liability as of September 30, 2001 included the effect of Public Law No. 106-398 (the National Defense Authorization Act), which was signed into law on October 30, 2000. Under this legislation, TRICARE benefits were extended to military retirees and their beneficiaries eligible for Medicare, and a fund was established to pay these benefits. The Act also included a number of other enhanced medical benefits in addition to the specific Medicare eligible benefits. The effect of this law and other actuarial gains and losses resulted in an increase to the MRHB Actuarial Liability of \$388.5 billion. In FY 2002 the effects of the NDAA FY 2002 Benefit Definitions reduced the actuarial liability by \$36.5 billion. This decrease when combined with the actuarial gains and losses and related costs resulted in a much smaller net increase to the MRHB Actuarial Liability (See Note 17 for further details).

Intra-entity transactions have not been eliminated because the statements are presented as combined and combining.

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## **Note 23. Disclosures Related to the Statement of Custodial Activity**

A Statement of Custodial Activity is prepared by reporting entities whose primary mission is collecting taxes or other revenues, particularly sovereign revenues that are intended to finance the entire governments operations, or at least the programs of other entities, rather than their own activities.

### **Other Information Related to the Statement of Custodial Activity**

#### **Relevant Information for Comprehension**

“Under authority of the Arms Export and Control Act, the Foreign Military Sales Trust Fund (FMSTF) receives collections from foreign governments that are dedicated specifically to FMS purchases. Funds collected into the Trust Fund are in advance of the performance of services or sale of articles. These advance collections constitute a fiduciary relationship with the countries and are outside of the Federal budget. Current-year collections into the FMSTF for this fiscal year, 2002, equal \$10,732.3 million and disposition (disbursements) of collections equals (\$10,570.0). The Defense Security Cooperation Agency (DSCA) is the only organization within DoD that reports Funds using the Statement of Custodial Activity. This information is reflected in the financial statements. In accordance with the DoD Acting Chief Financial Officers memorandum of August 31, 1992, the FMSTF does not recognize nor report revenue, with the exception of cost clearing accounts which are reflected in all other components of the Audited Financial Statements except the Statement of Custodial Activity. Since various DoD components actually perform the services and sell the articles, recognition of revenue and expense to a non-government entity occurs in the financial statements of the applicable DoD components.”

## Note 24.A. Other Disclosures Leases

### ENTITY AS LESSEE - Operating Leases

As of September 30, (Amounts in millions)	2002				2001
	Asset Category				Total
	Equipment and Facilities	Military Family Housing	Motor Vehicles	Total	
Future Payments Due:					
Fiscal Year 2003	\$ 57.5	\$ 9.8	\$ 4.3	\$ 71.6	\$ 63.4
Fiscal Year 2004	58.4	8.4	1.4	68.2	62.8
Fiscal Year 2005	59.9	7.5	0.3	67.7	63.9
Fiscal Year 2006	60.3	7.3	0.1	67.7	60.0
Fiscal Year 2007	56.0	6.8		62.8	54.9
After 5 Years	52.7	24.9		77.6	74.8
<b>Total Future Lease Payments Due</b>	<b>\$ 344.8</b>	<b>\$ 64.7</b>	<b>\$ 6.1</b>	<b>\$ 415.6</b>	<b>\$ 379.8</b>

### Other Information Related to Entity as Lessee – Operating Leases

#### Relevant Information for Comprehension

- Category 1 - Leases for Equipment and Facilities.

“Office Space” is the largest component. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections used the Consumer Price Index (CPI) of 3.5 percent, rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites.

- Category 2 - Leases for Military Family Housing

The majority of these leases are for Section 801 Family Housing with a variety of lease terms. Leases are not expected to be renewed upon expiration.

- Category 3 - Leases for Motor Vehicles

Operating leases for Motor Vehicles are essentially one-year leases. The Department expects to continue to reduce the level of owned assets while increasing the number of operational

leases. The Department will strive to displace commercial leases in favor of GSA leases because GSA leases are typically more economical.

- Other Information

Definitions

- Lessee – A person or entity who receives the use and possession of leased property (e.g. real estate or equipment) from a lessor in exchange for a payment of funds.
- Operating Lease - A lease which does not transfer substantially all the benefits and risk of ownership. Payments should be charged to expense over the lease term as it becomes payable.

## Note 24.B. Other Disclosures

### Other Disclosures

The Military Retirement Trust Fund reports net pension expense for the actuarially accrued liability, as provided in the table below:

- Net Pension Expense

	<u>Year Ending Sept 30, 2002</u>	<u>Year Ending Sept. 30, 2001</u>
A. Beginning of Year Accrued Liability	\$ 705,249	\$ 687,584
B. Normal Cost Liability	12,935	11,371
C. Plan Amendment Liability	5,564	3,058
D. Assumption Change Liability	(2,334)	(49)
E. Benefit Outlays	(35,188)	(34,206)
F. Interest on Pension Liability	43,393	42,271
G. Actuarial Loss (Gain)	(2,704)	(4,780)
<b>H. End of Year Accrued Liability (A+B+C+D+E+F+G)</b>	<b>\$ 726,915</b>	<b>\$ 705,249</b>
<b>I. Net Change in Actuarial Liabilities (B+C+D+E+F+G)</b>	<b>\$ 21,666</b>	<b>\$ 17,665</b>

- Other Information

Each year the Accrued Liability is expected to increase with the normal cost, decrease with benefit outlays, and increase with the interest cost. In the absence of (1) actuarial gains and losses, (2) plan benefit changes, and (3) assumption changes, an increase of \$21.141 billion in the Accrued Liability was expected during FY 2002.

The September 30, 2002, Accrued Liability includes changes due to (1) new demographic assumptions, (2) benefit changes, and (3) an experience gain. The new assumptions include (a) non-disability retiree death and other loss rates, (b) retired pay adjustment factors, (c) first-year partial pay and benefit factors, and (d) enhancements to the reserve valuation model.

Changes in retirement benefits for FY 2002 are (a) reform of basic pay rates mandated by the FY 2002 DoD Authorization Act, and (b) giving the SBP benefit for survivors of members who die on active duty with less than 20 years of service. The combined effect of the benefit changes is an increase in the September 30, 2002, Accrued Liability to \$5.564 billion, shown in Line C. The combined effect of the actuarial assumption changes is a decrease in the September 30, 2002, Accrued Liability of \$2.334 billion, shown in Line D. The decrease in Accrued Liability due to the net experience gain of \$2.704 billion, shown in Line G, reflects primarily the new population on which the September 30, 2001, roll forward is based.