Department of Defense Agency Financial Report

2010

AFR

November 15, 2010

FOREWORD

The Department of Defense *Agency Financial Report* (AFR) for Fiscal Year 2010 provides an overview of the Department's financial information and performance goals and objectives. It also describes our priorities in response to challenges encountered in defense of our nation.

For FY 2010, the Department has chosen to produce the *Annual Financial Report* as an alternative to the *Performance and Accountability Report (PAR).* The alternative report is intended to simplify and summarize information to increase transparency while utilizing the Internet for providing additional details. The Department's FY 2010reporting consist of three components:

- Agency Financial Report – Published November 15, 2010
- Annual Performance Report – Published by February 7, 2011
- Summary of Performance and Financial Information – Published by February 15, 2011

All three reports will be available at the Comptroller's website: http://www.defenselink.mil/comptroller/reports.html

Agency Financial Report (AFR)

The AFR consists of the *Management's Discussion and Analysis* that provides executive-level information on the Department's history, mission, organization, key performance activities, analysis of the financial statements, controls and legal compliance and other challenges facing the Department.

Additional information is available in Addendum A, Other Accompanying Information of the AFR.

Annual Performance Report (APR)

The APR will be included in the Congressional Budget Justification and will provide the detailed performance information and description of results by performance measures.

Summary of Performance and Financial Information

This document will summarize the Department's financial and performance information from the AFR and APR, making the information more transparent and accessible to Congress, the public, and other key constituents.

We welcome your feedback regarding the content of this report. To comment or to request copies of the report, please e-mail us at DoDAFR@osd.mil, or write to:

U.S. Department of Defense
Office of the Under Secretary of Defense (OUSD) (Comptroller)
1100 Defense Pentagon
Washington, DC 20301-1100

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MESSAGE FROM THE DEPUTY SECRETARY OF DEFENSE

I am pleased to present this Agency Financial Report, which identifies how the Department of Defense (DoD) used public funds during the fiscal year (FY) that ended September 30, 2010. The Department is fully committed to proper accounting, reporting, and accountability for all its resources.

In FY 2010 – while military operations continued in Afghanistan, Iraq, and elsewhere in the world – DoD launched an equally important battle: to improve efficiency, effectiveness, and cost-consciousness within its own organization. Initial efforts focused on ending or restructuring troubled or excess weapons programs. In FY 2010, about 20 programs were affected, with additional changes included in the FY 2011 budget request.

The savings were substantial. The Nation's difficult economic and financial situation means, however, that additional changes will be needed so the Department can maintain the modest, real budget growth necessary to sustain current force structure and make additional investments in modernization.

In a series of statements and pronouncements during the course of FY 2010, Secretary of Defense Robert Gates challenged the Defense Department to find additional cost-savings, primarily within its own business operations. Specifically, the Secretary outlined a four-track approach for cutting support costs, with all savings to be reinvested in higher priority warfighting needs:

- Make changes, primarily in business processes, significant enough to save $100 billion over the next five years.
- Solicit and implement cost-saving ideas from DoD employees and outside sources.
- Focus on far-reaching changes in broad areas, including acquisition, logistics, and military health care.
- Pursue the specific organizational and other changes outlined by the Secretary in a presentation on August 9, 2010.

This broad, multi-pronged effort will bear fruit for years to come, and will help ensure that the Department manages taxpayer resources carefully and effectively. In addition, it provides tangible evidence that the Department is committed to making every defense dollar count.

William J. Lynn III
Deputy Secretary of Defense

November 15, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

FISCAL YEAR 2010 OVERVIEW

The FY 2010 defense budget was crafted to reshape the priorities of America's defense establishment, applying the lessons learned in Afghanistan and Iraq while also confronting the range of other potential threats around the world. The DoD's strategy and budget in FY 2010 strike an improved balance in three dimensions: between prevailing in current conflicts and preparing for a complex future; between institutionalizing proven wartime adaptations and preserving this nation's existing conventional and strategic advantages; and between accelerating acquisition and management reform while retaining proven best practices.

Secretary of Defense Robert Gates.

The Department remains committed to the goal of disrupting, dismantling, and defeating al-Qaeda in Afghanistan and Pakistan. At the direction of the President, beginning in December 2009, an additional 30,000 United States (U.S.) troops deployed to Afghanistan to meet Operation Enduring Freedom (OEF) mission requirements and implement the type of strategy that produced significant progress in Iraq. The U.S. forces, deployed in conjunction with international forces, operate under a strategic framework based in large part on U.S. counterinsurgency doctrine, which focuses on population security while also conducting counterterrorism operations.

The Department depends on America's men and women in uniform to execute its mission operations, and continues its commitment to attract and take care of its all-volunteer force – DoD's most important resource. The approximately 2.3 million Active and Reserve Soldiers, Sailors, Marines, and Airmen received pay increases and additional basic allowance for military housing. In addition, approximately 9.3 million eligible Service members, family members, and retirees received world-class healthcare.

The Department has placed continued emphasis in FY 2010 on improving cyber defense capabilities to protect its vital information networks. The Department established the new U.S. Cyber Command to address vulnerabilities and meet the ever-growing array of cyber threats to military information systems.

The Department invested in increased intelligence, surveillance, and reconnaissance support for the warfighter, such as unmanned aerial vehicles that have been in such high demand in both Afghanistan and Iraq.

The Department fielded more of our most capable theater missile defense systems to better protect our forces and those of our allies in theater from ballistic missile attack. After receiving the President's approval in September 2009, the Department started to implement a phased, adaptive approach for missile defense in Europe to respond to the growing Iranian missile threat.

An RQ-4 Global Hawk soars through the skies in route to record intelligence, surveillance and reconnaissance data. Because of its large coverage area the Global Hawk has become a useful tool for recording data and sending it to warfighters on the ground.

(Courtesy Photo, Beale Air Force Base).

The Department continues to implement needed reforms that improve the effectiveness of how it acquires new defense systems to maintain the U.S. military's technological and conventional edge. Over the past fiscal year, the Department worked to implement the Weapon Systems Acquisition Reform Act, intended to improve defense acquisition outcomes. The Department also hired acquisition professionals to revitalize the defense acquisition workforce and create a framework for restoring affordability and efficiency to defense procurement.

In addition to acquisition improvements, the Department curtailed or cancelled nearly 20 troubled or excess programs as part of the FY 2010 budget that would have cost more than $300 billion to complete. The Department launched efficiency initiatives designed to significantly reduce excess overhead costs and apply savings to force structure and modernization efforts. These measures can ensure that the annual rate of growth in warfighting needs is at the level necessary to give the Military Services what they require.

"DoD cannot expect America's elected representatives to approve budget increases each year unless we are doing everything possible to make every dollar count."

Robert M. Gates
Secretary of Defense

The Department is making significant progress in financial management, including moving toward audit readiness and installing new financial systems. Additionally, the business environment within the operational theater strengthened to improve effectiveness and ensure better control over resources. The Department is also actively pursuing the Administration's goal of further reducing improper payments, demonstrated by reducing improper contract payments by more than 75 percent in FY 2010.

In summary, during FY 2010, the Department sustained a military and provided necessary capabilities to fight two wars; confronted global terrorist threats; and provided needed humanitarian assistance and disaster response. Throughout, the Department remained focused on taking care of its people and their families.

Mission

One of the core responsibilities of the U.S. government is to protect the life and liberty of the American people or, as phrased in the Constitution, to "provide for the common defense." The mission of the Department of Defense is to provide the military forces needed to deter war and to protect the security of our country. Today's DoD plays a critical role in defending and advancing the safety and security of American citizens and interests. Whether in a period of peace or war, the U.S. Armed Forces have prepared for the unexpected, deterred aggression, responded to attack, rebuilt nations emerging from the ravages of conflict, and helped create and maintain a stable and resilient international system.

DoD Mission Statement

Provide military forces needed to deter war and protect the security of our country.

The United States faces a complex and uncertain security landscape in which the pace of change continues to accelerate. The distribution of global political, economic, and military power is becoming more diffuse. The rise of China, the world's most populous country, and India, the world's largest democracy, will continue to shape an international system—one in which the United States must increasingly work with key allies and partners to sustain stability and peace.

America's interests link to the integrity and resilience of the international system. Chief among these interests are security, prosperity, broad respect for universal values, and an international order that promotes cooperative action. Consistent with the President's vision, the United States will advance these interests by strengthening our domestic foundation and integrating all elements of national power; engaging abroad, based on mutual interest and mutual respect; and promoting an international order that advances our interests by reinforcing the rights and responsibilities of all nations.

U.S. Agency for International Development Administrator Rajiv Shah, Defense Secretary Robert M. Gates, Secretary of State Hillary Rodham Clinton, moderator Frank Sesno, take part in the U.S. Global Leadership Coalition discussion in Washington, D.C., Sept. 28, 2010.

DOD photo by Cherie Cullen

America's interests and role in the world require armed forces with unmatched capabilities and a willingness on the part of the nation to employ them in defense of our interests and the common good. The United States remains the only nation able to project and sustain large-scale operations over extended distances. This unique position generates an obligation to be responsible stewards of the power and influence that history, determination, and circumstance have provided.

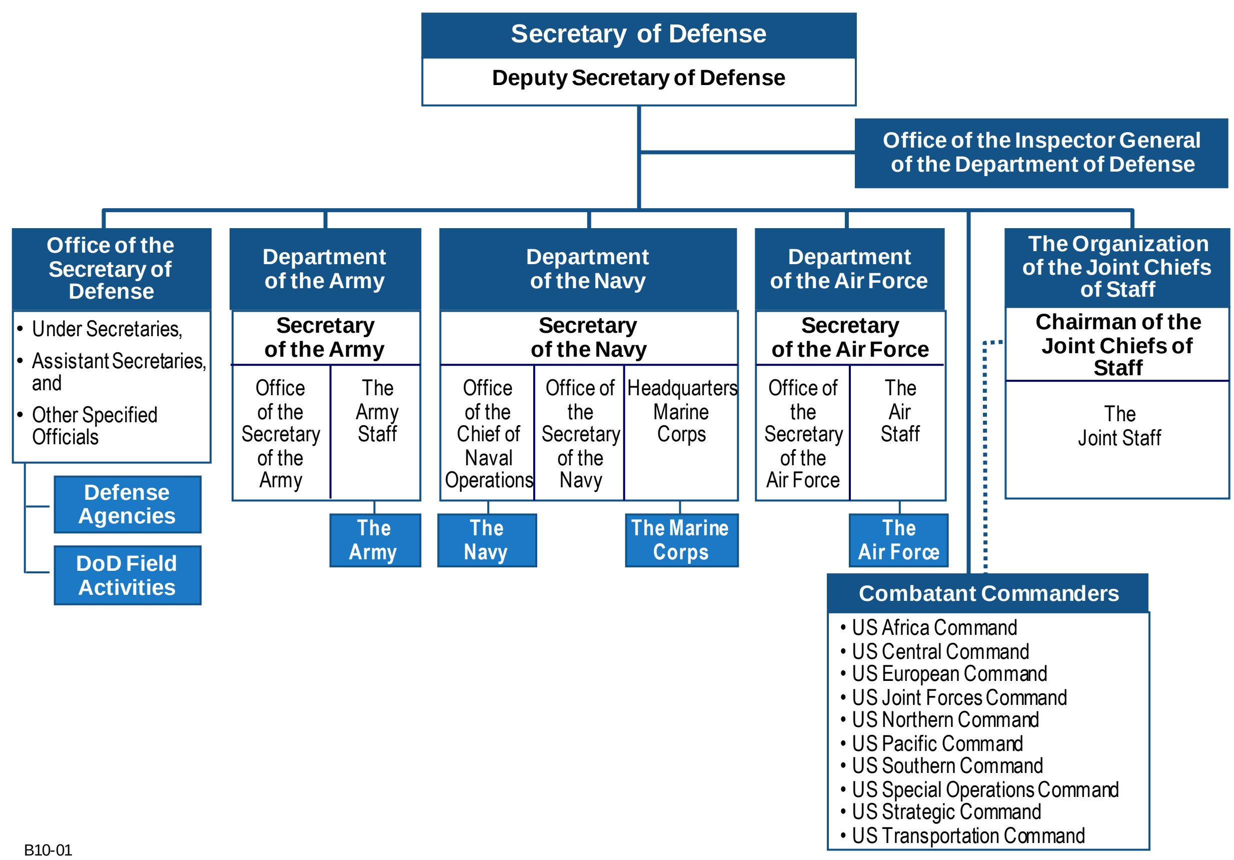
Organization

Since the creation of the Continental Army in 1775, the U.S. military has evolved to become a global presence. The Department embraces the core values of all successful organizations: leadership, professionalism, and technical knowledge. Its employees are dedicated to duty, integrity, ethics, honor, courage, and loyalty.

The Department is the successor agency to the National Military Establishment created by the National Security Act of 1947 (50 U.S.C. 401). The National Security Act Amendments of 1949 established DoD as an executive department with the Secretary of Defense as its head.

Under the President, who also is Commander in Chief, the Secretary of Defense exercises authority, direction, and control over the Department. The Department is composed of the Office of the Secretary of Defense; the separately organized military departments of the Army, Navy, and Air Force; the Joint Chiefs of Staff providing military advice; the unified Combatant Commands; the Defense Agencies; the DoD Field Activities; and such other offices, agencies, activities, and commands as may be established for specific purposes. Figure 1-1 shows how the Department is structured.

Figure 1-1. Department of Defense Organizational Structure



Office of the Secretary of Defense

The Office of the Secretary of Defense includes: the offices of the Deputy Secretary of Defense; Under Secretary of Defense for Acquisition, Technology & Logistics; Under Secretary of Defense for Policy; Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD; Under Secretary of Defense for Personnel and Readiness; Under Secretary of Defense for Intelligence; Deputy Chief Management Officer; General Counsel of the Department of Defense; Inspector General of the Department of Defense; Assistants to the Secretary of Defense; Director of Operational Test and Evaluation; and such other staff offices established by the Secretary of Defense to assist in carrying out his duties and responsibilities. The heads of these offices are staff advisers to the Secretary and perform functions he assigns to them.

Military Departments

Each of the Departments of the Army, Navy, and Air Force, organized under its own Secretary, functions under the authority, direction, and control of the Secretary of Defense. The Secretary of each military department is responsible to the Secretary of Defense for the operation and efficiency of his department. The military departments receive orders through the respective Secretaries or their designees, as established by the Secretary of Defense or provided by law.

The Joint Chiefs of Staff

The Joint Chiefs of Staff consist of the Chairman, the Vice Chairman, the Chief of Staff, U.S. Army; the Chief of Naval Operations; the Chief of Staff, U.S. Air Force; and the Commandant of the Marine Corps. Subject to the authority of the Chairman, they constitute the immediate military staff of the Secretary of Defense. The Chairman is the principal military adviser to the President, the National Security Council, and the Secretary of Defense. Other members of the Joint Chiefs of Staff are the senior military officers of their respective services and are military advisers to the President, the National Security Council, and the Secretary of Defense.

The Combatant Commands

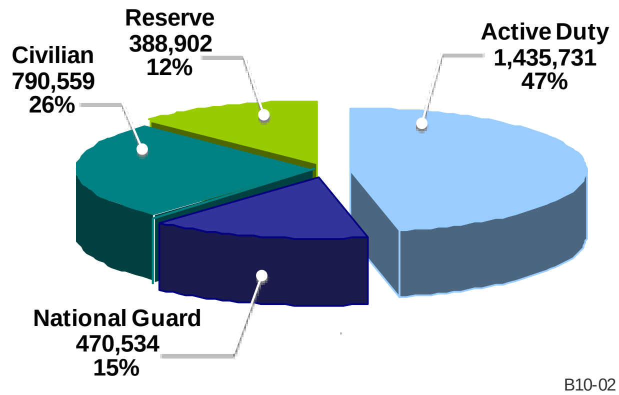
The commanders of unified Combatant Commands are responsible to the President and the Secretary of Defense for accomplishing the military missions assigned to them and for exercising command authority over forces assigned to them. The operational chain of command runs from the President to the Secretary of Defense to the commanders of the Combatant Commands.

Resources

The Department requires resources (personnel, facilities and infrastructure, and budget authority) to carry out key missions and execute management reforms. The strategic placement of our personnel, installations, and facilities are key for protecting our homeland and national resources. These resources have never been more important than they are today as the U.S. fights terrorists who plan and carry out attacks on our facilities and our people.

Our workforce consists of more than three million employees, both afloat and ashore, deployed throughout the world to meet mission requirements. Nearly half of the Department's workforce is comprised of men and women on Active Duty. To provide Americans with the highest level of national security, the Department consists of more 1,435,731 men and women on Active Duty, 859,436 Reserve and National Guard, and 790,559 civilians (Figure 1-2).

Figure 1-2. Staffing for FY 2010 (As of August 31, 2010)



During FY 2010, the Department mobilized approximately 120,000 Reserve Component members at any given time. The men and women of the Reserve and National Guard provided security and assistance in both the Afghanistan and Iraq theaters and maintained aircraft in the Horn of Africa, to name a few of their many missions. The skills and capabilities of the Reserve Component members match current and anticipated DoD requirements, thereby reducing the stress on the total force while increasing the capacity.

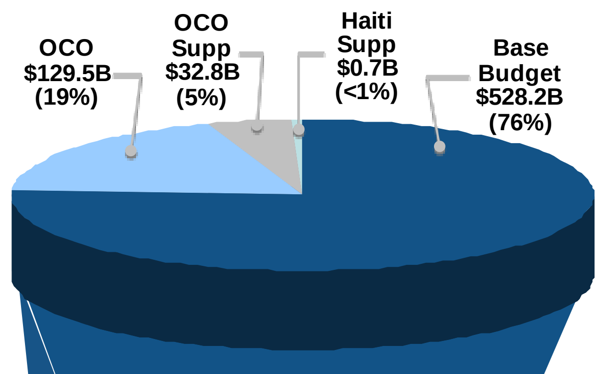
In FY 2010, every Service and all Components (Active and Reserve) again met or exceeded not only the aggressive numerical goals that had been set for new recruits, but also rigid quality goals for these recruits, including education and aptitude. The nation can be proud of these achievements, as well as the commitment of Service members and their families, as reflected in record high retention-rates.

Throughout FY 2010, the civilian workforce continued to play a critical role in supporting the accomplishment of DoD's mission. In FY 2010, we witnessed their continued voluntary and enthusiastic participation in new and challenging roles, especially in support of DoD's wartime efforts. The newly established Civilian Expeditionary Workforce Program has deployed volunteers to war zones to serve in career fields as far-reaching as intelligence, public affairs, policy development, and logistics. The remarkable people who comprise civilian and military teams are the Department's greatest asset in providing a strong and agile national security response.

The Department's worldwide infrastructure includes nearly 539,000 facilities (buildings and structures) located at more than 5,000 sites around the world, on more than 28 million acres. These sites vary greatly in size. They range from the very small (an unoccupied site supporting a single navigational aid that sits on less than one-half acre of land) to the vast and immense, such as the Army's White Sands Missile Range in New Mexico (with over 3.6 million acres) or the Navy's large complex of installations in Norfolk, Virginia. To protect the security of the U.S., the Department operates approximately 15,800 aircraft and 500 ships.

To support mission requirements, the Department continues to focus on investing financial resources effectively to meet the needs of the warfighter and the ever-changing battlefield. We continue to invest in weapon systems and capabilities to counter 21st Century threats, support the workforce, and accomplish mission requirements and objectives. During FY 2010, DoD's enacted budget authority amounted to $691.2 billion. Figure 1-3 depicts the composition of DoD's budget authority.

Figure 1-3. Department of Defense FY 2010 Enacted Budget ($691.2B)



Budget by Appropriation	$ in Billions
Military Personnel	151.8
Operation and Maintenance	298.0
Procurement	126.5
RDT&E	85.5
Military Construction	22.4
Family Housing	2.3
Revolving Funds	4.7
Total	**$691.2**

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The Overseas Contingency Operations (OCO) resources enable the Department to support and to fund efforts in Afghanistan, Iraq, Pakistan, and other areas around the globe. In Iraq, the Department executed the responsible drawdown of forces as it concluded Operation Iraqi Freedom and transitioned to Operation New Dawn. In Afghanistan, U.S. forces increased in FY 2010 to execute the President's plan. The U.S. troops continue to work with Afghan Security Forces and international partners to build a country that will not be a safe haven for terrorists.

The Department's funding levels ensured the nation could meet all national security objectives. Funding enabled the Department to maintain readiness to conduct missions abroad and a full spectrum of training, combat training center rotations, and recruiting and retention efforts. Modernization and recapitalization of equipment, focused on today's threats, greatly improved combat capabilities. These new capabilities included procurement and development of platforms, such as the fifth generation Joint Strike Fighter aircraft; the Littoral Combat Ship; unmanned aerial vehicles, such as Global Hawk and Predator; new generation ground vehicles, such as the Stryker; communications, navigation, missile warning, space situational awareness, and environmental monitoring satellites; and missile defense systems.

In FY 2010, resources funded the construction and maintenance of additional modernized housing, both government-owned and privatized. These constructed housing units support the Army and Marine Corps' growth in ground forces. In addition, DoD built wounded warrior facilities and schools and recapitalized other medical facilities. The Department funded the operation of 254 commissary stores and education for over 85,122 students in 191 schools.

In addition, the Department provided critical logistics, transportation, and communication capabilities to meet urgent disaster relief requirements in response to the devastating magnitude 7.0 earthquake that struck Haiti. The DoD also responded to Pakistan's call for humanitarian assistance as part of a multinational effort following the tragic and devastating flooding that started on July 29, 2010.

Men from the town of Kalam, Pakistan, form a chain to quickly unload a U.S. Army Chinook helicopter that is delivering humanitarian assistance and picking up victims of the flood in the Khyber Pakhtunkhwa province, Aug. 10, 2010.

DOD photo

The Base Realignment and Closure (BRAC) initiative continued with $7.5 billion in funding to keep the Department on track to meet its 2011 completion date. Military construction is well underway and personnel movements have begun.

To ensure the security of the U.S., the Department remains dedicated to obtaining the required resources and making the best use of them. Taking care of our people, reshaping and modernizing the force, and supporting our troops in the field also remains a high priority for the Department, which is committed to spending funds carefully and effectively.

Haitian children watch as U.S. Marines and Sailors with Operation Continuing Promise 2010 (CP10) repair a hospital roof in Port-de-Paix, Haiti, July 29, 2010. CP10 was a collaborative between military and civilian personnel that provided humanitarian assistance and disaster relief to the residents of Caribbean and Central and South American countries.

(U.S. Marine Corps photo by Sgt. Samuel R. Beyers/Released) DOD photo

Program Performance Overview

Department of Defense Strategic Plan

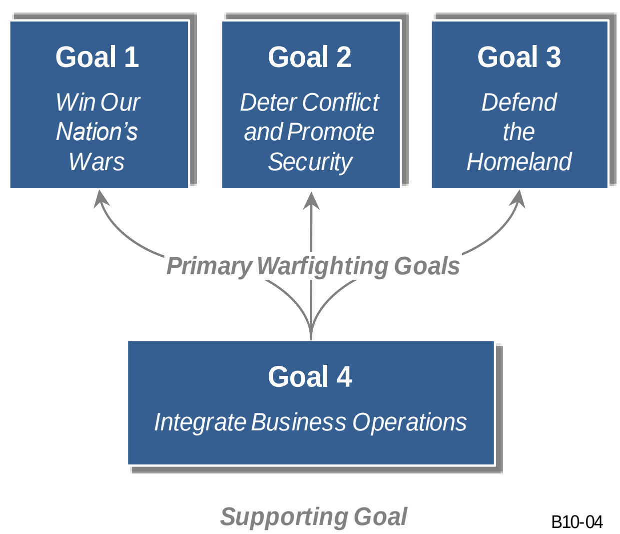
The Department examines America's defense needs by conducting the Quadrennial Defense Review (QDR). This review examines national defense strategy, force structure, force modernization plans, infrastructure, budget plans, and other elements of the defense program and policies of the United States, consistent with the most recent National Security Strategy and National Military Strategy. The QDR report constitutes DoD's strategic plan.

Defense Secretary Robert M. Gates conducts a press conference at the Pentagon, August 9, 2010. Gates said he is taking steps to reduce overhead and flatten the DoD organization. With these moves, the secretary said, he wants to instill a culture of saving in the department.
DoD photo by Cherie Cullen

In FY 2010, the Department completed and issued the latest QDR; however, DoD formulated the goals for FY 2010 before completion of this latest QDR. Thus the goals do not reflect that document's conclusions. Instead, the Department based the FY 2010 goals, depicted in Figure 1-4, on the 2008 National Defense Strategy objectives, plus an additional objective focused on business operations.

- Strategic Goal 1, "Win Our Nation's Wars," focuses on the ongoing conflict and extended stabilization campaigns in Afghanistan and Iraq.
- Strategic Goal 2, "Deter Conflict and Promote Security," focuses on integrated security cooperation and reorienting the Armed Forces to deter and defend against transnational terrorists around the world.
- Strategic Goal 3, "Defend the Homeland," focuses on DoD's contributions to our homeland defense mission. Success, under this goal, requires that all elements of national power work together to protect our national interests.
- Strategic Goal 4, "Integrate Business Operations," focuses on improving and integrating DoD business operations to better support the warfighter.

Figure 1-4. FY 2010 Strategic Goals



Department of Defense Performance Hierarchy

Primary responsibility for performance improvement rests with the Deputy Secretary of Defense in his role as the Chief Management Officer (CMO). The Deputy Secretary is assisted by the Deputy CMO/DoD Performance Improvement Officer, who advises and integrates performance information across the Department. The Principal Staff Assistants within the Office of the Secretary of Defense, in coordination with the Joint Chiefs of Staff, recommend the strategic objectives and performance targets, determined to be the most relevant for enterprise (DoD-wide) strategic focus. The strategic objectives and performance targets (measures and milestones) are subject to annual refinement based on changes in missions and priorities.

Figure 1-5 highlights that every level within the Department is accountable for performance and delivering results.

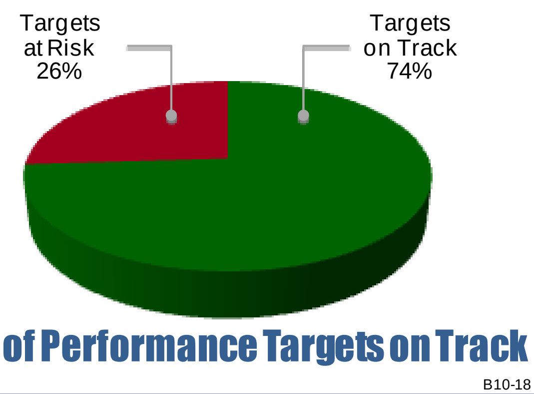
Figure 1-5. FY 2010 Strategic Goals

FY 2010 Department of Defense Key Performance Outcomes

The Department's initial FY 2010 Performance Plan included 53 performance targets at the enterprise (DoD-wide) level. Subsequently, the Deputy Secretary of Defense, in his role as CMO, approved a number of changes based on new Administration direction calling for, among other things, development of a limited number of Priority Performance Goals. As a result, the Department increased the number of enterprise-level performance targets, from 53 to 66 targets, in FY 2010.

The following tables, organized by DoD Strategic Goal and Objective, depict 19 key performance outcomes for FY 2010. Unless otherwise stated, the tables report progress through third quarter, FY 2010. Based on third quarter data, the Department is on track to meet 74 percent (Figure 1-6) of these key outcomes.

Figure 1-6. FY 2010 DoD Key Performance Outcome Analysis



Strategic Goal 1: Win Our Nation's Wars

Two key performance outcomes reflect the Department's success in meeting its military operational objectives in Afghanistan and Iraq. As reflected in the following chart, all Combatant Commanders reported they were ready to execute 100 percent of their Current Operations. In addition, the Joint Contracting Command (JCC) was successful in addressing critical personnel shortfalls in theater. As of third quarter, the JCC achieved its longer term goal for maintaining a 90 percent assignment rate of Contracting Officer Representatives (CORs) supporting Afghan contingency operations.

STRATEGIC GOAL 1: WIN OUR NATION'S WARS				
Performance Measures	**Strategic Plan Long-Term Performance Targets**	**Annual Performance Targets/Results**		
		FY 2009 Results	**FY 2010 Targets**	**FY 2010 3 Qtr Results**
Strategic Objective 1. OCO: Successfully conduct Overseas Contingency Operations (OCO) and support contingency business operations.				
1.OCO: Percent of the Combatant Commanders' (COCOMs) Current -Operations which they report ready to execute	1. OCO: For each fiscal year, DoD COCOMs will be ready to execute 100 percent of Current Operations.	100%	100%	100%
*1.OCO: Percent assigned of required Contracting Officer Representatives (CORs) supporting Afghan contingency operations	1. OCO: Beginning in FY 2012, the DoD will maintain an assignment rate of 90 percent of required Contracting Officer Representatives (CORs) supporting Afghan contingency operations.	Not Available	85%	90%
*Reflects DoD priority goal.				

Strategic Goal 2: Deter Conflict and Promote Security

Five performance outcomes are key to satisfying the Department's deterrence missions and achieving its national security objectives. The first two targets focus on Combatant Command readiness. As of third quarter, all Combatant Command reported they were ready to execute 100 percent of their Core or Theater Campaign Plan missions; however, they are falling short in meeting the goal of being ready to execute all of their Contingency Plans due to heavy resource commitment to our current efforts in Afghanistan. A third measure focuses on DoD Special Operations Forces' capability to address irregular/unconventional warfare. As of third quarter, the Department surpassed its annual target for increasing the number of DoD Special Operations personnel and is on track to meet its technology security actions target for providing international partners with access to equipment, technology, and training. The fifth and final outcome focuses on Defense Enterprise Human Intelligence (HUMINT). As of the third quarter, the Department exceeded its annual performance target by achieving a 99 percent customer satisfaction rate with Defense HUMINT support.

STRATEGIC GOAL 2: DETER CONFLICT AND PROMOTE SECURITY				
Performance Measures	Strategic Plan Long-Term Performance Targets	Annual Performance Targets/Results		
		FY 2009 Results	FY 2010 Targets	FY 2010 3 Qtr Results
Strategic Objective 2.1F1:	**Institutionalize irregular warfare and strengthen alliances and partnerships in order to deter conflicts and promote international security.**			
2.1F1: Percent of Combatant Commanders (COCOMs) that are ready to execute their Core or Theater Campaign Plan missions	2.1F1: For each fiscal year, DoD COCOMs will be ready to execute 100 percent of Core or Theater Campaign Plan missions.	100%	100%	100%
2.1F1: Percent of COCOMs' Contingency Plans which they report ready to execute	2.1F1: For each fiscal year, DoD COCOMs will be ready to execute 100 percent of their Contingency Plans.	89%	80%	78.6%
2.1F1: Cumulative percent increase in DoD Special Forces and Navy SEAL personnel achieved	2.1F1: By FY 2012, DoD will increase its Special Forces and Navy SEAL personnel by 32 percent from the FY 2006 actual end strength of 13,206.	23%	26%	27%
2.1F1: Annual number of Technology Security Actions (TSAs) approved	2.1F1: Beginning in FY 2007, DoD will increase the number of relevant technologies involving transfers to international partners by two percent per year.	143,600	146,472	96,149
Strategic Objective 2.1X2:	**Improve intelligence, surveillance, and reconnaissance (ISR) to enhance Battle Space awareness.**			
2.1X2: Rate of customer satisfaction with Defense enterprise HUMINT support	2.1X2: By FY 2011, DoD will achieve and maintain a customer satisfaction rate with Defense Enterprise HUMINT support of 90 percent or greater.	99%	88%	99%

Strategic Goal 3: Defend the Homeland

The Department assesses its contributions to our homeland defense mission by measuring two key performance outcomes, both of which focus on the capabilities necessary to mitigate attacks on the U.S. and its territories. As of third quarter, the Department is slightly ahead of schedule in destroying treaty-declared category 1 chemical weapons. In addition, DoD is on track to have 13 additional zonal diagnostic labs built and equipped for biological agent detection and response by the end of the FY 2010.

STRATEGIC GOAL 3: DEFEND THE HOMELAND				
Performance Measures	Performance Measures	Strategic Plan Long-term Performance Targets		
		FY 2009 Results	FY 2010 Targets	FY 2010 3 Qtr Results
Strategic Objective 3.1F2:	**Improve capabilities to prevent and mitigate attacks on U.S. personnel, facilities, and key assets.**			
3.1F2: Cumulative percent of treaty-declared category 1 chemical weapons destroyed	3.1F2: By FY 2021, DoD will have destroyed 100 percent of treaty-declared category 1 chemical weapons.	65.5%	74.2%	■75%
3.1F2: Cumulative number of zonal diagnostic labs built and equipped for biological agent detection and response	3.1F2: By FY 2013, DoD will have built and equipped 43 zonal diagnostic labs for biological agent detection and response.	19	32	■20

Strategic Goal 4: Integrate Business Operations

The Department assesses its infrastructure operations by measuring ten key performance targets. The first two targets address the acquisition function. While the Department exceeded its target in hiring additional acquisition personnel, the number of significant cost overruns on Major Defense Acquisition Programs (MDAPs) has more than tripled over the prior year (FY 2009) level. In addition, the Icelandic volcano delayed air shipments to the European theater, preventing the Department from achieving its FY 2010 customer wait time target for providing joint warfighting support to our operating forces.

The Department is on track to achieve four key performance outcomes that affect its ability to maintain an “All Volunteer” military force. One outcome reflects implementation of a healthcare-related process change used to determine military medical fitness for duty. As of third quarter, DoD surpassed its annual target concerning the percent of military members participating in a single disability evaluation. In addition, the Department continues to maintain its prescribed Active and Reserve Component end strength, and reducing the number of soldiers under stop loss.

The Department made less progress in two priority performance areas associated with security assistance and DoD audit readiness. As of the third quarter, FY 2010, the Department was under-executing its security assistance training target, but was projected to meet the training target by fiscal year end. Additionally, the Department was at risk of not meeting its audit readiness target for DoD appropriations received, primarily due to contractual process delays. However, the Department expects to have the independent audit firm validation contract in place and have 80 percent of this goal validated by the end of FY 2011.

The tenth and final key outcome focuses on another DoD priority performance goal area—i.e., personnel security clearance reform. By third quarter, FY 2010, the Department had cut in half the number of days it took in the prior year (FY 2009) to adjudicate personnel security clearance cases.

STRATEGIC GOAL 4: INTEGRATE BUSINESS OPERATIONS				
Performance Measures	Performance Measures	Strategic Plan Long-term Performance Targets		
		FY 2009 Results	FY 2010 Targets	FY 2010 3 Qtr Results
Strategic Objective 4.2E:	**Improve acquisition performance by integrating lifecycle management principles into DoD and Service acquisition, maintenance, and sustainment processes.**			
*4.2E: Number of Major Defense Acquisition Program (MDAP) breaches equal to or greater than 15 percent of current Acquisition Program Baseline (APB) unit cost or equal to or greater than 30 percent of original APB unit cost	4.2E: Beginning in FY 2010, DoD will ensure the number of breaches (significant cost overruns) for MDAPs is equal to or less than the previous fiscal year.	2	2	■7
*4.2E: Cumulative increase in the number of DoD civilian and military end strength performing acquisition functions	4.2E: By FY 2015, DoD will increase the total number of DoD civilian and military personnel performing acquisition functions by 19,887 end strength.	1,985	6,065	■6,248
Strategic Objective 4.2L:	**Integrate joint supply chains from source of supply to operational customers.**			
4.2L: Average customer wait time	4.2L: Beginning in FY 2007, DoD will reduce average customer wait time to 15 days.	16.2	15	■16.7
Strategic Objective 4.2M:	**Ensure the trust of the Total Force, their families, and the nation through superior care and support.**			
4.2M: Percent of military members participating in a single, disability evaluation/transition medical exam to determine fitness for duty and disability rating	4.2M: By FY 2011, 100 percent of military members will participate in a single, disability evaluation/ transition medical exam to determine fitness for duty and disability rating.	27%	40%	■47%
Strategic Objective 4.2P:	**Maintain and shape a mission ready All Volunteer force and enhance the civilian workforce.**			
4.2P: Percent variance in Active Component end strength	4.2P: For each fiscal year, DoD must maintain Active component end strength at or not to exceed three percent above the SECDEF/NDAA-prescribed end strength for that fiscal year.	0.9%	0-3%	■0.9%

STRATEGIC GOAL 4: INTEGRATE BUSINESS OPERATIONS				
Performance Measures	**Performance Measures**	**Strategic Plan Long-term Performance Targets**		
		FY 2009 Results	**FY 2010 Targets**	**FY 2010 3 Qtr Results**
4.2P: Percent variance in Reserve Component end strength	4.2P: For each fiscal year, DoD Reserve component end strength will not vary by more than three percent from the SECDEF/ NDAA-prescribed end strength for that fiscal year.	0%	+/-3%	1%
4.2P: Number of soldiers under stop loss	4.2P: By FY 2011, the Department will reduce the number of soldiers under stop loss to zero.	9,753	6,609	4,794
Strategic Objective 4.2T:	**Prepare the force to meet current and emerging challenges faced by operational commanders and reinvigorate the acquisition and security cooperation workforces.**			
*4.2T: Cumulative percent of incumbents who have been trained in security assistance in positions that require security assistance training	4.2T: By FY 2011, DoD will increase the percent of incumbents who trained in security assistance for positions that require security assistance training to 95 percent or better.	67%	80%	70%
Strategic Objective 4.2U:	**Strengthen joint headquarters, personnel security clearance, and financial management activities.**			
*4.2U: Percent of DoD Statement of Budgetary Resources Appropriations Received (line 3A) validated	4.2U: By FY 2013, 100 percent of DoD Statement of Budgetary Resources Appropriations Received (line 3A) will be reviewed, verified for accuracy, and "validated" or approved as audit-ready.	18.5%	53%	18.5%
*4.2U: Average number of days required to adjudicate the fastest 90 percent of initial top secret and secret personnel security clearance cases	4.2U: Beginning in FY 2010, the Department will adjudicate the fastest 90 percent of initial top secret and secret personnel security clearance cases within 20 days.	25	20	11
*Reflects DoD priority goal.				

The Department will address final year-end results for all 66-performance outcomes in DoD's more detailed performance report for FY 2010, submitted with the FY 2012 Congressional Budget Justification on or about February 7, 2011 at http://www.defenselink.mil/comptroller/.

Message from the Chief Financial Officer

As Chief Financial Officer for the Department of Defense (DoD), I am pleased to present our Agency Financial Report for FY 2010. This report summarizes how the Department managed $691.2 billion in funds appropriated by the Congress to sustain America's Armed Forces and to support operations in Afghanistan and Iraq. We believe that the information found here will be helpful to taxpayers who want to understand Defense spending.

DoD financial managers can be proud of some significant accomplishments. Most importantly, they ensure that warfighters have the resources and financial services needed to meet the country's national security requirements.

DoD also has been a successful partner in the Administration's efforts to reduce improper payments. The Department's improper payment rate for vendors is less than a tenth of one percent. The rate is less than one percent for most types of payments to employees, and the majority of these are underpayments that are quickly corrected.

However, DoD financial management suffers from enterprise-wide problems with systems and processes, and the lack of auditable financial statements is one manifestation of these problems. In response, DoD has established a new approach to this longstanding problem, focusing its efforts to achieve auditability on the budgetary and other information most used to manage. The new approach has provided a common focus and a sense that the audit effort is worthwhile. To implement this new approach, DoD also has:

- Established long term but also interim goals for achieving auditable statements;
- Created a governance process that includes close partnership with the Department's chief management officers; and
- Programmed substantial resources to correct the problems that prevent auditability.

As DoD's Chief Financial Officer, I am fully committed to meeting the resource needs of our warfighters. I am equally committed to managing taxpayer dollars in a manner that is effective and efficient, and to providing high-quality financial information that fully documents the Department's financial activities.

Robert F. Hale

Robert F. Hale
Under Secretary of Defense
(Comptroller)/Chief Financial Officer,
Department of Defense

November 15, 2010

Financial Performance Overview

The Department displays significant strengths in its financial management of taxpayer resources. Most importantly, Defense financial managers are successfully providing DoD's warfighters with the resources and financial services necessary to meet our national security objectives. They are doing so in Afghanistan, Iraq, and around the world.

The Department also has effective financial processes for many key functions. For example, DoD's payment processes successfully ensure timely and accurate payments in a very high percentage of cases, including employee payments, with 99 percent accuracy. In addition, DoD issues over $30 billion in commercial payments every month ($1.5 billion every business day), with an error rate at less than a tenth of one percent.

The Department has reduced interest payments dramatically. As of August 2010, DoD had reduced interest penalty payments by 29 percent since FY 2007, despite a 26 percent increase in amounts paid. Along with these significant improvements, DoD's summary cash reconciliation rates with the Department of the Treasury are very high. As we work to further improve DoD financial management, we must be careful not to achieve improvements at the expense of these successes.

Overall, the Department has made progress toward improving financial information and audit readiness in several entities. For example, the U.S. Army Corps of Engineers achieved fully auditable financial statements. Several Defense Agencies maintain auditable statements, including the Defense Finance and Accounting Service and the Defense Contract Audit Agency. Several large trust funds managed by DoD also are auditable. It also is clear, however, that the most daunting challenges for the Department remain ahead, particularly the challenge of moving the Military Services toward auditability.

Enterprise-Level Weaknesses

The Department recognizes that there are enterprise-wide weaknesses in DoD financial management. Some enterprise-level issues currently prevent the Department as a whole from receiving an unqualified opinion on its financial statements. The DoD's current business environment – including systems and processes – do not record the financial results of business events (such as contract signing) in a consistent and reliable manner. Many of DoD's information systems are old, designed decades ago to meet budgetary rather than proprietary accounting standards, and tend to be non-standard and without good financial controls.

The Department's enormous size and geographical dispersion substantially complicate the Department's financial improvement efforts. The DoD obligates an average of $2 billion to $3 billion every business day and handles hundreds of thousands of payment transactions, which take place in thousands of worldwide locations, including war zones. Because of DoD's size and mission requirements, it is not feasible to deploy a vast number of accountants to manually reconcile our books.

For these reasons, the Government Accountability Office (GAO) designated DoD's financial management operations and controls as a high-risk area in 1995. The GAO assessment reflects the inherent problems that have developed as DoD business operations have grown within a large, decentralized organization that is both mission-oriented and functionally "stove-piped." In this environment, individual organizational elements control and execute their budgets using different processes, controls, and systems, which makes it problematic to aggregate and report financial information as envisioned by the Chief Financial Officers Act. Further, the lack of compliant, integrated financial and financial-feeder business systems is a material weakness that makes this challenge even more daunting for an organization with this size and complexity.

Audits performed by DoD IG identified long-standing material weaknesses that continue for FY 2010. The material weaknesses fall into two categories:

(1) **Noncompliant Systems.** Most legacy systems do not comply with the wide range of systems requirements, and do not provide assurance that core financial systems and related information is traceable to source transactional information. Smaller organizations have successfully applied compensating controls, as demonstrated by favorable audit opinions, but these are not practical in larger organizations, such as the Military Departments.

(2) **Legacy Financial Processes.** Many financial processes, such as accounts receivable and accounts payable, do not comply with Generally Accepted Accounting Principles (GAAP) because they are dependent on the noncompliant legacy systems currently used to compile financial information for DoD financial statements.

The Department acknowledges these material weaknesses. DoD is working toward implementing solutions to improve Department-wide financial processes, controls, and systems.

Audit Readiness

The Department plans to achieve its financial management goals and audit readiness through an active partnership between the Deputy Chief Management Officer (DCMO), the Under Secretary of Defense (Comptroller) (USD(C)), and the Department's Chief Management Officers (CMOs). This partnership allows us to draw support from across the enterprise, including the acquisition, logistics, and other business communities. To enhance oversight and governance, USD(C) created the Financial Improvement and Audit Readiness (FIAR) Governance Board, co-chaired by the DoD Comptroller and the DCMO. This board includes the Military Department

CMOs, DoD's financial management leaders, and senior representatives from the functional communities. The Department also established the DoD Audit Advisory Committee (DAAC), which provides independent advice to the Secretary of Defense regarding DoD's financial management, including financial reporting policies, processes, systems of internal controls, audit processes, and processes for monitoring compliance with relevant laws and regulations. The DAAC members, appointed by the Secretary of Defense to three-year terms, are distinguished members of the audit, accounting, and financial communities.

The Department's Audit Readiness Plan. The Department has instituted a new approach to improve information and move toward audit readiness. Recognizing that many decisions are budget-related, DoD adjusted its FIAR strategy (depicted in Figure 1-7) to focus first on improving processes, controls, and systems that produce budgetary information and the existence and completeness (E&C) information needed to manage mission-critical assets. At the same time, the Department will seek a cost-effective approach that results in an unqualified audit opinion on all its financial statements. For more information on DoD's FIAR Plan, refer to http://comptroller.defense.gov/FIAR/.

Figure 1-7. FIAR Audit Readiness Strategy

By focusing on accuracy and timeliness of budgetary information, the Department will improve the reliability of information used most often by management and meet the goal of obtaining auditable financial statements, starting with the Statement of Budgetary Resources (SBR). Improving the reliability of information on the existence and completeness of mission-critical assets – such as Military Equipment, Real Property, Inventory, Operating Materials and Supplies, and General Equipment – will ensure that dependable information is available to those who manage assets.

Over the last year, the Department took a number of significant steps to ensure progress in achieving FIAR goals. These steps include:

- Redefining the FIAR strategy to focus improvement efforts on the information most used to manage;

- Setting long-term and interim goals;
- Increasing resources (people and dollars) for FIAR activities within the Office of the USD(C) and Component entities;
- Expanding the FIAR Governance Board to include most senior DoD financial leaders, functional community representatives, and DCMO, and the Military Department CMOs;
- Developing a phased-improvement methodology, identifying essential key tasks within each phase; and
- Formally issuing DoD-wide FIAR guidance that explains, in detail, the FIAR strategy and FIAR methodology.

Audit Progress to Date. The following FY 2010 achievements highlighted in Figure 1-8 reflect the Department's progress to improve financial management:

- The United States Marine Corps (USMC) asserted audit readiness and the DoD IG is auditing its FY 2010 Statement of Budgetary Resources. Although the audit outcome may not immediately result in a "clean opinion," USMC made significant progress in improving budget and other financial information and obtaining support from various communities to achieve auditable financial statements.
- The Defense Information Systems Agency Working Capital Fund addressed financial management deficiencies identified in a 2009 audit and asserted audit readiness for its financial statements.
- The Air Force and the Defense Logistics Agency asserted audit readiness on Appropriations Received in the fourth quarter of FY 2010.
- The Navy asserted audit readiness for existence and completeness of Military Equipment and the Ordnance category of Operating Materials and Supplies in the fourth quarter of FY 2010.
- The Navy asserted audit readiness for Transportation of People in the fourth quarter of FY 2010.
- Air Force continues to make significant progress to achieve its Mission Critical Asset Existence and Completeness priority for Military Equipment and Operating Materials and Supplies before the end of FY 2011.

Figure 1-8. FIAR Priority Audit Readiness Assertions

Component	Audit Readiness Assertions	Date
All Financial Statements		
DISA - WCF	All Financial Statements	3Q 2010
Statement of Budgetary Resources (SBR) Audit		
USMC	SBR	4Q 2008
Navy	Appropriations Received	2Q 2009
Navy	Civilian Pay	3Q 2010
Air Force	Appropriations Received	4Q2010
Air Force	Rescissions	4Q2010
Air Force	Non-expenditure Transfers	4Q2010
DLA	Appropriations Received	4Q 2010
Mission Critical Asset Existence and Completeness Audit		
Navy	Military Equipment	4Q 2010
Navy	OM&S - Ordnance	4Q 2010

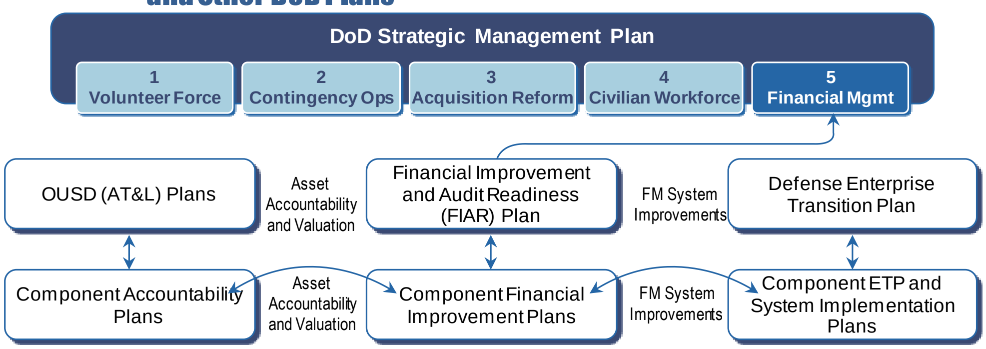
Full Auditability

The FY 2010 National Defense Authorization Act (NDAA) requires the Department to assert that its financial statements are ready for audit no later than September 30, 2017. The Department is committed to improving the reliability and accuracy of financial information with the highest priority placed on information most useful for decision-making. This priority has not changed, and the Department is continuing to focus on budget and mission critical-asset information.

In its report on the FY 2011 NDAA, the Senate Armed Services Committee directed the Department to perform a cost-benefit analysis of asset valuation alternatives and to develop a business case to justify its resulting decision. The Department currently is assessing the costs and associated benefits of reporting and auditing Balance Sheet cost information and will report the results in the May 2011 FIAR Plan Status Report. The Department also is discussing possible changes in financial reporting with the Office of Management and Budget (OMB) and the GAO.

In conclusion, the Department will aggressively work toward achieving current priorities and will continue to work with the Congress, GAO, and OMB to resolve the Department's concerns related to the cost of attaining full auditability under the existing Federal accounting and auditing standards.

Figure 1-9. FIAR Plan Relationship to the DoD Strategic Management Plan and Other DoD Plans



Improvements to Financial Systems

Working within the framework of the Business Enterprise Architecture (BEA) that defines basic standards for end-to-end business processes and data, the Department continues implementation of Enterprise Resource Planning (ERP) systems. These ERP initiatives target implementation of a standardized financial information structure that is compliant with Federal Financial Management Improvement Act (FFMIA) and BEA requirements.

In FY 2010, the Services and Defense Agencies made significant progress in implementing ERPs. The Army implemented two mini-deployments and a larger wave three deployment in the General Fund Enterprise Business System to 5,000 end users. The Navy deployed its ERP to 12,000 users within the Naval Air Systems Command, Naval Supply Systems Command, and Space and Naval Warfare Systems Center. The Air Force deployed complete accounting capability to Scott Air Force Base using the Defense Enterprise Accounting and Management System.

The Department also successfully implemented the Defense Agencies Initiative for all accounting functionality at two Defense Agencies. The Air Force, in partnership with the Defense Finance and Accounting Service, implemented Columbus Cash Accountability System. This system will identify Fund Balance with Treasury in-transit collection and disbursement transactions that need correction, redirection, or research, thereby providing actionable information for corrective action.

In addition, Military Departments and Defense Agencies implemented the Real Property Installation Lifecycle Management System to improve real property installation management and visibility and achieve better connection to direct and indirect costs.

The Department will continue to implement ERP solutions to improve the accuracy and reliability of its financial statements. The Investment Review Boards and the Defense Business Systems Management Committee will continue to provide oversight to ensure that progress continues and that implementation issues are timely and effectively resolved.

Financial Analysis

The Department's FY 2010 financial statements are presented in the Financial Information section. The DoD's management is responsible for the integrity of the financial information presented in these financial statements. At this time, management cannot provide reasonable assurance of effective internal management controls over financial reporting; however, DoD's financial improvement initiatives and systems' modernization efforts continue to demonstrate progress. The Department's leadership is committed to improving internal controls and safeguarding the resources entrusted to us.

These statements were prepared from the books and records of the Department in accordance with U.S. generally accepted accounting principles (USGAAP), when possible, the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements," and the "DoD Financial Management Regulation."

The financial statements have been prepared to report DoD's financial position and results of operations, and include the:

- Statement of Budgetary Resources
- Statement of Net Cost
- Balance Sheet
- Statement of Changes in Net Position

Summary of FY 2010 Financial Reporting. For FY 2010, the financial statements for six of 33 reporting entities within the Department received unqualified audit opinions. See Figure 1-10.

Figure 1-10. Audit Opinions

DoD Reporting Entity	Audit Opinions
U.S. Army Corps of Engineers	Unqualified
Military Retirement Fund	Unqualified
Defense Commissary Agency	Unqualified
Defense Finance and Accounting Service	Unqualified
Defense Contract Audit Agency	Unqualified
Office of the Inspector General	Unqualified

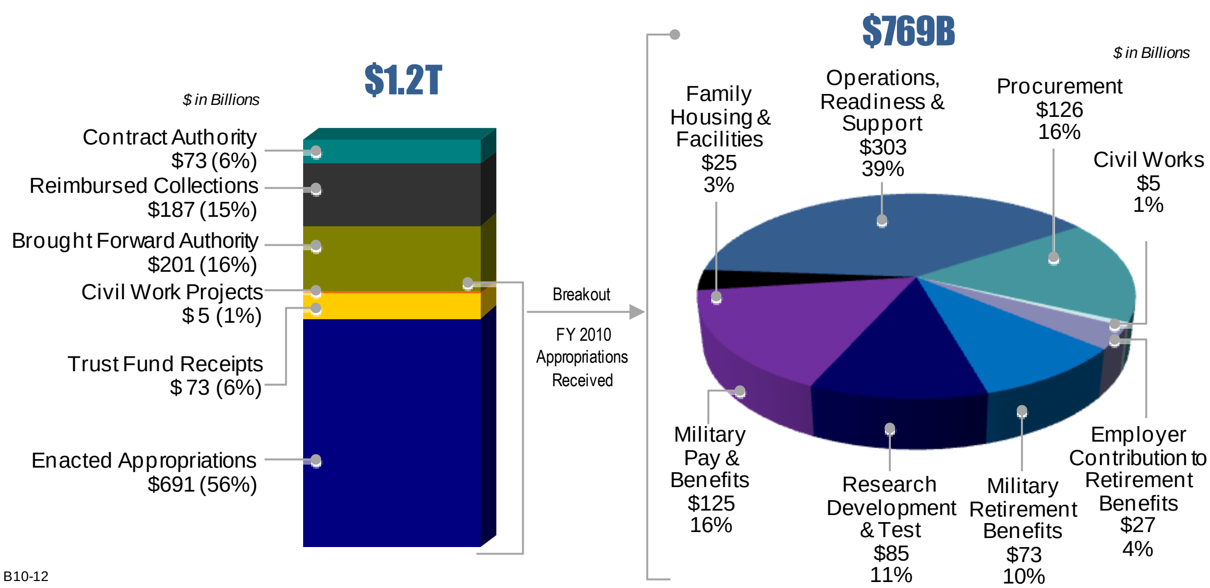
B10-11

Budgetary Resources. In accordance with Federal statutes and implementing regulations, obligations may be incurred and payments made only to the extent that budgetary resources are available to cover such items. The Statement of Budgetary Resources presents the DoD's total budgetary resources, their status at the end of the year, and the relationship between the budgetary resources and the outlays made against them.

The Department's FY 2010 enacted appropriations total $691.2 billion, as depicted in Figure 1-3 on page 9. The Department also received resources from the U.S. Treasury for retirement and health benefits and appropriations in support of civil work projects executed by the U.S. Army Corps of Engineers. In total, the Department received $769 billion in FY 2010 resources, as shown in Figure 1-11. Additional budgetary resources for the year include $201 billion for outstanding requirements carried forward from FY 2009, $187 billion in collections related to reimbursed activity, and $73 billion in contract authority. In total, the Department had $1.2 trillion in available budgetary resources.

Of the $1.2 trillion in total budgetary resources, $1.1 trillion (92 percent) were obligated and $994 billion (90 percent) of obligations were disbursed. The remaining ten percent of unobligated budgetary resources relate to

Figure 1-11. FY 2010 Total Budgetary Resources



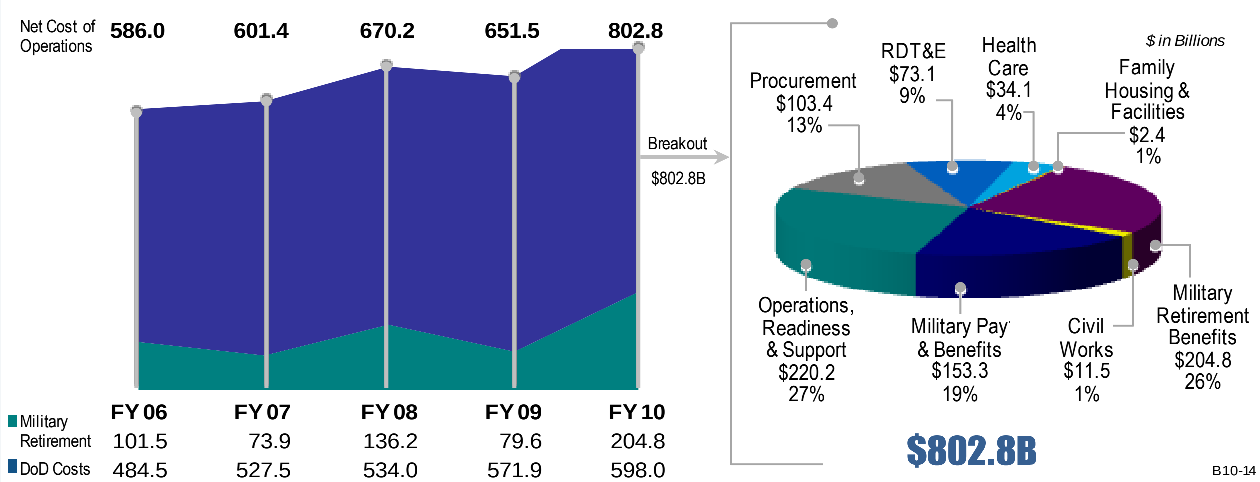
B10-12

appropriations available to cover multi-year modernization projects, which require additional time to procure.

The Department obligated much of its FY 2010 resources to responsibly draw down the military forces in Iraq as it concluded Operation Iraqi Freedom and transitioned to Operation New Dawn. In Afghanistan, U.S. forces worked with Afghan Security Forces and international partners to build a country that will not be a safe haven for terrorists. In addition, the Department used resources to maintain readiness to conduct missions abroad as well as to modernize and recapitalize equipment that greatly improve combat capabilities.

Net Cost of Operations. The Statement of Net Cost reports total expenses incurred less the revenues received from external sources to finance those expenses. The resulting balance of net cost is essentially equivalent to the outlays reported on the Statement of Budgetary Resources, less the assets purchased plus accrued liabilities and accounts payable. Differences between outlays of budgetary resources and net cost generally arise from the timing of expenses recognized. The Statement of Net Cost presents net cost of all the Department's programs for the Military Services and Components, as well as the Military Retirement benefits as depicted in Figure 1-12.

Figure 1-12. Net Cost of Operations



The Department's costs incurred relate primarily to operational activities and military retirement and health benefits. These costs were offset with revenues from external sources primarily from earnings on investments and contributions for retirement and health benefits, as well as earnings from reimbursed activities, resulting in $802.8 billion in net costs of operations. As depicted in Figure 1-12, the $802.8 billion represents a $151.3 billion (23 percent) increase from FY 2009. The Military Retirement Benefits accounted for $125.2 billion (83 percent) of the increase largely due to a

$136.4 billion increase from changes in key actuarial assumptions, offset by an $11.7 billion increase in earned revenue. Also contributing to the increase is $19.0 billion in procurement costs to modernize and recapitalize equipment, greatly improving combat capabilities, and a $9.6 billion increase in Military Pay and Benefits to attract and retain high-quality military personnel to execute the Department's mission.

Balance Sheet. The Balance Sheet, which reflects the Department's financial condition as of September 30, 2010 (Figure 1- 13), reports the DoD's resources (Assets), the amounts owed requiring use of assets available (Liabilities), and the difference between them (Net Position).

Figure 1-13. Net Assets and Liabilities

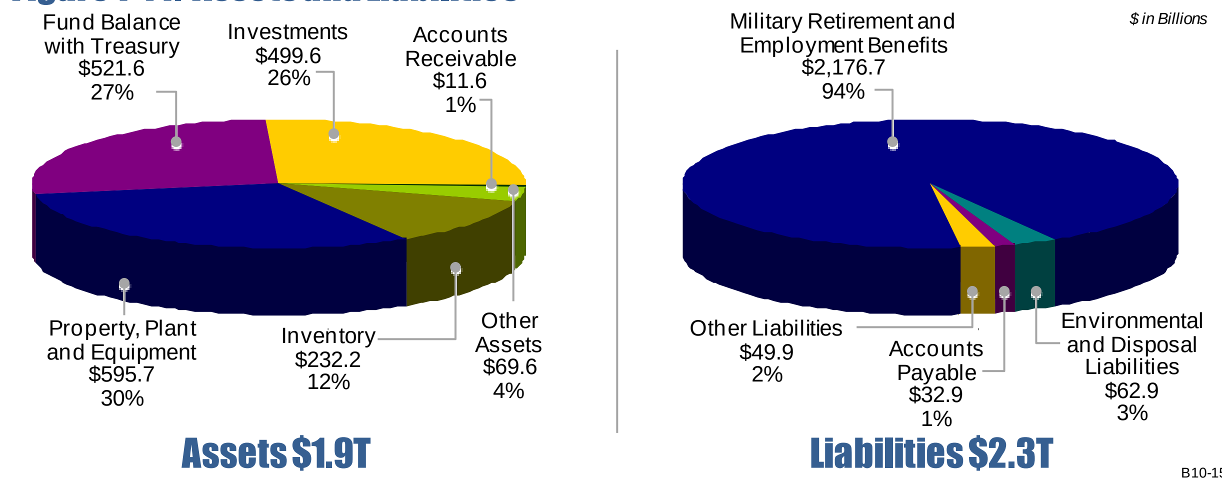
$ in Millions

Balance Sheet	
Total Assets	$ 1,930.3
Total Liabilities	$ 2,322.4
Total Net Position	**$ (392.1)**

B10-11a

The $1.9 trillion in assets shown in (Figure 1-14) represents amounts the Department owns and manages. Assets increased $132.9 billion (7 percent) from FY 2009, largely due to increases in Investments in U.S. Treasury securities and increases in General Property, Plant, and Equipment.

Figure 1-14. Assets and Liabilities

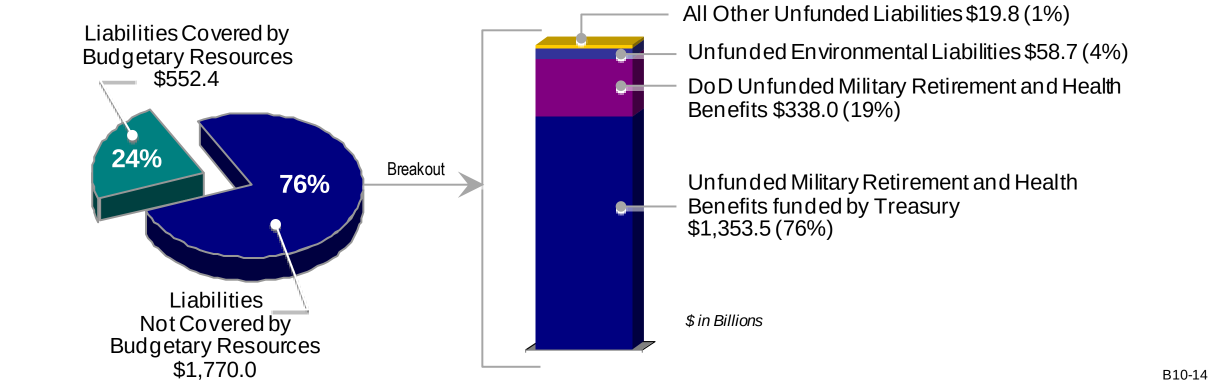


The $62.7 billion net increase in investments relate to expected normal growth to cover unfunded portions of future military retirement and health benefits. Funds not needed to pay current benefits are held in separate trust and special funds and are invested in U.S. Treasury securities.

The $37.5 billion net increase in General Property Plant and Equipment includes increases of $11.5 billion in facilities (buildings and structures) and $7.8 billion in construction in progress. These increases were associated with construction and maintenance of housing, wounded warrior facilities and schools, and recapitalization of other medical facilities. In addition, Military Equipment increased $7.2 billion, reflecting the Department's commitment to modernize and recapitalize equipment to improve combat capabilities.

The Department's liabilities increased $160.5 billion (7 percent) during FY 2010, primarily due to growth in actuarial liabilities (Figure 1-15) related to military retirement pension and health care benefits. The Department is confident in its ability to meet its financial obligations. The U.S. Treasury will fund $1.4 trillion (60 percent) of the $2.3 trillion in liabilities resulting from actuarial liability that existed at the inception of the Military Retirement and Health programs. Additionally, approximately $552.4 billion is already available, primarily invested in U.S. Treasury securities that cover an additional 24 percent of the outstanding liability. Figure 1-15 identifies the unfunded liabilities that require future resources.

Figure 1-15. Unfunded Liabilities



Summary

Although the financial statements are not auditable for FY 2010, the Department's financial managers are meeting warfighter needs for resources and financial services. The Department is committed to resolving its financial management challenges by moving away from "stove-piped" financial and accounting systems toward end-to-end business processes that cross multiple disciplines. A top priority is to achieve auditability of the Statements of Budgetary Resources (SBR) and to verify the existence and completeness of mission-critical assets. Focusing on the information people use to manage and make decisions, DoD can lay the groundwork for the broad business management requirements necessary for financial reform. This approach will improve the business operations, along with the quality and integrity of information, and ultimately allow DoD's financial statements to be reliable and auditable.

Under Secretary of Defense Comptroller Robert Hale, left, and Vice Adm. Steve Stanley, then Director, Force Structure, Resources and Assessment, Joint Staff, hold a press conference to provide an overview of the Fiscal Year 2011 budget and the Fiscal Year 2010 supplemental war funding request at the Pentagon in Arlington, Virginia, Feb. 1, 2010.

(DoD photo by Cherie Cullen/Released)

Management Assurances

DEPUTY SECRETARY OF DEFENSE
1010 DEFENSE PENTAGON
WASHINGTON, DC 20301-1010

The leadership of the Department of Defense (DoD) is committed to establishing and maintaining effective internal management controls and financial management systems that meet the objectives of the *Federal Managers' Financial Integrity Act* (FMFIA). This past fiscal year, the Department focused on strengthening the Managers' Internal Control Program and met with each reporting Component. In these meetings, the need to employ a risk-based self-assessment process that will identify, report, and correct internal control weaknesses was communicated. Senior management also promoted a proactive organizational culture, in which internal control weaknesses are reported before they adversely impact the effectiveness and efficiency of the mission.

The Department can provide qualified, reasonable assurance that it achieved the objectives of the FMFIA over non-financial operations. However, the Department's assessment of the internal management controls for financial reporting and financial systems revealed several material weaknesses. Details of the material weaknesses are available in Addendum A, Other Accompanying Information, "Management Assurance and Financial Statement Material Weaknesses."

The Department conducted its assessment of internal controls over financial reporting in accordance with the Office of Management and Budget's Circular No. A-123, Appendix A, "Management's Responsibility for Internal Control." This evaluation determined that, while the Department achieved measurable progress, it cannot provide reasonable assurance that internal management controls over financial reporting were effective as of June 30, 2010. Related to this financial reporting weakness, and as of the date of this report, the Department's financial systems are not in substantial compliance with the *Federal Financial Management Improvement Act*.

Improvements in DoD financial processes and systems continue thanks to the Department's Financial Improvement and Audit Readiness initiative and systems modernization efforts reflected in the enterprise transition plan. We remain fully committed to an effective program of internal controls that accomplishes our mission while safeguarding the resources entrusted to us.

William J. Lynn III
November 15, 2010

Managers' Internal Control Program

The Department is responsible for establishing, maintaining, and assessing internal controls in order to provide reasonable assurance that it meets the objectives of the Federal Managers' Financial Integrity Act (FMFIA), 31 U.S.C 3512, Sections 2 and 4, and the Federal Financial Management Improvement Act (FFMIA), Public Law 104-208. The OMB provides FMFIA guidance in OMB Circular No. A-123, entitled "Management's Responsibility for Internal Control in the Federal Government."

In addition, the Department provides FMFIA guidance in DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," and annually, the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) provides detailed MICP implementing guidance memoranda.

The MICP requires the Department's management to conduct self-assessments of internal management controls, in accordance with the FMFIA. These internal management controls are the checks and balances that assist program and financial managers to achieve results and safeguard the integrity of the programs. The FMFIA requires the head of each agency to provide an annual assurance statement that outlines what the agency has done to meet these requirements, including details for remaining material weaknesses. The detailed FMFIA results are available in Addendum A, Other Accompanying Information, under Management Assurances and Financial Statement Material Weaknesses.

U.S. Army General David H. Petraeus, commander, International Security Assistance Force, talks to soldiers on Forward Operating Base Salerno in Khost province, Afghanistan, Aug. 19, 2010. The soldiers are assigned to the 101st Airborne Division's Air Assault, 3rd Brigade Combat Team.

U.S. Air Force Photo By Staff Sgt. Bradley Lail

Management uses the following criteria to classify conditions as material weaknesses:

- Merits the attention of the Executive Office of the President and the relevant Congressional oversight committees;
- Impairs fulfillment of essential operations or mission;
- Significantly weakens established safeguards against waste, loss, unauthorized use or misappropriation of funds, property, other assets, or conflicts of interest;
- Substantial noncompliance with laws and regulations; or
- Nonconformance with government-wide, financial management system requirements.

The Department's leadership is committed to ensuring effective internal management controls for all mission-essential processes to support the reliability of financial information. The MICP holds managers throughout the Department accountable for ensuring effective internal management controls in their areas of responsibility. All Components are required to conduct a robust programmatic approach to establish and assess internal management controls for all non-financial, mission-essential operations. Components that produce stand-alone financial statements also are required to include financial reporting assurance in their programs.

The Department revitalized the MICP in FY 2010. In December 2009 the OUSD(C) program managers met with Component leaders and hosted a two-day seminar to communicate the Chief Financial Officer's vision and the risk-based, self-assessment approach. The Department tasked Components to assign responsibility for the analysis of specific functional areas within the organization to the workforce and to incentivize employees to self-report inefficiencies that may potentially impact the mission of the organization.

The Department advocates a "tone at the top" approach, with renewed emphasis on the importance of the internal control program that will permeate the culture of the entire organization. Instead of relying on external auditors to identify material internal control weaknesses, DoD employees have the in-depth knowledge and expertise in their operations to identify and develop solutions that mitigate high-risk control weaknesses. For FY 2011, the Department plans to validate each Component's implementation of MICP principles to include documentation of functional processes and procedures and solutions for correcting inefficiencies and related internal control deficiencies. This documentation is comprised of flowcharting key business processes that impact financial reporting and non-financial operations, identifying and assessing risk within the processes, identifying internal controls, testing internal controls, establishing or strengthening controls found to be deficient, and reporting on the results of the assessments and tests.

In FY 2010, for nonfinancial operations, the Department is reporting two additional internal control weaknesses: 1) Personnel Resources, Qualifications and Training, and 2) Acquisition and Procurement. Both of these weaknesses complement the GAO and DoD IG recommendations to elevate these two items as both "High Risk" and of "Management Concern" due to the significant impact inefficiencies in these areas have had on the overall mission of the Department.

Statement of Assurance

More information regarding the Department's process for developing the Statement of Assurance is available at:

http://www.defenselink.mil/comptroller/micp.html.

Top Management Challenges and Management's Responses

The Reports Consolidation Act of 2000 requires the annual financial report include a statement from the DoD IG that summarizes the most serious management and performance challenges facing the Agency and briefly assesses the progress toward addressing those challenges. The DoD IG identified the following eight management and performance challenges facing the Department for FY 2010. These challenges are in addition to GAO's list of government-wide, high-risk management areas.

- Financial Management
- Acquisition Processes and Contract Management
- Joint Warfighting and Readiness
- Information Assurance, Security, and Privacy
- Health Care
- Equipping and Training Iraqi and Afghan Security Forces
- Nuclear Enterprise
- American Recovery and Reinvestment Act (ARRA)

The following pages highlight these challenges and management's assessment in addressing these issues.

1. **Financial Management.** The Department continues to face financial management challenges that adversely affect its ability to provide reliable, timely, and useful financial and managerial data needed to support operating, budgeting, and policy decisions. In the FY 2009 audit of DoD's consolidated financial statements, DoD IG reported the same 13 material internal control weaknesses as the previous year, weaknesses that affect the safeguarding of assets, proper use of funds, and impair the prevention and identification of fraud, waste, and abuse. These pervasive and longstanding financial management issues directly affect DoD's ability to obtain an unqualified opinion on its financial statements. The DoD IG is auditing the U.S. Marine Corps' FY 2010 Statement of Budgetary Resources (SBR), the first audit of a Military Component's financial statement. The U.S. Marine Corps has encountered many challenges during this first-time audit, and the Department is learning from this audit experience as well. Although DoD is far from reaching an unqualified opinion, the Department has demonstrated improvement. The ongoing initiatives in the area of financial management demonstrate that the Department is responding to the significant and pervasive financial management issues and is positioning itself to leverage planned systems and business improvements to achieve sustainable and long-term solutions.

Management's Assessment. The Department adjusted its FIAR strategy to focus on improving information most often needed to manage the Department. Recognizing that many decisions are budget related, DoD's priorities focus on improving processes, controls, and systems that produce budgetary information and the information needed to manage DoD's mission-critical assets. To date, the Department has made measured progress in improving financial information. Specifically, the DoD IG is auditing the Marine Corp's FY 2010 SBR resulting in significant improvements to budget and other financial information. In addition, the Defense Information Systems Agency Working Capital Fund addressed financial management deficiencies and asserted audit readiness for its financial statements; and the Air Force and Defense Logistics Agency asserted audit readiness on appropriations received in the fourth quarter for FY 2010. The DoD's leadership remains focused on improving information most needed to manage the Department.

2. **Acquisition Processes and Contract Management.** Acquisition initiatives that began in the 1990s led to reductions in acquisition oversight resources. When the spending trend dramatically reversed after September 11, 2001, the Department was not able to react quickly to the need for more contract and oversight support. In FY 2010, the Defense budget, including funds for contingency operations, exceeded nearly $700 billion. This total is more than double the last DoD budget preceding September 11, 2001. Keeping pace with this spending would be a difficult proposition if acquisition and oversight resources were increasing at a proportional rate. In 2009, the level of staffing of the acquisition workforce was below those in 1998. Efforts to train and ready the DoD acquisition workforce to handle a significant increase in workload demand and complexity resulting from extensive services contracting, counter-insurgency operations, and other critical missions continue to challenge the Department. The DoD continues to make limited progress in controlling the cost and schedule of major acquisition programs and will have to make critical decisions about which systems should be cut based on competing resources. Through the last two DoD budgets, the Secretary of Defense has made difficult decisions by proposing to end all or part of at least a half dozen major defense acquisition programs that were either no longer needed or performing poorly.

Management's Assessment. The Secretary of Defense established a 23-point plan of action to reform acquisition processes through initiatives that target affordability and control cost growth; incentivize productivity and innovation in industry; promote real competition; improve tradecraft in services acquisition; and reduce non-productive processes and bureaucracy. The Department is implementing these initiatives and is monitoring policy implementation and compliance. In addition, the Department recently developed a new Joint Contingency Contracting

Handbook that provides essential information, tools, templates, and training material to meet the challenges in any contracting environment. In addition, the Department increased its acquisition workforce by 6,200 professionals and continued to work toward achieving the Secretary of Defense's growth goals of 20,000 professionals by FY 2015.

3. **Joint Warfighting and Readiness.** Despite the high operating tempo, U.S. Forces are executing their missions globally. Sustained operations in Iraq and Afghanistan have affected equipment, the troops, and their families. In the near-term, DoD's execution of the withdrawal in Iraq and the redeployment or resetting of equipment, either for use in Afghanistan or for standing inventory, requires management's continued attention and presents its own challenges to the overall joint warfighting and readiness process. In the long-term, the Department faces the challenge of resetting the Services; retraining skills that have not been required for the current operations; and reengaging with other nations' militaries. This challenge encompasses the need to ensure basic services continue uninterrupted for the members of the armed forces and their families. Available resources and capabilities are finite and require constant monitoring to enable the Department to operate successfully with the shifting global dynamics. Maintaining readiness, resetting the force during the extended war, modernizing to face future challenges, and allowing troops to reconnect with their families are challenges that the Department and the Congress must continually address.

Management's Assessment. The Department remains focused on ensuring the forces deployed to fight our Nation's wars are trained, equipped, and ready to perform their assigned missions. Our forward-deployed forces are ready, but that readiness often comes at the expense of the non-deployed force readiness. Non-deployed forces often experience less than optimal dwell time and focus their non-deployed training time on their next Iraq or Afghanistan mission requirements. This focus, however, can result in forces not being trained for the full spectrum of potential global missions, and combined with the impact of stay-behind equipment and personnel turmoil, can lead to reduced readiness levels. Withdrawing large numbers of troops and equipment from Iraq, while simultaneously increasing force and equipment levels in Afghanistan, is an extremely complex operation. To successfully meet this challenge of the future, the Department will have to engage the total force, which will include continued use of the Reserve Components for operational missions. The Department is expending significant effort to ensure this is accomplished in the most effective and cost-efficient manner. We also recognize our obligation to properly take care of our soldiers, sailors, airmen, and marines -- and their families -- that have carried the burden of extended combat operations, multiple deployments, and the resultant human toll from those efforts. We must be particularly vigilant of those traumatized in our Nation's battles, trauma which can have long-term effects on the individual. The Department is intent on striking the optimal, albeit delicate balance to meet our competing needs in these challenging fiscal times. Key competing challenges include maintaining readiness, resetting the force, structuring the force to meet future threats, modernization, and taking care of our most valuable asset – our people.

4. **Information Assurance, Security, and Privacy.** Managing risk continues to be a daunting challenge to the Department. One significant area where the Department must assess the risk that a particular threat will adversely impact its operations is in the acceptance and use of internet-based capabilities. Internet-based capabilities include social networking services, social media, instant messaging, and discussion forums. During this past year, DoD has taken steps to address the issues surrounding its use of Internet-based capabilities. Another challenge that DoD faces is defending its information and information systems against today's mounting cyber threats. On a daily basis, those wanting to not only steal DoD information but do harm to DoD programs, operations, and personnel continuously attack DoD's information technology infrastructures. In May 2010, DoD announced the establishment of the U.S. Cyber Command, a sub-unified command subordinate to the U.S. Strategic Command that will work to improve DoD's capabilities to ensure resilient, reliable information and communication networks, counter cyberspace threats, and assure access to cyberspace.

Management's Assessment. On February 25, 2010, the Deputy Secretary of Defense issued Directive-Type Memorandum (DTM) 09-026, which establishes DoD policy and assigns responsibilities for effective use of Internet-based capabilities, including social networking services. While DoD has postured itself to embrace the benefits of Internet-based capabilities in its daily operations, it still faces a challenge of ensuring Commanders at all levels and heads of DoD Components take the appropriate actions to safeguard missions and preserve operations security. In May 2010, DoD took a significant step to address its most daunting challenge of defending its information and information systems by announcing the establishment of the U.S. Cyber Command. The U.S. Cyber Command will improve DoD's capabilities to ensure resilient, reliable information and communication networks, counter cyberspace threats, and assure access to cyberspace. Service elements, such as the Army Forces Cyber Command, will support the U.S. Cyber Command's mission. To be successful, the Department will be required to use all its current cyber assets and develop new ones. Civilian acquired cyber capabilities reside in the Reserve Component is one place to expand the Department's cyber capabilities. While the Department has taken a significant step, challenges remain in centralizing cyberspace operations, developing workable strategies, protecting information networks, and obtaining cyber expertise.

In March 2010, the Department announced proposed changes to the Defense Federal Acquisition Regulation Supplement (DFARS) in the Federal Register Volume 75, No. 41, that address requirements for safeguarding unclassified information. In addition, DoD continued to enhance the Defense Industrial Base (DIB) Cyber Security and Information Assurance Program, established in 2007. Under DoD Instruction 5205.13, dated January 29, 2010, DoD outlined its policy to create a timely, coordinated, and effective partnership with the DIB to develop standard policy and procedures in areas such as contracting and acquisition and to improve the protection of unclassified DoD information on DIB unclassified systems and networks.

5. **Health Care.** The DoD Military Health System (MHS) must provide quality care for approximately 9.6 million eligible beneficiaries within fiscal constraints while facing increased user demands, legislative imperatives, and inflation that make cost control difficult in both the public and private sectors. The DoD budget for health care costs was approximately $50 billion in FY 2010, an increase of more than 60 percent ($31 billion) since FY 2005. The DoD Military Health System has been moving forward on improving health care while attempting to control costs. The MHS implemented the Quadruple Aim Concept, building upon the Institute for Healthcare Improvement's Triple Aim concept that describes the results achieved when all elements of a health care system work together. Quarterly Force Health Protection Survey results show continued improvement in service members' medical readiness, except for the Reserves and National Guard. The Department established specific milestones to implement a personal health record prototype and to expand bi-directional sharing of health information with the Department of Veterans Affairs. The Department has encountered delays in establishing the electronic health record, but continues to progress in sharing electronic medical records with the Department of Veterans Affairs.

Management's Assessment. The Department is actively working to eliminate unnecessary administrative overhead and unwarranted variation in both its clinical and administrative processes. The DoD agreed upon a set of strategic imperatives, used in quarterly reviews, to ensure it meets its targets for both quality and cost. One area of particular emphasis this year is to reduce overutilization of emergency rooms, a significant contributor to recent increases in per capita cost.

The Department is working with the Reserves and National Guard to address challenges in force readiness, particularly in the area of mental readiness. Recent data is showing significant improvement in overall medical readiness. Our human capital team is actively addressing the need for additional mental health services in support of the readiness of the force. Over the past three years, DoD added nearly 3000 new mental health professionals to the workforce and expanded the TRICARE network in the area of behavioral health. Deployment of the Patient Centered Medical Home, which includes embedded behavioral health workers in primary care, will add to the capability to address the psychological health needs of service members and their families.

The Department is continuously improving care for the wounded, ill, and injured, and their families. Since 2007, over 13,000 Service members have enrolled in the integrated disability evaluation system. The Department reduced the disability evaluation period, and Service member satisfaction with the process is improving. In addition, the National Intrepid Center of Excellence, which provides specialized services for service members with Post Traumatic Stress Disorder and traumatic brain injuries, will reach full operating status before the end of the year.

In addition, strengthened acquisition structure and processes ensure effective and efficient major acquisitions, such as the Electronic Health Record. The Department of Defense and the Department of Veterans Affairs are working together to implement the Virtual Lifetime Electronic Record (VLER), with successful pilots now operating at several sites. The VLER vision is to make health, benefits, and personnel information of a Service member or Veteran from the time of accession to internment, available as necessary. The MHS is actively working to achieve meaningful use of health information with the rapid implementation of secure messaging and providing essential health information to patients in digital formats.

6. **Equipping and Training Iraq and Afghan Security Forces.** The Department faces significant challenges in accomplishing U.S. policy and related DoD military strategic goals in Southwest Asia. In Iraq, DoD is continuing the training, equipping, and mentoring of the Iraqi Security Forces (ISF), including development of the ISF's logistics sustainment base, while conducting a responsible drawdown of military forces by December 31, 2011. In addition, DoD is faced with transitioning all remaining training, equipping, and mentoring activities to the Office of Security Cooperation under Chief of Mission authority, as well as laying the groundwork for a robust security assistance and Foreign Military Sales program that will endure after the last U.S. military forces leave in December 2011. In the Afghanistan-Pakistan region, DoD challenges include an intensive effort to train, equip, and mentor the Afghan National Security Forces to enable them to assume a lead security operations role to enable a conditions-based drawdown of U.S. combat forces beginning the summer of 2011. Another major objective includes assisting the Pakistan Security Forces develop the capacity to maintain internal security and eliminate extremist Taliban and al-Qaeda forces in the Northwest Frontier safe haven. Limited resources are available for these complex tasks.

Management's Assessment. The DoD objective between now and December 2011 is to develop an ISF capable of providing internal security as well as a minimal foundation for external defense. Following the withdrawal of U.S. forces from Iraq in December 2011, the ISF will continue to mature in their leadership roles providing security and overall stability for the citizens of Iraq. The citizens of Iraq continue to develop their confidence in the ISF, and it is becoming clear that the growing professionalism of the ISF is a source of national pride.

A key strategic focus remains on training, equipping, and partnering with the Afghan National Security Forces (ANSF) to enable the transition of lead security responsibility to the Government of Afghanistan and initiate a "conditions-based" redeployment of U.S. combat forces, beginning in July 2011, with the ANSF leading security responsibilities by 2014.

The North Atlantic Treaty Organization (NATO) and the Government of Afghanistan continue to grow both the quality and quantity of the ANSF. Both the Afghan National Army (ANA) and the Afghan National Police (ANP) still need support from the international community—particularly in pledging institutional trainers for the ANSF and Operational Mentoring and Liaison Teams and Police Operational Mentoring and Liaison Teams—in order to train the ANSF and provide mentors and partners in the field.

As of August 2010, both ANA and ANP force levels were well above target goals, at approximately 136,000 and 120,000, respectively. NATO Training Mission-Afghanistan implemented several positive changes in the ANSF training regime since November 2009, including increasing the number of trainers, providing better marksmanship training, adding literacy training, and opening branch schools for higher end training. Still challenges remain, including Officer and Non-Commissioned Officer shortages.

7. **Nuclear Enterprise.** Since the end of the Cold War, there has been a dramatic decline in the level and intensity of focus on the nuclear enterprise and the nuclear mission. To reverse this trend, the Department is re-focusing on the nuclear enterprise. The Department continues to analyze and identify key deficiencies and methods for improvement and to develop and implement corrective action plans. Sustained commitment is required to create an environment that emphasizes the nuclear mission and provides adequate funding and leadership to ensure implementation.

Management's Assessment. The Department continues to make substantial progress in improving the nuclear enterprise. The DoD has taken positive action to address recommendations made in DOD IG and other oversight reports, conducted reviews of the enterprise to identify and correct deficiencies, and created new management structures, such as the Air Force Global Strike Command. In addition, the release of the Nuclear Posture Review and the Section 1251 Report to the Congress on DoD plans for the nuclear deterrent over the next ten years have provided an overarching path forward for sustaining the nuclear enterprise. The Department remains fully committed to restoring confidence in the nuclear enterprise and in the safe handling and accountability of DoD nuclear assets. While success in accomplishing this task will require years of sustained commitment, the Department will continue to engage in a robust effort to implement report recommendations and corrective action plans to address deficiencies.

8. **American Recovery and Reinvestment Act (ARRA).** Under ARRA, the Congress initially appropriated $7.4 billion to the Department to preserve and create jobs; promote economic recovery; assist those most affected by the recession; provide investments to increase economic efficiency through technological advances in science and health; and invest in transportation, environmental protection, and other infrastructure. The DoD Agency Plan and four program-specific plans met the 12 minimum OMB requirements. As noted in our 2009 DOD IG Assessment of Progress, DoD execution of the Recovery Act was not moving as quickly as the Department had planned, and much of the spending and actual work on the projects would occur in FY 2010. The DoD Recovery Act funds for facility repair projects, valued at $4.3 billion, were to expire for obligation at the end of FY 2010. The DoD continued to press forward to obligate these funds and, as of September 30, 2010, with the aid of a statutorily directed $260.5 million ARRA rescission, obligated 99.9 percent of the remaining $4.0 billion in expiring funds. The DoD also achieved its goal of expending by the end of FY 2010 at least 45 percent of all ARRA funds by expending 45 percent by September 30, 2010. Funds for new construction are available for obligation until FY 2014. As of September 30, 2010, DoD had obligated 71 percent of these funds. The continuing pressure to commence activities and expend Recovery Act funds as quickly as possible, consistent with prudent management, will add pressure to the Department's understaffed contracting professionals to award and administer contracts in an expedited manner. Additionally, without adequate and continuous management attention to Recovery Act implementation, especially contractor oversight and recipient reporting, the Department will have a recurring challenge to effectively meet the intent of the Recovery Act and maintain adequate transparency, accountability, and stewardship of taxpayer funds.

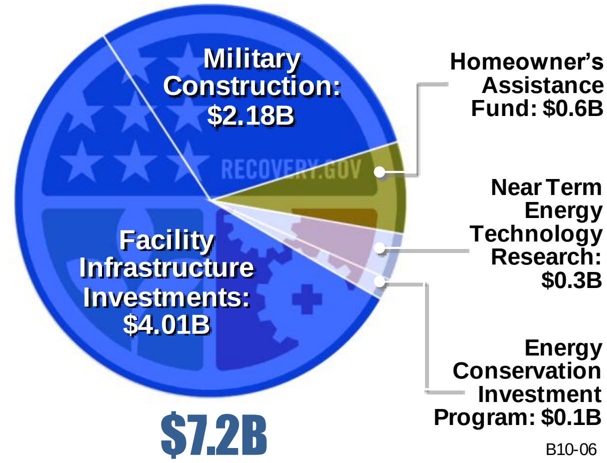
Management's Assessment. As of September 30, 2010, the Department obligated $6.5 billion (90 percent) and disbursed $3.2 billion (45 percent) of the $7.2 billion in ARRA funds for over 4,600 projects at over 400 sites. Obligations for Military Construction and Energy Conservation Investment projects and outlays for all programs will continue through FY 2011.

Other Management Information and Initiatives

Department of Defense Implementation of the ARRA of 2009

On February 17, 2009, the Congress passed ARRA and appropriated $7.4 billion to the Department for military construction, facility repair, energy efficiency investments, near-term energy research, and assistance to certain military members and civilians, who experienced financial losses during the U.S. housing market downturn. In addition, the USACE received $4.6 billion for its civil works program that is separate from DoD's other ARRA funds. The Congress rescinded $0.23 billion of ARRA funds in Public Law 111-226, reducing the total DoD Recovery Act funding to $7.2 billion (Figure 1-16). The purpose for these investments is to stimulate the U.S. economy while enhancing our national security. Building new facilities, repairing aging facilities, or bringing buildings up to date with the most modern energy efficiency standards creates and preserves U.S. jobs. Targeted research on energy projects creates technical jobs and aids the Department in reducing its long-term energy costs and improving current energy efficiency in the near-term.

Figure 1-16. Recovery Act Funds for the Department of Defense



As of September 30, 2010, the Department obligated $6.5 billion (90 percent) and disbursed $3.2 billion (45 percent) in ARRA funds of the $7.2 billion in ARRA funds for over 4,600 projects at over 400 sites. Savings of $370 million realized from project awards funded 380 of these projects. The table below describes the breakout of obligation and disbursements by major programs. Obligations for Military Construction and Energy Conservation Investment projects and disbursements for all programs will continue through FY 2011.

PROGRAM	For Period Ended September 30, 2010		
Dollars in Billions	Authority	Obligations	Expenditures
Facilities Sustainment, Restoration, and Modernization	$ 4.01	$ 4.00	$ 2.18
Military Construction	$ 2.18	$ 1.55	$ 0.26
Energy Conservation Investment	$ 0.12	$ 0.09	$ 0.05
Near Term Energy-Efficient Technologies	$ 0.30	$ 0.30	$ 0.13
Home Owners Assistance Program	$ 0.56	$ 0.52	$ 0.48
TOTAL	**$ 7.17**	**$ 6.46**	**$ 3.10**

For details regarding the Department's recovery act implementation and accountability, refer to DoD website at http://www.defenselink.mil/recovery.

The Department's Path Forward for 2011 and Beyond

Protecting the American people and advancing our Nation's interests is a mission the Department does not take lightly. Recognizing that the U.S. is a Nation at war, the U.S. and its allies and partners remain engaged in a broader war – a multifaceted political, military and moral struggle – against al-Qaeda and its allies around the world. As a global power, the strength and influence of the U.S. intertwine deeply with the fate of the broader international system – a system of alliances, partnerships, and multinational institutions that our country has helped build and sustain for more than sixty years. The U.S. military must, therefore, be prepared to support broad national goals of promoting stability in key regions, providing assistance to nations in need, and promoting the common good.

With these realities in mind, the Department must rebalance the capabilities of America's Armed Forces to prevail in today's wars while building the capabilities needed to deal with future threats. The Department also must reform DoD's institutions and processes to better support the urgent needs of the warfighter; buy weapons that are usable, affordable, and truly needed; and spend taxpayer dollars wisely and responsibly.

In order to help defend and advance our national interests, the Department balances resources and risk to prevail in today's wars, prevent and deter conflict, prepare to defeat adversaries and succeed in a wide range of contingencies, and preserve and enhance the All-Volunteer Force. These priorities shape not only considerations on the capabilities our Armed Forces need, but also the aggregate capacity required to accomplish current and future missions. The approach must evolve and adapt in response to a changing security environment.

As the U.S. military proceeds with the responsible drawdown in Iraq, the U.S. will continue to play important roles advising, training, and supporting Iraqi forces and to work with partners and allies to locate and dismantle terrorist networks. While U.S. forces are heavily engaged in current wars, DoD's prevent-and-deter activities focus on preventing the emergence or reemergence of transnational terrorist threats and deterring other potential major adversaries. In addition, the Defense Department will continue to provide the President with options across a wide range of contingencies, such as responding to an attack or natural disasters at home, defeating aggression by adversary states, supporting and stabilizing fragile states that face serious internal threats, and preventing human suffering due to mass atrocities or large-scale natural disasters abroad.

To significantly enhance the U.S. forces' ability to protect and advance U.S. interests, the Department is focusing on rebalancing America's Armed Forces in preparing them for the future by achieving the following key objectives:

- Defend the U.S. and support civil authorities at home
- Succeed in counterinsurgency, stability and counterterrorism operations
- Build the security capacity of partner states
- Deter and defeat aggression in anti-access environments
- Prevent proliferation and counter weapons of mass destruction
- Operate effectively in cyberspace

Years of war have demanded that America's Armed Forces rapidly innovate and adapt—the Department's institutional base must do the same. The Secretary is taking actions that enable the Department to redirect resources away from lower-priority programs and activities to address needs that are more pressing. Where it has not been possible to set initiatives in motion to meet certain future operational needs, the Secretary has identified vectors for the evolution of the force, calling on DoD Components to devote sustained efforts toward developing new concepts and capabilities to address those needs. Assessments of future operating environments will continue, with an eye toward refining our understanding of future needs. At the same time, the Department will continue to look aggressively for savings in underperforming programs and activities, divestiture, technology substitution, less-pressing mission and program areas, and other accounts, so that more resources can be devoted to filling these gaps.

"In order to help defend and advance our national interests, the Department of Defense balances resources and risk among four priority objectives: prevail in today's wars, prevent and deter conflict, prepare to defeat adversaries and succeed in a wide range of contingencies, and preserve and enhance the All-Volunteer Force."

Excerpt from 2010 QDR

The Department also is assessing other areas requiring particular attention. Reforming security assistance will be necessary to meet urgent warfighter needs and to create new and more responsive mechanisms for security assistance. Improving how we buy will transform how the Department matches requirements with mature technologies, maintains disciplined systems engineering approaches, institutionalizes rapid acquisition capabilities, and implements more comprehensive testing. Our efforts must also include reforming the U.S. export control system for the 21st century, and spurring continued improvements in the provision of rapid logistical support to our forces abroad. Strengthening the industrial base will maintain our strategic advantage by establishing a consistent, realistic, and long-term strategy for shaping the structure and capabilities of the defense technology and industrial bases—a strategy that better accounts for the rapid evolution of commercial technology, as well as the unique requirements of ongoing conflicts.

The established priorities, along with both the FY 2010 and FY 2011 budgets, reflect the Secretary's consistent emphasis on ensuring the Department does everything possible to enable success in today's wars while preparing for a complex and uncertain future. The Department's key priority objectives along with modernization of capabilities and its investment portfolios is critical to shaping how the Department of Defense will support America's men and women in uniform today, and build the policy and programmatic foundation for security in the years to come.

Summary

While focusing on balancing the capabilities to fight today's wars, the Department's leadership remains committed to improving financial management processes, controls, and systems. The size and complexity of DoD's business operations and the rapid pace of change in the business environment make it imperative to create a more agile, responsive, and efficient organization. The Department stands strong and committed to transforming the DoD's institutions and processes, including our financial management practices, to better support the urgent needs of the warfighter; buy weapons that are usable, affordable, and truly needed; and spend taxpayer dollars wisely and responsibly.

Financial Information

Independent Auditor's Report

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

November 15, 2010

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER

SUBJECT: Independent Auditor's Report on the DOD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements (Report No. D-2011-011)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying DOD Agency-Wide Consolidated Balance Sheet as of September 30, 2010 and 2009, and the Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of DOD management. DOD is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the DOD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance With Laws and Regulations (Report). The Report is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us that the DOD Agency-Wide FY 2010 and FY 2009 Basic Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and that DOD financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2010. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government Accountability Office, "Government Auditing Standards," and Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," as amended,* to determine whether material amounts on the financial statements were presented fairly.

* OMB Memorandum No. 09-33, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," September 23, 2009.

Prior audits have identified, and DOD has acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses may affect the reliability of certain information contained in the Basic Financial Statements. Therefore, we are unable to express, and we do not express, an opinion on the Basic Financial Statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information presented with the Basic Financial Statements. Accordingly, we express no opinion on that information.

As discussed in Note 26, DOD restated its financial statements as of September 30, 2009, to correct errors in assets, liabilities, gross costs, and net position. We did not withdraw our auditor's report on the FY 2009 financial statements because we issued a disclaimer of opinion on those statements.

Summary of Internal Control

In planning our work, we considered DOD internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control.

Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified material weaknesses continued to exist in the following areas.

- Financial Management Systems
- Fund Balance with Treasury
- Accounts Receivable
- Inventory
- Operating Materials and Supplies
- General Property, Plant, and Equipment
- Government-Furnished Material and Contractor-Acquired Material
- Accounts Payable
- Environmental Liabilities
- Statement of Net Cost
- Intragovernmental Eliminations

- Other Accounting Entries
- Reconciliation of Net Cost of Operations to Budget

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We determined that Contingent Legal Liabilities continues to be a significant deficiency.

Internal control work that we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies. The Attachment offers additional details on previously identified material weaknesses. The DOD reported the above material weaknesses in its FY 2010 Statement of Assurance.

Summary of Compliance With Laws and Regulations

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

Management's Responsibilities

Management is responsible for:

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

We provided a draft of this report to the Under Secretary of Defense (Comptroller)/Chief Financial Officer, who provided technical comments that we have incorporated as appropriate.

Patricia A. Marsh

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

Attachment:
As stated

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

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

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continued to exist in the following areas.

Financial Management Systems

Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," requires financial management system controls that are adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and recorded in accordance with Federal accounting standards. Statement of Federal Financial Accounting Concepts No. 1 also requires that financial management system controls ensure assets are properly safeguarded to deter fraud, waste, and abuse and that performance measurement information is adequately supported.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged that DOD financial management and feeder systems do not substantially comply with Federal financial management system requirements. The DOD financial management and feeder systems were not designed to adequately support various material amounts on the financial statements. These systemic deficiencies in financial management and feeder systems and inadequate DOD business processes prevent DOD from collecting and reporting financial and performance information that is accurate, reliable, and timely.

Fund Balance With Treasury

Statement of Federal Financial Accounting Standards (SFFAS) No. 1, "Accounting for Selected Assets and Liabilities," the Treasury Manual, and DOD Regulation 7000.14-R, "DOD Financial Management Regulation," require DOD to resolve financial and accounting inconsistencies to accurately report Fund Balance with Treasury. However, inconsistencies continue to exist related to in-transit disbursements, unmatched disbursements, negative unliquidated obligations, and unreconciled differences between U.S. Treasury records and DOD accounting records.

Attachment
Page 1 of 6

Accounts Receivable

According to SFFAS No. 1, a receivable should be recognized when a Federal entity establishes a claim to cash or other assets against other entities, based on either legal provisions or goods and services provided. DOD acknowledged that it was unable to accurately record, report, collect, and reconcile intragovernmental accounts receivable as well as accounts receivable due from the public.

Inventory

SFFAS No. 3, "Accounting for Inventory and Related Property," requires DOD to use historical cost, the latest acquisition cost (adjusted for holding gains and losses), or moving average cost for valuing inventory. However, DOD acknowledged that the existing inventory value for most activities was not reported in accordance with U.S. GAAP, and the Department's legacy systems do not maintain the historical cost data necessary to comply with SFFAS No. 3. Additionally, DOD did not distinguish between Inventory Held for Sale and Inventory Held in Reserve for Future Sale as required by SFFAS No. 3.

Operating Materials and Supplies

SFFAS No. 3 states that Operating Materials and Supplies must be expensed when the items are consumed. DOD acknowledged that significant amounts of Operating Materials and Supplies were expensed when purchased instead of when consumed. In addition, DOD could not accurately report the value of operating materials and supplies, which causes the potential for a misstatement in financial reporting.

General Property, Plant, and Equipment

SFFAS No. 6, "Accounting for Property, Plant, and Equipment," requires DOD to record General Property, Plant, and Equipment (General PP&E) at acquisition cost; capitalize improvement costs; and recognize depreciation expense. However, the cost and depreciation of DOD General PP&E was not reliably reported because of: (1) an accounting requirement that classified Military Equipment as General PP&E (such costs were previously expensed); (2) a lack of supporting documentation for aged General PP&E items; and (3) a failure to integrate most legacy property and logistics systems with acquisition and financial systems. In addition, DOD property and logistics systems were not designed to capture acquisition cost and the cost of modifications and upgrades, or to calculate depreciation.

DOD acknowledged that it did not meet U.S. GAAP for the financial reporting of personal property, and the documentation for personal property was neither accurate nor reliable. In addition, DOD did not have adequate internal controls in place to provide reasonable assurance that real property assets were identified and properly reported in its financial reports. DOD also acknowledged that its inability to accurately report the value of military equipment increases the risk that the financial statements are materially misstated.

Government-Furnished Material and Contractor-Acquired Material

SFFAS No. 11, "Amendments to Accounting for Property, Plant, and Equipment," requires that property and equipment in the possession of a contractor for use in accomplishing a contract be considered Government property. Such property should be accounted for based on the nature of the item, regardless of who has possession. DOD acknowledged that it was unable to comply with these requirements for Government-Furnished Material and Contractor-Acquired Material. As a result, the value of DOD property and material in the possession of contractors was not reliably reported.

Accounts Payable

According to SFFAS No. 5, "Accounting for Liabilities of the Federal Government," a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future. DOD acknowledged that it did not meet accounting standards for the financial reporting of public accounts payable. DOD cannot support its accounts payable balances because it lacks standard procedures for recording, reporting, and reconciling the amounts between the financial, accounting, and reporting systems.

Environmental Liabilities

DOD acknowledged that its internal controls for reporting environmental liabilities did not provide reasonable assurance that cleanup costs for all of its ongoing, inactive, closed, and disposal operations were identified, consistently estimated, and appropriately reported. In addition, guidance and audit trails for estimating environmental liabilities were insufficient, and the inventory of ranges and operational activities was incomplete. DOD also acknowledged uncertainty regarding the accounting estimates used to calculate the reported Environmental Liabilities.

Statement of Net Cost

Statement of Federal Financial Accounting Concepts No. 2, "Entity and Display," requires the Statement of Net Cost to provide an understanding of the net costs of each organization and each program. In addition, the Statement of Net Cost is to provide gross and net cost information that can be related to the amounts of outputs and outcomes for the programs and organization. DOD acknowledged the following deficiencies related to the Statement of Net Cost:

- The amounts presented for General Funds may not report actual accrued costs.
- Although the funds were generally recorded on an accrual basis for Working Capital Funds, the systems did not always capture actual costs in a timely manner.
- The Statement of Net Cost is not presented by programs that align with major goals and outputs described in DOD's strategic and performance plans as required by the Government Performance and Results Act.
- Revenues and expenses were reported by appropriation categories because financial processes and systems do not collect costs in line with performance measures.

Intragovernmental Eliminations

DOD disclosed that it could not accurately identify most of its intragovernmental transactions by customer because its systems do not track the buyer and seller data needed to match related transactions. In addition, DOD was unable to fully reconcile intragovernmental transactions with all Federal partners. DOD acknowledged that its inability to reconcile most intragovernmental transactions resulted in adjustments that cannot be fully supported.

Other Accounting Entries

DOD acknowledged that it continued to enter material amounts of unsupported accounting entries.

Reconciliation of Net Cost of Operations to Budget

SFFAS No. 7, "Accounting for Revenue and Other Financing Sources," requires a reconciliation of proprietary and budgetary information to assist users in understanding the relationship between the net cost of operations and the budgetary resources obligated by the entity during the period. DOD acknowledged that it was unable to reconcile budgetary obligations to net costs without making unsupported adjustments. Specifically, budgetary data do not agree with proprietary expenses and capitalized assets.

Previously Identified Significant Deficiencies

As part of our financial-related audits, we noted the following significant deficiency that continued to exist.

Contingent Legal Liabilities

SFFAS No. 5, as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," requires contingent legal liabilities to be disclosed if there is at least a reasonable possibility that a loss may be incurred. We noted that significant deficiencies continued to exist relating to the DOD process for reporting contingent legal liabilities. For example:

- DOD excluded from its legal representation letters at least 93 pending cases, with a total claim amount of $3.6 billion, that individually did not exceed the DOD Agency-Wide individual reporting threshold, but in aggregate exceeded this threshold.

- The legal representation letters from the DOD Office of General Counsel showed that DOD General Counsel was unable to express an opinion on the likely outcome of 32 of the 40 pending legal actions, totaling $2.3 trillion.

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

Attachment
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Compliance With Laws and Regulations

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

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires DOD to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2010, DOD did not fully comply with FFMIA. DOD acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2010.

Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]) limits DOD and its agents to making or authorizing only expenditures or obligations that do not exceed the available appropriations or funds. Additionally, DOD or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As stated in 31 U.S.C § 1517 (2004), DOD and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act (ADA), the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken.

During FY 2010, DOD reported 11 cases of violation of ADA. Therefore, DOD did not comply with 31 U.S.C. § 1341 (1990) and 31 U.S.C § 1517 (2004).

DOD internal guidance limits the time from identification to reporting of ADA violations to 12 months. Our review of DOD ADA violations reported in FY 2010 showed that DOD did not process 10 of 11 ADA violation cases within 12 months. Additionally, 19 investigations of potential ADA violations have been open for more than 12 months.

Audit Disclosures

The Under Secretary of Defense (Comptroller)/Chief Financial Officer acknowledged to us on March 17, 2010, that the DOD financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements and that previously identified material weaknesses continued to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to these selected provisions of laws and regulations: Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, Prompt Payment Act, and Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act of 1996).

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

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PRINCIPAL FINANCIAL STATEMENTS AND NOTES

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of 31 U.S.C. 3515(b). The statements are prepared from accounting records of the Department in accordance with OMB Circular No. A-136 and, to the extent possible, USGAAP. The statements, in addition to the financial reports, are used to monitor and control budgetary resources, which are prepared from the same records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

The financial statements of the Department include four principal statements listed in Figure 2-1.

The financial statements reflect the aggregate financial posture of the Department and include both the proprietary (federal accounting standards) and budgetary resources of the Department. The Department is large and complex with an asset base of $1.9 trillion, and more than 3 million military and civilian employees on installations in every state and around the world.

Figure 2-1. Four Principal Financial Statements

Statement	***What Information It Provides***
Balance Sheet	Reflects the Department's financial position as of the statement date (September 30, 2010). The assets are the amount of future economic benefits owned or managed by the Department. The liabilities are amounts owed by the Department. The net position is the difference between the assets and liabilities.
Statement of Net Cost	Shows separately the components of the net cost of the Department's operations for the period. Net cost is equal to the gross cost incurred by the Department less any exchange revenue earned from its activities.
Statement of Changes in Net Position	Presents the sum of the cumulative results of operations since inception and unexpended appropriations provided to the Department that remain unused at the end of the fiscal year. The statement focuses on how the net cost of operations is financed. The resulting financial position represents the difference between assets and liabilities as shown on the consolidated balance sheet.
Statement of Budgetary Resources	Provides information about how budgetary resources were made available as well as their status at the end of the period. It is the only financial statement exclusively derived from the Department's budgetary general ledger in accordance with budgetary accounting rules.

Department of Defense Consolidated Balance Sheet
Agency Wide

Dollars in Millions

	2010 Consolidated	Restated 2009 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 521,641.7	$ 502,754.3
Investments (Note 4)	497,136.9	434,884.0
Accounts Receivable (Note 5)	1,249.2	1,219.6
Other Assets (Note 6)	1,874.7	2,594.7
Total Intragovernmental Assets	**$ 1,021,902.5**	**$ 941,452.6**
Cash and Other Monetary Assets (Note 7)	2,066.7	2,316.8
Accounts Receivable, Net (Note 5)	9,756.2	7,731.4
Loans Receivable (Note 8)	522.3	398.5
Inventory and Related Property, Net (Note 9)	232,234.3	229,270.0
General Property, Plant and Equipment, Net (Note 10)	595,656.6	558,131.0
Investments (Note 4)	2,489.7	2,017.1
Other Assets (Note 6)	65,635.1	56,131.9
Stewardship Property, Plant & Equipment (Note 10)		
TOTAL ASSETS	**$ 1,930,263.4**	**$ 1,797,449.3**
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,754.5	$ 2,207.8
Debt (Note 13)	518.3	391.7
Other Liabilities (Note 15)	13,781.4	11,485.7
Total Intragovernmental Liabilities	**$ 16,054.2**	**$ 14,085.2**
Accounts Payable (Note 12)	31,135.4	35,579.8
Military Retirement and Other Federal Employment Benefits (Note 17)	2,176,698.9	2,012,166.1
Environmental and Disposal Liabilities (Note 14)	62,902.2	66,230.0
Loan Guarantee Liability (Note 8)	19.8	21.1
Other Liabilities (Note 15)	35,563.5	33,837.9
Commitments & Contingencies (Note 16)		
TOTAL LIABILITIES	**$ 2,322,374.0**	**$ 2,161,920.1**
NET POSITION		
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 304.8	$ 5.6
Unexpended Appropriations - Other Funds	528,499.8	503,394.3
Cumulative Results of Operations - Earmarked Funds	(1,440,006.0)	(1,343,134.7)
Cumulative Results of Operations - Other Funds	519,090.8	475,264.0
TOTAL NET POSITION	**$ (392,110.6)**	**$ (364,470.8)**
TOTAL LIABILITIES AND NET POSITION	**$ 1,930,263.4**	**$ 1,797,449.3**

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

Department of Defense Consolidated Statement of Net Cost Agency Wide		Dollars in Millions
	2010 Consolidated	Restated 2009 Consolidated
Program Costs		
Gross Costs	**$ 701,969.3**	**$ 669,954.2**
Military Retirement Benefits	56,741.5	56,179.3
Civil Works	13,300.4	11,712.0
Military Personnel	154,374.9	144,750.6
Operations, Readiness & Support	276,976.6	272,133.8
Procurement	107,960.0	89,150.2
Research, Development, Test & Evaluation	82,506.6	84,388.7
Family Housing & Military Construction	10,109.3	11,639.6
(Less: Earned Revenue)	(63,242.2)	(46,167.9)
Net Cost before Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	**$ 638,727.1**	**$ 623,786.3**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	164,089.0	27,703.1
Net Cost of Operations	**$ 802,816.1**	**$ 651,489.4**

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

Department of Defense Consolidated Statement of Changes in Net Position
Agency Wide

Dollars in Millions

	2010 Earmarked Funds	2010 All Other Funds	2010 Eliminations	2010 Consolidated	Restated 2009 Earmarked Funds	Restated 2009 All Other Funds	2009 Eliminations	Restated 2009 Consolidated
Cumulative Results Of Operations								
Beginning Balances	$ (1,252,265.5)	$ 385,526.0	$ 0.0	$ (866,739.5)	$ (1,259,693.0)	$ 335,935.7	$ 0.0	$ (923,757.3)
Prior Period Adjustments:								
Changes in accounting principles	0.0	0.0	0.0	0.0	0.0	1,689.6	0.0	1,689.6
Corrections of errors	(276.3)	(854.9)	0.0	(1,131.2)	0.5	(11,545.3)	0.0	(11,544.8)
Beginning balances, as adjusted	**$ (1,252,541.8)**	**$ 384,671.1**	**$ 0.0**	**$ (867,870.7)**	**$ (1,259,692.5)**	**$ 326,080.0**	**$ 0.0**	**$ (933,612.5)**
Budgetary Financing Sources:								
Appropriations used	23.9	738,746.2	0.0	738,770.1	3.8	708,428.3	0.0	708,432.1
Nonexchange revenue	2,960.9	(15.0)	0.0	2,945.9	2,767.7	(13.7)	0.0	2,754.0
Donations and forfeitures of cash and cash equivalents	46.3	0.0	0.0	46.3	38.0	0.2	0.0	38.2
Transfers(in/out without reimbursement)	(780.1)	983.2	0.0	203.1	(836.7)	930.9	0.0	94.2
Other	1.4	(810.5)	0.0	(809.1)	0.0	(4.2)	0.0	(4.2)
Other Financing Sources (Non-Exchange)								
Donations and forfeitures of property	0.0	6.4	0.0	6.4	0.7	1.5	0.0	2.2
Transfers(in/out without reimbursement)	(244.3)	810.5	0.0	566.2	(88.2)	45.4	0.0	(42.8)
Imputed financing	0.6	18,507.2	12,911.6	5,596.2	0.0	17,017.3	12,313.5	4,703.8
Other	29.0	2,417.5	0.0	2,446.5	(19.2)	1,272.9	0.0	1,253.7
Total Financing Sources	**$ 2,037.7**	**$ 760,645.5**	**$ 12,911.6**	**$ 749,771.6**	**$ 1,866.1**	**$ 727,678.6**	**$ 12,313.5**	**$ 717,231.2**
Net Cost of Operations	88,237.1	727,489.5	12,910.5	802,816.1	(5,284.6)	669,087.5	12,313.5	651,489.4
Net Change	**$ (86,199.4)**	**$ 33,156.0**	**$ 1.1**	**$ (53,044.5)**	**$ 7,150.7**	**$ 58,591.1**	**$ 0.0**	**$ 65,741.8**
Cumulative Results of Operations	**$ (1,338,741.2**	**$ 417,827.1**	**$ 1.1**	**$ (920,915.2)**	**$ (1,252,541.8)**	**$ 384,671.1**	**$ 0.0**	**$ (867,870.7)**
Unexpended Appropriations								
Beginning Balances	5.6	504,339.3	0.0	504,344.9	4.9	446,864.3	0.0	446,869.2
Prior Period Adjustments:								
Correction of Error	0.0	(945.0)	0.0	(945.0)	0.0	24,949.2	0.0	24,949.2
Beginning balances, as adjusted	**$ 5.6**	**$ 503,394.3**	**$ 0.0**	**$ 503,399.9**	**$ 4.9**	**$ 471,813.5**	**$ 0.0**	**$ 471,818.4**
Budgetary Financing Sources:								
Appropriations received	323.2	775,081.9	0.0	775,405.1	4.5	754,440.5	0.0	754,445.0
Appropriations transferred (in/out)	20.2	608.6	0.0	628.8	0.0	(188.4)	0.0	(188.4)
Other adjustments	0.1	(11,859.2)	0.0	(11,859.1)	0.0	(14,243.0)	0.0	(14,243.0)
Appropriations used	(23.9)	(738,746.2)	0.0	(738,770.1)	(3.8)	(708,428.3)	0.0	(708,432.1)
Total Budgetary Financing Sources	**$ 319.6**	**$ 25,085.1**	**$ 0.0**	**$ 25,404.7**	**$ 0.7**	**$ 31,580.8**	**$ 0.0**	**$ 31,581.5**
Unexpended Appropriations	**$ 325.2**	**$ 528,479.4**	**$ 0.0**	**$ 528,804.6**	**$ 5.6**	**$ 503,394.3**	**$ 0.0**	**$ 503,399.9**
Net Position	**$ (1,338,416.0)**	**$ 946,306.5**	**$ 1.1**	**$ (392,110.6)**	**$ (1,252,536.2)**	**$ 888,065.4**	**$ 0.0**	**$ (364,470.8)**

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

Department of Defense Combined Statement Of Budgetary Resources Agency Wide Page 1 of 2 *Dollars in Millions*	Budgetary Financing Accounts		Nonbudgetary Financing Accounts	
	2010 Combined	Restated 2009 Combined	2010 Combined	Restated 2009 Combined
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 146,041.0	$ 134,381.8	$ 23.6	$ 26.3
Recoveries of prior year unpaid obligations	54,701.2	63,272.9	0.0	47.5
Budget authority				
Appropriation	899,278.4	855,564.3	0.0	0.0
Borrowing authority	0.0	0.0	26.8	58.4
Contract authority	73,059.7	67,626.3	0.0	0.0
Spending authority from offsetting collections				
Earned:				
Collected	184,468.6	178,143.5	69.6	45.1
Change in receivables from federal sources	(350.9)	1,188.9	0.0	0.0
Change in unfilled customer orders:				
Advance received	(81.9)	1,030.8	0.0	0.0
Without advance from federal sources	2,415.7	(88.3)	(34.9)	(10.8)
Expenditure transfers from trust funds	851.0	862.5	0.0	0.0
Subtotal	**$ 1,159,640.6**	**$ 1,104,328.0**	**$ 61.5**	**$ 92.7**
Nonexpenditure transfers, net, anticipated and actual	803.3	(15.7)	0.0	0.0
Temporarily not available pursuant to Public Law	(60,328.7)	(39,190.4)	0.0	0.0
Permanently not available	(87,880.6)	(85,969.3)	(13.9)	(0.1)
Total Budgetary Resources	**$ 1,212,976.8**	**$ 1,176,807.3**	**$ 71.2**	**$ 166.4**
Status of Budgetary Resources				
Obligations incurred:				
Direct	857,647.6	847,069.9	46.3	142.7
Reimbursable	195,380.6	183,695.8	0.0	0.0
Subtotal	**$ 1,053,028.2**	**$ 1,030,765.7**	**$ 46.3**	**$ 142.7**
Unobligated balance:				
Apportioned	137,589.8	128,132.0	24.8	0.3
Exempt from apportionment	6,172.0	3,374.0	0.0	0.0
Subtotal	**$ 143,761.8**	**$ 131,506.0**	**$ 24.8**	**$ 0.3**
Unobligated balance not available	16,186.8	14,535.6	0.1	23.4
Total status of budgetary resources	**$ 1,212,976.8**	**$ 1,176,807.3**	**$ 71.2**	**$ 166.4**

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

Department of Defense Combined Statement of Budgetary Resources Agency Wide Page 2 of 2 *Dollars in Millions*	Budgetary Financing Accounts 2010 Combined	Budgetary Financing Accounts Restated 2009 Combined	Nonbudgetary Financing Accounts 2010 Combined	Nonbudgetary Financing Accounts Restated 2009 Combined
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	453,958.7	432,118.5	770.4	872.9
Less: Uncollected customer payments from federal sources, brought forward, October 1	(67,702.3)	(66,602.2)	(132.2)	(143.0)
Total unpaid obligated balance	**$ 386,256.4**	**$ 365,516.3**	**$ 638.2**	**$ 729.9**
Obligations incurred net	1,053,028.2	1,030,765.7	46.3	142.7
Less: Gross outlays	(993,664.7)	(945,652.5)	(197.3)	(197.7)
Less: Recoveries of prior year unpaid obligations, actual	(54,701.2)	(63,272.9)	0.0	(47.5)
Change in uncollected customer payments from federal sources	(2,064.7)	(1,100.5)	34.9	10.8
Obligated balance, net, end of period				
Unpaid obligations	458,621.0	453,958.8	619.4	770.4
Less: Uncollected customer payments from federal sources	(69,767.0)	(67,702.7)	(97.3)	(132.2)
Total, unpaid obligated balance, net, end of period	**$ 388,854.0**	**$ 386,256.1**	**$ 522.1**	**$ 638.2**
Net Outlays				
Net Outlays:				
Gross outlays	993,664.7	945,652.5	197.3	197.7
Less: Offsetting collections	(185,237.8)	(180,036.9)	(69.6)	(45.1)
Less: Distributed offsetting receipts	(77,722.2)	(65,912.1)	0.0	0.0
Net Outlays	**$ 730,704.7**	**$ 699,703.5**	**$ 127.7**	**$ 152.6**

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

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of Defense (DoD), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with, to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board; the Office of Management and Budget (OMB) Circular No. A-136, Financial Reporting Requirements; and the DoD Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the Department is responsible unless otherwise noted. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernable.

The Department is unable to fully implement all elements of USGAAP and OMB Circular No. A-136, due to limitations of financial and nonfinancial management processes and systems that support the financial statements. The Department derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with USGAAP. The Department continues to implement process and system improvements addressing these limitations.

The Department has 13 auditor-identified material weaknesses: (1) Financial Management Systems; (2) Fund Balance with Treasury; (3) Accounts Receivable; (4) Inventory; (5) Operating Materials [sic] and Supplies; (6) General Property, Plant, and Equipment; (7) Government-Furnished Materials [sic] and Contractor-Acquired Materials [sic]; (8) Accounts Payable; (9) Environmental Liabilities; (10) Statement of Net Cost; (11) Intragovernmental Eliminations; (12) Other Accounting Entries; and (13) Reconciliation of Net Cost of Operations to Budget.

1.B. Mission of the Reporting Entity

The Department was established by the National Security Act of 1947. The Department provides the military forces needed to deter war and protect the security of our country. Since the creation of America's first army in 1775, the Department and predecessor organizations have evolved into a global presence with a worldwide infrastructure dedicated to defending the United States by deterring and defeating aggression and coercion in critical regions.

The Department includes the Military Departments and the Defense Agencies. The Military Departments consist of the Army, the Navy (of which the Marine Corps is a component), and the Air Force. The Defense Agencies provide support services commonly used throughout the Department.

1.C. Appropriations and Funds

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

General Funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction. These general funds also include supplemental funds enacted by the

American Recovery and Reinvestment Act (Recovery Act) of 2009. Details relating to Recovery Act appropriated funds are available on line at http://www.defenselink.mil/recovery.

Working Capital Funds (WCF) received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations and transactions that flow through the fund. The WCF resources the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The Department is required to separately account for and report on the receipt, use and retention of revenues and other financing sources for earmarked funds.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. They are not Department funds, and as such, are not available for the Department's operations. The Department is acting as an agent or custodian for funds awaiting distribution.

The Department is a party to allocation transfers with other federal agencies as a transferring (parent) entity or receiving (child) entity. An allocation transfer is an entity's legal delegation of authority to obligate budget authority and outlay funds on its behalf. Generally, all financial activity related to allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity. Exceptions to this general rule apply to specific funds for which OMB has directed that all activity be reported in the financial statements of the child entity. These exceptions include U.S. Treasury-Managed Trust Funds, Executive Office of the President (EOP), and all other funds specifically designated by OMB. Based on an agreement with OMB, funds for Security Assistance programs are reported separately from the Department's financial statements and notes.

The Department receives allocation transfers from the following agencies: Departments of Agriculture, Interior, Energy, and Transportation; the Appalachian Regional Commission; and the Federal Highway Administration.

Additionally, the Department receives allocation transfers from certain funds meeting the OMB exception and all related activity is included in the Department's financial statements. The exceptions reported by the Department include South Dakota Terrestrial Wildlife Habitat Restoration, Inland Waterways and Harbor Maintenance, and the EOP other than funds executed by Defense Security Cooperation Agency for Security Assistance.

As a parent, the Department allocates funds to the Departments of Transportation and Agriculture, and reports all related activity in these financial statements.

1.D. Basis of Accounting

The Department's financial management systems are unable to meet all full accrual accounting requirements. Many of the Department's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by USGAAP. Most of the Department's financial and nonfinancial legacy systems were designed to record information on a budgetary basis.

The Department's financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the Military Services and Defense Agencies and their sub-entities. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated level, these abnormal balances may not be evident. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

The Department is determining the actions required to bring financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the current revision of accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Until all of the Department's financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by USGAAP, the Department's financial data will be derived from budgetary transactions, data from nonfinancial feeder systems, and accruals.

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds that expire annually, on a multi-year basis, or do not expire. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full-cost pricing is the Department's standard policy for services provided as required by OMB Circular No. A-25, User Charges. The Department recognizes revenue when earned within the constraints of its current system capabilities. In some instances, revenue is recognized when bills are issued.

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

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

1.F. Recognition of Expenses

For financial reporting purposes, the Department's policy requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. In the case of Operating Materiel and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses. Under the consumption method, OM&S would be expensed when consumed. Due to system limitations, in some instances expenditures for capital and other long-term assets may be recognized as operating expenses. The Department continues to implement process and system improvements to address these limitations.

1.G. Accounting for Intragovernmental Activities

Accounting standards require that an entity eliminate intraentity activity and balances from consolidated financial statements in order to prevent overstatement for business with itself. However, the Department cannot accurately identify intragovernmental transactions by customer because the Department's systems do not track buyer and seller data at the transaction level. Generally, seller entities within the Department provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal Department accounting offices. In most cases, the buyer-side records are adjusted to agree with the Department's seller-side balances and are then eliminated. The Department is implementing replacement systems and a standard financial information structure which will incorporate the necessary elements that will enable the Department to correctly report, reconcile, and eliminate intragovernmental balances.

The U.S. Treasury's Federal Intragovernmental Transactions Accounting Policies Guide and Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government, provide guidance for reporting and reconciling intragovernmental balances. While the Department is unable to fully reconcile intragovernmental transactions with all federal agencies, the Department is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The Department's proportionate share of public debt and related expenses of the Federal government is not included. The Federal government does not apportion debt and related costs to federal agencies. The Department's financial statements do not report any public debt, interest, or source of public financing, whether from issuance of debt or tax revenues. Generally, financing for the construction of the Department's facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the U.S. Treasury does not allocate such costs to the Department.

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis, the Department's FBWT is adjusted to agree with the U.S. Treasury's accounts.

1.J. Cash and Other Monetary Assets

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

The majority of cash and all foreign currency is classified as “nonentity” and is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

The Department conducts a significant portion of operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations:(1) operations and maintenance; (2) military personnel; (3) military construction; (4) family housing operation and maintenance; and (5) family housing construction. The gains and losses are calculated 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 foreign currency fluctuation transactions.

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon an 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 in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual at http://www.fms.treas.gov/tfm/vol1/07-03.pdf.

1.L. Direct Loans and Loan Guarantees

The Department operates a direct loan and loan guarantee program authorized by the National Defense Authorization Act for FY 1996 (Public Law (PL) 104-106, Section 2801). The Act 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 the 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.

The National Defense Authorization Act for FY 2005 (PL 108-375, Section 2805) provided permanent authorities to the Military Housing Privatization Initiative (MHPI).

The Department operates the Armament Retooling and Manufacturing Support Initiative under Title 10 United States Code 4551-4555. This loan guarantee program is designed to encourage commercial use of inactive government facilities. The revenue generated from property rental offsets the cost of maintaining these facilities.

The Department administers the Foreign Military Financing program on behalf of the EOP. This program is authorized by sections 23 and 24 of the Arms Export Control Act of 1976, as amended, PL 90-629, as amended, and Section 503(a). This program provides loans to help countries purchase U.S. produced weapons, defense equipment, services, or military training. The direct loans and loan guarantees related to Foreign Military Sales are not included in these financial statements, per the Department's agreement with OMB; this information is provided separately as other accompanying information.

The Federal Credit Reform Act of 1990 governs all amended direct loan obligations and loan guarantee commitments made after FY 1991.

1.M. Inventories and Related Property

The Department values approximately 72 percent of resale inventory using the moving average cost method. An additional 9 percent (fuel inventory) is reported using the first-in-first-out method. The Department reports the remaining 19 percent of resale inventories at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, Accounting for Inventory and Related Property. Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (PL 104-208). The Department is continuing to transition the balance of the inventories to the moving average cost method through the use of new inventory systems. Most transitioned balances, however, were not baselined to auditable historical cost and remain noncompliant with SFFAS No. 3.

The Department manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in the Department's materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies. The Department is currently developing a methodology to be used to account for "inventory held for sale" and "inventory held in reserve for future sale," with a completion date of year-end FY 2011 reporting.

Related property includes OM&S and stockpile materiel. The OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchase method. Under this method, materiel and supplies are expensed when purchased. During FY 2010 and FY 2009, the Department expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the Department and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

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

The Department recognizes excess, obsolete, and unserviceable inventory and OM&S at a net realizable value of $0 pending development of an effective means of valuing such materiel.

Inventory available and purchased for resale includes consumable spare and repair parts, and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make it suitable for sale. Often, it is more economical to repair these items rather than to procure them. The Department often relies on weapon systems and machinery no longer in production. As a result, 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. Work in process balances include: (1) costs related to the production or servicing of items, including direct material, labor, and applied overhead; (2) the value of finished products or completed services that are yet to be placed in service; and (3) munitions in production and depot maintenance work with associated costs incurred in the delivery of maintenance services.

1.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 are amortized over the term of the investments using the effective interest rate method or another method that yields similar results. The Department's intent is to hold investments to maturity unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The Department invests in nonmarketable, market-based U.S. Treasury securities, which are issued to federal agencies by the U. S. Treasury's Bureau of the Public Debt. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

The Department's net investments are held by various trust and special funds. These funds include the Military Retirement Fund; Medicare-Eligible Retiree Health Care Fund; Other Defense Organizations General Fund trust and special funds; donations (gift funds); and the U. S. Treasury managed trust funds reported by USACE including the South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Funds.

Other investments represent joint ventures with private developers constructing or improving military housing on behalf of the Department under the authority of the MHPI, authorized by PL 104-106, Section 2801. These investments do not require market value disclosure. The Department's potential losses on these ventures are limited to the amounts invested.

1.O. General Property, Plant and Equipment

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

The Department's General Property, Plant, and Equipment (PP&E) capitalization threshold is $100 thousand except for real property, which is $20 thousand. The Department has not fully implemented the threshold for real property; therefore, the Department is primarily using the capitalization threshold of $100 thousand for General PP&E, and most real property.

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

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

The USACE Civil Works General PP&E is capitalized at acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost exceeds $25 thousand. The exception is buildings and structures related to hydropower projects, which are capitalized regardless of cost.

When it is in the best interest of the government, the Department provides government property to contractors 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 meets or exceeds the Department's capitalization threshold, federal accounting standards require that it be reported on the Department's Balance Sheet.

The Department developed policy and a reporting process for contractors with government furnished equipment that provides appropriate General PP&E information for financial statement reporting. The Department requires that entities maintain, in their property systems, information on all property furnished to contractors. These actions are structured to capture and report the information necessary for compliance with federal accounting standards. The Department has not fully implemented this policy primarily due to system limitations.

1.P. Advances and Prepayments

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

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, the Department records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The Department records the asset and liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The Department, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risks of ownership. Payments for operating leases are expensed over the lease term as they become payable.

Office space and leases entered into by the Department are the largest component of operating leases and are based on costs gathered from existing leases, General Services Administration bills, and interservice support agreements. Future year projections use the Consumer Price Index.

1.R. Other Assets

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

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 may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulation, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the government. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost reimbursement contracts. It is the Department's policy to record certain contract financing payments as other assets. The Department has not fully implemented this policy primarily due to system limitations.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion. The Defense Federal Acquisition Regulation Supplement authorizes progress payments based on a percentage or stage of completion only for construction of real property, shipbuilding and ship conversion, alteration, or repair. Progress payments based on percentage or stage of completion are reported as Construction in Progress.

1.S. Contingencies and Other Liabilities

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

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

Other liabilities also arise as a result of anticipated disposal costs for the Department's assets. Consistent with SFFAS No. 6, Accounting for Property, Plant, and Equipment, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Based on the Department's policy, which is consistent with SFFAS No. 5, Accounting for Liabilities of the Federal Government, nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. The Department recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

1.T. Accrued Leave

The Department reports liabilities for military leave and accrued compensatory and annual leave for civilians. Sick leave for civilians is expensed when taken. The liabilities are based on current pay rates.

1.U. Net Position

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

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

Cumulative results of operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains) since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.V. Treaties for Use of Foreign Bases

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

1.W. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury.

Supported disbursements and collections are evidenced by corroborating documentation. Unsupported disbursements and collections do not have supporting documentation for the transaction and most likely would not meet audit scrutiny.

The Department's policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Supported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly. Unsupported, undistributed disbursements are recorded as disbursements in transit and reduce nonfederal accounts payable. Unsupported, undistributed collections are recorded in nonfederal other liabilities.

1.X. Fiduciary Activities

Fiduciary cash and other assets are not assets of the Department and are not recognized on the balance sheet. Fiduciary activities are reported in the financial statement note schedules.

1.Y. Significant Events

During FY 2010, the Department implemented Statement of Federal Financial Accounting Standard (SFFAS) No. 33, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates" that prescribes a standard for selecting the discount rate and valuation date used in estimating actuarial liabilities and requires a separate presentation of gains and losses from changes in long-term assumptions used to estimate the actuarial liability. Refer to Note 17, Military Retirement and Other Federal Employment Benefits and Note 18, General Disclosures Related to the Statement of Net Cost, for additional information.

Note 2. Nonentity Assets

Nonentity Assets		*Dollars in Millions*
As of September 30	**2010**	**Restated 2009**
Intragovernmental Assets		
Fund Balance with Treasury	$ 620.5	$ 823.2
Accounts Receivable	0.5	0.0
Total Intragovernmental Assets	**$ 621.0**	**$ 823.2**
Nonfederal Assets		
Cash and Other Monetary Assets	$ 2,001.0	$ 2,239.4
Accounts Receivable	6,412.3	4,583.5
Other Assets	184.8	186.2
Total Nonfederal Assets	**$ 8,598.1**	**$ 7,009.1**
Total Nonentity Assets	**$ 9,219.1**	**$ 7,832.3**
Total Entity Assets	**$ 1,921,044.3**	**$ 1,789,617.0**
Total Assets	**$ 1,930,263.4**	**$ 1,797,449.3**

Nonentity assets are assets for which the Department maintains stewardship accountability and reporting responsibility but are not available for the Department's normal operations.

The Department identified the following restatements: (1) errors impacting ending account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems; (2) property, plant and equipment valued incorrectly; (3) overstated accounts receivable (nonfederal) established to recover pharmacy costs from drug manufacturers; (4) inventory valued incorrectly; and (5) contract financing payments based on auditor-recommended adjustments. To correct the errors, the Department restated Note 2, Nonentity Assets, Total Entity Assets by $2.0 billion. Refer to Note 26, Restatements, for further information.

Intragovernmental Fund Balance with Treasury (FBWT) consists of deposit funds. Deposit funds are generally used to record amounts held temporarily until paid to the appropriate party. Additionally, the balance includes residual amounts of seized Iraqi cash and the Development Fund for Iraq (DFI). Seized Iraqi cash is former Iraqi regime monies confiscated by coalition forces and restricted for support of the Iraqi people. The DFI consists of proceeds from Iraqi oil sales, repatriated assets from the United States and other nations, and deposits from unencumbered oil-for-food proceeds. DFI funds are restricted for Iraqi infrastructure and other Iraqi support needs.

Intragovernmental Accounts Receivable consists of amounts due from cancelled appropriations.

Nonfederal Cash and Other Monetary Assets primarily consists of cash held by Disbursing Officers to carry out payment, collection, and foreign currency accommodation exchange missions.

Nonfederal Accounts Receivable consists of amounts due from canceled year appropriations, and interest, fines, and penalties due on debt. Generally, the Department cannot use the collections and must distribute them to the U.S. Treasury. Where the Department has specific statutory authority to retain collections from certain canceled year accounts receivable, those receivables are reported as entity assets.

Nonfederal Other Assets consists of an Advance Payment Pool Agreement with a nonprofit educational institution to finance research and development projects.

Note 3. Fund Balance with Treasury

Fund Balance with Treasury		*Dollars in Millions*		
As of September 30		2010		2009
Fund Balance				
Appropriated Funds	$	507,886.2	$	491,763.4
Revolving Funds		9,965.4		7,804.2
Trust Funds		2,400.9		1,874.0
Special Funds		716.3		395.8
Other Fund Types		672.9		916.9
Total Fund Balance	**$**	**521,641.7**	**$**	**502,754.3**
Fund Balance Per Treasury Versus Agency				
Fund Balance per Treasury	$	528,003.5	$	509,703.2
Fund Balance per Agency		521,641.7		502,754.3
Reconciling Amount	**$**	**6,361.8**	**$**	**6,948.9**

Other Fund Types primarily consists of deposit funds, receipt accounts, and Development Fund for Iraq.

The Department shows a reconciling net difference of $6.4 billion with the U.S. Treasury. This includes canceling year authority of $5.5 billion, unavailable receipts of $688.0 million, and fiduciary activities of $178.9 million.

Status of Fund Balance with Treasury		*Dollars in Millions*
As of September 30	**2010**	**Restated 2009**
Unobligated Balances		
Available	$ 143,733.4	$ 131,437.2
Unavailable	503,114.4	440,714.6
Obligated Balance not yet Disbursed	459,240.3	454,275.7
Nonbudgetary FBWT	807.8	899.8
NonFBWT Budgetary Accounts	(585,254.2)	(524,573.0)
Total Fund Balance	**$ 521,641.7**	**$ 502,754.3**

The Department identified errors impacting ending FY 2009 account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems. To correct the errors, the Department restated Note 3, Fund Balance with Treasury, Status of Fund Balance with Treasury. Refer to Note 26, Restatements, for further information.

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support the FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable balance consists primarily of funds invested in U.S. Treasury securities that are temporarily precluded from obligation by law. Certain unobligated balances are restricted for future use and are not apportioned for current use. Unobligated balances for trust fund accounts are restricted for use by the public law that established the funds.

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

Nonbudgetary FBWT includes accounts that do not have budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts, and nonentity FBWT.

NonFBWT Budgetary Accounts reduces the Status of FBWT and consists of investments in U.S. Treasury securities, unfilled customer orders without advance, contract and borrowing authority, and receivables.

Note 4. Investments and Related Interest

Investments and Related Interest As of September 30	2010 Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure *Dollars in Millions*
Intragovernmental Securities					
Nonmarketable, Market-Based					
Military Retirement Fund	$ 325,124.5	See Below	$ (6,559.6)	$ 318,564.9	$ 351,050.7
Medicare-Eligible Retiree Health Care Fund	168,568.9	See Below	(4,134.2)	164,434.7	182,212.1
US Army Corps of Engineers	5,716.8	See Below	(11.2)	5,705.6	5,987.4
Other Funds	3,525.3	See Below	(39.3)	3,486.0	3,670.9
Total Nonmarketable,Market-Based	$ 502,935.5		$ (10,744.3)	$ 492,191.2	$ 542.921.1
Accrued Interest	4,945.7			4,945.7	4,945.7
Total Intragovernmental Securities	$ 507,881.2		$ (10,744.3)	$ 497,136.9	$ 547,866.8
Other Investments					
Total Other Investments	$ 2,489.7		$ 0.0	$ 2,489.7	N/A
Amortization Method Used: Effective Interest					

Investments and Related Interest As of September 30	Restated 2009 Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure *Dollars in Millions*
Intragovernmental Securities					
Nonmarketable, Market-Based					
Military Retirement Fund	$ 281,250.3	See Below	$ (5,774.0)	$ 275,476.3	$ 283,292.6
Medicare-Eligible Retiree Health Care Fund	150,184.3	See Below	(3,345.5)	146,838.8	150,820.6
US Army Corps of Engineers	5,239.5	See Below	(41.7)	5,197.8	5,363.2
Other Funds	2,915.6	See Below	(28.8)	2,886.8	2,618.8
Total Nonmarketable, Market-Based	$ 439,589.7	See Below	$ (9,190.0)	$ 430,399.7	$ 442,095.2
Accrued Interest	4,484.3			4,484.3	4,484.3
Total Intragovernmental Securities	$ 444,074.0		$ (9,190.0)	$ 434,884.0	$ 446,579.5
Other Investments					
Total Other Investments	$ 2,017.1		$ 0.0	$ 2,017.1	N/A
Amortization Method Used: Effective Interest					

The Department invests primarily in non-marketable, market-based securities which fluctuate in tandem with the current selling price of the equivalent marketable security on the open market. These securities are purchased with the intent to hold until maturity, thus balances are not adjusted to market value.

The U.S. Treasury securities are issued to the earmarked funds as evidence of its receipts and are an asset to the Department and a liability to the U.S. Treasury. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash generated from earmarked funds are deposited in the U.S. Treasury, which uses the cash for general government purposes. Since the Department and the U.S. Treasury are both part of the Federal Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements.

The U.S. Treasury securities provide the Department with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Department requires redemption of these securities to make expenditures, the Government will finance them from accumulated cash balances by raising taxes or other receipts, borrowing from the public or repaying less debt, or curtailing other expenditures. The Federal Government uses the same method to finance all other expenditures.

Other Funds primarily consists of $2.2 billion in investments of the DoD Education Benefits Trust Fund, $843.0 million in investments of the Host Nation Support for U.S. Relocation Activities Trust Fund, and $413.8 million in investments of the Voluntary Separation Incentive Trust Fund.

Note 5. Accounts Receivable

Accounts Receivable			*Dollars in Millions*
	2010		
As of September 30	**Gross Amount Due**	**Allowance For Estimated Uncollectibles**	**Accounts Receivable, Net**
Intragovernmental Receivables	$ 1,249.2	N/A	$ 1,249.2
Nonfederal Receivables (From the Public)	10,411.4	(655.2)	9,756.2
Total Accounts Receivable	**$ 11,660.6**	**$ (655.2)**	**$ 11,005.4**

Accounts Receivable			Dollars in Millions
	Restated 2009		
As of September 30	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 1,219.6	N/A	$ 1,219.6
Nonfederal Receivables (From the Public)	8,245.8	(514.4)	7,731.4
Total Accounts Receivable	**$ 9,465.4**	**$ (514.4)**	**$ 8,951.0**

Accounts receivable represent the Department's claim for payment from other entities. The Department only recognizes an allowance for uncollectible amounts from the public. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules.

The Department identified errors impacting ending account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems; and overstated accounts receivable (nonfederal) established to recover pharmacy costs from drug manufacturers. To correct the errors, the Department restated Note 5, Accounts Receivable. Refer to Note 26, Restatements, for further information.

Note 6. Other Assets

Other Assets		Dollars in Millions
As of September 30	2010	Restated 2009
Intragovernmental Other Assets		
Advances and Prepayments	$ 1,749.8	$ 2,469.8
Other Assets	124.9	124.9
Total Intragovernmental Other Assets	**$ 1,874.7**	**$ 2,594.7**
Nonfederal Other Assets		
Outstanding Contract Financing Payments	$ 63,420.7	$ 54,541.6
Advances and Prepayments	1,810.7	1,234.1
Other Assets (With the Public)	403.7	356.2
Total Nonfederal Other Assets	**$ 65,635.1**	**$ 56,131.9**
Total Other Assets	**$ 67,509.8**	**$ 58,726.6**

The Department overstated contract financing payments in FY 2009. To adjust the balances, the Department restated Nonfederal Other Assets by $505.6 million. Refer to Note 26, Restatements, for further information.

Intragovernmental Other Assets represents the Department's right to approximately 6 million barrels of crude oil held by the Department of Energy.

The balance of Outstanding Contract Financing Payments includes $61.9 billion in contract financing payments and an additional $1.6 billion in estimated future payments to contractors upon delivery and government acceptance of satisfactory products. Refer to Note 15, Other Liabilities, for further information.

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

The balance of Other Assets (With the Public) includes $218.9 million for inventory returned to vendors pending credit and $184.8 million for an Advance Payment Pool Agreement with a nonprofit institution.

Note 7. Cash and Other Monetary Assets

Cash and Other Monetary Assets		Dollars in Millions
As of September 30	2010	2009
Cash	$ 634.8	$ 810.8
Foreign Currency	1,431.9	1,506.0
Other Monetary Assets	0.0	0.0
Total Cash, Foreign Currency, and Other Monetary Assets	**$ 2,066.7**	**$ 2,316.8**

Cash (except for $65.7 million in undeposited collections and imprest funds) and Foreign Currency represent nonentity assets and are restricted and unavailable to fund the Department's mission.

Note 8. Direct Loan and Loan Guarantees

Direct Loan and Loan Guarantee Programs

The Department operates the following direct loan and/or loan guarantee programs:

- Military Housing Privatization Initiative (MHPI) and
- Armament Retooling and Manufacturing Support Initiative (ARMS)

The Federal Credit Reform Act of 1990 governs all new and amended direct loan obligations and loan guarantee commitments made after FY 1991.

Direct loans are reported at the net present value of the following projected cash flows:

- Loan disbursements;
- Repayments of principal; and
- Payments of interest and other payments over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties, and other recoveries.

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

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

Military Housing Privatization Initiative

The MHPI includes both direct loan and loan guarantee programs. The programs are authorized by the National Defense Authorization Act for FY 1996 (PL 104-106, Section 2801) and includes a series of authorities that allow the Department to work with the private sector to renovate and build military family housing. The MHPI accelerates the construction of new housing built to market standards and leverages private sector capital. One of the goals of the Department is to obtain private sector capital to leverage government dollars. The Department provides protection to the private sector partner against specific risks, such as base closure or member deployment.

Armament Retooling and Manufacturing Support Initiative

The ARMS Initiative, Title 10 United States. Code 4551-4555, is a loan guarantee program designed to encourage commercial use of the Army's inactive ammunition plants through incentives for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements, however; this capacity may be needed by the military in the future. Revenues from property rentals are used to help offset the overhead costs for the operation, maintenance and environmental cleanup at the facilities.

In an effort to preclude any additional loan liability, the Army instituted an ARMS loan guarantee moratorium in FY 2004. The Army continues to operate under the moratorium and does not anticipate new loans.

Summary of Direct Loans and Loan Guarantees *Dollars in Millions*

	2010	2009
Loans Receivable		
Direct Loans:		
Foreign Military Loan Liquidating Account	$ 0.0	$ 0.0
Military Housing Privatization Initiative	522.3	398.4
Foreign Military Financing Account	0.0	0.0
Military Debt Reduction Financing Account	0.0	0.0
Total Direct Loans	**$ 522.3**	**$ 398.4**
Defaulted Loan Guarantees:		
Foreign Military Financing Account	0.0	0.0
Military Housing Privatization Initiative	0.0	0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.1
Total Default Loan Guarantees	**$ 0.0**	**$ 0.1**
Total Loans Receivable	**$ 522.3**	**$ 398.5**
Loan Guarantee Liability		
Foreign Military Liquidating Account	$ 0.0	$ 0.0
Military Housing Privatization Initiative	16.2	18.7
Armament Retooling & Manufacturing Support Initiative	3.6	2.4
Total Loan Guarantee Liability	**$ 19.8**	**$ 21.1**

Direct Loans Obligated		*Dollars in Millions*
	2010	**2009**
Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method):		
Foreign Military Loan Liquidating Account		
Loans Receivable Gross	$ 0.0	$ 0.0
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Loan Losses	0.0	0.0
Value of Assets Related to Direct Loans, Net	**0.0**	**0.0**
Direct Loans Obligated After FY 1991 (Present Value Method):		
Military Housing Privatization Initiative		
Loans Receivable Gross	$ 651.5	$ 510.9
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Subsidy Cost (Present Value)	(129.2)	(112.5)
Value of Assets Related to Direct Loans	**522.3**	**398.4**
Foreign Military Financing Account		
Loans Receivable Gross	0.0	0.0
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Subsidy Cost (Present Value)	0.0	0.0
Value of Assets Related to Direct Loans	**0.0**	**0.0**
Military Debt Reduction Financing Account		
Loans Receivable Gross	0.0	0.0
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Subsidy Cost (Present Value)	0.0	0.0
Value of Assets Related to Direct Loans	**0.0**	**0.0**
Total Direct Loans Receivable	**$ 522.3**	**$ 398.4**

Loans receivable, net, or value of assets related to loans, is not the same as the proceeds the Department would expect to receive from selling the loans.

Interest receivable is calculated using the interest earned method.

Total Amount of Direct Loans Disbursed		*Dollars in Millions*
	2010	**2009**
Direct Loan Programs		
Military Housing Privatization Initiative	$ 151.0	$ 171.7
Foreign Military Financing Account	0.0	0.0
Military Debt Reduction Financing Account	0.0	0.0
Total	**$ 151.0**	**$ 171.7**

Subsidy Expense for Direct Loan by Program

Dollars in Millions

2010	Interest Differential	Defaults	Fees	Other	Total
New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 18.7	$ 16.2	$ 0.0	$ 0.0	$ 34.9
Foreign Military Financing Account	0.0	0.0	0.0	0.0	0.0
Military Debt Reduction Financing Account	0.0	0.0	0.0	0.0	0.0
Total	**$ 18.7**	**$ 16.2**	**$ 0.0**	**$ 0.0**	**$ 34.9**
2009	Interest Differential	Defaults	Fees	Other	Total
New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 16.0	$ 16.4	$ 0.0	$ 0.0	$ 32.4
Foreign Military Financing Account	0.0	0.0	0.0	0.0	
Military Debt Reduction Financing Account	0.0	0.0	0.0	0.0	0.0
Total	**$ 16.0**	**$ 16.4**	**$ 0.0**	**$ 0.0**	**$ 32.4**
2010	Modifica-tions	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ (4.0)	$ (7.7)	$ (11.7)	$ (11.7)
Foreign Military Financing Account	0.0	0.0	0.0	0.0	0.0
Military Debt Reduction Financing Account	0.0	0.0	0.0	0.0	0.0
Total	**$ 0.0**	**$ (4.0)**	**$ (7.7)**	**$ (11.7)**	**$ (11.7)**
2009	Modifica-tions	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ (3.4)	$ (12.5)	$ (15.9)	$ (15.9)
Foreign Military Financing Account	0.0	0.0	0.0	0.0	0.0
Military Debt Reduction Financing Account	0.0	0.0	0.0	0.0	0.0
Total	**$ 0.0**	**$ (3.4)**	**$ (12.5)**	**$ (15.9)**	**$ (15.9)**

	2010	2009
Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	$ 23.2	$ 16.5
Foreign Military Financing Account	0.0	0.0
Military Debt Reduction Financing Account	0.0	0.0
Total	$ 23.2	$ 16.5

Subsidy Rate for Direct Loans by Program					*Dollars in Millions*
As of September 30	Interest Differential	Defaults	Fees and other Collections	Other	Total
Budget Subsidy Rates for Direct Loans					
Military Housing Privatization Initiative	19.61%	10.43%	0.00%	0.00%	30.04%
Foreign Military Financing Account	0.00%	0.00%	0.00%	0.00%	0.00%
Military Debt Reduction Financing Account	0.00%	0.00%	0.00%	0.00%	0.00%

Subsidy rates pertain to the loan agreements contracted during the current fiscal year. 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 disbursed in the current year results from disbursements of loans from current and prior year loan agreements. The subsidy expense reported in the current year also includes reestimates.

Schedule for Reconciling Subsidy Cost Allowance Balances for Post FY1991 Direct Loans		*Dollars in Millions*
	2010	2009
Beginning Balance, Changes, and Ending Balance:		
Beginning Balance of the Subsidy Cost Allowance	**$ 112.5**	**$ 103.6**
Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
Interest Rate Differential Costs	18.7	16.0
Default Costs (Net of Recoveries)	16.2	16.4
Fees and Other Collections	0.0	0.0
Other Subsidy Costs	0.0	0.0
Total of the above Subsidy Expense Components	**$ 34.9**	**$ 32.4**
Adjustments		
Loan Modifications	$ 0.0	$ 0.0
Fees Received	0.0	0.0
Foreclosed Property Acquired	0.0	0.0
Loans Written Off	0.0	0.0
Subsidy Allowance Amortization	(6.5)	(7.6)
Other	0.0	0.0
Total of the above Adjustment Components	**$ (6.5)**	**$ (7.6)**
Ending Balance of the Subsidy Cost Allowance before Reestimates	**$ 140.9**	**$ 128.4**
Add or Subtract Subsidy Reestimates by Component		
Interest Rate Reestimates	(4.0)	(3.4)
Technical/Default Reestimate	(7.7)	(12.5)
Total of the above Reestimate Components	**$ (11.7)**	**(15.9)**
Ending Balance of the Subsidy Cost Allowance	**$ 129.2**	**$ 112.5**

Defaulted Guaranteed Loans As of September 30	Dollars in Millions 2010	2009
Defaulted Guaranteed Loans from Pre-FY 1992 Guarantees (Allowance for Loss Method):		
Foreign Military Loan Liquidating Amount		
Defaulted Guaranteed Loans Receivable, Gross	$ 0.0	$ 0.0
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Loan Losses	0.0	0.0
Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	**$ 0.0**	**$ 0.0**
Defaulted Guarranteed Loans from Post-FY 1991 Guarantees (Present Value Method):		
Military Housing Privatization Initiative		
Defaulted Guaranteed Loans Receivable, Gross	$ 0.0	$ 0.0
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Subsidy Cost (Present Value)	0.0	0.0
Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	**$ 0.0**	**$ 0.0**
Armament Retooling & Manufacturing Support Initiative		
Defaulted Guaranteed Loans Receivable, Gross	$ 0.7	$ 0.7
Interest Receivable	0.0	0.0
Foreclosed Property	0.0	0.0
Allowance for Subsidy Cost (Present Value)	(0.7)	(0.6)
Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	**$ 0.0**	**$ 0.1**
Total Value of Assets Related to Defaulted Guaranteed Loans Receivable	**$ 0.0**	**$ 0.1**

Guaranteed Loans Outstanding As of September 30	Dollars in Millions Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
2010		
Guaranteed Loans Outstanding		
Military Housing Privatization Initiative	$ 461.6	$ 461.6
Armament Retooling & Manufacturing Support Initiative	2.7	2.3
Foreign Military Liquidating Account	0.0	0.0
Total	**$ 464.3**	**$ 463.9**

2009				
Guaranteed Loans Outstanding				
Military Housing Privatization Initiative	$	467.2	$	467.2
Armament Retooling & Manufacturing Support Initiative		3.0		2.4
Foreign Military Liquidating Account		0.0		0.0
Total	**$**	**470.2**	**$**	**469.6**

2010				
New Guaranteed Loans Disbursed				
Military Housing Privatization Initiative	$	0.0	$	0.0
Armament Retooling & Manufacturing Support Initiative		0.0		0.0
Total	**$**	**0.0**	**$**	**0.0**
2009				
New Guaranteed Loans Disbursed				
Military Housing Privatization Initiative	$	0.0	$	0.0
Armament Retooling & Manufacturing Support Initiative		0.0		0.0
Total	**$**	**0.0**	**$**	**0.0**

Liabilities for Loan Guarantees As of September 30	*Dollars in Millions*			
	2010		**2009**	
Liabilities for Losses on Loan Guarantees from Pre 1992 (Allowance for Loss):				
Foreign Military Liquidating Account	$	0.0	$	0.0
Total Loan Guarantee Liability (Pre-FY 1992)	**$**	**0.0**	**$**	**0.0**
Liabilities for Loan Guarantee from Post 1991 (Present Value)				
Military Housing Privatization Initiative	$	16.2	$	18.7
Armament Retooling & Manufacturing Support Initiative		3.6		2.4
Total Loan Guarantee Liability (Post FY 1991)	**$**	**19.8**	**$**	**21.1**
Total Loan Guarantee Liability	**$**	**19.8**	**$**	**21.1**

Subsidy Expense for Loan Guarantees by Program
As of September 30 *Dollars in Millions*

2010	Interest Differential	Defaults	Fees	Other	Total
New Loan Guarantees Disbursed					
Military Housing Privatization Initiative	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	**$ 0.0**	**$ 0.0**	**$ 0.0**	**$ 0.0**	**$ 0.0**

2009	Interest Differential	Defaults	Fees	Other	Total
New Loan Guarantees Disbursed					
Military Housing Privatization Initiative	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	**$ 0.0**	**$ 0.0**	**$ 0.0**	**$ 0.0**	**$ 0.0**

2010	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ (1.1)	$ (2.4)	$ (3.5)	$ (3.5)
Armament Retooling & Manufacturing Support Initiative	0.0	0.0	0.0	0.0	0.0
Total	**$ 0.0**	**$ (1.1)**	**$ (2.4)**	**$ (3.5)**	**$ (3.5)**

2009	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.0	$ (1.6)	$ (3.0)	$ (4.6)	$ (4.6)
Armament Retooling & Manufacturing Support Initiative	0.0	0.1	0.0	0.1	0.1
Total	**$ 0.0**	**$ (1.5)**	**$ (3.0)**	**$ (4.5)**	**$ (4.5)**

	2010	2009
Total Loan Guarantee:		
Military Housing Privatization Initiative	$ (3.5)	$ (4.6)
Armament Retooling & Manufacturing Support Initiative	0.0	0.1
Total	**$ (3.5)**	**$ (4.5)**

There are no new loan guarantees in FY 2010.

Subsidy Rates for Loan Guarantees by Program					
As of September 30	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Budget Subsidy Rates for Loan Guarantees					
Military Housing Privatization Initiative	0.00%	0.00%	0.00%	0.00%	0.00%
Armament Retooling & Manufacturing Support Initiative	0.00%	0.00%	0.00%	0.00%	0.00%

There are no new loan guarantees in FY 2010.

Schedule for Reconciling Loan Guarantee Liability Balances for Post-FY 1991 Loan Guarantees As of September 30	2010	2009
		Dollars in Millions
Beginning Balance, Changes, and Ending Balance:		
Beginning Balance of the Loan Guarantee Liability	$ 21.1	$ 24.5
Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
Interest Supplement Costs	$ 0.0	$ 0.0
Default Costs (Net of Recoveries)	0.0	0.0
Fees and Other Collections	0.0	0.0
Other Subsidy Costs	0.0	0.0
Total of the above Subsidy Expense Components	**$ 0.0**	**$ 0.0**
Adjustments		
Loan Guarantee Modifications	$ 0.0	$ 0.0
Fees Received	0.0	0.0
Interest Supplements Paid	0.0	0.0
Foreclosed Property and Loans Acquired	0.0	0.0
Claim Payments to Lenders	0.0	0.0
Interest Accumulation on the Liability Balance	1.1	1.1
Other	1.1	0.0
Total of the above Adjustments	**$ 2.2**	**$ 1.1**
Ending Balance of the Loan Guarantee Liability before Reestimates	**$ 23.3**	**$ 25.6**
Add or Subtract Subsidy Reestimates by Component		
Interest Rate Reestimate	$ (1.1)	$ (1.5)
Technical/Default Reestimate	(2.4)	(3.0)
Total of the above Reestimate Components	**$ (3.5)**	**$ (4.5)**
Ending Balance of the Loan Guarantee Liability	**$ 19.8**	**$ 21.1**

Administrative Expenses

Administrative Expenses are limited to separately identified expenses for administering pre-FY 1992 and post-FY 1991 Direct Loans and Loan Guarantee Programs. The Department does not maintain a separate program to capture the expenses related to direct loans and loan guarantees for MHPI. Administrative expenses for the ARMS Initiative represent a fee paid to the U.S. Department of Agriculture, Rural Business Cooperative Service for servicing the loan guarantee program.

Note 9. Inventory and Related Property, Net

Inventory and Related Property *As of September 30*	2010	Restated 2009
		Dollars in Millions
Inventory, Net	$ 84,625.0	$ 83,288.0
Operating Materiel & Supplies, Net	147,011.2	145,258.4
Stockpile Materiel, Net	598.1	723.6
Total Inventory and Related Property	**$ 232,234.3**	**$ 229,270.0**

Inventory, Net				Dollars in Millions
	2010			Valuation Method
As of September 30	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	
Inventory Categories				
Available and Purchased for Resale	$ 81,226.4	$ (18,648.9)	$ 62,577.5	LAC,MAC
Held for Repair	28,950.1	(7,947.2)	21,002.9	LAC,MAC
Excess, Obsolete, and Unserviceable	8,443.0	(8,443.0)	0.0	NRV
Raw Materiel	710.6	0.0	710.6	MAC,SP,LAC
Work in Process	334.0	0.0	334.0	AC
Total Inventory, Net	**$ 119,664.1**	**$ (35,039.1)**	**$ 84,625.0**	

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
MAC = Moving Average Cost

Inventory, Net				Dollars in Millions
	Restated 2009			Valuation Method
As of September 30	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	
Inventory Categories				
Available and Purchased for Resale	$ 87,742.2	$ (23,949.4)	$ 63,792.8	LAC,MAC
Held for Repair	28,055.7	(9,578.0)	118,477.7	LAC,MAC
Excess, Obsolete, and Unserviceable	7,833.8	(7,833.8)	0.0	NRV
Raw Materiel	490.3	0.0	490.3	MAC,SP,LAC
Work in Process	527.2	0.0	527.2	AC
Total Inventory, Net	**$ 124,649.2**	**$ (41,361.2)**	**$ 83,288.0**	

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
MAC = Moving Average Cost

During FY 2010, the Department identified inventory valued incorrectly. To correct the error, the Department restated Note 9, Inventory and Related Property, Available and Purchased for Resale, by $473.4 million. Refer to Note 26, Restatements, for further information.

Restrictions

The following are restrictions on the use, sale, or disposition of inventory.

- War reserve materiel valued at $2.7 billion;
- Commissary items valued at $401.9 million held for purchase by authorized patrons; and
- Dispositions pending litigation or negotiation valued at $87.6 million.

There are no known restrictions on inventory disposition related to environmental or other liabilities.

General Composition of Inventory

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

- Held for sale, or held for repair and eventual sale;
- In the process of production for sale; or
- To be consumed in the production of goods for sale or in the provision of service for a fee.

The Department assigns inventory items to a category based upon the type and condition of the asset.

Operating Materiel and Supplies, Net *Dollars in Millions*

As of September 30	2010			Valuation Method
	OM&S, Gross Value	Revaluation Allowance	OM&S, Net	
OM&S Categories				
Held for Use	$ 131,524.9	$ 0.0	$ 131,524.9	SP, LAC, MAC
Held for Repair	17,532.2	(2,045.9)	15,486.3	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	2,631.6	(2,631.6)	0.0	NRV
Total OM&S	**$ 151,688.7**	**$ (4,677.5)**	**$ 147,011.2**	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
SP = Standard Price
NRV = Net Realizable Value
MAC = Moving Average Cost

Operating Materiel and Supplies, Net *Dollars in Millions*

As of September 30	Restated 2009			Valuation Method
	OM&S, Gross Value	Revaluation Allowance	OM&S, Net	
OM&S Categories				
Held for Use	$ 128,932.9	$ 0.0	$ 128,932.9	SP, LAC, MAC
Held for Repair	17,984.2	(1,658.7)	16,325.5	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	3,386.2	(3,386.2)	0.0	NRV
Total OM&S	**$ 150,303.3**	**$ (5,044.9)**	**$ 145,258.4**	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
SP = Standard Price
NRV = Net Realizable Value
MAC = Moving Average Cost

Restrictions

Some munitions included in Operating Materiel and Supplies (OM&S) are restricted due to condition. Restricted munitions are considered obsolete or unserviceable when they cannot meet performance requirements. However, obsolete and unserviceable OM&S may be used in emergency combat situations in which no other suitable munitions are immediately available.

General Composition of OM&S

OM&S includes spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally-managed aircraft engines held for consumption. The Department assigns OM&S items into a category based upon the type and condition of the asset.

Stockpile Materiel, Net				*Dollars in Millions*
	2010			Valuation Method
As of September 30	Stockpile, Materiel Amount	Allowance for Gains (Losses)	Stockpile Materiel, Net	
Stockpile Material Categories				
Held for Sale	$ 568.8	$ 0.0	$ 568.8	AC, LCM
Held in Reserve for Future Sale	29.3	0.0	29.3	AC, LCM
Total Stockpile Material	**$ 598.1**	**$ 0.0**	**$ 598.1**	
Legend for Valuation Methods:				
AC = Actual Cost		*LCM = Lower of Cost or Market*		

Stockpile Materiel, Net				*Dollars in Millions*
	Restated 2009			Valuation Method
As of September 30	Stockpile, Materiel Amount	Allowance for Gains (Losses)	Stockpile Materiel, Net	
Stockpile Material Categories				
Held for Sale	$ 694.3	$ 0.0	$ 694.3	AC, LCM
Held in Reserve for Future Sale	29.3	0.0	29.3	AC, LCM
Total Stockpile Material	**$ 723.6**	**$ 0.0**	**$ 723.6**	
Legend for Valuation Methods:				
AC = Actual Cost		*LCM = Lower of Cost or Market*		

Restrictions

Materiel held by the National Defense Stockpile (NDS) is restricted unless released by congressional action and made available for sale on the open market. Stockpile materiel may not be disposed except for: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained; or (4) authorization by law.

Before selling any materiel, Congress must enact specific enabling legislation (e.g., the National Defense Authorization Act). When authorized to offer materiel for sale, NDS removes the materiel from Materiel Held in Reserve and reclassifies these items as Materiel Held for Sale. The estimated market price of the stockpile materiel held for sale as of 4th Quarter, FY 2010, is $1.3 billion

General Composition of Stockpile Materiel

The Department holds strategic and critical stockpile materiel due to statutory requirements for use in national defense, conservation, or national emergencies.

Note 10. General PP&E, Net

General PP&E, Net		2010			*Dollars in Millions*
As of September 30	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 10,502.8	N/A	$ 10,502.8
Buildings, Structures, and Facilities	S/L	20 or 40	207,363.3	(111,929.1)	95,434.2
Leasehold Improvements	S/L	Lease term	976.0	(402.2)	573.8
Software	S/L	2-5 or 10	9,440.1	(6,148.3)	3,291.8
General Equipment	S/L	5 or 10	90,290.3	(58,283.2)	32,007.1
Military Equipment	S/L	Various	822,316.6	(408,613.4)	413,703.2
Assets Under Capital Lease[1]	S/L	Lease term	957.0	(642.2)	314.8
Construction-in-Progress	N/A	N/A	38,604.1	N/A	38,604.1
Other			1,226.0	(1.2)	1,224.8
Total General PP&E			**$ 1,181,676.2**	**$ (586,019.6)**	**$ 595,656.6**

[1] *Note 15 for additional information on Capital Leases*
Legend for Valuation Methods: S/L = Straight Line N/A = Not Applicable

General PP&E, Net		Restated 2009			*Dollars in Millions*
As of September 30	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 10,501.3	N/A	$ 10,501.3
Buildings, Structures, and Facilities	S/L	20 or 40	191,993.0	(108,100.2)	83,892.8
Leasehold Improvements	S/L	Lease term	703.1	(548.0)	155.1
Software	S/L	2-5 or 10	9,022.9	(5,610.1)	3,412.8
General Equipment	S/L	5 or 10	74,776.3	(52,333.9)	22,442.4
Military Equipment	S/L	Various	796,842.6	(390,333.2)	406,509.4
Assets Under Capital Lease[1]	S/L	Lease term	956.3	(601.2)	355.1
Construction-in-Progress	N/A	N/A	30,809.5	N/A	30,809.5
Other			53.9	(1.3)	52.6
Total General PP&E			**$ 1,115,658.9**	**$ (557,527.9)**	**$ 558,131.0**

[1] *Note 15 for additional information on Capital Leases*
Legend for Valuation Methods: S/L = Straight Line N/A = Not Applicable

The Department identified and restated property, plant and equipment valued incorrectly. Refer to Note 26, Restatements, for further information.

Heritage Assets and Stewardship Land

Statement of Federal Financial Accounting Standards No. 29, "Heritage Assets and Stewardship Land," requires note disclosures for these types of assets. The Department's policy is to preserve its heritage assets, which are items of historical, cultural, educational, or artistic importance.

The mission of the Department is to provide the military forces necessary to deter war and protect the security of the United States. In that mission, the Department, with minor exceptions, uses most of the buildings and stewardship land in its daily activities and includes the buildings on the Balance Sheet as multi-use heritage assets (capitalized and depreciated).

Differences in the heritage assets and stewardship land quantities from the FY 2009 ending and FY 2010 beginning unit counts resulted from efforts to improve quality of reported data. During FY 2009, FY 2008 data was used to report some categories of heritage assets and stewardship land.

Heritage assets within the Department consist of buildings and structures, archeological sites, and museum collections. The Department defines these as follows:

- Buildings and Structures. Buildings and structures that are listed, or eligible for listing, on the National Register of Historic Places, including Multi-Use Heritage Assets.
- Archeological Sites. Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Register of Historic Places in accordance with Section 110 National Historic Preservation Act.
- Museum Collection Items. Items which are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics.

The Department is unable to identify all quantities of heritage assets and stewardship land added through donation or devise in FY 2010 due to limitations of the Department's financial and nonfinancial management processes and systems that feed the financial statements. Currently, the Department has identified 42 Fine Art Objects acquired through donation or devise during FY 2010

Categories	Measure Quantity	As of 9/30/09	Additions	Deletions	As of 9/30/10
Buildings and Structures	Each	50,090	25,935	3,271	72,754
Archeological Sites	Each	29,650	1,061	2,130	28,581
Museum Collection Items (Objects, not including fine art)	Each	1,260,709	68,287	5,205	1,323,791
Museum Collection Items (Objects, fine art)	Each	30,238	2,695	70	32,863

Stewardship land is land and land rights owned by the Department, but not acquired for, or in connection with, items of General Property, Plant, and Equipment. All land provided to the Department from the public domain or at no cost, regardless of its use, is classified as Stewardship Land.

Stewardship land is presented in context of all categories of DoD lands and reported in acres based on the predominant use of the land. The three categories of Stewardship land held in public trust are: State-Owned Land, Withdrawn Public-Land, and Public Land.

The Department's stewardship land consists mainly of mission essential land.

The Department held the following acres of land as of September 30, 2010.

Facility Code	Predominant Land Use Categories	As of 9/30/09 *(Acres in Thousands)*	Additions	Deletions	As of 9/30/10
9110	Government Owned Land	6,490	3,626	426	9,690
9111	State Owned Land	12	12	12	12
9120	Withdrawn Public Land	16,078	117	55	16,140
9130	Licensed and Permitted Land	2,030	523	203	2,350
9140	Public Land	202	12	11	203
9210	Land Easement	324	80	27	377
9220	In-leased Land	264	112	106	270
9230	Foreign Land	448	32	1	479
	Grand Total				**29,521**
	Total – All Other Lands				**13,166**
	Total – Stewardship Lands				**16,355**

Other Disclosures

The Department has use of overseas land, buildings, and other facilities obtained through international treaties and agreements negotiated by the Department of State. Treaty covenants restrict the Department's use and disposal of real property (land and buildings) located outside the United States.

The Department does not have the acquisition value for all General PP&E and uses several cost methodologies to provide General PP&E values for financial statement reporting purposes.

Other consists of assets awaiting disposal.

Assets Under Capital Lease		*Dollars in Millions*
As of September 30	**2010**	**Restated 2009**
Entity as Lessee, Assets Under Capital Lease		
Land and Buildings	$ 759.8	$ 759.8
Equipment	197.2	196.5
Accumulated Amortization	(642.2)	(601.2)
Total Capital Leases	**$ 314.8**	**$ 355.1**

Note 11. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources *As of September 30*		2010		Restated 2009 *Dollars in Millions*
Intragovernmental Liabilities				
Accounts Payable	$	13.2	$	4.3
Debt		5.6		8.1
Other		2,184.4		1,873.5
Total Intragovernmental Liabilities	**$**	**2,203.2**	**$**	**1,885.9**
Nonfederal Liabilities				
Accounts Payable	$	1,057.1	$	628.2
Military Retirement and Other Federal Employment Benefits		1,691,538.8		1,587,744.7
Environmental Liabilities		58,671.4		62,565.3
Other Liabilities		16,493.5		14,829.0
Total Nonfederal Liabilities	**$**	**1,767,760.8**	**$**	**1,665,767.2**
Total Liabilities Not Covered by Budgetary Resources	**$**	**1,769,964.0**	**$**	**1,667,653.1**
Total Liabilities Covered by Budgetary Resources	**$**	**552,410.0**	**$**	**494,267.0**
Total Liabilities	**$**	**2,322,374.0**	**$**	**2,161,920.1**

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

The Department identified errors impacting ending account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems; and contract financing payments based on auditor recommended adjustments. To correct the errors, the Department restated Note 11, Liabilities Not Covered by Budgetary Resources, Total Liabilities Covered by Budgetary Resources by $58.0 million. Refer to Note 26, Restatements, for further information.

Intragovernmental Accounts Payable and Nonfederal Accounts Payable primarily represent liabilities in cancelled appropriations that, if paid, will be disbursed using funds current in the year of disbursement.

Debt consists primarily of borrowing from the U.S. Treasury for capital improvements to the Washington Aqueduct Project. Arlington County and Falls Church, Virginia, will complete reimbursement to the Department by 2023.

Intragovernmental Liabilities Other primarily consists of $1.4 billion in unfunded Federal Employees Compensation Act liabilities, $550.3 million in unfunded unemployment liabilities, and $251.2 million in unfunded Judgment Fund liabilities not due during FY 2009.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities primarily consist of $944.1 billion in pension liabilities and $738.9 billion in health benefit liabilities. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Environmental Liabilities represents the Department's liability for existing and anticipated environmental clean up and disposal.

Nonfederal Liabilities, Other primarily consists of $10.9 billion in unfunded annual leave, $3.0 billion in expected expenditures for disposal of conventional munitions, and $2.1 billion in contingent liabilities.

Note 12. Accounts Payable

Accounts Payable			*Dollars in Millions*
	2010		
As of September 30	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 1,754.5	N/A	$ 1,754.5
Nonfederal Payables (To the Public)	31,129.0	6.4	31,135.4
Total Accounts Payable	**$ 32,883.5**	**$ 6.4**	**$ 32,889.9**

Accounts Payable			*Dollars in Millions*
	Restated 2009		
As of September 30	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 2,207.8	N/A	$ 2,207.8
Nonfederal Payables (To the Public)	35,573.5	6.3	35,579.8
Total Accounts Payable	**$ 37,781.3**	**$ 6.3**	**$ 37,787.6**

The Department identified errors impacting ending FY 2009 account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems. To correct the errors, the Department restated Accounts Payable (Nonfederal). Refer to Note 26, Restatements, for further information.

Accounts Payable includes amounts owed to federal and nonfederal entities for goods and services received by the Department. The Department's systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side accounts payable are adjusted to agree with interagency seller-side accounts receivable. Accounts Payable was adjusted by reclassifying amounts between federal and nonfederal entities.

Note 13. Debt

Debt			Dollars in Millions
	2010		
As of September 30	Beginning Balance	Net Borrowing	Ending Balance
Agency Debt (Intragovernmental)			
Debt to the Treasury	$ 391.7	$ 126.6	$ 518.3
Debt to the Federal Financing Bank	0.0	0.0	0.0
Total Agency Debt	**$ 391.7**	**$ 126.6**	**$ 518.3**

Debt			Dollars in Millions
	2009		
As of September 30	Beginning Balance	Net Borrowing	Ending Balance
Agency Debt (Intragovernmental)			
Debt to the Treasury	$ 245.7	$ 146.0	$ 391.7
Debt to the Federal Financing Bank	16.9	(16.9)	0.0
Total Agency Debt	**$ 262.6**	**$ 129.1**	**$ 391.7**

The Department's debt consists of interest and principal payments due to the U.S. Treasury and the Federal Financing Bank. The Department borrows funds for the Washington Aqueduct Project, the Military Housing Privatization Initiative, and the Armament Retooling and Manufacturing Support Program.

The Department must pay the debt on direct loans if borrowers (e.g. county or city governments, or housing builders) default. For loan guarantees, the Department must pay the amount of outstanding principal guaranteed.

Note 14. Environmental Liabilities and Disposal Liabilities

Environmental Liabilities and Disposal Liabilities *As of September 30*	2010	2009
Dollars in Millions		
Environmental Liabilities–Nonfederal		
Accrued Environmental Restoration Liabilities		
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 8,065.3	$ 7,957.4
Active Installations—Military Munitions Response Program (MMRP)	4,646.6	5,223.5
Formerly Used Defense Sites-IRP & BD/DR	3,426.3	3,452.9
Formerly Used Defense Sites--MMRP	11,811.9	13,545.9
Other Accrued Environmental Liabilities—Non-BRAC		
Environmental Corrective Action	429.2	772.8
Environmental Closure Requirements	2,162.5	2,193.7
Environmental Response at Operational Ranges	127.2	164.0
Asbestos	1,335.8	1,183.3
Non-Military Equipment	113.5	114.4
Other	1,201.6	1,222.8
Base Realignment and Closure Installations (BRAC)		
Installation Restoration Program	3,936.4	3,684.7
Military Munitions Response Program	1,015.5	1,063.6
Environmental Corrective Action / Closure Requirements	329.5	344.0
Environmental Disposal for Military Equipment / Weapons Programs		
Nuclear Powered Military Equipment / Spent Nuclear Fuel	13,290.9	12,672.4
Non-Nuclear Powered Military Equipment	36.4	36.4
Other Weapons Systems	183.6	194.4
Chemical Weapons Disposal Program		
Chemical Demilitarization – Chemical Materials Agency (CMA)	5,286.9	6,956.0
CAMD Demilitarization – Assembled Chemical Weapons Alternatives (ACWA)	5,503.1	5,447.8
Total Environmental Liabilities	**$ 62,902.2**	**$ 66,230.0**

Other Accrued Environmental Liabilities, Non-BRAC, Other primarily consists of remediation related to Formerly Utilized Sites Remedial Action Program (FUSRAP). The Department is responsible for FUSRAP, which remediates radiological contamination from the Department of Energy's U.S. Atomic Energy and Weapons Program.

The unrecognized portion of the estimated total cleanup costs associated with General Property, Plant & Equipment (PP&E) is $2.9 billion for FY 2010. Not all Components of the Department are able to compile the necessary information for this disclosure, thus the amount reported may not accurately reflect the Department's total unrecognized costs associated with General PP&E. The Department is implementing procedures to address these deficiencies.

Other Disclosures

Types of Environmental Liabilities and Disposal Liabilities Identified

The Department has cleanup requirements for Defense Environmental Restoration Program (DERP) sites at active installations, BRAC installations, Formerly Used Defense Sites, sites at active installations that are not covered by DERP, weapons systems programs, and chemical weapons disposal programs. The weapons systems programs consist of chemical weapons disposal, nuclear-powered aircraft carriers, nuclear-powered submarines, and other nuclear ships. All cleanup is done in coordination with regulatory agencies, other responsible parties, and current property owners.

Applicable Laws and Regulations for Cleanup Requirements

The Department is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activity that created a public health or environmental risk. The Department accomplishes this effort in coordination with regulatory agencies and, if applicable, other responsible parties and current property owners. The Department is also required to recognize closure and post-closure costs for its General PP&E and environmental corrective action costs for current operations. Each of the Department's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapons systems, and environmental costs related to BRAC actions that have taken place.

The Department follows the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), Superfund Amendment and Reauthorization Act, Resource Conservation and Recovery Act (RCRA) or other applicable federal or state laws to clean up contamination. The CERCLA and RCRA require the Department to clean up contamination in coordination with regulatory agencies, current owners of property damaged by the Department, and third parties that have a partial responsibility for the environmental restoration. Failure to comply with agreements and legal mandates puts the Department at risk of incurring fines and penalties.

The cleanup requirements for nuclear-powered aircraft carriers, submarines, and other nuclear ships are based on laws that affect the Department's conduct of environmental policy and regulations. The Atomic Energy Act of 1954, as amended, assures the proper management of source, special nuclear, and byproduct materiel. As in all cases with nuclear power, the Department coordinates actions with the Department of Energy. The Nuclear Waste Policy Act of 1982 requires all owners and generators of high-level nuclear waste and spent nuclear fuel to pay their respective shares of the full cost of the program. Finally, the Low-Level Radioactive Waste Policy Amendments Act of 1986 provides for the safe and efficient management of low-level radioactive waste.

The Chemical Weapons Disposal Program is based on FY 1986 National Defense Authorization Act (PL 99-145, as amended) that directed the Department to destroy the unitary chemical stockpile in accordance with the requirements of the Chemical Weapons Convention Treaty.

The Army, as Executive Agent within the Department, provides policy, direction, and oversight for both the Chemical Stockpile Program and the Nonstockpile Chemical Materiel Project. As such, the Army is responsible for the safe and economical disposal of the U.S. stockpile of lethal and incapacitating chemical warfare agents and munitions.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

The Department uses engineering estimates and independently validated models to estimate environmental costs. The models include the Remedial Action Cost Engineering Requirements (RACER) application and the Normalization of Data (NORM) System. The Department validates the models in accordance with DoD Instruction 5000.61 and uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

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

For General PP&E placed into service after September 30, 1997, the Department expenses associated environmental costs systematically over the life of the asset using two methods: physical capacity for operating landfills and life expectancy in years for all other assets. The Department expenses the full cost to clean up contamination for Stewardship PP&E at the time the asset is placed into service.

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

The Department had changes in estimates resulting from overlooked or previously unknown contaminants, reestimation based on different assumptions, and other changes in project scope. Environmental liabilities may change in the future due to changes in laws and regulation, changes in agreements with regulatory agencies, and advances in technology.

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

The environmental liabilities for the Department are based on accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

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

The Department has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The Department is unable to provide a reasonable estimate at this time because the extent of required restoration is unknown.

Note 15. Other Liabilities

Other Liabilities As of September 30	2010 Current Liability	2010 Noncurrent Liability	2010 Total *Dollars in Millions*
Intragovernmental			
Advances from Others	$ 1,473.1	$ 0.0	$ 1,473.1
Deposit Funds and Suspense Account Liabilities	906.0	0.0	906.0
Disbursing Officer Cash	2,190.3	0.0	2,190.3
Judgment Fund Liabilities	261.2	0.0	261.2
FECA Reimbursement to the Department of Labor	621.4	780.9	1,402.3
Custodial Liabilities	3,806.2	2,595.4	6,401.6
Employer Contribution and Payroll Taxes Payable	530.1	0.0	530.1
Other Liabilities	616.8	0.0	616.8
Total Intragovernmental Other Liabilities	**$ 10,405.1**	**$ 3,376.3**	**$ 13,781.4**
Nonfederal			
Accrued Funded Payroll and Benefits	$ 10,375.8	$ 0.0	$ 10,375.8
Advances from Others	4,498.7	0.0	4,498.7
Deferred Credits	0.00	0.0	0.0
Deposit Funds and Suspense Accounts	430.1	0.0	430.1
Temporary Early Retirement Authority	0.0	0.0	0.0
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	8.8	245.2	254.0
Excess/Obsolete Structures	105.8	131.3	237.1
Conventional Munitions Disposal	0.0	2,072.3	2,072.3
Accrued Unfunded Annual Leave	10,977.1	0.0	10,977.1
Capital Lease Liability	12.1	63.4	75.5
Contract Holdbacks	733.6	0.2	733.8
Employer Contribution and Payroll Taxes Payable	588.5	0	588.5
Contingent Liabilities	1,255.6	3,793.2	5,048.8
Other Liabilities	271.3	0.5	271.8
Total Nonfederal Other Liabilities	**$ 29,257.4**	**$ 6,306.1**	**$ 35,563.5**
Total Other Liabilities	**$ 39,662.5**	**$ 9,682.4**	**$ 49,344.9**

Other Liabilities As of September 30	Restated 2009 (Amounts in Millions)		
	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	$ 1,619.9	$ 0.0	$ 1,619.9
Deposit Funds and Suspense Account Liabilities	471.4	0.0	471.4
Disbursing Officer Cash	2,419.6	0.0	2,419.6
Judgment Fund Liabilities	171.9	0.0	171.9
FECA Reimbursement to the Department of Labor	589.9	804.0	1,393.9
Custodial Liabilities	3,676.0	908.8	4,584.8
Employer Contribution and Payroll Taxes Payable	454.8	0.0	454.8
Other Liabilities	369.4	0.0	369.4
Total Intragovernmental Other Liabilities	**$ 9,772.9**	**$ 1,712.8**	**$ 11,485.7**
Nonfederal			
Accrued Funded Payroll and Benefits	$ 9,799.0	$ 0.0	$ 9,799.0
Advances from Others	4,472.0	0.0	4,472.0
Deferred Credits	(0.3)	0.0	(0.3)
Deposit Funds and Suspense Accounts	216.4	0.0	216.4
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	3.5	262.4	265.9
Excess/Obsolete Structures	105.6	599.0	704.6
Conventional Munitions Disposal	0.0	2,072.3	2,072.3
Accrued Unfunded Annual Leave	9,807.6	0.0	9,807.6
Capital Lease Liability	11.4	100.0	111.4
Contract Holdbacks	659.9	0.4	660.3
Employer Contribution and Payroll Taxes Payable	741.5	0.0	741.5
Contingent Liabilities	1,237.3	2,913.2	4,150.5
Other Liabilities	835.6	1.1	836.7
Total Nonfederal Other Liabilities	**$ 27,889.5**	**$ 5,948.4**	**$ 33,837.9**
Total Other Liabilities	**$ 37,662.4**	**$ 7,661.2**	**$ 45,323.6**

The Department identified errors impacting ending FY 2009 account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems. To correct the errors, the Department restated Other Liabilities (Nonfederal). Refer to Note 26, Restatements, for additional information.

Nonfederal Other Liabilities primarily consist of accrued estimates for repairs; accrued moving allowance and miscellaneous expenses; and accrued liabilities for inventory owned and managed on behalf of foreign governments.

Contingent Liabilities includes $1.6 billion related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The Department is under no obligation to pay contractors for amounts greater than the amounts authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of potential future payments are estimable, the Department has recognized a contingent liability for estimated future payments which are conditional pending delivery and government acceptance.

Total contingent liabilities for progress payments based on cost represent the difference between the estimated costs incurred to date by contractors and amounts authorized to be paid under progress payments based on cost provisions within the FAR. Estimated contractor-incurred costs are calculated by dividing the cumulative unliquidated progress payments based on cost by the contract-authorized progress payment rate. The balance of unliquidated progress payments based on cost is deducted from the estimated total contractor-incurred costs to determine the contingency amount.

Capital Lease Liability				*Dollars in Millions*
	2010 — Asset Category			
As of September 30	Land and Buildings	Equipment	Other	Total
Future Payments Due				
2011	$ 41.3	0.1	0.0	41.4
2012	15.5	0.1	0.0	15.6
2013	11.1	0.0	0.0	11.1
2014	8.8	0.0	0.0	8.8
2015	8.7	0.0	0.0	8.7
After 5 Years	0.0	0.0	0.0	0.0
Total Future Lease Payments Due	**$ 85.4**	**$ 0.2**	**$ 0.0**	**$ 85.6**
Less: Imputed Interest Executory Costs	10.1	0.0	0.0	10.1
Net Capital Lease Liability	**$ 75.3**	**$ 0.2**	**$ 0.0**	**$ 75.5**
Capital Lease Liabilities Covered by Budgetary Resources				**70.4**
Capital Lease Liabilities Not Covered by Budgetary Resources				**5.1**

Capital Lease Liability				*Dollars in Millions*
	Restated 2009 — Asset Category			
As of September 30	Land and Buildings	Equipment	Other	Total
Future Payments Due				
2010	$ 43.9	$ 0.0	0.0	43.9
2011	41.3	0.0	0.0	41.3
2012	15.5	0.0	0.0	15.5
2013	11.1	0.0	0.0	11.1
2014	8.8	0.0	0.0	8.8
After 5 Years	8.7	0.0	0.0	8.7

Total Future Lease Payments Due	$ 129.3	$ 0.0	$ 0.0	$ 129.3
Less: Imputed Interest Executory Costs	17.9	0.0	0.0	17.9
Net Capital Lease Liability	**$ 111.4**	**$ 0.0**	**$ 0.0**	**$ 111.4**
Capital Lease Liabilities Covered by Budgetary Resources				**98.4**
Capital Lease Liabilities Not Covered by Budgetary Resources				**13.0**

Note 16. Commitments and Contingencies

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests. The Department has accrued contingent liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The Department records Judgment Fund liabilities in Note 12, Accounts Payable, and in Note 15, Other Liabilities.

The Department has 40 legal actions with individual claims greater than the Department's FY 2010 materiality threshold of $128.7 million. The total of the 40 actions is approximately $2.4 trillion. Of this amount, the OGC determined that claims totaling approximately $10 billion are classified "reasonably possible," $46.1 billion are classified "remote," and $2.3 trillion are classified "unable to determine the probability of loss." The Department also had a number of potential claims that individually did not meet the Department's materiality threshold but did meet the individual Components' thresholds. These claims are disclosed in the Components' financial statements.

Other Commitments and Contingencies

The Department is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the Department has limited automated system processes by which it captures or assesses these potential contingent liabilities, therefore, the amounts reported may not fairly present the Department’s contingent liabilities.

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

Note 17. Military Retirement and Other Federal Employment Benefits

Military Retirement and Other Federal Employment Benefits			*Dollars in Millions*
	2010		
As of September 30	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Pension and Health Actuarial Benefits			
Military Retirement Pensions	$ 1,258,463.1	$ (314,380.5)	$ 944,082.6
Military Retirement Health Benefits	329,492.1	0.0	329,492.1
Military Medicare-Eligible Retiree Benefits	572,995.2	(163,587.6)	409,407.6
Total Pension and Health Actuarial Benefits	**$ 2,160,950.4**	**$ (477,968.1)**	**$ 1,682,982.3**

Military Retirement and Other Federal Employment Benefits			Dollars in Millions
	2010		
As of September 30	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits			
FECA	$ 6,418.7	$ 0.0	$ 6,418.7
Voluntary Separation Incentive Programs	959.3	(397.0)	562.3
DoD Education Benefits Fund	1,900.5	(1,900.5)	0.0
Other	6,470.0	(4,894.4)	1,575.6
Total Other Actuarial Benefits	**$ 15,748.5**	**$ (7,191.9)**	**$ 8,556.6**
Total Military Retirement and Other Federal Employment Benefits	**$ 2,176,698.9**	**$ (485,160.0)**	**$ 1,691,538.9**

Actuarial Cost Method Used: Aggregate Entry-Age Method
Assumptions: Effective Interest
Market Value of Investments in Market-based and Marketable Securities: $354.2 billion

Military Retirement and Other Federal Employment Benefits			Dollars in Millions
	2009		
As of September 30	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Pension and Health Actuarial Benefits			
Military Retirement Pensions	$ 1,173,456.3	$ (271,798.1)	$ 901,658.2
Military Retirement Health Benefits	313,959.2	0.0	313,959.2
Military Medicare-Eligible Retiree Benefits	509,466.4	(145,850.2)	363,616.2
Total Pension and Health Actuarial Benefits	**$ 1,996,881.9**	**$ (417,648.3)**	**$ 1,579,233.6**

Military Retirement and Other Federal Employment Benefits			Dollars in Millions
	2009		
As of September 30	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits			
FECA	$ 6,318.2	$ 0.0	$ 6,318.2
Voluntary Separation Incentive Programs	1,042.1	(450.4)	591.7
DoD Education Benefits Fund	1,797.2	(1,797.2)	0.0
Other	6,126.7	(4,525.3)	1,601.4
Total Other Actuarial Benefits	**$ 15,284.2**	**$ (6,772.9)**	**$ 8,511.3**
Total Military Retirement and Other Federal Employment Benefits	**$ 2,012,166.1**	**$ (424,421.2)**	**$ 1,587,744.9**

Actuarial Cost Method Used: Aggregate Entry-Age Method
Assumptions: Effective Interest
Market Value of Investments in Market-based and Marketable Securities: $374.5 billion

Dollars in Millions

Military Retirement and Other Federal Employment Benefits	2010				
As of September 30	Military Retirement Pensions	Military Pre - Medicare Eligible Retiree Health Benefits	Military Medicare - Eligible Retiree Health Benefits	Voluntary Separation Incentive Programs	DoD Education Benefits Fund
Beginning Actuarial Liability	$ 1,173,456.1	313,959.2	509,466.4	1,042.1	1,797.2
Normal Cost Liability	23,932.7	10,977.0	10,583.7	0.0	464.1
Assumption Change Liability	66,642.6	0.0	0.0	21.1	(59.4)
Benefit Outlays	(50,416.6)	(11,161.9)	(8,633.9)	(141.5)	(417.5)
Interest Cost	66,965.8	18,367.4	29,658.1	43.7	81.9
Actuarial (gains)/losses due to changes in experience	(22,117.6)	(1,389.0)	3,323.2	(6.2)	35.8
Actuarial (gains)/losses due to changes in trend assumptions	0.0	(34,532.1)	(90,883.7)	0.0	0.0
Actuarial (gains)/losses due to other factors	0.0	33,271.5	119,481.3	0.0	(1.5)
Ending Actuarial Liability	**$ 1,258,463.0**	**329,492.1**	**572,995.1**	**959.2**	**1,900.6**
Change in Actuarial Liability	**$ 85,006.9**	**15,532.9**	**63,528.7**	**(82.9)**	**103.4**

Actuarial Cost Method Used: Aggregate Entry-Age Method
Assumptions: Effective Interest
Market Value of Investments in Market-based and Marketable Securities: $354.2 billion

During FY 2010, the Department implemented Statement of Federal Financial Accounting Standard (SFFAS) No. 33, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates." The standard requires the separate presentation of gains and losses from changes in long-term assumptions used to estimate liabilities associated with pensions, other retirement and other postemployment benefits. The SFFAS No. 33 also provides a standard for selecting the discount rate and valuation date used in estimating these liabilities.

Military Retirement Pensions

The Military Retirement Fund is a defined benefit plan authorized by Public Law (PL) 98-94 to provide funds used to pay annuities and pensions to retired military personnel and their survivors. The Department of Defense (DoD) Retirement Board of Actuaries approves the long-term economic assumptions for inflation, salary, and interest. The actuaries calculate the actuarial liabilities annually using economic assumptions and actual experience (e.g., mortality and retirement rates). Due to reporting deadlines, the current year actuarial present value of projected plan benefits rolls forward from the prior year's valuation results. The actuaries used the following assumptions to calculate the FY 2010 roll-forward amount:

Military Retirement Pensions	Inflation	Salary	Interest
Fiscal Year 2010	0.0% (actual)	3.4% (actual)	5.0%
Fiscal Year 2011	0.0% (actual)	1.4% (estimated)	5.0%
Long Term	2.4%	3.6%	5.0%

Actuarial Cost Method Used: Aggregate Entry-Age Normal Method
Market Value of Investments in Market-Based and Marketable Securities: $354.2 billion
Assumed Interest Rate: 5.0%

Historically, the initial unfunded liability of the program was amortized over a 50-year period. Effective FY 2008, the initial unfunded liability is amortized over a 42-year period to ensure the annual payments cover the interest on the unfunded actuarial liability, with the last payment expected to be made October 1, 2025. All subsequent gains and losses experienced are amortized over a 30-year period.

Military Retirement Health Benefits (MRHB)

The MRHB are post-retirement benefits the Department provides to non-Medicare-eligible military retirees and other eligible beneficiaries through private sector health care providers and the Department's medical treatment facilities. The actuaries calculate the actuarial liabilities annually using assumptions and actual experience. For the FY 2010 actuarial liability calculation, the actuaries used the following assumptions:

MRHB Medical Trend	FY 2009 – FY 2010	Ultimate Rate FY 2034
Medicare Inpatient (Direct Care)	3.63%	5.65%
Medicare Outpatient (Direct Care)	2.76%	5.65%
Medicare Prescriptions (Direct Care)	2.75%	5.65%
Non-Medicare Inpatient (Direct Care)	7.24%	5.65%
Non-Medicare Outpatient (Direct Care)	7.60%	5.65%
Non-Medicare Prescriptions (Direct Care)	2.00%	5.65%
Non-Medicare Inpatient (Purchased Care)	3.00%	5.65%
Non-Medicare Outpatient (Purchased Care)	3.00%	5.65%
Non-Medicare Prescriptions (Purchased Care)	8.76%	5.65%
U.S. Family Health Plan (USFHP) (Purchased Care)	7.51%	5.65%
Actuarial Cost Method Used: Aggregate Entry-Age Normal Method *Assumed Interest Rate: 5.0%*		

Medicare-Eligible Retiree Health Care Fund (MERHCF) Benefits

In accordance with PL 106-398, MERHCF accumulates funds to finance the health care program liabilities of Medicare-eligible retirees for all the Uniformed Services and specific Medicare-eligible beneficiaries. The DoD Board of Actuaries approves the long-term assumptions for medical trends and interest. The actuaries calculate the actuarial liabilities annually using actual experience (e.g., mortality and retirement rates, direct care costs, purchased care). Due to reporting deadlines, the current year actuarial present value of projected plan benefits rolls forward from the prior year's results. The actuaries used the following assumptions to calculate the FY 2010 roll-forward amount:

MERHCF Benefits — Medical Trend	FY 2009 – FY 2010	Ultimate Rate FY 2034
Medicare Inpatient (Direct Care)	3.63%	5.65%
Medicare Inpatient (Purchased Care)	4.63%	5.65%
Medicare Outpatient (Direct Care)	2.76%	5.65%
Medicare Outpatient (Purchased Care)	3.26%	5.65%
Medicare Prescriptions (Direct Care)	2.75%	5.65%
Medicare Prescriptions (Purchased Care)	7.51%	5.65%
Medicare USFHP (Purchased Care)	5.49%	5.65%
Actuarial Cost Method Used: Aggregate Entry-Age Normal Method *Market Value of Investments in Market-Based and Marketable Securities: $184.0 billion* *Assumed Interest Rate: 5.0%*		

The MERHCF liability includes Medicare liabilities for all Uniformed Services. The $573.0 billion liability includes $560.1 billion for the Department, $11.6 billion for the Coast Guard, $1.2 billion for the Public Health Service, and $81.5 million for National Oceanic and Atmospheric Administration (NOAA). The FY 2010 contributions from each of the Uniformed Services were $10.8 billion from the Department, $263.8 million from the Coast Guard, $35.6 million from the Public Health Service, and $1.8 million from NOAA.

Federal Employees Compensation Act (FECA)

The Department of Labor (DOL) annually determines the liability for future workers' compensation benefits, which includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred-but-not-reported claims. The liability is determined using historical benefit payment patterns related to a specific incurred period to predict the final payment related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year U.S. Treasury notes and bonds. A 3.65% interest rate was assumed for year one and 4.30% was assumed for year two and thereafter.

The DOL calculates this liability using wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIM). The actual rates for these factors for charge back year (CBY) 2010 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 were as follows:

Federal Employees — Compensation Act (FECA)		
CBY	**COLA**	**CPIM**
2010	N/A	N/A
2011	2.23%	3.45%
2012	1.13%	3.43%
2013	1.70%	3.64%
2014	1.90%	3.66%
2015+	1.93%	3.73%

The model's resulting projections were analyzed by DOL to ensure the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model of economic assumptions, (2) a comparison of the percentage change in the liability amount to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2010 to the average pattern observed during the prior three charge back years, and (4) a comparison of the estimated liability per case in the 2010 projection to the average pattern for the projections for the most recent three years.

Voluntary Separation Incentive (VSI) Program

The VSI Program was established by PL 102-190 to reduce the number of military personnel on active duty. The DoD Board of Actuaries approved the assumed annual interest rate of 4.1% used to calculate the actuarial liability. Since the VSI Program is no longer offered, the actuarial liability calculated annually is expected to continue to decrease with benefit outlays and increase with interest cost.

Market Value of Investments in Market-based and Marketable Securities: $446.7 million

DoD Education Benefits Fund (EBF)

The EBF program was established by PL 98-525 to recruit and retain military members and aid in the readjustment of military members to civilian life. The actuaries calculate the actuarial liability annually based on the assumed interest rate of 4.1% that was approved by the EBF Board of Actuaries.

Market Value of Investments in Market-based and Marketable Securities: $2.4 billion

Other Federal Employment Benefits

Other Federal Employment Benefits primarily consists of accrued pensions and annuities, and an estimated liability for incurred-but-not-reported medical claims not processed prior to fiscal year end.

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

General Disclosures Related to the Statement of Net Cost		*Dollars in Millions*
As of September 30	2010	Restated 2009
Intragovernmental Costs	$ 35,897.0	$ 33,891.6
Public Costs	830,161.3	663,765.7
Total Costs	**$ 866,058.3**	**$ 697,657.3**
Intragovernmental Earned Revenue	(23,473.3)	(10,577.0)
Public Earned Revenue	(39,768.9)	(35,590.9)
Total Earned Revenue	**$ (63,242.2)**	**$ (46,167.9)**
Net Cost of Operations	**$ 802,816.1**	**$ 651,489.4**

The Department identified the following restatements: (1) errors impacting ending account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems; (2) property, plant and equipment valued incorrectly; (3) overstated accounts receivable (nonfederal) established to recover pharmacy costs from drug manufacturers; (4) inventory valued incorrectly; and (5) contract financing payments based on auditor recommended adjustments. The corrections resulted in a $156.1 million net reduction of Gross Costs on the Statement of Net Cost (SNC) and are reflected in Public Costs on the restated Note 18, General Disclosures Related to the SNC. Refer to Note 26, Restatements, for further information.

Other Disclosures

The SNC represents the net cost of programs and organizations of the Federal Government that are supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department's current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The Department is in the process of reviewing available data and developing a cost reporting methodology as required by the SFFAS No. 4, " Managerial Cost Accounting Concepts and Standards for the Federal Government", as amended by SFFAS No. 30, "Inter-entity Cost Implementation".

Intragovernmental costs and revenue represent transactions made between two reporting entities within the Federal Government. Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity. Public costs include actuarial gains/losses on pension, other retirement benefits, and/or other postemployment benefits assumption changes.

The Department's systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between federal and nonfederal expenses. Intradepartmental revenues and expenses are then eliminated.

The SNC presents information based on budgetary obligation, disbursement, and collection transactions, as well as data from nonfinancial feeder systems. Amounts are adjusted for accruals such as payroll expenses, accounts payable, and environmental liabilities. The General Fund data is primarily derived from budgetary transactions (obligations, disbursements, and collections), data from nonfinancial feeder systems, and accruals made for major items. While Working Capital Funds primarily record transactions on an accrual basis, the systems do not always capture actual costs in a timely manner.

The Department's accounting systems generally do not capture information relative to heritage assets separately and distinctly from normal operations.

During FY 2010, the Department implemented SFFAS No. 33, Pension, Other Retirment Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates. The standard requires the separate presentation of gains and losses from changes in long-term assumptions used to measure liabilities associated with pensions, other retirement benefits, and other postemployment benefits. The SFFAS No. 33 also provides a standard for selecting the discount rate and valuation date used in estimating these liabilities.

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

Budgetary Financing Sources – Nonexchange revenue and its related contra account has an abnormal balance of $8.8 million. This is due to a decrease in the allowance for loss on non-entity receivable for 4th Quarter, FY 2010.

The Department identified the following restatements: (1) errors impacting ending account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems; (2) property, plant and equipment valued incorrectly; (3) overstated accounts receivable (nonfederal) established to recover pharmacy costs from drug manufacturers; (4) inventory valued incorrectly; and (5) contract financing payments based on auditor recommended adjustments. To correct the errors the Department restated the Statement of Changes in Net Position (SCNP) by $2.1 billion. Refer to Note 26, Restatements, for further information.

Other Financing Sources, Other consists primarily of nonexchange gains and losses to reconcile the proprietary and budgetary amounts, as well as gains and losses on disposition of assets. Due to financial system limitations, the Department adjusts for these unreconciled differences.

Earmarked Cumulative Results of Operations ending balance on the SCNP does not agree with the Earmarked Cumulative Results reported on the Balance Sheet because the cumulative results on the Balance Sheet are presented net of eliminations. In the SCNP, offsetting balances for intradepartmental activity between Earmarked Funds and All Other Funds are reported on the same lines. The Eliminations column contains all appropriate elimination entries, which net to zero within each respective line, except for intraentity imputed financing costs.

Appropriations Received on the SCNP do not match the Appropriations on the Statement of Budgetary Resources (SBR). The difference of $123.9 billion is primarily related to the Military Retirement Fund and Medicare-Eligible Retirement Health Care Fund appropriations. In order to preserve visibility with the President's Budget, these appropriations are effectively reported twice on the SBR. They are reported once by the Military Departments and Defense Agencies as appropriated and once by the individual trust funds as receipts. Refer to Note 20, Disclosures Related to the Statement of Budgetary Resources, for further details.

Note 20. Disclosures Related to the Statement of Budgetary Resources

Disclosures Related to the Statement of Budgetary Resources		*Dollars in Millions*
As of September 30, 2009	**2010**	**Restated 2009**
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period.	$ 467,972.2	$ 450,737.4

Restatements

During the transition to an automated interface between the budget execution and financial statement reporting systems, the Department identified $1.3 billion in errors related to FY 2009 and prior years for the Statement of Budgetary Resources. To correct the errors, the Department restated several balances in the Statement of Budgetary Resources. Refer to Note 26, Restatements, for additional details.

Reconciliation Differences

Appropriations Received on the SBR exceeds Appropriations Received on the Statement of Changes in Net Position by $123.9 billion. This difference represents trust and special fund receipts reported as exchange revenue on the Statement of Net Cost and included in appropriations on the SBR. In accordance with Office of Management and Budget (OMB) guidance, $104.9 billion of General Fund appropriations received by the Department are also recognized on the SBR as appropriations received for trust and special funds. The difference is primarily due to duplicate reporting in the SBR of the Military Services' contributions and U.S. Treasury's payments to the Military Retirement Fund and the Department of Defense Medicare-Eligible Retiree Health Care Fund.

The SBR 2009 comparative column includes $93.9 billion more in budget authority than reported in the 2009 actual column of the President's FY 2011 Budget. The difference is primarily due to the duplicate reporting discussed above and advances the U.S. Army Corps of Engineers (USACE) received from the District of Columbia. USACE reports the advances (account 96X6094) in its SBR. However, this account is not included in the budget.

The SBR FY 2009 column includes $331.2 million less in obligations than reported in the 2009 actual column of the President's FY 2011 Budget. The difference is primarily due to abnormal (negative) collections reported in the SBR. These abnormal collection were reported as obligations and outlays in the President's Budget.

The SBR FY 2009 column includes $65.9 billion less in net outlays than reported in the 2009 actual column of the President's FY 2011 Budget. The SBR reduces net outlays by the distributed offsetting receipts. In addition $288.1 million of abnormal collections were reported as obligations and outlays in the President's Budget.

The SBR includes $77.2 billion less in net outlays than reported in the SF-133, Report on Budget Execution. The SBR reduces net outlays by the distributed offsetting receipts. However, the SF-133, Report on Budget Execution does not reduce the Department's outlays by the distributed offsetting receipts. In addition, budget authority, obligations, and net outlays in the SBR will differ from amounts reported in the SF-133, Report on Budget Execution for deposit account 96X6094. Deposit account 96X6094 represents advances the U.S. Army Corps of Engineers (USACE) receive from the District of Columbia. USACE reports this depost account in its SBR. However, this depost account is not included in the budget. USACE is working with the OMB examiner to change the reporting of these advances in FY 2011.

Permanent Indefinite Appropriations

The Department of Defense (DoD) received the following permanent indefinite appropriations:

- Department of the Army General Gift Fund (10 USC 2601(b)(1))
- Department of the Navy General Gift Fund (10 USC 2601(b)(2))
- Department of the Air Force General Gift Fund (10 USC 2601 (b)(3))
- Department of Defense General Gift Fund (10 USC 2601)
- Disposal of Department of Defense Real Property (40 USC 485(h)(2)(A)(B))
- Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
- United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
- Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
- Midshipmen’s Store (10 USC 6971B)
- Burdensharing Contributions (10 USC 2350j)
- Forest Program (10 USC 2665)
- Medicare Eligible Retiree Health Care Fund (MERHCF) (10 USC 1111)
- Military Retirement Fund (10 USC 1461)
- Education Benefits Fund (10 USC 2006)
- Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
- Hydraulic Mining Debris Reservoir (33 USC 683)
- Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
- Payments to States (33 USC 701c-3)
- Wildlife Conservation (16 USC 670-670(f))
- Ainsworth Bequest (31 USC 1321)
- DoD Family Housing Improvement Fund (10 USC 2883 (a))
- DoD Military Unaccompanied Housing Improvement Fund (10 USC 2883 (a))
- Voluntary Separation Incentive Fund (10 USC 1175(h))
- Rivers & Harbors Contributed Funds (33 USC 560, 701h)
- Concurrent Receipt Accrual Payments to the Military Retirement Fund (10 USC 1466(b)(1))
- Rocky Mountain Arsenal, Restoration (100 Statue, 4003 SEC 1367)
- Department of Defense Family Improvement Fund (Section 504(f), Federal Credit Reform Act of 1990 and 2 U.S.C. 661c(f))

- Homeowners Assistance Fund (10 USC 4551-4555; 42 USC 3374(d), Title United States Code; Public Law 111-5)

The above permanent indefinite appropriations cover a wide variety of purposes to help the Department accomplish its missions. These purposes include: (1) military retirees' health care benefits, retirement and survivor pay, and education benefits for veterans; (2) wildlife habitat restoration and water resources maintenance; (3) relocation of armed forces to a host nation; (4) separation payments for foreign nationals; and (5) upkeep of libraries and museums.

Apportionment Categories for Obligations incurred

The Department reported the following amounts of direct obligations: (1) $585.1 billion in category A; (2) $270.0 billion in category B; and (3) $2.6 billion in exempt from apportionment. The Department reported reimbursable obligations of (1) $23.8 billion in category A, (2) $171.6 billion in category B and (3) $39.5 million in exempt from apportionment. Category A relates to appropriations for a specific period of time (e.g., Military Personnel appropriation), and category B relates to appropriations for a specific project (e.g., Military Construction appropriation).

Legal Arrangements Affecting the Use of Unobligated Balances

A portion of the Department's unobligated balances represents trust fund receipts collected in the current fiscal year that exceed the amount needed to pay benefits or other valid obligations. These receipts are temporarily precluded from obligation by law due to a benefit formula or other limitation. The receipts, however, are assets of the funds and are available for obligation as needed in the future. The Department operates within the constraints of fiscal law and has no additional legal arrangements affecting the use of unobligated balances.

Other Disclosures

The SBR includes intraentity transactions because the statements are presented as combined.

The Department utilizes borrowing authority for the Military Housing Privatization Initiative and the Armament Retooling and Manufacturing Support Initiative. Borrowing authority is used in accordance with OMB Circular No. A-129, "Managing Federal Credit Programs."

The Department received additional funding of $158.3 billion to cover obligations incurred above baseline operations, which includes $151.6 billion in support of the Overseas Contingency Operations.

Note 21. Reconciliation of Net Cost of Operations to Budget

Reconciliation of Net Cost of Operations to Budget *As of September 30, 2010 and 2009*	*Dollars in Millions* 2010	Restated 2009
Resources Used to Finance Activities		
Budgetary Resources Obligated:		
Obligations incurred	$ 1,053,074.5	$ 1,030,908.4
Less: Spending authority from offsetting collections and recoveries (-)	(242,038.4)	(244,492.1)
Obligations net of offsetting collections and recoveries	**$ 811,036.1**	**$ 786,416.3**
Less: Offsetting receipts (-)	(77,722.2)	(65,912.1)
Net obligations	**$ 733,313.9**	**$ 720,504.2**

Reconciliation of Net Cost of Operations to Budget *As of September 30, 2010 and 2009*	2010		Restated 2009	*Dollars in Millions*
Other Resources:				
Donations and forfeitures of property	$	6.4	$	2.2
Transfers in/out without reimbursement (+/-)		566.2		(42.8)
Imputed financing from costs absorbed by others		5,596.2		4,703.8
Other (+/-)		2,446.5		1,253.7
Net other resources used to finance activities	**$**	**8,615.3**	**$**	**5,916.9**
Total resources used to finance activities	**$**	**741,929.2**	**$**	**726,421.1**
Resources Used to Finance Items not Part of the Net Cost of Operations				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:				
Undelivered Orders (-)	$	(17,234.8)	$	(43,375.4)
Unfilled Customer Orders		2,298.9		931,6
Resources that fund expenses recognized in prior Periods (-)		(7,004.9)		(13,983.5)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		2,599.2		1,928.6
Resources that finance the acquisition of assets (-)	$	(125,255.3)	$	(145,109.8)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:				
Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	$	0.0	$	(10.0)
Other (+/-)		(3,008.2)		24,649.8
Total resources used to finance items not part of the Net Cost of Operations	**$**	**(147,605.1)**	**$**	**(174,968.7)**
Total resources used to finance the Net Cost of Operations	**$**	**594,324.1**	**$**	**551,452.4**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period				
Components Requiring or Generating Resources in Future Period:				
Increase in annual leave liability	$	2,688.6	$	819.9
Increase in environmental and disposal liability		873.4		929.2
Upward/Downward reestimates of credit subsidy expense (+/-)		4.7		0.4
Increase in exchange revenue receivable from the public (-)		(295.0)		815.5
Other (+/-)		166,438.4		32,796.5
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	**$**	**169,710.1**	**$**	**35,361.5**
Components not Requiring or Generating Resources:				
Depreciation and amortization	$	39,255.3	$	41,079.5
Revaluation of assets or liabilities (+/-)		4,119.3		5,969.1
Other (+/-)				
Trust Fund Exchange Revenue		(46,694.0)		(34,909.0)
Cost of Goods Sold		67,434.1		72,948.9
Operating Materiel and Supplies Used		28,690.0		30,868.3
Other		(54,022.8)		(51,281.3)

Reconciliation of Net Cost of Operations to Budget *As of September 30, 2010 and 2009*	2010	Restated 2009
Total Components of Net Cost of Operations that will not Require or Generate Resources	**$ 38,781.9**	**$ 64,675.5**
Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	**$ 208,492.0**	**$ 100,037.0**
Net Cost of Operations	**$ 802,816.1**	**$ 651,489.4**

Dollars in Millions

The Department identified errors impacting ending FY 2009 account balances while migrating from a manual to an automated interface between budget execution and financial statement reporting systems. To correct the errors the Department restated Note 21, Reconciliation of Net Cost of Operations to Budget. Refer to Note 26, Restatements, for further information.

Due to the Department's financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. The difference between budgetary and proprietary data is a previously identified deficiency. The following adjustments (absolute value) were made to balance the Reconciliation of Net Cost of Operations to the Statement of Net Cost:

	(Amounts in millions)
Resources that Finance the Acquisition of Assets	$8,623.9
Other Components not Requiring or Generating Resources	786.4
Total Amount	**$9,410.3**

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

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

Other Resources, Other, primarily consists of $2.5 billion in nonexchange gains and losses necessary to reconcile the proprietary and budgetary amounts, as well as ($0.1) billion in gains and losses on disposition of assets.

Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations, Other, primarily consists of ($2.5) billion in nonexchange gains and losses necessary to reconcile the proprietary and budgetary amounts, ($0.6) billion in financial sources transferred in without reimbursement, and $0.1 billion in gains and losses on disposition of assets.

Components Requiring or Generating Resources in Future Period, Other, consists primarily of $165.8 billion in other federal employment benefits.

Components not Requiring or Generating Resources, Other primarily consists of cost capitalization offsets and other expenses not requiring budgetary resources.

Note 22. Disclosures Related to Incidental Custodial Collections

The Department collected $1.2 million of incidental custodial revenues generated primarily from forfeitures of unclaimed money and property. These funds are not available for use by the Department. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.

Note 23. Earmarked Funds

Earmarked Funds					*Dollars in Millions*
	2010				
As of September 30	Military Retirement Fund	Medicare-Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
Balance Sheet					
Assets					
Fund balance with Treasury	$ 25.4	$ 196.0	$ 3,181.0	$ 0.0	$ 3,402.4
Investments	321,686.8	166,203.5	9,246.4	0.0	497,136.7
Accounts and Interest Receivable	37.0	562.9	1,107.8	(42.5)	1,665.2
Other Assets	0.0	0.0	1,441.1	0.0	1,441.1
Total Assets	**$ 321,749.2**	**$ 166,962.4**	**$ 14,976.3**	**$ (42.5)**	**$ 503,645.4**
Liabilities and Net Position					
Military Retirement Benefits and Other Federal Employment Benefits	$ 1,262,672.9	$ 573,671.3	$ 2,859.8	$ 0.0	$1,839,204.0
Other Liabilities	2.0	303.7	2,594.2	(118.3)	2,781.6
Total Liabilities	**$ 1,262,674.9**	**$ 573,975.0**	**$ 5,454.0**	**$ (118.3)**	**$1,841,985.6**
Unexpended Appropriations	$ 0.0	$ 0.0	$ 325.2	$ (20.4)	$ 304.8
Cumulative Results of Operations	(940,925.7)	(407,012.6)	9,197.1	(101,264.8)	(1,440,006.0)
Total Liabilities and Net Position	**$ 321,749.2**	**$ 166,962.4**	**$ 14,976.3**	**$ (101,403.5)**	**$ 402,284.4**
Statement of Net Cost					
Program Costs	$ 136,098.0	$ 71,579.4	$ 2,302.9	$ (2,497.6)	$ 207,482.7
Less Earned Revenue	(93,929.7)	(26,420.1)	(1,393.4)	104,870.9	(16,872.3)
Net Program Costs	42,168.3	45,159.3	909.5	102,373.3	190,610.4
Net Cost of Operations	**$ 42,168.3**	**$ 45,159.3**	**$ 909.5**	**$ 102,373.3**	**$ 190,610.4**
Statement of Changes in Net Position					
Net Position Beginning of the Period	$ (898,757.4)	$ (361,576.6)	$ 8,074.1	$ 0.0	$(1,252,259.9)
Net Cost of Operations	42,168.3	45,159.3	909.5	102,373.4	190,610.5
Budgetary Financing Sources	0.0	0.0	2,572.0	1,088.2	3,660.2
Other Financing Sources	0.0	(276.7)	(214.3)	0.0	(491.0)
Change in Net Position	**$ (42,168.3)**	**$ 45,436.0**	**$ 1,448.2**	**$ (101,285.2)**	**$ (187,441.3)**
Net Position End of Period	**$ (940,925.7)**	**$ (407,012.6)**	**$ 9,522.3**	**$ (101,285.2)**	**$(1,439,701.2)**

Earmarked Funds As of September 30	2009 Military Retirement Fund	2009 Medicare-Eligible Retiree Health Care Fund	2009 Other Earmarked Funds	2009 Eliminations	2009 Total
					Dollars in Millions
Balance Sheet					
Assets					
Fund balance with Treasury	$ 20.5	$ 5.0	$ 2,246.2	$ 0.0	$ 2,271.7
Investments	278,347.0	148,403.4	8,133.7	0.0	434,884.1
Accounts and Interest Receivable	31.9	147.9	988.8	(6.0)	1,162.6
Other Assets	0.0	0.0	2,136.9	0.0	2,136.9
Total Assets	**$ 278,399.4**	**$ 148,556.3**	**$ 13,505.6**	**$ (6.0)**	**$ 440,455.3**
Liabilities and Net Position					
Military Retirement Benefits and Other Federal Employment Benefits	$ 1,177,154.9	$ 510,286.8	$ 2,839.4	$ 0.0	$1,690,281.1
Other Liabilities	1.9	122.9	2,591.6	(72.0)	2,644.4
Total Liabilities	**$1,177,156.8**	**$ 510,409.7**	**$ 5,431.0**	**$ (72.0)**	**$1,692,925.5**
Unexpended Appropriations	$ 0.0	$ 0.0	$ 5.6	$ 0.0	$ 5.6
Cumulative Results of Operations	(898,757.4)	(361,853.4)	8,069.0	(90,592.9)	$(1,343,134.7)
Total Liabilities and Net Position	**$ 278,399.4**	**$ 148,556.3**	**$ 13,505.6**	**$ (90,664.9)**	**$ 349,796.4**
Statement of Net Cost					
Program Costs	$ 73,004.0	$ 17,612.9	$ 2,510.2	$ (2,567.2)	$ 90,559.9
Less Earned Revenue	(75,267.8)	(22,469.4)	(674.6)	94,121.9	(4,289.9)
Net Program Costs	(2,263.8)	(4,856.5)	1,835.6	91,554.7	86,270.0
Net Cost of Operations	**$ (2,263.8)**	**$ (4,856.5)**	**$ 1,835.6**	**$ 91,554.7**	**$ 86,270.0**
Statement of Changes in Net Position					
Net Position Beginning of the Period	$ (901,021.2)	$ (366,709.9)	$ 8,043.0	$ 0.0	$(1,259,688.1)
Net Cost of Operations	(2,263.8)	(4,856.5)	1,835.6	91,554.7	86,270.0
Budgetary Financing Sources	0.0	0.0	1,973.7	943.6	2,917.3
Other Financing Sources	0.0	0.0	(106.5)	18.2	(88.3)
Change in Net Position	**$ 2,263.8**	**$ 4,856.5**	**$ 31.6**	**$ (90,592.9)**	**$ (83,441.0)**
Net Position End of Period	**$ (898,757.4)**	**$ (361,853.4)**	**$ 8,074.6**	**$ (90,592.9)**	**$(1,343,129.1)**

Other Disclosures

The Statement of Federal Financial Accounting Standards (SFFAS) No. 27, "Identifying and Reporting Earmarked Funds," requires the disclosure of Earmarked Funds separate from All Other Funds on the Statement of Changes in Net Position and Balance Sheet. Funds must meet three criteria to be classified as earmarked: (1) a statute committing use of specifically-identified revenues for designated purposes, (2) explicit authority to retain the revenues, and

(3) a requirement to account and report on the revenues. The Department's earmarked funds are either special or trust funds and use both receipt and expenditure accounts to report activity to the U.S. Treasury. There have been no changes in legislation that significantly changed the purposes of the funds.

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

The SFFAS No. 27 requires the presentation of gross amounts of Earmarked Funds separate from All Other (nonearmarked) Funds. Cumulative Results of Operations ending balances for Earmarked Funds on the SCNP do not agree with the Cumulative Results of Operations for Earmarked Funds reported on the Balance Sheet because the Cumulative Results of Operations on the Balance Sheet are presented net of eliminations, whereas the SCNP presents Cumulative Results of Operations gross Cumulative Results of Operations.

Military Retirement Fund (MRF), 10 United States Code (USC) 1461. The MRF accumulates funds in order to finance, on an actuarially sound basis, the liabilities of the Department's military retirement and survivor benefit programs. Financing sources for the MRF are interest earnings on Fund assets, monthly Department contributions, and annual contributions from the U.S. Treasury. The monthly Department contributions are calculated as a percentage of basic pay. The contribution from the U.S. Treasury represents the amortization of the unfunded liability for service performed prior to October 1, 1984, plus the amortization of actuarial gains and losses that have arisen since then. The U.S. Treasury annual contribution also includes the normal cost amount for the concurrent receipt provisions of the FY 2004 National Defense Authorization Act.

Medicare-Eligible Retiree Health Care Fund (MERHCF), 10 USC 1111. The MERHCF accumulates funds to finance, on an actuarially sound basis, liabilities of the Department and the uniformed services health care programs for qualified Medicare-eligible beneficiaries. Financing sources for MERHCF are provided primarily through an annual actuarial liability payment from the U.S. Treasury, annual contributions from each Uniformed Service (Army, Navy, Air Force, Marine Corps, U.S. Coast Guard, National Oceanic and Atmospheric Administration, and U.S. Public Health Service) and interest earned from the Fund's investments.

Other Earmarked Funds

Special Recreation Use Fees, 16 USC 4061-6a note. The United States Army Corps of Engineers (USACE) is granted the authority to charge and collect fair and equitable Special Recreation Use Fees at campgrounds located at lakes or reservoirs that are under the jurisdiction of USACE. Types of allowable fees include daily use fees, admission fees, recreational fees, annual pass fees, and other permit type fees. The receipts are used for the operation and maintenance of the recreational sites.

Hydraulic Mining in California, Debris, 33 USC 683. Operators of hydraulic mines through which debris flows in part or in whole to a body restrained by a dam or other work erected by the California Debris Commission are required to pay an annual tax as determined by the Commission. Taxes imposed under this code are collected and expended under the supervision of USACE and the direction of the Department of the Army. The funds are used for repayment of funds advanced by the Federal government or other agencies for construction, restraining works, settling reservoirs, and maintenance.

Payments to States, Flood Control Act of 1954, 33 USC 701c-3. Seventy-five percent of all funds received and deposited from the leasing of lands acquired by the United States for flood control, navigation, and allied purposes (including the development of hydroelectric power) are returned to the state in which the property is located. USACE collects lease receipts into a receipt account. Funds are appropriated for the amount of receipts the following fiscal year. The funds may be expended by the states for the benefit of public schools and public roads of the counties in which such property is situated, or for defraying any of the expenses of county government.

Maintenance and Operation of Dams and Other Improvements of Navigable Waters, 16 USC 803(f) and 810. When a reservoir or other improvement is constructed by the U.S., the Federal Energy Regulatory Commission (FERC) assesses charges against licensees directly benefited. The statute requires all proceeds from any Indian reservation be placed to the credit of the Indians of the reservation. All other charges arising from licenses, except those charges established by the FERC for administrative reimbursement, are paid to the U.S. Treasury and allocated for specific uses. The Army is allocated 50 percent of charges from all licenses, except licenses for the occupancy and use of public lands and national forests. These funds are deposited in a special fund and used for maintenance, operation, and improvement of dams and other navigation structures that are owned by the United States, or in construction, maintenance, or operation of headwater, or other improvements to navigable waters of the United States.

Fund for NonFederal Use of Disposal Facilities (for dredged material), 33 USC 2326. Any dredged material disposal facility under the jurisdiction of, or managed by, the Secretary of the Army may be used by a nonfederal interest if the Secretary determines that such use will not reduce the availability of the facility for project purposes. Fees may be imposed to recover capital, operation, and maintenance costs associated with such use. Any monies received through collection of fees under this law shall be available to, and used by, the Secretary of the Army for the operation and maintenance of the disposal facility from which the fees were collected.

South Dakota Terrestrial Wildlife Habitat Restoration Trust Fund, Public Law 106-53 Sec. 603. Yearly transfers are made from the General Fund of the U.S. Treasury to the Trust Fund for investment purposes. Investment activity is managed by the Bureau of the Public Debt (BPD). The BPD purchases and redeems nonmarketable market-based securities. Investments include one-day certificates, bonds, and notes. When the fund reaches the aggregate amount of $108 million, withdrawals may be made by USACE for payment to the State of South Dakota. The state uses the payments to fund annually-scheduled work for wildlife habitat restoration.

Costal Wetlands Restoration Trust Fund and Costal Wetlands Planning, Protection, and Restoration Act, 16 USC 3951-3956. USACE (along with the Environmental Protection Agency, and the Fish and Wildlife Service) is granted the authority to work with the State of Louisiana to develop, review, evaluate, and approve a plan to achieve a goal of "no net loss of wetlands" in coastal Louisiana. USACE is also responsible for allocating funds among the named task force members. Federal contributions are established at 75 percent of project costs or 85 percent if the state has an approved Coastal Wetlands Conservation Plan.

Rivers and Harbors Contributed and Advance Funds, 33 USC 701h, 702f, and 703. Whenever any state or political subdivision offers to advance funds for a flood control project duly adopted and authorized by law, the Secretary of the Army may, in his discretion, receive such funds and expend them in the immediate prosecution of such work. The funding may be used to construct, improve, and maintain levees, water outlets, flood control, debris removal, rectification and enlargement of river channels, etc. in the course of flood control and river and harbor maintenance.

Inland Waterways Trust Fund, 26 USC 9506. This law made the Inland Waterways Trust Fund available for USACE expenditures for navigation, construction, and rehabilitation projects on inland waterways. Collections for excise taxes from the public are made into the Trust Fund. The collections are invested and investment activity is managed by the BPD. The BPD purchases and redeems nonmarketable market-based securities. Investments include one-day certificates, bonds, and notes.

Harbor Maintenance Trust Fund, 26 USC 9505. The USACE Civil Works mission is funded by the Energy and Water Development Appropriations Act. The Water Resources Development Act of 1986 covers a portion of USACE operations and maintenance costs for deep draft navigation. The Harbor Maintenance Trust Fund is available for making expenditures to carry out the functions specified in the Act and for the payment of all expenses of administration incurred by the U.S. Treasury, USACE, and the Department of Commerce. Collections are made into the Trust Fund from taxes collected from imports, domestics, passengers, and foreign trade. The collections are invested and investment activity is managed by the BPD.

Foreign National Employees Separation Pay Account Trust Fund, 10 USC 1581. This fund makes payments from amounts obligated by the Secretary of Defense that remain unexpended for separation pay for foreign national employees of the Department. The foreign national employees' separation pay funded by Foreign Military Sales administrative funds is maintained as a separate fund.

Defense Commissary Agency Surcharge Trust Fund, 10 USC 2685. This fund was established as the repository for the surcharge on sales of commissary goods paid for by authorized patrons to finance certain operating expenses and capital purchases of the Commissary System, which are precluded by law from being paid with appropriated funds. Most surcharge revenue is generated by the 5 percent surcharge applied to each sale. These funds may be used to pay for commissary store-related information technology investments, to purchase commissary equipment, to finance advance design modifications to prior year projects, for both minor and major construction projects, and to maintain and repair commissary facilities and equipment.

Education Benefit Fund, 10 USC 2006. This fund was established to finance, on an actuarially sound basis, the liabilities of the Department's education benefit programs for current and former active duty, guard, and reserve members of the armed forces, and members of the Coast Guard. Financing sources for the Education Benefit Fund are interest earnings on Fund assets and monthly Department contributions.

Voluntary Separation Incentive Fund, 10 USC 1175. This fund was established to finance, on an actuarially sound basis, the liabilities of the Department's incentive program for early separation from military service. Financing sources for the Voluntary Separation Incentive Fund are interest earnings on Fund assets and annual Department contributions

Military Housing Privatization Initiative, Public Law 104-106, Section 2801. The MHPI includes both direct loan and loan guarantee programs, is authorized by the National Defense Authorization Act for FY 1996, and includes a series of authorities that allow the Department to work with the private sector to renovate and build military family housing. The MHPI accelerates the construction of new housing built to market standard and leverages private sector capital with government dollars. The Department provides protection to the private sector partner against specific risks, such as base closure or member deployment.

Armament Retooling and Manufacturing Support Initiative, 10 USC 4551-4555. The Armament Retooling and Manufacturing Support Initiative is a loan guarantee program designed to incentivize commercial use of the Army's inactive ammunition plants for businesses willing to locate to a government ammunition production facility. The production capacity of these facilities is greater than current military requirements, however, this capacity may be needed in the future. Revenue from property rentals are used to pay for the operation, maintenance and environmental cleanup at the facilities.

Note 24. Fiduciary Activities

Schedule of Fiduciary Activity *As of September 30*	*Dollars in Millions* 2010	2009
Fiduciary net assets, beginning of year	$ 187.4	$ 166.4
Contributions	256.7	264.6
Investment earnings	$ 17.2	$ 17.0
Distributions to and on behalf of beneficiaries	(282.4)	(260.6)
Increase/(Decrease) in fiduciary net assets	(8.5)	21.0
Fiduciary net assets, end of period	**$ 178.9**	**$ 187.4**

Schedule of Fiduciary Net Assets *As of September 30*	*Dollars in Millions* 2010	2009
Fiduciary Assets		
Cash and cash equivalents	**$ 178.9**	**$ 187.4**
Total Fiduciary Net Assets	**$ 178.9**	**$ 187.4**

Fiduciary activities exist when the Department has collected, received, held, or made disposition of assets on behalf of an individual or nonfederal entity. Fiduciary assets are not recognized on the Balance Sheet.

Public Law 89-538 authorized the Department, through the Savings Deposit Program, to collect voluntary contributions from members of the Armed Forces serving outside the United States or its possessions in designated areas. These contributions and earned interest are deposited in the U.S. Treasury on behalf of the members.

Note 25. Other Disclosures

Other Disclosures	2010— Asset Category			*Dollars in Millions*
As of September 30	Land and Buildings	Equipment	Other	Total
Entity as Lessee – Operating Leases				
Future Payments Due				
Fiscal Year 2011	$ 550.4	$ 2.0	$ 106.5	$ 658.9
Fiscal Year 2012	518.2	1.7	109.7	629.6
Fiscal Year 2013	479.7	1.3	112.7	593.7
Fiscal Year 2014	471.7	1.3	116.0	589.0
Fiscal Year 2015	489.0	1.3	135.5	625.8
After 5 Years	907.0	1.1	121.2	1,029.3
Total Future Lease Payments Due	**$ 3,416.0**	**$ 8.7**	**$ 701.6**	**$ 4,126.3**

Operating leases are leases that do not transfer all the benefits and risks of ownership of capital leases. Payments are charged as expenses over the lease term. Office space is the largest component of land and building leases. Other leases are generally one-year leases that are not building or equipment leases. Future year cost projections use the Consumer Price Index.

Note 26. Restatements

The Department restated its financial statements as of September 30, 2009 to correct errors in assets, liabilities, gross costs, and net position identified during ongoing audit readiness efforts.

Adjustment #1: During the transition to an automated interface between the budget execution and financial statement reporting systems, the Department identified $1.3 billion in errors related to FY 2009 and prior years account balances. To correct the errors, the Department restated the Statement of Budgetary Resources; Accounts Receivable (Nonfederal), Accounts Payable (Nonfederal), Other Liabilities (Nonfederal), Unexpended Appropriations, and Cumulative Results of Operations on the Balance Sheet; Gross Costs on the Statement of Net Costs, Unexpended Appropriations and Cumulative Results of Operations on the Statement of Changes of Net Position. Related notes restate were: Note 2, Nonentity Assets; Note 5, Accounts Receivable (Nonfederal); Note 11, Liabilities Not Covered by Budgetary Resources; Note 12, Accounts Payable (Nonfederal); Note 15, Other Liabilities (Nonfederal); Note 18, General Disclosures Related to the Statement of Net Cost; Note 20, Disclosures Related to the Statement of Budgetary Resources; Note 21, Reconciliation of Net Cost of Operations to Budget; and Note 23, Earmarked Funds.

Adjustment #2: The Department corrected a $1.5 billion overstatement of General Property, Plant and Equipment for property purchased prior to FY 2009 to remove programs capitalized that should have been expensed, to correct the related depreciation expense and to align the accounting records to the property accountability system. This correction decreased General Property, Plant and Equipment, Net; and Cumulative Results of Operations on the Balance Sheet; Cumulative Results of Operations on the Statement of Changes in Net Position; Gross Costs on the Statement of Net Costs; and General Property, Plant and Equipment. Note 2, Nonentity Assets; Note 10, General Property, Plant Equipment; Note 18, General Disclosures Related to the Statement of Net Cost; and Note 21, Reconciliation of Net Cost of Operations to Budget were restated.

Adjustment #3: The Department restated $503.2 million of Accounts Receivable (Nonfederal) for refunds requested from pharmaceutical manufacturers participating in the DoD's Retail Pharmacy Program. Upon the advice of the General Counsel the Department has removed these receivables pending a final court decision. The Department restated Accounts Receivable (Nonfederal) and Cumulative Results of Operations on the Balance Sheet; Gross Costs on the Statement of Net Costs, and Cumulative Results of Operations on the Statement of Changes in Net Position. Related notes restated were: Note 2, Nonentity Assets; Note 5, Accounts Receivable; Note 18, General Disclosures Related to the Statement of Net Cost; Note 21, Reconciliation of Net Cost of Operations to Budget; and Note 23, Earmarked Funds.

Adjustment #4: The Department corrected a $473.4 million understatement of inventory and related property resulting from incorrect credits to the inventory allowance account for customer returns of inventory. The allowance account was not adjusted when the returned inventory was subsequently resold. The Department restated Inventory and Related Property, Net; and Cumulative Results of Operations on the Balance Sheet; Gross Costs on the Statement of Net Costs, and Cumulative Results of Operation on the Statement of Changes in Net Position. Related notes restated were: Note 2, Nonentity Assets; Note 9, Inventory and Related Property;

Note 18, General Disclosures Related to the Statement of Net Cost; and Note 21, Reconciliation of Net Cost of Operations to Budget.

Adjustment #5: The Department reduced outstanding contract financing payment by $505.6 million and accounts payable by $69 million in FY 2009 based on auditor recommended adjustments. Restatements were made to Other Assets (Nonfederal), Accounts Payable (Nonfederal), and Unexpended Appropriations on the Balance Sheet; Gross Costs on the Statement of Net Costs, Unexpended Appropriations on the Statement of Changes in Net Position; and the Statement of Budgetary Resources. Related notes restated were Note 2, Nonentity Assets; Note 18, General Disclosures Related to the Statement of Net Cost; Note 20, Disclosures Related to the Statement of Budgetary Resources; and Note 21, Reconciliation of Net Cost of Operations to Budget.

Effect on FY 2010 beginning Comparative Results and Unexpended Appropriations

FY 2010 Statement of Changes in Net Position		*Dollars in Billions*
Cumulative Results of Operations		**FY 2010**
Correction of Errors (+/-) Adjustment #1	$	0.4
Correction of Errors (+/-) Adjustment #2		(1.5)
Correction of Errors (+/-) Adjustment #3		(0.5)
Correction of Errors (+/-) Adjustment #4		0.5
Beginning balance adjustments	**$**	**(1.1)**
Unexpended Appropriations		
Correction of Errors – Adjustment #1	$	(0.4)
Correction of Errors – Adjustment #5		(0.6)
Beginning balance adjustments	**$**	**(1.0)**

Effect on Comparative Balances

FY 2009 Balance Sheet		*Dollars in Billions*
Accounts Receivable, Net (Nonfederal) – Adjustment #3	$	(0.5)
Inventory – Adjustment #4		0.5
General Property, Plant and Equipment, Net – Adjustment #2		(1.5)
Other Assets (Nonfederal) – Adjustment #5		(0.5)
Total Assets	**$**	**(2.0)**
Accounts Payable (Nonfederal) – Adjustment #5		0.1
Total Liabilities	**$**	**0.1**
Net Position	**$**	**(2.1)**
Total Liabilities and Net Position	**$**	**(2.0)**

FY 2009 Balance Sheet		*Dollars in Billions*
FY 2009 Statement of Net Cost		*Dollars in Billions*
Gross Costs – Adjustment #1	$	(0.8)
Gross Costs – Adjustment #2		(0.3)
Gross Costs – Adjustment #3		0.5
Gross Costs – Adjustment #4		(0.1)
Gross Costs – Adjustment #5		0.6
Net Cost of Operations	**$**	**(0.1)**
FY 2009 Statement of Changes in Net Position		*Dollars in Billions*
Cumulative Results of Operations		
Correction of Errors (+/-) Adjustment #1	$	0.4
Correction of Errors (+/-) Adjustment #2		(1.8)
Correction of Errors (+/-) Adjustment #4		0.4
Beginning balance adjustments	**$**	**(1.0)**
Budgetary Financing Sources:		
Appropriations used – Adjustment #1	$	(0.8)
Appropriations used – Adjustment #5		0.6
Net Cost of Operations Adjustment #1	$	0.8
Net Cost of Operations Adjustment #2		0.3
Net Cost of Operations Adjustment #3		(0.5)
Net Cost of Operations Adjustment #4		0.1
Net Cost of Operations Adjustment #5		(0.6)
Cumulative Results	**$**	**(1.1)**
Unexpended Appropriations		
Correction of Errors – Adjustment #1	$	(1.2)
Beginning balance adjustments	**$**	**(1.2)**
Budgetary Financing Sources:		
Appropriations Used – Adjustment #1		0.8
Appropriations Used – Adjustment #5		(0.6)
Unexpended Appropriations	$	(1.0)
Net Position	**$**	**(2.1)**

FY 2009 Balance Sheet		*Dollars in Billions*
FY 2009 Statement of Budgetary Resources		*Dollars in Billions*
Budgetary Resources:		
Unobligated Balance, brought forward – Adjustment #1	$	(1.3)
Total Budgetary Resources	**$**	**(1.3)**
Status of Budgetary Resources:		
Obligations Incurred:		
Direct – Adjustment #1	$	(1.7)
Direct – Adjustment #5		(0.1)
Reimbursable – Adjustment #1		0.4
Unobligated balance: Apportioned – Adjustment #5		0.1
Total Status of Budgetary Resources	**$**	**(1.3)**
Change in Obligated Balance:		
Obligations Incurred – Adjustment #1	$	(1.3)
Obligations Incurred – Adjustment #5		(0.1)
Less: Gross Outlays – Adjustment #1		1.3
Unpaid Obligations – Adjustment #5		(0.1)
Net Outlays:		
Gross Outlays – Adjustment #1	$	(1.3)

Required Supplementary Stewardship Information

Federal financial reporting requires DoD to report on its stewardship over certain resources that cannot be measured in traditional financial reports. These resources do not meet the criteria for assets and liabilities required to be reported in the financial statements, but are important to understand the operations and financial condition of DoD at the date of the financial statements and in subsequent periods.

The Department's stewardship investments are comprised of, and are measured in terms of, expenses incurred for: 1) federally-financed, but not federally-owned, physical property (Nonfederal Physical Property); and 2) federally-financed research and development (Research and Development (R&D)). Information on additional reporting requirements for Nonfederal Physical Property and R&D follows.

NONFEDERAL PHYSICAL PROPERTY

The Nonfederal Physical Property investments support the purchase, construction, or major renovation of physical property owned by state and local governments. In addition, Nonfederal Physical Property investments include federally-owned physical property transferred to state and local governments.

Nonfederal Physical Property
Department of Defense Consolidated — Nonfederal Physical Property
Yearly Investments in State and Local Governments
For Fiscal Years 2010 through 2006
Dollars in Millions

Categories	2010	2009	2008	FY 2007	FY 2006
Transferred Assets:					
National Defense Mission Related	$ 2,126.2	$ 1,224.7	$ 1,169.2	$ 1,051.0	$ 1,295.5
Funded Assets:					
National Defense Mission Related	0.0	26.7	19.6	2.8	8.5
Total	**$ 2,126.2**	**$ 1,251.4**	**$ 1,188.8**	**$ 1,053.8**	**$ 1,304.0**

INVESTMENTS IN RESEARCH AND DEVELOPMENT

Investment values included in this report are based on R&D expenses. The R&D programs are classified in the following categories: Basic Research, Applied Research, and Development. The amounts reported in the Investments in R&D table show outlays from FY 2006 – FY 2010 for all DoD Components. The definition for each type of R&D Category and Subcategories are explained below.

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

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

Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development consists of the five stages defined in the Investments in R&D table.

Advanced Technology Development is the systematic use of the knowledge or understanding gained from research and directed toward proof of technological feasibility and assessment of producibility rather than directed toward the development of hardware for service use. It employs demonstration activities intended to prove or test a technology or method.

Advanced Component Development and Prototypes evaluates integrated technologies in an operating environment as realistic as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components and complete weapon systems ready for operational and developmental testing and field use.

System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapons systems finalized for complete operational and developmental testing.

Research, Development, Test, and Evaluation Management Support is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the Research and Development program.

Operational Systems Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development stages which have received approval for production and production funds have been budgeted in subsequent fiscal years.

Investments in Research and Development (R&D)
Department of Defense Consolidated
Yearly Investments in Research and Development
For the Current and Four Preceding Fiscal Years
Dollars in Millions

Categories	2010	2009	2008	2007	2006
Basic Research	$ 1,805.5	$ 821.0	$ 1,346.4	$ 1,445.7	$ 1,408.5
Applied Research	4,927.0	1,944.0	3,812.3	4,647.1	4,756.9
Development					
Advanced Technology Development	6,353.4	2,263.2	5,977.9	6,019.7	5,737.4
Advanced Component Development and Prototypes	14,304.6	12,148.3	15,410.6	14,109.6	11,906.9
System Development and Demonstration	15,156.7	21,501.9	18,052.9	16,737.8	13,209.8
Research, Development, Test and Evaluation Management Support	5,503.6	5,141.3	5,471.0	4,705.4	3,736.0
Operational Systems Development	23,986.2	42,450.6	20,246.7	13,535.1	5,509.8
Totals:	**$72,037.0**	**$86,270.3**	**$70,317.8**	**$61,200.4**	**$46,265.3**

Required Supplementary Information

REAL PROPERTY DEFERRED MAINTENANCE

This section includes the deferred maintenance information and Statement of Disaggregated Budgetary Resources.

Real Property Deferred Maintenance and Repair

For Fiscal Year Ended September 30, 2010 *Dollars in Millions*

Property Type	Current Fiscal Year (CFY)		
	1. Plant Replacement Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage
1. Category 1	$490,578	$92,502	19%
2. Category 2	$40,564	$11,801	29%
3. Category 3	$10,727	$1,031	10%

The deferred maintenance amount is based on facility Q-ratings found in the Department's real property inventory. Q-ratings represent work needed to bring a facility to a fully serviceable condition with no repair needs. The reported deferred maintenance is the difference between the facility Q-rating and the target Q-rating that represents the acceptable operating condition established by each Component within the Department. The percentage column reflects the percent of total plant replacement value for each category represented by deferred maintenance.

Facility Categories are as follows:

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

MILITARY EQUIPMENT DEFERRED MAINTENANCE

Depot maintenance requirements for military equipment are developed during the annual budget process. The table below shows the deferred unfunded requirements for the depot maintenance program.

Military Equipment Deferred Maintenance

For Fiscal Year Ended September 30, 2010 *Dollars in Million*

Major Categories	Amounts
1. Aircraft	$2,032.1
2. Automotive Equipment	$226.9
3. Combat Vehicles	$410.0
4. Construction Equipment	$65.9
5. Electronics and Communications Systems	$927.7
6. Missiles	$279.4
7. Ships	$85.2
8. Ordnance Weapons and Munitions	$153.2
9. General Purpose Equipment	$93.8
10. All Other Items Not Identified to above Categories	$151.4
Total	**$4,425.6**

Statement Of Disaggregated Budgetary Resources *For the Years Ended September 30, 2010 and 2009* *Dollars in Millions*	2010								
	Military Personnel	Procurement	Research, Development, Test and Evaluation	Family Housing /Military Construction	Military Retirement Benefits	Civil Works	Operations, Readiness, & Support	2010 Combined	2009 Combined
Budgetary Financing Account									
Budgetary Resources									
Unobligated balance, brought forward, October 1	$ 1,793.3	$ 65,091.5	$ 14,808.0	$ 15,212.0	$ 0.0	$ 17,344.6	$ 31,791.6	$ 146,041.0	$ 134,381.8
Recoveries of prior year unpaid obligations	8,388.5	8,415.8	4,198.0	3,511.5	0.0	40.1	30,147.3	54,701.2	63,272.9
Budget authority									
Appropriation	151,763.5	125,850.3	77,262.6	15,316.7	119,894.5	6,558.2	402,632.6	899,278.4	855,564.3
Contract authority	0.0	0.0	0.0	0.0	0.0	0.0	73,059.7	73,059.7	67,626.3
Spending authority from offsetting collections									
Earned									
Collected	1,081.4	3,322.6	9,862.4	7,721.2	0.0	10,201.9	152,279.1	184,468.6	178,143.5
Change in receivables from Federal sources	112.1	410.0	(499.4)	(51.1)	0.0	4.4	(326.9)	(350.9)	1,188.9
Change in unfilled customer orders									
Advance received	(0.1)	(10.5)	(48.4)	(50.8)	0.0	62.2	(34.3)	(81.9)	1,030.8
Without advance from Federal sources	5.0	(24.3)	228.7	1,085.6	0.0	(192.4)	1,313.1	2,415.7	(88.3)
Expenditure transfers from trust funds	0.0	0.0	0.0	0.0	0.0	851.0	0.0	851.0	862.5
Subtotal	152,961.9	129,548.1	86,805.9	24,021.6	119,894.5	17,845.3	628,923.3	1,159,640.6	1,104,328.0
Nonexpenditure transfers, net, anticipated and actual	1,469.1	8,728.6	351.4	(570.5)	0.0	183.6	(9,358.9)	803.3	(15.7)
Temporarily not available pursuant to Public Law	0.0	0.0	0.0	0.0	(60,175.6)	0.0	(153.1)	(60,328.7)	(39,190.4)
Permanently not available	(256.1)	(3,073.4)	(1,685.4)	(1,461.8)	0.0	(8.0)	(81,395.9)	(87,880.6)	(85,969.3)
Total Budgetary Resources	$ 164,356.7	$ 208,710.6	$ 104,477.9	$ 40,712.8	$ 59,718.9	$ 35,045.6	$ 599,954.3	$ 1,212,976.8	$ 1,176,807.3

Status Of Budgetary Resources *For the Years Ended September 30, 2010 and 2009* *Dollars in Millions*	2010								
	Military Personnel	Procurement	Research, Development, Test and Evaluation	Family Housing /Military Construction	Military Retirement Benefits	Civil Works	Operations, Readiness & Support	2010 Combined	2009 Combined AFR
Obligations incurred:									
Direct	$ 161,600.8	$ 125,706.2	$ 78,044.3	$ 14,192.9	$ 59,719.0	$ 13,114.0	$ 405,270.4	$ 857,647.6	$ 847,069.9
Reimbursable	1,213.9	3,714.4	10,482.2	10,826.4	0.0	10,862.5	158,281.2	195,380.6	183,695.8
Subtotal	162,814.7	129,420.6	88,526.5	25,019.3	59,719.0	23,976.5	563,551.6	1,053,028.2	1,030,765.7
Unobligated balance:									
Apportioned	523.2	76,841.0	14,466.3	15,222.8	0.0	10,038.5	20,498.0	137,589.8	128,132.0
Exempt from apportionment	0.0	0.0	0.0	0.0	0.0	1,030.6	5,141.4	6,172.0	3,374.0
Subtotal	523.2	76,841.0	14,466.3	15,222.8	0.0	11,431.9	25,639.4	143,761.8	131,506.0
Unobligated balance not available	1,018.7	2,449.0	1,485.0	470.8	0.0	0.0	10,763.3	16,186.8	14,535.6
Total status of budgetary resources	164,356.6	208,710.6	104,477.8	40,712.9	59,719.0	35,045.6	599,954.4	1,212,976.8	1,176,807.3
Change in Obligated Balance:									
Obligated balance, net									
Unpaid obligations, brought forward, October 1	$ 9,482.2	$ 153,616.0	$ 42,679.2	$ 26,257.9	$ 3,871.9	$ 11,299.6	$ 206,751.9	$ 453,958.7	$ 432,118.5
Less: Uncollected customer payments from Federal sources, brought forward, October 1	9.1	(3,980.1)	(5,143.9)	(9,411.9)	0.0	(3,253.3)	(45,922.2)	(67,702.3)	(66,602.2)
Total unpaid obligated balance	$ 9,491.3	$ 149,635.9	$ 37,535.3	$ 16,846.0	$ 3,871.9	$ 8,046.3	$ 160,829.7	$ 386,256.4	$ 365,516.3
Obligations incurred net	162,814.7	129,420.6	88,526.5	25,019.3	59,719.0	23,976.6	563,551.5	1,053,028.2	1,030,765.7
Less: Gross outlays	(152,257.3)	(133,280.6)	(82,872.0)	(19,802.3)	(59,014.1)	(22,101.4)	(524,337.0)	(993,664.7)	(945,652.5)
Obligated balance transferred, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Less: Recoveries of prior year unpaid obligations, actual	(8,388.5)	(8,415.8)	(4,198.0)	(3,511.5)	0.0	(40.1)	(30,147.3)	(54,701.2)	(63,272.9)
Change in uncollected customer payments from Federal sources	(117.1)	(385.7)	270.8	(1,034.5)	0.0	187.9	(986.1)	(2,064.7)	(1,100.5)
Obligated balance, net, end of period									
Unpaid obligations	11,651.1	141,340.2	44,135.7	27,963.3	4,576.9	13,134.6	215,819.2	458,621.0	453,958.8
Less: Uncollected customer payments (+/-) from Federal sources	(107.9)	(4,365.8)	(4,873.1)	(10,446.4)	0.0	(3,065.4)	(46,908.4)	(69,767.0)	(67,702.7)
Total, unpaid obligated balance, net, end of period	$ 11,543.2	$ 136,974.4	$ 39,262.6	$ 17,516.9	$ 4,576.9	$ 10,069.2	$ 168,910.8	$ 388,854.0	$ 386,256.1
Net									
Net Outlays:									
Gross outlays	$ 152,257.3	$ 133,280.6	$ 82,872.0	$ 19,802.3	$ 59,014.1	$ 22,101.4	$ 524,337.0	$ 993,664.7	$ 945,652.5
Less: Offsetting collections	(1,081.3)	(3,312.1)	(9,814.0)	(7,670.4)	0.0	(11,115.1)	(152,244.9)	(185,237.8)	(180,036.9)
Less: Distributed Offsetting receipts	0.0	0.0	0.0	0.0	(73,739.4)	(1,071.5)	(2,911.3)	(77,722.2)	(65,912.1)
Net Outlays	$ 151,176.0	$ 129,968.5	$ 73,058.0	$ 12,131.9	$ (14,725.3)	$ 9,914.8	$ 369,180.8	$ 730,704.7	$ 699,703.5

Combined Statement Of Budgetary Resources *For the Years Ended September 30, 2010 and 2009* *Dollars in Millions*	Non Budgetary		
	Other	2010 Combined	2009 Combined
Non Budgetary Financing Accounts			
Budgetary Resources			
Unobligated balance, brought forward, October 1	$ 23.6	$ 23.6	$ 26.3
Recoveries of prior year unpaid obligations	0.0	0.0	47.5
Budget authority			
Borrowing authority	26.8	26.8	58.4
Spending authority from offsetting collections			
Earned			
Collected	69.6	69.6	45.1
Change in unfilled customer orders			
Without advance from Federal sources	(34.9)	(34.9)	(10.8)
Subtotal	61.5	61.5	92.7
Permanently not available	(13.9)	(13.9)	(0.1)
Total Budgetary Resources	$ 71.2	$ 71.2	$ 166.4

Statement of Disaggregated Budgetary Resources *For the Years Ended September 30, 2010 and 2009* *Dollars in Millions*	Non Budgetary		
	Other	2010 Combined	2009 Combined
Non Budgetary Financing Accounts			
Obligations incurred:			
Direct	$ 46.3	$ 46.3	$ 142.7
Subtotal	**$ 46.3**	**$ 46.3**	**$ 142.7**
Unobligated balance:			
Apportioned	24.8	24.8	0.3
Subtotal	24.8	24.8	0.3
Unobligated balance not available	0.1	0.1	23.4
Total status of budgetary resources	**$ 71.2**	**$ 71.2**	**$ 166.4**
Change in Obligated Balance:			
Obligated balance, net			
Unpaid obligations, brought forward, October 1	$ 770.4	$ 770.4	$ 872.9
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(132.2)	(132.2)	(143.0)
Total unpaid obligated balance	**$ 638.2**	**$ 638.2**	**$ 729.9**
Obligations incurred net	46.3	46.3	142.7
Less: Gross outlays	(197.3)	(197.3)	(197.7)
Less: Recoveries of prior year unpaid obligations, actual	0.0	0.0	(47.5)
Change in uncollected customer payments from Federal sources	34.9	34.9	10.8
Obligated balance, net, end of period			
Unpaid obligations	619.4	619.4	770.4
Less: Uncollected customer payments (+/-) from Federal sources	(97.3)	(97.3)	(132.2)
Total, unpaid obligated balance, net, end of period	**$ 522.1**	**$ 522.1**	**$ 638.2**
Net			
Net Outlays:			
Gross outlays	$ 197.7	$ 197.7	$ 197.7
Less: Offsetting collections	(69.6)	(69.6)	(45.1)
Net Outlays	**$ 127.7**	**$ 127.7**	**$ 152.6**

APPENDIX A: GLOSSARY

Acronym	Definition
AFR	Agency Financial Report
ANA	Afghan National Army
ANP	Afghan National Police
ANSF	Afghan National Security Forces
ARRA	American Recovery and Reinvestment Act
BEA	Business Enterprise Architecture
BRAC	Base Realignment and Closure
CFO	Chief Financial Officer
CMO	Chief Management Officer
COCOM	Combatant Command
COR	Contracting Officer Representative
DAAC	DoD Audit Advisory Committee
DBSMC	Defense Business Systems Management Committee
DCMO	Deputy Chief Management Officer
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DoD	Department of Defense
DIB	Defense Industrial Board
DTM	Directive-Type Memorandum
EHR	Electronic Health Record
ERP	Enterprise Resource Planning
FBWT	Fund Balance With Treasury
FFMIA	Federal Financial Management Improvement Act
FIAR	Financial Improvement and Audit Readiness
FIPS	Federal Information Processing Standard
FMFIA	Federal Managers' Financial Integrity Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GPRA	Government Performance and Results Act
HUMINT	Human Intelligence
IPIA	Improper Payment Information Act
ISF	Iraqi Security Forces
IT	Information Technology
JCC	Joint Contracting Command

Acronym	Definition
MDAP	Major Defense Acquisition Programs
MHS	Military Health System
MICP	Managers' Internal Control Program
NATO	North Atlantic Treaty Organization
NDAA	National Defense Authorization Act
OCO	Overseas Contingency Operations
OEF	Operation Enduring Freedom
OIF	Operation Iraqi Freedom
DOD IG	Office of Inspector General
OMB	Office of Management and Budget
OND	Operation New Dawn
PCS	Permanent Change of Station
QDR	Quadrennial Defense Review
SBR	Statement of Budgetary Resources
SEAL	Sea, Air and Land Teams
SECDEF	Secretary of Defense
TDY	Temporary Duty
USACE	U.S. Army Corps of Engineers
USD(C)	Under Secretary of Defense (Comptroller)
USSOUTHCOM	U.S. Southern Command
VLER	Virtual Lifetime Electronic Record
	Weapon of Mass Destruction

APPENDIX B: USEFUL WEB SITES FOR RELEVANT INFORMATION

Web Address and Report Description
www.defenselink.mil • Main DoD Web site, and links to other DoD Web sites.
www.defenselink.mil/comptroller The DoD Comptroller Web site includes: • Agency Financial Report Reports DoD's financial condition, financial execution, plans, and accomplishments. • Annual Performance Plan Describes DoD's strategic goals and objectives and the respective performance measures and targets used to assess progress. • Annual Performance Report Contains details of DoD's performance results and progress in achieving its strategic goals as required by the Government Performance and Results Act (GPRA). • Citizen's Report Summarizes DoD's mission, key goals, budget allocation, and progress on key performance goals linking to the strategic goals. • Congressional Budget Justification The Department of Defense's budget request to the Congress. • Financial Improvement and Audit Readiness Plan Describes DoD's strategy for improving financial management and reports progress in achieving financial statement audit readiness.
www.bta.mil The DoD's Business Transformation Agency Web site includes: • Business Enterprise Architecture Blueprints DoD standard processes, data, data standards, business rules, operating requirements, and information exchanges for the Department's business and financial management activities. • Enterprise Transition Plan Sets the defense business systems modernization strategy and defines the target systems environment.
www.defenselink.mil/qdr/report/Report20060203.pdf • Quadrennial Defense Review Dated February 1, 2010, provides DoD's strategic plan.

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