Department of the Air Force

Agency Financial Report

Fiscal Year 2019

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COVER PHOTO CREDIT

A F-22 Raptor is parked on the flightline at Joint Base Langley-Eustis, Virginia., Feb. 11, 2019. The jets were staged as part of a routine night flying training mission. (Photo: U.S. Air National Guard Senior Airman Bryan Myhr)

Barbara Barrett

Message from the Secretary of the Air Force

For the Fiscal Year 2019 Agency Financial Report

On behalf of the Air Force's men and women in uniform and the civilians who support them, I am proud to present our Agency Financial Report for fiscal year 2019. In line with the National Defense Strategy, the Air Force remains committed to deliver faster results to our Airmen, to embrace a culture of innovation, and to drive fiscal accountability. We are also forging a digital Air Force that will incorporate agile business practices to generate superior management processes that are more responsive to the needs of the service.

Following the conclusion of the fiscal year 2018 first full financial statement audit, the Secretary of Defense issued a memorandum with his top priorities for the fiscal year 2019 audit. I am pleased to announce that the Air Force has made significant strides to accomplish these priorities and we can report a positive outcome from ongoing efforts to more precisely account for our assets and help ensure more complete and accurate financial records. The Independent Public Accounting firm of Ernst & Young, has provided us with recommendations to assist with our ongoing remediation efforts and process improvements of internal controls, significant deficiencies and material weaknesses. The Air Force remains steadfastly focused on improving readiness while investing in the capabilities necessary for the high-end fight.

This past fiscal year, we also implemented a new business operations strategy. A first of its kind, the plan establishes a roadmap for reform and improvement in Air Force practices and processes. It outlines measurable goals and clear lines of accountability to improve our internal operations. Some of the plan's objectives include boosting aviator retention, adding family support programs, increasing data availability, and implementing predictive maintenance capabilities for our weapon systems. The reform of our organizational structures and outdated policies will reduce overhead, gain efficiencies, and generate superior management outcomes in support of our Airmen.

Barbara Barrett

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MANAGEMENT'S DISCUSSION AND ANALYSIS

An F-16D Fighting Falcon pilot from the 40th Flight Test Squadron demonstrates proper flare technique during a training mission near Eglin Air Force Base, Florida. A flare is an aerial infrared countermeasure used by planes or helicopters to counter an infrared homing surface-to-air missile or air-to-air missile. (U.S. Air Force photo by Senior Airman Joshua Hoskins)

OVERVIEW

Created in 1907 as a functional component of the United States (U.S.) Army, the U.S. Air Force (the "Air Force," "we," "us," and "our") is the youngest branch of the U.S. Armed Forces. The Department of the Air Force was then established 40 years later, becoming one of three military departments within the Department of Defense (DoD). The Air Force is a military service branch organized within the DoD.

Our mission is to fly, fight, and win… in air, space, and cyberspace. To achieve that mission, the Air Force has a vision: *The United States Air Force will be a trusted and reliable joint partner with our sister services known for integrity in all of our activities, including supporting the joint mission first and foremost. We will provide compelling air, space, and cyber capabilities for use by the combatant commanders. We will excel as stewards of all Air Force resources in service to the American people, while providing precise and reliable Global Vigilance, Reach and Power for the nation*.

As a steward of government resources, the Air Force prepares its Agency Financial Report each Fiscal Year (FY) to convey its financial position and performance results to taxpayers. It demonstrates our commitment to the Air Force's mission, accountability, and stewardship over the resources entrusted to us by members of Congress, the President of the United States, and the public. In the following sections, this report includes:

Management's Discussion and Analysis—A narrative composed of the organization and mission of the Air Force, a high-level discussion of performance over the past FY, and an analysis of the financial statements, management assurances, and forward-looking information.

Financial Section—Annual financial statements are presented for the Air Force General Fund and Working Capital Fund, which are composed of the principal financial statements (Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources), their associated notes, the Required Supplementary Stewardship Information, and the Required Supplementary Information.

Other Information Section—The final section is composed of the Air Force's annual Fraud Reduction Report, as well as a summary of the financial statement audit and management assurances.

DID YOU KNOW?

In FY 2020, the Department of the Air Force will add the newest military service, the U.S. Space Force, to its organization. The U.S. Space Force will protect the Nation's interest in space and the peaceful use of space for all responsible actors, consistent with applicable law, including international law.

From its creation and looking forward to the future, the Air Force is poising itself to remain superior while confronting the reemergence of greater competition for power among nations.

A Delta IV carrying the GPS III SV2 satellite lifts off from Space Launch Complex-37 at Cape Canaveral Air Force Station. (United Launch Alliance courtesy photo)

MISSION

In accordance with the National Defense Strategy, the United States (U.S.) Air Force must build a more lethal and ready force, strengthen alliances and partnerships, and deliver greater, more affordable performance. The Air Force requires the right size and mix of agile capabilities to compete, deter, and win in a more competitive and dangerous international security environment than we have encountered in generations. As part of the joint team, the Air Force's first responsibility is to integrate air and space capabilities across the domains.

The Air Force has five core missions:

1. Air and Space Superiority… *freedom from attack and freedom to attack*

Air superiority ensures that advantages of the other Air Force core missions, and the formidable capabilities of sister services, are broadly available to combatant commanders. It includes the ability to control the air, so that U.S. military forces are not concerned about being attacked from the air, while ensuring that joint forces have the freedom to attack in the air, on the ground, and at sea. Air superiority has provided decades long asymmetric advantages and is essential to the overall mission.

America's freedom to operate effectively across the spectrum of conflict rests not only on the Air Force's ability to dominate in the air, but also on its ability to exploit space. We provide critical capabilities that enhance the military's ability to navigate accurately, see clearly, communicate securely, and strike precisely. Joint, interagency, and coalition forces depend on Air Force space operations to perform their missions every day, on every continent, in the air, on land, and at sea. In a dangerous and uncertain future, the ability to access and exploit space, even when others try to deny it, will be vital to the nation's security.

F-22 Raptors from the 3rd Wing and 477th Fighter Group participate in a close formation taxi, known as an Elephant walk, with an E-3 Sentry and a C-17 Globemaster III. (Photo: Justin Connaher)

2. Global Strike… *any target, any time*

The Air Force's nuclear and conventional precision strike forces can deter, credibly threaten, and effectively conduct global strikes by holding any target on the planet at risk and, if necessary, disabling or destroying it promptly—even from bases within the continental United States. These forces possess the unique ability to achieve tactical, operational, and strategic effects all in a single combat mission. Global strike missions include a wide range of crisis response and escalation-control options, such as providing close air support to troops at risk, interdicting enemy forces, inserting special operations forces, or targeting an adversary's vital centers. Whether employed from forward bases or enabled by in flight refueling, a global strike derives from a wide range of systems that include bombers, missiles, special operations platforms, fighters, and other Air Force aircraft.

A 1,000-foot wall of fire explodes below the F-22 Raptor during a high-speed pass maneuver at the "Mission Over Malmstrom" open house event in Great Falls, Montana. (Photo: 2nd Lt. Samuel Eckholm)

3. Rapid Global Mobility… *delivery on demand*

American power can be projected quickly to anywhere on the face of the earth because of the Air Force's rapid global mobility. Air mobility provides swift deployment and sustains operations by delivering essential equipment and personnel for missions ranging from major combat to humanitarian relief operations around the world. Beyond moving cargo and equipment, Air Force rapid global mobility is linked to unprecedented survival rates because of our highly skilled aeromedical transport teams who swiftly evacuate wounded troops back to safety. Mobility forces also provide in-flight refueling, which is a unique Air Force capability and the linchpin to joint-power projection at intercontinental distances.

F-16 Fighting Falcons conducting a mission during a RED-FLAG-Alaska 10-2 sponsored exercise. (Photo: Master Sgt. Burt Traynor)

4. Intelligence, Surveillance, and Reconnaissance… *global eyes and ears on adversaries*

Intelligence, surveillance, and reconnaissance (ISR) helps leaders make informed decisions to maintain deterrence, contain crises, or achieve success in battle. Through a mix of aircraft, satellites, and other technologies that collect, exploit, and disseminate critical information, Air Force ISR gives policymakers the ability to minimize uncertainty about adversaries and their capabilities. It does so by strengthening deterrence, making adversaries act more cautiously, providing intelligence that gives commanders a decision-making advantage, and delivering real-time information on which joint, interagency, and coalition operations rely on to fight effectively and win. Globally integrated ISR allows American forces to carry out functions that they previously performed under much greater danger and at higher cost.

Gen. Mike Holmes, commander of Air Combat Command, and Chief Master Sgt. Frank Batten III, command chief of ACC, visit a radar tower at Al Dhafra Air Base. (Photo: Senior Airman Mya M. Crosby)

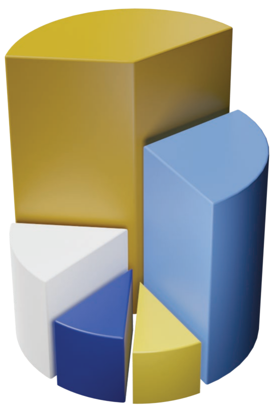
5. Command and Control… *right information, right person, right time*

Airmen employ the Air Force's other four interdependent and enduring core missions through robust, adaptable, and survivable command and control systems. The Air Force provides access to reliable communications and information networks so that the joint team can operate globally at an up-tempo level of intensity. Air Force command and control systems give commanders the ability to conduct highly coordinated joint operations on an unequaled scale using centralized command, distributed control, and decentralized execution. The capability to deliver airpower is intimately dependent on the ability to operate effectively in cyberspace. This cyberspace arena is where all core missions are conducted, and is critical to the Air Force's command and control systems. Providing the right information to the right person at the right time is essential to the American way of war.

Air Force Chief of Staff Gen. David L. Goldfein delivers remarks during the Koren Kollegian Jr. Trophy Award Ceremony. (Photo: Adrian Cadiz)

ORGANIZATIONAL STRUCTURE

The "Total Force" of the United States (U.S.) Air Force consists of more than 685,000 active duty (including Active Enlisted and Officer), Air National Guard, Air Force Reserve, and Civilian Airmen. This combined strength allows the Total Force to accomplish a variety of missions with varying manpower requirements—all while operating as one Air Force.



TOTAL 685,400

- ACTIVE ENLISTED 258,900
- CIVILIAN 186,000
- AIR NATIONAL GUARD 105,400
- AIR FORCE RESERVE 70,400
- ACTIVE OFFICER 64,700

The bulk of the Total Force consists of active duty officers and enlisted Airmen. The reserve component is made up of the Air Force Reserve (see Air Force Reserve Command) and the Air National Guard (ANG). The ANG has both a federal and state mission. This dual mission, a provision of the U.S. Constitution, results in each guardsman holding membership in the National Guard of his or her state and in the National Guard of the U.S. Another major component of the Air Force is the Civil Air Patrol. As a Total Force partner and auxiliary of the Air Force, the Civil Air Patrol is America's premier public service organization for carrying out emergency services and disaster relief missions nationwide. The Civil Air Patrol's vigilant citizen volunteers are there to search for and find lost individuals, provide comfort in times of disaster, and work to keep the homeland safe.

HEADQUARTERS AIR FORCE

Headquarters Air Force consists of two entities: The Office of the Secretary of the Air Force (the Secretariat), which includes the Secretary of the Air Force (the Secretary) and the Secretary's principal staff, and the Air Staff, which is headed by the Chief of Staff of the Air Force (the Chief). The Secretariat and Air Staff help the Secretary and the Chief direct the Air Force's mission.

The Secretariat. The Secretary, a civilian and presidential appointee, reports to the Secretary of Defense. To assure unit preparedness and overall effectiveness of the Air Force, the Secretary is responsible for and has the authority to conduct all affairs of the Department of the Air Force. This includes training, operations, administration, logistical support and maintenance, and welfare of personnel. The Secretary's responsibilities include research and development, and any other activity prescribed by the President of the United States or the Secretary of Defense. The Secretary exercises authority through civilian assistants and the Chief, but retains immediate supervision of activities that involve vital relationships with Congress, the Secretary of Defense, other governmental officials, and the public.

The Air Staff. The Chief—which is normally a four-year role—is appointed by the President of the United States, with the consent of the Senate and at the recommendation of Air Force general officers. The Chief serves as a member of the Joint Chiefs of Staff (JCS) and the Armed Forces Policy Council. In the JCS capacity, the Chief is one of the military advisers to the President of the United States, the National Security Council, and the Secretary of Defense. The Chief is also the principal adviser to the Secretary on Air Force activities. The Chief presides over the Air Staff, transmits Air Staff plans and recommendations to the Secretary, and acts as the Secretary's agent in carrying out such plans and recommendations. The Chief is responsible for the efficiency of the Air Force, the preparation of its forces for military operations, and for activities assigned to the Air Force by the Secretary of Defense. In addition, the Chief supervises the administration of Air Force personnel assigned to unified organizations and specified commands, as well as support of these forces assigned by the Air Force as directed by the Secretary of Defense.

FIELD ORGANIZATIONS

Direct Reporting Units (DRUs), Field Operating Agencies (FOAs), Major Commands (MAJCOMs), and their subordinate elements constitute the field organizations that carry out the Air Force mission. DRUs have specialized and restricted missions and are directly subordinate to the Chief or to his or her representative on the Air Staff. Currently, the Air Force has three DRUs: the Air Force District of Washington, the Air Force Operational Test and Evaluation Center, and the United States Air Force Academy.

FOAs are a subdivision of the Air Force directly subordinate to a Headquarters Air Force functional manager. FOAs perform field activities beyond the scope of any MAJCOM, and their activities are unique and associated with the Air Force-wide mission. Currently, the Air Force has more than 20 active FOAs. While DRUs, FOAs, and MAJCOMs all directly report to Headquarters Air Force, DRUs and FOAs are assigned focused missions that are restricted in scope when compared to the mission of a MAJCOM.

For more information about DRUs and FOAs, go to: https://www.afhra.af.mil/Information/Organizational-Records/DRU-and-FOA/

Currently, there are 10 active MAJCOMs that are assigned specific responsibilities on a functional basis in the United States, as well as on a geographic basis overseas. They accomplish designated phases of Air Force worldwide activities and further organize, administer, equip, and train their subordinate elements to accomplish assigned missions. MAJCOM headquarters have the full range of functional staff, excluding functions that have been centralized elsewhere for Air Force-wide execution.

Within MAJCOMs, the organizational structure has two schemes: unit and non-unit. Unit organizations are hierarchically organized by Numbered Air Force, wing, group, squadron, and flight, whereas non-unit organizations are hierarchically organized by center, complex, directorate, division, branch, and section. The basic unit for generating and employing combat capability is the wing, which has always been the Air Force's prime war-fighting instrument. Composite wings operate more than one kind of aircraft and may be configured as self-contained units designated for quick air intervention anywhere in the world. Other wings continue to operate a single aircraft type, ready to join air campaigns anywhere they are needed. Air-base and specialized-mission wings, such as training, intelligence, and test, also support the Air Force mission. Within the wing, operations, logistics, and support groups are the cornerstones of the organization.

Finally, there are lead and component MAJCOMs. A lead MAJCOM consolidates responsibilities for a particular function in a single MAJCOM, supporting the entire Air Force (as applicable). A component MAJCOM is the Air Force component to a Unified Combatant Command. Each of the active MAJCOMs, along with their respective mission, vision statements, and functional responsibilities, are described below.

Air Combat Command (ACC)

Mission: ACC organizes, trains, and equips combat-ready Airmen to control and exploit the Air (and Space)

Vision: Warrior Airmen, committed to excellence, trained and ready to fly, fight and win...anytime, anyplace

ACC is the primary force provider of combat airpower to America's warfighting commands. To support the global implementation of National Security Strategy of the United States of America, ACC operates fighter, reconnaissance, battle-management, and electronic-combat aircraft. It also provides command, control, communications, and intelligence systems, and conducts global information operations.

For more information about ACC, go to: https://www.acc.af.mil/

Air Education and Training Command (AETC)

Mission: Recruit, train and educate Exceptional Airmen

Vision: The First Command: Developing Airmen of character - the foundation of a lethal force

AETC's mission begins with the recruitment of quality men and women with the right skills, at the right time, in the right numbers to sustain the combat capability of the Air Force. AETC provides basic military training, initial and advanced technical training, flying training, and professional military and degree granting professional education.

For more information about AETC, go to: https://www.aetc.af.mil/

Air Force Global Strike Command (AFGSC)

Mission: Airmen providing strategic deterrence, global strike and combat support… anytime, anywhere!

Vision: Innovative leaders providing safe, secure and lethal combat-ready forces for nuclear and conventional global strike… today and tomorrow!

AFGSC provides nuclear and conventional global strikes, a key component of strategic deterrence. AFGSC is responsible for the nation's three intercontinental ballistic missile wings; the Air Force's entire bomber force, to include B-52, B-1, and B-2 wings; the Long Range Strike Bomber program; Air Force Nuclear Command, Control and Communications systems; and operational and maintenance support to organizations within the nuclear enterprise.

For more information about AFGSC, go to: https://www.afgsc.af.mil/

Air Force Materiel Command (AFMC)

Mission: Deliver and support agile war-winning capabilities

Vision: Innovative Airmen, trusted and empowered, creating agile, cost-effective war-winning capabilities for the Nation

AFMC delivers war-winning expeditionary capabilities to the warfighter through development and transition of technology, professional acquisition management, exacting test and evaluation, and world-class sustainment of all Air Force weapon systems. From cradle to grave, AFMC provides the work force and infrastructure necessary to ensure the U.S. remains the world's most respected air and space force.

For more information about AFMC, go to: https://www.afmc.af.mil/

Air Force Reserve Command (AFRC)

Mission: Provide combat-ready forces to fly, fight and win

Vision: Reserve Citizen Airmen - an Agile, Combat-Ready Force Answering our Nations Call... Always There!

AFRC provides citizen airmen to defend the U.S. and protect its interests through aerospace power. Reservists support nuclear deterrence operations; air, space, and cyberspace superiority, command, and control; global integrated intelligence surveillance reconnaissance; global precision attacks; special operations; rapid global mobility; and personnel recovery. AFRC also performs space operations, aircraft flight testing, aerial port operations, civil engineering, security forces, military training, communications, mobility support, transportation, and service missions.

For more information about AFRC, go to: https://www.afrc.af.mil/

Air Force Space Command (AFSPC)

Mission: Provide resilient, defendable and affordable space capabilities for the Air Force, Joint Force and the Nation

Vision: Innovate, Accelerate, Dominate

AFSPC provides military-focused space capabilities with a global perspective to the joint warfighting team. Through the command and control of all Department of Defense (DoD) satellites, satellite operators provide force-multiplying effects—continuous global coverage, low vulnerability, and autonomous operations. Maintaining space superiority is an emerging capability required to protect U.S. space assets, and plays a critical role in maintaining world peace and ensuring the nation's safety and security.

For more information about AFSPC, go to: https://www.afspc.af.mil/

Air Force Special Operations Command (AFSOC)

Mission: Provide our Nation's specialized airpower, capable across the spectrum of conflict … Any Place, Any Time, Anywhere

Vision: Air Commandos … Ready Today, Relevant Tomorrow, Resilient Always

AFSOC provides Air Force Special Operations Forces (SOF) for worldwide deployment and assignment to regional unified commands. The Command's SOF are comprised of highly trained, rapidly deployable Airmen, conducting global special operations missions ranging from precision application of firepower to infiltration, exfiltration, resupply and refueling of SOF operational elements.

For more information about AFSOC, go to: https://www.afsoc.af.mil/

Air Mobility Command (AMC)

Mission: Rapid Global Mobility... Right Effects, Right Place, Right Time!

Vision: Air Mobility Warriors - Projecting Decisive Strength Across Contested Domains and Delivering Hope... Always

AMC is composed of a total force effort to execute rapid global mobility and enable global reach—the ability to respond anywhere in the world in a matter of hours. This is accomplished through AMC's four core mission areas: airlift, air refueling, air mobility support, and aeromedical evacuation.

For more information about AMC, go to: https://www.amc.af.mil/

Pacific Air Forces (PACAF)

Mission: PACAF delivers agile air, space, and cyberspace capabilities in support of United States Indo-Pacific Command's objectives, uniting allies and partners to enhance regional stability and security

Vision: A lethal, innovative, and interoperable force upholding a free and open Indo-Pacific with decisive advantage from cooperation to conflict

PACAF delivers rapid and precise air, space, and cyberspace capabilities to protect and defend the U.S., its territories, and its allies and partners. PACAF provides integrated air and missile warning and defense, promotes interoperability throughout the area of responsibility, maintains strategic access and freedom of movement across all domains, and is postured to respond across the full spectrum of military contingencies in order to restore regional security.

For more information about PACAF, go to: https://www.pacaf.af.mil/

U.S. Air Forces in Europe–Air Forces Africa (USAFE-AFAFRICA)

Mission: To forward project power across air, space and cyber domains, defend United States interests, demonstrate warfighting readiness, and forge strong partnerships in support of United States European Command (USEUCOM) and United States Africa Command (USAFRICOM) campaign objectives

Vision: The preeminent forward-based air force – lethal, agile, highly respected, and always ready – a fully engaged partner

USAFE-AFAFRICA is the air component for two DoD unified commands—U.S. European Command and U.S. Africa Command. USAFE-AFAFRICA executes the Air Force, USEUCOM, and USAFRICOM missions with forward-based airpower and infrastructure to conduct and enable theater and global operations.

For more information about USAFE-AFAFRICA, go to: https://www.usafe.af.mil/

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

The National Defense Strategy directs a more lethal and ready force, prepared to defeat adversaries in high-end combat. This past year, the primary objective of the United States (U.S.) Air Force was to restore readiness to, or above, levels prior to sequestration. Throughout the year, the Air Force made progress in readiness restoration and significant first steps in building the "Air Force We Need," to include maintaining personnel and equipment that are ready to "fight tonight" against emerging threats. Ready and more capable than ever, the Air Force is effectively adapting to meet new threats and the technical demands of 21st century warfare.

This Fiscal Year (FY), the Air Force made deliberate decisions to focus the additional resources provided by Congress on pacing squadrons (the 204 operational squadrons required in the opening days of a near peer fight). With these resources, the Air Force is better prepared for major combat operations today than it was two years ago. More than 90 percent of Air Force pacing squadrons are ready to "fight tonight" with their lead force packages—the first Airmen to deploy at the beginning of a conflict.

AIR FORCE'S STRATEGIC FOCUS AREAS

- **The Air Force We Need -** Supplying the force and capabilities we need to implement the National Defense Strategy
- **Building a More Lethal and Ready Air Force -** Confronting challenges from adversaries with forward-thinking operational concepts, new technologies, and optimized force structures
- **Fielding Tomorrow's Air Force Faster and Smarter -** Instituting a culture of innovation and rapid acquisition as we reform for greater performance and affordability

With the additional resources the Air Force received this FY, we achieved the following accomplishments:

Members of the Kentucky Air National Guard's 123rd Airlift Wing are reunited with friends and family. (Photo: Master Sgt. Phil Speck)

People. Readiness recovery is, first and foremost, about people. Manning levels in frontline units today are at 95 percent or higher, a six percent increase since FY 2016. Building upon prior-year efforts, the Air Force is now up to 24,500 additional Airmen, and effectively closed the shortage of active duty maintainers by adding more than 4,000 of these highly skilled Airmen. To address the aircrew shortage, the Air Force implemented initiatives to increase the number of pilots trained, to season them in operational units, and to retain experienced aircrews. This year, the Air Force is on course to increase the number of pilots we train, aiming to surpass 1,500 by FY 2022.

Outside of adding new servicemen and women, the Air Force must retain and take care of the quality airmen already supporting our mission. For years, the Air Force suffered with retention following sequestration. The Air Force is now working tirelessly to give back to Airmen and their families through a variety of means, including streamlining administrative tasks, cancellation of some exercises, and pursuing quality of life and quality of service programs. The new Talent Marketplace gives Airmen greater transparency on their assignment process and is reducing the number of year-long deployments to improve stability and reduce the burden on families. The attention to quality of life is for both Total Force personnel, as well as spouses and families, as the family is the backbone of the Air Force.

Training. Airmen are shifting their focus to the Great-Power Competition, and must be trained and equipped for the high-end fight. At the start of 2019, the average flying hours per month was 16. By the end of this year, the Air Force increased this average to 21 flying hours per month. Once in the air, training against a peer adversary is necessary, so new training technologies and upgraded training ranges are explored. The Pilot Training Next program uses virtual reality and more simulators to train pilots effectively and efficiently. Modern training ranges include live and virtual training techniques and infrastructure, which provide relevant and realistic training capabilities against our most advanced threats. The Air Force is boosting space operator training by fielding the Standard Space Trainer, and by standing up the Virtual Test and Training Center at Nellis Air Force Base in Nevada to provide a realistic training environment for honing high-end tactics both on the range and in the simulator.

Tech. Sgt. Matthew Plew, 48th Fighter Wing Public Affairs photojournalist, takes a selfie while documenting two F-15E Strike Eagles and an F-15C Eagle. (Photo: Tech. Sgt. Matthew Plew)

Cost-Effective Maintenance and Logistics. The Air Force is focusing on innovative ways to maintain and supply aging fleets. We are fielding technologies to streamline supply chains, drive engineering improvements, and manage fleets. As part of the "Digital Air Force" initiative, the Air Force is using data to make maintenance personnel more efficient and effective by testing analytic tools and monitoring sensors to match industry best practices. By being able to better predict when a part will fail, the Air Force can improve readiness while saving time and money. Initial tests on several E-3 and C-5 components show the potential to reduce up to 30 percent of unscheduled maintenance. Additionally, the Oklahoma Depot is now completing major repairs on the KC-135 fleet 40 percent faster and at half the cost of recent industry contract proposals. Better depot maintenance practices have returned aircraft to the warfighter early, yielding nearly 9,000 additional days when aircraft were available to fly in FY 2019.

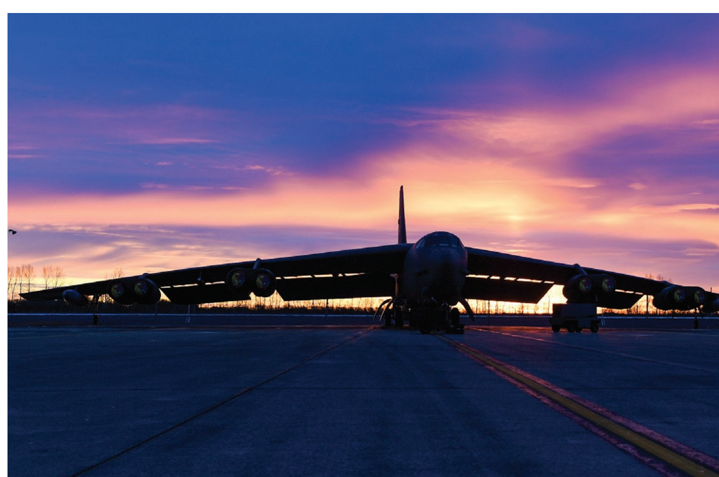
Senior Airman Joanna Escamilla, 4th Component Maintenance Squadron hydraulics technician, assembles an elevator actuator for an A-10 Thunderbolt. (Photo: Senior Airman Victoria Boyton)

Modernization. Potential adversaries are rapidly fielding capabilities that approach the level of American capabilities. The Air Force must retain its technological edge and equip its Airmen with highly advanced and lethal tools to prevail in high-end combat. The Air Force is investing in game-changing technologies to achieve and sustain a warfighting advantage, including hypersonic weapons, directed energy, and adaptive jet propulsion. Notable advancements in aircraft include the following:

Senior Airman Michael Hirsch, 492nd Aircraft Maintenance Unit maintainer, secures a panel on an F-15E Strike Eagle during exercise Combat Hammer at Mountain Home Air Force Base, Idaho. (Photo: Tech. Sgt. Matthew Plew)

- **B-21 Raider:** The next generation penetrating bomber, the B-21 Raider, is proceeding on schedule and building on three years of successful development. It will be able to deliver both gravity bombs and the Long Range Standoff Weapon to hold adversary targets at risk around the world. High-end conflicts will require the long-range capability of an advanced bomber fleet, and the B-21 is central to the expanded bomber capacity and capability needed.
- **KC-46 Tanker:** The Air Force recently welcomed its first KC-46 tankers and are proposing to buy 12 more KC-46 tankers in FY 2020. The Air Force's aerial refueling capability underwrites the global nature of Air Force power and enables the rapid deployment of aircraft.
- **T-7A Red Hawk:** In September 2019, Acting Secretary Matthew Donovan unveiled the name and tail design of the Air Force's newest trainer, the T-7A Red Hawk. The supersonic trainer, scheduled to go into service in 2023, will be a key element in training future pilots so they are proficient in fifth generation airplanes and tactics.

Fielding Tomorrow's Air Force Faster and Smarter. In May 2019, the Air Force met its "Century Challenge" milestone by cutting more than 100 years of "unnecessary schedule" from existing weapon development program plans since May 2018. Through the use of prototyping, experimentation, tailored acquisition strategies, and agile software development, Air Force delivered better and faster results to our warfighters. Additionally, some of this year's most notable achievements came from our scientists and research development teams. For example, the Air Force conducted flight tests with the carriage of a hypersonic missile from a B-52, making hypersonics more reality than mere theory.



The sun rises behind a B-52H Stratofortress at Minot Air Force Base, North Dakota. (Photo: Senior Airman Jonathan McElderry)

ANALYSIS OF FINANCIAL STATEMENTS AND STEWARDSHIP INFORMATION

The accompanying financial statements and related note disclosures represent the United States (U.S.) Air Force's enduring commitment to fiscal accountability and transparency. The Air Force made significant progress toward improving the quality and timeliness of financial reporting through business transformation initiatives, financial systems enhancements, and expansion of the internal control program. However, due to continued limitations of financial and non-financial systems and management processes, the Air Force is unable to implement all elements of U.S. Generally Accepted Accounting Principles (U.S. GAAP) and Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements* (OMB A-136). These limitations prevented the Independent Public Accountant from issuing an opinion on the Fiscal Year (FY) 2019 Air Force financial statements.

The Air Force is organized into two reporting entities: The Air Force General Fund (GF) and the Air Force Working Capital Fund (AFWCF). Each reporting entity has a separate set of financial statements and accompanying note disclosures comprised of the following:

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

GENERAL FUND

The Air Force GF supports the core missions and overall operations of the Air Force. The GF is financed primarily by enacted congressional appropriations in the following five major appropriation categories:

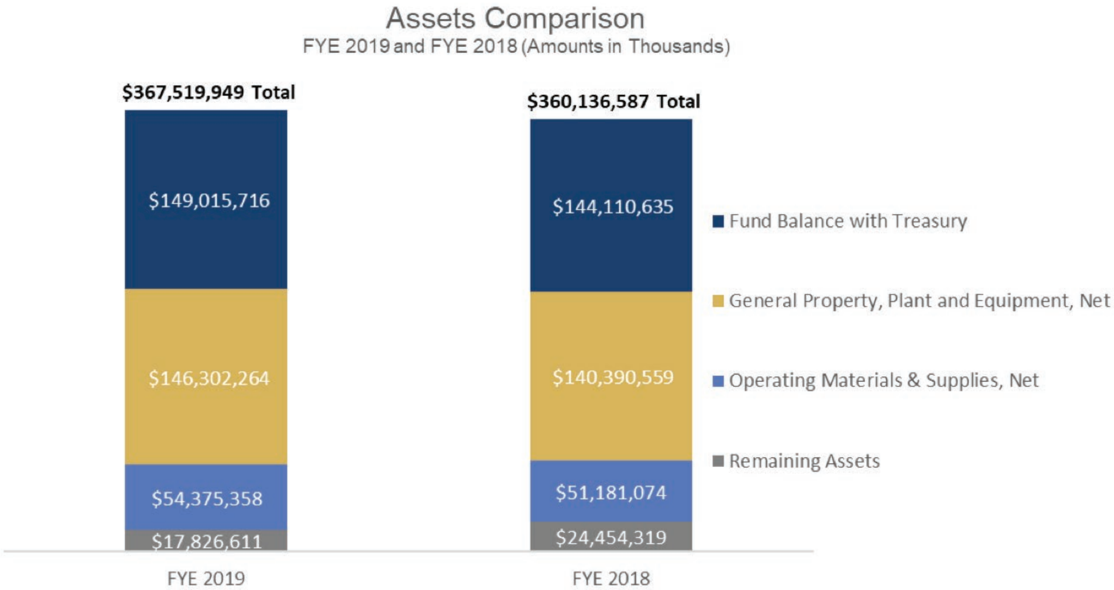
- Military Personnel (MILPERS)
- Operations and Maintenance (O&M)
- Procurement
- Research, Development, Test, and Evaluation (RDT&E)
- Military Construction (MILCON)

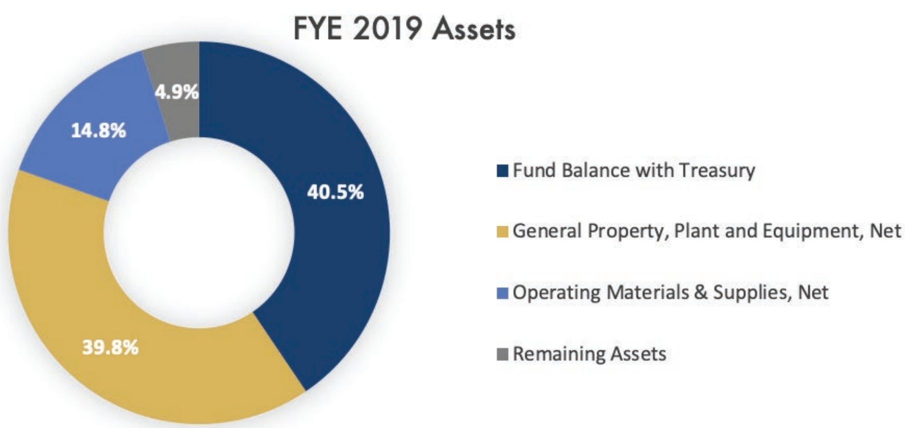
Consolidated Balance Sheet

The Consolidated Balance Sheet reports the Air Force's amounts of future economic benefits owned or managed by the Air Force (assets) against the amounts owed (liabilities) and the amounts that comprise the difference (net position).

The Fiscal Year-End (FYE) 2019 Air Force GF Consolidated Balance Sheet includes total assets of $367.5 billion. This is approximately a two percent overall increase from FYE 2018. Figure 1 shows the comparison of asset line items as of FYE 2019 and FYE 2018.

Figure 1. Air Force General Fund Assets (Unaudited)





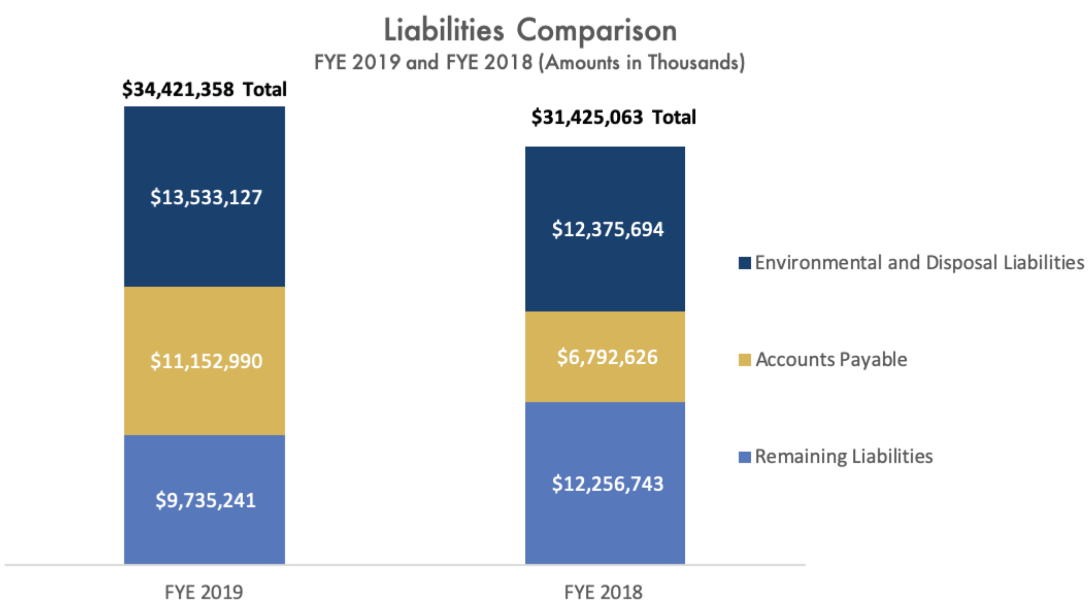
Material changes and underlying causes related to Air Force's GF assets between FYE 2019 and 2018 are as follows:

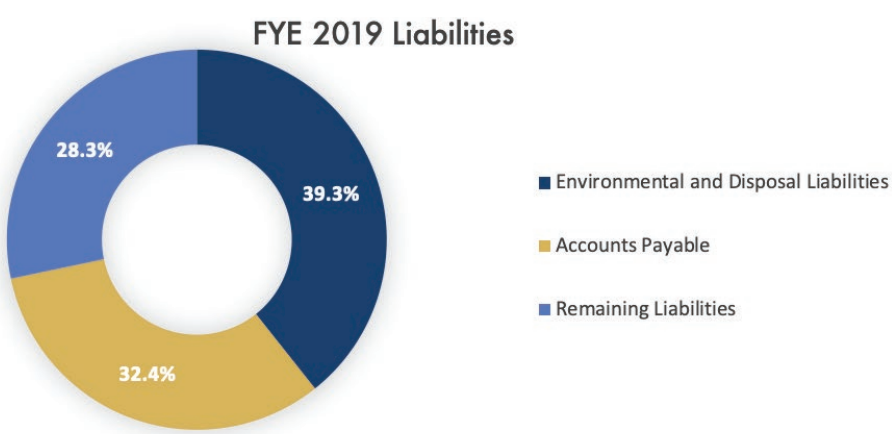
- **Fund Balance with Treasury:** Air Force GF Fund Balance with Treasury (FBwT) increased by $4.9 billion (3%). MILCON increased by $2.0 billion related to the Combatant Commanders' highest construction priorities. In addition, infrastructure investments increased to support the modernization and recapitalization of programs such as Lockheed Martin F-35A Lightning II, Boeing KC-46A Pegasus, Presidential Aircraft Recapitalization, and General Atomics MQ-9A Reaper. RDT&E increased by $1.8 billion due to additional funding for space capabilities and modernization efforts and innovative technologies. The remaining $1.1 billion increase is attributed to additional funding in Procurement and O&M.
- **General Property, Plant, and Equipment, Net:** Air Force GF General Property, Plant and Equipment (GPP&E) increased by $5.9 billion (4%). This increase is attributed to new aircraft deliveries in FY 2019 primarily for the F-35, C-130, and KC-46 that totaled $8.9 billion. An increase of $3.2 billion is also attributed to valuation adjustments for aircraft and satellites. Construction-in-Progress for military equipment decreased by $2.7 billion, Construction-in-Progress for buildings, improvements, and renovations decreased by $1.3 billion. Real Property, net, decreased by approximately $1.5 billion as a result of depreciation expense of approximately $2.6 billion offset by Real Property additions of $1.1 billion. Other general equipment decreased by a total of $541 million due to accountable property system of record migration and clean-up activities.

- **Operating Materials & Supplies, Net:** Air Force GF Operating Materials & Supplies (OM&S) increased by $3.2 billion (6%). This increase is attributed to an increase in munitions of $2.1 billion. The Air Force increased the purchase of preferred munitions to the maximum industrial capacity to replenish declining inventory. The remaining difference is due to a physical inventory reconciliation in the Combat Ammunitions System, the Air Force munitions APSR that resulted in an increase to OM&S.
- **Remaining Assets:** Air Force GF remaining assets decreased by $6.6 billion (27%). Largely, this variance is attributed to the reclassification of contract progress payments from the Mechanization of Contract Administration Services (MOCAS) from Other Assets to operating expenses of approximately $3.4 billion. Additionally, the change is due to a decrease in contract financing payments of $3.1 billion in Air Force procurement of the KC-46, communications satellites, and the Joint Strike Fighter.

The Air Force GF total liabilities at FYE 2019 were $34.4 billion. This is approximately a ten percent overall increase from FYE 2018. Figure 2 shows the comparison of liability types as of FYE 2019 and FYE 2018.

Figure 2. Air Force General Fund Liabilities (Unaudited)





Material changes and underlying causes related to Air Force's GF liabilities between FYE 2019 and 2018 are as follows:

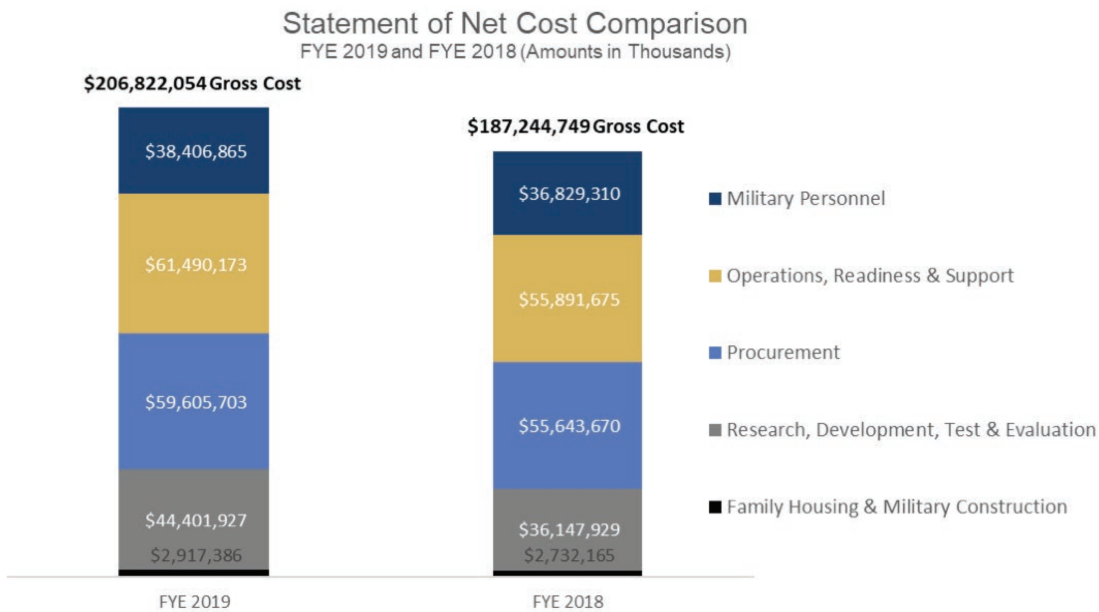
- **Environmental and Disposal Liabilities:** Air Force GF Environmental and Disposal Liabilities increased $1.2 billion (9%). This increase is attributable to multiple factors:
  - The environmental and disposal liability for non-nuclear powered general equipment increased $641.3 million with a majority of the increase related to intercontinental ballistic missiles due to the availability of historical cost data used to calculate the estimated liability.
  - Base Realignment and Closure (BRAC) Installation Restoration Program increased $341.1 million. Perfluorooctane Sulfonic Acid and Perfluorooctanoic Acid accounted for new response actions requiring remediation to address drinking water at Reese Air Force Base and follow-on requirements after the results of site inspections at four installations.
  - The remaining increase is attributed to recording additional asbestos liabilities.
- **Accounts Payable:** The Accounts Payable line item increased by $4.4 billion (64%). This increase is attributable to the policy change (FPM 18-01) which caused the reclassification of contract progress payments and required these amounts to be recorded as an Accounts Payable versus a contingent liability as it had in the previous FY. The amount attributable to this policy change is $3.3 billion. The remaining change is attributed to increased payables to the Washington Headquarters Services and the U.S. Transportation Command.
- **Remaining Liabilities:** Air Force GF Other Liabilities decreased by $2.5 billion (21%). Largely, this variance is attributed to the reclassification of contract progress payments from the Mechanization of Contract Administration Services (MOCAS). Beginning third quarter FY 2019, the Office of the Under Secretary of Defense Comptroller memorandum, Policy Change for Recording Contract Progress Payments (FPM 18-01), required these amounts to be recorded as an Accounts Payable versus a contingent liability as it had in the previous FY. The amount attributed to this policy change is $3.3 billion. In addition, there was an increase of $678 million in other non-federal liabilities which consisted of an increase in advances from others in RDT&E and the Judgment Fund due to a contract dispute.

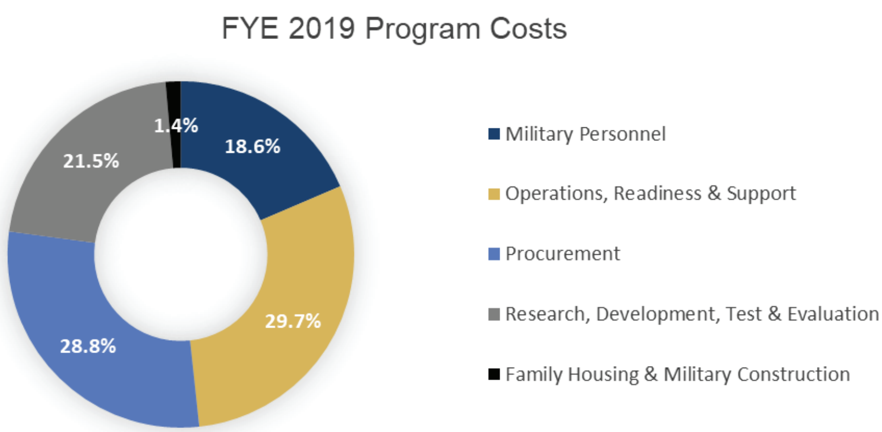
Consolidated Statement of Net Cost

The Consolidated Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Air Force supported by appropriations or other means. The SNC provides 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 FYE 2019 Air Force GF net cost of operations was $194.8 billion. This is approximately a nine percent increase from FYE 2018. This fluctuation is attributed to a variety of factors including, but not limited to, the FPM 18-01 policy change, increase in base support, increases in military personnel costs, and increases related to the space launch vehicle program, KC-46, and advanced engine development.

Figure 3 depicts a comparison of the gross program costs included within the Air Force's SNC. The culmination of the five program cost categories (Military Personnel; Operations, Readiness, and Support; Procurement; Research, Development, Test and Evaluation; and Family Housing and Military Construction), less earned revenue, make up the net cost of operations.

Figure 3. Air Force General Fund Statement of Net Cost (Unaudited)

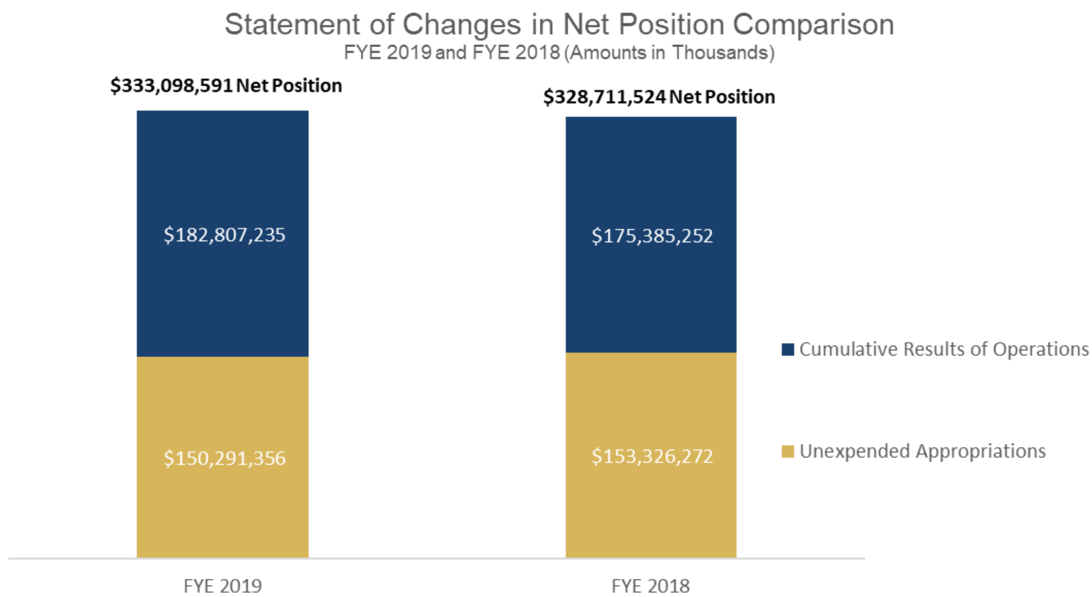




Consolidated Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position represents the total Net Position, which is composed of Unexpended Appropriations and Cumulative Results of Operations. The Air Force GF net position at FYE 2019 totaled $333.1 billion and $328.7 billion at FYE 2018, just over a one percent increase. Figure 4 shows the comparison of GF Unexpended Appropriations and Cumulative Results of Operations as of FYE 2019 and FYE 2018.

Figure 4. Air Force General Fund Statement of Changes in Net Position (Unaudited)



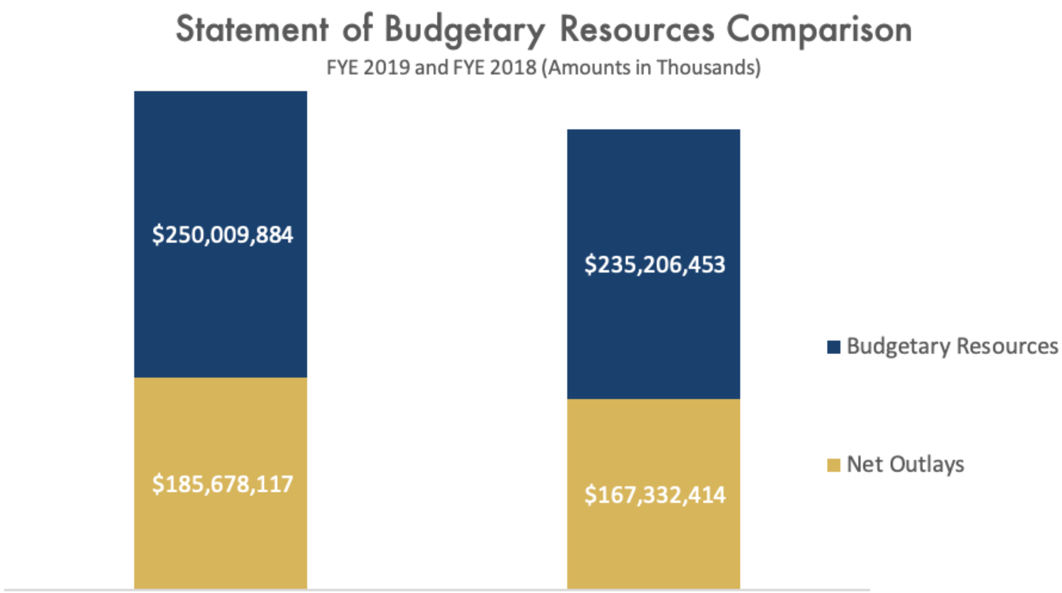
Material changes in the balances for Unexpended Appropriations and Cumulative Results of Operations, and the underlying causes driving those changes between FYE 2019 and FYE 2018, are as follows:

- **Cumulative Results of Operations:** Cumulative Results of Operations increased by $7.4 billion (4%). This change is largely attributed to a $6.6 billion 'transfer in' used to record new assets from Special Operations Command (SOCOM) in the first quarter of FY 2019.
- **Unexpended Appropriations:** Unexpended Appropriations decreased by $3.0 billion (2%). Procurement and RDT&E had increases in appropriations used during FY 2019. The increased spending can be attributed to additional investments in more modernized weapons systems such as the Air Force Command and Control (C2), Boeing E-3 Sentry, Lockheed Martin F-22 Raptor, Boeing B-52 Stratofortress, Boeing B-1 Lancer, as well as additional space capabilities necessary to remain competitive.

Combined Statement of Budgetary Resources

The Combined Statement of Budgetary Resources provides information on the budgetary funding available to the Air Force. The Air Force's resources consist primarily of funds received from two sources: appropriations from Congress for the current Fiscal Year and unobligated balances from prior Fiscal Years. The Air Force GF Budgetary Resources and Net Outlays were approximately $250.0 and $185.7 billion at FYE 2019 and $235.2 and $167.3 billion at FYE 2018, respectively, representing an increase of approximately six percent in Budgetary Resources and an increase of approximately 11% in Net Outlays. A comparison of these significant balances reflected in Air Force's GF Combined Statement of Budgetary Resources is depicted in Figure 5 as of FYE 2019 and FYE 2018.

Figure 5. Air Force General Fund Statement of Budgetary Resources (Unaudited)



- **Budgetary Resources:** Air Force GF Budgetary Resources increased by $14.8 billion (6%). Obligations for RDT&E increased by $9.5 billion largely related to modernization of the nuclear force, increased space capabilities, and investments in innovative technologies. In addition, obligations increased for Procurement by $5.5 billion. This increase is attributed to additional funding for modifications of aircraft, support and specialized ground support equipment, and modernization efforts.

- **Net Outlays:** Air Force GF Net Outlays increased by $18.5 billion (11%). The most significant driver for the outlays were an increase of $7.5 billion stemming from investments in innovative technologies, modernization of the nuclear force, and the transformation of major space capabilities to better perform in a contested environment. RDT&E also increased investments in developmental prototyping efforts in adaptive engines, hypersonics, space, cyber/electronic warfare, and low cost-attributable aircraft technology. Modernization efforts also continued for the Boeing VC-25B, Combat Rescue Helicopter, and the Sikorsky HH-60G Pave Hawk helicopters.

  In addition, $4.4 billion of the increase is attributed to spending in Procurement. Largely, this increase is related to additional investments in more lethal, cost effective, and modernized weapons systems. Procurement also increased due to fund modifications of aircraft, support and specialized ground support equipment, training devices, and spare parts. Modernization investments continued for programs including Air Force Command and Control (C2), Boeing E-3 Sentry, Lockheed Martin F-22 Raptor, Boeing B-52 Stratofortress, Boeing B-1 Lancer, among others. In addition, the increase is attributable to operations and maintenance spending for weapon system sustainment support requirements of approximately $3.8 billion; as well as, an additional $2.4 billion in MILPERS related to additional personnel, increases in military pay, and allowances for housing and subsistence.

WORKING CAPITAL FUND

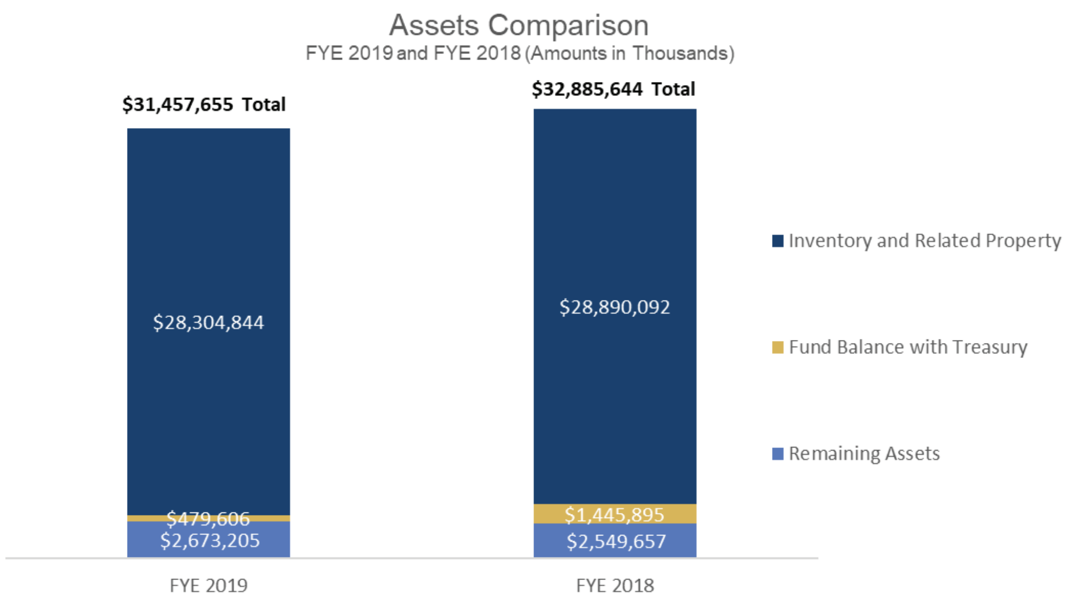
The AFWCF activities provide maintenance services, weapon system parts, base and medical supplies, and transportation services in support of Air Force core functions. The AFWCF is designed to be a self-sustaining, "business-like" activity that generates revenue from providing goods and services. It is integral to readiness and sustainability of Air Force's air and space assets and its ability to deploy forces around the globe in support of Overseas Contingency Operations and National Military Strategy requirements. Directly and indirectly, working capital fund activities provide warfighters the key services needed to meet mission capability requirements.

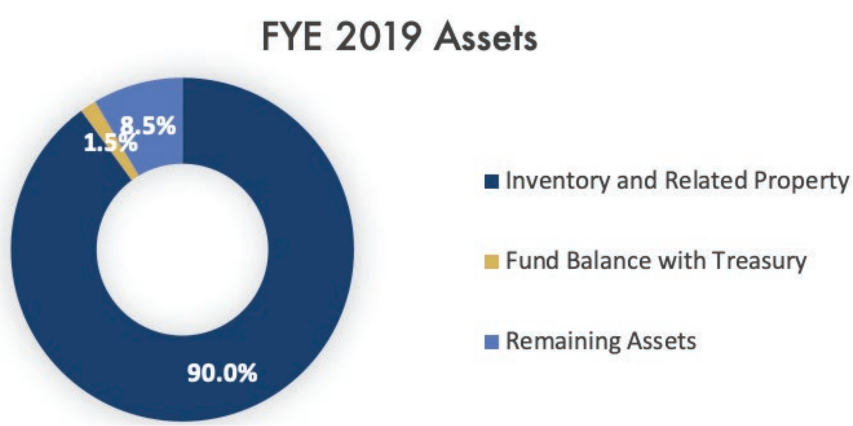
Consolidated Balance Sheet

The Consolidated Balance Sheet reports the Air Force's amounts of future economic benefits owned or managed by the Air Force (assets) against the amounts owed (liabilities) and the amounts that comprise the difference (net position).

The FYE 2019 AFWCF Consolidated Balance Sheet includes total assets of approximately $31.5 billion. This is over a four percent overall decrease from FYE 2018. Figure 6 shows the comparison of asset types as of FYE 2019 and 2018.

Figure 6. Air Force Working Capital Fund Assets (Unaudited)





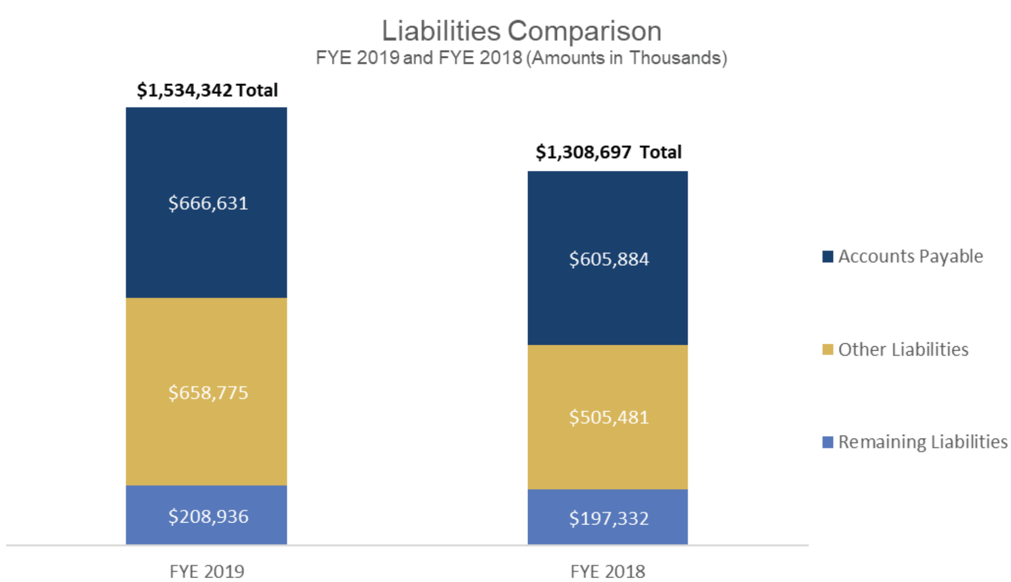
Significant balances of AFWCF assets, as well as material changes and underlying causes between FYE 2019 and FYE 2018, are as follows:

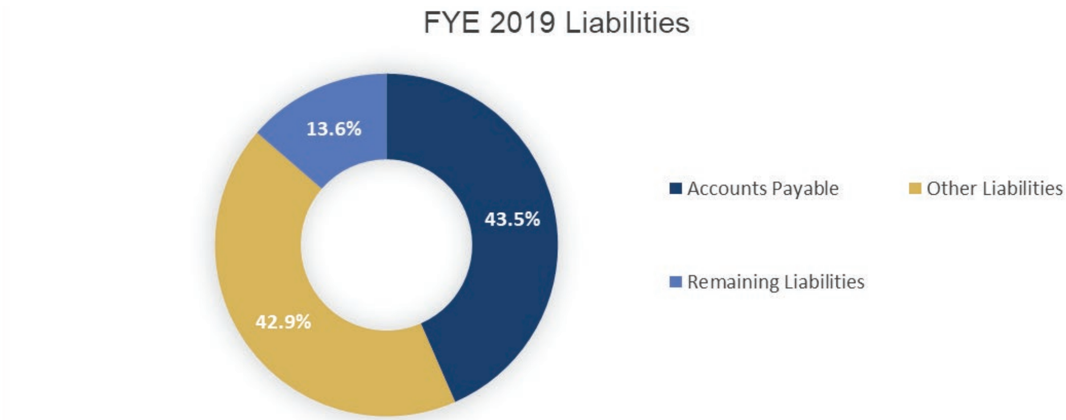
- **Inventory and Related Property, Net:** AFWCF reported $28.3 billion in Inventory and Related Property, Net at FYE 2019, compared to $28.9 billion reported at FYE 2018. The $0.6 billion (2%) decrease is driven by two significant adjustments recorded in FY 2019. An adjustment to decrease inventory by $3.4 billion was recorded to reflect the value of inventory in-transit and another adjustment of $1.4 billion was recorded which increased inventory balances to correct negative net inventory values within the inventory records. The remaining variance is attributable to purchases and sales of inventory occurring in the normal course of business.
- **Fund Balance with Treasury:** AFWCF reported approximately $479.6 million in Fund Balance with Treasury at FYE 2019, compared to $1.4 billion reported at FYE 2018, a decrease of nearly $966.3 million (67%).

  The decrease can be attributed to the $779.0 million decrease in the Supply Activities, coupled with an additional $187.3 million decrease in the depot maintenance activities. The decreases in Supply Activities is primarily due to inventory purchases to support the expected increases in demand for both reparable and consumable spare parts in support of the Flying Hour Program. The decrease in the Maintenance Activities can be attributed to production delays in engines, aircraft, and exchangeable workloads.
- **Remaining Assets:** AFWCF reported approximately $863.5 million in Accounts Receivable at FYE 2019, compared to $734.8 million reported at FYE 2018, an increase of nearly $128.7 million (18%). The increase is primarily due to a $58.0 million increase in the balance for Foreign Military Sales customers, resulting from September Uncollected Accounts Receivables, and a $52.9 million increase resulting from the recordation of a non-recurring reimbursable surcharge posted on September 30, 2019.

The AFWCF reported total liabilities of approximately $1.5 billion at FYE 2019. This is over a 17 percent overall increase from that of FYE 2018. Figure 7 shows the comparison of liability types as of FYE 2019 and FYE 2018.

Figure 7. Air Force Working Capital Fund Liabilities (Unaudited)





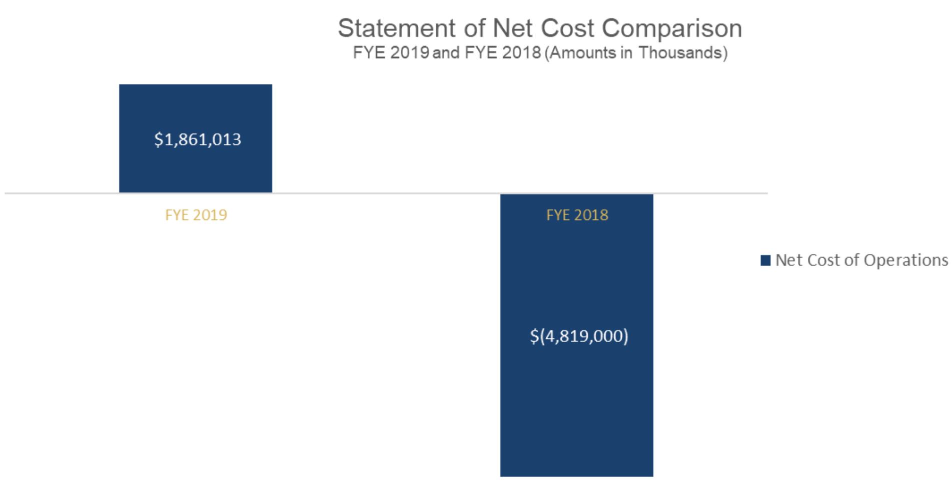
Material changes and underlying causes related to Air Force's AFWCF liabilities between FYE 2019 and 2018 are as follows:

- **Accounts Payable:** AFWCF reported approximately $666.6 million in Accounts Payable at FYE 2019, compared to $605.9 million at FYE 2018, an increase of about $60.7 million (10%). This increase is primarily due to increased costs in both Defense Logistics Agency and Contract Support services.
- **Other Liabilities:** AFWCF reported approximately $658.8 million in Other Liabilities at FYE 2019, compared to $505.5 million at FYE 2018, an increase of $153.3 million (30%). This increase can be attributed to the recordation of the civilian accrued leave liability. As a result of increased detailed reports received from the Defense Civilian Pay System, AFWCF can now identify and report the AFWCF portion of the accrued leave liability. In FY 2019, AFWCF recorded, for the first time, $115.7 million in accrued leave liability associated with accrued annual leave, restored annual leave, credit hours, compensatory hours, and frozen annual leave.

Consolidated Statement of Net Cost

The SNC presents the gross cost incurred by the AFWCF to conduct its operations less any exchange revenues earned from its activities. The FYE 2019 AFWCF net cost of operations was approximately $1.9 billion. Figure 8 displays the comparison of this balance for FYE 2019 and 2018.

Figure 8. Air Force Working Capital Fund Statement of Net Cost (Unaudited)



Gross Costs represents the only material change on the Air Force's AFWCF SNC for FYE 2019 and 2018. AFWCF reported approximately $14.6 billion in Gross Costs at FYE 2019, compared to $7.9 billion at FYE 2018, approximately a $6.7 billion increase. The increase can be attributed to the $1.6 billion increase in Gross Costs resulting from inventory adjustments recorded in the current year, compared to a $5.8 billion decrease in Gross Costs resulting from inventory adjustments recorded in FY 2018.

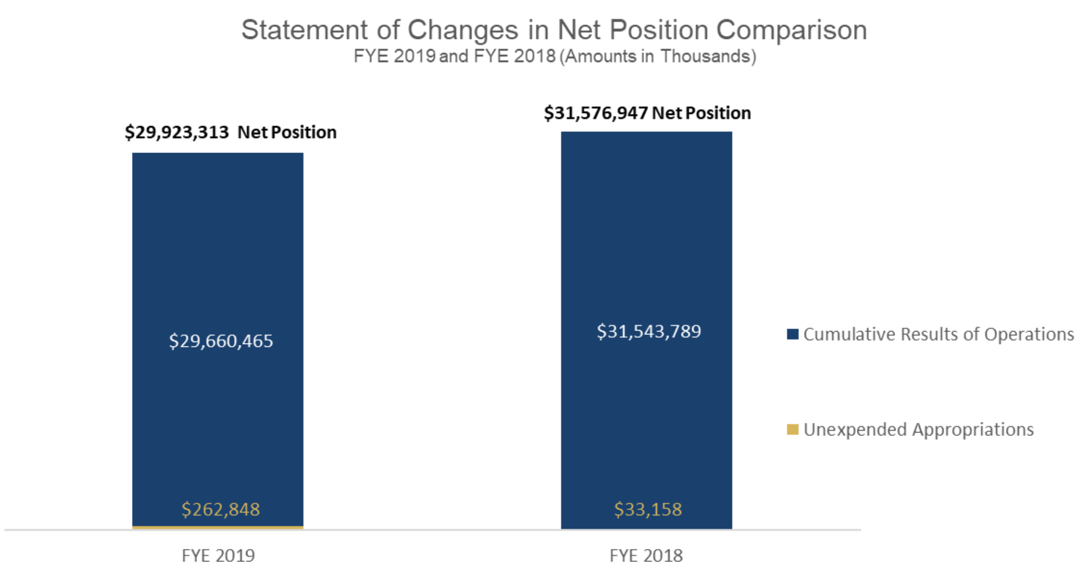
In FY 2019, AFWCF recorded two material adjustments that increased Gross Costs. AFWCF recorded an adjustment of $1.4 billion to increase Inventory and Related Property, Net and to decrease Gross Costs to correct negative net inventory values within the inventory records. A second adjustment, totaling $3.4 billion was processed to decrease Inventory and Related Property, Net with corresponding adjustments of $3.0 billion to increase Gross Costs, and $0.4 billion to decrease Other Financing Sources (Non-exchange) disclosed within the Statement of Change in Net Position. AFWCF made this adjustment to accurately reflect the value of inventory in-transit.

In comparison, AFWCF recorded $5.8 billion in adjustments decreasing Gross Costs in FY 2018. AFWCF recorded $3.7 billion in adjustments that increased Inventory and Related Property, Net and decreased Gross Costs that resulted from the reconciliation between logistic and financial systems. AFWCF recorded a second adjustment of $2.1 billion, increasing Inventory and Related Property, Net and decreasing Gross Costs to correct duplicate inventory transactions.

Consolidated Statement of Changes in Net Position

The Consolidated Statement of Changes in Net Position represents the total Net Position, which is composed of Unexpended Appropriations and Cumulative Results of Operations. At FYE 2019, the AFWCF net position was approximately $29.9 billion, compared to $31.6 billion at FYE 2018, approximately a five percent decrease. Figure 9 shows the comparison of AFWCF Unexpended Appropriations and Cumulative Results of Operations as of FYE 2019 and FYE 2018.

Figure 9. Air Force Working Capital Fund Statement of Changes in Net Position (Unaudited)



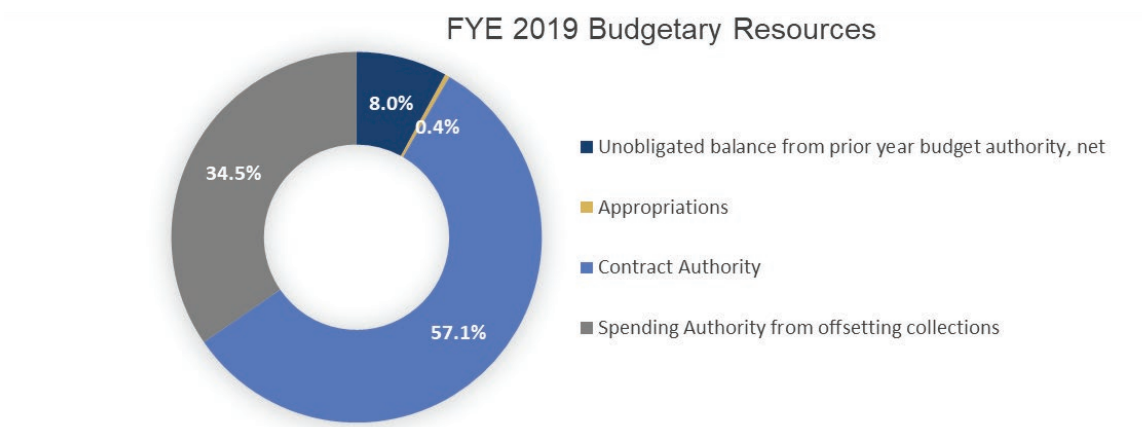
Material changes and underlying causes related to Air Force's AFWCF Statement of Changes in Net Position between FYE 2019 and 2018 are as follows:

- **Unexpended Appropriations:** AFWCF reported $262.8 million in Unexpended Appropriations at FYE 2019, compared to $33.2 million at FYE 2018, an increase of $229.7 million (693%). This increase is the result of the receipt of a $233.9 million appropriation transfer of unobligated balances in accordance with the Omnibus 2019 Reprogramming Action.
- **Budgetary Financing Sources:** AFWCF reported $81.8 million in Budgetary Financing Sources at FYE 2019, compared to $22.2 million in FY 2018, an increase of $59.6 million (268%). This increase can be attributed to the $59.0 million in transfers out without reimbursement recorded in FY 2018, as the result of a reprogramming action that did not occur in FY 2019.
- **Other Financing Sources:** AFWCF transferred out $104.1 million in Other Financing Sources at FYE 2019, compared to a transfer in of $216.9 million in FY 2018, a decrease of $321.0 million. This decrease can be attributed to additional inventory transfers out without reimbursement in FY 2019.
- **Net Cost of Operations:** AFWCF reported $1.9 billion in Net Cost of Operations at FYE 2019, compared to a negative $4.8 billion at FYE 2018, an increase of $6.7 billion. This increase can be attributed to the $6.7 billion increase in Gross Costs previously discussed in the SNC.

Combined Statement of Budgetary Resources

The AFWCF's Budgetary Resources is a culmination of unobligated balances from the prior year budget authority, appropriations, contract authority, and spending authority from offsetting collections. AFWCF's Budgetary Resources for FYE 2019 were approximately $19.2 billion, a slight increase just under one percent compared to $19.1 billion at FYE 2018. A percentage breakdown of the AFWCF budgetary resources for FYE 2019 is depicted in Figure 10.

Figure 10. Air Force Working Capital Fund Budgetary Resources (Unaudited)



Material changes and underlying causes related to the AFWCF Combined Statement of Budgetary Resources between FYE 2019 and 2018 are as follows:

- **Unobligated Balance from Prior Year Budget Authority, Net:** AFWCF reported approximately $1.5 billion in Unobligated balance from prior year budget authority, net at FYE 2019, compared to $1.3 billion reported at FYE 2018, an increase of $255.5 million (20%). This increase can be attributed to the receipt of a $233.9 million appropriation transfer of unobligated balances in accordance with the Omnibus 2019 Reprogramming Action.

- **Appropriations:** AFWCF reported approximately $77.6 million in Appropriations at FYE 2019, compared to $66.5 million at FYE 2018, an increase of $11.2 million (17%). This increase was primarily due to an increase in War Reserve Material requirements from the U.S. Air Force in Europe.

- **Net Outlays:** AFWCF reported approximately $1.3 billion in Net Outlays at FYE 2019, compared to $424.2 million at FYE 2018, an increase of $853.6 million (201%). This increase is primarily due to the $530.8 million increase in disbursements in the AFWCF supply activities to support increases in expected demand for both reparable and consumable spare parts.

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

The United States (U.S.) Air Force commanders and managers are responsible for ensuring the integrity of their systems and controls, as well as compliance with applicable laws and regulations. A key element of this responsibility is adherence to the requirements of the *Federal Financial Management Improvement Act* (FFMIA) and the *Federal Managers' Financial Integrity Act* (FMFIA) for internal controls that address financial and non-financial reporting, financial systems, and non-financial operations. Accessible financial information and effective internal controls increase accountability and transparency, thereby enhancing public confidence in the Air Force's stewardship of public resources. The Air Force continues to design and implement internal control activities to improve the integration of business processes, systems, and financial reporting to eliminate errors that could lead to misstatement or noncompliance with laws and regulations.

SYSTEMS

The Air Force is committed to improving Financial Management (FM) Information Technology (IT) operations across the Air Force enterprise. Pursuant to this commitment, the Air Force has established the goal of achieving a modernized, sustainable, and audit compliant portfolio of FM systems and applications for the Air Force as soon, and as cost effectively, as possible.

The current FM IT operating environment is not sustainable. One clear implication of the current environment is the need to reduce our current "footprint" and become more agile as we deliver digital finance solutions to the FM community. Legacy systems also represent increasing sustainment costs at a time when Air Force IT budgets will likely continue to be under pressure. The Air Force is moving toward implementation of cloud technology, advanced data analytics, process automation, and the use of artificial intelligence as viable options for enhancing the efficiency and effectiveness of FM IT capabilities while reducing cost and infrastructure.

The Air Force's long-term vision, as described in the Fiscal Year (FY) 2019 FM IT Strategy, is to move from our improving, but uneven, FM IT environment to one characterized by uniformly effective internal controls, standardized business processes, integrated financial systems, and a workforce marked by human capital best practices. Cross matrixed working groups will be the norm as we work through various IT solutions. These working groups will inform and guide three strategies to achieve our goals:

- The concept of Tiered Accountability—holding organizations accountable for achieving IT compliance and performance goals at all levels,
- Prioritizing platforms, and reducing systems and applications based on a comprehensive Application Rationalization strategy, and
- Leading the Air Force in data management capabilities in the cloud.

The FM IT Strategy will leverage industry best practices with an aggressive timeline for migrating data and applications to the cloud, consolidating or retiring systems and reducing infrastructure, executing on a future architecture, and achieving compliance with regulatory standards.

Lt. Col. Bryan Ferrari, 16th Airlift Squadron pilot, assigned to Joint Base Charleston, South Carolina, pilots a C-17A Globemaster III during an aerial refueling. (Photo: Senior Airman Gracie I. Lee)

CONTROLS

The Air Force is in the process of establishing a fully compliant Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (OMB A-123) program. In FY 2019, the Air Force developed, and is currently implementing, a sustainable OMB A-123 strategy. This strategy builds upon previous activities, progress, and accomplishments, and defines current internal control initiatives.

The Air Force's OMB A-123 program is comprised of 17 Primary Reporting Elements (PREs) consisting of the Secretariat and Air Staff offices, Major Commands (MAJCOMs), the Army and Air Force Exchange Service, and Direct Reporting Units (DRUs). The Air Force implements its internal control program at all levels, in order to:

- Improve the efficient and effective use of resources (personnel, information, technology, and capital),
- Increase accountability in all functional areas, and
- Monitor the continued effectiveness of its service providers.

OMB A-123 calls for managers to apply internal controls to all operational and mission responsibilities, including oversight of service providers. Further, no aspect of Air Force operations is exempt from the FMFIA requirements. Air Force PREs determine how far the subdivision should progress in order to achieve adequate oversight of internal controls at their respective levels. The PREs prepare and update management control plans with detailed program descriptions and an inventory of assessable units. The Air Force subdivides its activities along organizational lines into assessable units to facilitate reviews. To the extent practical, assessable units are standardized for the operation of common functions and activities.

In FY 2019, the Air Force made significant strides in the implementation of an internal control governance structure and the shaping of the internal control organization from the top of the governance structure downward. The Air Force leveraged its existing Enterprise Productivity Improvement Council (EPIC) to fulfill the roles of the Risk Management Council (RMC) and Senior Management Council (SMC), as defined by OMB A-123. To fulfill the role of the RMC, the EPIC is responsible for overseeing the establishment of the Air Force's risk profile, ongoing assessment of risk, and development of appropriate risk responses. To fulfill the role of the SMC, the EPIC is responsible for assessing and monitoring operational deficiencies in internal control. Additionally, the Air Force leveraged its existing Executive Steering Committee (ESC) to fulfill the role of the Senior Assessment Team (SAT), as defined in OMB A-123. To fulfill the role of the SAT, the ESC is responsible for leading assessments related to the objective of internal control over reporting and financial systems.

Management Assurances

The Air Force conducted an assessment of the effectiveness of internal controls in accordance with OMB A-123, the Government Accountability Office (GAO) Green Book, and the FMFIA. The objectives of the Air Force's system of internal controls are to provide reasonable assurance regarding:

- Effectiveness and efficiency of operations,
- Reliability of financial and non-financial reporting,
- Compliance with applicable laws and regulations, and
- Financial information systems compliance with the FFMIA of 1996 (Public Law 104-208).

We evaluated our system of internal controls and maintain sufficient documentation to support the evaluation and level of assurance. Air Force PREs continuously assess the design and operating effectiveness of internal controls and submit an annual Statement of Assurance to the Secretary of the Air Force. The FY 2019 assessment process disclosed a number of findings including errors, irregularities, deficiencies, and weaknesses.

It also identified other conditions requiring improvement, correction, or reporting, which did not meet the criteria for inclusion in the Secretary's annual Statement of Assurance.

The Air Force Auditor General and Air Force Inspector General operate strong collateral programs, which are important to the total effort devoted to the evaluation of internal controls. Their activities are indispensable to the identification and reporting of internal control deficiencies and the validation of corrective actions. Additionally, information from other sources such as the GAO, Department of Defense Inspector General, management studies, self-assessment programs, and internal reviews were used throughout the evaluation.

Internal Control over Operations

The Air Force conducted an assessment of the effectiveness of internal control over operations in accordance with OMB A-123, the GAO Green Book, and the FMFIA. Based on the results of the assessment, we identified 11 material weaknesses in internal control over operations as shown in Table 1.

Table 1. Fiscal Year 2019 Material Weaknesses in Internal Control over Operations

Material Weakness	Description of Material Weakness	Summary of Corrective Actions	Target Correction Year
Defense Contract Management Agency Contracts	The Defense Contract Management Agency (DCMA) does not consistently reconcile and close contracts before the associated funding cancels. As a result, the Air Force does not deobligate funds in a timely manner.	Review contracts to determine if future billings are warranted or if deobligations are warranted. Coordinate with DCMA to close cancelling-year contracts.	FY 2020
Overseas Housing Allowance	Discrepancies were identified in the processing of Overseas Housing Allowance (OHA) claims for military members.	Revise OHA processes and policies and provide updated training to personnel. Perform quality assurance reviews of OHA transactions.	FY 2020
Energy Meter Management	The Air Force installed energy meters as a management tool for improving building efficiency; however, personnel did not develop a meter-implementation plan to address funding, personnel, and tools to enable the effective use of meters.	Develop and execute a meter implementation plan to address funding, personnel, and tools to enable the effective use of meters.	FY 2020
Air Force Review Boards Agency Case Backlogs	Air Force Review Boards Agency (AFRBA) case backlogs have resulted in noncompliance with Congressional, Office of the Secretary of Defense, and Air Force-directed timelines.	Deploy a more efficient and reliable case-management system, increase personnel, and update business process to perform more timely case reviews. Monitor and report on ability of the AFRBA to maintain sufficient production levels to sustain case-review compliance.	FY 2020
Enterprise Information Protection Capability	Air Force MAJCOMs, DRUs, and installation-level commanders did not properly establish Information Protection Offices (IPOs) or effectively manage core information protection programs.	Review and revise Air Force instructions to address position responsibilities in IPOs to ensure the information protection requirements are followed. Establish and execute IPO governance processes to monitor and maintain acceptable performance.	FY 2021
Defense Travel System Controls	The Air Force does not have segregation of duties for the approval of temporary duty travel within the Defense Travel System (DTS).	Update Air Force DTS business rules with enhanced guidance on DTS permission levels. Provide oversight for accountable officials' training to ensure that segregation of duties and permission levels are addressed. Monitor and validate that appropriate segregation of duties are in place and maintained for DTS.	FY 2020

Material Weakness	Description of Material Weakness	Summary of Corrective Actions	Target Correction Year
Foreign Government Employment	Air Force personnel did not effectively manage the Foreign Government Employment (FGE) approval process.	Provide additional training for Air Force personnel on the FGE approval process. Design and implement an internal control activity to identify members who are currently employed by foreign governments without approval and provide guidance for FGE approval.	FY 2021
Electronic Records Hygiene	Air Force personnel did not perform backups or provide protection for electronic records.	Develop an information system contingency policy. Establish an internal control oversight process. Issue a policy memorandum on service provider backups of electronic records.	FY 2021
Criminal History Data Reporting Requirements	The Air Force identified a breakdown in submitting criminal history data to the Federal Bureau of Investigation to include in its criminal history database.	Procure software systems to close technology gaps, establish policy and process improvements, and coordinate manpower realignments to ensure compliance with regulatory mandates. Identify and deploy a long-term enhanced software solution for case management to replace the existing system. Develop a compliance reporting tool to track fingerprint and DNA submissions and identify trends. Establish an Air Force Criminal Justice Information Cell to oversee all criminal data and reporting.	FY 2023
Cybersecurity of Network Component Purchases	Air Force officials did not account for network components, assess component configurations for vulnerabilities, or monitor component configurations for continued cybersecurity resulting in cybersecurity vulnerabilities.	Complete a documented evaluation of network component vulnerabilities and require change management under a configuration plan for assets at the network component level susceptible to vulnerabilities. Update the Air Force Enterprise Configuration Monitoring Strategy to include investigating, identifying, and disseminating the best use of monitoring tools and techniques for the network component level.	FY 2020
Cyber Security Control of Integrated Tactical Warning Attack Assessment Weapons Systems	The *Federal Information Security Management Act* requires each Chief Information Officer to report material weaknesses in policies, procedures, or practices annually to the Office of Management and Budget. Air Force Space Command personnel did not address Integrated Tactical Warning Attack Assessment (ITWAA) weapon system cyber vulnerabilities in accordance with established criteria.	Develop and deploy a new system for compliance tracking to ensure that all systems, including ITWAA, are evaluated for cyber vulnerabilities in accordance with established criteria.	FY 2020

Internal Control over Reporting

The Air Force is committed to Financial Improvement and Audit Remediation and continues to execute a well-designed program to monitor audit progress and sustain remediation efforts. Established by the Deputy Assistant Secretary of the Air Force, Financial Management and Comptroller for Financial Operations, the Deficiency Remediation Tracking Program is utilized to comply with relevant financial management laws, regulations, and policies and:

- Allows the Air Force to identify a comprehensive universe of deficiencies impacting the financial statements,
- Deploys a standardized methodology to prioritize deficiencies,
- Establishes training, required reporting elements, and standardized corrective action plan development methods, and
- Implements a transparent, continuous data collection, tracking, and reporting process.

The Air Force conducted an assessment of the effectiveness of internal control over reporting (including financial and non-financial reporting) in accordance with OMB A-123 *Appendix A*. Based on the results of the assessment, we identified 25 material weaknesses in internal control over reporting, as shown in Table 2.

Table 2. Fiscal Year 2019 Material Weaknesses in Internal Control over Reporting

Material Weakness	Description of Material Weakness	Summary of Corrective Actions	Target Correction Year
Financial Reporting (General Fund)	The Air Force is unable to define the universe of transactions that are interfaced from the feeder systems to the financial reporting system.	Perform a complete migration of the current financial reporting system, General Accounting and Finance System – Reengineered, to the new and enhanced Defense Enterprise Accounting and Management System (DEAMS). Identify significant feeder systems impacting the financial reporting system. Perform periodic reconciliations between feeder file data and the financial reporting system. Perform root-cause analysis of variances, and design and implement system and/or process changes to remediate the occurrence of variances.	FY 2024
Oversight and Monitoring (General Fund)	The Air Force cannot always provide supporting documentation to validate that internal controls are in place and operating effectively.	Deliver Internal Control Refresher and Managers' Internal Control Program training to all MAJCOMs. Ensure that documentation repository and retention policies are appropriately designed and followed.	FY 2022
Statement of Net Cost (General Fund)	The Air Force organizes its statement of net cost (SNC) by appropriation rather than by program type, as required by federal accounting standards.	Build a cost-allocation methodology to capture costs by program. Update the format of the SNC and implement in the Defense Departmental Reporting System – Audited Financial Statements.	FY 2020
Reconciliation of Net Cost of Budget to Operations (General Fund)	The Air Force cannot always reconcile the resources obligated during the period to the costs of operations in that period.	Review General Accounting and Finance System-Reengineered posting logic to ensure that it supports the reconciliation of budgetary amounts to actual proprietary expenses, assets, and liabilities. Work with Defense Finance and Accounting Services (DFAS) to validate the accuracy of the new reconciliation of net cost to net outlays in compliance with Statement of Federal Financial Accounting Standards (SFFAS) 53, *Budget and Accrual Reconciliation.*	FY 2020
Intragovernmental Eliminations (General Fund)	The Air Force cannot always reconcile transactions or balances with other Federal Agencies.	Require identification of buyer side trading partners in General Accounting and Finance System- Reengineered. Require the use of trading partners identification in DEAMS.	FY 2024

Material Weakness	Description of Material Weakness	Summary of Corrective Actions	Target Correction Year
Government-Furnished Equipment (General Fund)	The Air Force does not have accountability of Government Furnished Equipment (GFE) in the Air Force Equipment Management System or the Air Force accountable property system of record.	Update policies and processes to ensure GFE accountability is established and maintained.	FY 2021
Operating Materials and Supplies (General Fund)	The Air Force does not always value Operating Materials and Supplies (OM&S) using the historical cost method and does not always value Inventory and Related Property using the Moving Average Cost (MAC) method. Significant OM&S categories include munitions, uninstalled missile motors, spare parts, and spare engines.	Develop a tool to calculate MAC for the munitions stockpile. Implement the Theater Integrated Combat Munitions System to calculate MAC for munitions and uninstalled missile motors.	FY 2020
Contractor Inventory Control Point (General Fund)	The Air Force does not have accountability of government furnished material in an Air Force accountable property system of record (APSR).	Develop an auditable solution, in lieu of an APSR, to financially report contractor managed or possessed property not in a government APSR.	FY 2028
In-Transit Inventory (Working Capital Fund)	The Air Force is unable to synchronize in-transit inventory financial data with logistics data.	Develop and implement processes and internal controls to support consistent and accurate in-transit inventory valuation, tracking, and visibility.	FY 2022
Multiservice Contract Accounting Department of Defense Accounting Policies (General Fund)	The Air Force does not always allocate progress payments and recoupments on multiservice contracts correctly.	Develop and implement a policy to facilitate Air Force's timely and comprehensive monitoring of multiservice contracts to ensure that payment instructions on these contracts reflect the actual work being performed, and that payments are accurately recorded in the financial reporting system.	FY 2020
Inaccurate Financial Records (formerly "Air Force Accounting Policies and Procedures")(General Fund)	The Air Force sometimes improperly identifies and records recoveries in the accounting system. Advance payments and progress payments are sometimes incorrectly recorded in the accounting system.	Perform an analysis over the affected population of deficient transactions, design and implement monitoring controls, and update General Accounting and Finance Systems – Reengineered scripts where necessary.	FY 2025
Real Property Valuations (General Fund)	The Air Force has not maintained Key Supporting Documents (KSDs) to support the acquisition cost, Construction in Progress (CIP), and related expenses recorded in the financial statements.	Design and implement procedures and internal controls to record the full acquisition cost of future real property, CIP, and depreciation expenses in accordance with SFFAS 6, *Accounting for Property, Plant and Equipment*. Ensure that documentation repository and retention policies for KSDs are appropriately designed and followed.	FY 2025
Miscellaneous Obligations/ Reimbursement Documents (General Fund)	The Air Force is not following Miscellaneous Obligations/Reimbursement Document (MORD) policies and lacks specificity and oversight regarding the usage of MORDs.	Update MORD guidance to address specificity and oversight issues.	FY 2020
Lack of Complete Universe of Transactions (General Fund and Working Capital Fund)	The Air Force lacks a complete Universe of Transactions (UoT) including a central warehouse repository, transactional data files, and data reconciliations for both financial and Logistics (Log).	Develop and establish a central warehouse repository for data files and financial quantitative drill down/UoT files. Identify and collect transactional data files for Log. Develop and implement interface files and perform detailed reconciliations for Log.	FY 2020

Material Weakness	Description of Material Weakness	Summary of Corrective Actions	Target Correction Year
Fund Balance with Treasury (Working Capital Fund)	The Air Force Working Capital Fund's (AFWCF) current processes are not sufficient to validate a complete and accurate reconciliation of the Air Force's general ledger fund balance with treasury (FBwT) amount to the U.S. Treasury amount, or to validate the completeness and accuracy of journal vouchers posted to its FBwT account. The AFWCF is unable to rely on the Consolidated Cash Accountability System and cannot verify that the FBwT line item is complete and accurate.	Develop, implement, and maintain policies and procedures that include identifying the underlying cause of variances at the voucher detail level. Develop a root cause analysis for the weaknesses around Air Force's Consolidated Cash Accountability System/Department Reconciliation Reporting Tool and implement system changes, as necessary, based on the analysis.	FY 2021
Fund Balance with Treasury (General Fund)	Current Air Force processes are not sufficient to explain and support reconciling items between the Air Force's general ledger balance and the U.S. Treasury. There are insufficient internal control processes around maintaining adequate documentation evidencing the performance of controls over monitoring and timely clearing of variances identified in reconciliations.	Identify root causes for types of variances occurring between the Air Force's general ledger balance and the U.S. Treasury balance and develop corrective action plans specific to root causes. Update policies and procedures and implement risk-based corrective actions.	FY 2021
Accumulating and Preparing Financial Statements (Working Capital Fund)	The AFWCF lacks a sufficient data analytics infrastructure, and unique data elements to timely perform monitoring over accounting data and transactions.	Develop and implement a more comprehensive oversight program, to include a robust data analytics environment. Routinely perform data analysis, ensuring identification and resolution of potential unusual transactions and balances.	FY 2022
General Property, Plant and Equipment (Working Capital Fund)	The AFWCF has not developed procedures to periodically evaluate general equipment condition and identify any assets that are deemed unrepairable or obsolete and make corresponding adjustments to their recorded value.	Establish a process to periodically evaluate general equipment condition and identify any assets that are deemed unrepairable or obsolete and make corresponding adjustments to their recorded value.	FY 2020
Earned Revenue (Working Capital Fund)	The AFWCF does not routinely monitor and update total estimated costs of a project, and therefore, is recognizing revenue as a percentage of the initial estimated costs of a project, which could result in an overstatement or understatement of recorded revenue.	Develop policies and procedures to properly apply the percentage of completion accounting guidance for recognizing revenue as outlined in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*	FY 2024
Oversight and Monitoring of Internal Controls (Working Capital Fund)	The AFWCF has not fully implemented an effective internal control program in compliance with OMB A-123 or the Air Force instruction governing the Managers' Internal Control Program.	Implement and execute the WCF's OMB A-123 program. Develop and maintain supporting documentation for WCF identified assessable units, develop corrective action plans, and track progress toward remediation.	FY 2021

Material Weakness	Description of Material Weakness	Summary of Corrective Actions	Target Correction Year
Establishing Opening Budgetary Balances (Working Capital Fund)	The AFWCF Supply Maintenance Activity Group and Depot Maintenance Activity Group were unable to provide detailed transaction-level data for General Ledger Account Code beginning balances.	Update Air Force policies and procedures to include internal controls requiring adequate support for material amounts in the basic financial statements including Fiscal Year beginning balances.	FY 2021
Establishing Opening Balances for Assets Used in Operations (Working Capital Fund)	The AFWCF identified material differences between the Financial Inventory Accounting and Billing System (FIABS) and its feeder systems. The AFWCF is unable to validate the originating feeder system(s) data to support beginning balances and current activity.	Identify the root cause of the material differences between FIABS and its feeder systems. Implement feeder-system data to FIABS data reconciliations.	FY 2023
Integration and Reconciliation of Legacy Financial Systems (Working Capital Fund)	AFWCF does not have a complete understanding of its universe of transactions. The WCF lacks appropriate reconciliations between the general ledger and multiple accountable property system of record (APSR), and between APSR and multiple feeder systems to the APSR for its legacy systems. AFWCF does not have a review process to ensure the posting of underlying transactions are appropriately mapped in accordance with the Treasury Financial Manual (TFM).	Develop a complete understanding of the UoT to document applicable feeder systems used to generate the AFWCF financial statements and key internal controls performed to ensure data is complete and accurate. Develop an internal control processes to ensure feeder systems are routinely reconciled to the financial reporting system and differences are investigated and resolved. Ensure posting logic rules comply with the TFM.	FY 2024
Inventory Held by Working Capital Fund (Working Capital Fund)	AFWCF lacks sufficient inventory count procedures and controls. AFWCF lacks sufficient controls over inventory movement transactions. AFWCF incorrectly reports inventory valuation due to deficiencies in the moving average cost computation process, the existence of negative net inventory values, and errors in the application of the Latest Repair Cost process within the inventory repair allowance.	Develop and implement sufficient policies and procedures for physical inventory counts. Design appropriate control activities over inventory movement transactions. Establishing appropriate policies and procedures for the moving average cost computation and inventory repair allowance determination processes.	FY 2022
Inventory Held by Others (Working Capital Fund)	The AFWCF does not have controls in place to ensure balances being recorded through the Defense Logistics Agency Distribution Standard System (DLA DSS) are complete and accurate.	Develop a process to routinely monitor variances between DLA DSS and Air Force and adjust the two sets of records to the actual inventory on hand.	FY 2022

Internal Control over Financial Systems

The Air Force lacks an integrated financial management system that is compliant with the following regulations and guidance:

- FFMIA
- OMB A-123, Appendix D: *Compliance with the Federal Financial Management Improvement Act of 1996*,
- The Department of Defense Financial Management Regulation (DoD FMR) Volume 1, Chapter 3, *Requirements for compliance under the FFMIA of 1996 and the FMFIA of 1982*
- 10 United States Code (USC) 2222, Defense Business Systems: *Architecture, Accountability, and Modernization*.

The design of legacy Air Force financial management and feeder systems do not allow for the collection and recording of financial information based on a full accrual accounting basis. Systems do not have the necessary security controls or comply with the U.S. Standard General Ledger at the transaction level. In FY 2010, the Assistant Secretary of the Air Force, Financial Management and Comptroller, with the concurrence of Air Force's Senior Assessment Team (SAT), declared a material weakness over internal control over financial systems. For FY 2019, the Air Force SAT confirmed that the internal control over financial systems material weaknesses still existed. Further, the internal control over financial systems material weakness was substantiated and confirmed as a result of the Air Force FY 2019 financial statement audit. The Air Force continues to develop integrated corrective action plans to remediate and mitigate the risks associated with the deficiencies. While the Air Force transitions to the target integrated financial management systems, proprietary financial reporting continues to be largely based on budgetary transactions. The Air Force continues to rely on logistics management feeder systems to provide financial data to the accounting system of record.

Table 3 below describes the two material weaknesses in internal control over financial systems, along with the corresponding corrective actions to remediate the material weaknesses, reported by the Assistant Secretary of the Air Force (Financial Management and Comptroller).

Table 3. Fiscal Year 2019 Material Weaknesses in Internal Control over Financial Systems

Material Weakness	Description of Material Weakness	Summary of Corrective Actions	Target Correction Year
Financial Systems (General Fund)	Air Force financial systems and financial supporting systems do not substantially meet FFMIA or DoD FMR Volume 1, Chapter 3 requirements for compliance under the *Federal Managers' Financial Integrity Act of 1982.*	Develop and implement an integrated financial management system to meet federal system requirements, comply with federal accounting standards, post transactions, and report in compliant formats.	FY 2021
Lack of Integrated Financial Systems (Working Capital Fund)	AFWCF financial feeder systems do not meet 10 USC 2222 (Defense Business Systems: Architecture, Accountability, and Modernization) requirements.	Develop and implement an integrated business system and processes to comply with 10 USC 2222 requirements.	FY 2028

SECRETARY OF THE AIR FORCE
WASHINGTON

OCT 15 2019

MEMORANDUM FOR SECRETARY OF DEFENSE

SUBJECT: Annual Statement of Assurance Required Under the *Federal Managers' Financial Integrity Act (FMFIA)* for Fiscal Year 2019

As Secretary of the Air Force, I recognize that the Air Force is responsible for managing risks and maintaining effective internal controls to meet objectives in Sections 2 and 4 of the *Federal Managers' Financial Integrity Act (FMFIA) of 1982*. The Air Force conducted its assessment of risk and internal control in accordance with the Office of Management and Budget (OMB) Circular No. A-123, "Management's Responsibility for Enterprise Risk Management and Internal Control"; and the Government Accountability Office (GAO) Green Book, GAO-14-704G, "Standards for Internal Control in the Federal Government." Based on the results of the assessment, the Air Force can provide reasonable assurance, except for the 38 total material weaknesses reported in the *Significant Deficiencies and Material Weaknesses (Appendix D)*, that internal controls over operations, reporting, and compliance are operating effectively as of September 30, 2019.

The Air Force conducted its assessment of the effectiveness of internal controls over operations in accordance with OMB Circular No. A-123, the GAO Green Book, and the FMFIA. The *Internal Control Evaluation (Appendix C)* section provides specific information on how the Air Force conducted this assessment. Based on the assessment results, the Air Force can provide reasonable assurance, except for the 11 material weaknesses reported in the *Significant Deficiencies and Material Weaknesses (Appendix D),* that internal controls over operations and compliance are operating effectively as of September 30, 2019.

The Air Force conducted its assessment of the effectiveness of internal controls over reporting (including internal and external financial reporting) in accordance with OMB Circular No. A-123, Appendix A. The *Internal Control Evaluation (Appendix C)* section, provides specific information on how the Air Force conducted this assessment. Based on the results of the assessment, the Air Force can provide reasonable assurance, except for the 25 material weaknesses reported in the *Significant Deficiencies and Material Weaknesses (Appendix D),* that internal controls over reporting (including internal and external reporting) and compliance are operating effectively as of September 30, 2019.

The Air Force also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with FMFIA and OMB Circular No. A-123, Appendix D. The *Internal Control Evaluation (Appendix C)* section provides specific information on how the Air Force conducted this assessment. Based on the results of this assessment, the Air Force can provide reasonable assurance, except for the two (2) material weaknesses reported in the *Significant Deficiencies and Material Weaknesses (Appendix D),* that internal controls over the financial systems are in compliance with the FMFIA, Section

4; FFMIA, Section 803; and OMB Circular No. A-123, Appendix D, as of September 30, 2019.

The Air Force assessed entity-level controls, including fraud controls, in accordance with the GAO Green Book, OMB Circular No. A-123, the *Fraud Reduction and Data Analytics Act (FRDAA) of 2015*, and GAO Fraud Risk Management Framework. Based on the results of the assessment, the Air Force is unable to provide assurance that entity-level controls, including fraud controls, are operating effectively as of September 30, 2019. Our ongoing remediation efforts include the establishment of governance structures to oversee enterprise-wide risks and controls, a communication strategy focused on risk and deficiency remediation, a standardized approach to assessment and documentation, and training for key stakeholders during the implementation of A-123. Once complete, these actions will directly support future assessments of reasonable assurance over entity level controls.

If there are any questions regarding this Statement of Assurance for Fiscal Year 2019, my point of contact is Mr. Mike Mason, SAF/FMFA. He can be reached at (240) 612-5253 or michael.j.mason22.civ@mail.mil.

Matthew P. Donovan
Acting Secretary of the Air Force

Attachments:
1. FY 2019 Internal Control Evaluation (Appendix C)
2. Significant Deficiencies and Material Weaknesses (Appendix D)
3. Material Weaknesses Closure Memorandum (Appendix E)
4. Risk Assessment (Appendix F)
5. Significant A-123 Internal Control Program Accomplishments (Appendix G)
6. Entity Level and Fraud Control Checklist (Appendix H)

Note: The attachments mentioned above are not included in the Agency Financial Report (AFR).

LEGAL COMPLIANCE

ANTI-DEFICIENCY ACT

The *Anti-Deficiency Act* (ADA) is codified in 31 United States Code §§1341(a)(1), 1342, and 1517(a). The ADA provides that Federal Agencies may not:

- Obligate or expend funds in excess of the amount available in an appropriation or fund or in advance of appropriations,
- Accept voluntary services on behalf of the Government or employ personal services in excess of that authorized by law, except as it may be necessary in emergencies involving the safety of human life or the protection of property, or
- Obligate, authorize, or expend funds that exceed an apportionment or amount permitted by a regulation prescribed for the administrative control of an appropriation.

An ADA violation is a serious matter as it represents a violation of a federal statute. A federal employee who violates the ADA may be subject to administrative sanctions (such as suspension from duty without pay or removal from office) and/or penal sanctions (such as fines or imprisonment). Confirmed ADA violations are reported to the President of the U.S. through the Director of the OMB, Congress, and the Comptroller General of the U.S.

The Air Force started FY 2019 with eight open ADA cases and ended the year with seven cases remaining. During the year, the Air Force opened an additional 11 new cases, for a total of 19 open cases in FY 2019. The Air Force was able to close 12 of these cases, none of which resulted in a reportable ADA violation, thereby resulting in the remaining number of seven open cases at year-end. Of the remaining seven cases, three are expected to close as "no ADA violation" once corrective actions are complete. The other four cases remain under investigation with the outcome yet to be determined.

COMPLIANCE WITH OTHER KEY LEGAL AND REGULATORY REQUIREMENTS

As of September 30, 2019, the Air Force is in the process of developing and implementing a program to perform a comprehensive assessment of compliance with key legal and regulatory financial requirements. The Air Force plans to provide the results of the compliance assessment in future Agency Financial Reports.

FORWARD-LOOKING INFORMATION

The United States (U.S.) Air Force is the world's preeminent force in air, space and cyberspace. We maintain that distinction by maintaining our objective of global vigilance, reach, and power, and remaining true to our vision statement: The World's Greatest Air Force—Powered by Airmen, Fueled by Innovation. The Air Force will continue to achieve our mission goals and support the National Defense Strategy in FY 2020 and beyond.

The National Defense Strategy acknowledges a future global security environment that will see the reemergence of the Great-Power Competition between nations. As a result, the Air Force will continue to build upon prior-year efforts of making readiness a priority, and support the strategy demands of warfighting readiness to field a more lethal force. To prepare for the future fight, we will grow, modernize, and reduce operational tempo to relieve years of excessive burden on Air Force personnel and equipment.

AIR FORCE'S READINESS TARGET

By Fiscal Year (FY) 2022, all operational squadrons should reach the 80% readiness target as the Air Force continues to build the force required to meet the National Defense Strategy objectives.

Grow. The two facets of growing a force include size and training. The Air Force's FY 2020 budget aims to add 4,400 Airmen and 5,143 civilian Airmen to the Total Force, to include an additional 1,480 pilots. Additionally, we will continue efforts to train pilots better and faster through the implementation of technologically-advanced pilot training programs.

"The Air Force that we enjoy today is actually the Air Force that was built by our predecessors, such is the time phase associated with building an Air Force." - General David L. Goldfein, Chief of Staff of the U.S. Air Force, at the Air Force Association Air, Space & Cyber Conference, Sept. 17, 2019, in National Harbor, Maryland. (Photo: Wayne Clark) Speech transcript

Modernize. To implement the National Defense Strategy, the Air Force is investing in a wide array of technologies that will ultimately play key roles in how we advance our combat lethality. Further, modernization will require changes to the ways we organize, train, develop, and employ our forces.

U.S. Air Force Academy cadets in the Unmanned Aerial System Operations Program familiarize themselves with quad-copter flight controls. (Photo: Joshua Armstrong)

Reduce Operational Tempo. For more than a decade, the Air Force has been operating at a highly demanding tempo. Future years should see a reduced tempo, as we restore the force and give back time to our Airmen and their families.

Lastly, the future of the Air Force will expand further into space. In years to come, we will prototype, field, and demonstrate remarkable space technologies. With the establishment of Space Force as a new armed service within the Air Force, we will be the best in the world at space, posturing it for the future in the new era of strategic competition.

OTHER MANAGEMENT INFORMATION, INITIATIVES, AND ISSUES

The United States (U.S.) Air Force first-ever business operations plan, Sharpening the Air Force's Competitive Edge: A Business Operations Plan, Fiscal Years 2019-2021, was released in March 2019. The purpose of the plan is to define and communicate the Air Force's business operations, objectives, and activities that directly support the 2018 National Defense Strategy, the Fiscal Years (FY) 2018-2022 National Defense Business Operations Plan, and the Air Force strategic focus areas.

The plan provides a cross cutting framework to synchronize business operations across different organizational and functional boundaries. Goals in the plan include building a more ready and lethal force, strengthening alliances and partnerships, and reforming business practices to deliver greater, more affordable performance. More specifically, some examples of activities called for in the plan include the following:

- Increase aviator retention through incentive pay, bonuses, and granting greater input on assignments.
- Create a realistic, integrated training environment that allows our forces to train in operationally and tactically relevant employment schemes to achieve and sustain full-spectrum readiness.
- Implement innovative sustainment measures, such as conditions-based maintenance, to empower maintainers, decrease costs, and increase aircraft availability.
- Continue to mature the Air Force Warfighting Integration Capability, our future force design team, as we continue to pursue the "Air Force We Need."
- Optimize the Air Force's execution of foreign military sales by reducing the time between a Letter of Request to Letter of Offer and Acceptance.
- Continue to reduce redundancy and duplication in the IT business mission area by developing a future-state roadmap, optimizing the architecture, and refining governance structures.

The plan's design is to be a management tool with measurable goals and clear lines of accountability. Each objective is assigned an office of primary responsibility that reports progress and associated metrics on a quarterly basis.

LIMITATIONS OF THE FINANCIAL STATEMENTS

The principal financial statements are prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of Title 31 of the United States Code, Section 3515(b). The statements are prepared from the books and records of federal entities in accordance with federal Generally Accepted Accounting Principles and the formats prescribed by Office of Management and Budget. Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. Government.

A B-2 Spirit aircraft is prepped for launch July 17, 2019 at Whiteman Air Force Base, Missouri. (Photo: Senior Airman Thomas M. Barley)

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FINANCIAL SECTION

Maj. Paul Lopez, F-22 Demonstration Team commander, flies a twilight demonstration during EAA AirVenture in Oshkosh, Wisconsin, July 28, 2019. Founded in 2007, the F-22 Raptor Demonstration Team showcases the unique capabilities of the world's premier fifth-generation fighter aircraft. (U.S. Air Force photo by 2nd Lt. Samuel Eckholm)

John P. Roth

"Achieving a clean audit opinion requires an unwavering commitment to improving our business management processes across the enterprise and at every level."

Message from the Chief Financial Officer

For the Fiscal Year 2019 Agency Financial Report

November 8, 2019

I am honored to join Secretary Barrett in presenting the Department of the Air Force Agency Financial Report for Fiscal Year (FY) 2019. The Agency Financial Report is our principal means to provide the American people with an assessment of our financial status and to convey our commitment to sound financial management practices governing the stewardship of public funds.

Developing and executing a predictable budget is foundational for the Air Force to plan and program with clarity. In FY 2019, we used our on-time appropriation from Congress to capitalize on a multi-year effort to recover our readiness. In doing so, we prioritized our resources to restore our end strength, while focusing on aircrew and personnel shortages. In addition, we funded critical supplies and equipment to advance a "fight tonight" ethos, honed our technological edge by increasing research and development efforts, and fielded innovative new technologies.

Informed by our FY 2018 audit, the financial management community developed a comprehensive strategy to drive the Air Force closer to its objective of a clean financial statement audit opinion. We will continue to address and prioritize reported audit findings related to weaknesses and deficiencies, along with the recommendations received from the Independent Public Accounting firm of Ernst & Young to improve our financial management operations. Consistent with the Secretary of Defense's FY 2019 audit priorities, we have made significant progress toward improving the accountability of our assets and limiting system access to only those who need it. In addition, we adopted process automation technology to improve user controls, reducing the risk of unauthorized access to our financial systems. Achieving a clean audit opinion also requires an unwavering commitment to improving our business management processes across the enterprise and at every level. Over the past year, I have had the pleasure to see, first-hand, the work being accomplished and the progress made as we conclude our second year of a full financial statement audit.

We are also moving quickly to consolidate and refine our management systems and practices, merging requirements, activities, and systems where appropriate, and implementing plans that foster innovation, process improvement, and force development. Our Business Operations Plan outlines our plans to reform our processes, practices, and policies to produce greater accountability and generate higher states of operational readiness and lethality. In addition, our new Digital Air Force initiative will empower us to field an information technology infrastructure responsive to the demands of modern combat, leverage data to enable faster decision-making and enhanced warfighter support, and improve the effectiveness and efficiency across our enterprise with agile business techniques.

John P. Roth
Assistant Secretary of the Air Force
(Financial Management and Comptroller)

AIR FORCE GENERAL FUND

The United States (U.S) Air Force General Fund (the "Air Force," "we," "us," and "our") financial statements and related notes summarize financial information for the General Fund for the Fiscal Year (FY) ended September 30, 2019 and are presented on a comparative basis with information previously reported for the FY ended September 30, 2018. The Principal Statements and related notes have been prepared to report financial position pursuant to the requirements of the *Chief Financial Officers Act of 1990*, the *Government Management Reform Act of 1994*, and the Office of Management and Budget (OMB) A-136, *Financial Reporting Requirements* (OMB A-136).

The following statements comprise the Air Force's General Fund Principal Statements:

Consolidated Balance Sheets

The Consolidated Balance Sheets, as of September 30, 2019 and 2018, represent those resources owned or managed by the Air Force, which are available to provide future economic benefits (assets), amounts owed by the Air Force that will require payments from those resources or future resources (liabilities), and residual amounts retained by the Air Force, comprising the difference (net position).

Consolidated Statements of Net Cost

The Consolidated Statements of Net Cost present the net cost of the Air Force's operations for the FYs ended September 30, 2019 and 2018. The Air Force's net cost of operations includes the gross costs incurred by the Air Force less any exchange revenue earned from Air Force activities.

Consolidated Statements of Changes in Net Position

The Consolidated Statements of Changes in Net Position present the change in the Air Force's net position resulting from the net cost of Air Force's operations, budgetary financing sources other than exchange revenues, and other financing sources for the FYs ended September 30, 2019 and 2018.

Combined Statements of Budgetary Resources

The Combined Statements of Budgetary Resources present the budgetary resources available to the Air Force during FY 2019 and 2018, the status of these resources at September 30, 2019 and 2018, and the outlays of budgetary resources for the FYs ended September 30, 2019 and 2018.

Air Force General Fund
CONSOLIDATED BALANCE SHEETS
As of September 30, 2019 and 2018

(Amounts in Thousands)

	2019 Consolidated (Unaudited)	2018 Consolidated (Unaudited)
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 149,015,716	$ 144,110,635
Investments (Note 5)	7	7
Accounts Receivable (Note 6)	481,903	589,401
Other Assets (Note 10)	220,320	123,059
Total Intragovernmental Assets	$ 149,717,946	$ 144,823,102
Cash and Other Monetary Assets (Note 4)	$ 151,145	$ 89,512
Accounts Receivable, Net (Note 6)	236,593	230,172
Operating Materials & Supplies, Net (Note 8)	54,375,358	51,181,074
General Property, Plant and Equipment, Net (Note 9)	146,302,264	140,390,559
Other Assets (Note 10)	16,736,643	23,422,168
TOTAL ASSETS	$ 367,519,949	$ 360,136,587
STEWARDSHIP LAND AND HERITAGE ASSETS (Note 9)		
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable	$ 3,471,367	$ 2,617,439
Other Liabilities (Note 15 & 17)	1,980,022	1,302,020
Total Intragovernmental Liabilities	$ 5,451,389	$ 3,919,459
Accounts Payable	$ 7,681,623	$ 4,175,187
Military Retirement and Other Federal Employment Benefits (Note 13)	1,023,809	1,013,170
Environmental and Disposal Liabilities (Note 14)	13,533,127	12,375,694
Other Liabilities (Note 15 & Note 17)	6,731,410	9,941,553
TOTAL LIABILITIES	$ 34,421,358	$ 31,425,063
COMMITMENTS AND CONTINGENCIES (NOTE 17)		
NET POSITION		
Unexpended Appropriations - Other Funds	$ 150,291,356	$ 153,326,272
Cumulative Results of Operations - Dedicated Collections (Note 20)	34,245	27,305
Cumulative Results of Operations - Other Funds	182,772,990	175,357,947
TOTAL NET POSITION	$ 333,098,591	$ 328,711,524
TOTAL LIABILITIES AND NET POSITION	$ 367,519,949	$ 360,136,587

The accompanying notes are an integral part of these statements.

Air Force General Fund
CONSOLIDATED STATEMENTS OF NET COST
For Years Ended September 30, 2019 and 2018

(Amounts in Thousands)

	2019 Consolidated (Unaudited)	2018 Consolidated (Unaudited)
Program Costs		
Military Personnel	$ 38,406,865	$ 36,829,310
Operations, Readiness & Support	61,490,173	55,891,675
Procurement	59,605,703	55,643,670
Research, Development, Test & Evaluation	44,401,927	36,147,929
Family Housing & Military Construction	2,917,386	2,732,165
Gross Costs	$ 206,822,054	$ 187,244,749
(Less: Earned Revenue)	(11,975,527)	(8,231,824)
Net Cost of Operations	$ 194,846,527	$ 179,012,925

The accompanying notes are an integral part of these statements.

Air Force General Fund
CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION
For Years Ended September 30, 2019 and 2018

(Amounts in Thousands)	2019 Consolidated (Unaudited)	2018 Consolidated (Unaudited)
UNEXPENDED APPROPRIATIONS:		
Beginning Balances (Includes Funds from Dedicated Collections - See Note 18)	$ 153,326,272	$ 135,697,230
Beginning balances, as adjusted	153,326,272	135,697,230
Budgetary Financing Sources:		
Appropriations received	195,851,242	190,147,759
Appropriations transferred-in/out	(118,046)	104,381
Other adjustments (+/-)	(4,807,401)	(3,715,745)
Appropriations used	(193,960,711)	(168,907,353)
Total Budgetary Financing Sources (Includes Funds from Dedicated Collections - See Note 18)	$ (3,034,916)	$ 17,629,042
Total Unexpended Appropriations (Includes Funds from Dedicated Collections - See Note 18)	$ 150,291,356	$ 153,326,272
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 175,385,252	$ 186,274,074
Prior Period Adjustments:		
Changes in accounting principles (+/-)	1,281,781	(2,033,401)
Beginning balances, as adjusted (Includes Funds from Dedicated Collections - See Note 18)	176,667,033	184,240,673
Budgetary Financing Sources:		
Appropriations used	193,960,711	168,907,353
Non-exchange revenue	3,215	8,319
Donations and Forfeitures of Cash and Cash Equivalents	7,594	4,721
Transfers-in/out without reimbursement	74,420	58,996
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	6,974,017	(238,849)
Imputed financing from costs absorbed by others	853,779	790,529
Other (+/-)	(887,007)	626,435
Total Financing Sources (Includes Funds from Dedicated Collections - See Note 18)	$ 200,986,729	$ 170,157,504
Net Cost of Operations (+/-) (Includes Funds from Dedicated Collections - See Note 18)	194,846,527	179,012,925
Net Change	6,140,202	(8,855,421)
Cumulative Results of Operations (Includes Funds from Dedicated Collections - See Note 18)	182,807,235	175,385,252
NET POSITION	$ 333,098,591	$ 328,711,524

The accompanying notes are an integral part of these statements.

Air Force General Fund
COMBINED STATEMENTS OF BUDGETARY RESOURCES
For Years Ended September 30, 2019 and 2018

(Amounts in Thousands)

	2019 Combined (Unaudited)	2018 Combined (Unaudited)
Budgetary Resources:		
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 45,687,157	$ 36,325,787
Appropriations (discretionary and mandatory)	194,708,989	189,701,583
Spending Authority from offsetting collections (discretionary and mandatory)	9,613,738	9,179,083
Total Budgetary Resources	$ 250,009,884	$ 235,206,453
Status of Budgetary Resources:		
New obligations and upward adjustments (total)	$ 212,402,167	$ 193,052,669
Unobligated balance, end of year:		
Apportioned, unexpired accounts	32,388,888	36,361,083
Exempt from apportionment, unexpired accounts	18,050	14,458
Unapportioned, unexpired accounts	1,302	3,159
Unexpired unobligated balance, end of year	32,408,240	36,378,700
Expired unobligated balance, end of year	5,199,477	5,775,084
Unobligated balance, end of year (total)	37,607,717	42,153,784
Total Budgetary Resources	$ 250,009,884	$ 235,206,453
Outlays, net:		
Outlays, net (total) (discretionary and mandatory)	186,143,926	167,672,059
Distributed offsetting receipts (-)	(465,809)	(339,645)
Agency Outlays, net (discretionary and mandatory)	$ 185,678,117	$ 167,332,414

The accompanying notes are an integral part of these statements.

Fiscal Year 2019

GENERAL FUND

Notes to the Principal Statements (Unaudited)

Notes to the financial statements communicate information essential for fair presentation of the financial statements that is not displayed on the face of the financial statements.

Note 1 Summary of Significant Accounting Policies

A. Reporting Entity

The United States (U.S.) Air Force is organized under the Headquarters Air Force and Field Organizations. The Headquarters Air Force includes the Secretary of the Air Force who is responsible for all affairs of the Air Force and reports to the Secretary of Defense. The Headquarters Air Force also includes the Chief of Staff who is responsible for the efficiency of the Air Force and the preparation of its forces for military operations. The Field Organizations are comprised of the Major Commands, Direct Reporting Units, Field Operating Agencies, and their subordinate elements that carry out the mission of the Air Force.

B. Mission of the Reporting Entity

The Air Force was created on September 18, 1947 by the *National Security Act of 1947* and operates under the direction, authority, and control of the Secretary of the Air Force. The Air Force's overall mission is to deliver sovereign options for the defense of the United States of America and its global interests to "Aim High…Fly, Fight, Win" in air, space, and cyberspace. The Air Force carries out its mission by adhering to a strategic framework of core values consisting of Integrity First, Service Before Self, and Excellence in All We Do. In addition, the Air Force is committed to providing Global Vigilance, Global Reach, and Global Power, while defending and protecting the U.S.

C. Basis of Presentation

These financial statements have been prepared to report the consolidated financial position, net cost of operations, changes in net position, and combined budgetary resources of the Air Force, as required by the *Chief Financial Officers Act of 1990*, as amended and expanded by the *Government Management Reform Act of 1994*, and other applicable legislation. The financial statements have been prepared from the books and records of the Air Force in accordance with, and to the extent possible, U.S. Generally Accepted Accounting Principles (U.S. GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB), the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements* (OMB A-136), and the Department of Defense (DoD), *Financial Management Regulation* (FMR). The accompanying financial statements account for all resources for which the Air Force is responsible unless otherwise noted. Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

The Air Force is unable to fully implement all elements of U.S. GAAP and OMB A-136 due to limitations of financial and non-financial management processes and systems that support the financial statements. The Air Force derives reported values and information for major asset and liability categories largely from non-financial 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 U.S. GAAP. The Air Force continues to implement process and system improvements addressing these limitations.

The Air Force is involved in various programs whereby procurement contracts are used to buy goods and services for multiple Federal Government entities. The Air Force determined its accounting for such contracts does not always reflect the specific Air Force allocation of contract costs. Collections, obligations, and outlays of the Air Force are misstated by the difference between Air Force expenditures and the Air Force actual allocations of contract costs. The Air Force cannot currently estimate the amount of misstatement but has concluded it may be material.

D. Basis of Accounting

The Air Force's financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the Air Force's sub-entities. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), non-financial feeder systems, and accruals made for major items such as payroll expenses, Accounts Payable, and Environmental and Disposal Liabilities. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated Air Force 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 Air Force presents the Balance Sheets, Statements of Net Cost, and Statements of Changes in Net Position on a consolidated basis which is the summation of the components less the eliminations. The Statements of Budgetary Resources are presented on a combined basis, which is the summation of the components. The financial transactions are recorded on a proprietary accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recognized when incurred, without regard to the timing of receipt or payment of cash. Whereas, under the budgetary basis, the legal commitment or obligation of funds is recognized in advance of the proprietary accruals and in compliance with legal requirements and controls over the use of federal funds.

The Air Force's continued effort towards full compliance with U.S. GAAP for the accrual method of accounting is encumbered by various system limitations and the sensitive nature of the Air Force's activities. The Air Force is unable to meet all full accrual accounting requirements. This is primarily because many of the Air Force's financial and non-financial systems and processes were designed prior to the legislative mandate to produce financial statements in accordance with U.S. GAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis but were designed to record information on a budgetary basis.

The Air Force has not completed the process of evaluating the effects that will result from adopting the below pronouncements of the *FASAB Handbook of Accounting Standards and Other Pronouncements, as Amended*. These pronouncements are expected to have an impact on the Air Force's financial statements. The Air Force is currently unable to determine the materiality of changes that adopting the below pronouncements will have on its financial position, results of its operations, net position, and budgetary activity when such pronouncements are adopted.

1) Statement of Federal Financial Accounting Standards (SFFAS) 47: *Reporting Entity*. Issued on December 23, 2014. Effective Date: Reporting periods beginning after September 30, 2017. The Air Force was required to adopt SFFAS 47 for the year ended September 30, 2018.

SFFAS 47 requires Federal Government entities to analyze their relationships with related entities to determine which, if any, entities should be reported with the reporting entity on a consolidated basis, those that should be disclosed as inter-related with the reporting entity, and those that should be disclosed by the reporting entity as related parties. The Air Force's SFFAS 47 analysis is not complete. The consolidation decisions related to that analysis, when complete, could have a material impact on the Air Force's financial statements.

2) SFFAS 48: *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*. Issued on January 27, 2016. Effective Date: Reporting periods beginning after September 30, 2016.

The Air Force plans to utilize deemed cost to value beginning balances for Operating Materials and Supplies (OM&S), as permitted by SFFAS 48. The Air Force has valued some of its OM&S using deemed cost methodologies as described in SFFAS 48. However, systems required to account for historical cost for Inventory and Related Property in accordance with SFFAS 3, *Accounting for Inventory and Related Property* are not yet fully in place. Therefore, the Air Force is not making an unreserved assertion with respect to this line item.

3) SFFAS 49: *Public-Private Partnerships: Disclosure Requirements*. Issued on April 27, 2016. Effective Date: Reporting periods beginning after September 30, 2018.

The Air Force has begun to evaluate arrangements and transactions for Public-Private Partnership (P3) criteria to determine the complete population of arrangements and transactions requiring disclosure under SFFAS 49 but has not completed a full analysis of all arrangements as of September 30, 2019.

4) SFFAS 50: *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*. Issued on August 4, 2016. Effective Date: Reporting periods beginning after September 30, 2016.

The Air Force plans to utilize deemed cost to value beginning balances for General Property, Plant, and Equipment (General PP&E), as permitted by SFFAS 50. The Air Force has valued some of its General PP&E using deemed cost methodologies as described in SFFAS 50. However, systems required to account for historical cost for General PP&E in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*, are not yet fully in place. Therefore, the Air Force is not making an unreserved assertion with respect to this line item.

5) SFFAS 54: *Leases: An Amendment of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment.* Issued on April 17, 2018. Effective Date: Reporting periods beginning after September 30, 2020. Early adoption is not permitted.

6) SFFAS 55: *Amending Inter-entity Cost Provisions*. Issued on May 31, 2018. Effective Date: Reporting periods beginning after September 30, 2018.

Pursuant to SFFAS 55, Office of the Secretary of Defense (OSD) issued a policy in September 2018 directing all DoD components not to recognize imputed costs and corresponding imputed financing from non-business type activities other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements. This election is permitted under SFFAS 55. USAF is in the process of adopting this SFFAS.

7) SFFAS 56: *Classified Activities.* Issued on October 4, 2018. Effective Date: Upon issuance.

SFFAS 56 permits certain modifications to prevent disclosure of classified information in an unclassified General Purpose Federal Financial Report.

8) SFFAS 57: *Omnibus Amendments 2019*. Issued on September 27, 2019. Effective Date: Paragraphs 9 and 10 of this Statement, which amend paragraph 26 of SFFAS 6, are effective upon issuance; Paragraph 2 of this Statement, which rescinds SFFAS 8, *Supplementary Stewardship Reporting*, is effective for reporting periods beginning after September 30, 2019 and early adoption is not permitted; Paragraphs 3 through 8, 11 and 12 of this Statement, which updates references to leases in SFFAS 5, *Accounting for Liabilities of the Federal Government*, SFFAS 6, and SFFAS 49, are effective for reporting periods beginning after September 30, 2020 and early adoption is not permitted.

9) Technical Bulletin 2017-1: *Intragovernmental Exchange Transactions*. Issued on November 1, 2017. Effective date: Upon issuance.

10) Technical Bulletin 2017-2: *Assigning Assets to Component Reporting Entities*. Issued on November 1, 2017. Effective date: Upon issuance.

11) Technical Release 17: *Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment*. Issued on April 10, 2017. Effective Date: Upon Issuance.

As this Technical Release serves as implementation guidance for SFFAS 50, the Air Force is in the process of adopting this Technical Release as of September 30, 2019.

12) Technical Release 18: *Implementation Guidance for Establishing Opening Balances*. Issued on October 2, 2017. Effective Date: Upon issuance.

As this Technical Release serves as implementation guidance for SFFAS 48 and SFFAS 50, the Air Force is in the process of adopting this Technical Release as of September 30, 2019.

13) Staff Implementation Guidance 6.1: *Clarification of Paragraphs 40-41 of* SFFAS 6, *Accounting for Property, Plant, and Equipment, As Amended*. Issued on July 17, 2018. Effective Date: Upon issuance.

14) Interpretation 9: *Cleanup Cost Liabilities Involving Multiple Component Reporting Entities, An Interpretation of SFFAS 5 & SFFAS 6*. Issued on August 16, 2019. Effective Date: Reporting periods beginning after September 30, 2019.

The Air Force has not recorded all transactions consistent with U.S. GAAP because of limitations of certain systems and resource constraints. The Air Force continues to transition to systems that can produce U.S. GAAP compliant financial statements. The following known transactions were not recorded consistent with U.S. GAAP and are believed to be materially misstated in the financial statements (not an exhaustive list).

1) Accounting errors recorded in prior years and impacting the current year financial statements have not been recorded and corrected in accordance with U.S. GAAP.

2) Transactions that should have been recorded in prior years, were recorded in the current year.

The financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources and legal authority to do so.

E. Accounting for Intragovernmental Activities

The Treasury Financial Manual, Volume 1, Part 2 – Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, provides guidance for reporting and reconciling intragovernmental balances. Accounting standards require an entity to eliminate intra-entity activity and balances from consolidated financial statements to prevent overstatement for a business itself. Generally, seller entities within the DoD provide summary seller-side balances for Revenue, Accounts Receivable, and Unearned Revenue to the buyer-side internal DoD accounting offices. The DoD is implementing replacement systems and a standard financial information structure that will incorporate the necessary elements to enable the DoD to correctly report, reconcile, and eliminate intragovernmental balances.

Imputed financing represents the cost paid on behalf of the Air Force by another federal entity. Once the Air Force fully implements SFFAS 55, the Air Force will recognize the general nature of imputed costs only for business-type activities and other costs specifically required by OMB A-136, including 1) employee pension, post-retirement health, and life insurance benefits, 2) post-employment benefits for terminated and inactive employees, to include unemployment and workers compensation under the *Federal Employees' Compensation Act* (FECA), and 3) losses in litigation proceedings that are paid from the Treasury Judgment Fund. Unreimbursed costs of goods and services other than these are not included in the Air Force's financial statements.

For additional information, see Note 19, *General Disclosures Related to the Statement of Net Cost.*

F. Non-Entity Assets

The accounts used to prepare the financial statements are categorized as either entity or non-entity. The Air Force accounts consist of resources that are available for use in the operations of the entity. The Air Force is authorized to decide how to use resources in entity accounts or may be legally obligated to use these resources to meet entity obligations. Non-entity accounts, on the other hand, consist of assets that are held by an entity but that are not available for use in the operations of the entity.

For additional information, see Note 2, *Non-Entity Assets*.

G. Fund Balance with Treasury

The Air Force's monetary resources of collections and disbursements are maintained in U.S. Treasury accounts. The disbursing offices of Defense Finance and Accounting Services (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 Air Force'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.

DFAS and the 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 account.

For additional information, see Note 3, *Fund Balance with Treasury*.

H. Cash and Other Monetary Assets

Cash is the total of cash resources under the control of the Air Force including 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 foreign currencies exchanged for U.S. dollars and foreign currency received as payment for goods or services. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

The majority of cash and all foreign currency is classified as "non-entity" 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 Air Force 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 operations and maintenance, and 5) family housing construction. The gains and losses are calculated as the variance between the current exchange rate at the date of payment and a budget rate established at the beginning of each Fiscal Year (FY). Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Air Force does not separately identify currency fluctuation transactions.

For additional information, see Note 4, *Cash and Other Monetary Assets*.

I. Investments and Related Interest

The Air Force 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 obtaining similar results. The Air Force'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 Air Force invests in non-marketable market-based U.S. Treasury securities issued to Federal Agencies by the U.S. Treasury's Bureau of the Fiscal Service. These securities are not traded on any financial exchange but are priced consistently with publicly traded U.S. Treasury securities.

For additional information, see Note 5, *Investments and Related Interest*.

J. 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 factors such as aging of accounts receivable, debtor's ability to pay, and payment history. The Air Force does not recognize an allowance for estimated uncollectible amounts from other Federal Agencies. Claims for accounts receivable from other Federal Agencies are resolved between the agencies in accordance with the Intragovernmental Business Rules published in the Treasury Financial Manual Volume 1, Part 2, Chapter 4700.

In accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities* (paragraphs 44-49), the methodology for losses due to uncollectible amounts are based on an individual account analysis and/or group analysis. For individual account analysis, account balances are individually analyzed to determine the loss allowance. For group analysis, receivables are separated into groups of homogeneous accounts with similar risk characteristics. To allow for both requirements, a group analysis is performed in determining the allowance percentages by aging category applied to delinquent balances per the *Treasury Report on Receivables* or other sources of public receivable information. The allowance percentages by aging categories are based on three years of actual collection experience. In accordance with the DoD FMR Volume 4, Chapter 3, a secondary analysis may be performed on individual receivable balances greater than $100.0 thousand. Based on the analysis, the Air Force can either 1) completely remove the balance (full or partial) from the percentage calculation or 2) adjust the ending balance.

For additional information, see Note 6, *Accounts Receivable, Net*.

K. Direct Loans and Loan Guarantees

The *National Defense Authorization Act for FY 1996* (NDAA) contains the authorities for the Military Housing Privatization Initiative (MHPI). The NDAA includes a series of authorities that allow the Air Force to work with the private sector to build, renovate, and sustain military housing. The goals of the program 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 taxpayers. Other statutory authorities for this initiative include 10 USC 2873, 10 USC 2875, and 10 USC 2878. The most commonly used MHPI authorities the Air Force exercised include direct loans and loan guarantees (10 USC § 2873 and 2883), differential lease payments (10 USC § 2877 and 2883), equity investments (10 USC §§ 2875 and 2883), and conveyance or leasing of land and/or housing and other facilities (10 USC §§ 2878).

The Air Force entered into a competitive process with the private sector with a goal to provide its Uniformed Service Members and their families access to safe, secure, quality, affordable, and well-maintained housing in a military community where they choose to live. The projects are non-Federal Acquisition Regulation (FAR) real estate transactions with Project Owners (PO). The POs obtained financing, provided required equity, developed, own and operate the rental housing development for a period of 50 years. The expected life of each MHPI agreement corresponds to the duration of the ground lease (generally 50 years). The duration of the ground lease was established through negotiation with the PO and was considered to be the minimum duration required to ensure project success.

The Air Force predominately elected to enter into MHPI P3 by entering into long-term leases with private entities, conveying existing housing and other real estate assets, and offering direct loans for 27 projects, of which six included a limited loan guarantee and one included differential lease payments.

As required by SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, the present value of the subsidy costs associated with direct loans and loan guarantees is recognized as costs in the year the direct or guaranteed loan is disbursed.

OMB A-11, *Preparation, Submission, and Execution of the Budget*, Part 5 and OMB A-136, specify disclosure requirements for government direct loans and loan guarantees.

As discussed above within *Basis of Accounting*, the Air Force has begun implementing SFFAS 49, but has not completed a full analysis of all arrangements and transactions for P3 criteria as of September 30, 2019.

For additional information, see Note 7, *Direct Loans and Loan Guarantees, Non-Federal Borrowers*.

L. Operating Materials & Supplies, Net

The Air Force manages only military or government specific Operating Materials & Supplies (OM&S) under normal conditions. OM&S includes items such as weapon systems spares, ammunition, tactical missiles, aerial target drones, uninstalled aircraft and cruise missile engines, and uninstalled intercontinental ballistic missile motors. Items commonly used in, and available from, the commercial sector are not managed in the Air Force's OM&S management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The Air Force holds OM&S based on military need and support for contingencies.

OM&S, including Munitions not held for sale, are valued using various deemed cost methodologies including latest acquisition cost, standard price, estimated historical cost, actual historical cost, and replacement cost in accordance with SFFAS 48, using the moving average cost flow assumption. The Air Force uses the consumption method of accounting for OM&S. Newly acquired in-transit OM&S is not reported as part of the Air Force OM&S balance until it is accepted at the base and not when title transfers. The Air Force recognizes excess, obsolete, and unserviceable OM&S at a net realizable value of zero.

The Air Force, when applicable, will continue to adopt SFFAS 48 permitting alternative methods in establishing opening balances.

For additional information, see Note 8, *Operating Materials & Supplies, Net*.

M. General Property, Plant and Equipment

The Air Force generally records General PP&E at the estimated historical cost. The Air Force has established a deemed cost opening balance for some of its equipment assets in accordance with SFFAS 50. To establish the equipment opening balances, the Air Force accumulated information related to program funding and associated equipment, equipment useful lives, program acquisitions, and disposals. Opening balances for the equipment assets were then established using expenditure, acquisition, and disposal information. The Air Force, when applicable, will continue to use alternative methods in establishing opening balances for General PP&E in accordance with SFFAS 50.

The Air Force capitalizes General PP&E acquisitions per the DoD FMR Volume 4, Chapters 24, 25, and 27. The capitalization threshold for general equipment is $1.0 million and greater. The capitalization threshold for information technology equipment, internally developed software and real property is $250.0 thousand. These capitalization thresholds apply to asset acquisitions and modifications/improvements placed into service after September 30, 2013. General PP&E assets acquired prior to October 1, 2013 were capitalized at prior thresholds ($100.0 thousand for equipment and $20.0 thousand for real property). The Air Force depreciates all General PP&E on a straight-line basis.

The Air Force provides government-owned or leased General PP&E (Government-Furnished Equipment (GFE)) to contractors for performing a contract, for which the Air Force must recognize the GFE for accountability and financial reporting purposes.

Contractor-Acquired Property (CAP) is General PP&E acquired by a contractor on behalf of the Air Force for performing a contract, where the government will ultimately hold the title to the General PP&E. If the CAP has a useful life of at least two years and the value of CAP meets or exceeds the Air Force's capitalization threshold, federal accounting standards require that it be reported on the Air Force's Balance Sheet when title passes to the Air Force or when the General PP&E is delivered to the Air Force.

For additional information, see Note 9, *General PP&E, Net*.

N. Other Assets

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

The Air Force conducts business with commercial contractors under two primary types of contracts – fixed price and cost reimbursable. The Air Force may provide financing payments to contractors to alleviate the potential financial burden from long-term contracts. Contract financing payments are defined in the *Federal Acquisition Regulation (FAR), 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. Contract financing payments are not recorded in accordance with U.S. GAAP.

The *Defense Federal Acquisition Regulation Supplement* (DFARS) authorizes progress payments based on a percentage or stage of completion. Contract financing payments should not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion.

For additional information, see Note 10, *Other Assets*.

O. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease meets the criteria established in SFFAS 6, and the value equals or exceeds the current capitalization threshold, the Air Force records the applicable asset as though it was purchased with an offsetting liability and amortizes it. The Air Force records the asset and the 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 Air Force, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds.

An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are expensed over the lease term as they become payable. Office space leases entered into by the Air Force are the largest component of operating leases.

For additional information, see Note 16, *Leases*.

P. Accounts Payable

Accounts payable includes amounts owed to federal and non-federal entities for goods and services received by the Air Force.

Refer to Note 15, *Other Liabilities*, for information on the reclassification of progress payments for the estimated costs incurred by a contractor from Contingent Liabilities to Accounts Payable beginning in FY 2019.

Q. Liabilities

Liabilities represent the probable future outflow or other sacrifice of resources as a result of past transactions or events. However, no liability can be paid by the Air Force without proper budget authority. Liabilities covered by budgetary resources are appropriated funds for which funding is available to pay amounts due. Liabilities not covered by budgetary resources, for example, future environmental cleanup liabilities, represent amounts owed in excess of available appropriated funds or other amounts, where there is no certainty that the appropriations will be enacted. Liabilities that are not funded by the current year appropriation are classified as Liabilities Not Covered by Budgetary Resources.

For additional information, see Note 11, *Liabilities Not Covered by Budgetary Resources*.

R. Environmental and Disposal Liabilities

Liabilities also arise as a result of anticipated disposal costs for Air Force assets. Consistent with SFFAS 6, Air Force recognizes an anticipated Environmental and Disposal Liability for such assets. Based on DoD's policy, which is consistent with SFFAS 5, Environmental and Disposal Liabilities are recognized when management decides to dispose of an asset. In addition, the Air Force recognizes Environmental and Disposal Liabilities for nuclear-powered military equipment when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs. The Air Force does not recognize contingent liabilities associated with environmental disposals due to immateriality.

For additional information, see Note 14, *Environmental and Disposal Liabilities*.

S. Other Liabilities

Other liabilities consist of categories of liabilities that do not relate to Environmental and Disposal Liabilities. Other liabilities may be Federal or Non-Federal. Such liabilities include Advances from Others, FECA Reimbursement to the Department of Labor, Disbursing Officer Cash, Deposit Funds, Judgment Funds, Custodial liabilities, Contingent liabilities, Accrued Funded Payroll, Accrued Unfunded Annual Leave, Contract Holdbacks, and Employer Contributions and Payroll Taxes. The Air Force does not record contract holdbacks in accordance with U.S. GAAP.

For additional information, see Note 15, *Other Liabilities*.

T. Commitments and Contingencies

The Air Force recognizes contingent liabilities on the consolidated Balance Sheet for those legal actions where management considers an adverse decision to be probable and the loss amount is reasonably estimable. However, there are cases where amounts have not been accrued or disclosed because the likelihood of an adverse decision is considered remote or the amount of potential loss cannot be estimated.

The Air Force executes project agreements pursuant to the framework cooperative agreement with foreign governments. All of these agreements give rise to obligations that are fully reported in the Air Force's financial statements, pursuant to legal authority, appropriated funds, and none are contingent. The Air Force does not enter into treaties and other international agreements that create contingent liabilities.

For additional information, see Note 17, *Commitments and Contingencies*.

U. Military and Civilian Retirement Benefits

As an employer entity, the Air Force recognizes the annual cost of its civilian employees' pension, other retirement benefit plans and other postemployment benefit plans including health and life insurance plans. However, as the administering entity, the Office of Personnel Management (OPM) is responsible for executing the benefit plans including accounting for plan assets, liabilities and associated gains and losses. Accordingly, the Air Force does not display gains and losses from changes in long-term assumptions used to measure these liabilities on the Statement of Net Cost.

For additional information, see Note 13, *Military Retirement and Other Federal Employment Benefits* and Note 19, *General Disclosures Related to the Statement of Net Cost*.

V. Revenues and Other Financing Sources

The Air Force receives congressional appropriations as financing sources for general funds, trust funds, and special funds. The Air Force uses these appropriations and funds to execute its missions and subsequently report on resource usage. These funds either expire annually, some 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 Air Force 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 Air Force's standard policy for services provided as required by OMB Circular A-25, *User Charges* (OMB A-25). In some instances, revenue is recognized when bills are issued.

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

Trust funds contain receipts and expenditures of funds held in trust by the Federal 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 funds from dedicated collections. Funds from dedicated collections are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The Air Force is required to separately account for and report on the receipt, use, and retention of revenues and other financing sources for funds from dedicated collections.

In accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financing Accounting*, the Air Force recognizes non-exchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not directly receive value in return.

The Air Force 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 in Note 24, *Reconciliation of Net Cost to Net Outlays*. 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.

W. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. Estimates are made for major items such as payroll expenses, Accounts Payable, Environmental and Disposal Liabilities, and unbilled revenue. Some accounts such as civilian pay, military pay, and Accounts Payable are presented on the accrual basis of accounting on the financial statements.

In most instances, the Air Force uses the consumption method to recognize expense for OM&S. OM&S are expensed when consumed.

X. Treaties for Use of Foreign Bases

The Air Force has the use of land, buildings, and other overseas facilities obtained through various international treaties and agreements negotiated by the Department of State. The Air Force purchases capital assets overseas with appropriated funds. However, the host country retains title to the land and capital improvements. In accordance with the DoD FMR Volume 4, Chapter 24, the Air Force reports these assets on its consolidated balance sheet when an agreement exists between the U.S. and the host nation/foreign government and the agreement conveys a right to construct and operate facilities; the Air Force funded the asset's acquisition (e.g., purchase and construction) and/or capital improvements; the asset meets capital General PP&E useful life and threshold criteria; and the asset is used in operations. Treaty terms generally allow the Air Force continued use of these properties until the treaty expires. 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 non-retrievable 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.

For additional information, see Note 9, *General PP&E, Net*.

Y. Use of Estimates

The Air Force's management makes assumptions and reasonable estimates in the preparation of the financial statements based on current conditions which may affect the reported amounts. Actual results could differ materially from the estimated amounts. Significant estimates include such items as Environmental and Disposal Liabilities, year-end accruals of Accounts Payable, contingent legal liabilities, and actuarial liabilities related to workers' compensation.

Z. Parent-Child Reporting

The Air Force 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.

The Air Force receives allocation transfers for EOP (Foreign Military Sales – Military Assistance Program) meeting the OMB exception; however, activities for this fund are reported separately from the DoD financial statements.

AA. Transactions with Foreign Governments and International Organizations

Each year, the Air Force 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 Air Force 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.

AB. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-federal individuals or entities have an ownership interest that the Air Force must uphold. Fiduciary cash and other assets are not assets of the Air Force and are not recognized on the Balance Sheet.

For additional information, see Note 23, *Fiduciary Activities*.

AC. Tax Exempt Status

As an agency of the Federal Government, the Air Force is exempt from all income taxes imposed by any governing body whether it is a Federal, State, Commonwealth, Local, or Foreign Government.

AD. Subsequent Events

Subsequent events have been evaluated from the balance sheet date through November 8, 2019, which is the date the financial statements were available to be issued.

Note 2 Non-Entity Assets

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Intragovernmental Assets		
Fund Balance with Treasury	$ 383,750	$ 542,516
Total Intragovernmental Assets	$ 383,750	$ 542,516
Non-Federal Assets		
Cash and Other Monetary Assets	$ 151,145	$ 89,512
Accounts Receivable	673	3,424
Total Non-Federal Assets	$ 151,818	$ 92,936
Total Non-Entity Assets	$ 535,568	$ 635,452
Total Entity Assets	$ 366,984,381	$ 359,501,135
Total Assets	$ 367,519,949	$ 360,136,587

Non-entity assets are assets for which the Air Force maintains stewardship accountability and reporting responsibility but are not available for the Air Force's normal operations.

Intragovernmental Fund Balance with Treasury represents amounts in the Air Force's deposit fund and two suspense fund accounts (Uniformed Services Thrift Savings Plan Suspense and Thrift Savings Plan Suspense) that are not available for Air Force use.

Non-Federal Cash and Other Monetary Assets represent disbursing officers' cash and undeposited collections as reported on the Statement of Accountability (Standard Form 1219). These assets are held by Air Force Disbursing Officers as agents of the United States (U.S.) Treasury.

Non-Federal Accounts Receivable consists of amounts associated with cancelled year appropriations, as well as interest, fines and penalties due on debt. Generally, the Air Force cannot use the proceeds and must remit them to the U.S. Treasury unless permitted by law.

Note 3 Fund Balance with Treasury

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	$ 32,406,938	$ 36,375,543
Unavailable	5,200,782	5,778,246
Total Unobligated Balance	$ 37,607,720	$ 42,153,789
Obligated Balance not yet Disbursed	$ 114,432,869	$ 104,581,749
Non-Budgetary Fund Balance with Treasury		
Clearing accounts	$ (24,629)	$ (222,462)
Deposit funds	383,750	542,516
Total Non-Budgetary Fund Balance with Treasury	$ 359,121	$ 320,054
Non-Fund Balance with Treasury Budgetary Accounts		
Investments - Treasury Securities	$ (7)	$ (7)
Unfilled Customer Orders without Advance	(2,493,498)	(1,814,599)
Receivables and Other	(890,489)	(1,130,351)
Total Non-Fund Balance with Treasury Budgetary Accounts	$ (3,383,994)	$ (2,944,957)
Total Fund Balance with Treasury	$ 149,015,716	$ 144,110,635

The United States (U.S.) Treasury records cash receipts and disbursements on the Air Force's behalf and are available only for the purposes for which the funds were appropriated. The Air Force Fund Balance with Treasury (FBwT) consists of appropriation accounts, revolving funds, trust accounts, special funds and other fund types.

The Status of FBwT reflects the budgetary resources to support 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.

The 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 future obligations. The available balance consists primarily of the unexpired, unobligated balance that has been apportioned and available for new obligations. The unavailable balance consists 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.

The Obligated Balance not yet Disbursed represents funds obligated for goods and services but not yet paid.

Non-Budgetary FBwT includes accounts without budgetary authority, such as deposit funds, clearing accounts, and non-entity FBwT.

Non-FBwT Budgetary Accounts include investments, unfilled customer orders without advance, and accounts receivable that reduce the status of FBwT.

Total FBwT does not include funds held as a result of allocation transfers received from other Federal Agencies and fiduciary activities. As the child entity, the Air Force received allocation transfers from other Federal Agencies for execution on their behalf in the amount of $154.3 thousand in Fiscal Year (FY) 2019. As the parent entity, the Air Force issued allocation transfers to other DoD or Federal Government agencies for execution on behalf of the Air Force in the amount of $20.8 million in FY 2019. In addition, the Air Force held cash and cash equivalents for fiduciary activities in the amount of $1.8 million in FY 2019; these amounts are not reported in FBwT in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 31, *Accounting for Fiduciary Activities*.

The FBwT reported in the financial statements has been adjusted to reflect the Air Force's balance as reported by the U.S. Treasury. The difference between FBwT in the Air Force's general ledgers and FBwT reflected in the U.S. Treasury accounts is attributable to transactions that have not been posted to the individual detailed accounts in the Air Force's general ledger, as a result of timing differences or the inability to obtain valid accounting information; prior to the issuance of the financial statements. The following adjustments were necessary for the Air Force to reconcile their general ledger to the U.S. Treasury: $51.8 million in net undistributed collections ($84.5 million in gross undistributed collections), and $1.1 billion in net undistributed disbursements ($3.2 billion in gross undistributed disbursements). When research is completed, these transactions will be recorded in the appropriate individual detailed accounts in the Air Force's general ledger accounts.

The Air Force has $3.4 billion of funds in expired appropriations that were returned to Treasury at the end of FY 2019.

Note 4 Cash and Other Monetary Assets

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Cash	$ 54,644	$ 63,632
Foreign Currency	96,501	25,880
Total Cash, Foreign Currency, & Other Monetary Assets	$ 151,145	$ 89,512

Cash and Foreign Currency are non-entity assets and consist of cash held by Disbursing Officers. Both of these assets are considered restricted and are not available to fund the Air Force's normal operations. Refer to Note 2, *Non-Entity Assets*, for additional information.

The Air Force reported $32.0 million and $25.2 million in cash held from dedicated collections as of September 30, 2019 and September 30, 2018, respectively. Refer to Note 18, *Funds from Dedicated Collections*.

Note 5 Investments and Related Interest

As of September 30	2019 (Unaudited)				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
(Amounts in Thousands)					
Intragovernmental Securities					
Non-Marketable, Market-Based					
Other Funds	$ 7		$ 0	$ 7	$ 7
Total Non-Marketable, Market-Based	$ 7		$ 0	$ 7	$ 7
Total Intragovernmental Securities	$ 7		$ 0	$ 7	$ 7

As of September 30	2018 (Unaudited)				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
(Amounts in Thousands)					
Intragovernmental Securities					
Non-Marketable, Market-Based					
Other Funds	$ 7		$ 0	$ 7	$ 7
Total Non-Marketable, Market-Based	$ 7		$ 0	$ 7	$ 7
Total Intragovernmental Securities	$ 7		$ 0	$ 7	$ 7

The Air Force invests primarily in non-marketable, market-based United States (U.S.) Treasury securities. The value of these securities fluctuates in tandem with the selling price of the equivalent marketable security. 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 funds from dedicated collections as evidence of its receipts and are an asset to the Air Force 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 funds from dedicated collections. The cash generated from funds from dedicated collections are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Since the Air Force and the U.S. Treasury are both part of the Federal Government, these assets and liabilities offset each other at a consolidated level. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

The U.S. Treasury securities provide the Air Force with authority to access funds to make future benefit payments or other expenditures. When the Air Force requires redemption of securities to make expenditures, the Federal Government will meet the requirement by using accumulated cash balances, raising taxes or other receipts, borrowing from the public or repaying less debt, or curtailing other expenditures. The Federal Government used the same method to finance all other expenditures.

Intragovernmental Securities (Other Funds) primarily represents the Air Force Gift Fund investment in U.S. Treasury Securities.

Note 6 Accounts Receivable, Net

As of September 30	2019 (Unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in Thousands)			
Intragovernmental Receivables	$ 481,903	$ N/A	$ 481,903
Non-Federal Receivables (From the Public)	$ 264,046	$ (27,453)	$ 236,593
Total Accounts Receivable	$ 745,949	$ (27,453)	$ 718,496

As of September 30	2018 (Unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in Thousands)			
Intragovernmental Receivables	$ 589,401	$ N/A	$ 589,401
Non-Federal Receivables (From the Public)	$ 275,836	$ (45,664)	$ 230,172
Total Accounts Receivable	$ 865,237	$ (45,664)	$ 819,573

Accounts receivable represents the Air Force's claim for payment from other entities. The Air Force only recognizes an allowance for uncollectible amounts from the public. Claims with other Federal Agencies are resolved in accordance with the business rules published in the Treasury Financial Manual, Volume I, Part 2, Chapter 4700. Refer to Note 1.J, *Summary of Significant Accounting Policies – Accounts Receivable*, for additional information regarding the method utilized to estimate the allowance for uncollectible amounts.

Note 7 Direct Loans and Loan Guarantees, Non-Federal Borrowers

Direct Loans and Loan Guarantees Programs (the Program)

The Air Force is in the process of reviewing its business arrangements and transactions to determine those that meet the disclosure requirements of Statement of Federal Financial Accounting Standards (SFFAS) 49, *Public-Private Partnerships: Disclosure Requirements*. To date, the Air Force has identified the Military Housing Privatization Initiative (MHPI) as meeting the requirements for disclosure in its financial statements in accordance with SFFAS 49. Disclosure information for the MHPI as well as consideration of other Air Force arrangements which may meet the criteria for SFFAS 49 disclosure are described in Note 25, *Public-Private Partnerships*. Due to the complexity of some of the MHPI arrangements, it is possible that previous transactions may need to be adjusted in order to be United States Generally Accepted Accounting Principles (U.S. GAAP) compliant.

Since inception of the Program, no direct loan project has ever defaulted on its obligations to the Military Housing Privatization Initiative (MHPI). However, situations have risen necessitating the modification of the terms of certain direct loan agreements to ensure the sustainability of the affected projects. Currently the following projects are under review and subject to possible modification:

- Two Air Force projects, Air Education and Training Command (AETC) and Robins Air Force Base (AFB), had debt coverage ratios of less than 1.05, requiring the application of additional risk of repayment factors during the Fiscal Year (FY) 2020 subsidy reestimates for the FY 2021 President's Budget. The Air Force is monitoring the Robins AFB project closely and reviewing a restructure proposal to ensure long-term financial viability. See below for additional detail on AETC I due to catastrophic impact of Hurricane Michael at Tyndall AFB in October 2018.
- The restructure of another Air Force project, BLB Group, is under consideration. A proposed modification is pending approval by the Office of the Secretary of Defense (OSD) and is anticipated to be sent to the Office of Management and Budget (OMB) for approval in the first quarter of FY 2020. The estimated modification cost, using Air Force budgetary authority, is $55.0 million. The proposed restructure of the government direct loan is not the result of debt issues, but is needed to keep the project competitive within its marketplace to ensure the long-term sustainability of the project.
- In October 2018, Tyndall AFB suffered a direct hit by Hurricane Michael and all 867 privatized units (813 end state and 54 excess units) sustained damage resulting in the largest loss in the history of Air Force privatized housing. All units were damaged and the Basic Allowance for Housing (BAH) at Tyndall was and continues to be cut off. Tyndall provided 42.0% of total Net Operating Income (NOI) for the AETC I direct loan project consisting of Altus AFB, Oklahoma; Luke AFB, Arizona; Sheppard AFB, Texas; and Tyndall AFB, Florida. In January 2019, OMB approved a 12 month forbearance of the AETC I direct loan (currently in an interest only period) while a restructuring plan is developed. The Air Force and project owner developed a two-phased approach, working closely with the senior lender in establishing a plan to restore and rebuild homes at Tyndall AFB with a central focus on achieving the stated mission of the project. The Phase I Tyndall restoration is planned to be approved by OMB in October 2019. The Phase I plan uses funds from the Non-Debt Sized Units (NDSUs) at the Northern Group and Western Group MHPI projects as a loan to the AETC Group I project through a credit facility to address a funding shortfall in the proposed restoration plan in Phase I. The loan is non-recourse, no interest, and payable at the end of the AETC I lease term. The Phase I plan also includes Air Force take-back of 274 units for demolition (approximately $6.5 million). Phase II will include a restructure of the AETC I project to ensure long-term sustainment and is anticipated to include adjustments to the Government Direct Loan. While the insurance coverages for the AETC I project are comparable to those required by commercial lenders and investors for natural catastrophic events, the insurance payout will not provide all funding required to restore and rebuild the proposed housing end-state (593 homes). Some factors leading to a reduced end state for Tyndall include the following:
    - The AETC I project is responsible for funding the 5.0% policy deductible ($11.0 million),

- The complex calculation formula for the policy payout is affected by depreciation offsets and planned restoration activities, and
- The senior lender will require that some of the payout be used to pay down the senior loan by an amount commensurate with the loss of income attributable to the approximately 274 homes that will not be rebuilt ($33.0 million).
- The reduced end state supports the number of military tenants previously housed at Tyndall AFB as well as the returning mission.

Loan Guarantees

The loan guarantee program, in accordance with the *Federal Credit Reform Act*, allows funds in the loan guarantee financing account held by the Treasury to accrue and earn interest. The funds are held for the purpose of guaranteeing third party loans to non-federal partners participating in the MHPI program in the event of a default.

See Note 12, *Debt*, and Note 25, *Public-Private Partnerships,* for additional information on activities related to the MHPI.

Note 8 Operating Materials & Supplies, Net

As of September 30	2019 (Unaudited)		
	OM&S, Gross	Revaluation Allowance	OM&S, Net
(Amounts in Thousands)			
Held for Use	$ 40,807,159	$ N/A	$ 40,807,159
Held in Reserve for Future Use	1,406,243	N/A	1,406,243
Held for Repair	12,161,956	0	12,161,956
Excess, Obsolete, and Unserviceable	507,121	(507,121)	0
Total	$ 54,882,479	$ (507,121)	$ 54,375,358

As of September 30	2018 (Unaudited)		
	OM&S, Gross	Revaluation Allowance	OM&S, Net
(Amounts in Thousands)			
Held for Use	$ 36,526,467	$ N/A	$ 36,526,467
Held in Reserve for Future Use	1,217,727	N/A	1,217,727
Held for Repair	13,436,880	0	13,436,880
Excess, Obsolete, and Unserviceable	351,300	(351,300)	0
Total	$ 51,532,374	$ (351,300)	$ 51,181,074

General Composition of Operating Materials & Supplies

Operating Materials & Supplies (OM&S) consists of tangible personal property to be consumed in normal operations. Excluded are 1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, 2) stockpile materials, 3) goods held under price stabilization programs, 4) foreclosed property, 5) seized and forfeited property, and 6) inventory. Repairables are assets that are cost-effective to repair and include, but are not limited to, high-value Munitions, Cruise Missiles, Spare Engines, Uninstalled Missile Motors, and Aerial Targets. Consumables are those assets that are not cost effective to repair and include, but are not limited to, low-value Munitions and Spare Parts.

OM&S includes items with a useful life of two or more years if those items are expected to be returned or transferred after use with the intent of re-use. OM&S includes weapon systems spares, ammunition, tactical missiles, aerial target drones, uninstalled aircraft and cruise missile engines, and uninstalled intercontinental ballistic missile motors.

Currently, the Air Force cannot disclose an Allowance for Repair as required by Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*, but is actively working to implement a corrective action to properly report this amount.

Contractor - Inventory Control Point (C-ICP) represents the portion of Air Force owned OM&S assets that are maintained at commercial entity locations. C-ICPs are responsible for possession, management, and logistical support of assets as assigned by the Air Force.

Restrictions on the Use of OM&S

The Air Force does not maintain any OM&S restricted assets.

Decision Criteria for Identifying the Category to Which OM&S Items Are Assigned

The Air Force assigns OM&S items to a category based on asset type and condition. Held for Use includes all materiel available for issuance. Held in Reserve for Future Use includes suspended stock, which is OM&S with one of the following conditions: 1) awaiting inspection to determine its condition, 2) inventory returned from customers or users to storage warehouses and awaiting condition classification, 3) inventory held at storage warehouses pending litigation or negotiation with contractors or common carriers, 4) quality-deficient inventory returned by customers or users due to technical deficiencies, and 5) inventory returned by salvage activities for which the material condition cannot be determined. Held for Repair generally includes all economically repairable materiel as defined by the Military Standard Transaction Reporting and Accounting Procedures Manual (DLM 4000.25-2-M). Held for Repair represents unserviceable repairable, unserviceable incomplete, suspended (in work), and suspended (reclaimed items, awaiting condition determination) recorded at Moving Average Cost (MAC) or standard price. MAC is not necessarily moving average historical cost. Excess, Obsolete, and Unserviceable includes all materiel that managers determine to be more costly to repair than to replace and only includes unserviceable OM&S. To date, the Air Force has not confirmed any proceeds received from the disposal of OM&S assets, and therefore, the Net Realizable Value (NRV) is currently reported as zero.

The Treasury U.S. Standard General Ledger (USSGL) Board approved the use of account 151600, OM&S In Development, for the Department of Defense (DoD) effective October 1, 2017. The Air Force is still in the process of implementing DoD policy regarding the use of this account.

OM&S Value

The Air Force uses the consumption method of accounting for OM&S. However, newly acquired in-transit OM&S is not reported in this balance until they are accepted at the base and not when title transfers. Once issued to the end user, OM&S is expensed. The Air Force has applied deemed cost in accordance with SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials,* to some of its OM&S, but has not yet made an unreserved assertion. Some OM&S assets do not yet have adequate support to apply a deemed cost methodology under SFFAS 48.

The Air Force valued Munitions, Spare Engines, Uninstalled Missile Motors, Aerial Targets, and Cruise Missiles using deemed cost methodologies as prescribed in SFFAS 48. Logistics systems do not maintain the historical cost data necessary to comply with SFFAS 3, *Accounting for Inventory and Related Property*. Therefore, the Air Force is not making an unreserved assertion with respect to this line item. Munitions purchased prior to 2016 are based on the Federal Logistics Information System catalogue price. Munitions purchased after 2016 are based on actual historical cost. Spare Engines, Aerial Targets, Uninstalled Missile Motors, and Cruise Missiles are valued based on estimated historical cost.

The Comprehensive Engine Maintenance System (CEMS) calculates MAC for Spare Engines. The Reliability and Maintainability Information Systems (REMIS) calculates MAC for Cruise Missiles and Aerial Targets. Legacy system functionality and the lack of a complete asset universe prevents the Air Force from recording OM&S spare parts and OM&S located at C-ICP at MAC. The Munitions Ledger process was used to capture accountable transactions from the Combat Ammunition Systems (CAS) and Logistics Modernization Program (LMP). Every transaction which impacts accountable balances is valued at MAC on the date of the actual transaction. This new process, initiated in Fiscal Year (FY) 2017, has continued to improve the variance between Stated Balance (on hand) and the Calculated Ending Balance based on transactions. Data latency and lack of transactions from external systems that report balances to CAS are the primary causes of these variances.

The Air Force's accounting system uses transaction type codes provided by Mechanization of Contract Administration Services (MOCAS) to determine how to record transactions. MOCAS was not designed to have separate transaction type codes to identify and account for contract financing payments at the level required to accurately determine the USSGL posting to the proper work in process type asset account, including OM&S In-Development. Until system modifications are made, contract financing payments, as disclosed in Note 10, *Other Assets*, are overstated and work in process type assets (including OM&S In-Development) are understated.

Other Air Force Disclosures

C-ICP represents $11.7 billion and $10.3 billion of the Air Force's OM&S as of September 30, 2019 and 2018, respectively. The Air Force has not been able to maintain a complete population of programs that contain contractor managed and possessed OM&S as contractor systems can only provide minimal OM&S accounting data that can be used to prepare the financial statements. The data provided consists of only beginning and ending balances for each of the following asset accounts: Held for Use, Excess, Obsolete, and Unserviceable, Held for Future Use, and Held for Repair. Without the required additional data (acquisitions, transfers in, amounts consumed, transfers out, trading partner data, etc.), the Air Force can only report the net change between prior period ending balances and the values reported as current period ending balances. The Air Force does not currently use MAC for C-ICP assets because there is no accountable property system of record (APSR) to perform the MAC calculation. In addition, the Air Forces does not require contractors to report SFFAS 3 compliant data that uses the MAC valuation method. The Air Force has identified C-ICP Programs and issued a Contract Data Requirements List (CDRL) requiring financial reporting on a quarterly basis. However, the Air Force has identified that not all C-ICP Programs are submitting required CFO Reporting or reporting through the Automated Logistics Management Support System.

There is an APSR for Base Possessed OM&S, the Integrated Logistics Supply System, which contains the functionality to calculate MAC. However, the Air Force is currently unable to validate that the inputs and the calculation are accurate.

The Air Force contributes funds to the Joint Strike Fighter (JSF) Program for the acquisition and sustainment of a global pool of spare parts and support equipment. The JSF Program Office maintains ownership title to pooled spares until the point at which they are installed and incorporated into Air Force owned F-35 aircraft, and maintains ownership title to pooled support equipment throughout its life. Therefore, pooled spares and support equipment are not reported on the Air Force's balance sheet because the Air Force does not own them. The Air Force's rights to benefit from the asset pools in relation to the funding it provides are based on decision memorandums developed by the JSF Program Office and signed by the Air Force and other program participants. The Air Force does not currently have a process in place to effectively reconcile the funds provided to the assets issued to it from the pool at an item level. The Air Force is participating in an Office of the Secretary of Defense (OSD) working group that is developing a process to allow the Air Force to properly account for its rights to the asset pools in accordance with U.S. GAAP.

Note 9 General PP&E, Net

As of September 30	2019 (Unaudited)				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
(Amounts in Thousands)					
Major Asset Classes					
Buildings, Structures, and Linear Structures*	S/L	20 or 40	$ 88,063,230	$ (52,299,855)	$ 35,763,375
Leasehold Improvements	S/L	Lease Term	63,807	(27,371)	36,436
Software	S/L	2-5 or 10	628,944	(439,627)	189,317
General Equipment	S/L	Various	364,542,544	(261,982,414)	102,560,130
Aircraft			288,277,666	(205,924,077)	82,353,589
Other			76,264,878	(56,058,337)	20,206,541
Construction-in-Progress	N/A	N/A	7,753,006	N/A	7,753,006
Military Equipment			6,325,412	N/A	6,325,412
Real Property			1,427,594	N/A	1,427,594
Total General PP&E			$ 461,051,531	$ (314,749,267)	$ 146,302,264

As of September 30	2018 (Unaudited)				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
(Amounts in Thousands)					
Major Asset Classes					
Buildings, Structures, and Linear Structures*	S/L	20 or 40	$ 86,945,313	$ (49,726,574)	$ 37,218,739
Leasehold Improvements	S/L	Lease Term	84,075	(27,690)	56,385
Software	S/L	2-5 or 10	628,945	(438,680)	190,265
General Equipment	S/L	Various	342,373,973	(251,213,993)	91,159,980
Aircraft			261,193,730	(191,002,787)	70,190,943
Other			81,180,243	(60,211,206)	20,969,037
Construction-in-Progress	N/A	N/A	11,765,190	N/A	11,765,190
Military Equipment			9,003,107	N/A	9,003,107
Real Property			2,762,083	N/A	2,762,083
Total General PP&E			$ 441,797,496	$ (301,406,937)	$ 140,390,559

Legend for Valuation Methods

S/L = Straight Line N/A = Not Applicable

* Estimated useful service life is 20 years for structures and linear structures, and 40 years for buildings.

General Property, Plant and Equipment

The Air Force has valued some of its General Property, Plant and Equipment (General PP&E) using deemed cost methodologies as defined in Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*. However, systems and processes required to consistently account for historical cost for all General PP&E in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment* and SFFAS 10, *Accounting for Internal Use Software*, as applicable, are not fully in place. Therefore, the Air Force is not making an unreserved assertion with respect to any General PP&E line item.

Buildings, Structures, and Linear Structures

As the Air Force continues to improve the underlying systems and data used to support Real Property values reported on our financial statements, interim adjustments occur while more permanent solutions are planned and executed to address root causes. The future goal is to address underlying data issues in our Real Property accountable property system of record (APSR) to correctly support deemed cost values through use of the approved Plant Replacement Value (PRV) calculation methodology. In the second quarter of Fiscal Year (FY) 2019, real property assets were revalued using PRV before all system and data issues were fully addressed. As a result, for the year ended September 30, 2019 the Air Force recorded interim adjustments to reverse PRV impacts in the general ledger.

- For the Defense Enterprise Accounting and Management System (DEAMS) general ledger, the Air Force was able to identify transactions related to PRV and reverse only those items back to previously recorded cost values. Separately, the Air Force allowed new activity unrelated to PRV to post without reversal. Depreciation and disposals were calculated based off recorded cost values and posted to the general ledger.
- For the General Accounting and Finance System-Reengineered (GAFS-R) general ledger, the Air Force was unable to identify transactions related to PRV so all activity after the implementation of PRV was reversed. Depreciation was calculated based off previously recorded cost values and posted to the general ledger. This approach removed the direct negative effects resulting from the premature implementation of PRV. However, it also removed any accurately recorded additions and disposals for Real Property during this period and related depreciation or gains/losses.

Leasehold Improvements

The Air Force has ongoing efforts to validate the leasehold improvement balance. Leasehold Improvements are additions, alterations, remodeling, or other changes to a leased property that either extend the useful life, or enlarge or improve the capacity of existing property.

Software

Internal use software (IUS) is comprised of both financial and administrative software, including those used for project management, and software used to produce goods and services. IUS may exist as a stand-alone application, or the combined software components of an Information Technology system. However, software that is integrated into and necessary to operate equipment rather than perform an application is not considered or treated as IUS. IUS encompasses the following types of software.

- Commercial off-the-shelf (COTS) software: Software acquired from a vendor or other government entity, typically in the form of a license, which is ready for use with little or no changes
- Developed software: Internally developed software is software that is developed by or under the oversight of Air Force Program Offices (Contractor developed), including new software and the modification of existing or purchased software or software licenses

As of FY 2019, the Air Force was unable to support the reported balance for IUS. The Air Force is in the process of implementing processes and controls in accordance with SFFAS 10, *Accounting for Internal USe Software*. Once these processes and controls are in place, the Air Force intends to write-off IUS balances in a future period as permitted by SFFAS 50.

General Equipment

General Equipment comprises multiple asset types such as Aircraft and Other General Equipment.

Aircraft: Represents the most significant portion of General Equipment and is comprised of eleven categories of aircraft based on mission types: attack, bomber, transport, electronic, fighter, trainer, helicopter, vertical takeoff and landing, utility, glider, and remotely piloted aircraft systems. In FY 2019, the Air Force continued to apply the "deemed cost" alternative valuation method to establish opening balances for 100.0% of its Military Equipment in accordance with SFFAS 50. The alternative valuation methods used to establish opening balances, as prescribed in SFFAS 50, were reasonable historical cost estimates based on: 1) cost of similar assets at the time of acquisition, 2) current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index), or 3) other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

Other General Equipment: These asset types include: satellites, intercontinental ballistic missiles, pods, and mine resistant ambush protected vehicles. In FY 2019, the Air Force continued to apply the "deemed cost" alternative valuation method, as described above, to establish opening balances for 100.0% of these assets in accordance with SFFAS 50.

Other General Equipment also includes assets classified as support equipment such as passenger carrying, non-mine resistant ambush protected vehicles, communications security equipment, nuclear weapons related material, small arms/light weapons, special tooling and special test equipment, either as equipment in the possession of the Air Force or as Government Furnished Equipment (GFE) with contractors. These equipment categories have not yet been valued using deemed cost to establish opening balances under SFFAS 50. The Air Force intends to value these equipment categories using deemed cost to establish opening balances under SFFAS 50 in future FYs.

The Air Force is unable to identify or establish accountability for the complete population of GFE. The Air Force can account for only a portion of its GFE. Additionally, the Air Force is in the process of implementing the Defense Property Accountability System (DPAS) as its APSR for GFE. Upon full implementation, which is expected to occur in FY 2020, the DPAS will provide the Air Force enhanced oversight capabilities for tracking, monitoring, and financially reporting assets in the possession of contractors.

Construction-in-Progress

The Air Force's accounting system uses transaction type codes provided by Mechanization of Contract Administration Services (MOCAS) to determine how to record transactions. MOCAS was not designed to have separate transaction type codes to identify and account for contract financing payments at the level required to accurately determine the USSGL posting to the proper work in process type asset account, including General PP&E construction-in-progress (CIP). Until system modifications are made, contract financing payments, as disclosed in Note 10, Other Assets, are overstated and work in process type assets (including General PP&E CIP) are understated.

Military Equipment – The Air Force began reporting CIP for selected Military Equipment assets under development as of September 30, 2017. The methodology to estimate CIP is based on the capitalizable expenditures during the period by program and by contract. CIP is reduced based on delivered assets placed in service which are then recorded in the APSR. The Air Force currently reports CIP balances for five Programs with future end-item deliverables - CV-22, F-35, KC-46, MQ-9, and C-130J. This CIP does not include costs associated with the construction of Space assets (i.e., satellites and common core ground systems) and Capital Improvements/Modifications. The CIP also does not include indirect costs such as Program Management Office, General and Administrative, Rent and Utilities, and Accruals for costs incurred but not yet paid.

Real Property – The Air Force constructs Real Property and works closely with other Military departments, the U.S. Army Corps of Engineers (USACE), and private and sector entities for design and construction. The Air Force has begun coordinating with all relevant stakeholders to establish consistent and repeatable processes for construction-in-progress. A majority of the real property construction is performed by USACE for the Air Force.

Restrictions on the use or convertibility of General PP&E

There are restrictions on the Air Force's ability to dispose of land, buildings, structures, and facilities located outside the continental United States (U.S.). The Air Force 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 Air Force's use and disposal of the restricted property located outside the U.S. Refer to Note 1.X., *Summary of Significant Accounting Policies – Treaties for Use of Foreign Bases*, for additional information.

Heritage Assets

Heritage Assets For Year Ended September 30, 2019 (Physical Count)					
Heritage Asset Categories	Measurement Quantity	As of 9/30/18	Additions (+)	Deletions (-)	As of 9/30/19
Buildings, Structures, and Linear Structures	Each	6,440	333	0	6,773
Archaeological Sites	Sites	2,141	1,332	0	3,473
Museum Collection Items (Objects, Not Including Fine Art)	Each	135,329	581	588	135,322
Museum Collection Items (Fine Art)	Each	15,044	25	6	15,063

Heritage assets consist of buildings, structures, and linear structures, archeological sites, and museum collections. Heritage assets have characteristics of natural, cultural, educational, architectural, or artistic significance. The Air Force defines these as follows:

- Buildings, structures, and linear structures are listed, or eligible for listing, on the National Register of Historic Places, including multi-use heritage assets.
- Archeological Sites are listed, or eligible for listing, on the National Register of Historic Places in accordance with Section 110 of the National Historic Preservation Act.
- Museum Collection Items are considered unique due to historical, natural, cultural, educational, artistic, technical, or architectural significance.

Air Force has become a large-scale owner of historic buildings, structures, archeological sites and artifacts, aircraft, and other cultural resources. The Air Force's policy is to preserve its heritage assets including items of historical, cultural, educational, or artistic importance. The Air Force, with minor exceptions, uses the buildings and structures in its daily activities and includes the buildings and structures on the Balance Sheet as multi-use heritage assets.

The Air Force is unable to identify quantities of heritage assets added through donation or devise due to limitations of the Air Force's financial and non-financial management processes and systems.

Buildings, Structures, and Linear Structures

Buildings, structures, and linear structures that are listed on, or eligible for listing on the National Register of Historic Places (NRHP), including multi-use facilities, are Heritage Assets. Each base's civil engineering group, as part of their overall responsibility, maintains these facilities in accordance with the *National Historic Preservation Act* (NHPA), and *The Secretary of Interior's Standards for The Treatment of Historic Properties*. The Air Force reported 6,440 buildings and structures on Air Force installations to be Heritage Assets as of September 30, 2018. The number of buildings, structures, and linear structures considered Heritage Assets as of September 30, 2019 is 6,773, an increase of 333 historic facilities. The total reflects an increase in National Register eligibility evaluations in FY 2019, and more rapid Historic Status Code changes by Base Real Property Officers and Cultural Resources Managers due to current Real Property Inventory reviews.

Heritage Asset buildings, structures, and linear structures are maintained by each base civil engineering group. These facilities are subject to NHPA Section 106 review and consultation requirements whenever Air Force undertakings might affect their historic characteristics. Section 106 reviews ensure State Historic Preservation Officers, tribal leaders, local leaders and preservation groups, and other party's concerns are taken into account when the Air Force decides to adversely affect Heritage Asset buildings, structures, and linear structures. Hundreds of Section 106 (now moved from Title 16 USC to Title 54 USC, Section 306108) reviews are in effect at any given time; many take more than a year to complete. Many are part of *National Environmental Policy Act* reviews, called the Environmental Impact Analysis Process (EIAP) in the Air Force.

Archaeological Sites

Prehistoric and historic archaeological sites considered Heritage Assets are 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 NHPA Section 110 and 36 Code of Federal Regulations (CFR) Part 60.4. The Air Force reported 2,141 archeological sites as Heritage Assets as of September 30, 2018. The number increased by 1,332, to 3,473 as of September 30, 2019. This cohort of archaeological Heritage Assets is a subset of nearly 24,000 archaeological sites recorded on Air Force controlled and owned lands in the U.S. and its Territories.

Museum Collection Items, Objects

This represents the number of objects which meet the criteria for historical property as defined in Air Force Instruction 84-103 and that have been evaluated, accessioned, and catalogued in the Air Force national historical collection. The National Museum of the United States Air Force (NMUSAF) performs inherently governmental functions by fulfilling statutory requirements delegated by the Secretary of the Air Force for management of the Air Force's national historic collection. The NMUSAF is fully accredited by the American Alliance of Museums.

During the period of October 1, 2018 through September 30, 2019 there have been 581 objects added to the collection which had 135,329 objects as of September 30, 2018. These additions are a result of private donations, transfers from the Air Force or other federal entities, curatorial administrative actions such as class code changes, accession breakouts, etc. and the continued documentation of newly reported artifacts at Air Force activities worldwide. 588 objects were deaccessioned from the collection as having been determined not to meet historic property criteria, were in poor condition, or were transferred to other federal historical activities resulting in a collection of 135,322 objects as of September 30, 2019. As part of the NMUSAF's active collection management process, the accession and deaccession of objects is continuous.

The historical collection, which is primarily located at the NMUSAF, is maintained through professional care from trained conservators and ever improving exhibit/storage conditions. During FY 2019 along with continued preventive maintenance on the aircraft collection, the World War II Gallery was re-populated following the opening of the Memphis Belle exhibit.

Museum Collection Items, Fine Art

In addition to its artifact collection, the NMUSAF holds a fine art collection separate from the Air Force Art Program Collection (SAF/AFAPO) totaling 989 items as of September 30, 2018. During the period, the NMUSAF recorded 2 additions and 6 deletions from the program resulting in 985 items as of September 30, 2019. Containing original oils, drawings, sketches and sculptures these fine art holdings are in direct support of NMUSAF exhibit requirements.

An additional art collection held by the Air Force Art Program also contains original oils, drawing, sketches and sculptures. As of September 30, 2018, those items totaled 14,055. These paintings were a direct result of the artists visiting bases and operations throughout the Air Force. The Air Force Art Program saw an increase of 23 pieces based upon those visits resulting in 14,078 items as of September 30, 2019.

The NMUSAF and Air Force Fine Arts Program combined held a total of 15,044 and 15,063 pieces of art as of September 30, 2018 and September 30, 2019, respectively.

General PP&E Land and Stewardship Land

GENERAL PP&E LAND AND STEWARDSHIP LAND For Year Ended September 30, 2019 (Acres in Thousands)					
Facility Code	Facility Title	As of 9/30/18	Additions	Deletions	As of 9/30/19
9110	Government Owned Land	1,573	75	0	1,648
9111	State Owned Land	0	0	0	0
9120	Withdrawn Public land	5,620	0	73	5,547
9130	Licensed and Permitted Land	746	0	1	745
9140	Public Land	0	0	0	0
9210	Land Easement	157	0	0	157
9220	In-leased Land	102	0	0	102
9230	Foreign Land	297	0	0	297
Total		8,495	75	74	8,496

The table above presents combined acreage amounts for both General PP&E Land and Stewardship Land. The Air Force is currently not able to accurately categorize land between General PP&E Land and Stewardship Land. Efforts are ongoing to derive separate land acreage amounts to report in each of these categories. In addition to the appropriate categorization of land between General PP&E Land and Stewardship Land, the Air Force has ongoing efforts to validate land acreage amounts for both of these categories.

General PP&E Land is land and land rights (such as easements) acquired for or in combination with General PP&E, and land acquired with the intent to construct General PP&E. In FY 2018 the Air Force applied the "deemed cost" alternative valuation method to the opening balance of General PP&E Land, in accordance with SFFAS 50, and wrote-off its recorded General PP&E Land value. The Air Force reported $0.0 opening balance for General PP&E Land in FY 2019 and will expense General PP&E Land acquisitions in future periods. The resulting FY 2018 adjustments to the respective beginning balances constitute a Change in Accounting Principle as defined in SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles*.

Stewardship Land represents land rights owned by the Federal Government, but not acquired for, or in combination with, items of General PP&E. All Air Force Stewardship Land is in acceptable condition, based on designated use. The Air Force is unable to identify quantities of Stewardship Land added through donation or devise due to limitations of the Air Force's financial and non-financial management processes and systems.

Note 10 Other Assets

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Intragovernmental Other Assets		
Advances and Prepayments	$ 220,320	$ 123,059
Total Intragovernmental Other Assets	$ 220,320	$ 123,059
Non-Federal Other Assets		
Outstanding Contract Financing Payments	$ 16,718,818	$ 23,417,983
Advances and Prepayments	17,825	4,185
Total Non-Federal Other Assets	$ 16,736,643	$ 23,422,168
Total Other Assets	$ 16,956,963	$ 23,545,227

Outstanding Contract Financing Payments (OCFP), a separate classification of advances and prepayments, includes $16.7 billion in Fiscal Year (FY) 2019 in contract financing payments made in contemplation of the future performance of services, receipt of goods, incurrence of expenditures or receipt of other assets. In comparison, FY 2018 OCFP included $20.0 billion in contract financing payments and an additional $3.4 billion in payments of estimated future amounts due to contractors upon delivery and acceptance. This additional Contract Financing Payment asset is related to the FY 2018 Contingent Liabilities reported in Note 15, *Other Liabilities*.

Advances and Prepayments are made in contemplation of the future performance of services, receipt of goods, incurrence of expenditures, or receipt of other assets, excluding those made as OCFP.

As discussed in Note 8, *Operating Materials & Supplies, Net*, and Note 9, *General PP&E, Net*, transaction codes used by the Air Force's accounting system were not designed to identify and account for contract financing payments at the level required to accurately determine the United States Standard General Ledger posting to the proper work in process type asset account. Until system modifications are made, contract financing payments disclosed above are overstated and work in process type assets are understated.

Note 11 Liabilities Not Covered by Budgetary Resources

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Intragovernmental Liabilities		
Federal Employees' Compensation Act	$ 183,258	$ 189,951
Other	271,310	33,971
Total Intragovernmental Liabilities	$ 454,568	$ 223,922
Non-Federal Liabilities		
Accounts Payable	$ 342,310	$ 244,613
Military Retirement and Other Federal Employment Benefits	1,021,517	1,005,921
Environmental and Disposal Liabilities	12,680,772	11,457,633
Other Liabilities	2,892,768	3,150,139
Total Non-Federal Liabilities	$ 16,937,367	$ 15,858,306
Total Liabilities Not Covered by Budgetary Resources	$ 17,391,935	$ 16,082,228
Total Liabilities Covered by Budgetary Resources	$ 17,029,423	$ 15,342,835
Total Liabilities	$ 34,421,358	$ 31,425,063

The material amounts and sensitive areas included in Total Liabilities Not Covered by Budgetary Resources are categorized as not covered because there is no current or immediate appropriation available for liquidation. These liabilities will require resources funded from future year appropriations.

Other Intragovernmental Liabilities are primarily comprised of unfunded employment related liabilities.

Accounts Payable primarily represents liabilities in cancelled appropriations, which if paid, will be disbursed using current year funds.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current Fiscal Year (FY). These liabilities primarily consist of the amount recorded by employer agencies for the actuarial present value of future *Federal Employees' Compensation Act* (FECA) benefits provided to federal employees or their beneficiaries as a result of work-related deaths, disability, or occupational disease. Refer to Note 13, *Military Retirement and Other Federal Employment Benefits*, for additional details and disclosures.

For additional details and disclosures related to Environmental and Disposal Liabilities, refer to Note 14, *Environmental and Disposal Liabilities*.

Other Non-Federal Liabilities are primarily comprised of the amounts recorded for unpaid leave earned to which an employee is entitled upon separation and for contingent liabilities, which are probable and measurable and will require resources funded from future year appropriations. During the compilation of the FY 2018 4th quarter financial statements, it was identified that the Air Force Working Capital Fund (AFWCF) civilian accrued leave liability was erroneously included in the Air Force General Fund's Defense Civilian Pay System (DCPS) report and reported in the Air Force General Fund's civilian accrued leave liability as of September 30, 2018. Beginning in FY 2019, the DCPS report breaks-out the AFWCF's civilian accrued leave liability from the Air Force General Fund's accrued leave liability and the AFWCF accrued leave liability is reported by the AFWCF.

Note 12 Debt

The Military Housing Privatization Initiative (MHPI) borrowed funds for the final direct loan distribution to Northern Group, which includes installations in Idaho, New Mexico, North Dakota, and South Dakota. The debt is established when MHPI borrows funds from the United States (U.S.) Treasury to provide loans to the private sector for the acquisition, construction, and rehabilitation of suitable housing for military families. When the private sector repays the loans, MHPI returns the funds to the U.S. Treasury.

See Note 7, *Direct Loan and Loan Guarantees, Non-Federal Borrowers*, and Note 25, *Public-Private Partnerships*, for additional information on activities related to the MHPI.

Note 13 Military Retirement and Other Federal Employment Benefits

As of September 30	2019 (Unaudited)		
	Liabilities	(Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in Thousands)			
Other Benefits			
Federal Employees' Compensation Act	$ 1,021,517	$ 0	$ 1,021,517
Other	2,292	(2,292)	0
Total Other Benefits	$ 1,023,809	$ (2,292)	$ 1,021,517
Total Military Retirement and Other Federal Employment Benefits	$ 1,023,809	$ (2,292)	$ 1,021,517

As of September 30	2018 (Unaudited)		
	Liabilities	(Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in Thousands)			
Other Benefits			
Federal Employees' Compensation Act	$ 1,005,921	$ 0	$ 1,005,921
Other	7,249	(7,249)	0
Total Other Benefits	$ 1,013,170	$ (7,249)	$ 1,005,921
Total Military Retirement and Other Federal Employment Benefits	$ 1,013,170	$ (7,249)	$ 1,005,921

Federal Employees' Compensation Act

The Air Force reports an actuarial liability for the *Federal Employees' Compensation Act* (FECA). The FECA provides federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for a total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. The FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. The actuarial liability for FECA is not covered by budgetary resources.

Actuarial Cost Method Used and Assumptions

The Air Force's actuarial liability for workers' compensation benefits is developed and provided by the Department of Labor (DOL) at the end of each Fiscal Year (FY). The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases; plus a component for incurred, but not reported claims.

The DOL calculates the future workers' compensation liability using wage inflation factors [e.g., Cost of Living Adjustment (COLA)] and medical inflation factors [e.g., Consumer Price Index Medical (CPIM)], which were applied to the calculation of projected future benefits. The actual rates for these factors for the Charge-Back Year (CBY) 2019 were also used to adjust the methodology's historical payments to current-year constant dollars.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the United States (U.S.) Treasury's Yield Curve for Treasury Nominal Coupon Issues to reflect the average duration of income payments and medical payments. Interest rate assumptions utilized for discounting were as follows:

Discount Rates
For wage benefits:
2.610% in Year 1 and Years thereafter;
For medical benefits:
2.350% in Year 1 and Years thereafter.

The compensation COLAs and CPIMs used in the projections for various CBYs were as follows:

CBY	COLA	CPIM
2019	N/A	N/A
2020	1.47%	2.86%
2021	1.85%	3.05%
2022	2.12%	3.09%
2023	2.17%	3.47%
2024 and thereafter	2.21%	3.88%

The model's resulting projections were analyzed to ensure that the estimates were reliable. Analysis was based on four tests: 1) a sensitivity analysis of the model to economic assumptions, 2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, 3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2019 to the average pattern observed during the most current three charge-back years, and 4) a comparison of the estimated liability per case in Fiscal Year 2020 projection to the average pattern for the projections of the most recent three years.

Other

The Other Federal Employment Benefits liability category under Other Benefits represents other post-employment benefits, which can include salary continuation, severance benefits, counseling, training, funded unemployment liability for federal employees, funded FECA liability, and the current portion of veterans' disability compensation benefits. This is not an actuarial liability. The Other Federal Employment Benefits liability is covered by budgetary resources.

Note 14 Environmental and Disposal Liabilities

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Environmental Liabilities—Non-Federal		
Accrued Environmental Restoration Liabilities		
Active Installations—Installation Restoration Program and Building Demolition and Debris Removal	$ 7,459,455	$ 7,343,776
Active Installations—Military Munitions Response Program	310,645	320,798
Other Accrued Environmental Liabilities—Non-BRAC		
Environmental Corrective Action	986,461	979,209
Environmental Closure Requirements	319,302	362,545
Asbestos	1,132,514	1,031,740
Base Realignment and Closure Installations		
Installation Restoration Program	2,542,839	2,201,726
Military Munitions Response Program	13,937	8,540
Environmental Corrective Action / Closure Requirements	0	696
Asbestos	595	570
Environmental Disposal for Military Equipment / Weapons Programs		
Non-Nuclear Powered Military Equipment	767,379	126,094
Total Environmental and Disposal Liabilities	$ 13,533,127	$ 12,375,694

An environmental liability is a probable and reasonably estimable future outflow or expenditure of resources that exists as of the financial reporting date for environmental cleanup costs resulting from past transactions or events. The Air Force is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other past activity, which has created a public human health or environmental risk.

Applicable Laws and Regulations of Cleanup, Closure, and/or Disposal Requirements

The following laws and regulations affect the activities for cleanup, closure, and/or disposal requirements:

- *Comprehensive Environmental Response, Compensation, and Liability Act* (CERCLA)
- *Superfund Amendments and Reauthorization Act*
- *Clean Water Act*
- *Safe Drinking Water Act*
- *Clean Air Act*
- *Resource Conservation and Recovery Act* (RCRA)
- *Toxic Substances Control Act*
- *Atomic Energy Act*
- *Nuclear Waste Policy Act*
- *Low Level Radioactive Waste Policy Amendments Act*

Types of Environmental Liabilities and Disposal Liabilities Identified

The Air Force does not report environmental liabilities for cases in which another Department of Defense (DoD) entity serves as the DoD lead Agent or executive Agent. The following DoD entities serve as the DoD lead or executive agent and are responsible for identifying funding requirements as well as disclosing financial information regarding the progress of programs: the United States Army Corps of Engineers is the lead agent for Formerly Used Defense Sites at active installations, Department of the Navy is the lead agent for nuclear-powered general equipment and spent nuclear fuel, and Department of the Army is the executive agent for the Chemical Weapons Disposal Program.

The Air Force has cleanup requirements for the Defense Environmental Restoration Program (DERP) sites at active installations and Base Realignment and Closure (BRAC) installations. The Air Force has additional cleanup requirements for active installations not covered by DERP and weapon systems programs. All cleanup efforts are performed in coordination with regulatory agencies, other responsible parties, and current property owners. If fully remediated within the current Fiscal Year (FY), environmental conditions that result from current operations and require immediate cleanup (e.g., de minimis spills or routine hazardous waste removal) are not considered environmental liabilities and are part of current operating expenses.

Accrued Environmental Restoration Liabilities

The Air Force has environmental liabilities associated with remedial actions eligible for DERP funding. The Air Force has environmental liabilities associated with the Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR) category. These remedial actions may address CERCLA (e.g., hazardous substances, pollutants, and contaminants), RCRA (e.g., hazardous waste or hazardous constituents), military munitions (e.g., Unexploded Ordnance (UXO) or Waste Military Munitions (WMM)), or demolition and removal of unsafe buildings and structures at facilities or sites. Cleanup costs ineligible for DERP funding are reported as Other Accrued Environmental Liabilities – Non-BRAC (OEL).

The Air Force also has environmental liabilities associated with the Military Munitions Response Program (MMRP) category defined as response actions (e.g., the identification, investigation, and removal actions, remedial actions, or a combination of removal and remedial actions) to address military munitions (e.g., UXO or WMM) or the chemical residues of munitions at locations other than operational ranges. As of September 30, 2019, the Air Force has 6,930 IRP and BD/DR sites and 1,022 MMRP sites across 136 active installations funded by DERP. As of September 30, 2019, the Air Force estimated and reported $7,770.1 million for Accrued Environmental Restoration Liabilities. This amount includes $7,459.5 million in Active Installations – IRP and BD/DR and $310.6 million in Active Installations – MMRP.

Other Accrued Environmental Liabilities – Non-BRAC

As of September 30, 2019, the Air Force reported liabilities of $986.5 million for Environmental Corrective Action (ECA), $319.3 million for Environmental Closure Requirements (ECR), and $1,132.5 million for asbestos. The Air Force has costs to remediate cleanup sites that are not eligible for funding to include Air National Guard (ANG) sites. Based on a change in policy application, ANG sites previously included under the ERA portion of the environmental liabilities are now included in the ECA and environmental liabilities associated with Environmental Response at Operational Ranges (EROR) for Munitions Constituents (MCs) migrating off an operational range.

Base Realignment and Closure Installations

The Air Force BRAC environmental cleanup cost estimate is based on 835 IRP and 24 MMRP sites across 40 BRAC installations. As of September 30, 2019, the Air Force estimated and reported $2,557.3 million for BRAC installations. This amount is comprised of $2,542.8 million in IRP liabilities, $13.9 million in MMRP liabilities, $0.0 in Environmental Corrective Action/Closure Requirements, and $0.6 million in asbestos liabilities.

Environmental Disposal for General Equipment / Weapons Programs

The Air Force reported liabilities for the environmental disposal of fixed-wing aircraft, helicopters, Intercontinental Ballistic Missiles (ICBMs), and Mine-Resistant Ambush Protected (MRAP) vehicles totaling $767.4 million, as of September 30, 2019. As of FY 2019, the Air Force did not record an environmental disposal liability for remotely piloted and vertical take-off and landing aircraft, as well as aircraft pods, due to a lack of actual historical cost data or reliable cost models to estimate the liabilities. The Air Force will report liabilities associated with these assets in future periods as historical data is obtained and cost models are refined. The Air Force determined that no future outflows of cash exist for the environmental disposal of satellites, as all satellites and their components are destroyed before reentry into the Earth's atmosphere, thus no liability was reported in either FY 2018 or FY 2019.

Methods for Assigning Total Cleanup, Closure, and/or Disposal Costs to Current Operating Periods

Accrued Environmental Restoration Liabilities

Active Installations – IRP and BD/DR and Active Installations – MMRP:

The Air Force uses one or more of the following methods to estimate the Cost-to-Complete (CTC) cleanup and disposal activities: pre-negotiated contract costs, historical costs, engineering estimates, parametric estimates, and cost estimation software (e.g., Remedial Action Cost Engineering and Requirements (RACER)). CTC estimates consider, on a current cost basis, all activities performed for the full duration of IRP and BD/DR, and MMRP, inclusive of program management costs. In addition to pre-set values included in the RACER software, the Air Force can add User Defined Costs (UDCs) to customize and refine estimates within RACER. For projects with an undefined duration, the Air Force uses a rolling 30-year period. These environmental liabilities are not associated with an asset having a useful life, thus the total estimated cleanup cost is recognized upon identification of the liability.

Other Accrued Environmental Liabilities – Non-BRAC

Environmental Corrective Actions:

The Air Force uses one or more of the following methods to estimate CTCs: pre-negotiated contract costs, historical costs, engineering estimates, parametric estimates, and cost estimation software (e.g., RACER). CTC estimates consider, on a current cost basis, all activities to be performed for the full duration of Environmental Corrective Action (ECA), inclusive of program management costs. In addition to pre-set values included in the RACER software, the Air Force can add UDCs to customize and refine estimates within RACER. For projects with an undefined duration, the Air Force uses a rolling 30-year period. These environmental liabilities are not associated with an asset having a useful life, thus the total estimated cleanup cost is recognized upon identification of the liability.

Environmental Closure Requirements:

Business rules are applied to data from the accountable property system of record (APSR) (e.g., Automated Civil Engineer System – Real Property (ACES-RP) and Next Generation Information Technology (NexGEN IT)) to isolate the assets with Environmental Closure Requirements (ECR). The Air Force uses one or more of the following approaches to generate estimates for assets with ECR: cost estimating software (e.g., RACER), historical costs, and engineering estimates. Estimates leverage industry-standard cost factors or comparable historical projects, bids, and expenditures. In addition to pre-set values included in the RACER software, the Air Force can add UDCs to customize and refine estimates within RACER. However, reliable information required to calculate a cleanup cost is not available for all ECR assets identified, and thus the reported balance reflects the ECR assets that are probable and reasonably estimable given the data available, as of September 30, 2019.

Asbestos:

Business rules are applied to data from the APSR to isolate the Potentially Asbestos Containing (PAC) asset population. Two separate cost estimation methodologies are used to generate liabilities for PAC building assets: 1) a power equation to estimate survey costs; and 2) look-up tables to estimate abatement costs based on building size, age, and type.

The PAC asset population consists of both friable (immediate health threat) and non-friable (not an immediate health threat) asbestos assets with a probable cleanup cost. However, reliable information required to calculate a cleanup cost is not available for all PAC assets identified, and thus the reported balance reflects the PAC assets that are probable and reasonably estimable given the data available, as of September 30, 2019.

Base Realignment and Closure Installations

IRP, MMRP, Environmental Corrective Action / Closure Requirements and Asbestos

The Air Force uses one or more of the following methods to produce CTC estimates: pre-negotiated contract costs, historical costs, engineering estimates, parametric estimates, and cost estimation software (e.g., RACER). CTC estimates consider, on a current cost basis, all activities performed for the full duration of IRP and MMRP, inclusive of program management costs. For projects with an undefined duration, the Air Force uses a rolling 30-year period. The total estimated cleanup cost for BRAC IRP, MMRP, and asbestos is recognized upon identification of the liability. No costs are recognized through the accretion method (see the "Unrecognized Portion of Estimated Total Cleanup Cost Associated with General Property, Plant and Equipment" section below).

Uncertainty Regarding Accounting Estimates Used to Calculate the Reported Environmental Liabilities

The Air Force has unrecognized portions of the estimated total closure and post-closure liabilities as of September 30, 2019, as detailed below.

The environmental liabilities for the Air Force 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 vary materially from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. The liabilities can be further impacted if further investigation of the environmental sites disclose contamination different than what is known at the time of the estimates.

Title 40 Code of Federal Regulations, *Environmental Protection Agency* (EPA), §266.202 (the EPA Regulation) exempts military munitions on active and inactive military ranges from the definition of hazardous waste. The EPA Regulation effectively excludes military munitions on an active military range from the definition of solid waste until a formal decision to close the range occurs or MCs migrate off the military range. Therefore, these military munitions do not meet the criteria of an environmental liability. Although the Air Force has an on-going program to assess potential off-range migration of MCs, as of September 30, 2019, the Air Force has not identified off-range migration that is probable and measurable, therefore a liability has not been recorded.

For ECR, the Air Force has identified assets within the non-hazardous waste landfills and wastewater lagoons/ponds categories that are probable, but not measurable, as of September 30, 2019, therefore a liability has not been recorded for closure and post-closure costs associated with these assets.

Material Changes in Total Estimated Cleanup Costs Due to Changes in Laws, Technology or Plans, and the Portion of the Change in Estimates that Relates to Prior Period Operations

Estimated environmental liabilities are adjusted each year for price growth (inflation) and increases in labor rates and materials. As of September 30, 2019, there are no changes to the environmental liability estimates due to deflation, changes in laws, regulations, agreements with regulatory agencies, and advances in technology. The Air Force is not aware of any pending changes, but the liability can change in the future due to changes in laws, regulations, changes in agreements with regulatory agencies, and advances in technology.

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

For Accrued Environmental Restoration Liabilities (OEL – ECA, OEL – asbestos), the Air Force applied inflation factors to bring historical costs forward to current-year dollars, in accordance with Air Force Manual 65-502, Inflation, (October 30, 2018). The Air Force utilizes inflation factors from the Air Force raw inflation indices which are based on the Office of the Secretary of Defense raw inflation rates for Operations and Maintenance.

The Air Force applied an inflation factor to BRAC historical cost estimates to bring costs forward to current-year dollars, in accordance with the Office of the Under Secretary of Defense (Comptroller) (memorandum, Inflation Guidance - FY 2020 President's Budget, (January 4, 2019) for Military Construction.

There is also uncertainty regarding recorded cost estimates for the emerging contaminants (Perfluorooctane Sulfonic Acid (PFOS) and Perfluorooctanoic Acid (PFOA)), at some installations due to the lack of promulgated cleanup standards and limited information. As of September 30, 2019, the Air Force has ongoing actions to investigate, assess, and mitigate contamination. As additional results are obtained and more details are known, these activities will provide a basis for estimating increases to future liability estimates over the next several years.

Unrecognized Portion of Estimated Total Cleanup Cost Associated with General Property, Plant and Equipment

For those General Property, Plant and Equipment assets for which the Air Force has calculated an estimated environmental liability, the Air Force records the entire liability rather than accrediting these costs over the life expectancy of the asset or the physical capacity, in the case of operating landfills. As a result, there is no unrecognized portion of the estimated total closure and post-closure liabilities for these General PP&E assets. The Air Force has evaluated that there are no such liabilities requiring use of the accretion method that would be materially significant to the overall environmental liability.

The Air Force has an unrecognized portion of the estimated total cleanup cost associated with general equipment/ weapons programs (fixed-wing aircraft, helicopters, and MRAPs). The Air Force has an unrecorded liability for remaining general equipment/weapons programs asset categories (remotely-piloted aircraft, vertical take-off and landing aircraft, and aircraft pods) where there is a lack of reliable information to calculate an estimated environmental liability. The liabilities reported for general equipment/weapons programs may change as more data becomes available and cost estimation methodologies are fully developed, executed, and refined.

The Air Force has an unrecorded liability for the remaining ECR asset categories and asbestos assets for which there is a lack of reliable information to calculate an estimated environmental liability. Specifically, the Air Force has not reported a liability associated with the following ECR asset categories: hazardous waste storage facilities, pipelines and piping, underground Oil Water Separators (OWSs), aboveground OWSs, wastewater treatment tanks and basins, solid waste incinerators, and water supply wells. Additionally, the Air Force has not reported a liability for non-building assets with asbestos on active installations. Therefore, the liabilities reported for ECR and asbestos may change as more data becomes available and cost estimation methodologies are fully developed, executed, and refined.

Other Disclosures

Year-over-year Changes

APSR data remains a significant driving factor behind year-over-year changes in environmental liabilities. As Corrective Action Plans (CAPs) related to the completeness and accuracy of real property inventory data continue to be implemented, the population of real property is subject to change. ECR and asbestos balances are dependent on movements and changes in APSR data.

Accrued Environmental Restoration Liabilities

The total Air Force Accrued Environmental Restoration Liabilities increased by 1.4% from FY 2018 to FY 2019. There were no significant year-over-year changes noted.

Other Accrued Environmental Liabilities – Non-BRAC (OEL)

The total Air Force OEL increased by 2.7% from FY 2018 to FY 2019, due to partial implementation of CAPs, which improved the process to develop supportable estimates for these environmental liability categories. These processes will continue to evolve over time and could result in future changes to these recorded estimates.

Environmental Corrective Action:

The Air Force reported an estimated environmental liability for ECA of $986.5 million in FY 2019. This was an increase of $7.3 million from FY 2018 to FY 2019. There were no significant year-over-year changes noted.

Environmental Closure Requirements:

The Air Force reported an estimated environmental liability for ECR assets of $319.3 million in FY 2019. This was a net decrease of $43.2 million from FY 2018 to FY 2019. In FY 2019, environmental liabilities were reported for one additional asset category (polychlorinated biphenyl transformers). In FY 2019, revisions to cost estimation methodologies, including updated cost factors, historical costs, and closure assumptions (e.g., reduced the number of samples required per Underground Storage Tank (UST)/Aboveground Storage Tank (AST)) contributed to the decrease.

Asbestos:

The Air Force reported an estimated environmental liability for asbestos of $1.13 billion in FY 2019. This was an increase of $100.8 million from FY 2018 to FY 2019. Key drivers to this fluctuation were changes in the real property inventory, revisions to the cost estimation methodology (e.g., refinement of exclusion criteria to identify asset populations), and the inflation factors applied to historical costs used to generate liability estimates.

BRAC Installations

The total Air Force BRAC environmental liabilities increased by 15.6% from FY 2018 to FY 2019.

BRAC IRP:

This line item increased by $341.1 million from FY 2018 to FY 2019. Of the $341.1 million increase, $229.0 million is due to PFOS and PFOA to account for new response actions to address drinking water at Reese Air Force Base (AFB) and follow-on requirements after the results of site inspections at four installations. The second largest contributor is $96.1 million for program management mainly attributed to Defense State Memorandum of Agreement due to additional remedial actions executed in order to address emerging contaminants (PFOS/PFOA), and secondly due to the San Antonio, Texas locality pay table being slightly higher than general United States pay scales. Additionally, $16.0 million is attributed to new requirements mainly at McClellan AFB due to an extent of contamination greater than anticipated requiring additional remediation activities and the discovery of new contamination.

BRAC MMRP:

This line item increased by $5.4 million from FY 2018 to FY 2019. This increase is due to the following: additional cleanup activities at two MMRP sites at the former Eaker AFB, and new requirements for former George AFB after discovering munitions burial mounds outside the original MMRP site boundary.

BRAC Environmental Corrective Action / Closure Requirements:

This line item decreased by $0.7 million from FY 2018 to FY 2019 due to fully liquidating the following projects: requirements at the former George AFB to remove a previously unknown OWS and UST; soil removal at the former March AFB; removal of an UST at the former Mather AFB; and lead-based paint soil removal at former Williams AFB.

BRAC Asbestos:

This line item increased by $25.0 thousand from FY 2018 to FY 2019, due to additional requirements for asbestos abatement at former Chanute AFB.

Environmental Disposal for General Equipment / Weapons Programs

Non-Nuclear Powered General Equipment:

The Environmental Disposal Liability for general equipment/weapons programs, non-nuclear powered general equipment increased from $126.1 million in FY 2018 to $767.4 million in FY 2019. This was due to an increase of environmental liabilities for general equipment assets not previously included in FY 2018. The Environmental Disposal Liability for fixed-wing aircrafts and helicopters increased from $126.1 million to $257.4 million due to the availability of helicopter historical cost data and an increase in published labor rates. The Environmental Disposal Liability for MRAPs increased from $0.0 to $1.8 million due to availability of historical cost data. The Environmental Disposal Liability for ICBMs increased from $0.0 to $508.2 million due to availability of historical cost data.

Ongoing Corrective Action Impacts

Due to ongoing implementation of CAPs across the OEL program, updates to the estimated liabilities associated with OEL sub-line items are expected to continue through FY 2024. Until full implementation of these programmatic changes is complete, balances will reflect only a portion of the liabilities at year end. The Air Force understands that additional assets on active installations with ECR and asbestos liabilities exist but are not yet reported due to ongoing implementation of corrective actions. These corrective actions are focused on assessing the remaining ECR and asbestos assets. There are seven remaining asset categories with ECR: hazardous waste storage facilities, pipelines and piping, underground OWSs, aboveground OWSs, wastewater treatment tanks and basins, solid waste incinerators, and water supply wells. Corrective actions are ongoing to assess non-building PAC assets. To help mitigate significant financial statement impacts of asset related environmental liabilities not yet estimated, the Air Force focused its efforts to identify and estimate environmental liabilities for assets with the most significant and material impact to ECR and asbestos liabilities using subject matter experts and current real property inventories to make these determinations.

While business rules have been developed governing the use of RACER for estimating Accrued Environmental Restoration Liabilities, ECA, and ECR, the Air Force is developing a process in FY 2020 to compare estimated environmental liabilities to subsequent actual expenditures which will support the validity of RACER-derived estimates and drive refinements to the estimation methodology, as appropriate.

Emerging Contaminants

Emerging contaminants are newly identified contaminants that require future cleanup. Recently, PFOS/PFOA was identified. Perfluorinated compounds, or PFCs, are a group of manmade chemicals used for a wide variety of residential, commercial and industrial purposes including: nonstick cookware, stain-resistant fabric and carpet, some food packaging and firefighting foam. In 2016, the EPA established health advisory levels in drinking water for two types of PFCs - PFOS and PFOA, which are components of legacy Aqueous Film Forming Foam (AFFF) that the Air Force began using in the 1970s as a firefighting agent to extinguish petroleum fires. PFOS and PFOA are classified as emerging contaminants because they do not have established regulatory standards, but evolving science has identified potential risk to humans and regulatory standards are under consideration. As the Air Force continues to investigate and the EPA continues to refine standards, estimates may increase. The Air Force's investigation work and mitigation actions are guided by the CERCLA, applicable state laws, and the EPA's lifetime drinking water health advisory of 70 parts per trillion. Other emerging contaminants could be identified in the future and would follow a similar process.

Note 15 Other Liabilities

As of September 30	2019 (Unaudited)		
	Current Liability	Non-Current Liability	Total
(Amounts in Thousands)			
Intragovernmental			
Advances from Others	$ 1,305,181	$ 0	$ 1,305,181
Deposit Funds and Suspense Account Liabilities	(24,634)	0	(24,634)
Disbursing Officer Cash	151,219	0	151,219
Judgment Fund Liabilities	263,747	0	263,747
Federal Employees' Compensation Act Reimbursement to the Department of Labor	81,522	101,736	183,258
Custodial Liabilities	0	599	599
Employer Contribution and Payroll Taxes Payable	93,078	0	93,078
Other Liabilities	7,574	0	7,574
Total Intragovernmental Other Liabilities	$ 1,877,687	$ 102,335	$ 1,980,022
Non-Federal			
Accrued Funded Payroll and Benefits	$ 2,530,188	$ 0	$ 2,530,188
Advances from Others	236,799	0	236,799
Deposit Funds and Suspense Accounts	383,755	0	383,755
Accrued Unfunded Annual Leave	2,591,488	0	2,591,488
Contract Holdbacks	622,986	0	622,986
Employer Contribution and Payroll Taxes Payable	64,365	0	64,365
Contingent Liabilities	0	301,267	301,267
Other Liabilities	562	0	562
Total Non-Federal Other Liabilities	$ 6,430,143	$ 301,267	$ 6,731,410
Total Other Liabilities	$ 8,307,830	$ 403,602	$ 8,711,432

As of September 30	2018 (Unaudited)		
	Current Liability	Non-Current Liability	Total
(Amounts in Thousands)			
Intragovernmental			
Advances from Others	$ 1,124,045	$ 0	$ 1,124,045
Deposit Funds and Suspense Account Liabilities	(222,467)	0	(222,467)
Disbursing Officer Cash	91,601	0	91,601
Judgment Fund Liabilities	21,013	0	21,013
Federal Employees' Compensation Act Reimbursement to the Department of Labor	84,713	105,238	189,951
Custodial Liabilities	0	1,335	1,335
Employer Contribution and Payroll Taxes Payable	83,560	0	83,560
Other Liabilities	12,982	0	12,982
Total Intragovernmental Other Liabilities	$ 1,195,447	$ 106,573	$ 1,302,020
Non-Federal			
Accrued Funded Payroll and Benefits	$ 2,300,205	$ 0	$ 2,300,205
Advances from Others	221,970	0	221,970
Deposit Funds and Suspense Accounts	542,522	0	542,522
Accrued Unfunded Annual Leave	2,652,571	0	2,652,571
Contract Holdbacks	112,746	0	112,746
Employer Contribution and Payroll Taxes Payable	244,358	0	244,358
Contingent Liabilities	0	3,867,169	3,867,169
Other Liabilities	12	0	12
Total Non-Federal Other Liabilities	$ 6,074,384	$ 3,867,169	$ 9,941,553
Total Other Liabilities	$ 7,269,831	$ 3,973,742	$ 11,243,573

Advances from Others represent liabilities for collections received to cover future expenses or acquisition of assets.

Deposit Funds and Suspense Accounts represent liabilities for receipts held in suspense temporarily for distribution to another fund or entity; or, held as an agent for others and paid at the direction of the owner.

The abnormal balance in Intragovernmental Deposit Funds and Suspense Accounts Liabilities of $24.6 million for Fiscal Year (FY) 2019 and $222.5 million for FY 2018 is due to a process change beginning in the 4th Quarter of FY 2016. At that time, the Air Force began moving various withholding and collection amounts from suspense clearing accounts to deposit fund accounts. The abnormal balances will be fully remediated once this process change is complete. The current and prior year abnormal balances are offset by the normal balances in the Non-Federal Deposit Funds and Suspense Accounts.

Disbursing Officer Cash represents liabilities for currency on hand, cash on deposit at designated depositories, cash in the hands of deputy disbursing officers, cashiers and agents, negotiable instruments on hand, and similar amounts. Disbursing Officer Cash is non-entity, restricted cash.

For information on Judgment Fund Liabilities, see Note 17, *Commitments and Contingencies*.

Federal Employees' Compensation Act (FECA) Reimbursement to the Department of Labor represents liabilities due under the Federal Employees' Compensation Act. Billed amounts payable in FY 2018 and FY 2019 and unbilled amounts for both incurred and estimated accrual amounts are included. Refer to Note 13, *Military Retirement and Other Federal Employment Benefits*, for the estimated FECA actuarial liability.

Custodial Liabilities represents liabilities for collections reported as non-exchange revenues where Air Force is acting on behalf of another Federal entity.

Employer Contribution and Payroll Taxes Payable represents the employer portion of payroll taxes and benefit contributions for health benefits, retirement, life insurance, and voluntary separation incentive payments.

Intragovernmental Other Liabilities primarily consists of unemployment compensation liabilities.

Office of Personnel Management (OPM) administers insurance benefit programs available for coverage to the Air Force's eligible civilian employees. These programs include life and health insurance, and employee participation is voluntary.

Accrued Funded Payroll and Benefits includes the life insurance program, Federal Employee Group Life Insurance (FEGLI) plan, which is a term life insurance benefit with varying amounts of coverage selected by the employee. The Federal Employees Health Benefits (FEHB) program is comprised of different types of health plans that are available to Federal employees for individual and family coverage for healthcare. OPM, as the administrating agency, establishes the types of insurance, options for coverage, the premium amounts to be paid by the employees and the amount of benefit received. The Air Force has no role in negotiating these insurance contracts and incurs no liabilities directly to the insurance companies. Employee payroll withholding related to the insurance and employer contributions are submitted to OPM. Additional information may be found on OPM's website.

Contract Holdbacks are amounts earned by contractors or suppliers during the production period but not yet paid to the contractor/supplier to ensure future performance. The Office of the Secretary of Defense (OSD) issued a policy memorandum in September 2019 directing Department of Defense Components to recognize contract holdbacks expected to be paid within one year of the balance sheet date as Accounts Payable, and to recognize contract holdbacks expected to be paid after one year of the balance sheet date as Other Liabilities. Due to system limitations, the Air Force is unable to distinguish current from non-current contract holdbacks and reported both current and non-current contract holdbacks as Other Liabilities as of September 30, 2018 and September 30, 2019. As such, the Air Force does not record contract holdbacks in accordance with U.S. GAAP.

Contingent Liabilities as of September 30, 2018 and 2019 includes contingent legal liabilities. $236.4 million of the $301.3 million of Contingent Liabilities as of September 30, 2019 is comprised of contingent legal liabilities. Refer to Note 17, *Commitments and Contingencies*, for additional information. The remaining $64.9 million of Contingent Liabilities as of September 30, 2019 relates to contingent liabilities for ongoing operations including acquisition of consumable inventory, supplies, and equipment maintenance. In the prior FY 2018, the Air Force recognized $3.4 billion of contingent liabilities for the estimated unpaid costs that were considered conditional for payment pending delivery and government acceptance, due to the probability the contractors would complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid were estimable. In accordance with OSD policy memorandum issued in April 2019, progress payments for the estimated costs incurred by a contractor were reclassified from Contingent Liabilities to Accounts Payable beginning in FY 2019.

Non-Federal Other Liabilities primarily consist of estimated costs for services, accrued liabilities which offset inventory owned and managed on behalf of foreign governments, and undistributed international tariff receipts. Non-Federal Other Liabilities reflect accrued moving allowance and miscellaneous expenses to contractors.

Note 16 Leases

Operating Leases

As of September 30	2019 (Unaudited)			
	Asset Category			
	Land and Buildings	Equipment	Other	Total
(Amounts in Thousands)				
Federal				
Fiscal Year				
2020	2,302	0	0	2,302
2021	266	0	0	266
2022	266	0	0	266
2023	266	0	0	266
2024	266	0	0	266
After 5 Years	266	0	0	266
Total Federal Future Lease Payments	$ 3,632	$ 0	$ 0	$ 3,632
Non-Federal				
Fiscal Year				
2020	2,111	0	22,599	24,710
2021	2,011	0	23,051	25,062
2022	1,440	0	23,512	24,952
2023	992	0	23,982	24,974
2024	489	0	24,462	24,951
After 5 Years	387	0	24,951	25,338
Total Non-Federal Future Lease Payments	$ 7,430	$ 0	$ 142,557	$ 149,987
Total Future Lease Payments	$ 11,062	$ 0	$ 142,557	$ 153,619

Land and Building leases include leased facilities for the active Air Force in the United States and overseas, and consist primarily of housing facilities and other mission critical assets.

Other leases are comprised of commercial vehicle leases between the Air Force and the general public, and include leases with dealerships and rental car companies.

Note 17 Commitments and Contingencies

Legal Contingencies

The Air Force is a party in various administrative proceedings, legal actions, and other claims awaiting adjudication which may result in settlements or decisions adverse to the Federal Government. These matters arise in the normal course of operations and generally relate to environmental damage, equal opportunity, and contractual matters and their ultimate disposition is unknown. In the event of an unfavorable judgment against the Federal Government, some of the settlements are expected to be paid from the Treasury Judgment Fund. In most cases, the Air Force does not have to reimburse the Judgment Fund reimbursement is only required when the case comes under either the *Contracts Disputes Act* or the *Notification and Federal Employee Antidiscrimination and Retaliation Act*.

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, as amended by SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government,* an assessment is made as to whether the likelihood of an unfavorable outcome is considered probable, reasonably possible, or remote. The Air Force has accrued contingent liabilities for material contingencies where an unfavorable outcome is considered probable and the amount of potential loss is measurable. No amounts have been accrued for contingencies where the likelihood of an unfavorable outcome is less than probable, where the amount or range of potential loss cannot be estimated due to a lack of sufficient information, or for immaterial contingencies. The presented amounts accrued for legal contingent liabilities are included within the contingent liabilities amount reported in Note 15, *Other Liabilities*.

Summary of Legal Contingent Liabilities* as of September 30	2019 (Unaudited) Estimated Range of Loss		
	Accrued Liabilities	Lower End	Upper End
(Amounts in Thousands)			
Legal Contingent Liabilities Probable	$ 236,354	$ -	$ -
Reasonably Possible	$ -	$ 100,550	$ 500,000

**OMB A-136, issued June 28, 2019, revised the presentation of commitments and contingencies. The revised format differs substantially from the format published in Fiscal Year (FY) 2018. Comparative FY 2018 numbers are not available in this format and, therefore, are not presented.*

The contingent legal liability amount of $236.4 million recorded in the financial statements is an estimate based on the average payout rate on claims for the previous three years.

As of September 30, 2019, legal claims exist for which the estimated loss amount or the range of loss cannot be reasonably measured. The ultimate outcomes in these matters cannot be predicted at this time. Sufficient information is not currently available to determine if the ultimate resolution of the proceeding, actions, and claims will materially affect the Air Force's financial position or results of operations.

Other Contingencies

The Air Force 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 budgetary resources. Currently, the Air Force's automated system processes have limited capability to capture these potential liabilities. Therefore, the amounts reported may not present Air Force commitments and contingencies.

The Air Force's normal course of business involves the execution of project agreements pursuant to the framework cooperative activity agreements with foreign governments. All of these agreements give rise to obligations that are appropriately reported in Air Force's financial statements, pursuant to legal authority and appropriated funds; none are contingent. It is the Air Force's practice to enter into treaties and other international agreements that do not create contingent liabilities, as defined in SFFAS 5.

Commitments

The amount of obligations related to cancelled appropriations for which the Air Force has a contractual commitment for payment is $1.9 billion.

Note 18 Funds from Dedicated Collections

Combined Balance Sheet - Funds from Dedicated Collections

As of September 30	2019 (Unaudited)			
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Combined Total
(Amounts in Thousands)				
ASSETS				
Fund balance with Treasury	$ 19,524	$ 2,489	$ 9,985	$ 31,998
Investments	7	0	0	7
Accounts and Interest Receivable	2	0	0	2
Other Assets	1,340	0	0	1,340
Total Assets	$ 20,873	$ 2,489	$ 9,985	$ 33,347
LIABILITIES and NET POSITION				
Accounts Payable and Other Liabilities	186	(657)	215	(256)
Total Liabilities	$ 186	$ (657)	$ 215	$ (256)
Cumulative Results of Operations	20,687	3,146	9,770	33,603
Total Liabilities and Net Position	$ 20,873	$ 2,489	$ 9,985	$ 33,347

As of September 30	2018 (Unaudited)			
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Combined Total
(Amounts in Thousands)				
ASSETS				
Fund Balance with Treasury	$ 15,918	$ 2,465	$ 6,806	$ 25,189
Investments	7	0	0	7
Accounts and Interest Receivable	1	0	0	1
Other Assets	1,340	0	0	1,340
Total Assets	$ 17,266	$ 2,465	$ 6,806	$ 26,537
LIABILITIES and NET POSITION				
Accounts Payable and Other Liabilities	96	(140)	216	172
Total Liabilities	$ 96	$ (140)	$ 216	$ 172
Cumulative Results of Operations	17,170	2,605	6,590	26,365
Total Liabilities and Net Position	$ 17,266	$ 2,465	$ 6,806	$ 26,537

Combined Statement of Net Cost – Funds from Dedicated Collections

For the period ended September 30	2019 (Unaudited)			
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Combined Total
(Amounts in Thousands)				
Gross Program Costs	$ 3,613	$ 1,033	$ 589	$ 5,235
Less: Earned Revenue	0	(1,468)	(3,766)	(5,234)
Net Program Costs	3,613	(435)	(3,177)	1
Net Cost of Operations	$ 3,613	$ (435)	$ (3,177)	$ 1

For the period ended September 30	2018 (Unaudited)			
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Combined Total
(Amounts in Thousands)				
Gross Program Costs	$ 2,916	$ 907	$ (12)	$ 3,811
Net Program Costs	2,916	907	(12)	3,811
Net Cost of Operations	$ 2,916	$ 907	$ (12)	$ 3,811

Combined Statement of Changes in Net Position – Funds from Dedicated Collections

For the period ended September 30	2019 (Unaudited)			
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Combined Total
(Amounts in Thousands)				
Net Position, Beginning of the Period	$ 17,170	$ 2,605	$ 6,590	$ 26,365
Budgetary Financing Sources	7,593	106	3	7,702
Other Financing Sources	(463)	0	0	(463)
Less: Net Cost of Operations	3,613	(435)	(3,177)	1
Change in Net Position	$ 3,517	$ 541	$ 3,180	$ 7,238
Net Position, End of Period	$ 20,687	$ 3,146	$ 9,770	$ 33,603

For the period ended September 30	2018 (Unaudited)			
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Combined Total
(Amounts in Thousands)				
Net Position, Beginning of the Period	$ 15,662	$ 2,376	$ 3,158	$ 21,196
Budgetary Financing Sources	4,721	1,136	3,420	9,277
Other Financing Sources	(297)	0	0	(297)
Less: Net Cost of Operations	2,916	907	(12)	3,811
Change in Net Position	$ 1,508	$ 229	$ 3,432	$ 5,169
Net Position, End of Period	$ 17,170	$ 2,605	$ 6,590	$ 26,365

Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Funds from Dedicated Collections*, as amended by SFFAS 43, *Dedicated Collections: Amending SFFAS 27, Identifying and Reporting Earmarked Funds*, defines the following three criteria for determining a fund from dedicated collections: 1) a statute committing the Federal Government to use specifically identified revenue and/or other financing sources that are originally provided to the Federal Government by a non-federal source only for designated activities, benefits, or purposes, 2) explicit authority for the fund to retain revenue and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes, and 3) a requirement to account for and report on the receipt, use, and retention of the revenue and/or other financing sources that distinguished the fund from the Federal Government's general revenue.

The Air Force's funds from dedicated collections are financed by specifically identified revenues and other financing sources, provided to the government by non-federal sources, required by statute to be used for designated activities, benefits or purposes that must be accounted for separately from the Government's general revenues. The Air Force, and no other component entity, is responsible for carrying out the program financed with revenues and other financing sources that are dedicated collections.

Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements* (OMB A-136), permits presentation of Funds from Dedicated Collections on either a consolidated or combined basis. In FY 2019, the Air Force elected to present information on Funds from Dedicated Collections on a combined basis. The FY 2018 information on Funds from Dedicated Collections has been reformatted to conform with the current year combined basis presentation.

The Combined Total column in the tables above is shown as combined and relates only to Funds from Dedicated Collections. This amount excludes eliminations with Other Funds and will not agree with the total Funds from Dedicated Collections shown in the Net Position section of the Balance Sheet. See Note 20, *General Disclosures Related to the Statement of Changes in Net Position*, for additional information.

Due to rounding, the Air Force Cadet Fund and the Wildlife Conservation Fund FY 2018 Fund Balance with Treasury, FY 2018 Total Assets, FY 2018 Cumulative Results of Operations, and FY 2018 Total Liabilities in Net Position presented in the FY 2018 Combined Balance Sheet - Funds from Dedicated Collections Table above do not agree to the FY 2018 Agency Financial Report.

General Gift Fund [10 USC 2601]

The Air Force General Gift Fund accepts, holds, and administers any gift, device, or bequest of real or personal property, made on the condition that it is used for the benefit (or in connection with the establishment, maintenance, or operation) of a school, hospital, library, museum, or cemetery under the Air Force's jurisdiction. The fund is available to such institutions or organizations subject to the terms of the gift, device, or bequest. Conditional gifts are invested in United States Treasury securities, and any interest earned on these securities is accumulated in the fund.

Wildlife Conservation Fund [16 USC 670]

The Wildlife Conservation Fund provides for 1) the conservation and rehabilitation of natural resources on military installations, 2) the sustainable multipurpose use of the resources which include hunting, fishing, trapping, and non-consumptive uses, and 3) the public access to military installations to facilitate its use, subject to safety requirements and military security. The fund is available to carry out these programs and other such expenses that may be necessary for the purpose of the cited statute.

Consisting of both appropriated and non-appropriated funding, this fund gives installation commanders the authority to collect fees from the sale of hunting and fishing permits.

Air Force Cadet Fund [10 USC 903]

The Air Force Cadet Fund is maintained for the benefit of Air Force Academy cadets. Disbursements are made for the personal services of cadets such as laundry, arts, and athletics while collections are received from the same cadets at least equal to any disbursements made.

The Air Force General Gift Fund and Wildlife Conservation Fund are trust funds. The Air Force Cadet Fund is classified as a special fund. All three funds utilize receipt and expenditure accounts in accounting for and reporting the funds.

Note 19 General Disclosures Related to the Statement of Net Cost

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amount in Thousands)		
Military Personnel		
Gross Cost	$ 38,406,865	$ 36,829,310
Less: Earned Revenue	(449,945)	(531,001)
Net Program Costs	$ 37,956,920	$ 36,298,309
Operations, Readiness & Support		
Gross Cost	$ 61,490,173	$ 55,891,675
Less: Earned Revenue	117,753	363,068
Net Program Costs	$ 61,607,926	$ 56,254,743
Procurement		
Gross Cost	$ 59,605,703	$ 55,643,670
Less: Earned Revenue	(7,928,059)	(4,317,785)
Net Program Costs	$ 51,677,644	$ 51,325,885
Research, Development, Test & Evaluation		
Gross Cost	$ 44,401,927	$ 36,147,929
Less: Earned Revenue	(3,672,442)	(3,732,001)
Net Program Costs	$ 40,729,485	$ 32,415,928
Family Housing & Military Construction		
Gross Cost	$ 2,917,386	$ 2,732,165
Less: Earned Revenue	(42,834)	(14,105)
Net Program Costs	$ 2,874,552	$ 2,718,060
Consolidated		
Gross Cost	$ 206,822,054	$ 187,244,749
Less: Earned Revenue	(11,975,527)	(8,231,824)
Total Net Cost	$ 194,846,527	$ 179,012,925

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Air Force 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 Air Force's current processes and systems capture costs based on appropriation groups as presented in the schedule above. The lower level costs for major programs are not presented as required by the Government Performance and Results Act. The Department of Defense (DoD) is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, as amended by SFFAS 55, *Amending Inter-Entity Cost Provisions*.

The Air Force's systems do not track intragovernmental transactions by customer. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between federal and non-federal expenses. Intradepartmental revenues and expenses are then eliminated.

The Air Force does not meet accounting standards. Information presented is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

The Air Force's accounting systems generally do not capture information relative to heritage assets separately and distinctly from normal operations. The Air Force is working towards disclosing transfers of heritage assets and stewardship land, in addition to exchange revenues.

Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by the Air Force are recognized as imputed cost in the SNC and are offset by imputed revenue in the Statement of Changes in Net Position. Such imputed costs and revenues relate to employee benefits and claims to be settled by the U.S. Treasury Judgment Fund. However, unreimbursed costs of goods and services other than these above are not included in the Air Force's financial statements.

Refer to Note 1.V., *Summary of Significant Accounting Policies – Revenue and Other Financing Sources*, for exchange revenue pricing and loss information.

Note 20 Disclosures Related to the Statement of Changes in Net Position

Year Ended September 30, 2019 (Unaudited) Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations Received on the Statement of Changes in Net Position	*(Amounts in Thousands)*
	Total
Appropriations, Statement of Budgetary Resources	$ 194,708,989
Less: Appropriations Received, Statement of Changes in Net Position	195,851,242
Total Reconciling Amount	**$ (1,142,253)**
Items Reported as Reductions to Appropriations, Statement of Budgetary Resources	
Permanent and Temporary Reductions	$ (1,391,489)
Items Reported in Appropriations, Statement of Budgetary Resources	
Transfers	236,299
Trust and Special Fund Receipts	12,937
Total Reconciling Amount	**$ (1,142,253)**

Other Financing Sources, Other is comprised of unsupported adjustments to reconcile reported intragovernmental transfers, the majority of which are recorded at the Air Force Component level, as the respective federal partners could not be identified, nor the transfers reconciled.

The Appropriations Received on the Statement of Changes in Net Position (SCNP) do not agree with Appropriations on the Statement of Budgetary Resources (SBR) in the amount of $1.1 billion.

Year Ended September 30, 2019 (Unaudited) Reconciliation of Combined Dedicated Collections and Other Funds to Consolidated Dedicated Collections and Other Funds			*(Amounts in Thousands)*
Consolidating Net Position	**Combined**	**Consolidating Eliminations**	**Consolidated**
Cumulative Results of Operations – Dedicated Collections	$ 33,603	$ 642	$ 34,245
Cumulative Results of Operations – Other Funds	182,773,632	(642)	182,772,990
Unexpended Appropriations – Other Funds	150,291,356	0	150,291,356
Total Net Position	**$ 333,098,591**	**$ 0**	**$ 333,098,591**

Year Ended September 30, 2018 (Unaudited) Reconciliation of Combined Dedicated Collections and Other Funds to Consolidated Dedicated Collections and Other Funds			*(Amounts in Thousands)*
Consolidating Net Position	**Combined**	**Consolidating Eliminations**	**Consolidated**
Cumulative Results of Operations – Dedicated Collections	$ 26,365	$ 940	$ 27,305
Cumulative Results of Operations – Other Funds	175,358,887	(940)	175,357,947
Unexpended Appropriations – Other Funds	153,326,272	0	153,326,272
Total Net Position	**$ 328,711,524**	**$ 0**	**$ 328,711,524**

Funds from Dedicated Collections are presented on a combined basis in Note 18, *Funds from Dedicated Collections*. The tables above summarize the elimination of intradepartmental activity between Funds from Dedicated Collections and all Other Fund types to arrive at the consolidated net position totals as presented on the Balance Sheet.

Other Disclosures

Prior Period Adjustment

In fiscal year 2019, the Air Force recorded a $1.3 billion prior period adjustment to adjust the value of Military Equipment - Aircraft pursuant to the Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*. SFFAS 50 provides alternative valuation methods for establishing opening balances for General Property, Plant, and Equipment when historical records are unavailable and existing systems are unable to provide the information necessary for producing historical cost asset values in accordance with U.S. GAAP. The alternative valuation methods used to establish opening balances for Military Equipment, as permitted by SFFAS 50, were reasonable historical cost estimates based on: 1) cost of similar assets at the time of acquisition, 2) current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index), or 3) other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

Note 21 Disclosures Related to the Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) is presented on a combined basis in accordance with the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting* (OMB A-136); thus, intra-entity transactions have not been eliminated from the amounts presented. This presentation differs from other principal financial statements, which are presented on a consolidated basis.

Net Adjustments to Unobligated Balance, Brought Forward, October 1

There were no material adjustments as of September 30, 2019 to the budgetary resources available at the beginning of the year.

Terms of Borrowing Authority Used

The Air Force utilizes borrowing authority for the Military Housing Privatization Initiative (MHPI). Borrowing authority is used in compliance with OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables* (OMB A-129). See Note 7, *Direct Loans and Loan Guarantees, Non-Federal Borrower*, for additional information related to MHPI.

Available Borrowing/Contract Authority, End of Period

There was no available borrowing authority remaining at the end of Fiscal Year (FY) 2019 and FY 2018.

Undelivered Orders at the End of the Period

Budgetary Resources Obligated for Undelivered Orders at the End of the Period

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amount in Thousands)		
Intragovernmental		
Unpaid	$ 23,461,613	$ 24,919,775
Prepaid/Advanced	1,024,255	880,925
Total Intragovernmental	$ 24,485,868	$ 25,800,700
Non-Federal		
Unpaid	$ 76,560,654	$ 69,964,998
Prepaid/Advanced	16,736,643	20,052,565
Total Non-Federal	$ 93,297,297	$ 90,017,563
Total Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 117,783,165	$ 115,818,263

Legal Arrangements Affecting the Use of Unobligated Balances

A portion of the Air Force's unobligated balances represent trust fund receipts collected in the current FY exceeding 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 in the future. The Air Force operates within the constraints of fiscal law and has no additional legal arrangements affecting the use of unobligated balances.

Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

The table below presents a reconciliation between the budgetary resources, new obligations and upward adjustments, distributed offsetting receipts, and net outlays from the FY 2018 and the actual amounts from the "Analytical Perspectives – Federal Budget by Agency and Account" and "Appendix – Detailed Budget Estimates by Agency" sections of the FY 2020 President's Budget. The Budget with the actual amounts for FY 2019 will be available at a later date at https://www.whitehouse.gov/omb/budget.

Explanation of Differences between the SBR and the Budget of the U.S. Government

(Amounts in Billions)

As of September 30	Fiscal Year 2018 Actual			
	Budgetary Resources	New Obligations & Upward Adjustments (Total)	Distributed Offsetting Receipts	Agency Outlays, Net
Combined Statement of Budgetary Resources	$ 235.2	$ 193.1	$ 0.3	$ 167.7
Differences				
Expired accounts that are excluded from the Budget of the U.S. Government*	$ -8.1	$ -	$ -	$ -
Budget of the U.S. Government	$ 227.1	$ 193.1	$ 0.3	$ 167.7

**The difference reported above for Budgetary Resources is due to different reporting requirements on the SBR versus the Budget.*

Contributed Capital

There was no infusion of capital received for the year ended September 30, 2019.

Other Disclosures

Expired Unobligated Balance

The SBR reflects an unobligated expired appropriations in the amount of $5.2 Billion (2.1% of Total Budgetary Resources). The Air Force strives to obligate as close as prudently possible to 100 percent of available budget authority before it expires. Its internal controls and systems for administrative control of funds are designed to avoid over-obligating or over expending funds in violation of the Anti-Deficiency Act. The enormous number of contracts, projects, and activities (for example, construction projects, complex acquisitions, cutting edge/high risk technology efforts, and contingency operations) that must be carried out without exceeding available budget authority do result in liabilities that must be recorded against finite unobligated expired appropriation balances. Consequently, some level of unobligated expired appropriations must be available for recording adjustments to existing obligations, as authorized by § 1553 of Title 31 United States Code.

Apportionment Categories

Funds are apportioned by three categories: 1) Category A is apportioned quarterly, 2) Category B is apportioned by activity or project, and 3) Exempt is funds not subject to apportionment. The amounts of direct and reimbursable obligations incurred are stated in the table.

(Amounts in Billions)

Type	Direct	Reimbursable
Category A	$102.6	$4.9
Category B	$99.7	$5.2
Exempt	$0	$0
Total	**$202.3**	**$10.1**

Permanent Indefinite Appropriations

Permanent indefinite appropriations are as follows (refer to Note 18, *Funds from Dedicated Collections*, for additional information on the Department of the Air Force General Gift Fund, the Wildlife Conservation Fund, and the Air Force Cadet Fund):

Department of the Air Force General Gift Fund **[10 USC 2601]**

Wildlife Conservation Fund **[16 USC 670]**

Air Force Cadet Fund **[10 USC 903]**

Medicare-Eligible Retiree Health Fund Contribution, Air Force **[10 USC 1116]**

Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Air Force **[10 USC 1116]**

Medicare-Eligible Retiree Health Fund Contribution, National Guard Personnel, Air Force **[10 USC 1116]**

The Medicare-Eligible Retiree Health Fund Contribution is maintained for the accumulation of funds, in compliance with the law, in order to finance uniformed services retiree health care programs for Medicare-eligible beneficiaries. The Secretary of the Treasury will contribute an amount into the Fund from the General Fund of the Treasury, which is certified under the Secretary of Defense. Amounts paid will be for the costs of all uniformed service retiree health care programs for the benefit of members or former members of a participating uniformed service who are entitled to retired or retainer pay and are Medicare eligible, and eligible dependents who are Medicare eligible. The fund receives income from the three following sources: annual U.S. Treasury payment made on behalf of the Uniformed Services at the beginning of the year based on average budgeted force strengths, annual payments from the U. S. Treasury to amortize the unfunded liability, and investment income.

Legal limitations and time restrictions on the use of unobligated appropriation balances such as upward adjustments are provided under Public Law.

Appropriations Received

Appropriations on the SBR differ from those reported on the Statement of Changes in Net Position (SCNP). Refer to Note 20, *Disclosures Related to the Statement of Changes in Net Position*, for additional details.

Note 22 Disclosures Related to Incidental Custodial Collections

The Air Force collected $7.2 million of incidental custodial revenues generated primarily from the collection of accounts receivable related to cancelled accounts. These funds are not available for use by the Air Force. At the end of each Fiscal Year, the accounts are closed and the balances are rendered to the United States Treasury.

Note 23 Fiduciary Activities

Non-Entity Assets

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Fiduciary Net Assets, Beginning of Year	$ 2,780	$ 1,833
Contributions	40,718	7,317
Distributions To and On Behalf of Beneficiaries	(41,746)	(6,370)
Increase/(Decrease) in Fiduciary Net Assets	$ (1,028)	$ 947
Fiduciary Net Assets, End of Period	$ 1,752	$ 2,780

Schedule of Fiduciary Net Assets

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Fiduciary Assets		
Fund Balance with Treasury	$ 1,752	$ 2,780
Total Fiduciary Net Assets	$ 1,752	$ 2,780

A fiduciary relationship may exist anytime the Air Force collects or receives, and holds or makes, disposition of assets in which a non-federal individual or entity has an ownership interest that the Air Force must uphold. The relationship is based on statute or other legal authority and the fiduciary activity must be in furtherance of that relationship.

The Air Force's fiduciary activities consist solely of the Savings Deposit Program (SDP). SDP was established to provide members of the uniformed services serving in a designated combat zone the opportunity to build their financial savings.

Note 24 Reconciliation of Net Cost to Net Outlays

As of September 30	2019 (Unaudited)		
	Intragovernmental	With the public	Total
(Amounts in Thousands)			
Net Cost of Operations (Statement of Net Cost)	$ 34,679,453	$ 160,167,074	$ 194,846,527
Components of Net Cost That are Not Part of Net Outlays:			
Property, plant, and equipment depreciation	$ 0	$ (11,530,110)	$ (11,530,110)
Property, plant, and equipment disposal & revaluation	0	(2,265,591)	(2,265,591)
Other	(21,053)	2,859,123	2,838,070
Increase/(decrease) in assets:			
Account Receivable	(222,537)	7,156	(215,381)
Other assets	143,331	(6,623,892)	(6,480,561)
(Increase)/decrease in liabilities:			
Accounts payable	(966,097)	(3,933,809)	(4,899,906)
Salaries and benefits	(9,503)	(45,033)	(54,536)
Environmental and disposal liabilities	0	(1,157,433)	(1,157,433)
Other Liabilities (Unfunded Leave, Unfunded Federal Employees' Compensation Act, Actuarial Federal Employees' Compensation Act)	(289,528)	3,315,310	3,025,782
Other financing sources:			
Federal employee retirement benefit costs paid by Office of Personnel Management and Imputed to the agency	(823,868)	0	(823,868)
Transfers out (in) without reimbursement	(74,420)	0	(74,420)
Other imputed financing	(29,911)	0	(29,911)
Total Components of Net Cost That Are Not Part of Net Outlays	$ (2,293,586)	$ (19,374,279)	$ (21,667,865)
Components of Net Outlays That Are Not Part of Net Cost:			
Acquisition of capital assets	$ 0	$ 13,472,365	$ 13,472,365
Acquisition of inventory	0	6,977,486	6,977,486
Other	(6,247)	(19,923)	(26,170)
Total Components of Net Outlays That Are Not Part of Net Cost	$ (6,247)	$ 20,429,928	$ 20,423,681
Net Outlays	$ 32,379,620	$ 161,222,723	$ 193,602,343
Agency Outlays, Net, Statement of Budgetary Resources			$ 185,678,117
Reconciling Difference			$ 7,924,226

Budgetary and financial accounting information is used for different purposes. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position, so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provide an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The table above illustrates this reconciliation of key differences between net cost and net outlays. The reconciling difference of $7.9 billion in the table above is due to Air Force financial system limitations, causing budgetary data to not reconcile with proprietary expenses and capitalized assets.

Note 25 Public-Private Partnerships

The Statement of Federal Financial Accounting Standards (SFFAS) 49, *Public-Private Partnerships: Disclosure Requirements*, was issued in recognition of the increasing number of risk-sharing arrangements or transactions being entered into between Federal Government Agencies and the private sector. These arrangements are referred to as Public-Private Partnerships (P3s). SFFAS 49, is effective for periods beginning after September 30, 2018. Therefore, Fiscal Year (FY) 2019 is the first time that the Air Force is reporting under this Standard. However, the Air Force is not fully compliant with SFFAS 49 because it has not completed a comprehensive review and evaluation of all significant business arrangements that could require disclosure under SFFAS 49.

The Air Force is in the process of reviewing its business arrangements and transactions to determine those that meet the disclosure requirements of SFFAS 49. To date, the Air Force has identified the Military Housing Privatization Initiative (MHPI) as meeting the requirements for disclosure in its financial statements in accordance with SFFAS 49. Disclosure information for the MHPI as well as consideration of other Air Force arrangements which may meet the criteria for SFFAS 49 disclosure are described below.

In addition to developing appropriate disclosures to meet the requirements of SFFAS 49 for the MHPI, the Air Force is also in the process of reviewing the details of the individual arrangements within the MHPI to help ensure that the arrangements and their underlying transactions are/have been recorded and reported in accordance with United States Generally Accepted Accounting Principles (U.S. GAAP). Due to the complexity of some of the MHPI arrangements, it is possible that previous transactions may need to be adjusted in order to be U.S. GAAP compliant. The Air Force is currently not able to determine the materiality of adjustments that may result from its review of the MHPI arrangements and the identification and review of other P3 arrangements and the effect on its financial position, results of its operations and net position.

Military Housing Privatization Initiative

Funding

Federal funding for the MHPI agreements was provided through Air Force budgetary resources and/or the U.S. Treasury through Government Direct Loan disbursements at development completion or completed phases of development, limited loan guarantees of private debt against base closure, significant deployment or significant downsizing, direct upfront cash equity contribution and/or through differential lease payments for a stated period of time.

At inception of an MHPI agreement, the Air Force entered into a long-term land lease (generally 50 years), and conveyed the associated real property assets (buildings, structures, facilities, and in some cases utility infrastructure) to the MHPI P3 organized as a single purpose, bankruptcy remote, or Limited Liability Company (LLC).

The authorities under the Department of Defense (DoD) MHPI program allow for direct cash contributions, loans or limited loan guarantees of private debt to the LLCs. Contributions to MHPI P3 partners from the DoD Family Housing Improvement Fund (FHIF) requires a statement of scored cost including the conveyance or lease as determined by the Office of Management and Budget Approval and Congressional notification (10 USC § 2884). There are no contractual requirements for additional federal contributions to the LLCs.

The enactment of Pub. L. 115-91 § 603, required the Air Force to make direct payments to the MHPI entities (lessors) of 1.0% of the Basic Allowance for Housing (BAH) amount for the period from January 1, 2018 through December 31, 2018. The amount of BAH was calculated under § 403(b)(3)(A)(i) of the military pay statute in Title 37, USC for the area in which the covered housing existed.

From September 1, 2018 forward, Pub L. 115-232 § 606 directs that payments to the MHPI entities of 5.0% of BAH will occur monthly until Congress modifies or rescinds this direction.

The following table represents the aggregated Federal contribution amounts paid to the MHPI Program and LLCs through September 30, 2019:

Air Force Contributions	
Funding contributions to DoD MHPI program	$618.8M
Real property contributions to the LLCs (value of Real Property Assets (RPA) conveyed, per Office of Management and Budget (OMB) scoring documents)	$2.6B
Air Force direct payments as required by Pub. L. 115-91 § 603 (1.0% BAH) and 15-232 § 606 (5.0% BAH) for FY 2019	$ 50.5M
Air Force basic allowance for housing (BAH) under § 403 of title 37 to members living in privatized housing for FY 2019. The number of units of military family housing upon which these estimated payments are made is 41,835, and the number of units of military unaccompanied housing units upon which these estimated payments are made is 110.	$846.4M
DoD Contributions*	
Direct Cash Contributions	$89.5M
Differential Lease Payments	$16.5M
Direct loans Disbursed	$1.82B

**These financial amounts represented above are presented in the DoD's consolidated financial statements and their respective note disclosures and are not presented within the Air Force's financial statements.*

The DoD MHPI program received direct loan principal repayments in the amount of $28.1M through September 30, 2019 (aggregate). Annual payments vary based on direct loan repayment terms and interest rate tiers. Final repayment on Air Force direct loans occurs October 15, 2057. The Air Force does not receive loan payments from the LLCs.

With respect to indirect third party payments to MHPI entities, it is estimated that the Air Force paid BAH under § 403 of title 37 to members living in privatized housing in the amount of $846.4M in FY 2019. The number of military family housing units upon which these estimated payments were made is 41,835 in FY 2019. The number of units of military unaccompanied housing upon which these estimated payments were made is 110 in FY 2019. The indirect third party payments will continue as long as military members reside in MHPI housing.

The Air Force will continue to make monthly direct payments for 5.0% of BAH to the MHPI entities for a projected total of $4.4B over the remaining life of the Operating Agreements (OAs), unless this authority is rescinded or modified.

Non-federal funding for the MHPI agreements generally included cash equity contribution(s) investment(s) on the part of the private Partners and either bond or loan revenue obtained by the LLC for the purpose of financing the demolition/renovation/new construction of real property assets required to meet the end state number of housing units. The Air Force obtained the Office of the Secretary of Defense (OSD) and Office of Management and Budget (OMB) approval of the end state through the Scoring Reports and notifications provided to Congress for the MHPI P3 agreements.

The following table represents the aggregated contributions by the Private Partner to the LLC through September 30, 2019:

Contributions by Private Partners	
Direct cash contributions	$338.8M
Bonds/Loans contributed	$5.06B
Real property and land contributions	$1.2M

There is no requirement for the Private Partners to make any additional contributions after September 30, 2019 through the end of the agreements (approximately through 2063).

The MHPI entities have not borrowed or invested capital based on any Air Force promise to pay, either implied or explicit. The only payments contractually required from the Air Force to the MHPI entities are the direct cash investments and direct loan disbursements required upon execution of each phase of the MHPI agreement in accordance with the OA or Forward Commitment, if required. There are no other contractually required payments from the Air Force to the MHPI entities for the remaining term of the agreements.

The Air Force and Partner equity investments may occur at the beginning of any new equity project, as required by the OA. Any new Air Force cash investment in a MHPI P3 from the FHIF or Unaccompanied Housing Improvement Fund (UHIF) requires approval from the Office of the Assistant Secretary of Defense (Energy, Installations, and Environment) OASD(EI&E) and the OMB as well as Congressional notification (10 USC § 2883(f)). The Air Force entered into four equity investment projects with an Operating Agreement as a non-managing member of the LLC. The Air Force is not obligated by the OAs for equity arrangements to make any investments in the MHPI P3 beyond its initial investment in each arrangement. The Air Force has not made any in kind contributions/services or donations to the MHPI entities.

The Air Force may contribute budget authority to restructure a project in financial distress through a modification of the Government Direct Loan (GDL) under OMB Circular A-11 *Preparation, Submission and Execution of the Budget* (OMB A-11), Part 5, Section 185, *Federal Credit,* or by providing additional equity in the case where the Air Force is a non-managing member of the LLC. The Air Force is pursuing OSD and OMB approval of a GDL modification of the BLB Group project for which an estimated $56.4M in upfront budget authority will be contributed by the Air Force to cover the cost. The current projected effective date of the modification is February 15, 2020.

Risk of Loss

The DoD's risk of loss is the initial cash contribution to the program, the risk of default on a Government Direct Loan and the risk that a Guaranty Threshold Event under a Loan Guaranty Agreement will occur. In addition, the Air Force risks failing to deliver on its goal to provide quality housing services to Service Members. The private partner's risk of loss includes the recovery of the initial cash contributions, inability to repay bonds and/or loans, and the loss of a long term revenue source. Each MHPI Lockbox Agreement prescribes how funds flow through accounts ("waterfall"). This hierarchy ensures payments to "must pay" accounts, such as operating expenses and debt, occur first with Project Owners' (PO) fees at risk of delay or non-payment if insufficient cash flow is available. The waterfall is in effect a risk mitigation strategy to the LLC, should unexpected interruptions occur to the revenue stream during project operation.

The MHPI OAs and Lockbox Agreements do not explicitly identify risk of loss contingencies, but some projects include reserve accounts for specific circumstances, such as an Operating Expense Reserve Accounts or Utility Reserve Accounts to save funds for protection against unexpectedly high expenses.

The four Air Force equity deal OAs provide for orderly processes for dissolution or termination of the agreement. The OAs also provide processes through which the Air Force can enter into successor agreements in cases where the current private partner is no longer a member of the MHPI agreement.

Succession or removal of a PO under a debt deal structure is addressed through the project Lease of Property (LOP) or, in the case of grouped projects, through the Master Development and Management Agreement (MDMA).

Air Force projects with a Direct Loan (DL) may involve a restructure of the loan through an Administrative Workout under OMB A-11, Part 5, Section 185, Federal Credit, for a troubled loan or a loan in imminent default. The cost of this type of restructure is borne by the United States (U.S.) Treasury through permanent indefinite authority. The Air Force may also contribute budget authority to modify a DL to strengthen long term financial sustainment of the project under a DL Modification. The Air Force has successfully restructured two projects through an Administrative Workout of the DL, preventing the loans from imminent default. The Air Force is also in the process of requesting OASD (EI&E) and OMB approval of a direct loan modification for one project in order to strengthen long-term sustainment.

The entity cash flow is dependent on congressional authorization and appropriation of basic allowance for housing, which becomes a third party payment for rent to the MHPI entity. The Air Force can influence but cannot control the authorization and appropriation process. Additionally, as a result of ongoing congressional review of the MHPI program, there may be changes to the relationship between the Air Force and the entity based on congressional action. If or when action is taken, the Air Force will disclose any financial changes or impacts that this may pose / cause. There is potentially a remote impact which is not measurable at this time.

The FY 2019 Congressional hearings on privatized housing have prompted greater scrutiny into the structure and operations of the services' privatized housing programs. In response, the Air Force has commenced a number of initiatives to improve oversight and performance of the privatized housing projects. In addition, the Air Force Inspector General issued a report on privatized housing that identified a number of suggested improvement actions for the Air Force to implement. The Air Force has committed to implement all the recommended improvements. As a result, the Air Force has identified 51 Improvement Actions that are grouped into five Lines of Effort: Empower Residents, Improve Oversight, Integrate Leadership, Improve Communication, and Standardize Policy. The effects of implementing the improvement actions are not measurable as of this reporting date.

Gains and Losses

The Air Force is developing a plan to support the accounting recognition of unrealized gains or losses as applicable in accordance with the policy for *Accounting and Reporting of Equity Investments in Military Privatized Housing Projects and Additional Disclosure Requirements for Direct Loans and Loan Guarantees for Military Privatized Housing Projects* (FMP19-04) once issued.

Risk of Termination or Non-Compliance

The Air Force receives and tracks monthly financial reports and monitors for events of termination or default including failure to make required capital investments, judicial dissolution, insolvency, or other significant breach or agreements without resolution.

The conditions governing the early termination, hand-back, and renewal options vary from each MHPI agreement. If a going-concern, termination, or default occurs, the Air Force will conduct procedures to mitigate risk and to identify an entity to take over the partnership. Each MHPI OA for equity deals and Lease of Property (LOP) or MDMA provides for orderly processes for dissolution or termination of the agreement to include the sale of assets not on Air Force land and the reversion of real property assets to the Air Force. The OAs, LOP or MDMA, as applicable, also provide processes through which the Air Force can enter into successor agreements in cases where the current private partner is no longer a member of the MHPI agreement, thereby avoiding early termination of the project.

Early Termination Requirements:

Per the LOP, a Physical Condition Report (PCR) for each parcel of the Leased Premises will be prepared by the Government, and signed by the Parties, within ten (10) days after the expiration or earlier termination of this Lease for each respective parcel (Final PCR). The Final PCR will be used by the Government to determine whether the Lessee has fulfilled its obligations to maintain and restore the Leased Premises under the Lease, including without limitation, the Restoration and Surrender Condition and Maintenance of Leased Premises Condition.

Per the Lease of Property for each base, there are three options at lease termination to include restoration and surrender, with or without demolition of improvements or renewal of the lease.

Other Potential Public Private Partnership Arrangements

The Air Force conducted a review of certain agreements, which may have created a Public Private Venture (PPV)/P3. This review encompassed Enhanced Use Leases and Privatized Utilities. This analysis supports that these contracts and agreements do not constitute a PPV/P3 and do not require disclosure under SFFAS 47, *Reporting Entity* or SFFAS 49. The Air Force has not yet completed the entity-wide review of Renewable Energy Program Out-leases, Utility Energy Savings Contracts, Power Purchase Agreements, and Energy Savings Performance Contracts. It is possible that one or more of these relationships could constitute a PPV/P3.

See Note 7, *Direct Loan and Loan Guarantees, Non-Federal Borrowers* and Note 12, *Debt*.

Note 26 Disclosure Entities and Related Parties

Effective in fiscal year 2018, Statement of Federal Financial Accounting Standards 47, *Reporting Entity,* requires agencies to disclose certain information for disclosure entities and related parties. The Air Force is still in the early stages of implementing this significant standard and completing a full impact analysis. Once the Air Force fully implements this new standard, the Air Force will be able to provide a thorough disclosure for disclosure entities and related parties.

The Air Force has Public Private Partnership agreements that meet the criteria for disclosure as related parties. See Note 25, *Public-Private Partnerships*, for disclosures related to Public Private Partnership contributions, risks, and operations.

Fiscal Year 2019

GENERAL FUND

Required Supplementary Stewardship Information

STEWARDSHIP INVESTMENTS

Stewardship investments are substantial investments made by Department of Defense (DoD) for the benefit of the nation, but are not physical assets owned by DoD. Stewardship investments include expenses incurred for federally financed, but not federally owned, physical property (Non-Federal Physical Property) and federally financed research and development (Research and Development).

NON-FEDERAL PHYSICAL PROPERTY

Non-Federal Physical Property investments are expenses included in calculating net cost incurred by the reporting entity for the purchase, construction or major renovation of physical property owned by state and local governments. These expenses include the costs identified for major additions, alterations and replacements, purchases of major equipment, and purchases or improvements of other non-federal assets. In addition, Non-Federal Physical Property Investments include federally owned physical property transferred to state and local governments.

NON-FEDERAL PHYSICAL PROPERTY Yearly Investment in State and Local Governments For the Current and Four Preceding Fiscal Years (Amounts in millions)					
Categories	**FY 2019**	**FY 2018**	**FY 2017**	**FY 2016**	**FY 2015**
Funded Assets: National Defense Mission Related	$41.1	$16.4	$15.5	$17.2	$13.9
Totals	**$41.1**	**$16.4**	**$15.5**	**$17.2**	**$13.9**

The Air National Guard investments in Non-Federal Physical Property are strictly through the Military Construction Cooperative Agreements (MCCAs). These agreements involve the transfer of money only and allow joint participation with States, Counties, and Airport Authorities for construction or repair of airfield pavements and facilities required to support the flying mission assigned at these civilian airfields.

Investment values included in this report are based on Non-Federal Physical Property outlays (expenditures). Outlays are used because current DoD systems are unable to capture and summarize costs in accordance with United States (U.S) Generally Accepted Accounting Principles (GAAP) requirements.

INVESTMENTS IN RESEARCH AND DEVELOPMENT Yearly Investment in Research and Development For the Current and Four Preceding Fiscal Years (Amounts in millions)					
Categories	**FY 2019**	**FY 2018**	**FY 2017**	**FY 2016**	**FY 2015**
Basic Research	$545	$492	$521	$510	$539
Applied Research	$1,482	$1,454	$1,314	$1,241	$1,089
Development:					
Advanced Technology Development	$867	$827	$785	$675	$614
Advanced Component Development and Prototypes	$6,406	$4,962	$2,831	$1,555	$939
System Development and Demonstration	$5,288	$4,347	$3,858	$3,791	$3,274
Research, Development, Test and Evaluation Management Support	$3,757	$3,491	$1,691	$1,512	$1,497
Operational Systems Development	$23,139	$22,442	$17,257	$15,915	$14,880
Totals	**$41,484**	**$38,015**	**$28,257**	**$25,199**	**$22,832**

RESEARCH AND DEVELOPMENT

Research and Development investments are incurred in the search for new or refined knowledge and ideas, for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits.

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 practicality of proposed solutions and determining their parameters. Major outputs are scientific studies, investigations, 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 is comprised of the following five stages:

1) Advanced Technology Development is the systematic use of the knowledge or understanding gained from research directed towards proof of technological visibility and assessment of operational productivity rather than the development of hardware for service use. The United States Air Force employs demonstration activities intended to prove or test a technology or method.

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

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

4) 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, operations and maintenance of test aircraft and ships, and studies and analyses in support of the Research and Development (R&D) program.

5) Operational System Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development, which have received approval for production, for which production funds have been budgeted in subsequent Fiscal Years.

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

Basic Research:

Researchers funded by the U.S. Air Force Research Laboratory (AFRL) have discovered the first known material that has multiple quantum properties. The new novel material is projected to become the building block for a new era of quantum materials. The chemically composed Hf_2Te_2P (hafnium, tellurium, and phosphorous) will dramatically increase computing power and greatly reduce the amount of energy required to power electronics.

AFRL funded researchers have developed a groundbreaking method to optimize for reduced weight, cost and fuel consumption for future hypersonic vehicles. Boundary Layer Transitions (BOLT) experiments for hypersonic vehicles were conducted to analyze heat loads and drag increase during boundary layer transitions across complex surface shapes. Their successful results now enable completely new, revolutionary hypersonic vehicle designs.

Applied Research:

AFRL led live and virtual trials of multiple human-autonomy integrated teaming technologies within their multi-domain, multi-UxV Command and Control testbed. Integrated technologies were provided by the United States, Australia, Canada and the United Kingdom and included intelligent decision support, a multi-media narration module, adversarial battlespace planning, policy checking/management tools, a smart weapons engagement Graphical User Interface (GUI), a novel assessment capability, and a digital information architecture. The integrated tech solution provided a comprehensive tactical picture of all tracks in the area of interest and enabled a single operator to successfully manage 16 unmanned assets across air, sea, and ground unmanned platforms.

First ever on-orbit demonstration of the AFRL developed Advanced SpaceCraft Energetic Non-Toxic (ASCENT) green propellant began in June 2019 as part of the Department of Defense Space Test Program-2 (STP-2) mission launched on a SpaceX Falcon Heavy launch vehicle. This marks a major milestone in a national effort to develop new energetic propellants to replace hydrazine, the current established chemical propellant of choice for nearly all current satellite propulsion. Not only is ASCENT 50 percent higher performing than hydrazine, but it is also a vastly safer alternative, allowing for streamlined ground operations relative to legacy propellants.

AFRL's Starfire Optical Range (SOR) effort recently demonstrated quantum communication in daylight under conditions representative of space-to-Earth satellite links. Free-space quantum communication in the daytime has been a challenge for the scientific community as it is often negatively impacted by background light. In contrast to digital information which can be transmitted by radio waves, quantum information is carried by photons, individual particles of light. Transmitting individual photons over long distances and detecting them against background light is essential to exploit the full potential of quantum technologies. Quantum communication will allow the networking of quantum computers for increased computing power with unprecedented security.

AFRL completed U.S. Air Force interim qualification requirements for a new high temperature explosive, AFX-560. AFX-560 increases the thermal stability of composite main charge explosives. High temperature explosives increase the warhead design margin and reduce the insulation thicknesses for hypersonic weapons.

Partnering with IBM, AFRL unveiled the world's largest neuromorphic digital synaptic super computer, dubbed Blue Raven, at the Extreme Computing Facility in Rome, NY. This brain inspired computer system will enable advanced pattern recognitions at a low energy cost.

Advanced Technology Development:

AFRL researchers completed the preliminary design of the High Power Joint Electromagnetic Non-Kinetic Strike (HIJENKS) source, a compact and efficient high power microwave system that can be integrated into aerial platforms. Developmental models of the system have met design requirements for frequency, output power, beam width, size, and weight. These systems will be capable of disrupting and defeating a wide variety of electronic systems with low to zero collateral damage. The Office of Naval Research is a joint partner for the project.

AFRL's America Makes project recently resulted in process development for a 3-D printed titanium bracket. Lockheed participated in the Maturation of Advanced Manufacturing for Low-cost Sustainment (MAMLS) program to develop the process and subsequently qualify it for use on F-22 aircraft, making it the first ever metal printed part in Air Force usage. This new, corrosion-resistant bracket will substitute for a corrosion-prone aluminum component that currently requires replacement 80.0% of the time during maintenance. The printed part can be ordered and delivered to the depot as quickly as three days, enabling faster repair, reduced replacement needs, and improved mission capability for the warfighter. The printed part is now installed on F-22 aircraft as needed to monitor its performance and possible application to more complex parts.

AFRL's Ninja Counter Small Unmanned Aerial Systems (C-sUAS) project demonstrated innovative non-kinetic sUAS detect and defeat capabilities utilizing commercial off-the-shelf (COTS) hardware to be deployed from a fixed-site, vehicle-mobile, or man-portable configuration with minimal cost to budget and personnel requirements. Ninja achieved 0.0% false-positive detection rate and effectively eliminated over 80.0% of overall sUAS threat. AFRL began installation process to 180+ sites in coordination with Air Force Life Cycle Management Center (AFLCMC) and Air Force Materiel Command (AFMC). AFRL assisted with establishing and maintaining Outside Contiguous United States (OCONUS) C-sUAS capabilities in Pacific Air Forces (PACAF), United States Air Forces in Europe – Air Forces Africa (USAFE-AFAFRICA), and United States Central Command (CENTCOM) areas of responsibility (AORs) against prominent sUAS threats.

The XQ-58A Valkyrie demonstrator, a long-range, high subsonic unmanned air vehicle (UAV), completed its inaugural flight March 5, 2019 at Yuma Proving Grounds in Yuma, Arizona. AFRL partnered with Kratos Unmanned Aerial Systems to develop the XQ-58A. The development of the XQ-58A is part of the AFRL's Low Cost Attritable Aircraft Technology (LCAAT) portfolio, and is the first example of a class of UAV that is defined by low procurement and operating costs while providing game changing combat capability.

Advanced Component Development and Prototypes (ACD&P):

Efforts under Technology Transition include Air Force Experimentation and Prototyping. The Air Force Experimentation and Prototyping Fiscal Year (FY) 2019 accomplishments include conducting Directed Energy Weapons (DEW) and commercial space internet experimentation. The DEW experimentation is focused on base defense applications. In October 2018, a successful directed energy-based counter unmanned aerial system (C-UAS) experimentation event was held at White Sands Missile Range (WSMR), New Mexico, involving demonstrations of high power microwave and high energy laser capabilities in an integrated, operator-led, unscripted defense of varying C-UAS threats. Following that event, the Air Force began preparing for deployment of the systems for a 12 month operational field assessment outside the continental United States that will expand upon previous efforts by focusing on the maintainability, sustainment and life-cycle costs. Global Lightning is the experimentation and prototyping activity assessing commercial viability and potential military utility for the emerging commercial space internet. The Global Lightning team has begun commercial space internet testing onboard Air Force aircraft to assess performance during routine flight maneuvers, including tests with multiple satellites in view and various geometries between aircraft and spacecraft.

Additional FY 2019 Prototyping accomplishments include Adaptive Engine Transition Program (AETP) and two Hypersonics Rapid Prototyping (Sec 804) programs, Air-Launched Rapid Response Weapon (ARRW) and Hypersonic Conventional Strike Weapon (HCSW).

During FY 2019, AETP continued advanced component/rig testing and made significant progress in hardware development and next generation adaptive propulsion initial design efforts. The system-level reviews culminated the baseline programs' detailed design, driving fabrication and test of the first ever, flight-weight adaptive engines.

The AGM-183A ARRW Section 804 Rapid Prototyping program continues to leverage the technical base established by the Air Force and Defense Advanced Research Projects Agency (DARPA) partnership while pacing development of critical technology as the United States' first air-launched hypersonic system planned for fielding in FY 2022. ARRW is a hypersonic weapon designed to engage time sensitive targets and offers the potential for engagement of targets from longer ranges within a shorter kill-chain response time which will increase access for the joint force within contested regions.

- In March 2019, ARRW conducted a successful delta preliminary design review.
- In June 2019, ARRW successfully completed its first captive carriage test flight. The ARRW Instrumented Measurement Vehicle was integrated via a modified heavy stores adapter beam aboard a 412th Test Wing (Edwards AFB) B-52H. Captive carriage flight testing continued throughout FY 2019.
- During the remainder of FY 2019, ARRW continued system development, test, and manufacturing readiness activities to prepare for critical design review as well as commencement of booster test flights in FY 2020.

The AGM-182A HCSW Section 804 Rapid Prototyping program is leveraging common hypersonic glide body technology from the Conventional Prompt Strike (CPS) program to rapidly field a long range strike capability to reach targets through anti-access/area denial environments. Since contract award in May 2018, the program office has worked with industry to develop innovative system specifications for a pathfinder hypersonic weapon to reach early operating capability in FY 2022.

- In October 2018, HCSW completed a successful System Requirements Review (SRR), followed by a Solid Rocket Motor SRR in December.
- In March 2019, HCSW successfully completed a Preliminary Design Review (PDR) for the Payload, followed by the Payload Delivery Vehicle (PDV) and Booster system PDRs in June.
- During the remainder of FY 2019, HCSW conducted a System-Level PDR in July and begin PDV and Booster builds with an anticipated first All-Up-Round flight demonstration in December of 2020.

Weapons Systems Cyber Resiliency (WSCR)

The Air Force has a multi-pronged approach to provide assurance, resilience, affordability, and empowerment to enable the Air Force's assured cyber advantage to ensure our ability to fly, flight, and win in air, space, and cyberspace. The Cyber Resiliency Office for Weapons Systems (CROWS) takes a holistic approach to address cyber resiliency for the Air Force enterprise with major activities including development of enterprise-level solutions to mitigate critical weapon system vulnerabilities. It also enables programs to incorporate cyber resiliency into new weapon systems and modifications by delivering tools, training, cyber acquisition intelligence, and guidance to institutionalize cyber resiliency requirements into systems engineering, testing and contracting activities across the acquisition life cycle. FY 2019 CROWS enterprise activities include the following:

- Resilient Embedded Resilient Embedded Global Positioning System/Inertial Navigation System (GPS/INS) – CROWS partnered with the USAF Position Navigation and Timing (PNT) Program Office to prototype and develop the Resilient Embedded GPS/INS (R-EGI) to provide the warfighter with enhanced PNT capabilities that leverages open architecture. CROWS played a pivotal role in the initiative by incubating a partnership and contributing funding that allowed PNT Program Office to accelerate the project by at least two FYs. The prototype captured demonstration data and made additional enhancements to R-EGI data model which are being leveraged in Phase 3, delivering a more complex vision-aided capability. CROWS began the transition of the R-EGI virtual Systems Integration Lab (vSIL) from CROWS to the PNT Program Office. CROWS showcased the viability of using vSIL as a mechanism to develop future R-EGI systems.

- Hack the Technical Assistance Database System (TADS) - CROWS partnered with the F-15 Project Management Office (PMO) to help them ensure their new aircraft data transfer system called the TADS was cyber hardened in order to meet cyber security requirements in preparation for issuance of an Authority to Operate. The initiative was scoped by the Defense Digital Service at the Pentagon and involved physical access components in addition to a remote web based network, both of which were integral to the F-15 PMO's near, mid, and long-term fielding plans. This effort resulted in identifying potential vulnerabilities and associated mitigations for the F-15 PMO.
- 1553 Firewall Miniaturization – CROWS partnered with the AFRL and Air Force program offices to deliver ten prototype Vegas-S miniaturized firewall units, which allow only one-way data traffic on the MIL-STD-1553 data bus. The overarching objective of the program is to miniaturize the existing Vegas-L hardware into a smaller format. AFRL and CROWS considered the delivery of the ten units to be a major success as the results will allows aircraft to implement the capability with significantly reduced size, weight, and power impact.

Research, Development, Test and Evaluation Management Support:

The Air Force's Research, Development, Test and Evaluation (RDT&E) management support efforts include projects directed toward support of installations and operations required for testing at the Air Force Major Range and Test Facility Base (MRTFB) as well as for International Activities. It also includes the Air Force's Small Business Technology Transfer (STTR) and Small Business Innovation Research (SBIR) program along with Air Force-Wide developmental planning efforts.

The SBIR/STTR FY 2019 accomplishments include development of next-generation high strain composite laminates that can accommodate high-packaging strains while having a near zero coefficient of thermal expansion. The technology is a significant step toward meeting the challenge of designing high performance, low cost deployable antennas for small satellites. Roll Out Composite (ROC) Boom, for example, provides flexibility to stow on a small satellite, but stays rigid after deployment and functionally integrates with the antenna system. The performance of high strain polymer matrix composites after long-term storage is among the greatest concerns of antenna system engineers. In developing its high strain composite boom technology, Colorado-based Roccor LLC invested Air Force SBIR/STTR funding to advance new materials, robust mechanical designs for flight systems, and engineering standards that are now being applied for flight qualification to challenging requirements like long-term storage.

The Development Planning FY 2019 accomplishments include collaboration between the Strategic Development Planning and Experimentation (SDPE) Office and the Air University Blue Horizons students. SDPE sponsored six of the seven total Blue Horizons projects providing funding, contract vehicles, and technical guidance/support. The Chief of Staff of the Air Force was personally briefed on the efforts and was overwhelmingly supportive of the projects. SDPE has worked with each of the efforts to investigate continued development and/or transition partners to ensure the efforts continue once the students have graduated and moved on to other assignments. This collaboration will also help establish a pipeline of Blue Horizons graduates being assigned to SDPE to follow up on promising student projects and to bring fresh military perspective to their work.

Fiscal Year 2019

GENERAL FUND

Required Supplementary Information

DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2019 and 2018

(Amounts in Thousands)

	Research, Development, Test & Evaluation	Procurement	Military Personnel
Budgetary Resources			
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 10,119,937	$ 24,848,202	$ 1,442,551
Appropriations (discretionary and mandatory)	40,928,426	49,590,361	38,404,394
Spending Authority from offsetting collections (discretionary and mandatory)	4,474,190	557,137	473,920
Total Budgetary Resources	$ 55,522,553	$ 74,995,700	$ 40,320,865
Status of Budgetary Resources			
New obligations and upward adjustments (total)	$ 49,260,971	$ 52,983,712	$ 38,935,019
Unobligated balance, end of year:			
Apportioned, unexpired accounts	5,914,649	21,012,228	97,806
Exempt from apportionment, unexpired accounts	0	0	0
Unapportioned, unexpired accounts	0	0	0
Unexpired unobligated balance, end of year	$ 5,914,649	$ 21,012,228	$ 97,806
Expired unobligated balance, end of year	346,933	999,760	1,288,040
Unobligated balance, end of year (total)	$ 6,261,582	$ 22,011,988	$ 1,385,846
Total Budgetary Resources	$ 55,522,553	$ 74,995,700	$ 40,320,865
Outlays, Net			
Outlays, net (total) (discretionary and mandatory)	$ 38,830,676	$ 47,684,573	$ 37,944,200
Distributed offsetting receipts (-)	0	0	0
Agency Outlays, net (discretionary and mandatory)	$ 38,830,676	$ 47,684,573	$ 37,944,200

The accompanying notes are an integral part of these statements.

(Amounts in Thousands)

	Family Housing & Military Construction	Operations, Readiness & Support	2019 Combined	2018 Combined
Budgetary Resources				
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 4,309,163	$ 4,967,304	$ 45,687,157	$ 36,325,787
Appropriations (discretionary and mandatory)	3,376,850	62,408,958	194,708,989	189,701,583
Spending Authority from offsetting collections (discretionary and mandatory)	30,000	4,078,491	9,613,738	9,179,083
Total Budgetary Resources	$ 7,716,013	$ 71,454,753	$ 250,009,884	$ 235,206,453
Status of Budgetary Resources				
New obligations and upward adjustments (total)	$ 2,597,635	$ 68,624,830	$ 212,402,167	$ 193,052,669
Unobligated balance, end of year:				
Apportioned, unexpired accounts	4,926,090	438,115	32,388,888	36,361,083
Exempt from apportionment, unexpired accounts	0	18,050	18,050	14,458
Unapportioned, unexpired accounts	0	1,302	1,302	3,159
Unexpired unobligated balance, end of year	$ 4,926,090	$ 457,467	$ 32,408,240	$ 36,378,700
Expired unobligated balance, end of year	192,288	2,372,456	5,199,477	5,775,084
Unobligated balance, end of year (total)	$ 5,118,378	$ 2,829,923	$ 37,607,717	$ 42,153,784
Total Budgetary Resources	$ 7,716,013	$ 71,454,753	$ 250,009,884	$ 235,206,453
Outlays, Net				
Outlays, net (total) (discretionary and mandatory)	$ 1,332,806	$ 60,351,671	$ 186,143,926	$ 167,672,059
Distributed offsetting receipts (-)	0	(465,809)	(465,809)	(339,645)
Agency Outlays, net (discretionary and mandatory)	$ 1,332,806	$ 59,885,862	$ 185,678,117	$ 167,332,414

The Air Force has performance measures based on missions and outputs. The Air Force is unable to accumulate costs for major programs based on those performance measures because its financial processes and systems were not designed to collect and report this type of cost information. Until the processes and systems are upgraded, the Air Force will break out programs by major appropriation groupings.

The accompanying notes are an integral part of these statements.

Real Property Deferred Maintenance and Repair

Real Property Deferred Maintenance and Repair For Fiscal Year 2019* (Excludes Military Family Housing) (In Millions of Dollars)						
	2019 (Unaudited)			2018 (Unaudited)		
	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage (Required Work/ Plant Replacement Value)	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage (Required Work/ Plant Replacement Value)
Active Real Property						
Category Buildings, Structures, and Linear Structures (Enduring Facilities)	$285,055	$28,550	10.0%	$288,931	$31,791	11.0%
Category Buildings, Structures, and Linear Structures (Heritage Assets)	$32,428	$1,841	5.7%	$46,238	$1,305	2.8%
Inactive Real Property						
Category Buildings, Structures, and Linear Structures (Excess Facilities or Planned for Replacement)	$19,152	$1,737	9.1%	$129	$0	0.0%

** Information on Real Property Deferred Maintenance and Repair values in the table above reflects available data as of June 30, 2019, which is the most recent compilation of this data.*

Military Family Housing - Real Property Deferred Maintenance and Repair For Fiscal Year 2019* (In Millions of Dollars)						
	2019 (Unaudited)			2018 (Unaudited)		
	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage (Required Work/ Plant Replacement Value)	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage (Required Work/ Plant Replacement Value)
Active Real Property						
Category Buildings, Structures, and Linear Structures (Enduring Facilities)	$10,802	$1,737	16.1%	$11,413	$731	6.4%
Category Buildings, Structures, and Linear Structures (Heritage Assets)	$100	$4	4.0%	$84	$4	4.8%
Inactive Real Property						
Category Buildings, Structures, and Linear Structures (Excess Facilities or Planned for Replacement)	$87	$0	0.0%	$0	$0	0.0%

** Information on Real Property Deferred Maintenance and Repair values in the table above reflects available data as of June 30, 2019, which is the most recent compilation of this data.*

General Overview/Policy

Air Force Deferred Maintenance and Repair (DM&R), consistent with SFFAS 42, Deferred Maintenance and Repairs, amending SFFAS 6, 14, 29 and 32, is facility maintenance and repairs that were not performed when they should have been or were scheduled to be and which are delayed or rescheduled to a future period.

Air Force DM&R policy is to accomplish essential facility maintenance and repair to keep real property assets in a functional and safe condition. Maintenance and repairs include preventative maintenance; replacement of parts, systems, or components; and other activities needed to preserve or maintain the asset in safe, working condition.

These requirements are assessed for probability of asset failure and potential consequential risk to mission. DM&R funding requirements must be balanced with other Air Force priorities for allocation of limited resources.

The two key components for determining real property DM&R on an annual basis are Plant Replacement Value (PRV) and Q (Quality) -Ratings described below. The PRV is a modeled value that represents the cost in current year dollars, to replace an asset in the same location and for the same function. The Air Force continues to evaluate the accuracy of its PRV calculations. The Air Force observed that certain PRV calculations contained erroneous data resulting in invalid asset amounts. The Air Force is continuing to address the underlying data issues in order to support the accuracy of PRV amounts.

Measurement

Plant Replacement Value Process

The PRV and Q-Ratings requirements are updated annually and applied to the current real property quantities which are retrieved from the real property accountable property system of record (APSR). The PRV equation includes the following component factors:

1) Facility Quantity/Size information from the APSR

2) Replacement Unit Cost; Area Cost Factor; Historical Records Adjustment; and the Planning & Design Factor. These component factors are established by the Office of the Assistant Secretary of Defense (Sustainment) based on industry data and standards and are periodically updated.

3) Supervision Inspection & Overhead Factor and Contingency Factor. These component factors are established by the Office of the Assistant Secretary of Defense (Sustainment), the U.S. Army Corps of Engineers and the Naval Facilities Engineering Command based on industry standards. These component factors are periodically updated. The Air Force annually calculates the PRV for real property assets and then updates the real property APSR.

Quality Rating Process (Q-Ratings)/Facility Condition Index (FCI)

The Q-Rating is a value using the total cost of all repairs that have not been performed for real property assets listed in the APSR.

There are three sources of data currently used by the Air Force for producing the dollar value of the required repairs: the Automated Civil Engineering System-Project Management (ACES-PM), NexGen IT and the BUILDER SMS. The business rules for what data is used from these sources are included in the Integrated Data Call (IDC) Guidelines. This document is updated annually and provided to all Air Force Major Commands (MAJCOM) and Installation programmers.

At the end of the fiscal year, the Air Force Civil Engineer Center (AFCEC) develops a report utilizing asset values from ACES-PM and NexGen IT. AFCEC also produces the Q-Rating values and enters those values into Automated Civil Engineering System-Real Property.

Reporting Process

The MAJCOM, Installation Engineering Flight Programming section and Real Property Office (RPO) continually update the two real property subsidiary ledgers, ACES-RP and NexGen IT, throughout the year. In the last quarter of the fiscal year, Real Property Asset Database (RPAD) data is pulled from ACES-RP and NexGen IT. Once the RPAD report is developed, a data validation and verification tool is applied to identify errors that AFCEC reviews and then works with the applicable installation to achieve resolution. RPAD data is then generated and reviewed to produce the Air Force DM&R year-end report containing the current estimated requirements.

FY 2019 DM&R Amounts

The Deferred Maintenance and Repair (DM&R) amounts represent the total amount of maintenance required on all of the real property within the Air Force inventory. Maintenance, captured via work requests and maintenance projects, are captured in the Sustainment Management System (SMS) program that tracks maintenance for all real property. Historically the DM&R amount has grown by about $2 billion each year due to under funding and executing maintenance. This year the DM&R number only grew by $38.0 million, from $33.83 billion to $33.87 billion. The reduced year over year DM&R amount is due in part to a delay in some Air Force bases inputting maintenance and repair information into the SMS system. Two significant examples non-captured damage includes the repairs required at Tyndall and Offutt Air Force Bases, which could add as much as six to eight billion dollars to the DM&R amount.

Equipment Deferred Maintenance and Repair

Equipment Deferred Maintenance and Repair For Fiscal Year Ended September 30, 2019 (In Millions of Dollars)				
Major Categories	**PY DM&R**	**PB-61 Amounts**	**Adjustments**	**Totals**
Aircraft	$106.43	$11,914.23	$11,497.25	$416.98
Automotive Equipment	$0	$24.61	$24.61	$0
Combat Vehicles	$0	$83.83	$83.83	$0
Construction Equipment	$0	$0	$0	$0
Electronics and Communications Systems	$10.24	$2,952.93	$2,944.22	$8.71
Missiles	$3.10	$723.85	$723.41	$0.44
Ships	$0	$0	$0	$0
Ordnance Weapons and Munitions	$0	$67.65	$67.65	$0
General Purpose Equipment	$0.29	$190.85	$190.31	$0.54
All Other Items Not Identified to above Categories	$0	$45.05	$45.05	$0
Total	**$120.06**	**$16,003.00**	**$15,576.33**	**$426.67**

Deferred Maintenance and Repairs for Fiscal Year 2019

Weapon System Sustainment (WSS) is very diverse and encompasses over 120 weapon systems throughout the world supporting 12 Service Core Functions. Those weapon systems consist of fly (fixed wing and rotary wing) and non-fly systems. Fly systems are maintained to meet airworthiness standards and all weapon systems (fly and non-fly) are sustained to perform their assigned mission by the most economical means. Most requirements within WSS are considered Capitalized General Plant, Property, and Equipment.

Defining and Implementing Maintenance and Repair Policies in Practice

As permitted under SFFAS 42, several different basis of estimate methodologies are used to determine maintenance and repair requirements. For example, Programmed Depot Maintenance is a calendar driven interval developed by the Operational Safety, Suitability and Effectiveness authority for the weapon system. During the development of WSS maintenance and repair requirements, approved Force Structure changes are incorporated. Maintenance and Repair (M&R) requirements change from the time of publishing in support of the Program Objective Memorandum (POM) to development of the execution plan for the upcoming execution year. This reflects the most current requirement and funded customer order to support organic depot workload for planning materials and labor. During the WSS mid-year execution review, program office personnel receive guidance to reduce maintenance and repair requirements to what will execute that year unless deferred to another year. If this action would drive deferred maintenance and repair, the requirement remains as unfunded. One of two follow-on actions will occur depending on what Fiscal Year the maintenance and repair requirement is deferred. First, if there is available capacity the following execution year, the deferral will be added as an out-of-cycle requirement. Second, if there is no additional capacity in the following year, the deferral will be added during the normal scheduled requirements development in support of the next POM, which leaves sufficient lead-time for development of capacity.

Ranking and Prioritizing Maintenance and Repair Activities

The program office prioritizes maintenance and repair requirements during the requirements development phase in collaboration with the lead command. Risk-based methodologies determine the acceptable operational risk duringthe building of the POM and Execution Plan. During the execution year, emerging requirements and real world events drive review and reprioritization of maintenance and repair. During the mid-year execution review, programs adjust requirements to what will execute by end-of-year unless the requirement defers to a following year.

Factors Considered in Setting Acceptable Condition

WSS entity defines acceptable condition using Life-cycle costing Significant Changes from Prior Year and Related Events for Operating Agency Code (OAC) 62, (OAC) 41 and (OAC) 87.

The total projected deferred requirements of $426.7 million (M) is due to deferring:

Aircraft

- KC-135 - $81.3M:
    - o $62.8M: Seventeen F108-100 engines were not inducted due to parts constraints and will be moved to future years.
    - o $18.5M: Five F108-100 engines were not inducted due to AFRC’s request not to induct; engines deemed in good condition by the command engine manager and were removed off the wing. Inductions will be moved to future years.
- C-17 - $35.4M: Eight F-117 engines were not inducted due to parts constraints and will be moved to the out years. Three aircraft were deferred due to induction schedule reordering.
- B-52 - $38.6M: Twenty two engines were not inducted due to parts constraints and will be moved to future years.
- C-5 - $4.2M:
    - o $4.2M: Three scheduled vertical stabilizer attachment fittings replacements (Batman Fittings) were not inducted due to capacity constraints and will be moved to future years.
    - o $30.0 thousand: Two scheduled aircraft requiring torque box access panel installations were not inducted due to capacity constraints and will be moved to future years.
- A-10 - $12.7M: Four aircraft deferred due to depot availability
- C-130 - $27.8M: Three aircraft deferred due to PDM Interval date change by engineering

- E-8 - $25.1M: Twelve engines were deferred due to parts constraints
- F-15C/D - $113.5M: Twenty one aircraft were deferred due to parts constraints
- F-15E – $52.7M: 12 PDMs
  - $30.7M: 7 PDMs deferred due to 80% MC for F-22, F-35 and F-16.
  - $13.2M: 3 PDMs deferred due to Induction Pause.
  - $8.8M: 2 PDMs deferred due to no funding in FY 2019 Execution Plan so decision to defer.
- F-16 - $19.8M: Reflow of induction schedule to meet aircraft availability goals
- C-130J – $5.9M: 1 PDM due to the aircraft inability to arrive at depot because of a safety of flight issue

Electronics and Communications Systems

- Space Based Infrared System Programs – $8.7M total:
  - $6.6M: Other Major End Items repairs due to program office decision to move the requirement to a follow on contract which starts in FY 2020
  - $2.1M: Could not fully execute sustainment for RedLAN (a secure data processing and distribution enclave) due to a contract deadline that occurred prior to availability of funds

Missiles

- ICBM – $0.5M: Could not fully execute Higher Authority Communications/Rapid Message Processing Element software update due to late funding

General Purpose Equipment

- Support Equipment & Vehicles - $0.5M: Two A/M32A-60A Gas Turbine Generator Sets not inducted due to capacity constraints and will be moved to future years.

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 8, 2019

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER, DOD
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE AIR FORCE

SUBJECT: Transmittal of the Independent Auditor's Reports on the U.S. Air Force General Fund Financial Statements and Related Notes for FY 2019 and FY 2018 (Project No. D2019-D000FT-0091.000, Report No. DODIG-2020-016)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the U.S. Air Force General Fund Financial Statements and related notes as of and for the fiscal years ended September 30, 2019, and 2018. The contract required EY to provide a report on internal control over financial reporting and compliance with laws and other matters, and to report on whether the U.S. Air Force's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency "Financial Audit Manual," June 2018. EY's Independent Auditor's Reports are attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the U.S. Air Force General Fund financial statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with generally accepted accounting principles. Accordingly, EY did not express an opinion on the U.S. Air Force General Fund FY 2019 and FY 2018 Financial Statements and related notes.

EY's separate report "Internal Control Over Financial Reporting" discusses 12 material weaknesses related to the U.S. Air Force's internal controls over financial reporting.* Specifically, EY's report describes the following significant matters:

- The U.S. Air Force's lack of system integration and reconciliation prevented management from obtaining timely, accurate, and reliable information on the results of its business operations.
- The U.S. Air Force did not have policies and internal controls to support the balance and presentation of the Operating Materials and Supplies account.
- The U.S. Air Force could not report all current year real property activity, did not sufficiently review and monitor data, did not have sufficient procedures in place to record real property Construction-in-Progress, and lacked a process to accurately value real property.
- The U.S. Air Force did not have sufficient procedures to identify, value, and reflect current additions and deletions of General Equipment in its financial statements or to reconcile the accountability systems to the financial statement balances.
- The U.S. Air Force did not sufficiently oversee inventory managed and held by contractors and other defense organizations, and relied heavily upon the other party to report activity and balances related to those materials.
- The U.S. Air Force key internal controls and procedures over Fund Balance with Treasury did not always achieve a complete analysis of, or proper adjustment to the non-Fund Balance with Treasury side when the U.S. Air Force corrected the Fund Balance with Treasury account.
- The U.S. Air Force lacked a sufficient financial reporting process to ensure that complete and accurate financial statements, including related note disclosures, were prepared on a timely basis.

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* A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statements in a timely manner.

- The U.S. Air Force did not have an effective internal control program, which impacted its ability to identify and address significant risks for all key business processes.
- The U.S. Air Force lacked sufficient processes to properly account for contract financing payments, including assessing the completeness of the population of the payments.
- The U.S. Air Force did not consider an assessment of the likelihood of an unfavorable outcome or the reasonableness of a plaintiff's claim against it when calculating the total future liability associated with legal claims for financial reporting.
- The U.S. Air Force did not establish supported balance sheet account balances of the U.S. Air Force General Fund including, but not limited to, valuation of opening balances for Equipment, Real Property, and Operating Materials and Supplies.
- The U.S. Air Force financial information systems controls and computing environment had deficiencies including, but not limited to, access controls, configuration management, and interface controls.

EY's additional report "Compliance and Other Matters" discusses two instances of noncompliance with applicable laws and regulations. Specifically, EY's report described instances where the U.S. Air Force's financial management systems did not comply with the FFMIA, and evidence was not provided to ensure that the U.S. Air Force met the requirements of the Federal Managers' Financial Integrity Act (FMFIA).

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY's representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the U.S. Air Force General Fund FY 2019 and FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control over financial reporting, or conclusions on whether the U.S. Air Force's financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached reports, dated November 8, 2019, and the conclusions expressed within the reports.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

Lorin T. Venable

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting

Attachments:
As stated

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ey.com

Report of Independent Auditors

The Secretary of the United States Air Force and the
Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Department of the Air Force General Fund (USAF), which comprise the consolidated balance sheets as of September 30, 2019 and 2018, and the related consolidated statements of net cost, consolidated statements of changes in net position and combined statements of budgetary resources for the years then ended, and the related notes to the financial statements (the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and U.S. Office of Management and Budget (OMB) Bulletin No. 19-03 *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departures from U.S. Generally Accepted Accounting Principles

As described in Note 1, there are several areas where USAF is not following generally accepted accounting principles. Collections, obligations and outlays presented in the financial statements are misstated for the activity related to joint procurement programs and shared access vendor contracts. Additionally, as described in Note 9, a portion of the real property balance presented at September 30, 2019 does not reflect all the activity during the current fiscal year.

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Lastly, USAF has not implemented certain accounting standards related to accounting issues for the Department of Defense and the Federal government. The effect of these matters on the financial statement amounts and related disclosures involved is not currently determinable by USAF and could be material.

Basis for Disclaimer of Opinion

USAF continues to have unresolved accounting issues and material weaknesses in internal controls that cause USAF to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on USAF's financial statements as of and for the years ended September 30, 2019 and 2018.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis, Required Supplementary Stewardship Information and other Required Supplementary Information, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the information in accordance with auditing standards generally accepted in the United States because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Other Information

We were engaged for the purpose of forming an opinion on the financial statements that collectively comprise the USAF's financial statements. The Other Information, as listed in the Table of Contents, is presented for purposes of additional analysis and is not a required part of the financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

EY
Building a better working world

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 8, 2019 on our consideration of USAF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the USAF's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering USAF's internal control over financial reporting and compliance.

Ernst + Young LLP

November 8, 2019

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Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Air Force and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Department of the Air Force General Fund (USAF), which comprise the consolidated balance sheet as of September 30, 2019 and the related consolidated statement of net cost, consolidated statement of changes in net position and combined statement of budgetary resources for the year ended September 30, 2019, and the related notes to the financial statements and have issued our report thereon dated November 8, 2019. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2019 and the related notes to the financial statements.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered USAF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of USAF's internal control. Accordingly, we do not express an opinion on the effectiveness of USAF's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. 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.

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Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. As described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

Material Weaknesses

The issues, and combinations of issues, forming the material weaknesses represent long-standing internal control deficiencies that reflect a lack of focus prior to recent years on the design of financial accounting and financial information technology control environments. USAF's ability to remediate these material weaknesses, as well as ultimately achieve an unmodified opinion on its financial statements, is dependent on USAF being able to implement and operate a sustainable and auditable business environment given its information system and resource limitations.

Strong collaboration and coordination between the financial management (FM) and functional communities are essential to the development of corrective action plans and related efforts. Several of the newly identified issues in FY19 resulted because FM and all relevant functional areas were not working in concert. Likewise, the development of a long-term strategy to correct deficiencies requires the active participation of senior leaders across the organization to ensure accountability and drive progress.

Further details regarding each of the following matters are included in Appendix A.

ONGOING ACCOUNTING PROCESSES

I. Integration and reconciliation of financial systems

To ensure that the entire population of financial transactions has been recorded in the financial statements, it is necessary to reconcile feeder systems to the general ledger. The USAF has a complex systems environment consisting of multiple non-integrated systems that use non-standard data. The systems environment is composed of legacy mainframe and standalone systems along with an enterprise resource planning (ERP) system, Defense Enterprise Accounting and Management System (DEAMS). These systems are not integrated and require numerous manual workarounds. The lack of an integrated system prevents management from obtaining timely, accurate and reliable information on the results of its business operations. USAF continues to rely on both manual re-entry of data into multiple systems and complex system interfaces that are not fully reconciled. The lack of integration prevents data from processing without significant manual intervention.

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We identified the following:

- Inability to validate the completeness of transactions underlying the financial statements
- Inconsistent execution of Miscellaneous Obligation and Reimbursement Document (MORD) policy
- Multiple control issues with DEAMS
- Transactions not recorded in accordance with the United States Standard General Ledger (USSGL)
- Accounting for joint procurement programs and shared access vendor contracts may not be in accordance with US GAAP
- Unsupported trading partner adjustments
- Inability to maintain and/or provide sufficient documentation in a timely manner

II. Operating Materials and Supplies (OM&S) – OM&S is comprised of munitions, spare engines, uninstalled missile motors (UMM), cruise missiles and other weapon system spare parts. The lack of sufficient policies and internal controls prevents USAF from substantiating existence, completeness, valuation, rights and obligations and presentation and disclosure of OM&S.

We identified the following:

- Lack of sufficient accounting processes to value and report OM&S
- Enhanced procedures are needed to record ongoing OM&S activity

III. Real Property – While additional efforts were made to substantiate existence and completeness of real property assets, including buildings and structures, significant efforts are still needed to remediate identified weaknesses, including the following:

- Inability to report all current year activity
- Insufficient review and monitoring of accountable property system of record (APSR) data
- Insufficient procedures in place to record real property construction-in-progress (CIP)
- Process to assign value to real property needs improvement

IV. General Equipment (Including Military Equipment) – Although certain accountability processes are effective, USAF does not have sufficient procedures in place to identify, value and reflect current additions and deletions of general equipment in its financial statements or to reconcile the accountability systems to the balances reflected in the financial statements.

We identified the following:

- Enhanced processes are needed to record current activity

- Insufficient procedures in place to record all construction-in-progress
- Process to assign value to newly acquired equipment needs improvement

V. Property and materials held by others – USAF has shared service arrangements with other branches of the military, other defense organizations (ODO) and commercial contractors to hold inventory and equipment to avoid duplication of efforts. We found that in many of these instances USAF is heavily reliant upon the other party to report activity and balances related to those materials.

We identified the following:

- Insufficient oversight of OM&S managed by the US Army and the Defense Logistics Agency (DLA)
- Insufficient oversight of government furnished property and contractor-acquired property
- Lack of sufficient accounting for Joint Strike Fighter (JSF) spare parts and associated costs

VI. Fund Balance with Treasury (FBwT) – FBwT is an asset account that shows the available budget spending authority of federal agencies. During our testing of FBwT controls, EY identified that key review controls achieved reconciliation of differences between USAF and Treasury balances and recorded the necessary adjustments to FBwT. However, those procedures did not always achieve a complete analysis of, or proper adjustment to, the non-FBwT side of the correcting entry.

ONGOING FINANCIAL REPORTING

VII. Accumulating and Preparing Financial Statements – The financial reporting compilation function, along with the recording of journal vouchers, is central to any entity's internal control environment and ability to support an audit. While USAF has made progress in improving its financial reporting, several critical areas are not yet resolved. USAF's financial reporting process lacks sufficient processes and internal controls to ensure that complete and accurate financial statements, including related note disclosures, are prepared on a timely basis.

We identified the following:

- Lack of sufficient centralized financial statement analytical and review functions
- Lack of assessment, monitoring and effective implementation of recent accounting guidance
- Enhanced financial statement review procedures are needed

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VIII. Oversight and Monitoring of Internal Control – Internal Control is a process affected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, Appendix A, (Circular A-123) also emphasizes management's responsibility for establishing and maintaining effective internal control over financial reporting. USAF does not have an effective OMB Circular A-123 program, which has impacted USAF's ability to identify and address significant risks for all key business processes.

We identified the following:

- Lack of an effective internal control program
- Lack of sufficient monitoring of third-party service providers

IX. Contract Financing Payments – USAF lacks sufficient processes to properly account for contract financing payments, including the assessment of population completeness. Capitalized costs incurred before assets are placed in service should be recognized in General Property, Plant and Equipment (GPP&E) or Inventory and Related Property (I&RP), however, USAF currently reports these amounts as "Non-Federal Other Assets." Additionally, contract holdbacks are reported as a component of "Other Liabilities," instead of "Accounts Payable."

X. Contingent Legal Liabilities – USAF's contingent liabilities include contingent legal liabilities where General Counsel considers an adverse decision probable and the amount of the loss measurable. USAF also discloses those cases that are determined to be reasonably possible for adverse decision. The lack of sufficient policies and procedures prevents USAF from substantiating the completeness, accuracy and presentation and disclosure of contingent legal liabilities. Additionally, USAF does not consider an assessment of the likelihood of unfavorable outcome or the reasonableness of plaintiff claims against USAF when calculating the total future liability associated with legal claims for financial reporting.

<u>BEGINNING BALANCES</u>

XI. Establishing opening balances for assets (and related liabilities) used in operations – The processes to establish the balance sheet account balances of USAF that were initiated by transactions occurring in prior years have not been completed. This requires a substantial effort to establish the completeness of the population of those assets, and liabilities, as well as gathering documentation supporting the value of the population identified or using recently established accounting guidance to estimate those values.

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We identified the following:

- Valuation of opening balances for equipment cannot be supported
- Valuation of opening balances for real property cannot be supported
- Enhanced procedures are needed to identify the beginning balance population for real property
- Insufficient procedures in place to record all environmental and disposal liabilities
- Opening balance valuation and ownership cannot be supported for OM&S

FINANCIAL INFORMATION SYSTEMS

XII. Financial Information Systems – Our assessment of USAF's IT controls and the computing environment identified deficiencies which collectively constitute a material weakness in the design and operation of information systems controls over financial data. Based on our testing, we identified the lack of sufficient controls in the following areas:

- Security management
- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Interface controls

Significant Deficiency

During our audit, we also noted the following matter involving internal control over financial reporting and its operation that we consider to be a significant deficiency. Further details regarding this matter is included in Appendix B.

I. Reimbursable Programs – USAF does not have sufficient controls in place to ensure that reimbursable costs are being properly billed to customers in accordance with their reimbursable agreements / customer orders.

We identified the following:

- Unsupported adjustments to balance unfilled customer orders (UFCOs) to reimbursable obligations
- Lack of sufficient reviews over reimbursable activity
- Improper accounting for reimbursable agreements

USAF's Response to Findings

USAF's response to the findings identified in our engagement, as described above, are included in its letter dated November 8, 2019, which has been included at the end of this report. USAF's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 8, 2019

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Appendix A – Material Weaknesses

ONGOING ACCOUNTING PROCESSES

I. INTEGRATION AND RECONCILIATION OF FINANCIAL SYSTEMS

USAF has a complex systems environment consisting of multiple non-integrated systems that use non-standard data. The systems environment is composed of legacy mainframe and standalone systems along with USAF's enterprise resource planning (ERP) system, Defense Enterprise Accounting and Management System (DEAMS). The lack of a fully integrated system prevents management from obtaining timely, accurate and reliable information on the results of its business operations. USAF continues to rely on both manual re-entry of data into multiple systems and complex system interfaces that are not fully reconciled. The lack of integration prevents data from processing without significant manual intervention. Additionally, many of USAF's corrective actions to date have resulted in workarounds (e.g., additional reconciliations, journal vouchers) to address identified weaknesses given current system or resource limitations. The next significant step in the evolution of USAF's financial control environment, however, needs to be the inclusion of a multi-layer analysis, review, repair and remediation cycle. USAF will need to implement and operate a sustainable and auditable business environment through enhanced integration and innovation capabilities deployed in a targeted manner.

The following deficiencies aggregated into this material weakness:

(a) Inability to validate the completeness of transactions underlying the financial statements

If an entered transaction does not contain the necessary data elements required to post to the general ledger (e.g., fiscal year, appropriation, account, amount), or there are other issues with the transaction, the transaction will not post in the General Accounting and Finance System-Reengineered (GAFS-R), USAF's legacy general ledger, and will be held pending further analysis. These excluded transactions are a significant cause of supporting system balances not agreeing with the respective balances in GAFS-R. Accordingly, to find and correct these discrepancies, reconciliations should be performed at the transaction level and include all systems that directly or indirectly supply financial data to GAFS-R.

USAF has worked with its service provider, the Defense Finance and Accounting Service (DFAS), to create the Statement of Budgetary Resources Automated Reconciliation Tool (SBR-ART), which is used to reconcile approximately 20 feeder systems to GAFS-R. SBR-ART represents a significant effort to achieve an automated and sustainable reconciliation process. DFAS has a process to research the excluded transactions identified by SBR-ART; however, the activity remains excluded from GAFS-R until the individual transactions are researched and remediated. Similar unmatched transactions occur in DEAMS and reconciliation procedures are performed to

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research and correct the transactions. However, again, no provision is made to reflect the unreconciled activity in period-end financial statements.

Integrated Logistics Systems-Supply (ILS-S) and Mechanization of Contract Administration Services (MOCAS) are also significant feeder systems into GAFS-R. ILS-S is reconciled within SBR-ART at the summary trial balance level, while MOCAS is not included within SBR-ART. During our procedures, we had the following observations related to those feeder system reconciliations:

- As Military Standard Requisitioning and Issue Procedures (MILSTRIP) General Supply transactions from the ILS-S post at a summary level in GAFS-R, a reconciliation is needed between detailed budgetary ILS-S transactions and the ILS-S summary file. An automated ILS-S to GAFS-R detail to summary reconciliation is still in development. Until that reconciliation process can be regularly performed, USAF is unable to support the recorded MILSTRIP general supply obligations and disbursements.
- Although there is a process to reconcile the MOCAS feeder system to General Accounting and Finance System-Base Level (GAFS-BQ), variances are not remediated on a timely basis.
- During FY19, USAF implemented a reconciliation between MOCAS and DEAMS. Due to the lack of a direct interface between MOCAS and DEAMS, MOCAS transactions do not flow to DEAMS and must be manually entered. In our discussions with USAF and DFAS, as well as review of the standard operating procedures (SOP), we noted that a manual input is required to indicate that a transaction is a MOCAS transaction. As a result, there is a risk that the complete population of MOCAS transaction may not be identified in performance of the reconciliation.

USAF also has Accountable Property Systems of Record (APSR), which are logistical systems used to accumulate financial related data for mission critical assets, including general equipment, real property, inventory, operating materials and supplies and internal use software (IUS). USAF has sought to develop separate reconciliation procedures, at a detail and summary level, to assess the completeness of data flowing from APSRs to the financial statements. We were unable to reperform these various APSR reconciliations due to incomplete or inaccurate process steps within the reconciliation, including but not limited to the following:

- Failure to reconcile the complete APSR data population
- Lack of sufficient evidence of review of the reconciliations
- Lack of timely completion of reconciliations
- Reconciliation process only verified whether entries made to the proprietary accounts were appropriately reconciled and did not consider budgetary accounts
- Research performed to identify variances were not sufficiently evaluated, documented and validated

The Unadjusted Trial Balance to Adjusted Trial Balance (UTB to ATB) reconciliation is designed to reconcile the feeder systems to the financial statements and provide reasonable assurance that these trial balances are complete and accurate. During FY19, USAF overhauled the UTB-ATB reconciliation and continues to refine their process of reconciling feeder systems to the financial statements. USAF currently performs a UTB to ATB reconciliation at the summary trial balance level by manually reconciling the GAFS-R and DEAMS feeder files to the Department of Defense (DoD)-wide Defense Departmental Reporting System-Budgetary (DDRS-B), DDRS-B UTB to ATB, DDRS-B to DDRS-Audited Financial Statements (AFS), and DDRS-AFS to Governmentwide Treasury Account Symbol (GTAS) trial balances at a summary level. All variances are then researched and reviewed. USAF has not yet finalized documentation for the updated process. EY re-performed the UTB to ATB utilizing the universe of transactions data and JV logs and identified numerous variances between the DEAMS to DDRS reconciliation. USAF was not able to timely reconcile these variances.

(b) Inconsistent execution of MORD policy

Miscellaneous Obligation and Reimbursement Documents (MORDs) are designed to be used to temporarily record known obligations or reimbursements when the required documents to support the obligation/reimbursable transactions are not immediately available, as well as other limited purposes.

During FY19, we performed limited additional testing of MORDs due to the pending corrective actions. We noted that the following outstanding conditions where USAF MORD policy was not followed based on our previous testing:

- Obligations and unfilled customer orders (UFCOs) where adequate documentation existed but were placed on MORDs to be fully executed, rather than using the intended mechanism (e.g., contract, MIPR).
- USAF recorded obligations in advance of a legally binding agreement. These MORDs were used to reserve funds until a contract was signed and, at the time, should have instead been recorded as a commitment.
- Incorrect MORD type was used to reclassify Foreign Military Sales (FMS) civilian pay labor obligations from direct obligations to reimbursable. Instead of using a zero-balance MORD that does not generate a financial statement impact, USAF created a new reimbursable obligation in addition to the direct obligation previously recorded. This resulted in a duplicate obligation.

Given the significant usage of MORDs throughout the organization for varied purposes, USAF lacks sufficient centralized oversight to understand and monitor how MORDs are being used throughout the organization, including whether they are in accordance with established policies and whether they are appropriately supported. Additionally, MORDs are often used to record estimates. Estimates represent risks, particularly related to valuation, as accounting estimates can

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vary widely in complexity and degree of uncertainty associated with determining the amount. It is important that USAF also assess the sufficiency of documentation supporting how estimates were determined, including assumptions used in the calculation.

EY noted that in FY19 USAF began actions to address the above conditions. This includes an analysis of MORDs with activity between October 2017 and June 2019 and testing samples to assess the MORD category/type, purpose code, extent of supporting documentation and segregation of duties considerations between preparer and approver. Preliminary results from USAF's samples found consistent results, including inconsistent use or missing category/type, purpose code or adequate supporting documentation. USAF is using the insights gained as a result of this testing to further refine its planned corrective actions.

(c) Multiple control issues with DEAMS

As mentioned above, USAF is in the process of deploying DEAMS, an ERP system designed to manage the USAF General Fund. Beginning in FY19, DEAMS no longer is a feeder system of GAFS-R. Instead, DEAMS is USAF's second general ledger system that feeds directly to DDRS.

We have identified several conditions which indicate that USAF needs to continue to develop the DEAMS control environment, including the following:

- Insufficient DEAMS trial balance reconciliation
- Lack of sufficient review over the End of Period (EoP) exception report. This report is a cumulative, aggregated listing of all identified variances and exceptions that are outstanding. There is no aging of exceptions or variances within the report. This and other report design issues inhibits the ability of USAF to review and monitor the timely resolution of variances, including whether any adjustments are required for the period.
- Lack of sufficient monitoring over DEAMS reject files
- Insufficient monitoring over DEAMS posting logic compliance with the USSGL and US Treasury Financial Manual (TFM). A significant number of DEAMS Transaction Codes (T-Codes) are not mapped to a corresponding TFM entry.
- Insufficient review of DEAMS journal vouchers (JVs)
- Lack of sufficient review over the DEAMS sub-ledger to DEAMS general ledger reconciliation. There is no aging of exceptions or variances within the report. Additionally, the report only tracks the count of exceptions, not the materiality of any exceptions identified. This and other report design issues inhibit the ability of USAF to review and monitor the timely resolution of variances.

USAF has indicated that DEAMS is currently awaiting a major system update to Oracle R12, which is currently anticipated in FY20. System design/change requests are generally on hold pending this update. As a result, there is a large backlog of tickets that will need to be resolved, some of which relate to the above conditions, once DEAMS is updated to Oracle R12.

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(d) Transactions not recorded in accordance with the USSGL

USAF's posting logic utilizes postings and accounting that are not compliant with the United States Standard General Ledger (USSGL) and Standard Financial Information Structure (SFIS) posting logic. Examples of accounting that are not compliant with the USSGL and have not been remediated include:

- Budgetary and proprietary transactions are not posted utilizing single lines of the posting logic. Each transaction is posted by separate posting logic for budgetary and proprietary accounting. This is non-compliant with SFIS and USSGL transaction-level posting guidance and impedes the ability to perform a budgetary to proprietary reconciliation at a transaction level.
- The USAF records progress payments as advances rather than incurred expenses, which does not comply with either USSGL accounting or DoD policy.
- The USAF utilizes a process known as assumption accounting to post certain reimbursable transactions. As certain systems do not have the ability to distinguish between direct and reimbursable obligations, USAF assumes that when cash is received, a corresponding disbursement has already been recorded using direct budget authority. USAF then uses unsupported and non-compliant entries to reclassify the disbursement from direct budget authority to reimbursable.
- A recovery represents a reduction recorded in the current year for a delivered or undelivered order recorded in the prior fiscal period. The USAF utilizes system generated adjustments to identify and post the recoveries population rather than identifying recoveries at the transaction level. However, we identified several recovery transactions that were improperly generated by the system adjustments, overstating recoveries and obligations as a result. These identified errors occurred because the system script improperly identified transactions as recoveries and manual controls did not detect the error.
- In our testing of USAF's approximately 2,000 GAFS-R posting logic rules, approximately 550 were inappropriately mapped to the TFM and approximately 880 had not been mapped by USAF to the TFM or could not be evaluated due to missing data elements. As mentioned in (c) above, there were also a significant amount of DEAMS T-Codes that were also not mapped to the TFM.

(e) Accounting for joint procurement programs and shared access vendor contracts

USAF has indicated that amounts presented for collections, obligations and outlays related to joint procurement programs and shared access vendor contracts may not be stated materially correct. While the activity for these programs and contracts may be accounted for in accordance with DoD policies, in some instances, the accounting treatment is not in accordance with U.S. generally accepted accounting principles (GAAP). Collections, obligations and outlays are misstated by any difference between USAF expenditures and the USAF actual specific allocations of contract cost, which cannot be calculated. Additionally, due to a lack of comprehensive financial management

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policies related to these activities and insufficient assessment of guidance, the accounting treatment in some instances is not in accordance with GAAP.

While updated DoD guidance and related accounting standards have been issued, USAF has not fully assessed the impact of these revisions, including the resulting impact on USAF's ability to support budgetary beginning balances.

(f) Unsupported trading partner adjustments

Intragovernmental transactions result from business activities conducted between two federal government entities, called trading partners. Accounting differences occur in government-wide financial reporting when trading partners record differing amounts for transactions that should eliminate or net to zero. Entities must reconcile and resolve these differences on a routine basis with their trading partners. Through September 30, 2019, USAF followed the DoD Financial Management Regulation (FMR) guidance (Volume 6b Chapter 13) whereby the DoD reporting entity making sales, or providing services ("seller-side"), to another DoD reporting entity ("buyer-side"), would be the basis for reporting most of its intra-DoD balances.[1]

In accordance with DoD guidance, DFAS-Indianapolis obtained the seller-side data from USAF's trading partners in order to make adjustments. DFAS-Columbus compared the seller-side data obtained from DFAS-Indianapolis to the GAFS trial balance data at the appropriation level by trading partner. That difference was the basis for the adjustments. There was no reconciliation at the agreement or document level to the trading partner adjustments that are being made. Trading partner adjustments are recorded in DDRS-AFS as top-side adjustments and are identified as unsupported by DFAS.

(g) Inability to maintain and/or provide sufficient documentation in a timely manner

Further progress is needed by USAF and its service providers to provide complete documentation, in a timely manner to support an audit.

During our current year testing, we identified the following:

- Improper management and retention of supporting documentation (e.g., support agreement, customer order/acceptance, delegation of authority, customer voucher)
- Lack of consistent implementation of documentation standards at USAF for maintaining complete records

[1] In its Memorandum dated May 3, 2019, the policy mandating the use of "seller side" information to derive the buyer's balance was rescinded effective the first quarter of FY20.

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- Lack of sufficient support for estimates, including the analysis that was utilized to develop the estimate, the factors utilized to develop the estimate and a subsequent reconciliation of estimates to actuals
- Inability to provide supporting documentation to auditors in a timely manner

USAF's inability to provide adequate support for accounting transactions, increases the risk of a misstatement that could impact the financial statements. Furthermore, without such supporting documentation and proper audit trail, there is an increased risk of noncompliance with applicable laws and regulations.

Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Continue to implement and develop feeder system reconciliation processes for the identified systems to support completeness of the financial statements.
- Ensure that variances identified in any universe of transaction reconciliation are investigated and remediated on a timely basis.
- Evaluate the effectiveness of the design, implementation, and operation of the APSR reconciliation process and develop an adequate standard operating procedure for reconciling each APSR system.
- Perform an analysis of the period-end reconciling items that documents the appropriate adjustments for any unrecorded transactions. If an adjustment cannot be determined, or if USAF management decides to not make an adjustment, USAF should document the impact of not recording an adjustment, including an assessment of the impact of these unrecorded transactions on the financial statements.
- Develop/enhance process to perform a quarterly detail level UTB to ATB reconciliation using the full detail data sets to ensure the completeness and accuracy of the data as it flows from the general ledger to the financial statements.
- Improve compliance with MORD policies:
    - Evaluate current policies and procedures against practices in the field to identify the root cause(s) of conditions. Identify key gaps and inconsistencies in current procedures versus field implementation
    - Implement and/or enhance supporting documentation and estimation guidelines for MORD obligations, as needed
    - Provide training and implementation guidance on any procedures where issues were noted to ensure consistent application, including:
        - Documenting detailed explanation for MORD use and estimation of obligation amount.
        - Retaining documentation for resulting expenses and verifying that they do not exceed obligated funds

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  - Evaluate whether additional centralized oversight is needed to monitor whether MORDs are being used for the intended purposes as stated within the USAF MORD Policy.
- Implementation of the DEAMS R12 Oracle upgrade. Prioritize the outstanding system change requests, such as those that relate to the conditions noted above
- Review established procedures to ensure that JV support packages and associated review are performed and documented appropriately
- Improve monitoring over the general ledger to identify and correct accounting that does not comply with the TFM.
- Identify accounting policies or practices that do not comply with the TFM and take corrective actions.
- Implement necessary data elements to allow all reimbursable obligations to be entered in the general ledger utilizing reimbursable budget authority.
- Accounting for joint procurement programs and shared access vendor contracts
  - USAF should implement monitoring procedures over recorded disbursements and collections to validate they represent USAF transactions.
  - USAF should continue to coordinate with the Office of the Undersecretary of Defense (Comptroller), DFAS and others to determine if the current accounting policies are GAAP compliant and what, if any, corrective actions are needed to move to a GAAP compliant policy.
- Unsupported trading partner adjustments
  - Evaluate trading partner adjustments, prioritize based on dollar value and risk and begin a reconciliation process at the document level.
  - When implementing DEAMS, take into consideration requirements for reconciling trading partner adjustments and evaluate how to incorporate those needs into the new system.
  - Implement document level reconciliations with USAF trading partners and develop a process for resolving differences at the document level.
- Address USAF's ability to access and provide supporting documentation for all significant transactions:
  - Evaluate current and specific processes / policies and procedures against practices within USAF to identify root cause of conditions noted. Identify key gaps and inconsistencies in current procedures versus field implementation.
  - Increase communication between Secretary of Air Force/Financial Management team (SAF/FM) and process owners to ensure sufficient, complete documentation is provided as part of documentation requests.
  - Assess resource and training needs to meet the requirements for undergoing an audit
  - Implement an on-going monitoring process of field implementation compared to procedures to ensure consistent application and understanding of key processes and transactions.

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- o Evaluate individual issues identified in the conditions above and perform corrective action, as needed, to ensure identified samples have required supporting documentation and are provided to the auditor in a timely manner.

II. OPERATING MATERIALS AND SUPPLIES

(a) Lack of sufficient accounting processes to value and report OM&S

OM&S is classified as held for use (USSGL 1511), held in reserve for future use (USSGL 1512), held for repair (USSGL 1514) and excess, obsolete and unserviceable (EOU) (USSGL 1513). Financial statement classification is supported by mapping logistics supply categories and condition codes to USSGL accounts, as well as an assessment of obsolescence.

During our testing we identified findings which could lead to a material misstatement of balances reported on the balance sheet and/or disclosure misstatements between OM&S categories. These examples highlight the lack of sufficient coordination between the financial management and the functional community regarding the accounting/financial reporting impact of non-financial data maintained by the functional community.

<u>Supply Categories</u>

Logistics supply categories relate the quantity of a given item to its expected use during the year. These categories include:

- The Approved Acquisition Objective (AAO) level is the quantity of an item authorized for peacetime and wartime requirements to equip and sustain U.S. and allied forces according to current DoD policies and plans.
- Economic Retention Stock is the level of stock above the AAO level that it is more economical to retain than to dispose and then potentially repurchase if subsequently needed.
- Contingency Retention Stock is stock above the AAO and Economic Retention Stock levels that is held to support specific contingencies.
- Excess inventory is the amount of inventory above the sum of the AAO and inventory retained for economic and contingency purposes.

During our testing, we identified the following instances where OM&S was classified as held for use (USSGL 1511) instead of another classification:

- The balance of munitions and spare engine retention stock are not classified as held in reserve for future use (USSGL 1512).
- The balance in excess of munitions and spare engine requirements and retention stock are not classified as excess, obsolete and unserviceable (USSGL 1513).

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Supply Condition Codes

Supply condition codes classify material in terms of readiness for issue and use or identify action underway to change the status of the material. Supply condition codes are assigned at base level/ depot level by the Program Office based on the status of the assets. USAF lacks independent accounting review controls to analyze whether the accounting classification of assets in a condition code complies with the Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*. For example, USAF uses condition codes "E" Unserviceable, "J" Suspended In Stock, and "K" Suspended (Returns) to classify assets needing additional expenditures related to inspection or restoration. USAF relies on the relevant section of the DoD FMR to assign these condition codes to OM&S held in reserve for future use. USAF has not evaluated whether the munitions are maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, as required by SFFAS 3. Additionally, USAF has not fully remediated the issue identified in the prior year where the condition codes tagged on certain uninstalled missile motor (UMM) assets did not correspond with the condition codes as indicated in the APSR. While USAF undertook actions to reconcile all tagged UMM condition codes with the APSR, USAF is still assessing the impact of a new APSR, Theater Integrated Combat Munitions System (TICMS), relative to the long-term intent of streamlining the condition code process.

Obsolescence

Additionally, USAF lacks a sufficient process to assess obsolete OM&S, which are materials and supplies that are no longer needed due to changes in technology, laws, customs or operations. Obsolete OM&S are considered impaired and should be recorded at an estimated net realizable value (NRV). USAF has not developed and disclosed criteria for identifying obsolete munitions, spare engines and contractor inventory control points (C-ICP). Additionally, USAF did not sufficiently assess and document its decision to classify the following UMMs as held for use, rather than obsolete:

- Rocket System Launch Program (RSLP) Program is established to provide storage and aging surveillance for deactivated Minuteman, Peacekeeper and other missile assets and will be demilitarized once funding is available. Currently the only active motor in Intercontinental Ballistic Missiles (ICBM) fleets is Minuteman III. RSLP has 460 non-Minuteman III motors, with a total moving average cost (MAC) value of $976 million classified as held for use (Condition Code A) as of FY19 Q2.
- As of FY19 Q2, 23 Minuteman II motors under ICBM program, with total MAC value of $7 million, were classified as held for use (Condition Code A). The Minuteman IIs are no longer active and USAF reclaims parts from Minuteman IIs for Minuteman IIIs. Based on our testing, the ICBM Program Office reclassified these assets as Obsolete OM&S in FY19 Q3.

During our procedures, we noted several other instances where USAF needs improvement in its processes to value and report OM&S, including:

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- Lack of systems in place to account for inventory and related property under SFFAS 3
- USAF's current process allows for the expensing of capitalized assets at initial acceptance, which are then reversed and capitalized when assets are received at the final destination. This process leads to a series of non-TFM compliant entries. In addition, based on their current treatment, USAF lacks a reconciliation to ensure that all initially recorded capitalizable expenses are fully reversed when new acquisitions/assets are accepted at the final destination and capitalized. As a result, there is a risk of variances between the initial expensed cost and the final capitalized cost. For example, for C-ICP, the assets are initially expensed at the historical price. When the assets are capitalized, USAF uses the catalog price from the Federal Logistics Information System (FLIS). The difference is currently not recognized.
- Insufficient accounting of NRV for EOU OM&S. USAF currently reports NRV for EOU OM&S as $0, which does not reflect the economic value of recoveries. USAF does not have a process to document its analysis of the estimated amount that can be recovered from selling or disposing of an item less the estimated costs of completion, holding and disposal.
- Lack of OM&S repair allowance for OM&S that is Held for Repair (USSGL 1514)

Finally, we identified several other conditions that indicate a lack of sufficient accounting oversight over OM&S activity:

- Insufficient monitoring of APSR activity, including review of the posting logic utilized in the generation of a Chief Financial Officer (CFO) report summarizing current period transactions
- Lack of sufficient review over journal vouchers used to record munitions in DDRS-B
- Insufficient assessment and reconciliation of budgetary and proprietary OM&S transactions
- Incomplete assessment of transportation and storage support equipment (e.g., load adapters and reusable containers) currently included within the munitions OM&S balance
- Lack of an analysis documenting USAF's determination that obligated engines (i.e., engines that have already been issued to an aircraft) that are uninstalled from an aircraft for maintenance should be classified as OM&S
- Lack of sufficient assessment of the accounting treatment for FMS transactions

(b) Enhanced procedures are needed to record ongoing OM&S activity

USAF did not have a complete and accurate population of its OM&S assets due to unremediated conditions identified in the prior year, including:

- Spare engines are not updated timely in the APSR
- Munitions are not recognized in the APSR until they are physically received at an Air Force location, although they have been previously accepted by the Defense Contract Management Agency (DCMA) at a vendor location prior to shipment. During this shipment period, the USAF has ownership of the asset, but these assets are not included in USAF systems.

While USAF has taken actions to address each of these conditions in FY19, the issues have not been fully addressed.

EY has additionally identified potential segregation of duties conflicts and management override conditions that has not been sufficiently assessed and documented:

- Spare engines
    - The Engine Manager records transactions that affect the inventory balance, performs the physical inventory count, and records inventory adjustments
    - The Engine Manager can print engine data plates and control the serial number on the plates
- UMMs - the ICBM Aerospace Vehicle Distribution Officer (AVDO) authorizes shipping and receiving transactions by signing the DD Form 1149 and then records the transaction in the Integrated Missile Database (IMDB) using the same source document
- Munitions
    - The munitions in-checker takes possession of munitions at the base and records transactions in Combat Ammunition System (CAS), the munitions APSR. This step combines custody and accounting functions in one person's responsibility.
    - The munitions inspector initiates condition code changes through inspection and records the condition code changes in CAS, combining authority and accounting in one person's responsibility.

Recommendations:

EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Establish criteria, as well as policies and procedures, on how to implement the proper use of Logistic Supply Condition Codes and Logistic Supply Categories.
- USAF should develop policies and regularly perform an analysis to identify obsolete OM&S.
- Establish formalized plan and timeline for completion of efforts to account for inventory and related property under SFFAS 3.
- Establish consistent accounting guidance and evaluate APSR business rules to ensure compliance with GAAP.
- Evaluate and redesign controls where roles and responsibilities of the control owner include a combination of authority, custody, and accounting to enforce segregation of duties
- Increase communication between the personnel who initiate and record transactions.

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III. REAL PROPERTY

USAF's Real Property (RP) consists of land, buildings, structures and linear structures. RP asset information and activity (e.g., acquisitions, transfers and disposals) is recorded within the APSR as utilized by the installation Real Property Office (RPO) as well as other applicable organizations within the functional community. Currently, the Air Force is in the process of transitioning all RP data and related tracking from their current system of record referred to as the Automated Civil Engineering System-Real Property (ACES-RP) to NexGen-IT (TRIRIGA). Therefore, some installations operate on ACES-RP while other have completed the migration to NexGen-IT.

The following deficiencies aggregated into this material weakness:

(a) Inability to report all current year activity

During FY19 procedures, EY inquired of USAF as to the main driver of significant movements of RP asset value noted within the APSRs. USAF performed an entity-wide rebaselining effort to deemed cost using Plant Replacement Value (PRV) for all RP assets during the second quarter of the current fiscal year. Refer to the section (b) below for further information on PRV.

The current year efforts to revalue Real Property assets resulted in the PRV baseline to increase the net book value of Real Property by approximately $115 billion or 313% in Q3 over the average asset balance. While it would be expected that the PRV value would be higher than the previously reported values, based on EY inquiries and additional USAF research, USAF communicated that there were significant errors in the rebaselined amounts originally reported in USAF's Q2 financial statements. These included:

- Errors in data elements driving the PRV calculation resulted in significant misstatements. For example, for one asset the unit of measure quantity in the APSR was "square feet" instead of "each." As a result, instead of multiplying the replacement unit cost (RUC) of $950,000 by 1 each, it was multiplied by 4,500 square feet, leading to an amount being reported of $5.4 billion. This asset had a total cost of $436,000 prior to the PRV rebaseline. Refer to section (b) for further information.
- Instead of being recorded as a prior period adjustment, the change in value was recorded in the current year, creating material misstatements in amounts reported for Real Property, Depreciation Expense and Transfers-In.

When the PRV rebaselining was executed by USAF, the existing acquisition costs were overwritten by PRV amounts. Until an accurate and complete revaluation can be performed using validated PRV inputs, USAF has determined that reporting historical values is a better presentation of real property balances than the inflated PRV amounts and has recorded adjustments to mitigate the negative impact on the financial statements. However, as a result, a significant amount of current year activity has been reversed, including non-PRV activity related to ongoing operations. While USAF is able to delineate the PRV transactions in NexGen-IT and DEAMS, this currently

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cannot be done with ACES-RP and GAFS-R data. As a result, the real property balances being reported in the financial statements at Q4 varies by system:

- Amounts recorded in GAFS-R from ACES-RP represent balances as of December 31, 2018, with an estimated depreciation expense calculated based off pre-PRV historical values.
- Amounts recorded in DEAMS from NexGen-IT should reflect ongoing (i.e., non-PRV) activity from 2019.

As a result of the above, real property and related activity accounts may be misstated, but the amount of the misstatement cannot be determined.

(b) Insufficient review and monitoring of APSR data

Real property asset information and activity (e.g., acquisitions, transfers and disposals) is recorded within the APSRs as utilized by the installation RPO as well as other applicable organizations within the functional community. Assets have various characteristics recorded in the APSRs based upon the nature and category of the asset as set forth within the DoD Real Property Categorization System (RPCS) that serves as the framework for identifying, categorizing, and analyzing DoD's inventory of land and facilities. Much of the information currently within the APSR, although some data elements are non-financial in nature, has a direct or indirect impact on USAF's financial statements. During our procedures, we noted that USAF does not have sufficient review and monitoring procedures over the completeness and accuracy of data contained within its APSRs (i.e., ACES-RP and NexGen-IT).

Additions and Disposals

During our testing, we identified instances across all installations in which the USAF real property APSRs were not complete and/or accurate.

While the USAF has a documented control in which the RPO receives, reviews, and enters information from the Form DD 1354 into the APSR within 10 days of the placed in-service date, not all USAF assets that EY physically observed during our existence and completeness procedures were included in the APSR. Additionally, USAF lacked sufficient procedures to compensate for periodic DoD-wide system outages of the Data Analytics and Integration Support (DAIS) system that assigns Real Property Unique Identifiers and Real Property Site Unique Identifiers. While USAF had communicated a procedure intended to work around the DAIS challenge, this procedure was not consistently followed by RPOs. This led to a number of real property assets not being added to the APSR in a timely manner.

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Additionally, EY identified insufficient controls related to the demolition or disposal of facilities. Across installations visited, EY noted instances where facilities:

- Had been physically demolished, but remained within the APSR as an active asset
- Had been removed from the APSR without proper receipt of an approved AF Form 300 and Form DD 1354 and, while potentially slated for demolition, remains physically intact on an installation.

USAF undertook efforts in FY19 to perform 100 percent reconciliation of real property assets, with particular focus on buildings, in order to address these issues. However, due to USAF's inability to report all current year activity as discussed in section (a) above, not all corrections that were identified as result of these procedures are reflected in USAF's APSR and resulting financial statement balances at September 30, 2019.

<u>Data Elements Utilized in the Calculation of PRV</u>

Based upon our discussions with USAF, it is our understanding that USAF will be using PRV (e.g., replacement cost) as an alternative valuation method for beginning balances of real property, as permitted by SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*.

Air Force General PP&E Real Property facilities are assigned a category code (CATCODE) that depicts the functions of the facilities and the major subcomponent spaces as they relate to the intended mission. A CATCODE is a five or six-digit code used by USAF that represents a specific type of facility. Each CATCODE is mapped to a specific Facility Analysis Category (FAC) Code, to include use of the unit of measure assigned to that FAC. A FAC is a grouping of RP assets that have a common unit of measure and equivalent cost based on that unit of measure. FAC is used to determine replacement unit costs, which is a key input into the PRV of an asset.

In addition to CATCODE, or facility use, Real Property assets as recorded within the APSRs contain various data elements that describe all characteristics of the facility (e.g. size, age, ownership, status, etc.). Each respective Base Civil Engineer (BCE) and RPO is required to verify these elements as accurate and ensure timely updates are made to the APSR. These data elements each individually contribute to the reportability of the assets for financial reporting purposes.

During our testing, we noted the following:

- Lack of sufficiently documented high-level review of APSR data for anomalies and/or inaccuracies

  While daily monitoring and verification of real property asset records is the responsibility of the individual installations, USAF does not conduct a high-level review of the consolidated

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APSR data with focus on key data fields that impact asset valuation or determination of rights and obligations. Through our independent high-level review of the APSR data, EY noted multiple instances of data anomalies that could not be explained by USAF or were subsequently confirmed by USAF to be errors. For example,

- EY identified instances in which RP facilities had a calculated PRV significantly greater than other facilities in the APSR with the same CATCODE. As a result of inquiry with USAF, it was noted that one of the primary drivers of the inconsistency was inappropriate designation of the Unit of Measure (UoM) for the asset. Consistent with the example discussed in section (a), this arose because some assets with a particular CATCODE had the appropriate UoM of “Each” (EA), while others were designated as “Square Feet” (SF) within the APSR. These errors require a correction of the UoM within the APSR.
- Instances where previous net book value (NBV) exceeded PRV. As discussed in section (a) above, in most cases, PRV would be higher than NBV. In one example, this situation arose because the RPO selected a CATCODE that was not entirely reflective of the level of complexity and nature of the asset, but the RPO felt this was the most appropriate.

Most of USAF’s policies regarding APSR data reviews and integrity are directed to individual RPOs. There currently is not a process in place to analyze APSR data and determine potential errors across locations that RPOs may not be in the position to individually identify.

- Further, as such we assessed the CATCODEs of a sample of RP assets observed and found the following:

  - Instances in which a CATCODE assigned to a RP facility in the APSR is not reasonable or consistent with the CATCODE guidance issued by USAF.
  - Instances where the application of CATCODE to a set of facilities is inconsistent both across installations and within a particular installation.

<u>APSR Posting Logic and Financial Reporting Impact</u>

USAF has not fully identified and assessed the posting logic utilized by both ACES-RP and NexGen-IT in the generation of financial statement amounts. We noted a lack of awareness and documented evidence of the downstream financial impact for changes made to key data fields within the APSR as a result of ongoing operations.

Further, as noted in the Integration and Reconciliation of Financial Systems section above we noted that the reconciliations of the APSR to the financial statements are not complete.

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NexGen-IT Migration Process

As indicated above, USAF is in the process of migrating real property data from ACES-RP to NexGen-IT. While USAF has developed detailed and extensive policies and directions to execute the migration process from ACES-RP to NexGen-IT, EY has noted insufficient oversight and monitoring controls over the migration despite identified and known issues resulting from complexities involved in the highly manual process. There is currently not a formalized process to ensure all applicable facility information is corrected in a timely and accurate manner. The migration will still proceed despite these known data readiness errors resulting in a potential loss of asset records or information. While there are also established guidelines for installations to follow after the migration, USAF has noted instances where data was not properly transferred. In such cases, RP assets or inputs are required to be manually entered into NexGen-IT. RP assets that fail to migrate are caused by variety of factors, but the primary reason is the quality of the data was not sufficient to complete the transfer. For all assets that fail to migrate, USAF has indicated it is the responsibility of the installation RPAO to add these assets back to the APSR in a timely manner.

During our testing of the migration process, we identified the following:

- Instances where asset records were entirely removed during the migration from ACES-RP to NexGen-IT.
- One installation where an additional 1,528 additional buildings, structures, and linear structures were being reported in the post-migration data within NexGen-IT. While some reasons were provided, we did not receive a complete and supported explanation for this change and USAF's response also acknowledged some errors.
- Lack of sufficient documentation retained at the installation level indicating a review of applicable system reports occurred or that the base appropriately assessed the migration from ACES-RP to NexGen-IT. USAF was unable to support a documented evaluation of RP assets from ACES-RP to NexGen-IT post-migration in a timely manner.

(c) Insufficient procedures in place to record real property construction-in-progress (CIP)

The two primary contracting agents used by the USAF to manage military construction (MILCON) of real property assets are the US Army Corps of Engineers (USACE) and the Naval Facilities Engineering Command (NAVFAC). The services provided by these Construction Agents (CA) are governed and supported by signed Memorandums of Understanding (MOU). During the construction phase of the project, the CA tracks the incurred construction cost and reports it to USAF. As part of the reconciliation process, the costs reported by the CAs are then to be reconciled with the construction advances made by USAF to achieve USAF financial oversight over the process and determine the period end CIP balance to be recorded by USAF.

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During our testing, we identified the following:

- Insufficient or inconsistent data was being provided by the CAs in support of ongoing MILCON CIP projects.
- USAF currently is unable to fully reconcile its data with that provided by the CA's data.
- Air Force has not yet commenced the appropriate procedures to evaluate the completeness and accuracy of CIP categories other than MILCON.

(d) Process to assign value to real property needs improvement

SFFAS 6, *Accounting for Property, Plant, and Equipment*, contains the accounting standards for Federally-owned PP&E and associated clean-up costs. This standard requires Federal agencies to record PP&E assets at cost. USAF does not have sufficient processes for ensuring newly acquired property is recorded in the APSR. Further, there are not sufficient procedures to ensure that the costs added to the APSR are determined in accordance with SFFAS 6. USAF currently does not have a definitive timeline for completion of this effort.

Recommendations:

EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Establish more robust communication protocols establishing roles and responsibilities of all individuals within the Real Property community throughout the implementation process of various policies and standards. These roles and responsibilities should also be defined and communicated for ongoing review and adjustments of Real Property data that impact the financial statements.
- Develop more robust training of all applicable groups within the Real Property community regarding the financial statement impact of changes made within the APSRs.
- Assess if updates to policy or guidance are needed to clarify the respective roles and responsibilities of all applicable civil engineering (CE) parties (i.e., RPO, Engineering Flight, Operations Flight, BCE) for the timely and accurate identification, communication and subsequent reporting of RP asset acquisitions and dispositions.
- Finalize updates currently in process to the business rules regarding asset disposition. USAF should also consider whether further updates to the business rules are necessary to address the conditions and root causes identified above.
- Develop entity-level monitoring and oversight controls over the execution of the aforementioned processes.
- Implement and communicate appropriate policies and procedures intended to both complete and ensure a successful data migration as well as to monitor and evaluate the migration after it occurs at the respective installations that include but are not limited to the following:

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- For data cleansing, consider appropriate methodology to include less manual rework of data prior to migration.
- Retain sufficiently documented validation evidence of APSR data pre- and post-migration confirming a successful transfer of all RP assets.
- Identify exceptions resulting from the migration and include appropriate protocols to resolve those exceptions in a timely manner. Justify the corrective action used to manually adjust or update any asset listings.

- Re-evaluate the USAF procedures in place to reconcile real property construction activity reported by the CAs with expenditures and expectations of USAF:
  - Challenge whether the internally developed CIP report is providing sufficient data to allow for timely and accurate reconciliation of CIP costs with the data elements as provided by the CAs.
  - Challenge whether the currently established MOUs with both USACE and NAVFAC require sufficient data to support timely and accurate reporting of CIP costs into the USAF reconciliation process.
- Evaluate current processes to determine appropriate actions needed for accumulating historical cost in order to comply with SFFAS 6

IV. GENERAL EQUIPMENT (INCLUDING MILITARY EQUIPMENT)

General Equipment are assets that meet the following criteria: greater than two years of useful life, not intended for sale during normal operations and intended for use by the Air Force. This includes equipment acquired by Air Force in the possession of contractors. USAF's Military Equipment assets are a sub-set of General Equipment and includes six categories of assets: aircraft, ICBMs, satellites, mine-resistant ambush protected vehicles (MRAP), remotely piloted aircraft systems (RPA) and aircraft pods. General Equipment (other than military equipment) consists of Support Equipment, Vehicles, Communication Security (COMSEC) Equipment, Nuclear Weapons Related Materials, Small Arms/Light Weapons, and Special Tooling and Special Test Equipment. All equipment balances are reported in the General Property, Plant, and Equipment line of the balance sheet.

The following deficiencies aggregated into this material weakness:

(a) Enhanced processes are needed to record current activity

During our current year procedures, we noted several instances where USAF needs enhanced processes to record ongoing activity for military equipment.

- Lack of timely review of key APSR inputs

  USAF utilizes the Reliability and Maintainability Information System (REMIS) as a common data repository for the collection, processing, and storage of assignment, status, and repair

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information for Air Force aerospace vehicles (e.g., aircraft, satellites). During our testing of depreciation and discussions with USAF, a number of errors that originated in FY18 or earlier were identified. These included:

- 27 F-35 aircraft were recorded in REMIS without a useful life, which resulted in no system-calculated depreciation.
- Two CV-22 aircraft records in REMIS with an erroneous acquisition cost, which resulted in incorrectly calculated depreciation

During FY19, USAF began performing a review of key data fields within REMIS. However, this review was only performed at Q4. As a result, late adjustments were required to correct balances in the FY19 financial statements.

- Lack of sufficient financial and operational reconciliations for ICBM inventory population

USAF possesses fully-functional ICBMs in accordance with the Strategic Arms Reduction Treaty (START). Each ICBM is composed of three solid rocket motors: stage 1, stage 2, and stage 3. Each of these motors has a unique serial number and, when the ICBM is disassembled, each of these motors is referred to as an UMM. UMMs are part of the I&RP line on the financial statements, while fully-assembled ICBMs are included as military equipment within GPP&E.

Upon removal of an ICBM from the missile silo, the ICBM Aerospace Vehicle Distribution Officer (AVDO) receives a notification email and updates the status in IMDB to a dissembled missile. Additionally, unit AVDOs initiate communication regarding the change in possessing organization, which is sent to the Global Strike Command AVDO, who updates the possessing organization and geographic location within REMIS.

USAF does not perform a monthly reconciliation between IMDB and REMIS to ensure the appropriate reporting of the location and operational status of both ICBMs and UMMs, as well as ensure assets are not double counted as both an UMM and as a component of an ICBM. During our testing of the March 31, 2019 REMIS 4630 report, there were 79 ICBMs that were marked with the incorrect physical location. Additionally, it was noted that an UMM can be reported as both an UMM and an ICBM while the UMM is in transit or disassembled and waiting for transport.

The Air Force Global Strike Command Supplement to the Air Force Instruction (AFI) 21-103, *Equipment Inventory, Status and Utilization Reporting* (AFGSCUP), also requires that the ICBM Program Office perform a series of reconciliations to ensure that the Maintenance Information System (MIS), IMDB and REMIS are reconciled to the actual ICBM inventory. This includes, but is not limited to, reconciling movement, ownership and asset condition

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codes, as well as complete physical accountability. USAF has not performed and/or sufficiently documented the required reconciliations in accordance with AFGSCSUP.

- Lack of timely acceptance of pods in the Reliability, Availability, Maintainability for Pods (RAMPOD) Pod Asset Reporting System (PARS)

  The base-level pod units perform a physical count of all pods daily, in accordance with AFI 21-103. The inventory count is performed to account for pods that are stored, in repair, or attached to aircraft, to verify that the possessed pod count matches for the inventory data contained in RAMPOD. The PARS module retains data, by serial number, for all pods by location, operational status, and configuration. It provides critical, real-time aircraft pod maintenance (elapsed time indicator, component repair info, and warranty status) and location data to field level pod maintainers, logistics mangers, and Major Command (MAJCOM) points of contact.

During our existence and completeness (E&C) site visit procedures, EY identified an instance where a contractor completed maintenance on and shipped 33 pods to a local DLA facility for storage. The contractor completed the work orders and shipped the pods from their facility, but these pods had not been accepted in PARS by the receiving USAF unit. As the pods warehoused at a DLA facility were never accepted in PARS by USAF, they remained assigned to another USAF base in RAMPOD, regardless of their actual physical location. The lack of sufficient controls in place to ensure PARS is updated upon transfers (e.g., maintenance, operational movement) could inhibit the ability of USAF leaders to make informed operational decisions.

During our current year procedures, we also noted several instances where USAF needs enhanced processes to record ongoing activity for general equipment (other than military equipment).

- Lack of sufficiently designed controls for recording equipment within the Defense Property Accountability System (DPAS)

  Historically, the APSR for General Equipment (Other Than Military Equipment) has been the Air Force Equipment Management System (AFEMS). In July 2019, the USAF has migrated this equipment to DPAS. USAF, however, has not fully designed and implemented controls for the recording and accounting of this equipment within the DPAS APSR.

- USAF has not identified a complete population of Internal Use Software assets

  USAF has stated that it is not currently accounting for Internal Use Software (IUS) assets in compliance with guidance provided in SFFAS 6 and SFFAS 10, *Accounting for Internal Use*

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Software, and cannot currently identify an associated complete population of assets. The reported balance of IUS assets is currently established through the utilization of data calls.

Further, as noted in the Integration and Reconciliation of Financial Systems section above we noted that the reconciliations of the APSR to the financial statements are not complete. Taken together these deficiencies would allow acquisitions or dispositions of property to be unrecorded and that lack of recording to remain undetected.

(b) Insufficient procedures in place to record all CIP

Construction-in-Progress is the amount of direct labor, direct material, and overhead incurred in the construction of GPP&E for which the entity will be accountable for financial reporting purposes. In accordance with DoD policy, upon completion of an asset, the associated costs will be transferred to the proper capital asset account as the acquisition cost of the item. As discussed under the OM&S material weaknesses, USAF does not perform reconciliations to ensure that all initially recorded capitalizable expenses are reversed fully when the assets are accepted at the final destination and capitalized.

USAF currently has a process whereby the Program Office Military Equipment Valuator notifies the designated SAF/FMF personnel of an in-progress capital project in order to estimate Construction-in-Progress values. Designated SAF/FMF personnel determine the amount of CIP for the identified projects and a journal voucher is used to record these amounts in the general ledger. While USAF has recorded amounts in CIP for several large weapon system programs, USAF has not established sufficient processes to accumulate and report CIP for all categories of equipment. Additionally, the procedures to record CIP do not consider the impact of USAF's improper accounting of Contract Financing Payments (refer to separate material weakness below).

(c) Process to assign value to newly acquired equipment needs improvement

SFFAS 6, *Accounting for Property, Plant, and Equipment*, contains the accounting standards for Federally-owned PP&E and associated clean-up costs. This standard requires Federal agencies to record PP&E assets at cost. USAF does not have sufficient procedures to account for its equipment in accordance with SFFAS 6. USAF is in the process of developing a model to accumulate and report all costs incurred to bring equipment to a form and location suitable for its intended use.

Recommendations:

EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Perform regular review of key data inputs in the APSR to allow for timely identification and correction of errors.

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- Implement a monthly reconciliation between IMDB and REMIS and ensure that discrepancies are resolved in a timely manner.
- USAF should develop policies and procedures for performing and documenting the reconciliations required by the Global Strike Command Supplement to AFI 21-103.
- Establish procedures to record and retain evidence of daily inventory process for Pods.
- Enhance entity-level monitoring controls to ensure consistent execution of asset transfer procedures.
- Continue to develop sufficient controls and policies within the DPAS APSR to consistently recognize, measure and report equipment.
- Continue to develop sufficient controls and policies to consistently recognize, measure and report IUS assets in accordance with SFFAS 6 and SFFAS 10.
- Establish procedures for weapon system program CIP categories to ensure that complete and accurate reporting of USAF costs of these programs are reported timely and accurately.
- Amend current processes to comply with SFFAS 6 by better matching expenditures to capital assets, other than CIP, within the APSR.

V. PROPERTY AND MATERIALS HELD BY OTHERS

The following deficiencies aggregated into this material weakness:

(a) Insufficient oversight of OM&S managed by Army and DLA

USAF's OM&S balance includes approximately $28 billion of munitions. Of that balance, the U.S. Army performs inventory management services for approximately $8.5 billion of munitions. USAF currently does not perform a periodic reconciliation with Army to ensure that assets recorded in USAF-owned systems (CAS) match the records for USAF-owned assets in Army systems. Army uses Logistics Modernization Program (LMP) to record munition assets. USAF does not receive transactional data from Army and USAF's system (CAS) is currently not capable of receiving transaction-level detail. USAF is in the process of implementing a new APSR, TICMS, which is expected to replace CAS in future audit periods.

Also included in OM&S are supplies managed by DLA. USAF relies on the DLA to report inventory quantities on hand at period end through the Distribution Standard System (DSS) application. USAF does not have sufficient policies or procedures in place to perform reconciliations for assets managed by DLA and reported by USAF. When there are discrepancies, USAF adjusts their inventory counts to the amounts reported by DLA without reconciliation or explanation of variances.

(b) Insufficient oversight of GFP and contractor-acquired property

USAF has government property in the custody of contractors. This includes government furnished equipment and contractor-acquired property. USAF lacks policies and procedures to sufficiently maintain accountability for, and to financially report, property in the custody of contractors.

During our testing, we identified the following:

- Inability to provide a complete population of government furnished equipment.

- Lack of sufficient controls over contractor inventory control points (C-ICP).

  C-ICP represents the portion of USAF-owned OM&S assets that are maintained at commercial entity locations for wholesale distribution. As of September 30, 2019, USAF reported approximately $11 billion of C-ICP, which represents approximately 20% of all General Fund OM&S. USAF has not identified and validated all potential C-ICP programs. Additionally, USAF has not developed policies to identify and monitor the population of C-ICP programs and has not maintained a current, accurate and complete centralized listing that reconciles to the financial reporting process.

  Each program is generally responsible for compiling and submitting a CFO financial reporting template on a quarterly basis. Currently 68 of 109 confirmed C-ICP programs do not report a balance to the financial statements. Based on USAF's timeline, an additional 46 programs are scheduled to report in FY20. For those that do report, USAF does not sufficiently monitor the variances between the changes in the C-ICP balances reported on the financial statements and the transaction detail in the CFO report. At FY19 Q4, the variance was approximately $176 million (absolute value of approximately $634 million). USAF does not consistently perform transaction-to-summary reconciliations for each program submitting transaction level data. For programs that do perform reconciliations, the process is not sufficiently documented.

  Additionally, USAF has not performed an analysis for equipment in the possession of contractors to determine if there are equipment items currently included in C-ICP that instead should be reported as GPP&E.

  As a result of the above conditions, the amounts reported as C-ICP, as well as related activity accounts, may not be fairly stated.

- Lack of timely updates to accountable property records for financially reportable events.

  For example, USAF has reported $647 million of contractor-possessed munitions (CPM) in 2019. Most CPM are undergoing repair and USAF has limited visibility on contractor transactions beyond shipping and receiving from contractor locations. While USAF program teams are required to validate and update munition inventory records every 30 days, asset classifications may not be reflected timely, leading to potential misstatement in Held for Use and Held for Repair categories at a given time. More broadly, the lack of visibility over CPM transactions could lead to unresolved variances that are not explained or supported by transactional data, leading to a potential misstatement in the OM&S balance.

(c) Lack of sufficient accounting for JSF spare parts and associated costs

The F-35 Lightning II (also known as the Joint Strike Fighter (JSF)) program is a joint, multinational acquisition program intended to develop and field a family of next-generation strike fighter aircraft for USAF, Navy and Marine Corps, as well as other international partners and FMS customers. As a program participant, the USAF contributes to the annual procurement of a global pool of assets based upon cost-sharing principles. The F-35 Program procures "whole" spares under annual sustainment contracts. As a result, the USAF's ownership interest equates to a percentage and not necessarily to a specific quantity of spares. USAF currently does not report an asset on the balance sheet related to its ownership interest in spares. USAF is working with the JSF Program office to develop a formalized process for accountability of spare parts, as well as an accounting solution to properly account for and report pooled assets.

Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Improve oversight of OM&S managed by Army and DLA
  - Munitions
    - Implement monitoring of munitions transactions posted by service providers (i.e., Army), including procedures to validate the completeness and accuracy of transactions.
    - Develop service agreements that require transactional level detail to enable the oversight and reconciliation processes.
  - Supplies
    - Design and implement internal controls related to the review of DLA Managed Inventory balances. These should include controls to assess the completeness and accuracy of information reported.
    - Develop a process to routinely monitor variances between DLA and USAF.
- Improve oversight of GFP and other materials held by contractors.
  - Complete actions to obtain a complete population of property held by contractors.
  - Develop sufficient oversight procedures to effectively monitor contractors, including the development of reconciliations between USAF and contractor records.
  - Require timely updates to USAF property records for all property in the custody of contractors. Evaluate whether the upcoming implementation of TICMS would enable contractors to report transactions to USAF in a timely manner.

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- Develop and require the use of contract clauses that require contractors to provide current and accurate lists of USAF property in their possession on a regular basis.
- Increase communication between program offices and financial management functions to ensure proper accounting treatment of ongoing business transactions.

- Lack of sufficient accounting for JSF spare parts and associated costs
  - Develop policies and procedures to properly account for, report and monitor USAF's share of pooled assets

VI. FUND BALANCE WITH TREASURY

Fund Balance with Treasury (FBwT) is an asset account that shows the available budget spending authority of federal agencies. Fund balance reconciliations are key controls for supporting the existence, completeness, and accuracy of the budget authority and outlays reported on the statements of budgetary resources. Several deficiencies which resulted in a material weakness in the design and operation of internal control for FBwT were noted as listed below.

- Each month USAF reconciles FBwT in DDRS-B to their balance as reported by Treasury and records an adjustment to bring those balances into agreement. At year end, USAF had identified differences between activity posted by Treasury and that posted in DDRS-B of approximately $3.3 billion absolute value and $1.1 billion net value. The differences are due to delays in USAF recognizing authorized FBwT transactions and adjustments recorded in the USAF general ledger. The differences were adjusted in a post-closing adjustment to DDRS-B (the "undistributed JVs") so that the financial statements of USAF reflect the balance reported by Treasury.
- The undistributed JVs to adjust for the differences between DDRS-B and Treasury impact various general ledger accounts including accounts payable, accounts receivable, and related budgetary accounts. Some of the undistributed JVs cannot be supported at the voucher detail level.
- Undistributed items are not cleared in a timely manner and a significant amount remain unresolved at year end.

Recommendations

EY recommends the following corrective actions related to the conditions described above:

- Analyze DFAS and USAF practices to identify the reasons why transactions impacting FBwT are not recorded at the same time that they are authorized to proceed. Design effective controls to avoid out-of-balance situations with Treasury that require journal entry corrections.
- Ensure that reconciliations are performed at a detailed level, so stakeholders can identify any discrepancies and have enough information to properly conduct research in a timely manner and propose corrective journal entries.

- Work with DFAS to develop a set of policies and procedures over the accrual process, including the consideration of disbursements that have not been recorded prior to period-end cutoff.
- Further, work with DFAS to address the need to maintain sufficient evidential matter in support of remediation efforts to fully reflect undistributed transactions in the financial statements.
- Establish a review process of FBwT entries such that before balancing JVs, are recorded they have been fully researched to determine whether amounts are supported by documentation, the documentation supporting the entry is available, and that the amounts can be reconciled to the cash accounting system.

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ONGOING FINANCIAL REPORTING

VII. ACCUMULATING AND PREPARING FINANCIAL STATEMENTS

The following deficiencies aggregated into this material weakness:

(a) Lack of sufficient centralized financial statement analytical and review functions

EY identified an overall lack of sufficient monitoring across USAF processes, however, the area of most concern is financial reporting. The below listing highlights several areas where we identified a lack of sufficient monitoring:

- Unposted transactions
- Lack of sufficient review and approval of journal vouchers
- Negative unliquidated obligations
- Abnormal conditions
- Omitted transactions

In addition, EY identified several accounting or posting logic errors, which are discussed further in section (d) of the Integration and Reconciliation of Financial Systems section, which could have been detected and corrected prior to reporting had an effective monitoring process been in place.

USAF does not have sufficient data analytics infrastructure or unique data elements to timely perform monitoring of accounting data and transactions. Additionally, USAF does not have a sufficient number of trained accounting personnel to perform monitoring over its financial reporting environment to compensate for the insufficient data infrastructure. Finally, USAF relies on its service provider, DFAS, to perform data analytics, reconciliations and other key data functions without the necessary capability/capacity to fully monitor or review DFAS' work.

(b) Lack of assessment, monitoring and effective implementation of recent accounting guidance

USAF does not have a formal process established to effectively assess, monitor and implement recent accounting guidance issued by the Federal Accounting Standards Advisory Board (FASAB) or other accounting guidance issued by OSD (e.g., DoD Financial Management Regulation (FMR) updates, Defense Audit Remediation Working Group (DARWG) papers). While USAF leadership is actively involved in working groups to stay abreast of new guidance, there is not one group that is responsible for ensuring the full implementation for financial reporting purposes.

USAF has not completed the process of evaluating the effects that will result from adopting the below pronouncements and other guidance issued by FASAB which are already effective. The effect on the financial statements amounts involved is not currently determinable by USAF and could be material.

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- SFFAS 47, *Reporting Entity.*
- SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies and Stockpile Materials.*
- SFFAS 49, *Public-Private Partnerships*
- SFFAS 50, *Establishing Opening Balances for General Property, Plant and Equipment*
- SFFAS 56, *Classified Activities.*
- Technical Bulletin 17-1, *Intragovernmental Exchange Transactions.*
- Technical Bulletin 17-2, *Assigning Assets to Component Reporting Entities.*
- Technical Release 18, *Implementation Guidance for Establishing Opening Balances.*
- Staff Implementation Guidance 6.1, *Clarification of Paragraphs 40-41 of SFFAS 6, Accounting for Property, Plant and Equipment.*

(c) Enhanced financial statement review procedures are needed

OMB Circular A-136, *Financial Reporting Requirements,* (OMB A-136) provides guidance to Federal entities required to submit Agency Financial Reports (AFRs) under the Chief Financial Officers Act of 1990, as amended. A financial statement audit under *Government Auditing Standards* includes a requirement to perform limited procedures on certain information that is required to be included in the AFR under OMB A-136 beyond the financial statements. While much progress has been made, USAF needs to continue to enhance its process for the preparation and review of its AFR. In performing our procedures on the AFR, we identified instances of the following:

- Supporting documentation that did not adequately support amounts included in the notes or could not be provided in a timely manner
- Lack of complete and accurate disclosures
- Insufficient commentary included in Management's Discussion and Analysis

Although many of the variances highlighted by our work were amended prior to the final release, we believe that USAF should continue to work across the organization to increase the usefulness of the AFR as a mechanism to communicate to the public the successes, plans and annual results of USAF.

In conjunction with our AFR review, we also identified a lack of sufficient implementation of Statement of Federal Financial Accounting Standards (SFFAS) 53 *Budget and Accrual Reconciliation*, which was effective for FY19. The reconciliation provided by this standard is intended to explain the relationship between the entity's net outlays on a budgetary basis and the net cost of operations. During our testing of this reconciliation included in Note 24 of the financial statements, we identified that there were differences between USAF's presentation and Treasury's detailed cross-walk guidance. Additionally, there is a reconciling difference of approximately $7.9 billion.

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In addition, in accordance with OMB Circular A-136, *Financial Reporting Requirements*, and Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display,* the Statement of Net Cost should present gross and net cost information for major organization and programs, as well as data related to its outputs and outcomes. USAF currently accumulates amounts reported in its Statement of Net Cost by major appropriation groups funded by Congress and not by major organization and programs as required.

Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Invest in hiring, training and retaining additional qualified accountants across the entity, as necessary, for the purpose of implementing a more comprehensive oversight program
- Dedicate resources to track and coordinate the assessment of the impact and implementation of recent guidance and technical updates commensurate with the size and complexity of USAF's operations.
    - Perform reviews of OMB Circular A-136 requirements to ensure updated guidance is evaluated and incorporated in a timely manner.
    - Develop white papers to document USAF's consideration of the guidance and plan for implementation.
    - Assessment of current checklists used in the financial reporting process to determine if checklists need to include enhanced review procedures.
- Continue to develop reviews by business process areas to ensure disclosures are complete, accurate and compliant with financial reporting guidance.
    - Sufficient and documented reviews by other business process areas to ensure disclosures are complete, accurate and compliant. These reviews should ensure that note disclosures are consistent with business activity occurring throughout the year.
    - Implement a robust data analytics environment, including the necessary hardware and software to analyze large data files.
    - Perform data analysis to identify and resolve potential unusual transactions, balances or other indicators of a potential misstatement.
- Statement of Net Cost
    - Determine the major organizations and programs most relevant to USAF
    - Implement processes to capture costs by major organization and program

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VIII. OVERSIGHT AND MONITORING OF INTERNAL CONTROL

The following deficiencies aggregated into this material weakness:

(a) Lack of an effective internal control program

OMB Circular A-123 defines management's responsibility for enterprise risk management and internal control in Federal agencies. Based on our review of USAF's FY 2019 Statement of Assurance, the description of activities related to the OMB Circular A-123 program, and also through discussions with USAF, we noted that USAF has not fully implemented an effective internal control program in compliance with OMB Circular A-123 or the Air Force Instruction governing the Manager's Internal Control Program (MICP).

In accordance with Circular A-123, USAF should have a thorough understanding of the specific processes and document flow involved in each of class of transactions. During our walkthroughs and site visits, we noted instances where USAF-prepared process cycle memorandums were either incomplete or inaccurate. We identified incomplete process documents for funds receipt and distribution (FRAD), real property, military equipment/weapon systems environmental liabilities base-possessed inventory and travel. Without complete and accurate process documentation, USAF is not able to completely evaluate internal control at the process, transaction or application level.

(b) Lack of sufficient monitoring of third-party service providers

For several business processes, including financial reporting, military and civilian payroll, and disbursing, USAF relies on service organizations (e.g., DFAS) for initiation, authorization, processing, recording and/or reporting of information that affects financial reporting of the financial statements The service organizations are subject to separate examination engagements on the service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve stated control objectives for various business processes. USAF's service providers design processes and related controls with the assumption that Complementary User Entity Controls (CUECs) would be placed in operation by user entities (i.e., USAF). The application of these controls by user entities is necessary to achieve certain control objectives within the service organization reports. USAF has created a Service Provider Team whose responsibility is to determine that service organization reports are being properly reviewed and that CUECs are being reviewed and monitored. Additionally, each of USAF's business process areas are responsible for understanding and evaluating CUECs and ensuring the business process incorporates applicable control activities, as well as understanding the impact of results within service organization reports. While measurable progress has been made, a full implementation and monitoring process across all in-scope reports is required to determine control effectiveness and risk mitigation.

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Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Develop and maintain supporting documentation for the USAF Statement of Assurance as evidence that USAF identified assessable units, developed management control plans, performed risk assessments, performed ongoing monitoring, developed corrective action plans and tracked progress towards remediation for all assessable units.
- Follow the assessment process contained in OMB A-123, Appendix A, to assess the effectiveness of internal control over financial reporting and compliance with financial-related laws and regulations.
- Maintain adequate and updated supporting documentation for all phases / steps outlined in OMB A-123, Appendix A.
- Increase the resources dedicated to the A-123 program to completely execute all aspects of the program requirements on an on-going basis.
- Perform updates to process narratives, policies and procedures to completely accurately reflect current key financial processes.
- Continue to assess and enhance the service provider monitoring process.
- Enhance processes to identify a complete listing of all service organization relationships and assess whether service organization reports address all relevant service organization processes.
- Develop policies and procedures to document control gaps related to service organizations in process cycle memos and related control documentation.

IX. CONTRACT FINANCING PAYMENTS

USAF conducts business with commercial contractors and may provide financing payments to contractors to alleviate the potential financial burden from long-term contracts. Contract Financing Payments (CFP) are authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. MOCAS is the primary system utilized to administer contracts with CFP for the acquisition of GPP&E and I&RP. For Progress Payments based on Costs, the customary progress payment rate is 80 percent, applicable to the total costs of performing the contract. Additionally, when satisfactory progress has not been achieved by a contractor during any period for which a progress payment is to be made, a percentage of the progress payment may be retained as Contract Holdbacks.

Due to MOCAS system limitations and a lack of sufficiently developed processes, EY identified the following during our testing:

- Lack of identified key controls related to CFP transactions
- Insufficient monitoring of the MOCAS CFP balance for accuracy and completeness.

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- Lack of reconciliation between the MOCAS CFP sub-ledger population and the general ledger by account
- Improper reporting of CFP related to capitalized equipment, OM&S and inventory as "Other Assets." The capitalized costs incurred before assets are placed in service should instead be recognized in GPP&E or I&RP. At September 30, 2019, USAF reported $16.7 billion in outstanding contract financing payments as "Non-Federal Other Assets.
- Improper reporting of all contract holdbacks as "Other Liabilities," which are not compliant with DoD policy. At September 30, 2019, USAF reported $623 million as contract holdbacks.

Recommendations:

EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Develop and implement a beginning-to-end process to properly record CFP. Consider the recent policy updates made in the DoD FMR and TFM.
- Determine whether financial statement balances reflect an accurate and complete population of contract financing payments by
  - Identifying and validating a complete MOCAS contract financing population
  - Developing and implementing a reconciliation between MOCAS contracting financing population and the general ledger
- Instead of Other Assets, report CFP assets under the appropriate financial statement line, such as Inventory and Related Property [OM&S – In Development (GLAC 1516)], Property, Plant and Equipment [Construction in Progress (GLAC 1720), Internal Use Software in Development (GLAC 1832)], or Gross Costs [Operating Expenses/Program Costs (GLAC 6100)].
- Report contract holdbacks as Accounts Payable.

X. CONTINGENT LEGAL LIABILITIES

While USAF made progress during the current year related its assessment of the likelihood of unfavorable outcome associated with legal claims (i.e., as probable, reasonably possible or remote), USAF does not consistently disclose the range of loss for cases determined to be reasonably possible or provide justification as to why a range cannot be determined.

Additionally, USAF does not consider an assessment of the likelihood of unfavorable outcome or the reasonableness of plaintiff claim against USAF when calculating the total future liability associated with legal claims for financial reporting. USAF is instead applying three-year average rates of payout (specific to type of case), to plaintiff claim requests of open claims made against the USAF. This calculation is made regardless of the probability of the likelihood of unfavorable outcome.

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Recommendations:

EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Ensure that legal claims are consistently assessed in accordance with GAAP and determined as probable, reasonably possible or remote. Develop a process to reasonably estimate the range of loss amounts or sufficiently justify why a range cannot be determined.
- Update policies as necessary to ensure that the contingent liabilities are only being recognized when counsel has determined the likely outcome as probable.

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BEGINNING BALANCES

XI. ESTABLISHING OPENING BALANCES FOR ASSETS (AND RELATED LIABILITIES) USED IN OPERATIONS

The following deficiencies aggregated into this material weakness:

(a) Valuation of opening balances for equipment cannot be supported

SFFAS 50, *Establishing Opening Balances for General Property, Plant and Equipment,* allows a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for GPP&E. The alternative methods are permitted after a period during which existing systems could not provide the information necessary for producing GAAP-based financial statements without use of the alternative.

USAF is applying SFFAS 50 to its equipment balances. Their efforts have been performed in two different time frames. The methods used have varied based upon the available information at the time of the analysis.

- In 2009 through 2011, the initial effort was conducted by Headquarters Air Force Logistics, Engineering and Force Protection (HAF/A4). That effort valued assets placed in service during or prior to FY 2009 using contract data as Key Supporting Documentation (KSD) from the ConData repository. ConData is a data warehouse which consolidates contract data from all ConWrite databases.
- In 2011, USAF transferred the responsibility for military equipment valuation (MEV) to the respective program offices. The program offices built off of the initial baseline values established during the FY2009 valuation effort adding estimated values of new asset additions and modifications using various valuation methodologies and KSDs.

We have tested various programs to gain an understanding of the methodologies applied by USAF. In our testing we found the program offices had a high degree of latitude as to how they approached valuation and the nature of supporting documentation retained varied widely.

Taking into consideration that differing methodologies are used and permitted by the standard, EY's inspection found areas where similar documentation was expected and not found. These exceptions impair the review of the work performed and could lead to undetected errors in the estimates. For example:

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- EY noted that the documentation within the MEV packages was insufficient to describe the methodology employed and the selection of KSDs.
- The rationale for cost allocations was not documented and at times were inconsistent between similar aircraft. EY could not audit the valuation packages without program office representatives available to provide verbal explanations for allocation decisions
- Key documentation such as contracts and supporting schedules used in the calculations were not always retained in an easily retrievable manner impeding our ability to audit the calculations.
- The Air Force Lifecycle Management Center (AFLCMC) has developed a SOP for performing valuations over OM&S and Military Equipment and is currently in the process of implementing it across the Air Force enterprise. This SOP will include further guidance to program offices regarding reconciliation requirements, appropriate KSD, document retention requirements, and internal review procedures, etc. We recommend that the alternative valuation work already completed be reviewed and updated to comply with this SOP.

(b) Valuation of opening balances for real property cannot be supported

As discussed further in the Real Property material weakness, USAF will be utilizing PRV as a starting point in establishing alternative cost estimates for real property in accordance with SFFAS 50. USAF has not yet completed this process.

(c) Enhanced procedures are needed to identify the beginning balance population for real property

USAF has not consistently followed its own policies related to facility numbers on structures. In our testing of existence and completeness, we identified instances across all installations where buildings and structures were not physically labeled with a facility number or were mislabeled. The application of facility numbers to a set of structures is inconsistent both across installations and within a particular installation. The Facility Number Business Rules specific to structures as approved by Headquarters Air Force (HAF/A4) are not clearly defined, communicated or monitored at the installation level. Consequently, the policy is not consistently implemented and executed by the appropriate individuals within the Civil Engineering group. The above factors create a control gap that is necessary for a complete real property inventory to be conducted in accordance with Air Force requirements.

The APSR serves as the basis for the existence and completion of the beginning real property balances. The veracity of the APSR is dependent upon historical record keeping, specific efforts performed to improve the record and required RPO physical inventories required by USAF policy. We reviewed the RPO procedures and determined that they were not sufficient to identify and/or correct the errors in the APSR in a timely basis. Additionally, it was noted that USAF's procedure for the performance of physical inventories do not address the risks associated with completeness.

RPOs rely on information within the APSR to conduct real property inventory inspections, thus only addressing the risk of existence.

USAF has not completed its assessment as to whether its APSR contains a complete and accurate population of linear structures. Linear structures are those facilities whose function requires that it traverse land (e.g., runway, road, rail line, pipeline, fence, pavement, electrical distribution line) or is otherwise managed or reported by a linear unit of measure. Due to the nature of linear structures, including both visible and underground assets, the complete and accurate reporting of these assets relies heavily on completeness and accuracy of a particular installation's Geographic Information System (GIS) data and maps. Initial and ongoing reconciliations between the APSR and GIS have been identified as a key step in ensuring accountability of all real property linear structure assets, however USAF has not completed this effort. USAF also has not completed their efforts to comply with DoD linear segmentation guidance.

The Air Force utilizes GIS for many mission critical purposes. GIS was used in the development of GeoBase which ensures the provision of and access to common, accurate and current geospatial information for all Air Force installations, ranges and property. This information can be used to track and represent various physical infrastructure information across installations for security and operational purposes. During our site visits for existence and completeness, GIS maps were used in navigating the installation to physically locate a specific facility, as well as for reconciliation purposes with the APSR. USAF has also indicated in its planned corrective actions for linear structures and land that a key requirement will be the reconciliation of facilities within GIS to the APSR. During our testing, we identified instances of inaccurate and/or incomplete GIS maps across all installations, including untimely updates to GIS Maps (i.e. missing facilities) or inappropriate/inconsistent labeling of RP assets within GIS Maps. We also identified instances where GIS maps did not agree with the APSR. Errors within the GIS impedes the RPO's ability to complete timely and accurate physical inventory observations as GIS maps support the inventory process.

RP asset inventory records, maintained for all facilities, contain current and historical information supporting activity such as facility acquisition, existence, location, use, capital improvements, evaluation, etc. These facility records or "jacket files" support the key inputs and data for the relevant facility within the APSR. During our testing, we selected a sample of facilities (i.e. Buildings and Structures) to review whether the associated jacket files contained the required KSDs. As a result of these procedures, we identified limited instances across a subset of installations visited in which the RPO was unable to provide the entire requested jacket file or not all the appropriate KSDs were maintained. We also identified instances across installations where DD Forms 1354 were recreated by USAF if original documentation was no longer available. Among other information included on the DD Form 1354 is the placed-in-serviced-date (PISD). These recreated DD Forms 1354 were generally accompanying by a memorandum for the record (MFR) that indicated that the RPO "exhausted all efforts" to locate original KSDs needed to determine the PISD as well as other key asset information. However, there was not always clear

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evidence of what alternative evidence was considered in recreating the DD Form 1354, which was then generally populated with information already within USAF's APSRs.

USAF also has not completed its audit readiness efforts for land. In conjunction with establishing opening balances in accordance with SFFAS 50, entities have an option to exclude land and land rights from the general PP&E balance. If this option for beginning balances is selected, all future land and land right acquisitions are also to be expensed. Instead, the entity is required to evaluate and disclose specific acreage information. USAF has not completed its acreage reconciliation efforts to the APSR as controls have not yet been fully finalized, communicated or implemented at the installation level.

(d) Insufficient procedures in place to record all environmental and disposal liabilities

USAF estimates environmental and disposal liabilities (E&DL) related to the restoration and other environmental clean-up efforts of real property assets. Environmental Restoration Liabilities (ERA) represent the future costs associated with identifying, investigating, remediating, and monitoring environmental contaminations within the United States, including program management costs. Other Environmental Liabilities (OEL) is comprised of the four remaining items: Environmental Corrective Action (ECA), Environmental Response at Operational Range (EROR), Environmental Closure Requirements (ECR) and Asbestos (ASB). Restoration and OEL estimates are triggered by two different activities: asset-driven or event-driven. ECR and ABS fall under asset-driven liabilities which are reported under OEL within the financials. Asset-driven liabilities are based on the characteristics of a particular real property asset and, therefore, are heavily dependent on information from the real property APSRs to determine the completeness of population for which a liability needs to be determined. As discussed in the GPP&E material weakness above, the USAF's APSRs may not capture all real property assets. As a result, the associated E&DL may not be complete. Additionally, as disclosed in Note 14 to the financial statements, USAF has identified ongoing corrective actions that further indicate that ED&L may not be complete.

USAF also estimates liabilities related to the disposal of decommissioned military equipment and weapon systems (ME/WS). These liabilities are assessed separately for each category of military equipment assets, including aircraft (fixed wing and rotary), remotely piloted aircraft, ICBMs, satellites, MRAPs and pods. USAF has not yet completed their assessment to appropriately estimate the ED&L for all the major military equipment asset categories.

(e) Opening balance valuation and ownership cannot be supported for OM&S

SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, permits a reporting entity to apply an alternative valuation method for establishing opening balances. Similar to SFFAS 50, SFFAS 48 can be applied after a period during which

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existing systems could not provide the information necessary for producing GAAP-based financial statements without use of the alternative valuation method.

Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances. Allowable methods for determining deemed cost include methods such as standard price (selling price) or fair value, latest acquisition cost, replacement cost, estimated historical cost, and actual historical cost.

USAF had insufficient beginning balance valuation documentation for uninstalled missile motors, munitions, spare engines and cruise missiles. This includes the lack of any or complete supporting documentation or differences between source documents and amounts recorded. USAF also has not completed the process of evaluating the impact of SFFAS 48 on the valuation of base-possessed inventory.

USAF also lacks sufficient supporting documentation demonstrating proof of title for spare engines. US Air Force tracks ownership of engines using ownership codes in the Comprehensive Engine Management System (CEMS). In addition to Air Force-owned engines, USAF accepts non-USAF engines into its possession for maintenance and other purposes. During our FY19 testing, we identified the following:

- Lack of proper proof of title for $7.2 billion of USAF-owned spare engines. USAF indicated that many of these engines were procured prior to 1990.
- Insufficient documentation to support other federal agency or contractor ownership of non-USAF owned engines that are tracked in CEMS.

Recommendations:

EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Valuation of opening balances for equipment
    - Continue implementation of standard processes to conduct valuation consistently across program offices.
    - Develop entity-level controls for monitoring program office compliance with standard valuation procedures.
    - Evaluate whether cost allocation methodology decisions are fully supported within the supporting documentation to enable stand-alone auditability of valuation packages.
- Valuation of opening balances for real property
    - Finalize efforts to develop and implement a process and a set of defined procedures to ensure complete and accurate calculation of RP PRV.

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- Enhanced procedures to identify the beginning balance population for real property
    - Develop internal controls to be executed by the RPO/RPAO to assess the completeness of RP assets as part of the physical inventory process.
    - Consider the use of GIS maps and the role they play in the assessment of completeness.
    - Recommunicate guidance and policies defining RP accountability and the reporting requirements applicable to each RPO, including the documentation to be retained in facility folders.
    - Evaluate if consistent guidance has been developed for determining PISD when original DD Form 1354 or other KSDs are not available, including documentation requirements necessary to support efforts undertaken to determine the PISD.
    - Evaluate the appropriateness of established corrective action plans and the reliance on current Installation GIS maps to address the risks of incomplete or inaccurate reporting of linear structures and land.
    - Develop internal controls at the installation level to effectively monitor the development and use of GIS maps in the identification and reconciliation of above ground linear structure assets.
    - Develop procedures and internal controls at the installation level to effectively establish and subsequently monitor the use of various technology and data sources to aid in the identification and reconciliation of underground linear structure assets.
    - Ensure the appropriate tools and models are developed to assist in the accurate measurement of land acreage.
    - Define and communicate the roles and responsibilities of those individuals involved in the real property inventory process, particularly related to facility numbering and identification.
    - Communicate the roles and responsibilities of all groups in the development, use and review of GIS maps in conjunction with the reporting and recording of RP assets.
    - Develop internal controls to be executed by the BCE to effectively monitor the updates made to GIS maps to more effectively identify, record and monitor RP assets. These controls should address the execution of a reconciliation process between the APSR data and GIS maps.
- Opening balance valuation and ownership for OM&S
    - Complete any open efforts for beginning balance valuation in accordance with SFFAS 48 and any related implementation guidance.
    - Ensure that supporting documentation is available and retained for opening balances.
    - Ensure appropriate price information on source documents are used to establish opening balance amounts.
    - Assess whether alternative documentation is needed to ensure USAF has title for all engines reported in its financial statements if original documentation is no longer available.
    - Develop proper controls to ensure that ownership codes are supported by proof of title documentation for all engines tracked in CEMS, whether owned by USAF, other federal agencies or contractors.

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- Procedures to record all E&DL—real property assets
    - Evaluate the appropriateness and timeliness of established corrective action plans to both address the risks or errors identified and support the reporting of compliance and accurate estimate of restoration and OEL liabilities.
- Procedures to record all E&DL – military equipment and weapon systems
    - Obtain and assess data to support the development of the related E&DL associated to each major asset category.
    - Develop controls and work plans/policies to consistently establish and subsequently monitor E&DL estimates.
    - Evaluate the appropriateness of current E&DL cost estimation models to accurately estimate environmental disposal costs.

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XII. FINANCIAL INFORMATION SYSTEMS

Information system security controls are fundamental to the confidentiality, integrity, and availability of all applications and the financial data they store, process, and transmit. For example:

- Security management controls provide reasonable assurance that overarching system risk management policies and procedures are in place.
- Access controls provide reasonable assurance that the access to system resources is consistent with job duties and restricted to authorized individuals.
- Segregation of duties provide reasonable assurance that incompatible duties are effectively segregated.
- Configuration management controls provide reasonable assurance that changes to the information system are authorized and operating as intended.
- Interface controls provide reasonable assurance that data from feeder systems is reliable, valid, complete, and properly converted from the feeder systems into the applications they support.

An internal control environment with risk and control gaps in any one of the above elements may be susceptible to the associated system risks. USAF continues to migrate its accounting and financial systems to the DEAMS processing environment, and modernizing or consolidating applications (NexGen-IT, Con IT), which may alter some of the inherent risks in its distributed and legacy system environment currently in place.

The USAF needs to continue to focus on implementing a robust internal control environment and information security program that is designed and operating effectively to mitigate key financial audit risks. Our assessment of the Information Technology (IT) controls and the computing environment identified deficiencies which collectively constitute a material weakness in the design and operation of information systems controls.

The deficiencies relate to the following areas:

- Security Management
- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Interface controls

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These deficiencies are discussed further below:

(a) Security Management

A security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures and controls implement the entity-wide policy. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

The identified security management weaknesses that represent a significant risk to the USAF financial management information systems environment include the following:

- Security controls were not regularly assessed for appropriateness, monitored, or tested in order to verify compliance.
- Plans of action and milestones (POA&Ms) were not prioritized and periodically tracked to completion, including testing and monitoring of corrective actions.
- For systems hosted by the Defense Information Systems Agency (DISA), the DISA System and Organization Controls (SOC) 1 report was not reviewed to the extent of performing assessments over the CUECs.
- Key system documentation is not updated timely (e.g., system security plans, configuration management plans, access management policies).

(b) Access controls / user access

Access controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. When properly implemented, access controls can help ensure that critical systems assets are physically safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed.

The identified access control weaknesses that represent a significant risk to the USAF financial management information systems environment include the following:

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- Access was not restricted to authorized users and was not assigned in accordance with the principle of least privilege.
- Policies and procedures for account authorization, provisioning, and termination were not documented.
- Procedures were not consistently followed for monitoring unused IDs, locked IDs, terminated users, or access re-certifications.
- Procedures for monitoring and auditing security violations and sensitive user activities, including activities of privileged users, were not documented, not being performed, or not configured appropriately within systems.
- Periodic reviews of sensitive and non-sensitive user access were not performed appropriately.
- Security auditing and monitoring of system activities was not established.
- Audit logging information was not protected against unauthorized access and modification.
- Password complexity and password lockout requirements were not being enforced.
- Access controls associated with the use of third-party systems have not been fully implemented.
- Inactive users are not disabled or removed timely and in accordance with organization defined policies.
- Oracle database profiles are not reviewed and maintained (addition, removal, modification) regularly and appropriately.
- FY19 DISA Hosting Services Service Organization Controls Report – Controls to provide reasonable assurance that logical access to financial systems is granted to properly authorized individuals were not operating effectively during the period.
- FY19 DISA Hosting Services Service Organization Controls Report – Controls to provide reasonable assurance that remote access to the network used to access operating environments is restricted to privileged users, and network devices supporting financial systems are configured in accordance with requirements outlined in applicable Security Technical Implementation Guides (STIGs) or Security Requirements Guides (SRGs) were not operating effectively during the period.

(c) Configuration management / change controls

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematically controls changes to that configuration during the system's life cycle. By implementing configuration management controls, USAF can ensure that only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

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The identified change control weaknesses that represent a significant risk to the USAF financial management information systems environment include the following:

- Developers were granted inappropriate access to make modifications directly to the production environment and delete system files within application modules.
- Configuration changes are not properly reviewed, approved and documented.
- Configuration changes to production environments are not being monitored to verify their appropriateness.
- The application code, configurations, and databases are not monitored for potentially unauthorized changes.
- Documented policies and procedures did not consistently address the process to implement emergency changes.
- Direct changes to data in production are able to be made unmonitored and without any required documentation, testing (if applicable), or approval.
- FY19 DISA Hosting Services Service Organization Controls Report – Controls to provide reasonable assurance that changes to the operating system and database software on operating environments are documented, authorized, and properly implemented were not operating effectively during the period.

(d) Segregation of duties (SoD) controls

An effective control environment guards against a particular user having incompatible functions within a system. Segregation of duties controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations without detection and thereby conducting unauthorized actions or gaining unauthorized access to assets or records.

The identified SoD weaknesses that represent a significant risk to the USAF financial management information systems environment include the following:

- Access rights and responsibilities were not appropriately restricted to independent users and assigned in accordance with segregation of duties policies.
- Policies and procedures were not always comprehensive and did not address potential SoD conflicts within the applications.
- Controls were not in place to verify conflicting roles were not assigned to individuals during the access provisioning process, and for known conflicts where SoD concerns were identified, subsequent logging and review of a user's activity was not in place and monitored for appropriateness. Conflicting roles that were deemed necessary or required due to a business need were not documented and assessed on a regular basis.

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- Users were assigned access to allow them to perform both administrator and end user functions; for example, users were able to add, modify, and delete user access to the application, while also having access to process and modify production data.

(e) Interface controls

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems.

The identified interface control weaknesses that represent a significant risk to the USAF financial management information systems environment include the following:

- Interface agreements are not reviewed on a periodic basis to verify they are accurate.
- Logs of interface processing activities are not retained to support subsequent auditing and monitoring. Error reporting of failed interface processing activities has not been implemented in some systems.
- Interface files are not protected from unauthorized access and modification prior to processing.
- Validation checks are not consistently implemented across interfaces to prevent the processing of duplicate or inaccurate data.
- Reconciliations are not being performed between source and target systems to verify completeness and accuracy of processing.

Recommendations:

The USAF should implement controls to address deficiencies in access controls, configuration management, segregation of duties, and interface procedures to include:

- Security Management
    - Define and implement consistent procedures related to periodic security controls assessments and testing.
    - Prioritize and monitor POA&M progress, and test and monitor corrective actions.
    - Review SOC 1 reports and perform an assessment over USAFs execution of relevant CUECs.
- Access controls / user access / segregation of duties:
    - Implement monitoring and review controls for users with elevated access privileges.
    - Document and follow procedures related to user account management and segregation of duties, including the entire life cycle from access provisioning to recertification, inactivity restrictions, and termination procedures.

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- Segregate roles and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.
- Restrict user access to a single account and eliminate shared accounts.
- Evaluate cross-application segregation of duties to identify potential conflicts for users accessing multiple systems.
- Review access logs and perform follow-up investigation of potential security violations.
- Coordinate with DISA to understand the impact of access control deficiencies to GF financial systems and identify/implement applicable compensating controls to address these risks.

- Configuration management / change controls:
  - Segregate developer access between development and production environments.
  - Identify complete and accurate populations of configuration changes in order to monitor whether changes are being implemented in accordance with policies and procedures.
  - Apply standard configurations developed by DISA to system environments (operating system, database and application layers).
  - Document process for expedited or emergency changes.
  - Review changes and execution procedures completed by third-parties and contractors.
  - Monitor the application and database(s) for potentially unauthorized changes.
  - Coordinate with DISA to understand the impact of change control deficiencies to GF financial systems and identify/implement applicable compensating controls to address these risks.
- Interface controls:
  - Implement stronger systemic checks for completeness and accuracy of interface file processing, to include tracking and logging procedures and protection from unauthorized access.
  - Maintain appropriate and comprehensive documentation covering all interfaces.
  - Document procedures for performing interface error handling and correction.

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Appendix B – Significant Deficiency

I. REIMBURSABLE PROGRAMS

The following deficiencies aggregated into this significant deficiency:

(a) Unsupported adjustments to balance unfilled customer orders (UFCOs) to reimbursable obligations

USAF must match current-year reimbursable authority received from customer orders to the corresponding obligations incurred for that order. If these amounts are not in balance, funds may need to be returned to the customer or de-obligated prior to the end of the fiscal year.

USAF performs balancing at various times during the year, primarily by estimating balances on MORDs and force reconciling balances on journal vouchers. USAF tracks its authority and obligations using Commanders' Resource Integration System (CRIS) reports in order to determine the required journal entries, but we identified a lack of supporting documentation and unique identifiers for these balancing transactions. USAF and DFAS often make these movements to force balances without consideration of the source documents required to evidence the entry. For example, moving transactions from UFCOs to reimbursements earned requires the performing agency provide proof of goods provided and/or services performed. If these amounts are not in balance, funds may need to be returned to the customer or de-obligated prior to the end of the fiscal year.

(b) Lack of sufficient reviews over reimbursable activity

Two of the primary systems that USAF uses for reimbursable activity is the Job Order Cost Accounting System II (JOCAS) and the Comprehensive Cost and Requirements System (CCaR). In JOCAS, reimbursable codes are used to identify the acceptable charges assigned to each Job Order Number (JON). These codes represent charges that USAF incurs to complete an order, determined based on allowable reimbursable costs in accordance with DoD guidance. However, CCaR relies on manual processes to identify, consolidate and allocate costs by element of expense/ investment code (EEIC) or JON if available.

As part of our testing, we identified several instances that indicate a lack of sufficient review. These include:

- Reimbursable codes in JOCAS are not regularly reviewed against updated DoD guidance. This could lead to USAF either over- or under-charging a customer depending on whether the costs are reimbursable.
- Lack of sufficient documentation for the approval of reimbursable codes assigned to a customer.

- Insufficient review over employee charges assigned to JONs in JOCAS. JOCAS permits supervisors to approve multiple timesheets without opening individual timesheets to verify the JONs charged.
- There is no documented review of individual amounts billed by JON or the full amount billed to the customer.
- Lack of timely processing and posting of bills generated in CCaR due to manually-intensive process for documenting, processing and recording transactions
- Lack of timely identification and action to resolve stale open reimbursable orders.
- Insufficient documentation supporting the review of receipt and acceptance for goods and services when performed in conjunction with a reimbursable order to ensure customer billings are correct.
- Insufficient documentation supporting the review of transactions posted to the general ledger against the source documents used to generate the transaction.

(c) Improper accounting for reimbursable agreements

During our testing, we identified several instances where reimbursable agreements were not properly accounted for or were not in accordance with USAF policy:

- USAF does not have sufficient procedures in place to ensure that transactions associated with intra-USAF reimbursable agreements are appropriately eliminated from the financial statements.
- Advance collections were improperly recorded as earned revenue. This occurred due to improper classification of transactions in the general ledger.

Recommendations:

EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Unsupported adjustments to balance UFCOs to reimbursable obligations
    - USAF should evaluate the causes for why unfilled customer orders and obligations created to fulfill those orders are not in balance. Depending on the causes identified, policies and procedures may need to be updated to fully address requirements to:
        - Minimize time lags between the disbursement of funding to meet the contractual obligations and the billing/collection from the customer.
        - Return funding to customer promptly if USAF knows the funding will not be fully utilized.
        - Properly record reimbursable obligations initially as reimbursable budget authority rather than direct budget authority, in order to prevent reclassifying at a later date.

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  - USAF should develop a process that will allow USAF to classify and identify all balancing transactions performed within GAFS and DEAMS data.
- Lack of sufficient reviews
  - Establish a process to regularly assess and update reimbursable codes within JOCAS, as well as those assigned to particular customers.
  - Implement and document review of the reasonableness of charges on the JONs and the customer bill, including ensuring the goods received or services performed comply with the requirements of the agreement.
  - Enhance the current process to determine stale balances are being monitored and ensure customers are billed and collected in a timely manner.
  - Develop policies and procedures to document a review over general ledger postings to reconcile the transactions posted against the source documents.
  - Develop or update policies to sufficiently support that goods provided or services performed satisfy the criteria of the order and include evidence of receipt and acceptance for the expenses incurred.
- Improper accounting for reimbursable agreements.
  - Ensure reimbursement accounting guidance and standard operating procedures are properly followed.
  - Perform an analysis to determine the pervasiveness of the conditions noted and determine if any additional adjustments/eliminations are needed to the financial statements.

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Report of Independent Auditors on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Air Force and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements,* the financial statements of the Department of the Air Force General Fund (USAF), which comprise the consolidated balance sheet as of September 30, 2019, and the related consolidated statement of net cost, consolidated statement of changes in net position and combined statement of budgetary resources for the year ended September 30, 2019, and the related notes to the financial statements and have issued our report thereon dated November 8, 2019. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2019 and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 19-03, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to USAF.

The results of our tests of compliance with laws and regulations described in the second paragraph of this report disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

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FFMIA

Under FFMIA, we are required to report whether USAF's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of tests disclosed instances in which USAF's financial management systems did not substantially comply with federal financial management systems requirements, applicable federal accounting standards or the USSGL.

(a) Federal financial management system requirements

As referenced in Fiscal Year (FY) 2019 USAF Statement of Assurance, the USAF identified that financial systems and financial portions of mixed systems do not substantially meet FFMIA or OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (Circular A-123) Appendix D.

EY also identified this material weakness as part of the Financial Information Systems material weakness, contained in the *Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards* (Report on Internal Control), where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with security management, access controls/user access, configuration management/change controls, segregation of duties and interface controls. These financial system deficiencies prevent USAF from being compliant with federal financial management system requirements and inhibit USAF's ability to prepare complete and accurate financial reports.

(b) Noncompliance with applicable federal accounting standards

As referenced in the FY 2019 USAF Statement of Assurance and Note 1 to the financial statements, USAF identified that the design of legacy financial systems does not allow USAF to comply with applicable federal accounting standards, including not being able to collect and record financial information on an accrual accounting basis. EY also identified noncompliance with federal accounting standards during our testing, which was included in our Report on Internal Control.

(c) Noncompliance with USSGL posting logic at the transaction level

As referenced in the FY 2019 USAF Statement of Assurance, USAF identified that the design of legacy financial systems does not allow USAF to comply with USSGL at the transaction level.

EY also identified noncompliance with USSGL posting logic during our testing, which was included in our Report on Internal Control.

FMFIA

Federal Managers' Financial Integrity Act (FMFIA) requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control.

The USAF was not able to provide evidence that they are in compliance with significant aspects of OMB Circular A-123, which implemented FMFIA. The USAF provided a FY 2019 Statement of Assurance, however there was not sufficient evidence that each process identified by USAF fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level. Based on the evidence received, EY noted that USAF has started to implement an A-123 testing strategy, however USAF is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

USAF's Response to Findings

Our Report on Internal Control dated November 8, 2019 includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance with FFMIA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from USAF's management responsible for addressing the noncompliance are provided in their letter dated November 8, 2019. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the entity's compliance. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 8, 2019

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AIR FORCE WORKING CAPITAL FUND

The United States (U.S.) Air Force Working Capital Fund financial statements and related notes summarize financial information for the Working Capital Fund for the Fiscal Year (FY) ended September 30, 2019 and are presented on a comparative basis with information previously reported for the FY ended September 30, 2018. The Principal Statements and related notes have been prepared to report financial position pursuant to the requirements of the *Chief Financial Officers Act of 1990*, the *Government Management Reform Act of 1994*, and the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements* (OMB A-136).

The following statements comprise the Air Force Working Capital Fund Principal Statements:

Consolidated Balance Sheets

The Consolidated Balance Sheets, as of September 30, 2019 and 2018, represent those resources owned or managed by the Air Force, which are available to provide future economic benefits (assets), amounts owed by the Air Force that will require payments from those resources or future resources (liabilities), and residual amounts retained by the Air Force, comprising the difference (net position).

Consolidated Statements of Net Cost

The Consolidated Statements of Net Cost present the net cost of the Air Force's operations for the FYs ended September 30, 2019 and 2018. The Air Force's net cost of operations includes the gross costs incurred by the Air Force less any exchange revenue earned from Air Force activities.

Consolidated Statements of Changes in Net Position

The Consolidated Statements of Changes in Net Position present the change in the Air Force's net position resulting from the net cost of Air Force's operations, budgetary financing sources other than exchange revenues, and other financing sources for the FYs ended September 30, 2019 and 2018.

Combined Statements of Budgetary Resources

The Combined Statements of Budgetary Resources present the budgetary resources available to the Air Force during FYs 2019 and 2018, the status of these resources at September 30, 2019 and 2018, and the outlays of budgetary resources for the FYs ended September 30, 2019 and 2018.

Air Force Working Capital Fund
CONSOLIDATED BALANCE SHEETS
As of September 30, 2019 and 2018

(Amounts in Thousands)

	2019 Consolidated (Unaudited)		2018 Consolidated (Unaudited)	
ASSETS (Note 2)				
Intragovernmental				
Fund Balance with Treasury (Note 3)	$	479,606	$	1,445,895
Accounts Receivable, Net (Note 4)		860,247		730,932
Other Assets (Note 7)		0		124,161
Total Intragovernmental Assets	$	1,339,853	$	2,300,988
Accounts Receivable, Net (Note 4)	$	3,215	$	3,871
Inventory and Related Property, Net (Note 5)		28,304,844		28,890,092
General Property, Plant and Equipment, Net (Note 6)		1,535,967		1,549,902
Other Assets (Note 7)		273,776		140,791
TOTAL ASSETS	$	31,457,655	$	32,885,644
LIABILITIES (Note 8)				
Intragovernmental				
Accounts Payable	$	166,352	$	149,749
Other Liabilities (Note 10 & 11)		58,690		55,581
Total Intragovernmental Liabilities	$	225,042	$	205,330
Accounts Payable	$	500,279	$	456,135
Military Retirement and Other Federal Employment Benefits (Note 9)		208,936		197,332
Other Liabilities (Note 10 & Note 11)		600,085		449,900
TOTAL LIABILITIES	$	1,534,342	$	1,308,697
COMMITMENTS AND CONTINGENCIES (NOTE 11)				
NET POSITION				
Unexpended Appropriations - Other Funds	$	262,848	$	33,158
Cumulative Results of Operations - Other Funds		29,660,465		31,543,789
TOTAL NET POSITION	$	29,923,313	$	31,576,947
TOTAL LIABILITIES AND NET POSITION	$	31,457,655	$	32,885,644

The accompanying notes are an integral part of these statements.

Air Force Working Capital Fund
CONSOLIDATED STATEMENTS OF NET COST
For Years Ended September 30, 2019 and 2018

(Amounts in Thousands)

	2019 Consolidated (Unaudited)	2018 Consolidated (Unaudited)
Program Costs		
Operations, Readiness & Support	$ 14,606,717	$ 7,855,683
Gross Costs	$ 14,606,717	$ 7,855,683
(Less: Earned Revenue)	(12,745,704)	(12,674,683)
Net Cost of Operations	$ 1,861,013	$ (4,819,000)

The accompanying notes are an integral part of these statements.

Air Force Working Capital Fund
CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION
For Years Ended September 30, 2019 and 2018

(Amounts in Thousands)	2019 Consolidated (Unaudited)	2018 Consolidated (Unaudited)
UNEXPENDED APPROPRIATIONS:		
Beginning Balances	$ 33,158	$ 47,941
Beginning balances, as adjusted	33,158	47,941
Budgetary Financing Sources:		
Appropriations transferred-in/out	311,518	66,462
Appropriations used	(81,828)	(81,245)
Total Budgetary Financing Sources	$ 229,690	$ (14,783)
Total Unexpended Appropriations	$ 262,848	$ 33,158
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 31,543,789	$ 26,485,596
Beginning balances, as adjusted	31,543,789	26,485,596
Budgetary Financing Sources:		
Appropriations used	81,828	81,245
Non-exchange revenue	6	(4)
Transfers-in/out without reimbursement	0	(58,996)
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(12,939)	(14,584)
Imputed financing from costs absorbed by others	217,949	199,650
Other (+/-)	(309,155)	31,882
Total Financing Sources	$ (22,311)	$ 239,193
Net Cost of Operations (+/-)	1,861,013	(4,819,000)
Net Change	(1,883,324)	5,058,193
Cumulative Results of Operations	29,660,465	31,543,789
NET POSITION	$ 29,923,313	$ 31,576,947

The accompanying notes are an integral part of these statements.

Air Force Working Capital Fund
COMBINED STATEMENTS OF BUDGETARY RESOURCES
For Years Ended September 30, 2019 and 2018

(Amounts in Thousands)

	2019 Combined (Unaudited)	2018 Combined (Unaudited)
Budgetary Resources:		
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 1,527,387	$ 1,271,915
Appropriations (discretionary and mandatory)	77,644	66,461
Contract Authority (discretionary and mandatory)	10,964,575	10,947,080
Spending Authority from offsetting collections (discretionary and mandatory)	6,639,343	6,794,693
Total Budgetary Resources	$ 19,208,949	$ 19,080,149
Status of Budgetary Resources:		
New obligations and upward adjustments (total)	$ 17,949,702	$ 17,786,636
Unobligated balance, end of year:		
Apportioned, unexpired accounts	1,259,247	1,293,513
Unexpired unobligated balance, end of year	1,259,247	1,293,513
Unobligated balance, end of year (total)	1,259,247	1,293,513
Total Budgetary Resources	$ 19,208,949	$ 19,080,149
Outlays, net:		
Outlays, net (total) (discretionary and mandatory)	1,277,805	424,231
Agency Outlays, net (discretionary and mandatory)	$ 1,277,805	$ 424,231

The accompanying notes are an integral part of these statements.

Fiscal Year 2019

WORKING CAPITAL FUND

Notes to the Principal Statements (Unaudited)

Notes to the financial statements communicate information essential for fair presentation of the financial statements that is not displayed on the face of the financial statements.

Note 1 Summary of Significant Accounting Policies

A. Reporting Entity

The United States (U.S.) Air Force is organized under the Headquarters Air Force and Field Organizations. The Headquarters Air Force includes the Secretary of the Air Force who is responsible for all affairs of the Air Force and reports to the Secretary of Defense. The Headquarters Air Force also includes the Chief of Staff who is responsible for the efficiency of the Air Force and the preparation of its forces for military operations. The Field Organizations are comprised of the Major Commands, Direct Reporting Units, Field Operating Agencies, and their subordinate elements that carry out the mission of the Air Force.

B. Mission of the Reporting Entity

The Air Force was created on September 18, 1947 by the *National Security Act of 1947* and operates under the direction, authority, and control of the Secretary of the Air Force. The Air Force's overall mission is to deliver sovereign options for the defense of the United States of America and its global interests to "Aim High…Fly, Fight, Win" in air, space, and cyberspace. The Air Force carries out its mission by adhering to a strategic framework of core values consisting of Integrity First, Service Before Self, and Excellence in All We Do. In addition, the Air Force is committed to providing Global Vigilance, Global Reach, and Global Power, while defending and protecting the U.S.

The stock and industrial revolving fund accounts were created by the *National Security Act of 1947*, as amended in 1949 and codified in United States Code 10 § 2208. The revolving funds were established to more effectively control the cost of work performed by the Department of Defense (DoD). The DoD began operating under the revolving fund concept on July 1, 1951.

Air Force Working Capital Fund (AFWCF) operations consist of two major activity groups: Consolidated Sustainment Activity Group (CSAG) and the Supply Management Activity Group - Retail (SMAG-R). All AFWCF CSAG and SMAG-R activities establish rates based on full cost recovery. If an operating loss or gain is incurred, the activity will make the appropriate adjustment in following years' prices to recoup the loss or return the gain to their customers.

The mission of CSAG is supply management of reparable and consumable items, and maintenance activities. Supply Division activities of CSAG are authorized to procure and manage reparable and consumable items for which the Air Force is the Inventory Control Point. The Supply Division manages items that are generally related to weapon systems and ground support, and include both depot level and non-depot level reparables.

Maintenance Division activities of CSAG are authorized to perform: a) overhaul, conversion, reclamation, progressive maintenance, modernization, software development, storage, modification, and repair of aircraft, missiles, engines, accessories, components, and equipment, b) the manufacture of parts and assemblies required to support the foregoing, and c) the furnishing of other authorized services or products for the Air Force and other DoD and non-DoD agencies. As directed by the Air Force Materiel Command (AFMC) or higher authority, the Maintenance Division may furnish the above-mentioned products or services to agencies of other departments or instrumentalities of the U.S. Government, and to private parties and other agencies, as authorized by law.

The SMAG-R consists of three business divisions: General Support Division (GSD), Medical-Dental Division, and Air Force Academy Division. GSD procures and manages consumable supply items related to maintenance, flying hour program, and installation functions. The majority are used in support of field and depot maintenance of aircraft, ground and airborne communication systems, and other support systems and equipment. The Medical-Dental Division procures and manages medical supply items and equipment necessary to maintain an effective Air Force Health Care system for the active military, retirees, and their dependents. The Air Force Academy Division procures and manages a retail inventory of uniforms, academic supplies, and other recurring issue requirements for the Cadet Wing of the United States Air Force Academy. Inventory procurement is only for mandatory items as determined by the Cadet Uniform Board.

C. Basis of Presentation

These financial statements have been prepared to report the consolidated financial position, net cost of operations, changes in net position, and combined budgetary resources of the AFWCF operations, as required by the *Chief Financial Officers Act of 1990*, as amended and expanded by the *Government Management Reform Act of 1994*, and other applicable legislation. The financial statements have been prepared from the books and records of the AFWCF in accordance with, and to the extent possible, U.S. Generally Accepted Accounting Principles (U.S. GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB), the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements* (OMB A-136), and the DoD, *Financial Management Regulation (FMR)*. The accompanying financial statements account for all resources for which the AFWCF is responsible, unless otherwise noted. Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

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

D. Basis of Accounting

The AFWCF's financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the AFWCF's sub-entities. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), non-financial feeder systems, and accruals made for major items such as "Flying Hour" revenue, payroll expenses, and accounts payable. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated AFWCF 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 AFWCF presents the Balance Sheets, Statements of Net Cost, and Statements of Changes in Net Position on a consolidated basis, which is the summation of the components less the eliminations. The Statements of Budgetary Resources (SBR) are presented on a combined basis, which is the summation of the components. The financial transactions are recorded on a proprietary accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recognized when incurred, without regard to the timing of receipt or payment of cash. Whereas, under the budgetary basis, the legal commitment or obligation of funds is recognized in advance of the proprietary accruals and in compliance with legal requirements and controls over the use of federal funds.

AFWCF's continued effort towards full compliance with U.S. GAAP for the accrual method of accounting is encumbered by various system limitations and the sensitive nature of the AFWCF's activities. The AFWCF is unable to meet all full accrual accounting requirements. This is primarily because many of the AFWCF's financial and non-financial systems and processes were designed prior to the legislative mandate to produce financial statements in accordance with U.S. GAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis but were designed to record information on a budgetary basis.

The AFWCF has not completed the process of evaluating the effects that will result from adopting the below pronouncements of the FASAB *Handbook of Accounting Standards and Other Pronouncements, as Amended*. These pronouncements are expected to have an impact on the AFWCF's financial statements. The AFWCF is currently unable to determine the materiality of changes that adopting the below pronouncements will have on its financial position, results of its operations, net position, and budgetary activity when such pronouncements are adopted.

1) Statement of Federal Financial Accounting Standards (SFFAS) 47: *Reporting Entity*. Issued on December 23, 2014. Effective Date: Reporting periods beginning after September 30, 2017. AFWCF was required to adopt SFFAS 47 for the year ended September 30, 2018.

SFFAS 47 requires Federal Government entities to analyze their relationships with related entities to determine which, if any, entities should be reported with the reporting entity on a consolidated basis, those that should be disclosed as inter-related with the reporting entity, and those that should be disclosed by the reporting entity as related parties. AFWCF's SFFAS 47 analysis is not complete. The consolidation decisions related to that analysis, when complete, could have a material impact on the AFWCF's financial statements.

2) SFFAS 48: *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*. Issued on January 27, 2016. Effective Date: Reporting periods beginning after September 30, 2016.

AFWCF plans to utilize deemed cost to value beginning balances for inventory and related property (I&RP), as permitted by SFFAS 48. However, systems required to account for historical cost for I&RP in accordance with SFFAS 3, *Accounting for Inventory and Related Property*, are not yet fully in place. Therefore, AFWCF is not making an unreserved assertion with respect to this line item.

3) SFFAS 49: *Public-Private Partnerships: Disclosure Requirements*. Issued on April 27, 2016. Effective Date: Reporting periods beginning after September 30, 2018.

AFWCF has begun to evaluate arrangements and transactions for Public-Private Partnerships (P3s) criteria to determine the complete population of arrangements and transactions requiring disclosure under SFFAS 49 but has not completed a full analysis of all arrangements as of September 30, 2019.

4) SFFAS 50: *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*. Issued on August 4, 2016. Effective Date: Reporting periods beginning after September 30, 2016.

AFWCF plans to utilize deemed cost to value beginning balances for General Property, Plant, and Equipment (General PP&E), as permitted by SFFAS 50. However, systems required to account for historical cost for General PP&E in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*, are not yet fully in place. Therefore, AFWCF is not making an unreserved assertion with respect to this line item.

5) SFFAS 55: *Amending Inter-entity Cost Provisions*. Issued on May 31, 2018. Effective Date: Reporting periods beginning after September 30, 2018.

Pursuant to SFFAS 55, Office of the Secretary of Defense (OSD) issued a policy in September 2018 directing all DoD components not to recognize imputed costs and corresponding imputed financing from non-business type activities other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements. This election is permitted under SFFAS 55. However, as a business-type activity, AFWCF is required to recognize imputed costs and imputed financing for goods and services received from other federal entities at no cost, or at a cost less than the full cost. AFWCF is in the process of adopting this SFFAS.

6) SFFAS 56: *Classified Activities*. Issued on October 4, 2018. Effective Date: Upon issuance.

SFFAS 56 permits certain modifications to prevent the disclosure of classified information in an unclassified General Purpose Federal Financial Report.

7) SFFAS 57: *Omnibus Amendments 2019*. Issued on September 27, 2019. Effective Date: Paragraphs 9 and 10 of this Statement, which amend paragraph 26 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, are effective upon issuance; Paragraph 2 of this Statement, which rescinds SFFAS 8, *Supplementary Stewardship Reporting*, is effective for reporting periods beginning after September 30, 2019 and early adoption is not permitted; Paragraphs 3 through 8, 11 and 12 of this Statement, which updates references to leases in SFFAS 5, *Accounting for Liabilities of the Federal Government,* SFFAS 6, and SFFAS 49, are effective for reporting periods beginning after September 30, 2020 and early adoption is not permitted.

8) Technical Bulletin 2017-1: *Intragovernmental Exchange Transactions*. Issued on November 1, 2017. Effective date: Upon issuance.

9) Technical Bulletin 2017-2: *Assigning Assets to Component Reporting Entities*. Issued on November 1, 2017. Effective date: Upon issuance.

10) Technical Release 17: *Conforming Amendments to Technical Releases for* SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*. Issued on April 10, 2017. Effective Date: Upon Issuance.

As this Technical Release serves as implementation guidance for SFFAS 50, AFWCF is in the process of adopting this Technical Release as of September 30, 2019.

11) Technical Release 18: *Implementation Guidance for Establishing Opening Balances*. Issued on October 2, 2017, Effective Date: Upon issuance.

As this Technical Release serves as implementation guidance for SFFAS 48 and SFFAS 50, AFWCF is in the process of adopting this Technical Release as of September 30, 2019.

12) Staff Implementation Guidance 6.1: *Clarification of Paragraphs 40-41 of SFFAS 6, Accounting for Property, Plant, and Equipment, As Amended.* Issued on July 17, 2018. Effective Date: Upon issuance.

13) Interpretation 9: *Cleanup Cost Liabilities Involving Multiple Component Reporting Entities. An Interpretation of* SFFAS 5 & SFFAS 6. Issued on August 16, 2019. Effective Date: Reporting periods beginning after September 30, 2019.

The AFWCF has not recorded all transactions consistent with U.S. GAAP because of limitations of certain systems and resource constraints. The AFWCF continues to transition to systems that can produce U.S. GAAP compliant financial statements. The following known transactions were not recorded consistent with U.S. GAAP and are believed to be materially misstated in the financial statements (not an exhaustive list).

1) Accounting errors recorded in prior years and impacting the current year financial statements have not been recorded and corrected in accordance with U.S. GAAP.

2) Transactions that should have been recorded in prior years, were recorded in the current year.

The financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources and legal authority to do so.

E. Accounting for Intragovernmental and Intergovernmental Activities

The Treasury Financial Manual, Volume 1, Part 2 – Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, provides guidance for reporting and reconciling intragovernmental balances. Accounting standards require an entity to eliminate intra-entity activity and balances from consolidated financial statements to prevent overstatement for a business with itself. Generally, seller entities within the DoD provide summary seller-side balances for Revenue, Accounts Receivable, and Unearned Revenue to the buyer-side internal DoD accounting offices. The DoD is implementing replacement systems and a standard financial information structure that will incorporate the necessary elements to enable the DoD to correctly report, reconcile, and eliminate intragovernmental balances.

Imputed financing represents the cost paid on behalf of the AFWCF by another federal entity. Once the AFWCF fully implements SFFAS 55, the AFWCF will recognize the general nature of imputed costs only for business-type activities and other costs specifically required by OMB A-136, including 1) employee pension, post-retirement health, and life insurance benefits, 2) post-employment benefits for terminated and inactive employees, to include unemployment and workers compensation under the *Federal Employees' Compensation Act* (FECA) *of 1916*, and 3) losses in litigation proceedings that are paid from the Treasury Judgement Fund. Unreimbursed costs of goods and services other than these are not included in the AFWCF's financial statements.

For additional information, see Note 12, *General Disclosures Related to the Statement of Net Cost.*

F. Non-Entity Assets

The accounts used to prepare the financial statements are categorized as either entity or non-entity. The AFWCF accounts consist of resources that are available for use in the operations of the entity. The AFWCF is authorized to decide how to use resources in entity accounts or may be legally obligated to use these resources to meet entity obligations. Non-entity accounts, on the other hand, consist of assets that are held by an entity but are not available for use in the operations of the entity.

For additional information, see Note 2, *Non-Entity Assets.*

G. Fund Balance with Treasury

The AFWCF's monetary resources of collections and disbursements are maintained in U.S. Treasury accounts. The disbursing offices of Defense Finance and Accounting Services (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 AFWCF'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.

DFAS and the 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 account.

For additional information, see Note 3, *Fund Balance with Treasury.*

H. 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 factors such as aging of accounts receivable, debtor's ability to pay, and payment history. The AFWCF does not recognize an allowance for estimated uncollectible amounts from other Federal Agencies. Claims for accounts receivable from other Federal Agencies are resolved between the agencies in accordance with the Intragovernmental Business Rules published in the Treasury Financial Manual Volume 1, Part 2, Chapter 4700.

In accordance with SFFAS 1, *Accounting for Selected Assets and Liabilities* (paragraphs 46-49), the methodology for losses due to uncollectible amounts are based on an individual account analysis and/or group analysis. For individual account analysis, account balances are individually analyzed to determine the loss allowance. For group analysis, receivables are separated into groups of homogeneous accounts with similar risk characteristics. To allow for both requirements, a group analysis is performed in determining the allowance percentages by aging category applied to delinquent balances per the *Treasury Report on Receivables* or other sources of public receivable information. The allowance percentages by aging categories are based on three years of actual collection experience. In accordance with the DoD FMR Volume 4, Chapter 3, a secondary analysis may be performed on individual receivable balances greater than $100.0 thousand. Based on the analysis, the AFWCF can either 1) completely remove the balance (full or partial) from the percentage calculation or 2) adjust the ending balance.

For additional information, see Note 4, *Accounts Receivable, Net.*

I. Inventory and Related Property, Net

The AFWCF 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 aircraft, missiles, engines, accessories, components, medical, dental, and support equipment. Items commonly used in, and available from, the commercial sector are not managed in AFWCF's materiel management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The AFWCF holds materiel based on military need and support for contingencies.

The AFWCF values its resale inventory using the Moving Average Cost (MAC) method.

Inventory Held for Sale includes consumable spares and repair parts, as well as reparable items owned and managed by AFWCF. This inventory is retained to support military or national contingencies. AFWCF values Inventory Held for Repair using the allowance method. 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. As the AFWCF often relies on weapon systems and machinery no longer in production, AFWCF supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining readiness for a lethal joint force. Inventory 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.

Operating Materials & Supplies (OM&S) Held for Use is valued using MAC. The AFWCF uses the consumption method of accounting for OM&S.

The AFWCF recognizes Excess, Obsolete, and Unserviceable Inventory and OM&S at a net realizable value of zero.

For additional information, see Note 5, *Inventory and Related Property, Net.*

J. General Property, Plant, and Equipment

The AFWCF capitalizes all General Property, Plant, and Equipment (General PP&E) used in the performance of their mission with a useful life of two or more years and with an acquisition cost that equals or exceeds capitalization thresholds. The AFWCF when applicable, will continue to use alternative methods in establishing opening balances for General PP&E in accordance with SFFAS 50.

AFWCF's capitalization threshold for General PP&E is $250.0 thousand. This capitalization threshold applies to asset acquisitions and modifications/improvements placed into service after September 30, 2013. General PP&E assets acquired prior to October 1, 2013 were capitalized at prior threshold levels ($100.0 thousand for Equipment and $20.0 thousand for Real Property). The AFWCF depreciates all General PP&E, on a straight-line basis.

Contractor-Acquired Property (CAP) is General PP&E acquired by a contractor on behalf of the AFWCF for performing a contract, where the government will ultimately hold the title to the General PP&E. If the CAP has a useful life of at least two years and the value of CAP meets or exceeds the AFWCF's capitalization threshold, federal accounting standards require that it be reported on AFWCF's Balance Sheet when title passes to the AFWCF or when the General PP&E is delivered to the Air Force.

For additional information, see Note 6, *General PP&E, Net.*

K. Other Assets

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

The AFWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. The AFWCF may provide financing payments to contractors to alleviate the potential financial burden from long-term contracts. Contract financing payments are defined in the *Federal Acquisition Regulations (FAR), 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.

The Defense Federal Acquisition Regulation Supplement (DFARS) authorizes progress payments based on a percentage or stage of completion. Contract financing payments should not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion.

For additional information, see Note 7, *Other Assets*.

L. Accounts Payable

Accounts Payable includes amounts owed to Federal and Non-Federal entities for goods and services received by the AFWCF.

Refer to Note 10, *Other Liabilities*, for information on the reclassification of progress payments for the estimated costs incurred by a contractor from Contingent Liabilities to Accounts Payable beginning in FY 2019.

M. Liabilities

Liabilities represent the probable future outflow or other sacrifice of resources as a result of past transactions or events. However, no liability can be paid by the AFWCF without proper budget authority. Liabilities covered by budgetary resources are liabilities for which funding will otherwise be available to pay amounts when due. Liabilities not covered by budgetary resources, such as, Other Federal Employment Benefits liabilities, represent amounts owed in excess of available funds or other amounts, where there is no certainty that the funds will be available. Liabilities that are not funded by the current year resources are classified as Liabilities Not Covered by Budgetary Resources.

For additional information, see Note 8, *Liabilities Not Covered by Budgetary Resources*.

N. Other Liabilities

Other liabilities may be Federal or Non-Federal. Such liabilities include FECA Reimbursement to the Department of Labor, Custodial Liabilities, Employer Contribution and Payroll Taxes Payable, Accrued Funded Payroll and Benefits, Advances from Others, Accrued Unfunded Annual Leave, Contract Holdbacks, and Non-Federal Other Liabilities.

For additional information, see Note 10, *Other Liabilities*.

O. Commitments and Contingencies

The AFWCF recognizes Contingent Liabilities on the consolidated Balance Sheet for those legal actions where management considers an adverse decision to be probable and the loss amount is reasonably estimable. However, there are cases where amounts have not been accrued or disclosed because the likelihood of an adverse decision is considered remote or the amount of potential loss cannot be estimated.

The AFWCF executes project agreements pursuant to the framework cooperative agreement with foreign governments. All of these agreements give rise to obligations that are fully reported in the AFWCF's statements, pursuant to legal authority, appropriated funds, and none are contingent. The AFWCF does not enter into treaties and other international agreements that create contingent liabilities.

For additional information, see Note 11, *Commitments and Contingencies*.

P. Military and Civilian Retirement Benefits

For information, see Note 9, *Military Retirement and Other Federal Employment Benefits*.

Q. Revenues and Other Financing Sources

Working capital funds (WCF) conduct business-like activities and receive funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. This corpus finances operations and transactions that flow through the fund. Each WCF obtains 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 execute its missions or to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

The primary sources of revenue recorded within the AFWCF result from the following activities:

1. The sale of repair services such as a) the repair of aircraft, missiles, engines, accessories, components, and equipment, and b) the remanufacture of parts and assemblies required to support the foregoing.

2. Inventory issued to the Flying Hour program. Instead of recognizing revenue based on the sale price of a spare part, revenue is recognized on a rate charged for a flying hour.

3. The sale of reparable (including both depot level and non-depot level reparables) and consumable items that are generally related to medical supplies, medical equipment, weapon systems, and ground support.

The CSAG Maintenance Division recognizes revenue according to the percentage of completion method. The CSAG Supply and SMAG-R Divisions recognize revenue based on flying hours executed and the sale of inventory items. Full-cost pricing is the AFWCF's standard policy for services provided as required by OMB Circular A-25, *User Charges* (OMB A-25).

In accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financing Accounting*, the AFWCF recognizes non-exchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not directly receive value in return.

The AFWCF 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 in Note 16, *Reconciliation of Net Cost to Net Outlays*. 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.

R. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. Estimates are made for major items such as Payroll Expenses, Accounts Payable and Unbilled Revenue. Some accounts such as Civilian Pay, Military Pay, and Accounts Payable are presented on the accrual basis of accounting on the financial statements, as required by U.S. GAAP.

The DoD has issued guidance under which DoD Components may expense OM&S using the purchase method of accounting rather than the consumption method. The AFWCF uses the consumption method to recognize expense for OM&S. OM&S are expensed when consumed.

S. Use of Estimates

The AFWCF's management makes assumptions and reasonable estimates in the preparation of financial statements based on current conditions, which may affect the reported amounts. Actual results could differ materially from the estimated amounts. Significant estimates include such items as year-end accruals of "Flying Hour" revenue, percentage of completion revenue recognition for maintenance services, accounts payable, and actuarial liabilities related to workers' compensation. Instead of recognizing revenue and receivables based on the sale of a spare part under the Flying Hour program, CSAG Supply recognizes revenue and receivables on a rate charged for a flying hour. CSAG Supply accrues for revenue and receivables based on an hourly rate times the estimated flying hours to be executed during the month. This process requires CSAG Supply to accrue an estimated amount of the forecasted flying hours to be executed for both the revenue and accounts receivable at the end of each month, until actual flying hour data is available. Once actual flying hour data is available, the accrual is reversed, actual revenue is calculated and recorded, and the customer is billed.

CSAG Maintenance recognizes revenue using the percentage of completion method. Estimated Total Costs are not evaluated and/or changed during the life of the project. The End Item Sales Price (EISP) is used as the total amount of cost that can be used in the revenue calculation. If actual total costs of project ever reaches the EISP, revenue stops being recorded; however, costs will continue to be recorded until project is financially closed. Management monitors open projects where total incurred costs exceeded the total amount of recognized revenue (EISP).

T. Transactions with Foreign Governments and International Organizations

Each year, the AFWCF sells defense articles and services to foreign governments and international organizations under the provisions of the *Arms Export Control Act of 1976* (the Act). Under the provisions of the Act, the DoD has the 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.

U. Tax Exempt Status

As an agency of the Federal Government, the AFWCF is exempt from all income taxes imposed by any governing body whether it is a Federal, State, Commonwealth, Local, or Foreign Government.

V. Subsequent Events

Subsequent events have been evaluated from the balance sheet date through November 8, 2019, which is the date the financial statements were available to be issued.

Note 2 Non-Entity Assets

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Non-Federal Assets		
Accounts Receivable	$ 7	$ 1
Total Non-Entity Assets	$ 7	$ 1
Total Entity Assets	$ 31,457,648	$ 32,885,643
Total Assets	$ 31,457,655	$ 32,885,644

Asset accounts are categorized as either entity or non-entity. Entity accounts consist of resources that are available for use in the operations of the entity.

Non-entity assets are not available for use in the Air Force Working Capital Fund's (AFWCF) normal operations. The AFWCF has stewardship accountability and reporting responsibility for non-entity assets.

Accounts Receivable consists of amounts associated with interest, fines and penalties due on debt. Generally, the AFWCF cannot use the proceeds and must remit them to the United States Treasury unless permitted by law.

Note 3 Fund Balance with Treasury

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Unobligated Balance		
Available	$ 1,259,247	$ 1,293,514
Total Unobligated Balance	$ 1,259,247	$ 1,293,514
Obligated Balance not yet Disbursed	$ 9,630,146	$ 8,961,963
Non-Budgetary Fund Balance with Treasury:		
Non-entity and other	$ 0	$ 2
Total Non-Budgetary Fund Balance with Treasury	$ 0	$ 2
Non-Fund Balance with Treasury Budgetary Accounts		
Unfilled Customer Orders without Advance	$ (3,930,287)	$ (3,940,912)
Contract Authority	(5,393,355)	(3,890,423)
Receivables and Other	(1,086,145)	(978,247)
Total Non-Fund Balance with Treasury Budgetary Accounts	$ (10,409,787)	$ (8,809,582)
Total Fund Balance with Treasury	$ 479,606	$ 1,445,895

Status of Fund Balance with Treasury

The Treasury records cash receipts and disbursements on the Air Force Working Capital Fund's (AFWCF) behalf and are available only for the purposes for which the funds were appropriated. The AFWCF's Fund Balance with Treasury (FBwT) consists of appropriation accounts and revolving funds.

The Status of FBwT reflects the budgetary resources to support 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.

The Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover future obligations. The available balance consists primarily of the unexpired, unobligated balance that has been apportioned and available for new obligations. Certain unobligated balances are restricted for future use and are not apportioned for current use. The AFWCF has no restrictions on unobligated balances.

The Obligated Balance not yet Disbursed represents funds obligated for goods and services but not yet paid.

Non-FBwT Budgetary Accounts reduces the status of FBwT. The amount reported as Non-FBwT Budgetary Accounts is comprised of contract authority, unfilled orders without advance from customers, and accounts receivable.

The FBwT reported in the financial statements has been adjusted to reflect the AFWCF's balance as reported by the United States (U.S.) Treasury. The difference between FBwT in the AFWCF's general ledgers and FBwT reflected in the U.S. Treasury accounts is attributable to transactions that have not been posted to the individual detailed accounts in the AFWCF's general ledger as a result of timing differences or the inability to obtain valid accounting information prior to the issuance of the financial statements. AFWCF made $281.8 million in net adjustments, which is approximately $375.5 million absolute; however, the total activity to support the adjustments cannot be supported. When research is completed, these transactions will be recorded in the appropriate individual detailed accounts in the AFWCF's general ledger accounts.

Note 4 Accounts Receivable, Net

As of September 30	2019 (Unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in Thousands)			
Intragovernmental Receivables	$ 860,247	$ N/A	$ 860,247
Non-Federal Receivables (From the Public)	$ 3,326	$ (111)	$ 3,215
Total Accounts Receivable	$ 863,573	$ (111)	$ 863,462

As of September 30	2018 (Unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in Thousands)			
Intragovernmental Receivables	$ 730,932	$ N/A	$ 730,932
Non-Federal Receivables (From the Public)	$ 3,982	$ (111)	$ 3,871
Total Accounts Receivable	$ 734,914	$ (111)	$ 734,803

Accounts Receivable represents the Air Force Working Capital Fund's (AFWCF) claim for payment from other entities. The AFWCF only recognizes an allowance for uncollectible amounts from the public. Claims with other Federal Agencies are resolved in accordance with the business rules published in the Treasury Financial Manual, Volume I, Part 2, Chapter 4700. Refer to Note 1.H, *Summary of Significant Accounting Policies, Accounts Receivable,* for additional information regarding the method utilized to account for the allowance for estimated uncollectibles.

Note 5 Inventory and Related Property, Net

Inventory and Related Property

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Inventory, Net	$ 28,178,750	$ 28,761,838
Operating Materials & Supplies, Net	126,094	128,254
Total Inventory and Related Property, Net	$ 28,304,844	$ 28,890,092

Inventory, Net

Inventory Categories

As of September 30	2019 (Unaudited)			
	Inventory, Gross	Revaluation Allowance	Inventory, Net	Valuation Method
(Amounts in Thousands)				
Held for Sale	$ 15,791,050	$ 0	$ 15,791,050	MAC
Held for Repair	18,009,152	(5,624,274)	12,384,878	MAC, LRC
Work-in-Progress	2,822	0	2,822	MAC
Excess, Obsolete, and Unserviceable	270,237	(270,237)	0	NRV
Total	$ 34,073,261	$ (5,894,511)	$ 28,178,750	

As of September 30	2018 (Unaudited)			
	Inventory, Gross	Revaluation Allowance	Inventory, Net	Valuation Method
(Amounts in Thousands)				
Held for Sale	$ 16,103,508	$ (762)	$ 16,102,746	MAC
Held for Repair	17,671,972	(5,017,740)	12,654,232	MAC, LRC
Work-in-Progress	4,860	0	4,860	MAC
Excess, Obsolete, and Unserviceable	289,520	(289,520)	0	NRV
Total	$ 34,069,860	$ (5,308,022)	$ 28,761,838	

Legend for Valuation Methods:

LRC = Latest Repair Cost MAC = Moving Average Cost NRV = Net Realizable Value

Inventory Adjustments

In Fiscal Year (FY) 2019, the Air Force Working Capital Fund (AFWCF) recorded two material adjustments that impacted Inventory and Related Property, Net and Gross Costs. The AFWCF recorded an adjustment of $1.4 billion to increase Inventory and Related Property, Net and to decrease Gross Costs to correct negative net inventory values within the inventory records. A second adjustment of $3.4 billion was recorded to decrease Inventory and Related Property, Net and to increase Gross Costs by $3.0 billion disclosed within the Statement of Net Cost and decrease Other Financing Sources by $0.4 billion disclosed within the Statement of Changes in Net Position to reflect the value of inventory in-transit.

In FY 2018, the AFWCF recorded two material adjustments that impacted Inventory and Related Property, Net. The first adjustment recorded an increase in Inventory and Related Property, Net and a decrease in Gross Costs of $3.7 billion resulting from the identification of inventory in the logistics system that was not recorded in the accounting system. The second adjustment recorded an increase in Inventory and Related Property, Net and a decrease in Gross Costs of $2.1 billion attributed to a systemic issues that resulted in the duplicate posting of transactions for inventory transfers.

General Composition of Inventory

Inventory includes weapon system consumable and reparable parts, base supply items, and medical-dental supplies. Inventory is tangible personal property that is held for sale or held for repair for eventual sale, in the process of production for sale, to be consumed in the production of goods for sale, or in the provision of services for a fee.

Restrictions

There are no restrictions on the use, sale, or disposition of inventory except for War Reserve Materiel (WRM) and nuclear related spare parts.

WRM is mission essential secondary items, principal end items, and munitions sufficient to attain and sustain operational objectives in scenarios authorized in the Secretary of Defense guidance and Joint Staff scenarios for committed forces. The WRM is only to be available for transfer without reimbursement when its issuance has been approved to satisfy requirements of a mobilization of U.S. Armed Forces. However, if authorized, WRM may be sold. The use, sale, and disposition of nuclear related spare parts is restricted by Air Force Instruction 20-110 and all applicable supplements.

Decision Criteria

The AFWCF assigns inventory items to a category based on asset type and condition.

Held for Sale includes all materiel available for issuance.

Held for Repair represents unserviceable (but repairable) items that are more economical to repair than to procure. Held for Repair items are recorded at Moving Average Cost (MAC), as it relates to gross costs. Inventory, Net is calculated as MAC less the repair allowance for the asset.

Work in process is the term used to describe products that are being repaired, but are not yet complete, and consists of the costs of direct materials, direct labor, and applied indirect costs pertaining to the item.

Excess, Obsolete, and Unserviceable includes inventory that is no longer required due to changes in technology, laws, customs, or operations, and damaged inventory that is more economical to dispose of than to repair.

Operating Materials and Supplies, Net

OM&S Categories

As of September 30	2019 (Unaudited)		
	OM&S, Gross Value	OM&S, Net	Valuation Method
(Amounts in Thousands)			
Held for Use	$ 126,094	$ 126,094	MAC
Total	$ 126,094	$ 126,094	

OM&S Categories

As of September 30	2018 (Unaudited)		
	OM&S, Gross Value	OM&S, Net	Valuation Method
(Amounts in Thousands)			
Held for Use	$ 128,254	$ 128,254	MAC
Total	$ 128,254	$ 128,254	

Legend for Valuation Methods:

MAC = Moving Average Cost

General Composition of Operating Materials and Supplies

The AFWCF assigns all Operating Materials and Supplies (OM&S) to the Held for Use category and includes consumable parts and supplies used to remanufacture spare parts and repair weapons systems.

Restrictions

There are no restrictions on the use, sale, or disposition of OM&S.

Note 6 General Property, Plant and Equipment, Net

Major General PP&E Asset Classes

As of September 30	2019 (Unaudited)							
	Depreciation/ Amortization Method	Service Life		Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value
(Amounts in Thousands)								
Major Asset Classes								
Buildings and Structures	S/L	20, or 40*	$	1,524,202	$	(930,372)	$	593,830
Software	S/L	2-5 or 10		1,169,886		(1,123,267)		46,619
General Equipment	S/L	Various		3,455,004		(2,823,620)		631,384
Construction-in-Progress	N/A	N/A		264,134		N/A		264,134
Total General PP&E			$	6,413,226	$	(4,877,259)	$	1,535,967

As of September 30	2018 (Unaudited)							
	Depreciation/ Amortization Method	Service Life		Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value
(Amounts in Thousands)								
Major Asset Classes								
Buildings and Structures	S/L	20, or 40*	$	1,512,038	$	(896,459)	$	615,579
Software	S/L	2-5 or 10		1,158,176		(1,119,474)		38,702
General Equipment	S/L	Various		3,391,739		(2,718,296)		673,443
Construction-in-Progress	N/A	N/A		222,178		N/A		222,178
Total General PP&E			$	6,284,131	$	(4,734,229)	$	1,549,902

Legend for Valuation Methods

S/L = Straight Line N/A = Not Applicable

* Estimated useful service life is 20 years for structures and linear structures, and 40 years for buildings.

Air Force Working Capital Fund (AFWCF) does not have any restrictions on the use or convertibility of General Property, Plant and Equipment (General PP&E), nor does the AFWCF have a material impairment that requires a disclosure in accordance with Statement of Federal Financial Accounting Standards (SFFAS) 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. Please reference Note 1.J, *Summary of Significant Accounting Policies – General Property, Plant and Equipment*, for the capitalization threshold.

The AFWCF's accounting system uses transaction type codes provided by Mechanization of Contract Administration Services (MOCAS) to determine how to record transactions. MOCAS was not designed to have separate transaction type codes to identify and account for contract financing payments at the level required to accurately determine the United States Standard General Ledger (USSGL) posting to the proper work in process type asset account. Until system modifications are made, contract financing payments, as disclosed in Note 7, *Other Assets*, are overstated and work in process type assets are understated.

Note 7 Other Assets

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Intragovernmental Other Assets		
Other Assets	$ 0	$ 124,161
Total Intragovernmental Other Assets	$ 0	$ 124,161
Non-Federal Other Assets		
Outstanding Contract Financing Payments	$ 125,810	$ 140,062
Advances and Prepayments	247	217
Other Assets (With the Public)	147,719	512
Total Non-Federal Other Assets	$ 273,776	$ 140,791
Total Other Assets	$ 273,776	$ 264,952

Intragovernmental Other Assets is zero as of September 30, 2019, compared to $124.2 million as of September 30, 2018. This decrease from Fiscal Year (FY) 2018 to FY 2019 resulted from a $147.5 million reclassification from Intragovernmental Other Assets to Non-Federal Other Assets (With the Public) in FY 2019. The Air Force Working Capital Fund (AFWCF) was unable to support an intragovernmental transaction totaling $147.5 million, and therefore, the amount was reclassified from Intragovernmental Other Assets to Non-Federal Other Assets (With the Public).

Outstanding Contract Financing Payments, a separate classification of Advances and Prepayments, includes $125.8 million in FY 2019 in contract financing payments made in contemplation of the future performance of services, receipt of goods, incurrence of expenditures or receipt of other assets. In comparison, FY 2018 Outstanding Contract Financing Payments included $128.2 million in contract financing payments and an additional $11.9 million in payments of estimated future amounts due to contractors upon delivery and government acceptance. This additional Contract Financing Payment asset is related to the FY 2018 Contingent Liabilities reported in Note 10, *Other Liabilities*.

As discussed in Note 6, *General Property, Plant, and Equipment, Net*, the transaction codes used by the Air Force's accounting system were not designed to identify and account for contract financing payments at the level required to accurately determine the United States Standard General Ledger posting to the proper work in process type asset account. Until system modifications are made, contract financing payments disclosed above are overstated and work in process type assets are understated.

Advances and Prepayments are made in contemplation of the future performance of services, receipt of goods, incurrence of expenditures, or receipt of other assets, excluding those made as Outstanding Contract Financing Payments.

The $147.7 million in Non-Federal Other Assets (With the Public) is comprised of Supply Management Activity Group's assets returned to vendors for which credit is pending. There will be no dollar payments received for this credit but vendor billings will be offset.

Note 8 Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Intragovernmental Liabilities		
Federal Employees' Compensation Act	$ 37,482	$ 37,263
Total Intragovernmental Liabilities	$ 37,482	$ 37,263
Non-Federal Liabilities		
Military Retirement and Other Federal Employment Benefits	$ 208,936	$ 197,332
Other Liabilities	115,703	0
Total Non-Federal Liabilities	$ 324,639	$ 197,332
Total Liabilities Not Covered by Budgetary Resources	$ 362,121	$ 234,595
Total Liabilities Covered by Budgetary Resources	$ 1,172,221	$ 1,074,102
Total Liabilities	$ 1,534,342	$ 1,308,697

The $37.5 million in Intragovernmental Liabilities - Other Liabilities is comprised of the portion of the total Air Force *Federal Employees' Compensation Act* (FECA) liability allocated to the Air Force Working Capital Fund (AFWCF).

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current Fiscal Year (FY). These liabilities primarily consist of the amount recorded by employer agencies for the actuarial present value of future FECA benefits provided to federal employees or their beneficiaries as a result of work related deaths, disability, or occupational disease. Refer to Note 9, *Military Retirement and Other Federal Employment Benefits*, for additional details and disclosures.

Non-Federal Liabilities - Other Liabilities is comprised of a portion of the total Air Force civilian accrued leave liability allocated to the AFWCF. The balance increased from $0.0 to $115.7 million due to a new process to record the civilian accrued leave liability. During the compilation of the FY 2018 fourth quarter financial statements, AFWCF discovered the accrued leave liability, associated to the AFWCF, was erroneously included in the Air Force General Fund's amount within the reports received from the Defense Civilian Pay System (DCPS). In FY 2019, the report now breaks out the AFWCF portion. The reported total of $115.7 million includes amounts for accrued annual leave, restored annual leave (including Base Realignment and Closure (BRAC) restored), credit hours, compensatory hours, and frozen annual leave.

Note 9 Military Retirement and Other Federal Employment Benefits

Military Retirement and Other Federal Employment Benefits

As of September 30	2019 (Unaudited)		
	Liabilities	(Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in Thousands)			
Other Benefits			
Federal Employees' Compensation Act	$ 208,936	$ 0	$ 208,936
Total Military Retirement and Other Federal Employment Benefits	$ 208,936	$ 0	$ 208,936

As of September 30	2018 (Unaudited)		
	Liabilities	(Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in Thousands)			
Other Benefits			
Federal Employees' Compensation Act	$ 197,332	$ 0	$ 197,332
Total Military Retirement and Other Federal Employment Benefits	$ 197,332	$ 0	$ 197,332

Federal Employees' Compensation Act

The Air Force Working Capital Fund (AFWCF) reports an actuarial liability for the *Federal Employees' Compensation Act* (FECA). The FECA provides federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for a total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. The FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death.

Actuarial Cost Method Used and Assumptions

The AFWCF's actuarial liability for workers' compensation benefits is developed and provided by the Department of Labor (DOL) at the end of each Fiscal Year (FY). The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred, but not reported claims.

The DOL calculates the future workers' compensation liability using wage inflation factors [e.g., Cost of Living Adjustment (COLA)] and medical inflation factors [e.g., Consumer Price Index Medical (CPIM)], which were applied to the calculation of projected future benefits. The actual rates for these factors for the Charge-Back Year (CBY) 2019 were also used to adjust the methodology's historical payments to current-year constant dollars.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the Treasury's Yield Curve for Treasury Nominal Coupon Issues to reflect the average duration of income payments and medical payments. Interest rate assumptions utilized for discounting were as follows:

Discount Rates

For wage benefits:
2.610% in Year 1 and Years thereafter;
For medical benefits:
2.350% in Year 1 and Years thereafter.

The compensation COLAs and CPIMs used in the projections for various CBYs were as follows:

CBY	COLA	CPIM
2019	N/A	N/A
2020	1.47%	2.86%
2021	1.85%	3.05%
2022	2.12%	3.09%
2023	2.17%	3.47%
2024 and thereafter	2.21%	3.88%

The model's resulting projections were analyzed by DOL to ensure that the estimates were reliable. Analysis was based on four tests: 1) a sensitivity analysis of the model to economic assumptions, 2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, 3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2019 to the average pattern observed during the most current three charge-back years, and 4) a comparison of the estimated liability per case in FY 2020 projection to the average pattern for the projections of the most recent three years.

Note 10 Other Liabilities

As of September 30	2019 (Unaudited)		
	Current Liability	Non-Current Liability	Total
(Amounts in Thousands)			
Intragovernmental			
Federal Employees' Compensation Act Reimbursement to the Department of Labor	$ 16,674	$ 20,808	$ 37,482
Custodial Liabilities	8	0	8
Employer Contribution and Payroll Taxes Payable	21,200	0	21,200
Total Intragovernmental Other Liabilities	$ 37,882	$ 20,808	$ 58,690
Non-Federal			
Accrued Funded Payroll and Benefits	$ 240,917	$ 0	$ 240,917
Advances from Others	186,708	0	186,708
Accrued Unfunded Annual Leave	115,703	0	115,703
Contract Holdbacks	12,388	0	12,388
Other Liabilities	44,369	0	44,369
Total Non-Federal Other Liabilities	$ 600,085	$ 0	$ 600,085
Total Other Liabilities	$ 637,967	$ 20,808	$ 658,775

As of September 30	2018 (Unaudited)		
	Current Liability	Non-Current Liability	Total
(Amounts in Thousands)			
Intragovernmental			
Federal Employees' Compensation Act Reimbursement to the Department of Labor	$ 16,618	$ 20,645	$ 37,263
Custodial Liabilities	1	0	1
Employer Contribution and Payroll Taxes Payable	18,317	0	18,317
Total Intragovernmental Other Liabilities	$ 34,936	$ 20,645	$ 55,581
Non-Federal			
Accrued Funded Payroll and Benefits	$ 224,118	$ 0	$ 224,118
Advances from Others	156,906	0	156,906
Contract Holdbacks	12,631	0	12,631
Contingent Liabilities	0	11,887	11,887
Other Liabilities	44,358	0	44,358
Total Non-Federal Other Liabilities	$ 438,013	$ 11,887	$ 449,900
Total Other Liabilities	$ 472,949	$ 32,532	$ 505,481

Federal Employees' Compensation Act (FECA) Reimbursement to the Department of Labor represents liabilities due under FECA. Billed amounts payable in Fiscal Year (FY) 2020 and unbilled amounts for both incurred and estimated accrual amounts are included. Refer to Note 9, *Military Retirement and Other Federal Employment Benefits*, for the estimated FECA actuarial liability.

Custodial Liabilities represent liabilities for collections reported as non-exchange revenues where Air Force Working Capital Fund (AFWCF) is acting on behalf of another federal entity.

Employer Contribution and Payroll Taxes Payable represent the employer portion of payroll taxes and benefit contributions for health benefits, retirement, life insurance, and voluntary separation incentive payments.

Office of Personnel Management (OPM) administers insurance benefit programs available for coverage to the AFWCF's eligible civilian employees. These programs include life and health insurance, and employee participation is voluntary.

Accrued Funded Payroll and Benefits includes the life insurance program, Federal Employee Group Life Insurance (FEGLI) plan, which is a term life insurance benefit with varying amounts of coverage selected by the employee. The Federal Employees Health Benefits (FEHB) program is comprised of different types of health plans that are available to Federal employees for individual and family coverage for healthcare. OPM, as the administrating agency, establishes the types of insurance, options for coverage, the premium amounts to be paid by the employees and the amount of benefit received. The AFWCF has no role in negotiating these insurance contracts and incurs no liabilities directly to the insurance companies. Employee payroll withholding related to the insurance and employer contributions are submitted to OPM. Additional information may be found on OPM's website.

Advances from Others represent liabilities for collections received to cover future expenses or acquisition of assets.

Accrued Unfunded Annual Leave is comprised of a portion of the total Air Force civilian accrued leave liability allocated to the AFWCF. Refer to Note 8, *Liabilities Not Covered by Budgetary Resources*, for additional information related to the increase of this balance.

Contract Holdbacks are amounts earned by contractors or suppliers during the production period but not yet paid to the contractor/supplier to ensure future performance. The Office of the Secretary of Defense (OSD) issued a policy memorandum in September 2019 directing DoD Components to recognize contract holdbacks expected to be paid within one year of the balance sheet date as Accounts Payable, and to recognize contract holdbacks expected to be paid after one year of the balance sheet date as Other Liabilities. Due to system limitations, the AFWCF is unable to distinguish current from non-current contract holdbacks and reported both current and non-current contract holdbacks as Other Liabilities as of September 30, 2018 and September 30, 2019.

The $44.4 million balance in Non-Federal Other Liabilities as of September 30, 2019 primarily consist of accrued liabilities established in the Consolidated Sustainment Activity Group (CSAG) Supply, which offset inventory owned and managed on behalf of foreign governments under a Cooperative Logistics Supply Support Agreement (CLSSA).

In the prior FY 2018, the AFWCF recognized $11.9 million of Contingent Liabilities for the estimated unpaid costs that were considered conditional for payment pending delivery and government acceptance, due to the probability the contractors would complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid were estimable. In accordance with OSD policy memorandum issued in April 2019, progress payments for the estimated costs incurred by a contractor were reclassified from Contingent Liabilities to Accounts Payable beginning in FY 2019.

Note 11 Commitments and Contingencies

Legal Contingencies

The Air Force Working Capital Fund (AFWCF) is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests. In accordance with Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, as amended by SFFAS 12, *Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government*, an assessment is made as to whether the likelihood of an unfavorable outcome is considered probable, reasonably possible, or remote. The AFWCF's Office of the General Counsel considers the possibility of the AFWCF sustaining any losses on these legal actions to be remote.

Other Contingencies

The AFWCF is a party to numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of budgetary resources. Currently, the AFWCF's automated system processes have limited capability to capture these potential liabilities, and therefore, the amounts reported may not fairly present the AFWCF's contingent liabilities. Contingencies considered both measurable and probable have been recognized as liabilities. Refer to Note 10, *Other Liabilities*, for further information.

The AFWCF's normal course of business involves the execution of project agreements pursuant to the framework cooperative activity agreements with foreign governments. All of these agreements give rise to obligations that are appropriately reported in AFWCF's financial statements, pursuant to legal authority and appropriated funds; none are contingent. It is the AFWCF's practice to enter into treaties and other international agreements that do not create contingent liabilities, as defined in SFFAS 5.

Note 12 General Disclosures Related to the Statement of Net Cost

Costs and Exchange Revenue by Major Program

As of September 30	2019 (Unaudited)		2018 (Unaudited)	
(Amounts in Thousands)				
Operations, Readiness & Support				
Gross Cost	$	14,606,717	$	7,855,683
Less: Earned Revenue		(12,745,704)		(12,674,683)
Total Net Cost	$	1,861,013	$	(4,819,000)

Gross Costs increased $6.7 billion in comparison to Fiscal Year (FY) 2018. This increase can be attributed to the $1.6 billion increase in Gross Costs resulting from inventory adjustments recorded in the current year, compared to the $5.8 billion decrease in Gross Costs resulting from inventory adjustments recorded in FY 2018.

In FY 2019, the Air Force Working Capital Fund (AFWCF) recorded an adjustment of $1.4 billion that increased Inventory and Related Property, Net and decreased Gross Costs to correct negative net inventory values within the inventory records. A second adjustment of $3.4 billion to decrease Inventory and Related Property, Net with corresponding adjustments of $3.0 billion to increase Gross Costs, and $0.4 billion to decrease Other Financing Sources (non-exchange) disclosed within the Statement of Change in Net Position to reflect the value of inventory in-transit.

In comparison, in FY 2018, the AFWCF recorded $3.7 billion in adjustments that increased Inventory and Related Property, Net and decreased Gross Costs that resulted from the reconciliation between logistic and financial systems. A second adjustment of $2.1 billion was recorded that increased Inventory and Related Property, Net and decreased Gross Costs to correct duplicate inventory transactions.

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the AFWCF that are supported by appropriations, contract authority and reimbursable authority. 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 of Defense's (DoD) current processes and systems capture costs based on appropriation groups as presented in the schedule above. The lower level costs for major programs are not presented as required by the *Government Performance and Results Act*. The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, as amended by SFFAS 55, *Amending Inter-Entity Cost Provisions*.

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

Public costs and revenues are exchange transactions made between the reporting entity and a Non-Federal entity.

Many of the AFWCF's systems do not track intragovernmental transactions by customer at the transaction level. Expenses were adjusted by reclassifying amounts between Federal and Non-Federal expenses.

The AFWCF records transactions on an accrual basis. The AFWCF may not have all the actual costs and revenues input into the system in time for reporting. Accrual estimates based upon budget information and historical data are made as required by Generally Accepted Accounting Principles. These estimates reverse as actual costs or revenues are recorded.

As mentioned in Note 1.Q., *Summary of Significant Accounting Policies - Revenue and Other Financing Sources*, the three primary sources of revenue for AFWCF are from the sale of repair services, revenue from the Flying Hour Program, and the sale of reparable and consumable items. For the 12 months ended September 30, 2019, consolidated revenue for each revenue stream is $4.3 billion, $4.2 billion, and $2.1 billion, respectively. The remaining $2.1 billion is associated to gains.

Note 13 Disclosures Related to the Statement of Changes in Net Position

Pursuant to Statement of Federal Financial Accounting Standards (SFFAS) 55, *Amending Inter-entity Cost Provisions*, the Office of the Secretary of Defense (OSD) issued a policy in September 2018 directing all Department of Defense (DoD) components not to recognize imputed costs and corresponding imputed financing from non-business type activities other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements. This election is permitted under SFFAS 55. However, as a business-type activity, Air Force Working Capital Fund (AFWCF) is also required to recognize imputed costs and imputed financing for goods and services received from other federal entities at no cost, or at a cost less than the full cost. AFWCF is in the process of adopting this SFFAS.

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations (discretionary and mandatory) on the Statement of Budgetary Resources (SBR). The $77.6 million in appropriations recorded in the AFWCF were transferred from the Defense Working Capital Fund, and are included in the Appropriation line item on the SBR; however, they are reported as "Appropriations Transferred In/Out," and not as "Appropriations Received" on the SCNP.

There are also additional transfer amounts included in the "Appropriations Transferred-In/Out" on the SCNP of $233.9 million as displayed in the table below.

Year Ended September 30, 2019 (Unaudited) Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations on the Statement of Changes in Net Position		*(Amounts in Thousands)*
		Total
Appropriations, Statement of Budgetary Resources	$	77,644
Less: Appropriations Transferred-In/Out, Statement of Changes in Net Position		311,518
Total Reconciling Amount	**$**	**233,874**
Items Reported in Unobligated Balance from Prior Year Budget Authority, Statement of Budgetary Resources, Net (Discretionary and Mandatory)		
Transfers - prior year balances	$	233,874
Total Reconciling Amount	**$**	**233,874**

The "Appropriations Transferred-In/Out " on the Fiscal Year (FY) 2019 SCNP does not agree with the Appropriations on the FY 2019 SBR by a difference of $233.9 million. This difference of $233.9 million represents appropriation transfers not included in the "Unobligated balance, end of year" of $1,293.5 million reported on the FY 2018 SBR and the $1,527.4 million "Unobligated balance from prior year budget authority, net (discretionary and mandatory)" on the FY 2019 SBR, which includes these appropriation transfers.

Note 14 Disclosures Related to the Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) is presented on a combined basis in accordance with Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements* (OMB A-136); thus, intra-entity transactions have not been eliminated from the amounts presented. This presentation differs from other principal financial statements, which are presented on a consolidated basis.

Undelivered Orders at the End of the Period

Budgetary Resources Obligated for Undelivered Orders at the End of the Period

As of September 30	2019 (Unaudited)	2018 (Unaudited)
(Amounts in Thousands)		
Intragovernmental		
Unpaid	$ 2,088,911	$ 1,922,741
Total Intragovernmental	$ 2,088,911	$ 1,922,741
Non-Federal		
Unpaid	$ 6,282,044	$ 5,856,673
Prepaid/Advanced	126,056	128,392
Total Non-Federal	$ 6,408,100	$ 5,985,065
Total Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 8,497,011	$ 7,907,806

Explanation of Differences between the Statement of Budgetary Resources and the Budget of the United States Government

The table below presents a reconciliation between the budgetary resources, new obligations and upward adjustments, distributed offsetting receipts, and net outlays from the Fiscal Year (FY) 2018 and the actual amounts from the "Analytical Perspectives – Federal Budget by Agency and Account" and "Appendix – Detailed Budget Estimates by Agency" sections of the FY 2020 President's Budget. The Budget with the actual amounts for FY 2019 will be available at a later date at https://www.whitehouse.gov/omb/budget/.

Explanation of Differences between the Statement of Budgetary Resources and the Budget of the United States Government

As of September 30	Fiscal Year 2018 Actual			*(Amounts in Billions)*
	Budgetary Resources	New Obligations & Upward Adjustments (Total)	Distributed Offsetting Receipts	Agency Outlays, Net
Air Force Working Capital Fund Statement of Budgetary Resources	$ **19.1**	$ **17.8**	$ **-**	$ **0.4**
Adjustments				
United States Transportation Command Statement of Budgetary Resources*	$ 9.3	$ 7.8	$ -	$ 0.4
Combined Air Force Working Capital Fund and United States Transportation Command	$ 28.4	$ 25.6	$ -	$ 0.8
Budget of the U.S. Government	$ **28.4**	$ **25.6**	$ **-**	$ **0.8**

**United States Transportation Command's (USTRANSCOM) financial results are not consolidated within AFWCF's financial results; however, AFWCF is required to report USTRANSCOM's cash in AFWCF's Budget of the U.S. Government.*

Other Disclosures

Non-expenditure Transfers of Unobligated Balance to or from Other Accounts

The Air Force Working Capital Fund (AFWCF) received $233.9 million in unobligated balance transfers in accordance with the Omnibus 2019 Reprogramming Action.

Note 15 Disclosures Related to Incidental Custodial Collections

The Air Force Working Capital Fund (AFWCF) collected $3.9 thousand of incidental custodial revenues generated primarily from non-entity interest, penalties and administrative fees collected for out of service debts. These funds are not available for use by AFWCF. At the end of each fiscal year, the accounts are closed and the balances relinquished to the United States Treasury.

Note 16 Reconciliation of Net Cost to Net Outlays

As of September 30	2019 (Unaudited)		
	Intragovernmental	With the public	Total
(Amounts in Thousands)			
Net Cost of Operations	$ (8,115,156)	$ 9,976,169	$ 1,861,013
Components of Net Cost That are Not Part of Net Outlays:			
Property, plant, and equipment depreciation	$ 0	$ (179,800)	$ (179,800)
Property, plant, and equipment disposal & revaluation	0	147,417	147,417
Other	(19,285)	(10,262,764)	(10,282,049)
Increase/(decrease) in assets:			
Account Receivable	125,760	(656)	125,104
Other assets	(124,161)	132,985	8,824
(Increase)/decrease in liabilities:			
Accounts payable	(23,273)	(73,703)	(96,976)
Salaries and benefits	(2,883)	(16,798)	(19,681)
Other Liabilities (Unfunded Leave, Unfunded Federal Employees' Compensation Act, Actuarial Federal Employees' Compensation Act	9,997	(115,432)	(105,435)
Other financing sources:			
Federal employee retirement benefit costs paid by Office Personnel Management and Imputed to the agency	(217,950)	0	(217,950)
Total Components of Net Cost That Are Not Part of Net Outlays	$ (251,795)	$ (10,368,751)	$ (10,620,546)
Components of Net Outlays That Are Not Part of Net Cost:			
Acquisition of capital assets	$ 0	$ 4,577,548	$ 4,577,548
Acquisition of inventory	4,232,363	897,580	5,129,943
Other	(6)	0	(6)
Total Components of Net Outlays That Are Not Part of Net Cost	$ 4,232,357	$ 5,475,128	$ 9,707,485
Other Temporary Timing Differences			
Net Outlays	$ (4,134,594)	$ 5,082,546	$ 947,952
Agency Outlays, Net, Statement of Budgetary Resources			$ 1,277,805
Reconciling Difference			$ (329,853)

Budgetary and financial accounting information is used for different purposes. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position, so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The table above illustrates this reconciliation of key differences between net cost and net outlays. The reconciling difference of $329.9 million is due to the Air Force Working Capital Fund's (AFWCF) financial system limitations, causing budgetary data to not reconcile with proprietary expenses and capitalized assets. This difference is a previously identified deficiency.

In addition, AFWCF identified that there are uncorrected misstatements in the classification of activity amongst the "Acquisition of Capital Assets," "Property, Plant, and Equipment Disposal and Revaluation," and "Other" lines within the table above. AFWCF is unable to make the identified reclassification adjustments as they would not be in accordance with the current Office of the Secretary of Defense policy. The issue is currently being researched to identify necessary corrective actions with plans for implementation in fiscal year 2020.

Note 17 Public-Private Partnerships

The Air Force Working Capital Fund (AFWCF) has begun to evaluate arrangements and transactions for Public-Private Partnerships criteria to determine the complete population requiring disclosure under Statement of Federal Financial Accounting Standards (SFFAS) 49, *Public-Private Partnerships: Disclosure Requirements*, but has not completed a full analysis of all arrangements as of September 30, 2019.

Note 18 Disclosure Entities and Related Parties

Effective in 2018, *Statement of Federal Financial Accounting Standards* (SFFAS) 47, *Reporting Entity,* requires agencies to disclose certain information for disclosure entities and related parties. The Air Force Working Capital Fund (AFWCF) is still in the early stages of implementing this significant standard and completing a full impact analysis. When AFWCF fully implements this new standard, AFWCF will be able to provide a thorough disclosure for Disclosure Entities and Related Parties.

Fiscal Year 2019

WORKING CAPITAL FUND

Required Supplementary Information

DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2019 and 2018

(Amounts in Thousands)

	Operations, Readiness & Support	2019 Combined	2018 Combined
Budgetary Resources			
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 1,527,387	$ 1,527,387	$ 1,271,915
Appropriations (discretionary and mandatory)	77,644	77,644	66,461
Contract Authority (discretionary and mandatory)	10,964,575	10,964,575	10,947,080
Spending Authority from offsetting collections (discretionary and mandatory)	6,639,343	6,639,343	6,794,693
Total Budgetary Resources	$ 19,208,949	$ 19,208,949	$ 19,080,149
Status of Budgetary Resources			
New obligations and upward adjustments (total)	$ 17,949,702	$ 17,949,702	$ 17,786,636
Unobligated balance, end of year:			
Apportioned, unexpired accounts	1,259,247	1,259,247	1,293,513
Unexpired unobligated balance, end of year	1,259,247	1,259,247	1,293,513
Unobligated balance, end of year (total)	$ 1,259,247	$ 1,259,247	$ 1,293,513
Total Budgetary Resources	$ 19,208,949	$ 19,208,949	$ 19,080,149
Outlays, Net			
Outlays, net (total) (discretionary and mandatory)	$ 1,277,805	$ 1,277,805	$ 424,231
Agency Outlays, net (discretionary and mandatory)	$ 1,277,805	$ 1,277,805	$ 424,231

The accompanying notes are an integral part of these statements.

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 8, 2019

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER, DOD
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE AIR FORCE

SUBJECT: Transmittal of the Independent Auditor's Reports on the U. S. Air Force Working Capital Fund Financial Statements and Related Notes for FY 2019 and FY 2018 (Project No. D2019-D000FT-0092.000, Report No. DODIG-2020-017)

We contracted with the independent public accounting firm of Ernst & Young LLP (EY) to audit the U.S. Air Force Working Capital Fund (WCF) Financial Statements and related notes as of and for the fiscal years ended September 30, 2019, and 2018. The contract required EY to provide a report on internal control over financial reporting and compliance with laws and other matters, and to report on whether the U.S. Air Force's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency "Financial Audit Manual," June 2018. EY's Independent Auditor's Reports are attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the U.S. Air Force WCF financial statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with generally accepted accounting principles. Accordingly, EY did not express an opinion on the U.S. Air Force WCF FY 2019 and FY 2018 Financial Statements and related notes.

EY's separate report, "Internal Control Over Financial Reporting," discusses 11 material weaknesses related to the U.S. Air Force's internal controls over financial reporting.* Specifically, EY's reports describe the following significant matters:

- The U.S. Air Force's lack of system integration and reconciliation prevented management from obtaining timely, accurate, and reliable information on the results of its business operations.

- The U.S. Air Force did not have sufficient internal controls and procedures for inventory counts, valuation, movement transactions, and in-transit inventory.

- The U.S. Air Force did not have sufficient oversight of inventory managed and held by contractors and other defense organizations and relied heavily upon the other party to report activity and balances related to those materials.

- The U.S. Air Force lacked sufficient internal controls for "Flying Hours" and supply revenue, incorrectly applied the percentage of completion revenue recognition method for maintenance revenue, and incorrectly presented revenue on a gross versus net basis.

- The U.S. Air Force did not have sufficient procedures to identify, value, and reflect current additions and deletions of General Property, Plant, and Equipment in its financial statements or to reconcile the accountability systems to the financial statement balances.

- The U.S. Air Force key controls and procedures over Fund Balance with Treasury did not always achieve a complete analysis of, or proper adjustment to, the non-Fund Balance with Treasury side when the U.S. Air Force corrected the Fund Balance with Treasury account.

- The U.S. Air Force lacked a sufficient financial reporting process to ensure that complete and accurate financial statements, including related note disclosures, are prepared on a timely basis.

- The U.S. Air Force did not have an effective internal control program, which impacted its ability to identify and address significant risks for all key business.

* A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statements in a timely manner.

- The U.S. Air Force lacked sufficient processes to properly account for contract financing payments, including assessing the completeness of the population of the payments.

- The U.S. Air Force did not establish supported balance sheet account balances of the U.S. Air Force WCF including, but not limited to, valuation of opening balance for General Property, Plant, and Equipment and Inventory and Related Property, Net.

- The U.S. Air Force financial information systems controls and computing environment had deficiencies including, but not limited to, access controls, configuration management, and interface controls.

EY's additional report, "Compliance and Other Matters," discusses two instances of noncompliance with applicable laws and regulations. Specifically, EY's report described instances where the U.S. Air Force's financial management systems did not comply with the FFMIA, and evidence was not provided to ensure that the U.S. Air Force met the requirements of the Federal Managers' Financial Integrity Act (FMFIA).

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY's representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the U.S. Air Force WCF FY 2019 and FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control over financial reporting, or conclusions on whether the U.S. Air Force's financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached reports, dated November 8, 2019, and the conclusions expressed within the reports.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting

Attachments:
As stated

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Report of Independent Auditors

The Secretary of the United States Air Force and the
Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Department of the Air Force Working Capital Fund (AFWCF), which comprise the consolidated balance sheets as of September 30, 2019 and 2018, and the related consolidated statements of net cost, consolidated statements of changes in net position and combined statements of budgetary resources for the years then ended, and the related notes to the financial statements (the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and U.S. Office of Management and Budget (OMB) Bulletin No. 19-03 *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departures from U.S. Generally Accepted Accounting Principles

As described in Note 1, AFWCF has not implemented certain accounting standards related to accounting issues for the Department of Defense and the Federal government. The effect of these matters on the financial statement amounts and related disclosures involved is not currently determinable by AFWCF and could be material.

Basis for Disclaimer of Opinion

AFWCF continues to have unresolved accounting issues and material weaknesses in internal controls that cause AFWCF to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on AFWCF's financial statements as of and for the years ended September 30, 2019 and 2018.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis and Required Supplementary Information, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Other Information

We were engaged for the purpose of forming an opinion on the financial statements that collectively comprise the AFWCF's financial statements. The Other Information, as listed in the Table of Contents, is presented for purposes of additional analysis and is not a required part of the financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 8, 2019 on our consideration of AFWCF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the AFWCF's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering AFWCF's internal control over financial reporting and compliance.

Ernst + Young LLP

November 8, 2019

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Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Air Force and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Department of the Air Force Working Capital Fund (AFWCF), which comprise the consolidated balance sheet as of September 30, 2019, the related consolidated statement of net cost, consolidated statement of changes in net position and combined statement of budgetary resources for the year ended September 30, 2019, and the related notes to the financial statements and have issued our report thereon dated November 8, 2019. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2019 and the related notes to the financial statements.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered AFWCF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of AFWCF's internal control. Accordingly, we do not express an opinion on the effectiveness of AFWCF's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. As described below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

Material Weaknesses

The issues, and combinations of issues, forming the material weaknesses represent long-standing internal control deficiencies that reflect a lack of focus prior to recent years on the design of financial accounting and financial information technology control environments. AFWCF's ability to remediate these material weaknesses, as well as ultimately achieve an unmodified opinion on its financial statements, is dependent on AFWCF being able to implement and operate a sustainable and auditable business environment given its information system and resource limitations.

Strong collaboration and coordination between the financial management (FM) and functional communities are essential to the development of corrective action plans and related efforts. Several of the newly identified issues in FY19 resulted because FM and all relevant functional areas were not working in concert. Likewise, the development of a long-term strategy to correct deficiencies requires the active participation of senior leaders across the organization to ensure accountability and drive progress.

Further details regarding each of these matters are included in Appendix A.

ONGOING ACCOUNTING PROCESSES

I. Integration and reconciliation of financial systems – To ensure that the entire population of financial transactions has been recorded in the financial statements, it is necessary to reconcile feeder systems to the general ledger. The AFWCF has a complex systems environment consisting of multiple non-integrated systems that use non-standard data and requires numerous manual workarounds. The lack of an integrated system prevents management from obtaining timely, accurate and reliable information on the results of its business operations. AFWCF continues to rely on both manual re-entry of data into multiple systems and complex system interfaces that are not fully reconciled. The lack of integration prevents information/data from processing without significant manual intervention.

We identified the following:

- Inability to validate the completeness of transactions underlying the financial statements
- Transactions not recorded in accordance with the United States Standard General Ledger (USSGL)
- Inability to maintain and/or provide supporting documentation in a timely manner
- Unsupported trading partner adjustments

II. Inventory held by AFWCF – Inventory is a component of inventory and related property, net within the consolidated balance sheet. The balance includes supplies and spare parts at bases and maintenance depots and parts awaiting or undergoing repair for reuse. The value of individual pieces is determined using different methods depending on their nature. Acquired supplies and parts are valued based upon acquisition cost while repairable or repaired parts are valued based upon the internal and external costs incurred to repair.

We identified the following:

- Lack of sufficient inventory count procedures and controls
- Lack of sufficient controls over inventory valuation
- Lack of sufficient controls over inventory movement transactions
- Inability to identify and value in-transit inventory

III. Inventory held by others – AFWCF has shared service arrangements with other defense organizations and commercial contractors to hold inventory and equipment to avoid duplication of efforts. We found that in many of these instances AFWCF is heavily reliant upon the other party to report activity and balances related to those materials.

We identified the following:

- Insufficient oversight of inventory managed by the Defense Logistics Agency (DLA)
- Insufficient oversight of inventory held by contractors and other defense organizations

IV. Earned revenue – AFWCF recognizes revenue for large scale long-term maintenance projects using a percentage of completion calculation. AFWCF recognizes "Flying Hours" revenue based upon the flying hours executed. AFWCF recognizes revenue for inventory sold based on the delivery of the inventory items.

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We identified the following:

- Incorrect application of the percentage of completion revenue recognition method for maintenance revenue
- Lack of sufficient controls for "Flying Hours" revenue
- Lack of sufficient controls for supply revenue
- Incorrect presentation of revenue on a gross versus net basis

V. General Property, Plant and Equipment (GPP&E) – GPP&E includes real property, general equipment and construction-in-progress. We found that although certain accountability processes are effective, AFWCF does not have procedures in place to identify, value and reflect current additions and deletions of GPP&E in its financial statements or to reconcile the accountability systems to the balances reflected in the financial statements.

We identified the following:

- Enhanced processes are needed to record ongoing GPP&E activity
- Process to assign value to newly acquired GPP&E needs improvement

VI. Fund Balance with Treasury (FBwT) – FBwT is an asset account that shows the available budget spending authority of federal agencies. Collections and disbursements by agencies increase or decrease the balance in the account. FBwT reconciliations are key controls for supporting the existence, completeness, and accuracy of the budget authority and outlays reported on the statements of budgetary resources and have been determined to not be operating effectively. During our testing of FBwT controls, EY identified that although key review controls achieved reconciliation of differences between AFWCF and Treasury balances and recorded the necessary adjustments to FBwT at a summary level, those procedures did not always achieve a complete analysis of or sufficient support for the adjustments recorded.

ONGOING FINANCIAL REPORTING

VII. Accumulating and Preparing Financial Statements – The financial reporting compilation function, along with the recording of journal vouchers, is central to any entity's internal control environment and ability to support an audit. While AFWCF has made progress in improving its financial reporting, several critical areas are not yet resolved. AFWCF's financial reporting process lacks sufficient processes and internal controls to ensure that complete and accurate financial statements, including related note disclosures, are prepared on a timely basis.

We identified the following:

- Lack of sufficient centralized financial statement analytical and review functions
- Lack of assessment, monitoring and effective implementation of recent accounting guidance
- Enhanced financial statement review procedures are needed

VIII. Oversight and Monitoring of Internal Control – Internal Control is a process affected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, Appendix A, (Circular A-123) also emphasizes management's responsibility for establishing and maintaining effective internal control over financial reporting. AFWCF does not have an effective OMB Circular A-123 program, which has impacted AFWCF's ability to identify and address significant risks for all key business processes.

We identified the following:

- Lack of an effective internal control program
- Lack of sufficient monitoring of third-party service providers

IX. Contract Financing Payments - AFWCF lacks sufficient processes to properly account for contract financing payments, including the assessment of population completeness. Capitalized costs incurred before assets are placed in service should be recognized in GPP&E or "Inventory and Related Property, Net," however, AFWCF currently reports these amounts as "Non-Federal Other Assets." Additionally, contract holdbacks are reported as a component of "Other Liabilities," instead of "Accounts Payable."

BEGINNING BALANCES

X. Establishing opening balances for assets used in operations – The processes to establish the balance sheet account balances of AFWCF that were initiated by transactions occurring in prior years have not been completed. This requires a substantial effort to establish the completeness of the population of those assets and liabilities, as well as gathering documentation supporting the value of the population identified or using recently established accounting guidance to estimate those values.

We identified the following:

EY
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- Valuation of opening balances of GPP&E cannot be supported
- Lack of sufficient identification of beginning balance population for inventory

FINANCIAL INFORMATION SYSTEMS

XI. Financial Information Systems – Our assessment of AFWCF's IT controls and the computing environment identified deficiencies which collectively constitute a material weakness in the design and operation of information systems controls over financial data. Based on our testing, we identified the lack of sufficient controls in the following areas:

- Security management
- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Interface controls

AFWCF's Response to Findings

AFWCF's response to the findings identified in our engagement, as described above, are included in its letter dated November 8, 2019, which has been included at the end of this report. AFWCF's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 8, 2019

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Appendix A – Material Weaknesses

ONGOING ACCOUNTING PROCESSES

I. INTEGRATION AND RECONCILIATION OF FINANCIAL SYSTEMS

The following deficiencies aggregated into this material weakness:

(a) Inability to validate the completeness of transactions underlying the financial statements

The Air Force Working Capital Fund (AFWCF) does not have a complete understanding of its universe of transactions. This assessment is critical for management to understand and document the mapping of the internal processes, flow of data and controls performed to ensure output data is complete and accurate. During our procedures, we identified the following:

- The Supply Maintenance Activity Group (SMAG) utilizes the following feeder systems: Integrated Logistics Systems-Supply (ILS-S), Defense Medical Logistics Standard Support (DMLSS) and Financial Inventory Accounting and Billing System (FIABS). These feeder systems process through the Standard Material Accounting System (SMAS) and then to GAFS-R. During our procedures, we noted that approximately 300 trial balances are summarized from the SMAG feeder systems. While the Defense Finance and Accounting Service (DFAS) performs a count to determine whether all trial balances have been included and accounted for, there are not procedures to determine whether all the activity has been interfaced completely and accurately.
- Accountable Property System of Record (APSR) reconciliations are reconciliations that occur in order to assert that the feeder files (i.e., FIABS, ILS-S, DMLSS, Defense Industrial Financial Management System (DIFMS), SMAS) to the general ledger (GAFS-R) are complete and accurate. AFWCF was unable to provide these reconciliations for FY19. AFWCF and DFAS indicated that these reconciliations will be part of the Statement of Budgetary Resources Automated Reconciliation Tool (SBR-ART) which is estimated to be fully implemented in FY21.
- DIFMS detail to DIFMS summary data is not fully reconciled. DIFMS is the maintenance side feeder system that flows into GAFS-R. There are three bases that produce DIFMS data: Tinker, Hill, and Warner Robins AFB. These files are produced periodically - some daily, weekly, bi-weekly, or monthly. On a quarterly basis, approximately 4500 files are produced. DIFMS then sends summarized data to GAFS-R on a quarterly basis. AFWCF was unable to provide sufficient supporting documentation to substantiate the underlying detail data has been reconciled with the summary posting.
- Aerospace Maintenance and Regeneration Group (AMARG) data is not reconciled to GAFS-R. AMARG is a base level system that records the maintenance activities related to

out of service assets. AFWCF was unable to provide detail data and supporting documentation to substantiate the activity recorded.

- The Unadjusted Trial Balance to Adjusted Trial Balance (UTB to ATB) reconciliation is designed to reconcile the feeder systems to the financial statements and provide reasonable assurance that these trial balances are complete and accurate. AFWCF currently performs a UTB to ATB reconciliation at the summary trial balance level and identifies journal vouchers (JV's) which explain the variance. AFWCF was unable to provide a sufficient UTB to ATB reconciliation as it was unable to identify JV's which impacted the reconciliation within the Defense Departmental Reporting System – Budgetary (DDRS-B) and AMARG, unable to identify prior year adjustments within DIFMS and GASF-R beginning balances which impacted the reconciliation, and unable to accurately reconcile all balances.

The above examples demonstrate the complexity of the system environment and the need for a robust understanding of the flow of data to the financial statements. As a result, AFWCF was unable to support whether the transactions recorded in the financial statements were complete or accurate.

(b) Transactions not recorded in accordance with the USSGL

Throughout the course of the year, transactions from base level systems (FIABS, ILS-S, SMAS and DMLSS on the supply side and DIFMS on the depot maintenance side) flow from the subledgers to the general ledger (GAFS-R). Posting logic applications take transactions at the subledger level and properly classifies them into general ledger accounts (i.e., USSGL). This mapping allows transactions to properly post and ultimately impact the intended financial statement line item.

FIABS, SMAS and DIFMS all apply posting logic. AFWCF and its service provider DFAS do not currently have a review process in place to ensure that the mappings applied are compliant with the Treasury Financial Manual (TFM).

(c) Inability to maintain and/or provide supporting documentation in a timely manner

Further progress is needed by AFWCF and its service providers to provide complete documentation, in a timely manner, to support an audit.

During our current year testing, we identified the following across nearly all testing areas:

- Improper management and retention of supporting documentation. (e.g., support agreement, customer order/acceptance, delegation of authority, customer voucher)
- Lack of consistent implementation of documentation standards for maintaining complete records.

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- Inability to provide supporting documentation to auditors in a consistent and timely manner.
- Lack of sufficient review controls around estimates to address and document the estimate model, range, key assumption, and risks to the financial statements. Further, there is no process in place to evaluate the risk profile of estimates and determine if the estimate warrants classification as a significant estimate.
- Inability to provide transactional data that reconciles to the summarized trial balance amounts that comprise the beginning budgetary and proprietary financial statement balances. Currently, there are no policies or procedures to mitigate this system weakness. Further, no documentation is maintained from prior periods to support beginning balances.
- Inability to provide an accounts receivable subsidiary ledger at the invoice level which reconciles to the general ledger.

AFWCF's inability to provide adequate support for accounting transactions, increases the risk of a misstatement that could impact the financial statements. Furthermore, without such supporting documentation and proper audit trail, there is an increased risk of noncompliance with applicable laws and regulations.

(d) Unsupported trading partner adjustments

Intragovernmental transactions result from business activities conducted between two federal government entities, called trading partners. Accounting differences occur in government-wide financial reporting when trading partners record differing amounts for transactions that should eliminate or net to zero. Trading partners must reconcile and resolve these differences on a routine basis with their trading partners. Through September 30, 2019, AFWCF followed the DoD FMR guidance (Volume 6b Chapter 13) whereby the DoD reporting entity making sales, or providing services ("seller-side"), to another DoD reporting entity who would be the recipient and purchaser of those goods or services ("buyer-side") would be the basis for reporting most of its intra-DoD balances.

In accordance with DoD guidance, DFAS-Indianapolis obtained the seller-side data from AFWCF's trading partners in order to make adjustments. DFAS-Columbus compared the seller-side data obtained from DFAS-Indianapolis to the GAFS-R trial balance data at the appropriation level by trading partner. That difference was the basis for the adjustments. There was no reconciliation at the agreement or document level to the trading partner adjustments that are being made. Trading partner adjustments are recorded in Defense Departmental Reporting System – Audited Financial Statements (DDRS-AFS) as top-side adjustments and are identified as unsupported by DFAS.

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Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Develop a better understanding of the Universe of Transactions to ensure all systems and transactions are accurately accounted for and reflected in SBR-ART reconciliations.
- Implement and document a formal reconciliation and review process to determine whether each inbound feeder file is complete before or after processing the file into GAFS-R.
- Develop an adequate internal control process to ensure lower level feeder systems reconcile to either SMAS or GAFS-R.
- Ensure an appropriate detail to summary reconciliation is performed for DIFMS.
- Develop/enhance process to perform a quarterly detail level UTB to ATB reconciliation using the full detail data sets, including appropriate identification of JV's, to ensure the completeness and accuracy of the data as it flows from the general ledger to the financial statements.
- Improve monitoring over the general ledger to identify and correct accounting that does not comply with the TFM.
- Identify accounting policies or practices that do not comply with the TFM and take corrective actions.
- Ensure mapping of SMAS, FIABS and DIFMS posting logic rules to TFM entries.
- For any new SMAS, FIABS or DIFMS posting logic rules, AFWCF should develop policies and procedures to review new posting logic rules for TFM compliance prior to implementation.
- Address AFWCF/DFAS ability to access and provide supporting documentation for all significant transactions:
    - Evaluate current and specific processes / policies and procedures against practices within AFWCF to identify root cause of conditions noted. Identify key gaps and inconsistencies in current procedures versus field implementation.
    - Increase communication with process owners to ensure sufficient, complete documentation is provided as part of documentation requests.
    - Assess resource and training needs to meet the requirements for undergoing an audit.
    - Implement an on-going monitoring process of field implementation compared to procedures to ensure consistent application and understanding of key processes and transactions.
- Update AFWCF policies and procedures to ensure its internal controls provide adequate support for material amounts on the basic consolidated financial statements pertaining to beginning budgetary and proprietary financial statement balances.
- Establish an understanding of the necessary key supporting documentation and its required retention period with service organizations.

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- Implement a process to identify estimates within the financial statements and review their risk profiles to determine if the estimation risk warrants classification as a significant estimate.
- Develop sufficient controls to reconcile and monitor the accounts receivable subsidiary ledger at the invoice level to the general ledger.
- Implement document level reconciliations with AFWCF trading partners and develop a process for resolving differences at the document level.

II. INVENTORY HELD BY AFWCF

The following deficiencies aggregated into this material weakness:

(a) **Lack of sufficient inventory count procedures and controls**

Complete and accurate information on inventory values and quantities are critical to the reliability of the financial statements. EY identified assets within the AFWCF inventory records in order to assess existence and completeness of inventory. EY then conducted multiple site visits during 2019 where EY counted the preselected assets and compared the counted quantities with the quantities in the subledger listings provided by the AFWCF.

Held for Repair Inventory – We had the following observations related to our physical inventory counts:

- The AFWCF does not have a formal policy or Standard Operating Procedure (SOP) in place for conducting annual physical or cycle count procedures for individual depots.
- In lieu of periodic inventory counts, Air Force Materiel Command (AFMC) relies upon other evidence of the existence and completion of parts on hand and in process of repair. However, the existence and review of that evidence is not documented as a control and the results of steps performed are not formalized or periodically summarized to evaluate any errors or findings centrally to ensure material or pervasive errors do not exist within the inventory records.

Supply Inventory – We had the following observations related to our physical inventory counts:

- The AFWCF does not have a formal policy or SOP in place for annual physical or cycle count procedures for individual bases with depot maintenance inventory. As a result of counts not being performed for depot maintenance inventory, errors and findings are not reviewed centrally by AFMC to ensure material errors do not exist within the inventory records.
- The AFWCF has implemented a formal policy and SOP in place for cycle count procedures at individual bases with base possessed inventory. Cycle counts are performed through-out the year as determined by each base's cycle count plan. Cycle count results are summarized and reviewed at each base on a monthly basis by base personnel. The procedures performed to review cycle count results are not sufficiently documented, do not include the validation of the

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completeness and accuracy of key reports from ILS-S utilized to perform the review, and do not specify the threshold or criteria used to identify items requiring further investigation. While the result of inventory counts (including identified errors and findings) are reviewed at a base level, they are not reviewed centrally by AFMC or others to ensure material or pervasive errors do not exist within the consolidated inventory records.

- AFWCF does not have a formal policy or SOP in place for physical count procedures for Medical Dental Division War Reserve Material (MDD WRM) production inventory. No physical inventory counts are being performed for MDD WRM production inventory.
- The AFWCF has a formal policy and SOP in place for physical cycle count procedures for individual bases with MDD WRM non-production inventory. The performance of cycle count procedures utilizes an Inventory Summary Report which has not been verified to be complete or accurate. AFWCF personnel review the results of the cycle count; however, evidence of the review procedures performed is not retained.

(b) Lack of sufficient controls over inventory valuation

In general inventory is valued at either an assigned value based on moving average cost (MAC) or an accumulation of internal and external costs incurred to restore a part to usable condition. We identified findings on both types of valuation and have summarized our findings segregated between those related to the application of MAC and the accumulation of cost:

MAC calculation process

The AFWCF uses the MAC process to value the majority of its inventory. MAC is an approved historical cost valuation methodology for inventory in accordance with SFFAS 3 *Accounting for Inventory and Related Property* (SFFAS 3). The MAC calculates historical cost based upon an average of the item's historical procurement prices. Approximately ninety two percent of the total dollar value of AFWCF inventory within its FIABS and ILS-S systems is valued using the automated MAC process. MAC values inventory on a perpetual basis; as receipt of property is inducted, ILS-S or FIABS automatically computes MAC. The calculation of MAC is a heavily automated process that requires interactions amongst groups of systems and interfaces within the AFWCF system environment. The AFWCF does not have the appropriate controls or procedures in place for reviewing changes or transactions related to the MAC calculation process, likely causing inaccuracies in the financial statements.

During our procedures, we had the following observations related to the MAC calculation process:

- AFWCF does not have insight into which contracting systems do not appropriately interface with the instance of FIABS performing the daily MAC calculation updates. Currently, there are not standard policies and procedures for the AFWCF to identify and resolve instances where a procurement occurred from a contract outside of the primary contracting database that should be used as an input into the daily MAC calculation within FIABS.

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- The MAC calculation includes new procurements only and excludes repairable inventory items that have been repaired by maintenance and restocked. The items coming from maintenance should trigger a new MAC recalculation, but no recalculation is occurring.
- EY identified an instance where parts were listed as one National Stock Number (NSN) identifier, but when the asset was counted, the tag indicated another NSN. The AFWCF identified this second NSN as a suitable substitute for the originally selected item. When this situation occurred, EY physically compared the assets to ensure the goods matched. In addition, EY obtained and inspected screenshots from ILS-S that verified the assets were categorized as suitable substitutes. However, when comparing the valuation of the two NSNs, the unit cost for each NSN did not equal, leading to inventory values not representing a comparative value from the original part to the suitable substitute.
- Currently there is a lack of periodic reviews of data inputs for local purchases in ILS-S and FIABS, as well as local purchases by DLA. The data entry is completed manually and no secondary review of these transactions or sample audit of these transactionsoccurs.
- There is no reconciliation process in place to ensure that the contract values interfacing to FIABS for purposes of calculating MAC updates are complete and accurate.
- Certain personnel have the ability to enter an amount and override the actual cost of the newly acquired inventory item within ILS-S. Changing the actual cost of a newly acquired inventory item can materially impact the MAC valuation of that inventory item.
- Daily updates to MAC calculations in FIABS run on automated jobs that occur overnight, crossing over the end of the period. The system then applies changes in MAC values prospectively, rather than applying these changes to the transaction date. This could result in over- or under-statement of inventory as of the cutoff date. As such, inventory would not be reflective of the MAC values for items with current day procurements.
- EY performed physical inventory counts at multiple locations within the United States. As part of these procedures, EY observed AFWCF personnel change the unit of measure from individual units to a box of units. Under the new unit of measure, any box containing 51% or more units would be considered one full box and valued as a full box regardless of how many units above 51% are present. Further, AFWCF personnel have the ability to change the unit of measure in ILS-S without any secondary review required. As a result, no controls over changes in inventory unit of measure exist and the MAC could be applied to the wrong quantity with extended values for those items being inaccurate.
- During our walkthroughs and site visits, we identified that the AFWCF-prepared process narrative pertaining to the valuation of base-possessed inventory was incomplete as descriptions of the process and associated internal controls for a material portion of base possessed inventory were not included.
- Pertaining to MAC valuation for Medical Dental Division (MDD), DLA inputs inventory pricing data into a pricing system. The pricing data is an input into the MAC calculation for MDD inventory. AFWCF has not documented a process narrative or associated controls for DLA’s involvement in the MDD inventory valuation process.

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Accumulation of Cost for Held for Repair Inventory

When a reparable, damaged inventory item (i.e. a carcass) is inducted into the AFWCF's inventory system, the item is valued gross at MAC (i.e. the value of a new part) and a repair contra-asset account or allowance is recorded based on an estimate of the latest repair cost (LRC). As part of the annual budget process, AFWCF will review repair costs, including labor and material costs, to assess if any changes to the LRC for reparable NSN's are necessary. Thus, inventory held for repair is to be valued at the same value as a serviceable item with an allowance for repairs contra-asset account (i.e., repairs allowance) being established. We noted several errors in the application of this process resulting from the lack of controls in place to ensure LRC adjustments are appropriately valued or that the accumulated balance of the allowance reflects the allowance required for the parts in process of repair on the floor:

- When the asset is repaired and released into a held for sale inventory status, the reserve is then debited in the amount of the asset's LRC on the day the asset repair is completed. The intent is that the newly repaired part is now valued at MAC. The LRC values are updated via the annual budget process. We noted in our testing that while the asset remains under repair, the allowance is not updated to reflect changes in the LRC. However, the entry to record the relief of the allowance is recorded at the current LRC. As such, the allowance is understated for those items under repair that were inducted in prior budget years. The accumulation of this error over time results in the consolidated inventory balance being misstated.
- During the annual budget process, LRC for the current fiscal year is developed based off of data from the two preceding fiscal years. During our current year procedures, we found that in some instances, inventory items have an LRC that is greater than the MAC value of that item, resulting in a recorded negative net inventory value for the carcass. AFWCF informed EY that an LRC greater than the MAC value can occur when manufacturers no longer supply the part, or manufacturers have not produced the parts in many years, therefore replacing the part may require custom manufacturing. The negative net inventory occurs due to the fact that AFWCF is not considering Latest Acquisition Cost (LAC) in calculating the repair allowance by asset. In fiscal 2019, AFWCF recorded a $1.4 billion adjustment to address this condition and increase the value of inventory and related property, net.
- The inventory allowance for LRC is relieved only upon completion of the repair process. For repairs that take an extended period which overlaps an accounting period end that allowance is overstated for the costs incurred to date and cost of repairs is overstated for the same amount.
- The credit given to customers for delivering carcasses is not equal to the net value assigned to the carcass in inventory (i.e. MAC less LRC) creating an unintended gain or loss in the books of the AFWCF.
- If an item is determined to be obsolete, impaired or condemned as a result of engineering inspecting the asset, AFWCF is to record an impairment charge to reduce the value of the

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asset to its fair value, which is zero for assets that are condemned. When classified as obsolete or condemned the allowance applied is 100% of the MAC value, leaving $0 net value on the financial statements. AFWCF does not change the condition code to unserviceable until the assets have been reviewed by the engineering group at the base. During our limited testing we found two instances where there was a substantial lag between the determination that a part was unusable and the time when the condition code (and therefore the allowance) was changed. This lag between classifying assets from repairable to unserviceable or condemned results in possible cutoff and valuation errors.

Further during our walkthroughs and site visits, we identified that the AFWCF-prepared process narrative pertaining to the inventory revaluation allowance was incomplete as a description of the process and associated internal controls were not included.

(c) Lack of sufficient controls over inventory movement transactions

AFWCF did not consistently execute internal controls to ensure inventory movements (inductions, issuances, or disposals) were completely and accurately reflected within the supply systems.

- Both AFWCF and DLA manage the movement of depot maintenance inventory. AFWCF manages the induction of base possessed inventory in ILS-S. During induction, the asset and associated data are received, inspected, and entered into the appropriate systems. Verification of the accuracy of the induction information is not appropriately segregated amongst multiple personnel or performed through other controls.
- The induction of inventory into FIABS is performed within multiple feeder systems. Discrepancies resulting from induction are researched and resolved. Evidence of the research and resolution of these discrepancies is not consistently maintained. Further, system generated information used to determine discrepancies has not been verified as complete and accurate.
- For base possessed inventory within ILS-S, AFWCF monitors assets that were issued but have not yet been signed for at the receiving location. This monitoring occurs through the use of a key report whose completeness and accuracy has not been assessed.
- AFWCF personnel utilize degraded operations procedures to record inventory movements when ILS-S is not online. Degraded operations transactions are manually recorded within a log and then manually transferred into ILS-S once it is back online. Sufficient review procedures currently are not in place to verify the completeness and accuracy of degraded operations activity entered into ILS-S.

(d) Inability to identify and value in-transit inventory

As inventory is moved between AFWCF locations, those in-transit items are removed from the supply systems until they reach their destination and then are re-recorded in the supply systems. While progress has been made in the current year, AFWCF remains unable to appropriately

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identify and value in-transit inventory at the item and transaction level. The balance of in-transit inventory recorded as of September 30, 2019 was determined based upon an aging based estimation methodology which lacks appropriate precision. This likely causes misstatements in inventory balances. During our procedures, we had the following observation related to the valuation of inventory-in transit:

- When inventory is shipped from one AFWCF location to another, the inventory is removed from the local base's subledger upon shipment. AFWCF is unable to identify inventory in-transit, as the receiving base does not recognize the inventory until inducted. When the inventory arrives at its destination, it is the responsibility of the receiving base to recognize the inventory in ILS-S.
- We identified an instance where we observed NSNs which had due-in from maintenance (DIFM) status and were recorded twice within the inventory subledger. Specifically, these items had already been inducted into ILS-S, but the DIFM record had not yet been cleared from the system. Thus, the actual quantity of the asset was recorded twice.
- Shipments are processed via manual entry into ILS-S or FIABS. EY identified instances where during the asset transportation process, either an individual at the base where the asset was received or personnel at the location where the item departed, created errors in the system when the shipments were recorded. As such, the shipment of the asset did not reconcile to the specific line of inventory that was transferred. This resulted in one inventory balance being overstated and one being understated. Since the lines did not appropriately reflect the in-transit transaction, discrepancies were caused in the subledger.

Recommendations:

EY recommends the following corrective actions related to the conditions described above:

Related to physical inventory counts

- Create an SOP for annual and/or cycle counts that will be used among all of the depots. The SOP should include provisions related to:
    - Involving of AFMC in the process of administering the policy.
    - Ensuring physical counts occur at or near period end.
    - Ensuring that proper support and documentation is retained and is available to corroborate counts.
- Create an SOP and associated internal controls for annual and/or cycle counts that will be implemented for MDD WRM production inventory.
- Implement an SOP to ensure AFMC, or a centralized group, reviews the results of all physical counts to ensure that there are not material errors or adjustments to the financial statements. Ensure that AFMC is involved in the process of administering the policies and review of results.

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- Develop policies and procedures surrounding the application of volume estimates judgment of the fullness of partially used boxes or containers of items to create consistency. These should incorporate consideration of the sensitivity of the unit on the extended inventory valuation. Additionally, provide supporting documentation for the judgment dictating the fullness of a partially full box. This judgment impacts whether or not a box of items would be rounded up to a whole unit or rounded down to zero units.
- Design control activities which prevent or detect the identified risks of material misstatement; such as, incomplete or inaccurate system information used in the performance of a control.
- Maintain appropriate evidence of the design and execution of the control activities.

Related to inventory valuation - MAC

- Implement additional interfaces to ensure contracts housed in databases outside of the primary contract database are appropriately incorporated into the computation of MAC.
- Update FIABS and ILS-S system logic to ensure that items turned in for repair that are subsequently restocked once a repair is complete trigger an updated MAC calculation.
- Implement periodic reviews or sample audits for data inputs for local purchases in ILS-S and FIABS.
- Implement reconciliation processes to ensure that the contract values interfacing as part of the MAC computation process are complete and accurate.
- Develop policies and procedures related to internal controls around inventory valuation. Provide trainings to the respective staff to ensure proper implementation.
- Update AFWCF-prepared process narratives to include a description of all material aspects of the MAC-valuation process and all existing controls which mitigate risk of material misstatement (RMM's).

Related to inventory valuation – Accumulation of Cost

- Establish policies and procedures so that the repair allowance is calculated consistently with SFFAS 3. This should include updating the LRC for the results of the annual budget process and reflecting the updates in the repair allowance account.
- Perform an analysis to determine the adjustment to the accumulated repair allowance difference as of the opening balance sheet date. Maintain supporting documentation and auditable evidence for the adjustment.
- Perform a review of the inventory items that have been inducted to be repaired at period end and record a reserve for assets that will be condemned and are awaiting engineering review.
- Update the AFWCF-prepared process narrative to include a description of all material aspects of the inventory revaluation allowance process and all existing controls which mitigate RMM's.

Related to inventory movement

- Design control activities which prevent or detect the identified risks of material misstatement such as incomplete or inaccurate system information used in the performance of a control.
- Design control activities which prevent or detect the identified risks of material misstatement such as inappropriate segregation of duties.
- Maintain appropriate evidence of the design and execution of control activities.

Related to in-transit inventory

- Develop policies and procedures related to in-transit inventory. Specifically, AFWCF should consider creating a sub-account for in-transit materials in order to maintain appropriate records in ILS-S and FIABS, especially around the cutoff dates. This sub-account could be charged when the asset departs from the local base and then reduced upon arrival to the receiving destination.
- Implement controls over the ILS-S system to prevent double counting and misplacement of inventory from occurring.
- Implement additional procedures for the review of inducted inventory to ensure DIFM status is cleared within a reasonable amount of time, specifically ensuring assets are cleared before a cutoff period.

III. INVENTORY HELD BY OTHERS

The following deficiencies aggregated into this material weakness:

(a) Insufficient oversight of inventory managed by DLA

During our current year procedures, we identified that AFWCF does not have controls in place to ensure balances being recorded through the Defense Logistics Agency Distribution Standard System (DLA DSS) are complete and accurate. DLA DSS is a feeder system which flows into the inventory subledger. AFWCF informed us that the policy of AFWCF was to record inventory quantities reported by DLA, which results in discrepancies when compared to the AFWCF records of DLA managed inventory items. AFWCF is currently not performing an analysis to determine the appropriateness of changes recorded as a result of DLA's balances compared to AFWCF records.

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(b) Insufficient oversight of inventory managed by contractors and other defense organizations

Complete and accurate information on inventory values and quantities are critical to the reliability of the financial statements. A reconciliation was performed by the AFWCF between the data from various inventory feeder systems impacting contractor and other defense organization inventory, including Commercial Asset Visibility Air Force System (CAV-AF), United States Army LMP, United States Navy ERP, Honeywell PBL, and the data which ultimately flows to the inventory subledger, FIABS. As a result of this reconciliation, AFWCF identified that there are quantity differences and potential duplicate records between the inventory subledger and the identified feeder systems. We identified the following conditions regarding the reconciliation:

- While progress has been made in determining and resolving the underlying causes of the quantity differences within the reconciliation, all differences have not been resolved. Further, evidence of the appropriate resolution of the quantity differences has not been retained.
- Interfaces between the feeder systems and the inventory subledger have not been identified and validated for completeness and accuracy.
- Dollar values have not been applied to all quantity differences to assess their complete financial statement impact.
- Controls to assess the completeness and accuracy of the various data sources which are used in the reconciliation have not been established.
- A standard operating procedure and ongoing internal controls pertaining to the reconciliation have not been developed.

AFWCF was unable to provide sufficient supporting documentation to substantiate inventory managed and/or possessed by third party contractors or other defense organizations and recorded within the feeder systems flowing into the inventory subledger. AFWCF has indicated that there has been no historical, and there is no current, requirement for contractors to report inventory statistics to the AFWCF. Further, inventory balances and activity are not monitored between the two parties in a timely manner in order to accurately research and resolve discrepancies. Discrepancies identified between AFWCF and contractor or other defense organization inventory are rectified by adjusting AFWCF records, but not within the feeder systems.

During our walkthroughs and site visits, we identified instances where AFWCF-prepared process narratives pertaining to inventory managed by contractors or other defense organizations were either incomplete or inaccurate. Specifically, descriptions of the process and associated internal controls for material components of the process pertaining to Depot Maintenance Interservice Agreement (DMISA) and Performance Based Logistics (PBL) inventory, were not included within AFWCF-prepared process narratives.

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Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Design and implement internal controls related to the DLA Managed Inventory Process. These should include controls to assess the completeness and accuracy of the beginning balance information reported within the DLA DSS system. In addition, the controls should ensure the ongoing interface from DLA DSS to the inventory subledger is operating effectively.
- Develop a process to routinely monitor variances between DLA DSS and AFWCF records and adjust the two sets of records to the actual inventory on hand.
- Design and implement controls to document management's review of the DLA DSS service auditors report (i.e., SOC-1 Report) evidencing internal controls for DLA managed inventory have been designed and executed appropriately.
- Pertaining to the reconciliation of various inventory feeder systems impacting contractor and other defense organization inventory and the data which ultimately flows to the inventory subledger:
    - Establish controls and procedures to document the underlying drivers of identified variances, the process by which those variances were investigated, and the eventual resolution of identified variances including appropriate retention of supporting evidence.
    - Identify and validate the completeness and accuracy of interfaces between the feeder systems and the inventory subledger.
    - Apply dollar values to all identified quantity differences in the reconciliation in order to assess their materiality.
    - Establish controls to assess the completeness and accuracy of the various data sources which are used in the reconciliation.
    - Develop a standard operating procedure and ongoing internal controls pertaining to the reconciliation.
- Provide greater oversight and monitoring of contractor and other defense organization inventory by putting in place periodic review controls for this category of inventory.
- Implement policies and procedures to ensure a reconciliation is performed on a monthly basis between detailed inventory balances held by others and AFWCF inventory listings. AFWCF should define criteria for variances to be investigated and ensure variances are investigated and resolved in accordance with this defined threshold.
- Ensure evidential matter exists to support the comprehensive listing of vendor locations and military locations which hold AFWCF owned inventory on behalf of AFWCF including the beginning balance of inventory at each location.
- Update the AFWCF-prepared process narrative to include a description of all material aspects of the contractor and other defense organization process and all existing controls which mitigate RMM's.

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IV. EARNED REVENUE

The following deficiencies aggregated into this material weakness:

(a) Incorrect application of the percentage of completion revenue recognition method for maintenance revenue

AFWCF recognizes revenue for large scale long-term maintenance projects using a percentage of completion calculation. AFWCF is incorrectly applying the percentage of completion calculation per SFFAS 7, *Accounting for Revenue and Other Financing Sources*. Currently, AFWCF does not have a system in place to routinely monitor and update total estimated costs of a project, and therefore, is recognizing revenue as a percentage of the initial estimated costs of the project rather than actual costs. By not identifying and monitoring projects where the total cost incurred will exceed (or not meet) the amount of costs initially estimated, AFWCF is incorrectly matching revenues to expenses in the reporting period. In addition, AFWCF currently does not have sufficient controls in place to ensure all direct labor hours have been charged to the appropriate maintenance project.

(b) Lack of sufficient controls for "Flying Hours" revenue

AFWCF recognizes "Flying Hours" revenue for the Consolidated Sustainment Activity Group (CSAG) Supply Division and Supply Management Activity Group – Retail (SMAG-R) based upon the flying hours executed. "Flying Hours" billings are computed monthly on a one-month lag. The year-end "Flying Hours" accrual is computed based upon a three-month average of actual billings. AFWCF has determined that the year-end "Flying Hours" revenue accrual is a significant estimate. EY identified that the review performed of the year-end "Flying Hours" revenue accrual was not sufficiently documented or of sufficient rigor. In addition, AFWCF determines the amount of "Flying Hours" billings based upon the preliminary quantity of flying hours executed by each Major Command. The final amount of executed flying hours are determined and provided to AFWCF subsequent to monthly billings occurring. AFWCF did not reconcile the preliminary quantity of flying hours executed to the final quantity of flying hours executed and make any corresponding adjustments to "Flying Hours" revenue recorded.

(c) Lack of sufficient controls for supply revenue

AFWCF recognizes supply revenue upon the sale of an inventory item. Prices are input into various pricing systems and interface to ILS-S or FIABS to measure revenue. EY identified that sufficient controls are not in place to ensure accurate approved prices are used to measure revenue. In addition, sufficient controls were not in place over the customer acceptance and maintenance process.

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(d) Incorrect presentation of revenue on a gross versus net basis

EY identified that certain AFWCF transactions were being inappropriately presented on a gross rather than net basis within the Statement of Net Cost due to a posting logic change. This resulted in a $1.3 billion overstatement of both Earned Revenue and Gross Costs within the Statement of Net Cost. There was no impact to Net Cost of Operations due to this error. The error was corrected by AFWCF within the Statement of Net Cost after identification by EY.

Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Develop policies and procedures to properly apply the percent of completion guidance as outlined in SFFAS 7.
- Implement a process to continually estimate and document the total cost of the project throughout the life of the project.
- Update the revenue recognition calculation to include a calculation for a proportionate amount of estimated losses each period.
- Implement a suite of controls over the calculation of the percentage of completion calculation to ensure revenue is being recognized appropriately under SFFAS 7.
- Design control activities which prevent or detect the identified risks of material misstatement. Such risks of material misstatement include expenses incurred are not completely and accurately allocated to each maintenance project, "Flying Hours" revenue billed is incomplete or inaccurate, supply revenue billings are incorrectly measured, and invalid supply customer transactions are recorded. Retain sufficient evidence of the execution of these controls.
- For significant estimates, design and implement review controls that properly consider the estimate's key assumptions, estimation model, and estimation uncertainty to ensure the significant estimate is calculated correctly. Consider additional evidence available subsequent to the balance sheet date but before the financial statements are issued within the determination of the estimate. Retain sufficient evidence of the execution of these controls.
- Implement sufficient review procedures over posting logic changes, which are executed by a qualified accountant, such that potential financial statement errors are prevented prior to implementation of the change.

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V. GENERAL PROPERTY PLANT & EQUIPMENT

The following deficiencies aggregated into this material weakness:

(a) Enhanced processes are needed to record GPP&E activity

AFWCF's GPP&E balance is primarily comprised of general equipment and real property (RP). During our testing, we identified deficiencies related to both of these categories.

AFWCF has recorded general equipment within the consolidated balance sheet that has been deemed unrepairable or obsolete due to the assets being removed from service. AFWCF has not developed procedures to periodically evaluate general equipment condition, identify any assets that are deemed unrepairable or obsolete, and make corresponding adjustments to its recorded value.

AFWCF's real property assets are primarily located at Tinker, Hill, and Warner-Robins. RP assets are managed by a single operation at each installation and are reported within the same Accountable Property System of Record (APSR). In addition, RP assets are tracked and maintained as a single population of assets by each installation's Real Property Office (RPO). As such, the processes and controls executed by the RPO apply to both General Fund and Working Capital Fund RP assets. Therefore, while real property challenges identified and reported as part of the General Fund generally do apply to AFWCF, the impact is more limited. Instead, AFWCF should exercise the oversight of the RPO to ensure that AFWCF has a complete and accurate population of its assets.

Further, as noted in the Integration and Reconciliation of Financial Systems section above, we noted that the reconciliations of the APSR to the financial statements are not complete. Taken together, these deficiencies would allow acquisitions or dispositions of property to be unrecorded and that lack of recording to remain undetected.

(b) Process to assign value to GPP&E needs improvement

Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, contains the accounting standards for Federally-owned PP&E and associated clean-up costs. This standard requires Federal agencies to record PP&E assets at cost. Consistent with the finding (a) above, AFWCF does not have a sufficient process for assuring newly acquired real property is recorded in the APSR. Further, there are not sufficient procedures to assure that the costs added to the APSR are determined in accordance with SFFAS 6.

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Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Establish a process to periodically assess the condition of general equipment and record an impairment of any assets that are deemed unrepairable or obsolete.
- Introduce a quarterly journal voucher to record the impairment of general equipment for unrepairable or obsolete assets.
- Develop entity-level monitoring and oversight controls over the individual installation's execution of the aforementioned controls.
- Evaluate current processes for assigning value to real property at historical cost in compliance with SFFAS 6 and determine appropriate corrective actions.

VI. FUND BALANCE WITH TREASURY

FBwT is an asset account that shows the available budget spending authority of federal agencies. Collections and disbursements by agencies increase or decrease the balance in the account. Fund balance reconciliations are key controls for supporting the existence, completeness, and accuracy of the budget authority and outlays reported on the statement of budgetary resources. Several deficiencies, which resulted in a material weakness in the design and operation of internal control for FBwT, are listed below.

- Each month AFWCF reconciles FBwT in GAFS-R to their balance as reported by Treasury and records an adjustment to bring those balances into agreement. At year end, AFWCF has identified differences between activity posted by Treasury and that posted in GAFS-R of $375.5 million absolute value and $281.8 million net value. The differences are due to delays in AFWCF recognizing authorized FBwT transactions and adjustments recorded in the AFWCF general ledger. The differences were adjusted in a post-closing adjustment to GAFS-R (the "undistributed JVs") so that the financial statements of AFWCF reflect the balance reported by Treasury. The undistributed JVs cannot be supported at the voucher detail level.
- AFWCF is not performing the reconciliation between the activity for all open appropriations in the USSGL 1010 FBwT account with the Treasury Central Accounting Reporting System (CARS) system expenditure and collection account balances.
    - The reconciliation documentation does not track and monitor the variances including research and resolution of work performed.
    - Reconciliations do not include causes of differences at the voucher detail level and do not clear aged undistributed items within 60 days.

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Recommendations

EY recommends the following corrective actions related to the conditions described above:

- Analyze DFAS and AFWCF practices to identify the reasons why transactions impacting FBwT are not recorded at the same time that they are authorized to proceed. Design effective controls to avoid out of balance situations with Treasury that require journal entry corrections.
- Conduct a root cause analysis for irreconcilable balances in Consolidated Cash Accountability System (CCAS).
- Ensure that reconciliations are performed at a detailed level so stakeholders can identify any discrepancies, have enough information to properly conduct research in a timely manner, and propose corrective journal entries.
- Work with DFAS to develop a set of policies and procedures over the accrual process, including the consideration of disbursements that have not been recorded prior to period end cutoff.
- Work with DFAS to address the need to maintain sufficient evidential matter in support of remediation efforts to fully reflect undistributed transactions in the financial statements.

ONGOING FINANCIAL REPORTING

VII. ACCUMULATING AND PREPARING FINANCIAL STATEMENTS

The following deficiencies aggregated into this material weakness:

(a) Lack of sufficient centralized financial statement analytical and review functions

EY identified an overall lack of sufficient monitoring across AFWCF processes, however, the area of most concern is financial reporting. The below listing highlights several areas where we identified a lack of sufficient monitoring:

- Unsupported transactions
- Approval and identification of journal vouchers accumulated within the trial balance
- Ineffective monitoring of abnormal balances
- Improper budgetary to proprietary tie-point balancing

In addition, EY identified several accounting or posting logic errors, which were previously discussed, that could have been detected and corrected prior to reporting if an effective monitoring process had been in place. Similarly, we were not fully able to reconcile the unadjusted trial

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balance to adjusted trial balance (UTB-ATB) due to insufficient monitoring and ability to address variances in a timely manner. Finally, AFWCF was unable to timely identify and remediate erroneous JVs that caused a material increase in activity within the Aerospace Maintenance and Regeneration Group (AMARG) during FY19. Initial Annual Operating Budget (AOB) journal entries were made based on erroneous calculations and were not fully remediated until Q4 of FY19. Due to timing of the journal entries, EY was unable to validate the support.

AFWCF does not have a sufficient data analytics infrastructure or unique data elements to timely perform monitoring of accounting data and transactions. Additionally, AFWCF does not have a sufficient number of trained accounting personnel to perform monitoring over its financial reporting environment to compensate for the insufficient data infrastructure. Finally, AFWCF relies on its service provider, DFAS, to perform data analytics, reconciliations, and other key data functions without the necessary capability or capacity to fully monitor or review DFAS' work.

(b) Lack of assessment, monitoring and effective implementation of recent accounting guidance

AFWCF does not have a formal process established to effectively assess, monitor, and implement recent accounting guidance issued by the Federal Accounting Standards Advisory Board (FASAB) or other accounting guidance issued by OSD (e.g., DoD Financial Management Regulation (FMR) updates, Defense Audit Remediation Working Group (DARWG) papers). While AFWCF leadership is actively involved in working groups to stay abreast of new guidance, there is not one group that is responsible for ensuring the full implementation for financial reporting purposes.

Additionally, AFWCF has not completed the process of evaluating the effects that will result from adopting the below pronouncements and other guidance issued by FASAB, which are already effective. The effect on the financial statements amounts involved is not currently determinable by AFWCF and could be material.

- Statement of Federal Accounting Standards (SFFAS) 47, *Reporting Entity*
- SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies and Stockpile Materials*
- SFFAS 49, *Public-Private Partnerships*
- SFFAS 50, *Establishing Opening Balances for General Property, Plant and Equipment*
- SFFAS 55, *Amending Inter-entity Cost Provisions*
- SFFAS 56, *Classified Activities*
- SFFAS 57, *Omnibus Amendments 2019*
- Technical Bulletin 2017-1, *Intragovernmental Exchange Transactions*
- Technical Bulletin 2017-2, *Assigning Assets to Component Reporting Entities*
- Technical Release 17, *Confirming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment*
- Technical Release 18, *Implementation Guidance for Establishing Opening Balances*

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- Staff Implementation Guidance 6.1, *Clarification of Paragraphs 40-41 of SFFAS 6, Accounting for Property, Plant and Equipment*
- Interpretation 9, *Cleanup Cost Liabilities Involving Multiple Component Reporting Entities*

(c) Enhanced financial statement review procedures are needed

OMB Circular A-136, *Financial Reporting Requirements,* (OMB A-136) provides guidance to Federal entities required to submit Agency Financial Reports (AFRs) under the Chief Financial Officers Act of 1990, as amended. A financial statement audit under *Government Auditing Standards* includes a requirement to perform limited procedures on certain information that is required to be included in the AFR under OMB A-136 beyond the financial statements. While much progress has been made, AFWCF needs to continue to enhance its process for the preparation and review of its AFR. In performing our procedures on the AFR, we identified instances of the following:

- Inaccurate balances reported in the notes to the financial statements
- Supporting documentation that did not adequately support amounts included in the notes
- Lack of complete and accurate disclosures
- Insufficient commentary included in management's discussion and analysis

Although many of the variances highlighted by our work were amended prior to the final release, we believe that AFWCF should continue to work across the organization to increase the usefulness of the AFR as a mechanism to communicate to the public the successes, plans, and annual results of AFWCF. Some variances identified during our audit procedures were unable to be corrected by AFWCF as the correction would not comply with Office of the Secretary of Defense policy.

In accordance with OMB Circular A-136, *Financial Reporting Requirements*, and Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display,* the Statement of Net Cost should present gross and net cost information for major organization and programs, as well as data related to its outputs and outcomes. AFWCF currently accumulates amounts reported in its Statement of Net Cost by major appropriation groups funded by Congress and not by major organization and programs as required. In addition, within Note 16 *Reconciliation of Net Cost to Net Outlays*, there are uncorrected misstatements in the classification of activity amongst the "Acquisition of capital assets" and "Other" lines. There also is an uncorrected reconciling difference in the reconciliation. The exact amounts of these misstatements cannot be quantified at this time.

Recommendations:
EY recommends that AFWCF consider the following corrective actions related to the conditions described above:

- Invest in hiring, training, and retaining additional qualified accountants across the entity, as necessary, for the purpose of implementing a more comprehensive oversight program.
- Develop effective controls to prevent abnormal balances from inaccurately being recorded in the financial records. Review the financial statements produced by DFAS to assess their accuracy including to confirm that no abnormal balances exist.
- Enhance internal control procedures for journal vouchers, including evaluating whether sufficient policies and procedures exist to ensure proper review and approval of a complete population of journal vouchers.
- Dedicate resources to track and coordinate the assessment of the impact and implementation of recent guidance and technical updates commensurate with the size and complexity of AFWCF's operations.
  - Perform reviews of OMB Circular A-136 requirements to ensure updated guidance is evaluated and incorporated in a timely manner.
  - Develop white papers to document AFWCF's consideration of the guidance and plan for implementation.
  - Assessment of current checklists used in the financial reporting process to determine if checklists need to include enhanced review procedures.
- Continue to develop reviews by business process areas to ensure disclosures are complete, accurate, and compliant with financial reporting guidance.
  - Sufficient and documented reviews should ensure that note disclosures are consistent with business activity occurring throughout the year.
  - Implement a robust data analytics environment, including the necessary hardware and software to analyze large data files.
  - Perform data analysis to identify and resolve potential unusual transactions, balances, or other indicators of a potential misstatement in a timely manner.
- Statement of Net Cost
  - Determine the major organizations and programs most relevant to AFWCF.
  - Implement processes to capture costs by major organization and program.

VIII. OVERSIGHT AND MONITORING

The following deficiencies aggregated into this material weakness:

(a) Lack of an effective internal control program

OMB Circular A-123 defines management's responsibility for enterprise risk management and internal control in Federal agencies. Based on our review of AFWCF's FY 2019 Statement of Assurance, the description of activities related to the OMB Circular A-123 program, and also through discussions with the AFWCF, we noted that AFWCF has not fully implemented an effective internal control program in compliance with OMB Circular A-123 or the Air Force

Instruction governing the Manager's Internal Control Program ("MICP"). While a sustainment strategy has been prepared, it does not meet all the intended requirements of OMB Circular A-123 Additionally, there is insufficient evidence that each assessable unit (AU) identified by AFWCF completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the AU's internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level.

In accordance with Circular A-123, AFWCF should have a thorough understanding of the specific processes and document flow involved in each class of transactions as well as the identification of applicable key controls that prevent and detect material misstatements in the financial statements. Thorough understanding of the processes and document flow will help in understanding where errors could occur and the controls necessary to adequately mitigate such risks. These controls can be both manual and technology-dependent and should mitigate the risks of material misstatement (RMM's) associated to the various financial statement assertions. During our walkthroughs and site visits, we identified instances where AFWCF-prepared process narratives were incomplete. Further, AFWCF-prepared process narratives did not include all existing interface, application, and technology dependent manual controls which mitigated RMM's.

(b) Oversight and monitoring of third-party service providers

For several business processes, including financial reporting, military and civilian payroll, and disbursing and receiving, AFWCF relies on service organizations (e.g., DFAS) for initiation, authorization, processing, recording and/or reporting of information that affects financial reporting of the financial statements. The service organizations are subject to separate examination engagements on the service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve stated control objectives for various business processes. AFWCF's service providers design processes and related controls with the assumption that Complementary User Entity Controls ("CUECs") would be placed in operation by user entities (i.e., AFWCF). The application of these controls by user entities is necessary to achieve certain control objectives within the service organization reports. AFWCF has created a Service Provider Team whose responsibility is to determine that service organization reports are being properly reviewed and that CUECs are being reviewed and monitored. Additionally, each of AFWCF's business process areas are responsible for understanding and evaluating CUECs and ensuring the business process incorporates applicable control activities, as well as understanding the impact of results within service organization reports. While measurable progress has been made, a full implementation and monitoring process across all in-scope reports is required to determine control effectiveness and risk mitigation.

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Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Develop and maintain supporting documentation for the AFWCF Statement of Assurance as evidence that AFWCF identified assessable units, developed management control plans, performed risk assessments, performed ongoing monitoring, developed corrective action plans, and tracked progress towards remediation for all assessable units.
- Follow the assessment process contained in OMB A-123, Appendix A, to assess the effectiveness of internal control over financial reporting and compliance with financial-related laws and regulations.
- Maintain adequate and updated supporting documentation and for all phases / steps outlined in OMB A-123, Appendix A.
- Increase the resources dedicated to the A-123 program to completely execute all aspects of the program requirements on an on-going basis.
- Update AFWCF-prepared process narratives to include a description of all material aspects of the processes and all existing controls which mitigate RMM's.
- Continue to assess and enhance the service provider monitoring process.
- Enhance processes to identify a complete listing of all service organization relationships and assess whether service organization reports address all relevant service organization processes.
- Develop policies and procedures to document control gaps related to service organizations in process cycle memos and related control documentation.

IX. CONTRACT FINANCING PAYMENTS

AFWCF conducts business with commercial contractors and may provide financing payments to contractors to alleviate the potential financial burden from long-term contracts. Contract Financing Payments (CFP) are authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Mechanization of Contract Administration Services (MOCAS) is the primary system utilized to administer contracts with CFP for the acquisition of GPP&E and Inventory and Related Property, Net (I&RP). For progress payments based on costs, the customary progress payment rate is 80 percent of the applicable total costs of performing the contract. Additionally, when satisfactory progress has not been achieved by a contractor during any period for which a progress payment is to be made, a percentage of the progress payment may be retained as Contract Holdbacks.

Due to MOCAS system limitations and a lack of sufficiently developed processes, EY identified the following during our testing:

- Lack of identified key controls related to CFP transactions.
- Insufficient monitoring MOCAS CFP balance for accuracy and completeness.
- Lack of reconciliation between the MOCAS CFP sub-ledger population and the general ledger by GLACs.
- Improper reporting of CFP related to capitalized equipment, operating materials and supplies (OM&S), and inventory as "Other Assets." The capitalized costs incurred before assets are placed in service should instead be recognized in GPP&E or I&RP. At September 30, 2019, AFWCF reported $126 million in outstanding contract financing payments as "Non-Federal Other Assets."
- Improper reporting of all contract holdbacks as "Other Liabilities," which is not compliant with DoD policy. At September 30, 2019, AFWCF reported $12 million as contract holdbacks.

Recommendations:

EY recommends that AFWCF consider the following corrective actions related to the conditions described above:

- Develop and implement a beginning-to-end process to properly record contract financing payments. Consider the recent policy updates made in the DoD FMR and TFM.
- Determine whether financial statement balances reflect an accurate and complete population of contract financing payments by:
    - Identifying and validating a complete MOCAS contract financing population.
    - Developing and implementing a reconciliation between MOCAS contracting financing population and the general ledger.
- Instead of Other Assets, report contract financing payment assets under the appropriate financial statement line, such as Inventory and Related Property [OM&S – In Development (GLAC 1516)], Property, Plant and Equipment [Construction in Progress (GLAC 1720), Internal Use Software in Development (GLAC 1832)], or Gross Costs [Operating Expenses/Program Costs (GLAC 6100)].
- Report contract holdbacks as Accounts Payable.

BEGINNING BALANCES

X. ESTABLISHING OPENING BALANCES FOR ASSETS USED IN OPERATIONS

The following deficiencies aggregated into this material weakness:

(a) Valuation of opening balances for GPP&E cannot be supported

AFWCF has not developed appropriate policies and procedures or maintained sufficient support pertaining to the valuation of opening balances of GPP&E in consideration of SFFAS 50 and its alternative valuation methods. In addition, AFWCF has not developed policies and procedures or maintained sufficient support pertaining to the determination of in-service dates of general equipment based upon receiving documents or other appropriate evidence in consideration of SFFAS 50.

(b) Lack of sufficient identification of beginning balance population for inventory

A reconciliation was performed by the Air Force between the data from the various inventory feeder systems including Commercial Asset Visibility Air Force System (CAV-AF), United States Army LMP, United States Navy ERP, Honeywell PBL, and DLA DSS, and the data which ultimately flows to FIABS. As a result of this reconciliation, AFWCF identified that there are quantity differences between FIABS and the identified feeder systems. While some progress has been made, AFWCF has not fully determined the underlying cause of the differences nor how to resolve them. Further, AFWCF has not applied dollar values to all of the quantity differences to fully assess their financial statement impact.

Assets were improperly classified as inventory instead of equipment. Inventory is classified as a short-term asset that is intended to be sold in the ordinary course of business (or mission). EY identified during inventory counts that containers were being used for storage/training purposes which is outside of its intended purpose. The items should be classified as equipment, subject to depreciation. Upon reclassification to GPP&E, the assets would be depreciated to reflect the net book value of the assets. This is a result of incomplete asset review controls that would identify the purpose of assets and their appropriate classification.

During a based-possessed inventory count at one Air Force Base, EY was unable to verify the existence and completeness of the base possessed inventory found within the provided population of assets held at that AFB. This was primarily due to significantly insufficient identification and tracking of inventory items by their NSNs. During our procedures, we had the following observation related to our physical inventory count at the AFB:

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- EY selected multiple NSNs related to a certain asset type. EY was unable to count our selected sample of this asset type due to the way the assets were being stored. The assets were stored in multiple locations with some or all pieces of the asset present, and without specific identification as to which asset each item represents. As a result, EY was not able to perform a complete and accurate count of these assets.
- EY selected certain assets for counting which varied in size and shape. Some of the observed quantities of the selected assets were not labeled. Further, they had differing sizes and shapes comingled in the same container. Each asset that was of a differing size and shape was assigned a differing value including those that were comingled in the same container. As a result, EY was not able to perform a complete and accurate count of these assets.
- The AFB initiated a War Plan Additive Requirement (WPAR), which involved containers housing inventory items being stenciled with new identifying numbers. As a result, EY was unable to match the document numbers from the inventory subledger to the physical assets.

AFWCF values its resale inventory using the moving average cost (MAC) method. The AFWCF was unable to provide adequate supporting documents to substantiate the historical cost of certain inventory items within ILS-S. The available support for moving average cost for these inventory items within ILS-S comes from webFLIS. WebFLIS only maintains current cost data. As such, AFWCF could not support the valuation of certain inventory items within ILS-S at historical cost under SFFAS 3.

AFWCF has not completed the process of evaluating the impact to the value of inventory, operating materials and supplies, and stockpile materials that will result from adopting SFFAS 48, *Opening Balances for Inventory, Operating Material and Supplies, and Stockpile Materials*. EY identified a number of inventory items with a total MAC value of zero within the inventory subledger. AFWCF confirmed that a zero MAC value is commonly assigned for assets that were procured prior to 2004 for which no subsequent procurement activity has occurred. AFWCF is unable to determine the historical cost of this inventory.

Recommendations:

EY recommends the following corrective actions related to the conditions described above:

- Develop policies and procedures pertaining to the valuation of opening balances of general equipment in consideration of SFFAS 50. Select which valuation method or methods should be applied to make a reasonable estimate of valuation.
    - Develop policies and procedures pertaining to the establishment of in-service dates for opening balances of general equipment in consideration of SFFAS 50.
- AFWCF should investigate and determine the cause of the inventory quantity variances within FIABS resulting from the lack of identified feeder system quantities. In addition, AFWCF should implement effective feeder system data reconciliation procedures and

controls to support the beginning balance of inventory within FIABS and ensure all balances in FIABS are reconciled to an identified feeder system on an ongoing basis.

- Recalculate the repair allowance for all items currently under repair to record a one-time adjustment to bring the repair allowance to the appropriate balance.
- Summarize the misclassified GPP&E assets and record a journal voucher to reclassify the containers (and any other depreciable asset that does not meet the definition of inventory) to general equipment
  - Calculate the historical value, accumulated depreciation, and net book value for each of the misclassified GPP&E assets.
- Validate the accuracy of unit price data within webFLIS on an annual basis or when significant changes to the MAC value in ILS-S occur.
- Implement a process to retain key supporting documentation to validate the MAC value of inventory within ILS-S at the item level.
- Develop policies and procedures pertaining to the valuation of opening balances of inventory, operating materials and supplies, and stockpile materials in consideration of SFFAS 48. Select which valuation method or methods should be applied to make a reasonable estimate of valuation.

XI. FINANCIAL INFORMATION SYSTEMS

Information system security controls are fundamental to the confidentiality, integrity, and availability of all applications and the financial data they store, process, and transmit. For example:

- Security management controls provide reasonable assurance that overarching system risk management policies and procedures are in place.
- Access controls provide reasonable assurance that the access to system resources is consistent with job duties and restricted to authorized individuals.
- Segregation of duties provide reasonable assurance that incompatible duties are effectively segregated.
- Configuration management controls provide reasonable assurance that changes to the information system are authorized and operating as intended.
- Interface controls provide reasonable assurance that data from feeder systems is reliable, valid, complete, and properly converted from the feeder systems into the applications they support.

An internal control environment with risk and control gaps in any one of the above elements may be susceptible to the associated system risks. AFWCF continues modernizing or consolidating applications (NexGen IT, Con IT), which may alter some of the inherent risks in its distributed and legacy system environment currently in place.

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The AFWCF needs to continue to focus on implementing a robust internal control environment and information security program that is designed and operating effectively to mitigate key financial audit risks. Our assessment of the Information Technology ("IT") controls and the computing environment identified deficiencies which collectively constitute a material weakness in the design and operation of information systems controls.

The deficiencies relate to the following areas:

- Security Management
- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Interface controls

These deficiencies are discussed further below.

(a) Security Management

A security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures and controls implement the entity-wide policy. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

The identified security management weaknesses that represent a significant risk to the AFWCF financial management information systems environment include the following:

- Security controls were not regularly assessed for appropriateness, monitored, or tested in order to verify compliance.
- Plans of action and milestones (POA&Ms) were not prioritized and periodically tracked to completion, including testing and monitoring of corrective actions.
- For systems hosted by the Defense Information Systems Agency (DISA), the DISA System and Organization Controls (SOC) 1 report was not reviewed to the extent of performing assessments over the Complementary User Entity Controls (CUECs).
- Key system documentation is not updated timely (e.g., system security plans, configuration management plans, access management policies).

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(b) Access controls / user access

Access controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. When properly implemented, access controls can help ensure that critical systems' assets are physically safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed.

The identified access control weaknesses that represent a significant risk to the AFWCF financial management information systems environment include the following:

- Access was not restricted to authorized users and was not assigned in accordance with the principle of least privilege.
- Policies and procedures for account authorization, provisioning, and termination were not documented.
- Procedures were not consistently followed for monitoring unused IDs, locked IDs, terminated users, or access re-certifications.
- Procedures for monitoring and auditing security violations and sensitive user activities, including activities of privileged users, were not documented, not being performed, or not configured appropriately within systems.
- Periodic reviews of sensitive and non-sensitive user access were not performed appropriately.
- Security auditing and monitoring of system activities was not established.
- Audit logging information was not protected against unauthorized access and modification.
- Password complexity and password lockout requirements were not being enforced.
- Access controls associated with the use of third-party systems have not been fully implemented.
- Inactive users are not disabled or removed timely and in accordance with organization defined policies.
- Oracle database profiles are not reviewed and maintained (addition, removal, modification) regularly and appropriately.
- FY19 DISA Hosting Services Service Organization Controls Report – Controls to provide reasonable assurance that logical access to financial systems is granted to properly authorized individuals were not operating effectively during the period.
- FY19 DISA Hosting Services Service Organization Controls Report – Controls to provide reasonable assurance that remote access to the network used to access operating environments is restricted to privileged users, and network devices supporting financial systems are configured in accordance with requirements outlined in applicable Security Technical

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Implementation Guides (STIGs) or Security Requirements Guides (SRGs) were not operating effectively during the period.

(c) Configuration management / change controls

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematically controls changes to that configuration during the system's life cycle. By implementing configuration management controls, AFWCF can ensure that only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

The identified change control weaknesses that represent a significant risk to the AFWCF financial management information systems environment include the following:

- Developers were granted inappropriate access to make modifications directly to the production environment and delete system files within application modules.
- Configuration changes are not properly reviewed, approved and documented.
- Configuration changes to production environments are not being monitored to verify their appropriateness.
- The application code, configurations, and databases are not monitored for potentially unauthorized changes.
- Documented policies and procedures did not consistently address the process to implement emergency changes.
- Direct changes to data in production are able to be made unmonitored and without any required documentation, testing (if applicable), or approval.
- FY19 DISA Hosting Services Service Organization Controls Report – Controls to provide reasonable assurance that changes to the operating system and database software on operating environments are documented, authorized, and properly implemented were not operating effectively during the period.

(d) Segregation of duties ("SoD") controls

An effective control environment guards against a particular user having incompatible functions within a system. Segregation of duties controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations without detection and thereby conducting unauthorized actions or gaining unauthorized access to assets or records.

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The identified SoD weaknesses that represent a significant risk to the AFWCF financial management information systems environment include the following:

- Access rights and responsibilities were not appropriately restricted to independent users and assigned in accordance with segregation of duties policies.
- Policies and procedures were not always comprehensive and did not address potential SoD conflicts within the applications.
- Controls were not in place to verify conflicting roles were not assigned to individuals during the access provisioning process, and for known conflicts where SoD concerns were identified, subsequent logging and review of a user's activity was not in place and monitored for appropriateness. Conflicting roles that were deemed necessary or required due to a business need were not documented and assessed on a regular basis.
- Users were assigned access to allow them to perform both administrator and end user functions; for example, users were able to add, modify, and delete user access to the application, while also having access to process and modify production data.

(e) Interface controls

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems.

The identified interface control weaknesses that represent a significant risk to the AFWCF financial management information systems environment include the following:

- Interface agreements are not reviewed on a periodic basis to verify they are accurate.
- Logs of interface processing activities are not retained to support subsequent auditing and monitoring. Error reporting of failed interface processing activities has not been implemented in some systems.
- Interface files are not protected from unauthorized access and modification prior to processing.
- Validation checks are not consistently implemented across interfaces to prevent the processing of duplicate or inaccurate data.
- Reconciliations are not being performed between source and target systems to verify completeness and accuracy of processing.

Recommendations:

The AFWCF should implement controls to address deficiencies in access controls, configuration management, segregation of duties, and interface procedures to include:

- Security Management – AFWCF should continue to:
  - Define and implement consistent procedures related to periodic security controls assessments and testing.
  - Prioritize and monitor POA&M progress, and test and monitor corrective actions.
  - Review SOC 1 reports and perform an assessment over AFWCFs execution of relevant CUECs.
- Access controls / user access / segregation of duties — AFWCF should continue to:
  - Implement monitoring and review controls for users with elevated access privileges.
  - Document and follow procedures related to user account management and segregation of duties, including the entire life cycle from access provisioning to recertification, inactivity restrictions, and termination procedures.
  - Segregate roles and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.
  - Restrict user access to a single account and eliminate shared accounts.
  - Evaluate cross-application segregation of duties to identify potential conflicts for users accessing multiple systems.
  - Review access logs and perform follow-up investigation of potential security violations.
  - Coordinate with DISA to understand the impact of access control deficiencies to AFWCF financial systems and identify/implement applicable compensating controls to address these risks.
- Configuration management / change controls — AFWCF should continue to:
  - Segregate developer access between development and production environments.
  - Identify complete and accurate populations of configuration changes in order to monitor whether changes are being implemented in accordance with policies and procedures.
  - Apply standard configurations developed by DISA to system environments (operating system, database and application layers).
  - Document process for expedited or emergency changes.
  - Review changes and execution procedures completed by third-parties and contractors.
  - Monitor the application and database(s) for potentially unauthorized changes.
  - Coordinate with DISA to understand the impact of change control deficiencies to AFWCF financial systems and identify/implement applicable compensating controls to address these risks.
- Interface controls— AFWCF should continue to:

- Implement stronger systemic checks for completeness and accuracy of interface file processing, to include tracking and logging procedures and protection from unauthorized access.
- Maintain appropriate and comprehensive documentation covering all interfaces.
- Document procedures for performing interface error handling and correction.

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Report of Independent Auditors on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Air Force and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements,* the financial statements of the Department of the Air Force Working Capital Fund (AFWCF), which comprise the consolidated balance sheet as of September 30, 2019, and the related consolidated statement of net cost, consolidated statement of changes in net position, and combined statement of budgetary resources for the year ended September 30, 2019, and the related notes to the financial statements and have issued our report thereon dated November 8, 2019. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2019, and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 19-03, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to AFWCF.

The results of our tests of compliance with laws and regulations described in the second paragraph of this report disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

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FFMIA

Under FFMIA, we are required to report whether AFWCF's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of tests disclosed instances in which AFWCF's financial management systems did not substantially comply with federal financial management systems requirements, applicable federal accounting standards or the USSGL.

(a) Federal financial management system requirements

As referenced in Fiscal Year (FY) 2019 USAF Statement of Assurance, the USAF identified that financial systems and financial portions of mixed systems do not substantially meet FFMIA or OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (Circular A-123) Appendix D.

EY also identified this material weakness as part of the Financial Information Systems material weakness, contained in the *Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards* (Report on Internal Control), where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with security management, access controls/user access, configuration management/change controls, segregation of duties and interface controls. These financial system deficiencies prevent AFWCF from being compliant with federal financial management system requirements and inhibit AFWCF's ability to prepare complete and accurate financial reports.

(b) Noncompliance with applicable federal accounting standards

As referenced in the FY 2019 AFWCF Statement of Assurance and Note 1 to the financial statements, AFWCF identified that the design of legacy financial systems does not allow AFWCF to comply with applicable federal accounting standards, including not being able to collect and record financial information on an accrual accounting basis. EY also identified noncompliance with federal accounting standards during our testing, which was included in our Report on Internal Control.

(c) Noncompliance with USSGL posting logic at the transaction level

As referenced in the FY 2019 USAF Statement of Assurance, AFWCF identified that the design of legacy financial systems does not allow AFWCF to comply with USSGL at the transaction

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level. EY identified noncompliance with USSGL posting logic during our testing, which was included in our Report on Internal Control.

FMFIA

Federal Managers' Financial Integrity Act (FMFIA) requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control.

AFWCF was not able to provide evidence that they are in compliance with significant aspects of OMB Circular A-123, which implemented FMFIA. AFWCF provided a FY 2019 Statement of Assurance; however, there was not sufficient evidence that each process identified by AFWCF fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level. Based on the evidence received, EY noted that AFWCF has started to implement an A-123 testing strategy, however AFWCF is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

USAF's Response to Findings

Our Report on Internal Control dated November 8, 2019 includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance with FFMIA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from AFWCF's management responsible for addressing the noncompliance are provided in their letter dated November 8, 2019. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the entity's compliance. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 8, 2019

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DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

NOV 08 2019

OFFICE OF THE ASSISTANT SECRETARY

SAF/FM
1130 Air Force Pentagon
Washington, DC 20330-1130

Mr. Timothy Winder
Partner, Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

Dear Mr. Winder:

The Department of the Air Force has reviewed the Independent Audit Reports prepared by Ernst & Young LLP for the Fiscal Year (FY) 2019 General Fund and Working Capital Fund financial statements. We concur with your conclusions and appreciate your recommendations. We are refining our audit strategy to focus on the remediation of material weaknesses and establishing an effective internal control environment.

This was the second year we have undergone a full financial statement audit. I am proud to say we learned from the first year and were able to successfully manage the significant and complex audit related workload. In response to your findings, we developed corrective action plans and committed ourselves to diligently monitoring our progress and holding responsible parties accountable for achieving success.

In response to the Secretary of Defense's audit remediation priorities for FY 2019, we have demonstrated tangible progress. We improved the accountability of our material assets by performing physical inventories of our military equipment, real property, and inventory. Also, we continue to pursue automated solutions for system access management and security event monitoring. Other initiatives will reduce our legacy systems footprint, migrate enduring systems to cloud environments, and standardize data to increase accuracy and analytical capabilities. Lastly, efforts are ongoing to establish a compliant enterprise risk management and internal control program.

Although we have made progress in FY 2019, we realize there are many challenges ahead. Generally, our challenges result from the age and complexity of our information technology (IT) systems environment and lack of an effective internal control program. We are dedicated to updating our legacy IT systems and business processes, as well as implementing a comprehensive internal control program. Our Airmen and Air Force leadership are devoted to making significant progress each year towards remediation of material weaknesses.

Financing the Fight

We continue to proactively seek opportunities for improvement and are currently developing a more comprehensive, long-term strategy that establishes multi-year priorities and milestones. This will focus our resources on top priority areas impacting the financial statement audit, meaningfully addressing material weaknesses, and enabling a more collaborative and productive working relationship across the enterprise.

Thank you for your professionalism and due diligence throughout this audit. We look forward to our continued collaboration in the future.

John P. Roth
Assistant Secretary of the Air Force
(Financial Management and Comptroller)

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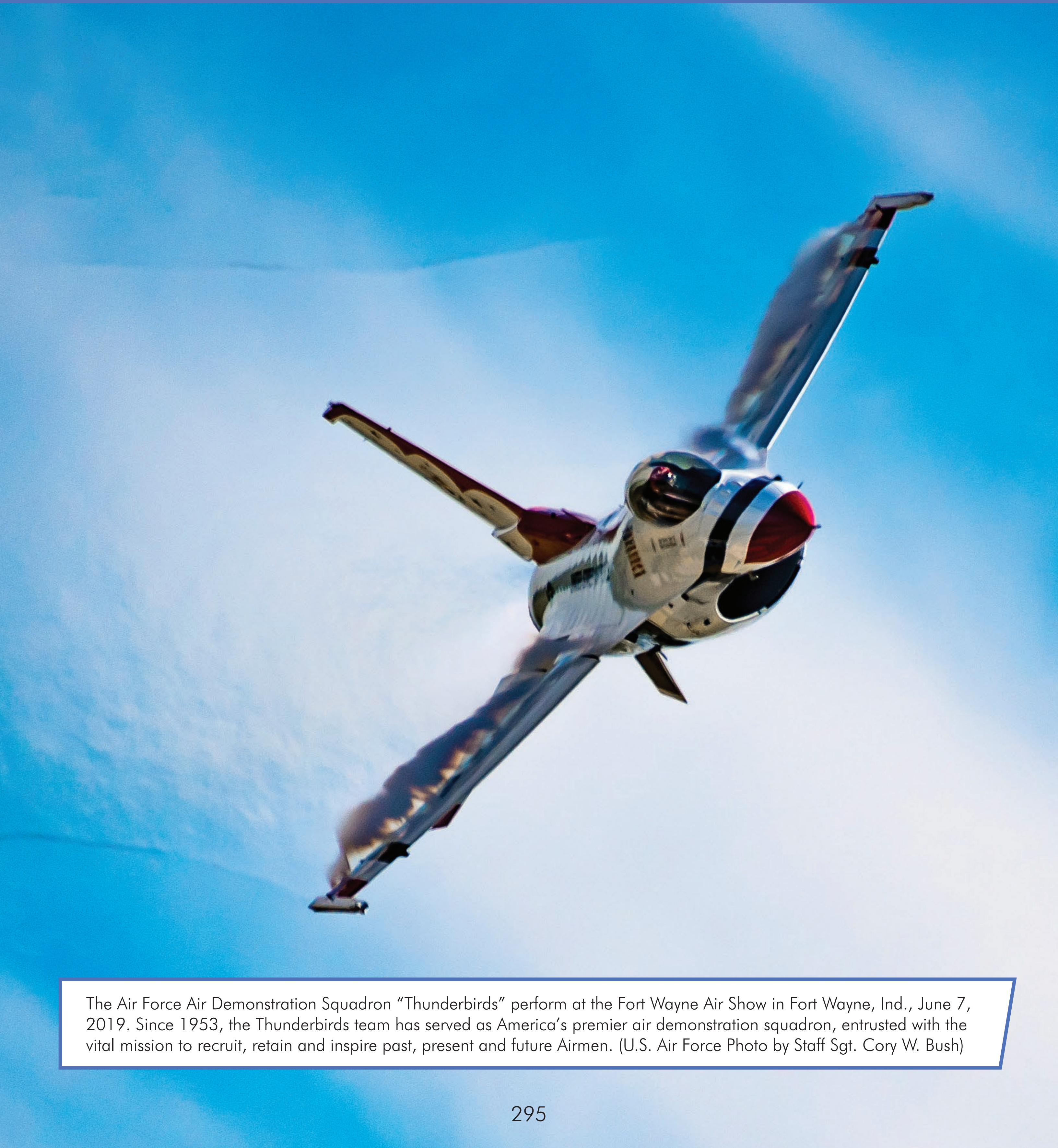
OTHER INFORMATION



The Air Force Air Demonstration Squadron "Thunderbirds" perform at the Fort Wayne Air Show in Fort Wayne, Ind., June 7, 2019. Since 1953, the Thunderbirds team has served as America's premier air demonstration squadron, entrusted with the vital mission to recruit, retain and inspire past, present and future Airmen. (U.S. Air Force Photo by Staff Sgt. Cory W. Bush)

SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

United States (U.S.) Air Force ("Air Force", "we," "us," and "our") management has a fiduciary responsibility to develop and maintain effective internal controls to ensure that its federal resources are used effectively, and its programs operate efficiently to achieve our mission. Managers throughout the Air Force are accountable for ensuring effective internal controls in their areas of responsibility.

Table 1 lists the 23 material weaknesses identified by the Independent Public Accountant (IPA) during the Air Force's financial statement audit.

Table 1. Fiscal Year 2019 Summary of Financial Statement Audit

Audit Opinion: Disclaimer of Opinion							
Restatement: No							
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance	General Fund	Air Force Working Capital Fund
Integration and Reconciliations of Financial Systems	2	-	-	-	2	1	1
Operating Materials and Supplies	-	1	-	-	1	1	-
Property and Materials Held by Others	1	-	-	-	1	1	-
Inventory Held by Air Force Working Capital Fund	1	-	-	-	1	-	1
Inventory Held by Others	1	-	-	-	1	-	1
General Property, Plant and Equipment	2	-	-	(1)	1	-	1
Real Property	-	1	-	-	1	1	-
General Equipment (including Military Equipment)	-	1	-	-	1	1	-
Earned Revenue	1	-	-	-	1	-	1
Fund Balance with Treasury	2	-	-	-	2	1	1
Accumulating and Preparing Financial Statements	2	-	-	-	2	1	1
Oversight and Monitoring of Internal Controls	2	-	-	-	2	1	1
Contingent Legal Liabilities	1	-	-	-	1	1	-
Contract Financing Payments	-	2	-	-	2	1	1
DoD Accounting Policies and Procedures	2	-	-	(2)	0	-	-
Establishing Opening Balances for Assets Used in Operations	2	-	-	-	2	1	1
Establishing Opening Budgetary Balances	2	-	-	(2)	0	-	-
Financial Information System	2	-	-	-	2	1	1
Total Material Weaknesses	23	5	-	(5)	23	12	11

As required, Air Force managers establish and assess internal control over financial reporting, mission-essential operations, and financial management systems. Management-identified weaknesses are determined by assessing internal controls, as required by the *Federal Managers' Financial Integrity Act of 1982* (FMFIA), the *Federal Financial Management Improvement Act of 1996* (FFMIA), and Office of Management and Budget Circular No. A-123 *Management's Responsibility for Enterprise Risk Management and Internal Control* (OMB A-123). Assessments of internal controls fall into one of the following categories:

- FMFIA Section 2, *Effectiveness of Internal Control over Financial Reporting*,
- FMFIA Section 2, *Effectiveness of Internal Control over Operations*, or
- FMFIA Section 4, *Compliance with Federal Financial Management Systems Requirements*.

Table 2 provides those areas where material weaknesses were identified by the Air Force in the above categories and where remediation work continues. In addition, it includes the status of compliance with Section 803(A) of the FFMIA. Air Force Management believes that the listing of Air Force-identified material weaknesses encompasses all material weaknesses also identified by the IPA for internal control over reporting and internal control over financial systems (though naming conventions and descriptions of the IPA-identified and Air Force-identified material weakness may vary).

Table 2. Fiscal Year 2019 Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting					
Statement of Assurance: Modified Assurance					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Reporting (General Fund)	1				1
Oversight and Monitoring (General Fund)	1				1
Statement of Net Cost (General Fund)	1				1
Reconciliation of Net Cost of Budget to Operations (General Fund)	1				1
Intragovernmental Eliminations (General Fund)	1				1
Government Furnished Equipment (General Fund)	1				1
Operating Materials & Supplies (General Fund)	1				1
Contractor Inventory Control Point (General Fund)	1				1
In transit Inventory (Working Capital Fund)	1				1
Multi Service Contract Accounting Department of Defense Accounting Policies (General Fund)	1				1
Inaccurate Financial Records (formerly 'Air Force Accounting Policies and Procedures') (General Fund)	1				1
Real Property Valuations (General Fund)	1				1
Miscellaneous Obligations/Reimbursement Documents (General Fund)	1				1
Lack of Complete Universe of Transactions (General Fund and Working Capital Fund)	1				1
Fund Balance with Treasury (Working Capital Fund)		1			1
Fund Balance with Treasury (General Fund)		1			1
Accumulating and Preparing Financial Statements (Working Capital Fund)		1			1
General Property, Plant and Equipment (Working Capital Fund)		1			1
Earned Revenue (Working Capital Fund)		1			1
Oversight and Monitoring of Internal Controls (Working Capital Fund)		1			1
Establishing Opening Budgetary Balances (Working Capital Fund)		1			1
Establishing Opening Balances for Assets Used in Operations (Working Capital Fund)		1			1
Integration and Reconciliation of Legacy Financial Systems (Working Capital Fund)		1			1
Inventory Held by Working Capital Fund (Working Capital Fund)		1			1
Inventory Held by Others (Working Capital Fund)		1			1
Total Material Weaknesses	14	11	0	0	25

Effectiveness of Internal Control Over Operations (FMFIA Section 2)					
Statement of Assurance: Modified Assurance					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Defense Contract Management Agency Contracts (General Fund)	1				1
Overseas Housing Allowance (General Fund)	1				1
Energy Meter Management (General Fund)	1				1
Air Force Review Boards Agency Case Backlogs (General Fund)	1				1
Enterprise Information Protection Capability (General Fund	1				1
Defense Travel System Controls (General Fund)	1				1
Foreign Government Employment (General Fund)	1				1
Electronic Records Hygiene (General Fund)	1				1
United States Air Forces Central Command Communications Security Assets (General Fund)	1		(1)		0
Wireless Network (General Fund)	1		(1)		0
Criminal History Data Reporting Requirements (General Fund)	1				1
Cyber Security of Network Component Purchases (General Fund)		1			1
Cyber Security Control of Integrated Tactical Warning Attack Assessment Weapons Systems (General Fund)		1			1
Total Material Weaknesses	**11**	**2**	**(2)**	**0**	**11**

Conformance With Federal Financial Management Systems Requirements (FMFIA Section 4)					
Statement of Assurance: Modified Assurance					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Systems (General Fund)	1				1
Lack of Integrated Financial Systems (Working Capital Fund)	1				1
Total Material Weaknesses	**2**	**0**	**0**	**0**	**2**

Compliance With Section 803(A) Of The Federal Financial Management Improvement Act (FFMIA)		
	Agency	Auditor
Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
United States Standard General Ledger at Transaction Level	Lack of compliance noted	Lack of compliance noted

FRAUD REDUCTION REPORT

The Air Force has multiple fraud prevention measures in place that support anti-fraud evaluations and controls, ethics, and compliance, including its Quality Assurance Program, Management Internal Control Toolset (MICT), and its Enterprise Risk Management (ERM) approach under Office of Management and Budget Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (OMB A-123) requirements. Fraud prevention and detection is the highest priority in the Air Force Financial Management Quality Assurance Program (Quality Assurance Program) documented in Air Force Instruction 65-202, *Administration of a Base Financial Management Quality Assurance Program* (AFI 65-202).

A Quality Assurance Manager is assigned at each Air Force installation and is responsible for administering the Financial Management Quality Assurance Program. The Quality Assurance Manager is the focal point for fraud prevention and awareness in the Air Force's financial management organizations. The Air Force is enhancing the Quality Assurance Program to integrate and improve ongoing anti-fraud evaluations and controls, ethics training and communication, and compliance programs. This year, the Air Force advanced its financial management-focused metrics into a Power BI data analysis environment to give the field, for the first time, the ability to objectively understand and correct noncompliant processes, and report systemic issues up to the Air Force-headquarter levels. The Air Force updated its MICT self-assessment checklists with Defense Enterprise Accounting and Management System Critical Task List requirements to give important controls to the Air Force's new accounting system. In addition, the Air Force developed a web-based quality assurance review and deficiency tracking tools, to allow standardized and verifiable evaluations and control testing. The year culminates at the Quality Assurance Worldwide Workshop, attended by all Quality Assurance Managers, to communicate how to conduct a successful Quality Assurance Program and to train on process improvement tools.

Under the umbrella of the Air Force Inspection System, a comprehensive Self-Assessment Program provides anti-fraud evaluations semiannually through the Air Force Inspector General's MICT. A checklist review is conducted to evaluate the effectiveness of existing fraud prevention measures and is validated by the Quality Assurance Manager.

The Air Force financial management community established clear fraud prevention measures that include:

Fraud awareness training and education:
- Introductory briefings on local fraud prevention measures for new hires,
- Distribution across organizations of fraud related items to include fraud cases external to the Air Force to raise awareness of potential fraud scenarios,
- Mandatory annual fraud, waste, abuse, and mismanagement briefings,
- Fraud indicators familiarization, and
- Ethics training.

Guidelines to mitigating potential controls:
- Comptroller access guides require the comptroller's review and signature attesting that adequate internal controls are in place for individuals with multiple systems access, and
- The Quality Assurance Manager must check for fraud, waste, abuse, and mismanagement in every review or audit conducted.

Clear instructions, within AFI 65-202, for Air Force installations to report any suspected fraud to the following individuals:
- Air Force Office of Special Investigations,
- Security Forces Investigative Unit,
- Air Force Audit Agency,
- Wing Inspector General, and
- Staff Judge Advocate (local legal office).

Independent of the Quality Assurance Program, periodic anti-fraud evaluations are included in the Air Force's internal control tests of operating effectiveness across most of its assessable units. High-risk assessable units for fraud, waste, abuse, and mismanagement include, but are not limited to, the following: civilian pay, military pay, mechanization of contract administrative services, vendor pay, travel, and mission critical assets. Anti-fraud controls are in place and tested periodically through the Secretary of the Air Force, Financial Reporting and Internal Control Division. This includes the internal control test of design and test of operating effectiveness at assessable units (including complementary user entity controls).

The Air Force is currently developing an ERM approach to comply with OMB A-123. The ERM approach addresses the full spectrum of the organization's external and internal risk (both operationally and financially) by understanding the combined impact of risk as an interrelated portfolio, rather than addressing risk only within silos. This approach provides input into how to prioritize resource allocations to ensure successful mission delivery. Risk management involves forward-looking management decisions, and balancing risk and return—so the Air Force may enhance its value to the taxpayer and increase its ability to achieve strategic objectives.

The Air Force ERM approach encompasses the risk of fraud through integration with OMB A-123 compliance. The Air Force Internal Control Playbook provides detailed information on risk management, to include an organizational risk assessment, materiality considerations, business process risk assessments, and fraud risk. The Internal Control Playbook will facilitate a risk-based approach to assess internal controls while seamlessly integrating audit outcomes to sustain operationally effective processes. When integrated, these processes provide management with the information required to support remediation efforts and effectively sustain an internal control environment. Accordingly, in the Air Force's effective ERM approach also complies with the *Fraud Reduction and Data Analytics Act* requirement to establish financial and administrative controls related to fraud and improper payments by conducting an evaluation of fraud risks, and using a risk-based approach to design and implement financial and administrative control activities to mitigate identified fraud risk.

GLOSSARY OF ACRONYMS

ACC	Air Combat Command
ACES-PM	Automated Civil Engineering System-Project Management
ACES-RP	Automated Civil Engineer System - Real Property
ADA	Anti-Deficiency Act
AETC	Air Education and Training Command
AETP	Adaptive Engine Transition Program
AFB	Air Force Base
AFGSC	Air Force Global Strike Command
AFI	Air Force Instruction
AFMC	Air Force Materiel Command
AFRBA	Air Force Review Boards Agency
AFRC	Air Force Reserve Command
AFRL	Air Force Research Laboratory
AFSOC	Air Force Special Operations Command
AFSPC	Air Force Space Command
AFWCF	Air Force Working Capital Fund
ALMSS	Automated Logistics Management Support System
AMC	Air Mobility Command
ANG	Air National Guard
APSR	Accountable property system of record
ARRW	Air-Launched Rapid Response Weapon
ASCENT	Advanced Spacecraft Energetic Non-Toxic
AST	Aboveground Storage Tank
BAH	Basic Allowance for Housing
BD/DR	Building Demolition and Debris Removal
BRAC	Base Realignment and Closure
C2	Command and Control
CAP	Contractor-Acquired Property
CAS	Combat Ammunition System
CBY	Charge-Back Year
C-ICP	Contractor-Inventory Control Point
CDRL	Contract Data Requirements List
CEMS	Comprehensive Engine Maintenance System

CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CIP	Construction-in-Progress
CLSSA	Cooperative Logistics Supply Support Agreement
COLA	Cost of Living Adjustment
COTS	Commercial off-the-shelf
CPIM	Consumer Price Index Medical
CROWS	Cyber Resiliency Office for Weapons Systems
CSAG	Consolidated Sustainment Activity Group
C-sUAS	Counter Small Unmanned Aerial Systems
CTC	Cost-to-Complete
DCMA	Defense Contract Management Agency
DCPS	Defense Civilian Pay System
DEAMS	Defense Enterprise Accounting and Management System
DERP	Defense Environmental Restoration Program
DEW	Directed Energy Weapons
DFAS	Defense Finance and Accounting Services
DFARS	Defense Federal Acquisition Regulation Supplement
DL	Direct Loan
DLA DSS	Defense Logistics Agency Distribution Standard System
DM&R	Deferred Maintenance and Repair
DoD	Department of Defense
DoD FMR	Department of Defense Financial Management Regulation
DOL	Department of Labor
DPAS	Defense Property Accountability System
DRU	Direct Reporting Unit
DTS	Defense Travel System
ECA	Environmental Corrective Action
ECR	Environmental Closure Requirements
EISP	End Item Sales Price
EOP	Executive Office of the President
EPA	Environmental Protection Agency
EPIC	Enterprise Productivity Improvement Council
ERM	Enterprise Risk Management
ESC	Executive Steering Committee
FAR	Federal Acquisition Regulations
FASAB	Federal Accounting Standards Advisory Board

FBwT	Fund Balance with Treasury
FECA	Federal Employees' Compensation Act
FEGLI	Federal Employee Group Life Insurance
FEHB	Federal Employees Health Benefits
FFMIA	Federal Financial Management Improvement Act
FGE	Foreign Government Employment
FHIF	Family Housing Improvement Fund
FIABS	Financial Inventory Accounting and Billing System
FM	Financial Management
FMFIA	Federal Managers' Financial Integrity Act
FMR	Financial Management Regulation
FOA	Field Operating Agency
FY	Fiscal Year
FYE	Fiscal Year-End
G&A	General and Administrative
GAAP	Generally Accepted Accounting Principles
GAFS-R	General Accounting and Finance System-Reengineered
GAO	Government Accountability Office
GDL	Government Direct Loan
GF	General Fund
GFE	Government Furnished Equipment
GPP&E	General Property, Plant, and Equipment
GPS/INS	Global Positioning System/Inertial Navigation System
GSD	General Support Division
GUI	Graphical User Interface
HCSW	Hypersonic Conventional Strike Weapon
Hf2Te2P	Hafnium, Tellurium, and Phosphorous
I&RP	Inventory and Related Property
ICBM	Intercontinental Ballistic Missile
IPA	Independent Public Accountant
IPO	Information Protection Office
IRP	Installation Restoration Program
ISR	Intelligence, Surveillance, and Reconnaissance
IT	Information Technology
ITWAA	Integrated Tactical Warning Attack Assessment
IUS	Internal Use Software

JCS	Joint Chiefs of Staff
KSD	Key Supporting Document
LLC	Limited Liability Company
LMP	Logistic Modernization Program
Log	Logistics
LOP	Lease of Property
MAC	Moving Average Cost
MAJCOM	Major Command
MC	Munitions Constituent
MDMA	Master Development and Management Agreement
MHPI	Military Housing Privatization Initiative
MICT	Management Internal Control Toolset
MILCON	Military Construction
MILPERS	Military Personnel
MMRP	Military Munitions Response Program
MOCAS	Mechanization of Contract Administration Services
MORD	Miscellaneous Obligations/Reimbursement Document
MRAP	Mine-Resistant Ambush Protected
NDAA	National Defense Authorization Act for FY 1996
NexGen IT	Next Generation Information Technology
NHPA	National Historic Preservation Act
NMUSAF	National Museum of the United States Air Force
No.	Number
NRV	Net Realizable Value
NWRM	Nuclear Weapons-Related Materiel
O&M	Operations and Maintenance
OA	Operating Agreement
OAC	Operating Agency Code
OASD(EI&E)	Office of the Assistant Secretary of Defense (Energy, Installations, and Environment)
OCFP	Outstanding Contract Financing Payments
OEL	Other Accrued Environmental Liability
OHA	Overseas Housing Allowance
OM&S	Operating Materials and Supplies
OMB	Office of Management and Budget
OPM	Office of Personnel Management

OSD	Office of the Secretary of Defense
OWS	Oil Water Separator
P3	Public-Private Partnership
PAC	Potentially Asbestos Containing
PACAF	Pacific Air Forces
PCR	Physical Condition Report
PDR	Preliminary Design Review
PDV	Payload Delivery Vehicle
PFC	Perfluorinated compound
PFOA	Perfluorootaonic Acid
PFOS	Perfluorooctane Sulfonic Acid
PMO	Program Management Office
PNT	Position Navigation and Timing
PO	Project Owner
POM	Program Objective Memorandum
PP&E	Property, Plant, and Equipment
PPV	Public Private Venture
PRE	Primary Reporting Element
PRV	Plant Replacement Value
RACER	Remedial Action Cost Engineering and Requirements
RCRA	Resource Conservation and Recovery Act
RDT&E	Research, Development, Test, and Evaluation
R-EGI	Resilient Embedded GPS/INS
REMIS	Reliability and Maintainability Information System
RMC	Risk Management Council
RPA	Real Property Assets
SAF	Secretary of the Air Force
SAT	Senior Assessment Team
SBIR	Small Business Innovation Research
SBR	Statement of Budgetary Resources
SCNP	Statement of Changes in Net Position
SDP	Savings Deposit Program
SDPE	Strategic Development Planning and Experimentation
SFFAS	Statement of Federal Financial Accounting Standards
SMAG-R	Supply Management Activity Group - Retail
SMC	Senior Management Council

SMS	Sustainment Management System
SNC	Statement of Net Cost
SOCOM	Special Operations Command
SOF	Special Operations Forces
SRR	System Requirements Review
STTR	Small Business Technology Transfer
sUAS	Small Unmanned Aerial Systems
TADS	Technical Assistance Database System
TFM	Treasury Financial Manual
UAV	Unmanned Aerial Vehicle
U.S. or US	United States
U.S. GAAP	United States Generally Accepted Accounting Principles
UDC	User Defined Cost
UoT	Universe of Transactions
USACE	United States Army Corps of Engineers
USAFE	United States Air Forces in Europe
USAFE-AFAFRICA	United States Air Forces in Europe - Air Forces Africa
USAFRICOM	United States Africa Command
USC	United States Code
USEUCOM	United States European Command
USSGL	United States Standard General Ledger
UST	Underground Storage Tank
USTRANSCOM	United States Transportation Command
UXO	Unexploded Ordnance
VSIL	Virtual Systems Integration Lab
WCF	Working Capital Fund
WMM	Waste Military Munitions
WRM	War Reserve Materiel
WSS	Weapon System Sustainment

BACK COVER CREDIT

The 143d Airlift Wing welcomes home more than 100 Airmen from their recent deployment in support of Operation Freedom's Sentinel, July 4, 2019 at Quonset Air National Guard Base, North Kingstown, Rhode Island. The Airmen returning include personnel from a cross-section of aviation operations, aircraft maintenance and support specialties. (Photo: Air National Guard by Staff Sgt. Deirdre Salvas)

FOR MORE INFORMATION OR TO CONTACT US:

Assistant Secretary of the Air Force
for Financial Management and Comptroller
SAF/FMFA (Financial Reporting)

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