FLY

FIGHT

WIN

Department of the Air Force Fiscal Year 2018 Agency Financial Report

TABLE OF CONTENTS

Heather Wilson

"We have to plan and prepare for the high-end fight."

Message from Secretary of Air Force

The National Defense Strategy directs the services to "drive budget discipline and affordability to achieve solvency." As such the Air Force has implemented initiatives to strip away 62 years from planned acquisitions schedules. We have reduced time in the request for proposal process from 16 months to 10 months, and we have saved more than $17 billion from original contract projections. We are building tomorrow's Air Force faster and smarter as good stewards of taxpayer dollars. But we have much more work to do.

In FY 2018 the Independent Public Accounting firm of Ernst and Young performed the first full audit of Air Force financial statements. Information gleaned through this effort will be extremely valuable in our on-going efforts to improve all aspects of Air Force operations. Ernst and Young reported deficiencies in key areas involving policies and procedures, critical asset accounting procedures, financial information systems and reporting, and completeness.

The Air Force is now focused on reviewing the audit results, prioritizing changes needed and developing plans to fix problems identified. We have already identified steps that will drive efficiencies and help prioritize remediation efforts in FY 2019 across the Air Force.

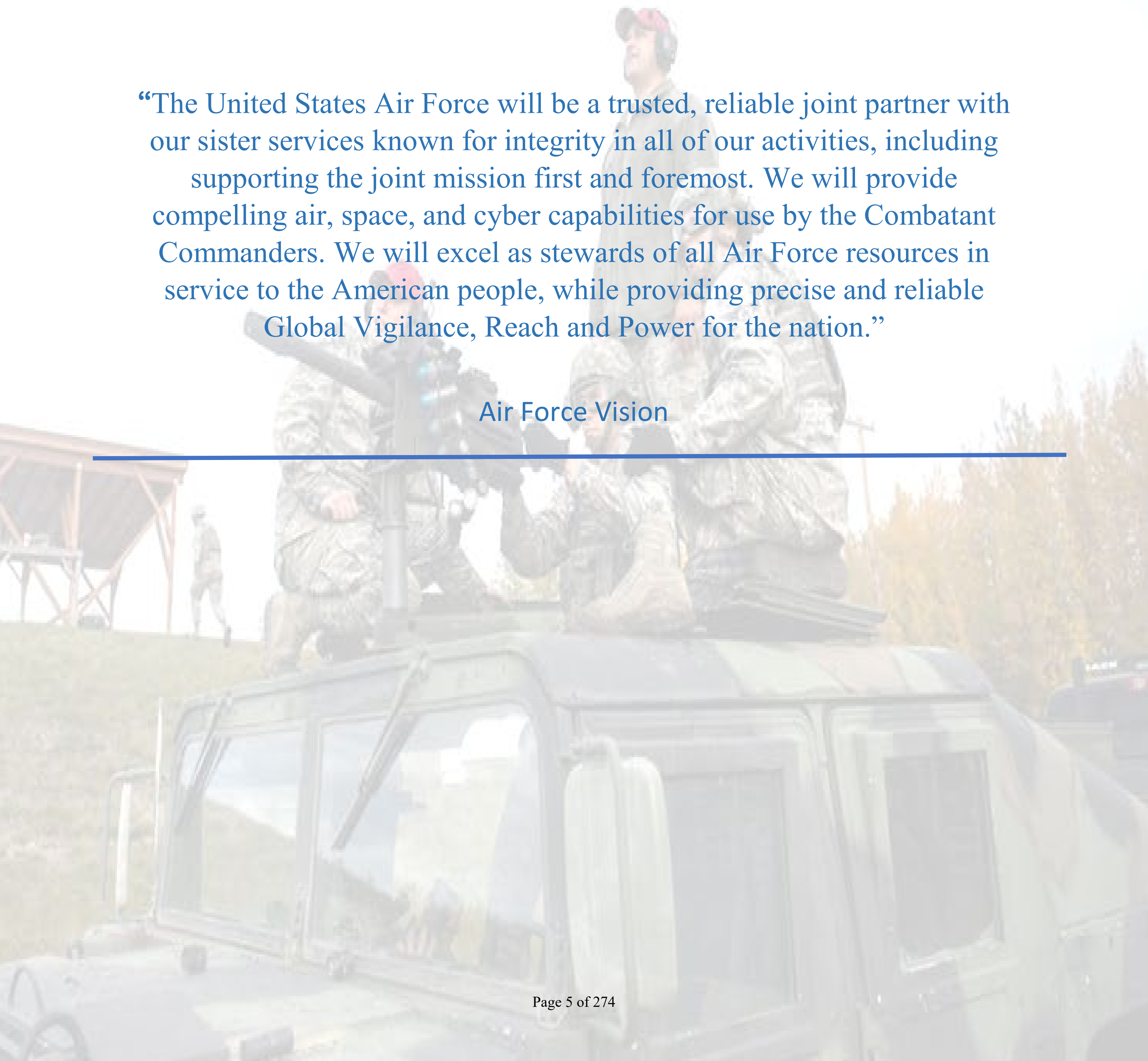
As we look back at a successful FY 2018 and look forward to FY 2019 and beyond, the Air Force will continue to commit resources, financial services, and decision support to deliver air, space, and cyber capabilities to our nation. The results from the FY 2018 audit have already helped identify opportunities for improvement. We are working on those improvements and looking forward to more in FY2019.

Heather Wilson

Heather Wilson

MANAGEMENT'S DISCUSSION AND ANALYSIS

FLY. FIGHT. WIN



"The United States Air Force will be a trusted, 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."

Air Force Vision

OVERVIEW

The U.S. Air Force (Air Force) is a military service branch organized within the Department of the Air Force, one of the three military departments of the Department of Defense (DoD). The Air Force, through the Department of the Air Force, is headed by the civilian Secretary of the Air Force, who reports to the Secretary of Defense, and is appointed by the President with Senate confirmation. The highest-ranking military officer in the Air Force is the Chief of Staff of the Air Force, who exercises supervision over Air Force units and serves as one of the Joint Chiefs of Staff. Air Force forces are assigned, as directed by the Secretary of Defense, to the combatant commanders, and neither the Secretary of the Air Force nor the Chief of Staff of the Air Force have operational command authority over them.

Along with conducting independent air and space operations, the Air Force provides air support for land and naval forces and aids in the recovery of troops in the field. Today's complex strategic environment calls for military forces that are ready to conduct a multitude of missions on short notice across the globe. As part of the joint team, America's Air Force unfailingly provides Global Vigilance, Reach, and Power across the full spectrum of operations. From humanitarian relief operations to the continuous Air Sovereignty, Space, Cyber, and Nuclear deterrence missions, the speed, precision, and versatility of the Air Force is tested and proven daily. The Air Force is a trusted and reliable joint partner with our sister services known for integrity in all our activities, including supporting the joint mission first and foremost. The Air Force provides compelling air, space, and cyber capabilities for use by the combatant commanders. We 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. The Air Force has three core competencies: **Developing Airmen**, **Technology-to-Warfighting,** and **Integrating Operations**.

The Department of the Air Force is responsible for the preparation of the air forces necessary for the effective prosecution of war and military operations short of war, and under integrated joint mobilization plans for the expansion of the peace-time component of the Air Force to meet the needs of war. Within the Department of the Air Force, the Air Force includes combat and service aviation forces.

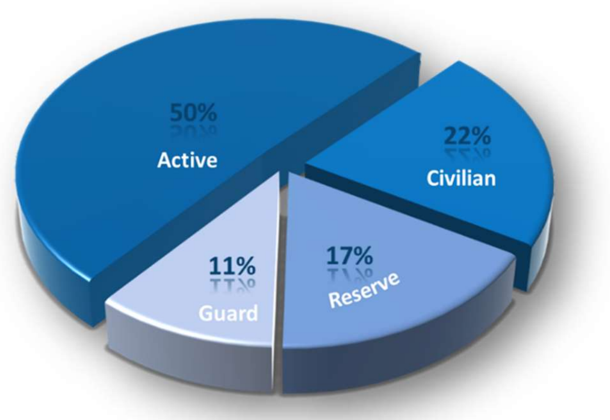
AIR FORCE RESOURCES

Places

A network of bases that reflect the Air Force's global competencies. The Air Force is a global force of Major Active-Duty Air Force Installations spanning facilities both in the United States and around the world.

People

Trained, motivated, and dedicated. The Air Force consists of over 739,052 military and civilian personnel. Aerospace power is a proven necessity for victory on land, sea, air, space, and cyberspace. The foundation for this is our people. The reserve component (Air Force Reserve and Air National Guard) has become more important than ever in sustaining worldwide operations. These warriors make possible the successful accomplishment of Air Force missions.



Caption 1: Vital resources to successful accomplishment of the Air Force mission.

The Air Force has approximately 14,000 pilots, over 3,000 navigators and about 1,500 air battle managers in the grade of lieutenant Colonel and below. The Service has over 25,000 nonrated line officers in the grade of Lieutenant Colonel and below. There are over 62,000 women serving in the Active Air Force. The Service has approximately 700 female pilots, 60 navigators, and 200 air battle managers.

Major Bases

The Air Force is a global force with facilities in the United States and around the world. The Service has 65 major bases in the continental United States and another 14 major bases outside the continental United States.

Aircraft

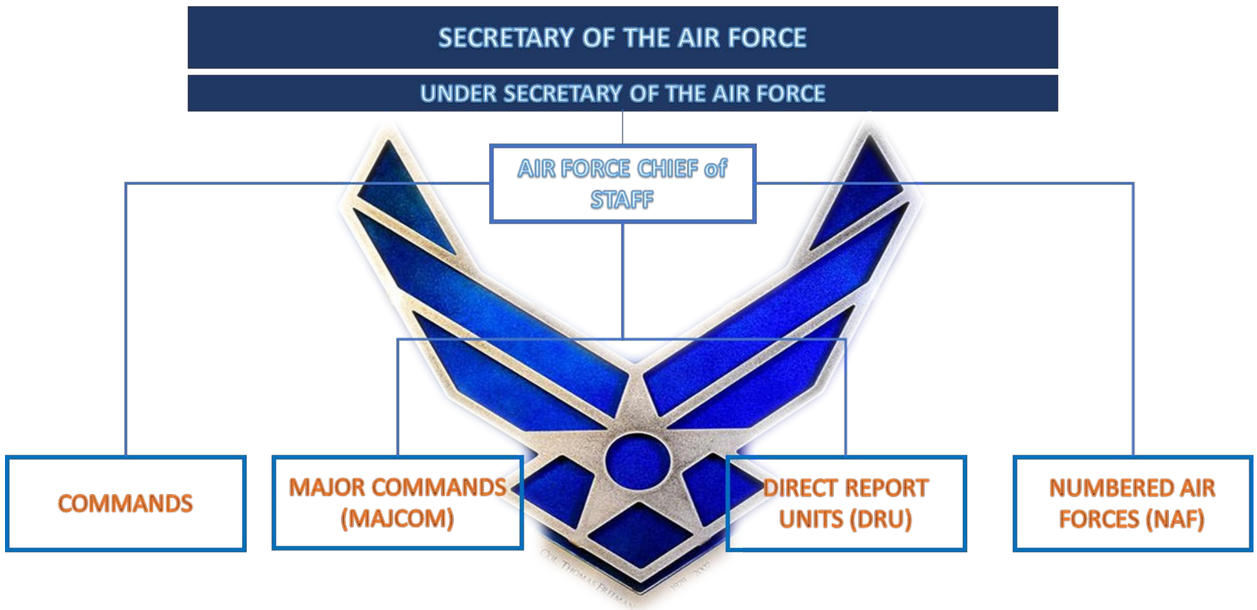
The Air Force has over 5,000 aircraft. Flying the most technologically advanced aircraft in the world helps us maintain air superiority, provide global mobility, and gives us precision strike capability.

Systems

Modern weapons platforms that integrate air, space, and cyber assets into an undefeatable force. Air Force “systems” no longer mean only “manned aircraft.” Systems also include space launch vehicles, satellites, intelligence, surveillance and reconnaissance assets, unmanned aerial systems, and the cohesive infrastructure to all Air Force systems. All Air Force systems are essential assets for the Service people to accomplish the mission.

Founded 18 September 1947

Title 10 U.S. Code Section 8075



Caption 2: Air Force Organizational Structure

ORGANIZATION AND MISSION

Air Force Management

The Department of the Air Force incorporates all elements of the U.S. Air Force. It is administered by a civilian secretary appointed by the President and is supervised by a military Chief of Staff. The Secretariat and Air Staff help the Secretary and the Chief of Staff direct the Air Force mission. To assure unit preparedness and overall effectiveness of the Air Force, the Secretary of the Air Force 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 or the Secretary of Defense. The Secretary of the Air Force exercises authority through civilian assistants and the Chief of Staff but retains immediate supervision of activities that involve vital relationships with Congress, the Secretary of Defense, other governmental officials and the public. Principal civilian assistants within the Secretariat are the assistant secretary for acquisition, Assistant Secretary for Manpower and Reserve affairs, Assistant Secretary for Installations, Environment and Logistics, and Assistant Secretary for Financial Management and Comptroller. The Office of the Secretary of the Air Force includes a General Counsel, Auditor General, Inspector General, Administrative Assistant, Public Affairs Director, Legislative Liaison Director, Small Business Director, Warfighting Integration and Chief Information Officer, and certain statutory boards and committees.

The Air Staff

The Chief of Staff, U.S. Air Force, is appointed by the president, with the consent of the Senate, from among Air Force General Officers - normally for a four-year term. The Chief of Staff (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, the National Security Council and the Secretary of Defense. Also, the Chief is the principal adviser to the Secretary of the Air Force on Air Force activities. The Chief of Staff presides over the Air Staff, transmits Air Staff plans and recommendations to the Secretary of the Air Force and acts as the Secretary's agent in carrying them out. the Chief is responsible for the efficiency of the Air Force and the preparation of its forces for military operations. The Chief of Staff supervises the administration of Air Force personnel assigned to unified organizations and unified and specified commands. Also, the Chief supervises support of these forces assigned by the Air Force as directed by the Secretary of Defense. In addition, the Chief of Staff has responsibility for activities assigned to the Air Force by the Secretary of Defense.

Other members of the Air Staff are the Vice Chief of Staff, Assistant Vice Chief of Staff, Chief Master Sergeant of the Air Force, Deputy Chief of Staff for Manpower and Personnel, Deputy Chief of Staff for Intelligence, Surveillance and Reconnaissance, Deputy Chief of Staff for Operations, Plans and Requirements, Deputy Chief of Staff for Logistics, Installations and Mission Support, Deputy Chief of Staff for Strategic Plans and Programs, Assistant Chief of Staff for Strategic Deterrence and Nuclear Integration, Chief of Safety, Director of Analyses, Assessments and Lessons Learned, Judge Advocate General, Director of Test and Evaluation, Surgeon General, Air Force Historian, Chief Scientist, Chief of the Air Force Reserve, Chief of the National Guard Bureau, and Chief of Chaplain Service.

Field Organizations

The ten major commands, field operating agencies, direct reporting units and their subordinate elements constitute the field organization that carries out the Air Force mission. In addition, there are two Reserve components, the Air Force Reserve, which is also a major command, and the Air National Guard.

The basic unit for generating and employing combat capability is the wing, which has always been the Air Forces 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.

Field operating agencies carry out field activities under the operational control of a Headquarters U.S. Air Force functional manager. Direct reporting units are not under the operational control of a Headquarters U.S. Air Force functional manager because of a unique mission, legal requirements or other factors. Field operating agencies and direct reporting units are other Air Force subdivisions and report directly to Headquarters U.S. Air Force. They are assigned a specialized mission that is restricted in scope when compared to the mission of a major command.

Major Command Structure

Major commands are organized on a functional basis in the United States and a geographic basis overseas. They accomplish designated phases of Air Force worldwide activities. Also, they organize, administer, equip and train their subordinate elements for the accomplishment of assigned missions. Major commands generally are assigned specific responsibilities based on functions. In descending order of command, elements of major commands include numbered air forces, wings, groups, squadrons, and flights.

Most units of the Air Force are assigned to a specific major command (MAJCOM), led by a General Officer. MAJCOMs have extensive functional responsibilities as shown on the following pages. They may be subdivided into Numbered Air Forces

(NAF) with each responsible for one or more wings or independent groups. Wings are the primary units of the working Air Force and are responsible for maintaining an Air Force base or carrying out a specific mission. Wings may be commanded by a General Officer or a Colonel. A wing may have several squadrons in more than one dependent group. Wings typically contain an operations group, a maintenance group, a mission support group and a medical group.

Many individual Officers and Airmen are assigned to a squadron, which may be composed of several flights. Additionally, there are other types of organizations in the Air Force structure such as centers, field operating agencies and direct reporting units.

Major Commands

Air Combat Command (ACC)

Mission: ACC is the primary provider of combat forces to America's warfighting commanders.

Responsibilities: To support global implementation of national security strategy, ACC operates fighter, bomber, reconnaissance, battle-management, and electronic-combat aircraft. It also provides command, control, communications and intelligence systems, and conducts global information operations. As a force provider and Combat Air Forces lead agent, ACC organizes, trains, equips and maintains combat-ready forces for rapid deployment and employment while ensuring strategic air defense forces are ready to meet the challenges of peacetime air sovereignty and wartime air defense. Additionally, ACC develops strategy, doctrine, concepts, tactics, and procedures for air and space-power employment. The command provides conventional and information warfare forces to all unified commands to ensure air, space and information superiority for warfighters and national decision-makers. The Command also has responsibility for inland search and rescue operations in the 48 contiguous states. ACC numbered air forces provide the air component to the Central, Southern, and Northern Combatant Commands. ACC also augments forces to the European, Pacific, and Strategic Combatant Commands.

Air Education and Training Command (AETC)

Mission: Recruit, train and educate Airmen to deliver airpower for America.

Responsibilities: As the Air Force core function lead for education and training, AETC ensures all Airmen learn the skills necessary to excel in their profession in any environment. The command provides Airmen a foundation of professionalism, a deep understanding of Integrity, Service, and Excellence, and the ability to apply these values every day. They produce men and women who embody professional competence, have the desire and tools to take care of their fellow Airmen, and possess the character to overcome any obstacle. AETC's role makes it the first command to touch the life of every Airman.

Air Force Global Strike Command (AFGSC)

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

Responsibilities: 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 B-21 program, and operational and maintenance support to organizations within the nuclear enterprise.

Air Force Materiel Command (AFMC)

Mission: Deliver and support agile war-winning capabilities.

Responsibilities: 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 United States remains the world's most respected Air and Space Force.

Air Force Reserve Command (AFRC)

Mission: To provide combat ready forces to fly, fight, and win.

Responsibilities: The AFRC augments the active component. The AFRC is extremely cost effective, providing approximately 14 percent of the total force for about 6 percent of the manpower budget and retains valuable military expertise and mission continuity on a ready-now, but called-up as needed basis. Reservists support nuclear deterrence operations, air, space and cyberspace superiority, command and control, global integrated intelligence surveillance reconnaissance, global precision attack, special operations, rapid global mobility and personnel recovery. They also perform space operations, aircraft flight testing, aerial port operations, civil engineering, security forces, military training, communications, mobility support, transportation and service missions.

Air Force Space Command (AFSPC)

Mission: Provide resilient and affordable space and cyberspace capabilities for the Joint Force and the Nation.

Responsibilities: Organizing, equipping, training and maintaining mission-ready space and cyberspace forces and capabilities for North American Aerospace Defense Command, U.S. Strategic Command and other combatant commands world-wide. AFSPC oversees Air Force network operations to provide capabilities in cyberspace, manages a global network of satellites, and is responsible for space system development and acquisition. It executes space lift operations to launch satellites with a variety of expendable launch systems and operates to provide space capabilities in support of combatant commanders. The command provides positioning, navigation, timing, communications, missile warning, weather and intelligence warfighting support. AFSPC operates sensors that provide direct attack warning and assessment to U.S. Strategic Command and North American Aerospace Defense Command.

Air Mobility Command (AMC)

Mission: Provide global air mobility ... right effects, right place, right time.

Responsibilities: AMC Airmen, which include active duty, Air National Guard, Air Force Reserve and civilians provide airlift and aerial refueling for all of America's armed forces. They also provide aeromedical evacuation and Global Reach laydown. The command has many special duty and operational support aircraft and plays a crucial role in providing humanitarian support at home and around the world.

Air National Guard (ANG)

Mission: 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 United States.

Federal Mission: Maintain well-trained, well-equipped units available for prompt mobilization during war and provide assistance during national emergencies, such as natural disasters or civil disturbances. During peace, the combat-ready units and support units are assigned to Air Force major commands to carry out missions compatible with training, mobilization readiness, humanitarian, and contingency operations. ANG provides almost half of the Air Force's tactical airlift support, combat communications functions, aeromedical evacuation, and aerial refueling. In addition, ANG has total responsibility for air defense of the entire United States.

State Mission: When ANG units are not mobilized or under federal control, they report to the governor of their respective state, territory or the commanding general of the District of Columbia National Guard. Under state law, ANG provides protection of life and property, and preserves peace, order and public safety through emergency relief support during natural disasters, search and rescue operations, support to civil defense authorities, maintenance of vital public services, and counterdrug operations.

Responsibilities: The Air National Guard provides tactical airlift, air refueling tankers, general purpose fighters, rescue and recovery capabilities, tactical air support, weather flights, strategic airlift, special operations capabilities, and aeromedical evacuation units. The ANG also provides support units, which are essential to the Air Force mission including air traffic control units, combat communications squadrons, civil engineering, communications flights and squadrons, weather flights, aircraft control and warning squadrons, a range control squadron, and an electronic security unit.

Pacific Air Forces (PACAF)

Mission: To deliver rapid and precise air, space and cyberspace capabilities to protect and defend the United States, its territories and our allies and partners; provide integrated air and missile warning and defense; promote interoperability throughout the Pacific area of responsibility; maintain strategic access and freedom of movement across all domains; and posture to respond across the full spectrum of military contingencies in order to maintain regional security.

Responsibilities: PACAF's area of responsibility is home to 60 percent of the world's population in 36 nations spread across 53 percent of the Earth's surface and 16 time zones, with more than 1,000 languages spoken. The unique location of the Strategic Triangle (Hawaii-Guam-Alaska) gives our nation persistent presence and options to project U.S. airpower from sovereign territory.

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

Mission: As the air component for both U.S. European Command (USEUCOM), and U.S. Africa Command (Air Force AFRICOM), Air Force-AFAFRICA executes the Air Force, USEUCOM, and US AFRICOM missions with forward-based airpower and infrastructure to conduct and enable theater and global operations.

Responsibilities: As the air component for both U.S. European Command, and U.S. Africa Command, Air Force directs air operations in a theater spanning three continents, covering more than 19 million square miles, containing 104 independent states, and possessing more than a quarter of the world's population and more than a quarter of the world's Gross Domestic Product.

Air Force Special Operations Command (AFSOC)

Mission: Provide our nation’s specialized airpower, capable across the spectrum of conflict … Any Place, Any Time, Anywhere.

Responsibilities: AFSOC provides Air Force special operations forces for worldwide deployment and assignment to regional unified commands. The Command's personnel are composed of highly trained, rapidly deployable Airmen, conducting global special operations missions ranging from precision application of firepower to infiltration, exfiltration, resupply and refueling of special operation elements. The command's core missions include battlefield air operations, agile combat support, aviation foreign internal defense, information operations/military support operations, precision strike, specialized air mobility; command and control; and intelligence, surveillance and reconnaissance. AFSOCs unique capabilities include airborne radio and television broadcast for psychological operations, as well as aviation foreign internal defense instructors to provide other governments military expertise for their internal development. The command's special tactics squadrons combine combat controllers, tactical air control party members, special operations weathermen and para-rescue-men with other service special operators to form versatile joint special operations teams.

Civil Air Patrol (CAP)

Mission: Support America’s communities with emergency response aerospace education, and cadet programs.

Responsibilities: CAP conducts nearly 90 percent of the inland search and rescue missions authorized by the Air Force Rescue Coordination Center. CAP flies a wide range of other operations daily, including aerial reconnaissance missions for the Drug Enforcement Administration, supporting counterdrug operations. They also execute serial target missions to maintain combat readiness of the air defense assets, conduct special-use airspace surveys and fly orientation flights for ROTC cadets.

Field Operating Agency (FOA)

A FOA is a subdivision of the Air Force that carries out field activities under the operational control of a Headquarters U.S. Air Force functional manager. FOAs perform field activities beyond the scope of any of the MAJCOMs. Examples of FOAs include the Air Force Audit Agency, the Air Force Civil Engineer Center, the Air Force Financial Services Center, the Air Force Services Agency, and the Air Force Weather Agency.

Core Missions

The United States now faces a more competitive and dangerous international security environment than we have seen in generations. Great power competition has reemerged as the central challenge to U.S. prosperity and security. China is rapidly modernizing its military and seeks regional preeminence. Russia aims to restore its national prestige and has shown its willingness to use military force and coercion in Europe and the Middle East. North Korea uses the threat of nuclear weapons to secure the survival of the regime. Iran has been a source of instability in the Middle East through the sponsorship of terrorism and exploitation of internal conflict in the region. Violent extremist organizations rooted in the Middle East, North Africa, and South Asia create instability and threaten the U.S. homeland and our allies and partners.

With global trends and intensifying pressure from major challengers, our relative advantage in air and space is eroding in several critical areas. The projected mismatch between demand and available resources has widened. Any American weakness emboldens competitors to subvert the rules-based international order and challenge the alliance and partnership network that underpins it.

In accordance with the National Defense Strategy, the 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 this environment, brought to bear by Airmen steeped in the business of joint and combined warfare.

Air and space power is indispensable to every joint force operation. The Air Force's first responsibility is to integrate air and space capabilities across the domains—delivering unmatched global advantage as an equal member of the joint team. We must be ready to design and lead joint and combined operations in support of national objectives. We have five core missions:

AIR AND SPACE SUPERIORITY … freedom from attack and freedom to attack: Air and space superiority gives our military and coalition forces the freedom to operate.

Caption 3: The Red Flag 14-1 cyber protection team works to find and thwart potential space, cyberspace, and missile threats against U.S.

Accelerating the campaign to defeat the Islamic State in Iraq and Syria (ISIS), Airmen conducted more than 172,000 sorties and 98,000 precision air strikes last year—over 70% of the total in the campaign—to support Iraqi and partner forces in Syria and Iraq. In the North Atlantic Treaty Organization (NATO)-led mission in Afghanistan, the Air Force executed a sustained air interdiction campaign of over 4,000 sorties to support Afghan partners, targeting Taliban so called safe zones, command and control nodes, illicit revenue-generating ventures, and logistical networks.

Cyberspace is critical to joint and Air Force operations. The use of cyberspace ensures the Air Force has a warfighting advantage in the 21st century. Through cyberspace operations, the Air Force finds and uses the best tools, skills, and capabilities to ensure the ability to fly, fight, and win in cyberspace. Cyberspace professionals such as cyber operators, intelligence professionals, acquisitions personnel, and aviators ensure the Air Force and joint force ability to conduct operations in, through and from cyberspace. The Air Force is moving forward with its cyber squadron initiative to beef up cyber forces to protect weapons systems from intrusions, starting with converting IT workers at seven bases to cyber operators by the end of 2018.

Space lift operations at the East and West Coast launch bases provide services, facilities and range safety control for the conduct of DOD, National Aeronautics and Space Administration (NASA) and commercial launches. Through the command and control of all DOD satellites, satellite operators provide force-multiplying effects -- continuous global coverage, low vulnerability and autonomous operations. Satellites provide essential in-theater secure communications, weather and navigational data for ground, air and fleet operations and threat warning. Ground-based radar, Space-Based Infrared System, and Defense Support Program satellites monitor ballistic missile launches around the world to guard against a surprise missile attack on North America. Space surveillance radars provide vital information on the location of satellites and space debris for the nation and the world. Maintaining space superiority is an emerging capability required to protect U.S. space assets.

Intelligence, Surveillance, and Reconnaissance (ISR) … global eyes and ears on adversaries: The Air Force has embraced globally integrated ISR as one of its featured calling cards. ISR is the foundation upon which every joint, interagency, and coalition operation achieves success. Our ISR Airmen identify and assess adversary targets and tactics with greater accuracy and speed than ever seen in the history of warfare.

Last year, the Air Force was tasked with nearly 25,000 ISR missions, collected 340,000 hours of full motion video, and produced 2.55 million intelligence products, which averages almost 5 products every minute that close intelligence gaps and support target analysis and development. Persistent ISR closely tied to precision weapons from the ground and air has been a linchpin element in the destruction of ISIS.

Caption 4: Col. Brandon Baker, the Director of Intelligence, Surveillance and Reconnaissance Capabilities, answers questions from the media after the release of the Small Unmanned Aircraft System Flight Plan.

Caption 5: Senior Airman Eric Pashnick inspects an engine on a C-17 Globemaster III aircraft. The primary mission of the C-17 is to provide rapid strategic delivery of troops and various types of cargo to bases throughout U.S. Central Command.

Rapid Global Mobility… delivery on demand: American power can be projected quickly anywhere on the earth because of the Air Force's ability to fly air refueling tankers and cargo planes globally on short notice. It provides swift deployment, in-flight refueling, and the capability to sustain operations from major combat to humanitarian relief. Rapid global mobility is woven into our history from the Berlin airlift to today.

Airlift provides the capability to deploy U.S. armed forces anywhere in the world within hours and help sustain them in a conflict. Air Mobility Command also supports presidential and senior leader airlift. Air Refuelers are the backbone of global reach, increasing coalition and U.S. aircraft's range mid-air.

Aeromedical evacuation ensures the wounded warriors get the care they deserve and have sustained the survival rate of 97 percent. In addition to enabling the force to respond to an enemy attack and sustain operations, rapid

Global Strike… any target, any time: Global strike means that the nation can project military power more rapidly, with greater flexibility, and with a lighter footprint than other military options. Airmen maintain the continuous alert of our missile forces. Last year, Airmen conducted 16,425 intercontinental ballistic missile alert tours and 248 missile convoys across 3 missile wings and 5 states. Our bombers flew 580 missions in the Indo-Pacific, strengthening security and stability in the region and reassuring our partners. Reinforcing NATO's eastern flank, American bombers flew 70 assurance and deterrence missions.

The Air Force's nuclear and conventional precision-strike forces can credibly threaten and effectively conduct global strike by holding any target on the planet at risk and, if necessary, disable or destroy it. Whether from forward bases or enabled by in-flight refueling, global strike derives from a wide range of systems that include bombers, missiles, special operations platforms, fighters, and other Air Force aircraft. This capability, unmatched by any other nation or service, will grow in importance as America rebalances its force structure and faces potential adversaries who are modernizing their militaries. The Air Force will focus future efforts on updating global strike assets to ensure that

global mobility brings humanitarian supplies and assistance to those in need who may live in austere locations.

Our tanker force extended joint power projection at intercontinental distances by passing more than 1 billion pounds of fuel in-flight, which could fill the Rose Bowl to the top.

Caption 6: An F-15E Strike Eagle fires flares during a flight in support of Operation Inherent Resolve June 21, 2017.

American forces are prepared to act when, where, and how they are needed.

America's alert intercontinental ballistic missiles (ICBMs) play a critical role in maintaining global stability and ensuring the nation's safety and security. As the nation's "silent sentinels," ICBMs and the Airmen who operate them, have remained on continuous, around-the-clock alert since 1959.

Command and Control… right info, right person, right time: The Air Force's other four interdependent core missions are enabled by 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. The delivery of airpower is intimately dependent upon operating effectively in cyberspace, which can increase the efficiency and effectiveness of air and space operations and help integrate capabilities across all domains. Adversaries are also making advances by linking their own combat capabilities electronically, creating military challenges that our forces must be prepared to address. The Air Force will field advanced command and control systems that are reliable, resilient, and interoperable, while recruiting and training innovative Airmen to operate them. Last year, our E4-B National Airborne Operations Center—the survivable mobile command center—conducted 53 alert tours and provided travel support to the Secretary of Defense. Our E-8C Joint Surveillance Target Attack Radar System flew over 5,000 hours, enabling a range of support for Combatant Commanders from command and control in the ISIS campaign to the interdiction of over 12,500 kilograms of illicit drugs before they entered our Nation's borders. The E-3 Airborne Warning and Control System was integral to coordinating search and rescue efforts during the 2017 hurricane season.

Caption 7: Two combat controllers with the 321st Special Tactics Squadron observe an A-10 Thunderbolt II landing on Jägala-Käravete Highway, August 10, 2017.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

Secretary of the Air Force, Dr. Heather Wilson, has outlined five initiatives to improve the Air Force:

- Restore Readiness
- Cost-Effective Modernization
- Drive Innovation
- Develop Exceptional Leadership
- Strengthen our Allies

The Air Force has greatly increased our readiness during the last year. Today more than 75 percent of the Air Force's core fighting units are combat ready with their lead forces packages. The service's goal is for 80 percent of those units to have the appropriate number of properly trained and equipped Airmen by the end of 2020, 6 years faster than projected when the Air Force developed a recovery plan. In FY 2018, Congress provided funding to allow the Air Force to address a severe shortage of maintainers. In September 2016, the Air Force was short 4,000 active duty maintainers, but by December 2018 that number is expected to be zero.

In addition to maintainers, the Air Force has placed an emphasis on addressing the national aircrew shortage, first by addressing quality of service and quality of life issues, and by increasing financial incentives and providing more control over assignments and career paths. The Air Force is increasing the number of pilots it trains from 1,160 a year in FY 2017 to 1,311 in FY 2019, building to 1,500 by FY 2022 and beyond.

As part of the readiness recovery, the Air Force is focused on providing relevant and realistic training to maintain an advantage over increasingly capable adversaries. We are improving secure simulators, threat emulators, and training ranges to enhance realism and enable our Airmen to train locally for a high-end, multi-domain fight.

The acquisition system the Air Force inherited from the Cold War era is too slow for the digital age. We are improving the way we purchase weapon systems to field tomorrow's Air Force faster and smarter. We set an aggressive goal of stripping 100 years of unnecessary schedule from our program plans. In six months, we have saved 56 years. Three contributing factors are making us faster: Prototyping, the use of tailored acquisition strategies, and agile software development.

We are committed to acquisition competition as well. The Air Force made major announcements on three critical programs: The Global Positioning Satellite IIIF, the UH-1N helicopter replacement, and the T-X jet trainer. Each of these programs gets the most out of competition through stable requirements, a mature technology base, and transparency with industry. In just these three programs alone, the Air Force saved the taxpayer over $13 billion from the independent cost estimates we used to plan the programs.

We are also seeking to become a leader in federal government procurement with small businesses and start-ups by pairing a government credit card swipe with a one-page Other Transaction Agreement. Pairing these mechanisms gives the Air Force a small dollar contracting mechanism that can "pay in a day." To test it, we are conducting a small business and start up day.

We are committed to developing exceptional leaders. Air Force leaders will be values-driven, mission-focused and people-oriented. We are pushing authorities down to the lowest appropriate level. The service will provide training opportunities and increase the number of Reserve Officer Training (ROTC) scholarships in Science, Technology, Engineering, and Mathematics (STEM) programs. We will develop strong leaders, particularly at the squadron level and cultivate relationships to lead the world's most powerful Air Force.

Mutually beneficial alliances and partnerships are crucial to our strategy. In July 2018, the Air Force established the Combined Space Operations Center. It is designed to improve coordination between the U.S., its allies, and commercial and civil partners for defensive space efforts. It will enhance individual and collective space capabilities in order to expand the overall multi-domain military effectiveness. By working together with allies and partners we assemble the greatest possible strength for the long-term advancement of American interests, maintaining favorable balances of power that deter aggression and support the stability that generates economic growth.

The Air Force We Need

At the height of the Cold War in 1987 the Air Force had about 1.1 million Total Force Airmen and 401 operational squadrons. Four years later the Air Force deployed for Operation Desert Storm with squadrons that had spent 20 years training for a high-end fight. One year after Operation Desert Storm, budget cuts forced the Air Force into its largest reorganization in its history. Squadrons were deactivated, bases closed, and major commands were consolidated. By 1996, Total Force end strength was reduced to 846,000, but Air Force combat missions continued.

A shrinking, combat-active Air Force taking on new missions with an aging manned aircraft fleet was stretched thin when the sequestration of 2013 hit. The impact was devastating. One-third of Air Force combat flying squadrons stood down for three months, large-scale exercises were cancelled, and the service lost over one million work hours of depot maintenance. Then in 2014, when dealing with the impact of sequester, ISIS, declared its caliphate and the Air Force answered the call to fight. By 2017, the Air Force was the smallest it had ever been, conducting combat operations with the oldest equipment it had ever used, and successfully employed nearly 30,000 weapons in Syria and Iraq.

The Air Force is too small for what the nation is asking us to do. We will have to grow in order to meet the demands of our multi-faceted mission. Our goal is increase the number of operational squadrons from 312 to 386.

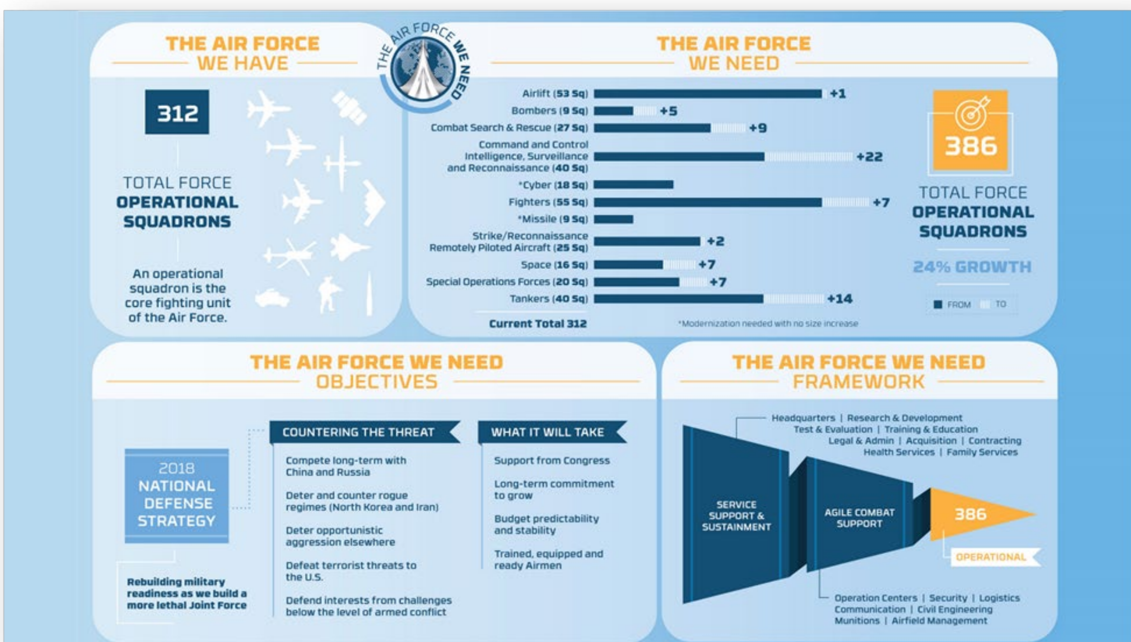


Figure 1: "The Air Force We Need" framework.

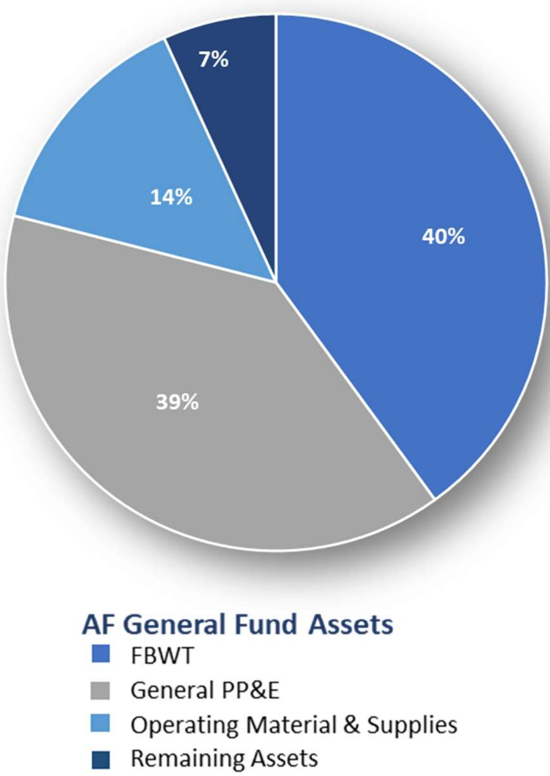
ANALYSIS OF FINANCIAL STATEMENTS

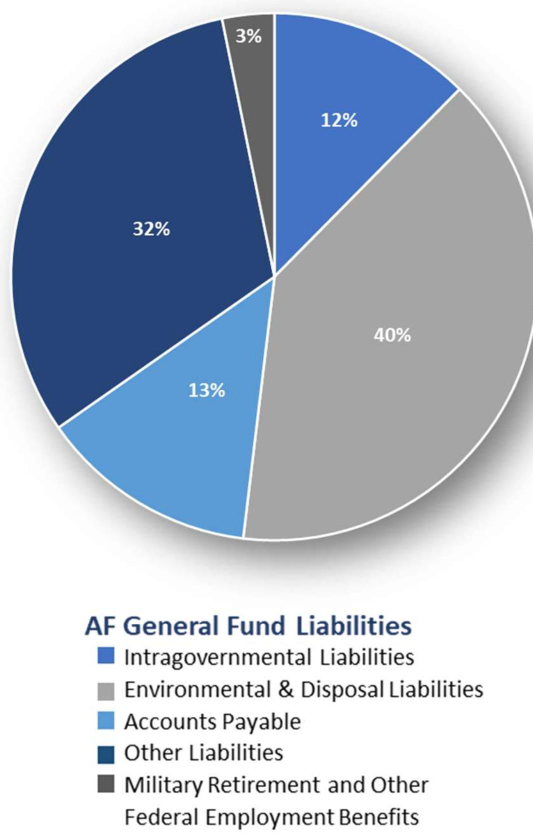
The accompanying financial statements and related disclosures represent the Air Force's enduring commitment to fiscal accountability and transparency. Through the FIAR plan and related business transformation initiatives discussed earlier, the Air Force has made significant progress toward improving the quality and timeliness of financial information. For financial reporting purposes, the Air Force is organized into two reporting entities: The Air Force General Fund (AFGF) and the Air Force Working Capital Fund (AFWCF). Each reporting entity has a separate set of financial statements and related disclosures.

Air Force General Fund Financial Results and Balance Sheet

The FY 2018 Air Force General Fund Balance Sheet includes total assets of $360 billion. Two asset categories, Fund Balance with Treasury (FBWT) and General Property, Plant and Equipment (PP&E), comprise 79 percent of total assets, with values of $144 billion and $140 billion, respectively. FBWT increased by $19 billion (15%) in fiscal year-end (FYE) 2018 compared to FYE 2017. The increase is attributable to the increase in funding from Congress during the year. General Property, Plant, and Equipment decreased by $7.7 billion (5%) in FYE 2018 compared to FYE 2017. The decrease is due to properly valuing assets in construction, exclusion of Land from the financial statements in accordance with SFFAS 50 and continued efforts to record assets using Deemed cost. Deemed cost is an amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortization assumes that the entity had initially recognized the asset or liability at the given date and that its cost was equal to the deemed cost. In addition, Operating Material & Supplies decreased by $4 billion (7%) in FYE 2018 compared to FYE 2017. The decrease is primarily attributed to continued baseline valuation efforts where assets are valued using Deemed Cost in FY 2018.

Total Liabilities primarily consist of $12 billion in Environmental Liabilities, $9.9 billion in Other Liabilities and $4 billion in non-federal Accounts Payable. Environmental Liabilities increased by $1.2 billion (11%) in FYE 2018 compared to FYE 2017. This increase is due to additional estimates of liabilities for environmental cleanup that were not previously recorded. Non-federal Accounts Payable increased by $1.1 billion (35%) at FYE 2018 compared to FYE 2017. The increase is largely the result of increases in current year obligations for contracts.





SELECT AIR FORCE GENERAL FUND ASSETS AND LIABILITIES

(Amounts in billions)

Asset Type	FY2018	FY2017	Change	Percentage of change	Percentage of FY2018 Assets
Fund Balance with Treasury	$144.1	$125.0	$19.1	15%	40%
General Property, Plant & Equipment	$140.4	$148.1	($7.7)	(5%)	39%
Operating Material & Supplies	$51.2	$55.2	($4.0)	(7%)	14%
Remaining Assets	$24.4	$22.7	$1.7	7%	7%
Total Assets	**$360.1**	**$351.0**	**$9.1**	**3%**	**100%**

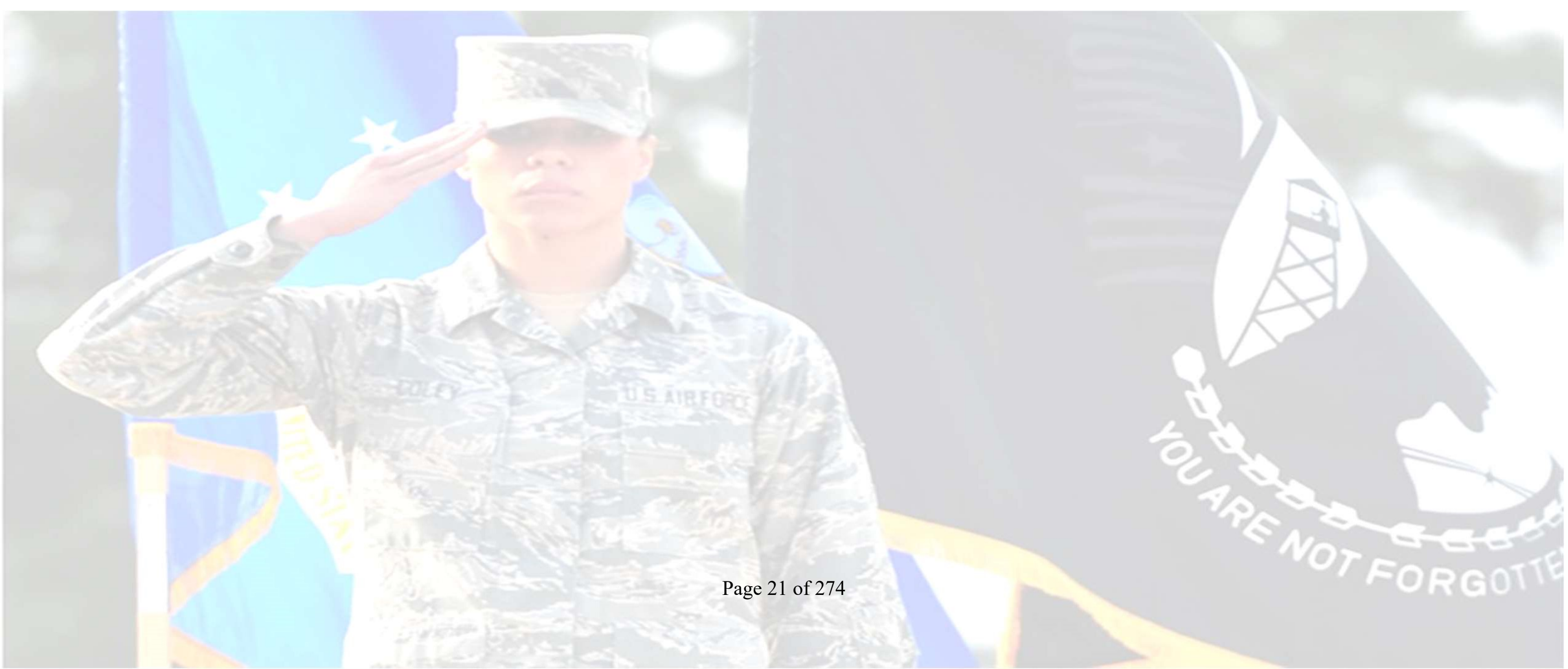
Liability Type	FY2018	FY2017	Change	Percentage of change	Percentage of FY2018 Liabilities
Intragovernmental Liabilities	$3.9	$3.2	$0.7	22%	12%
Environmental & Disposal Liabilities	$12.4	$11.2	$1.2	11%	40%
Accounts Payable	$4.2	$3.1	$1.1	35%	13%
Other Liabilities	$9.9	$10.6	($0.7)	(7%)	32%
Military Retirement and Other Federal Employment Benefits	$1.0	$1.0	($0.0)	0%	3%
Total Liabilities	**$31.4**	**$29.1**	**$2.3**	**8%**	**100%**

Air Force General Fund Results of Operations

The Combined Statement of Budgetary Resources presents total budgetary resources of $235 billion that were available to the General Fund during FY 2018. Total budgetary resources for FY 2017 were $214 billion. Total obligations incurred in FY 2018 were $193 billion compared to $181 billion for FY 2017.

Air Force General Fund Statement of Net Costs

The Consolidated Statement of Net Cost presents net cost of operations of $179 billion during FY 2018 compared to $156.2 billion for FY 2017, for an increase of approximately 15%. Net Cost of Operations represents gross costs incurred by the General Fund less earned revenue.



Air Force Working Capital Fund Financial Results

In support of Air Force core functions, the Air Force Working Capital Fund (AFWCF) activities provide maintenance services, weapon system parts, base and medical supplies. The working capital funds are integral to readiness and sustainability of our air and space assets and our ability to deploy forces around the globe and across any theater in support of Overseas Contingency Operations and National Military Strategy requirements. Maintenance depots provide the equipment, skills and repair services necessary to keep forces operating worldwide. Supply management activities procure and manage inventories of consumable and reparable spare parts required to keep all elements of the force structure mission ready. Directly or indirectly, working capital fund activities provide warfighters the key services needed to meet mission capability requirements.

The AFWCF conducts business in two primary areas: the Consolidated Sustainment Activity Group (CSAG) and the Supply Management Activity Group-Retail (SMAG-R). Air Force Materiel Command (AFMC) manages more than 90 percent of the AFWCF business activity for Supply Management and Depot Maintenance activities. These functions provide goods and services to the Air Force and DoD customers, as well as customers outside the DoD (e.g., local and foreign governments).

Consolidated Sustainment Activity Group (CSAG)

CSAG is an AFWCF business activity chartered for operation in FY 2009. The mission of CSAG is supply management of depot-level reparable and Air Force-managed consumable spares and maintenance services.

The **CSAG Maintenance Division** repairs weapon systems and spare parts to ensure readiness in peacetime and to provide sustainment for combat forces in wartime. This division operates on the funds received from its customers through sales of its services. In peacetime, the Air Force enhances readiness by efficiently and economically repairing, overhauling, and modifying aircraft, engines, missiles, components, and software to meet customer demands. The Maintenance Division's depots have unique skills and equipment required to support and overhaul both new, complex components as well as aging weapon systems. During wartime or contingencies, the depots can surge repair operations and realign capacity to support the war fighter's immediate needs.

CSAG Maintenance Division is managed by AFMC and employs nearly 26,000 personnel supporting three industrial locations:

- Ogden Air Logistics Complex
- Oklahoma City Air Logistics Complex
- Warner Robins Air Logistics Complex

The **CSAG Supply Division** is primarily responsible for Air Force-managed, depot-level reparable spares and consumable spares unique to the Air Force. Spares are an individual part, subassembly, or assembly supplied for the maintenance or repair of systems or equipment. In addition to management of these inventories, the Supply Division provides a wide range of logistics support services including requirements forecasting, item introduction, cataloging, provisioning, procurement, repair, technical support, data management, item disposal, distribution management, and transportation.

Supply Management Activity Group–Retail

The Air Force Supply Management Activity Group-Retail (SMAG-R) is comprised of three divisions: General Support, Medical-Dental, and the United States Air Force Academy.

The Air Force SMAG-R provides a wide range of logistics support services including requirements forecasting, item introduction, cataloging, provisioning, procurement, repair, technical support, data management, item disposal, distribution management, and transportation. Consumable item inventories are an integral part of SMAG-R and are maintained by each of the divisions in support of customer requirements. The SMAG-R objective is to replenish inventories and provide supplies to customers in a timely manner within customer funding constraints while maintaining fund solvency. The Air Force SMAG-R manages weapon system spare parts, medical-dental supplies and equipment, and other supply items used in non-weapon system applications.

The **General Support Division (GSD)** manages nearly 1.5 million items, which are procured from Defense Logistics Agency (DLA) and General Services Administration (GSA). GSD customers use the majority of these items to support field and depot maintenance of aircraft, ground and airborne communication, and electronic systems, as well as, other sophisticated systems and equipment. The GSD also manages many items related to installation, maintenance, and administrative functions.

The **Medical-Dental Division (MDD)** manages supplies for 74 Medical Treatment Facilities (MTF) worldwide. All supply and equipment requirements generated by Air Force MTFs are procured through this division. MDD also maintains a War Readiness Materiel (WRM) requirement. WRM provides initial war fighting capability until re-supply lines can sustain wartime demands for medical and dental supplies and equipment.

The **Air Force Academy Division** finances the purchase of uniforms and uniform accessories for sale to cadets in accordance with regulations of the Air Force Academy and related statutes. The customer base consists of approximately 4,000 cadets who receive distinctive uniforms procured from various manufacturing contractors.

Air Force Working Capital Fund Customers

AFWCF provides support to a variety of customers: Air Force Major Commands (including the Air National Guard & Air Force Reserves), the Army, the Navy, other WCFs, other government agencies and foreign countries.

Cash Management

Overall AFWCF cash is primarily impacted from operations, direct appropriations and cash transfers in/out of the fund. The AFWCF receives a direct appropriation for Medical-Dental War Readiness Material. The following table depicts a comparative analysis between fiscal year-end (FYE) 2018 compared to FYE 2017.

Comparative Cash Balance *(Amounts in Millions)*	**FY2018**	**FY2017**
Beginning Cash	**$1,862.7**	**$1,424.3**
Collections	$16,110.1	$16,686.7
Disbursements	($16,534.4)	($16,312.3)
Appropriations Received	$66.5	$64.0
Transfers In	$-	$-
Transfers Out	($59.0)	$-
Annual Change in Cash	**($416.8)**	**$438.4**
Ending Cash Balance	**$1,445.9**	**$1,862.7**

Air Force Working Capital Fund Balance Sheet

The significant asset line items to the AFWCF include Fund Balance with Treasury (FBWT), Inventory and Related Property, and General Property, Plant, and Equipment. The significant liability line items to the AFWCF include Accounts Payable, and Other Liabilities (non-federal) which primarily includes payroll, benefits, accrued annual leave, and advances.

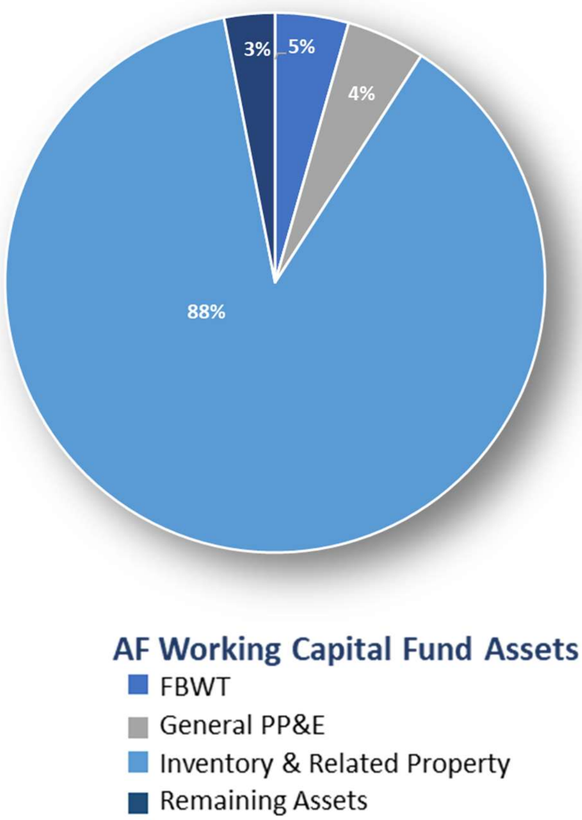
FBWT on the balance sheet decreased $416.8 million (22%) at FYE 2018 compared to FYE 2017. This decrease is primarily due to the result of a $371.1 million (planned) operational loss, before inventory adjustment, coupled with a $59.0 million cash transfer to the Air Force General Fund under the FY 2018 reprogramming action. Both FBWT impacts were within the Supply Division of the Consolidated Sustainment Activity Group.

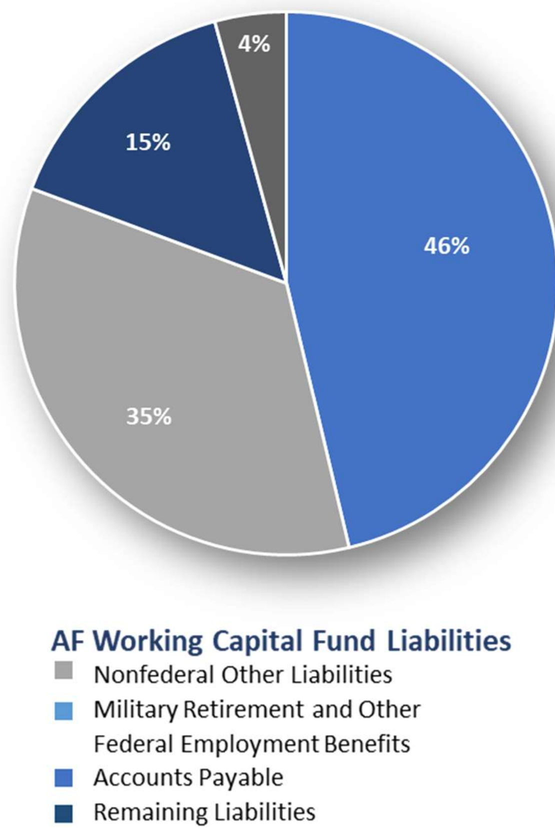
Inventory and Related Property increased $5.6 billion (24%) at FYE 2018 compared to FYE 2017. This increase is primarily attributed to an inventory reconciliation between the logistic and financial systems, and the correction of duplicate inventory transactions.

General Property, Plant, and Equipment remained stable with a mere $17.7 million decrease (1%) at FYE 2018 compared to FYE 2017.

Overall Accounts Payable was relatively stable with a minimal decrease of $11.5 million (2%) at FYE 2018 compared to FYE 2017. Accounts Payable (Intragovernmental), decreased $70.3 million (32%), however, in contrast, the Non-federal Accounts Payable increased $58.8 million (15%).

Non-federal Other Liabilities increased $46.1 million (11%) at FYE 2018 compared to FYE 2017. The variance is largely the result of a $22.4 million increase in Advances, coupled with a $19.8 million increase in Accrued Funded Payroll and Benefits.





Air Force Working Capital Fund Results of Operations

The Combined Statement of Budgetary Resources presents total budgetary resources of $19 billion that were available to the Working Capital Fund during FY 2018. Total budgetary resources for FY 2017 were $18 billion. Total obligations incurred in FY 2018 were $18 billion compared to $17 billion for FY 2017.

Air Force Working Capital Fund Statement of Net Costs

The Consolidated Statement of Net Cost presents net cost of operations of ($4.8) billion during FY 2018 compared to ($211) million for FY 2017, for an increase of approximately 2,183%.

SELECT AIR FORCE WORKING CAPITAL FUND ASSETS AND LIABILITIES

(Amounts in millions)

Asset Type	FY2018	FY2017	Change	Percentage of change	Percentage of FY2018 Assets
Fund Balance with Treasury	$1,445.9	$1,862.7	($416.8)	(22%)	4%
General Plant, Property & Equipment	$1,549.9	$1,567.6	($17.7)	(1)%	5%
Inventory & Related Property	$28,890.1	$23,311.1	$5,579.0	24%	88%
Remaining Assets	$999.8	$1,058.8	($59.0)	(6%)	3%
Total Assets	**$32,885.7**	**$27,800.2**	**$5,085.5**	**18%**	**100%**

Liability Type *(in millions)*	FY2018	FY2017	Change	Percentage of change	Percentage of FY2018 Liabilities
Accounts Payable	$605.9	$617.4	($11.5)	(2%)	46%
Nonfederal Other Liabilities	$449.9	$403.8	$46.1	11%	35%
Military Retirement and Other Federal Employment Benefits	$197.3	$190.4	$6.9	4%	15%
Remaining Liabilities	$55.6	$55.1	$.5	1%	4%
Total Liabilities	**$1,308.7**	**$1,266.7**	**$42.0**	**3%**	**100%**

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

Commanders and managers throughout the Air Force must ensure the integrity of their programs and operations. Part of this responsibility entails compliance with Federal requirements for financial reporting, financial management systems, and internal controls, such as the Federal Financial Management Improvement Act (FFMIA) and the Federal Managers' Financial Integrity Act (FMFIA). These requirements promote the production of more timely, reliable, and accessible financial information. Useful financial information and effective internal controls increase accountability and transparency, thereby enhancing public confidence in our stewardship of public resources, which is critical for the protection and sustainment of our nation and vital U.S. interests.

The Air Force maintains compliance with applicable laws and regulations by means of the Managers' Internal Control Program and the Quality Assurance Program. These programs evaluate and report on the effectiveness of internal controls throughout the organization to ensure effective operations, safeguard against fraud, waste and mismanagement, and comply with laws and regulations. We implement our internal control program at all levels and endeavor to improve the efficient and effective use of resources. The Air Force's overview of internal controls over non-financial operations, financial reporting, and financial systems is described within the enclosed sections.

MANAGEMENT ASSURANCES

The objectives of the Air Force's systems of internal accounting and administrative control are to provide reasonable assurance that:

- Obligations and costs are compliant with fiscal statutory and regulatory requirements;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Applicable revenues and expenditures are properly recorded and accounted for, to permit the preparation of reliable accounting, financial, and statistical reports and to maintain accountability over assets.

The Air Force conducted its risk assessment and internal control evaluation in accordance with the Office of Management and Budget Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control and* the Green Book, General Accounting Office (GAO) 14-704G, *Standards for Internal Control in the Federal Government*. This assessment addresses the responsibilities highlighted in the 2018 National Defense Strategy. The effective management of risk with well-designed controls will help the Air Force "gain full value from every tax payer dollar spent on defense, thereby earning the trust of Congress and the American People."

Internal Control over Operations (ICO)

The Air Force Office of Inspector General administers the Management Internal Control Toolset (MICT). The field operating units perform operational risk assessments for each assessable unit by self-reporting all control testing activities completed within the last year. This includes the results of unit inspections, safety inspections, and other operations-based control reviews.

Compliance risk assessments are performed throughout the Air Force. At the base level, compliance and operational risk assessments are performed through the self-reporting function in which the MAJCOM/Wing/Squadron can report the activities undertaken to support compliance. At the Air Force-wide level, compliance risk assessments are performed on the previous year Self-Identified Deficiencies (SIDs), as some SIDs may be related to gaps in compliance that were previously identified. Both the risk assessment and control testing activities are recorded in the Managers' Internal Control Program (MICP) Module of FMSuite.

The following table describes the 11 Operational Material Weaknesses reported by the Secretary of the Air Force Financial Management.

Outstanding Material Weaknesses

FY 2018 OPERATIONAL MATERIAL WEAKNESSES			
	Weakness	**Description**	**Target Correction Year**
1	Defense Travel System Controls	A Temporary Duty Travel Management material weakness related to segregation of duties within the Defense Travel System exists.	FY 2020
2	Enterprise Information Protection Capability	Major Commands, Direct Reporting Units and installation-level commanders did not properly establish Information Protection Offices or effectively manage core Information Protection Programs.	FY 2019
3	Air Force Review Boards Agency Case Backlogs	The Air Force Review Boards Agency case backlogs have resulted in noncompliance with Congressional, Office of the secretary of Defense, and Air Force directed timelines.	FY 2019
4	Foreign Government Employment	Air Force personnel did not effectively manage the Foreign Government Employment approval process.	FY 2019
5	Defense Contract Management Agency Contracts	The Defense Contract Management Agency does not consistently reconcile and close contracts before the associated funding cancels.	FY 2020
6	Energy Meter Management	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.	FY 2019
7	Overseas Housing Allowance	Discrepancies were identified in the processing of Overseas Housing Allowance claims for military members.	FY 2019
8	Electronic Records Hygiene	Air Force personnel did not perform backup and protection of electronic records.	FY 2019
9	United States Air Forces Central Command	United States Air Forces Central Command officials did not effectively manage Area of Responsibility Communication Security assets.	FY 2019
10	Wireless Network	Air Force personnel did not effectively manage wireless network security, wireless asset accountability and physical security, and wireless network requirements.	FY 2019
11	Criminal History Data Reporting Requirements	The Air Force identified a breakdown in submitting criminal history data to the Federal Bureau of Investigation for inclusion in their criminal history database.	FY 2023

Internal Control Over Reporting (ICOR)

In FY 2018, the Air Force continued to strengthen internal control assessment methodologies to meet the requirements of OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. These methodologies include activities to prevent and detect fraudulent financial reporting and misappropriation or theft of assets.

The Air Force is committed to Financial Improvement and Audit Remediation (FIAR) and continues to execute a well-designed plan to monitor audit progress and sustain remediation efforts. Air Force leadership exhibits strong tone-at-the-top support for FIAR efforts. During FY2018, the Assistant Secretary of the Air Force, Financial Management and Comptroller established the Deficiency Remediation Tracking Program in partnership with Air Force Functional Community members, Air Force Major Commands, shared service providers, and other key stakeholders involved in the process. The program is designed to comply with relevant financial management laws, regulations, and policies and:

- Allows the Air Force to identify a comprehensive universe of financial statement-impacting deficiencies, including those self-identified through Managers' Internal Control Program testing, end-to-end business process analyses, and Federal Information System Controls Audit Manual (FISCAM) reviews, as well as those identified by the Government Accountability Office, Department of Defense Inspector General, our Independent Public Accountant, and the Air Force Audit Agency.
- Deploys a standardized methodology to prioritize deficiencies from relevant sources so Air Force officials can allocate resources to remediate the most critical deficiencies impacting Air Force financial statement audit goals.
- Establishes training, required reporting elements, and standardized CAP development methods to provide consistency across the Air Force and oversight on Corrective Action Plan progress to drive timely development, implementation, and validation.
- Implements a transparent, continuous data collection, tracking, and reporting process that uses standard templates, tools, and spreadsheets to consolidate deficiency information and accurately report Air Force Corrective Action Plan progress, including risk management and mitigation techniques, to Office of the Under Secretary of Defense (Comptroller) officials, Air Force senior leaders, and other key stakeholders.

The following table describes the 14 Reporting Material Weaknesses reported by the Secretary of the Air Force Financial Management.

Outstanding Material Weaknesses

FY 2018 REPORTING MATERIAL WEAKNESSES			
Weakness		Description	Target Correction Date
1	Intragovernmental Eliminations	The Air Force cannot always reconcile transactions/balances with other federal agencies.	FY 2022
2	Statement of Net Cost	The Air Force organizes its Statement of Net Cost by appropriation rather than by program type as required by federal accounting standards.	FY 2020
3	Reconciliation of Net Cost of Budget to Operations	The Air Force cannot always reconcile the resources obligated during the period to the costs of operations in that period.	FY 2020
4	Deficiencies in Financial Reporting	The Air Force is unable to define the universe of transactions that are interfaced from the feeder systems to the financial system.	FY 2019
5	Oversight and Monitoring	The Air Force cannot always provide supporting documentation to validate that internal controls are in place and operating effectively.	FY 2019

6	Air Force Accounting Policies and Procedures	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.	FY 2019
7	Multi-Service Contract Accounting Department of Defense Accounting Policies	The Air Force does not always allocate progress payments and recoupments on multi-service contracts correctly.	FY 2020
8	Lack of complete Universe of Transactions	The Air Force lacks a complete Universe of Transactions including central warehouse repository, transactional data files and data reconciliations for both Financial and Logistics.	FY 2020
9	Miscellaneous Obligations/Reimbursement Document	The Air Force is not following Miscellaneous Obligations/Reimbursement Document policies and lacks specificity/oversight over the usage of Miscellaneous Obligations/Reimbursement Documents.	FY 2020
10	Government Furnished Equipment	The Air Force does not have accountability of Government Furnished Equipment in the Air Force Equipment Management System, or the Air Force Accountable Property System of Record.	FY 2019
11	Operating Materials & Supplies	The Air Force does not always value Operating Materials and Supplies using historical cost method and does not always value Inventory and Related Property use the moving-average-cost method.	FY 2019
12	Contractor Inventory Control Point	The Air Force does not have accountability of Government Furnished Material in an Air Force Accountable Property System of Record.	FY 2020
13	In-Transit Inventory	The Air Force is unable to synchronize in transit inventory financial data with logistics data.	FY 2019
14	Real Property Valuations	The Air Force has not maintained Key Supporting Documents to support the acquisition cost, construction in progress and related expenses recorded in the financial statements.	FY 2021

Internal Control over Financial Systems (ICOFS)

The Air Force understands ICOFS plays a key role in the generation and auditability of the Air Force financial statements. The Air Force is implementing a strategy for identifying and prioritizing assessment of financial and mixed systems. Multiple systems are utilized to support Air Force's complete set of financial statements. After a system is identified as relevant or critical to the audit of a segment assertion package, the Air Force works with segment managers to collect additional data points that will affect the assessment scope, approach, and timeline.

Integrated Financial Management System

The Air Force lacks an integrated financial system compliant with the Federal Financial Management Improvement Act, Office of Management and Budget Circular A-123, Appendix D, and the Department of Defense Financial Management Regulation Volume 1, Chapter 3, requirements for compliance under the *Federal Managers' Financial Integrity Act of 1982*.

The design of legacy Air Force financial management and feeder systems does not allow for the collection and recording of financial information based on a full accrual accounting basis. Systems do not have necessary system security controls or comply with the United States Standard General Ledger at the transaction level. In FY2010, Assistant Secretary of the Air Force, Financial Management and

Comptroller, with the concurrence of the Air Force's Executive Steering Committee (ESC), declared a material weakness over internal controls over financial systems. For FY2016, the Air Force ESC, confirmed an internal control over financial systems material weakness existed and expanded the coverage to include corrective action timelines associated with the FY2015 Schedule of Budgetary Activity audit results and FIAR corrective actions for those systems that impact the FIAR audit remediation assertion. In FY2018 the SAT elected to separate the General Fund and Working Capital Fund ICOFS material weaknesses to account for the different expected resolution dates. While the Air Force transitions to the targeted 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.

The Air Force identified 49 applications that are in scope to be self-assessed under the Federal Information System Controls Audit Manual. Application assessments are complete for 46 of 49 applications. The internal FISCAM assessments generated 279 CAPs to remediate deficiencies, the majority are self- reported as closed this FY. CAPs for 231 have been validated as complete. The Air Force completed accounting conformance reviews of 39 applications deemed to have a significant impact on Air Force financial reporting objectives. These reviews resulted in 71 CAPs under development and identification of four entity level, non-compliant areas related to the integration of financial reporting requirements and operational business processes. Corrective actions to address entity level issues are currently in development. Audit remediation activities have allowed the Air Force to identify and correct potential critical issues surrounding key Information Technology system controls and improve the risk profile.

The table below describes the 2 Financial Systems Material Weaknesses reported by the Secretary of the Air Force Financial Management.

FY 2018 FINANCIAL SYSTEMS MATERIAL WEAKNESS			
Weakness		Description	Target Correction Date
1	Financial Systems (General Fund)	The Air Force financial systems and financial supporting systems do not substantially meet the Federal Financial Management Improvement Act, and the Department of Defense Financial Management Regulations Vol. 1, Chapter 3 requirements for compliance under Federal Managers' Financial Integrity Act of 1982.	FY 2021
2	Lack of Integrated Financial Systems (Working Capital Fund)	The Air Force Working Capital Fund financial and feeder systems do not meet 10 United States Code 2222 (Defense Business Systems: Architecture, Accountability, and Modernization) requirements.	FY 2028

The following page is the management assurance letter for FY 2018.

SECRETARY OF THE AIR FORCE
WASHINGTON

INFO MEMO

SEP 3 0 2018

FOR: SECRETARY OF DEFENSE DepSec Action ________

FROM: Heather Wilson

SUBJECT: Annual Statement of Assurance for Fiscal Year 2018

- The Air Force is responsible for managing risks and maintaining effective internal controls required to support efficient operations, provide reliable financial reports and systems, and comply with law. These requirements are set out in the Federal Managers' Financial Integrity Act of 1982.

- The Air Force conducted its risk assessment (Tab 3) and internal controls evaluation (Tab 1) in accordance with Office of Management and Budget Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* and the Green Book, General Accounting Office-14-704G, *Standards for Internal Control in the Federal Government*. This assessment addresses the responsibilities highlighted in the 2018 National Defense Strategy, that the effective management of risk with well-designed internal controls will help the Air Force "gain full value from every taxpayer dollar spent on defense, thereby earning the trust of Congress and the American people."

- Based on the results of the assessment, the Air Force can provide reasonable assurance, except for the 27 material weaknesses reported in the *Material Weaknesses and Significant Deficiencies* (Tab 2), that internal controls over operations, reporting, and financial systems were operating effectively as of September 30, 2018. The Air Force has a plan in place to correct all 27 material weaknesses and has provided the expected completion dates for each corrective action in the *Material Weaknesses and Significant Deficiencies* (Tab 2).

Attachments:
1. FY 2018 Air Force Statement of Assurance – Internal Control Evaluation
2. FY 2018 Material Weaknesses and Significant Deficiencies
3. FY 2018 Risk Assessment

Prepared By: Mr. Mike Mason/SAF/FMFAS/240-612-5253

FY 2018 Financial Statement Audit

FY 2018 is the first year all Air Force financial statements are under audit by an Independent Public Accountant (IPA) firm. For the past three years the Air Force has published a Schedule of Budgetary Activity (SBA). The SBA presented a subset of activity and elements of the Statement of Budgetary Resources. The FY18 audit update fully incorporates the requirements of the Chief Financial Officer (CFO) Act and Office of Management and Budget (OMB) Circular A-123, Appendix A, driving efficiency in the integration of the Department's resources to meet the Department's objective of achieving audit readiness by September 30, 2017 (for full financial statements audits).

In FY 2018 the IPA conducted 175 site visits at 69 unique locations. Airmen at the Headquarters, MAJCOM, and unit level worked in concert to respond to the aggressive audit schedule and responded to over 9,000 auditor requests. In June 2018 the IPA communicated their intent to disclaim on the FY 2018 financial statements. A disclaimer indicates that the auditor could not obtain sufficient audit evidence to issue an opinion. This was not a surprise to Air Force management. It is expected to take several years to get a favorable opinion on our financial statements.

In July 2018, the Air Force released new Deficiency, Remediation, and Tracking Program guidance to ensure all Air Force personnel are prepared to take immediate action when the IPA notes an exception. The program provides a standard, centralized process to manage, track, and report all relevant deficiencies, corrective actions, and remediation progress. Using the Office of the Deputy Chief Financial Officer (ODCFO) Notice of Findings and Recommendations (NFR) Database, the Air Force maintains oversight for deficiencies, from all sources, that impact Air Force financial statement auditability.

Deficiencies are tracked and monitored from identification to correction through validation and progress is reported to various stakeholders throughout the process. Additionally, standardized CAP development methods are used to promote consistency across the Air Force.

COMPLIANCE WITH OTHER KEY LEGAL AND REGULATORY REQUIREMENTS

As of September 30, 2018, the Air Force is in the early stages of developing and implementing a robust program to perform a comprehensive assessment of compliance with key legal and regulatory financial requirements. The Air Force plans to provide the results of its compliance assessment in future Agency Financial Reports.

FORWARD LOOKING INFORMATION

On October 11, 2018, as a result of Hurricane Michael, Tyndall Air Force Base in Panama City, Florida sustained a direct hit which resulted in extensive damage across the base. Because of the hurricane, the base remains partially closed with limited operations at this time. The Air Force is still in the process of evaluating the financial impact of the damage to the base and its operations and is unable to quantify the extent of the damage currently.

LIMITATION OF 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 31 U.S.C. § 3515(b). The statements are prepared from the books and records of Federal entities in accordance with Federal GAAP and the formats prescribed by OMB. 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.

November 2018

Message from the Assistant Secretary of the Air Force for Financial Management and Comptroller

Strong financial management is needed to achieve the Air Force mission. Air Force financial managers strive daily to maximize each taxpayer dollar. We are responsible for getting the right resources where they need to be, when they need to be there, advising and executing financial services across the organization, and providing the decision support needed to make it happen. These financial statements detail how financial management professionals are delivering financial management capability in support of Air Force operations around the world.

FY 2018 represents the first year our full financial statements were audited by an independent public auditor. We continue to receive a "disclaimer," meaning that the auditors, were for a variety of reasons, unable to perform sufficient testing to form a conclusion on the accuracy of these statements. As with many first-year audits, and particularly with enterprises as large and complex as the Air Force, we did not expect the first year audit to result in a "clean" opinion. This is consistent with the experience of much smaller Federal agencies in the past and is no surprise. Submitting our statements for audit is a major accomplishment in and of itself.

Being under audit (regardless of the opinion) allows us to focus on the most important areas, increase business discipline, and improve the quality of our information. This consistent level of scrutiny will provide valuable insight for further improvement that will allow us to measure progress and improve efficiency. In the near term, there may be additional costs involved in making necessary improvements to strengthen controls or make the audit more cost-effective. It will be several years before we begin to see positive audit opinions emerge, so it is critical that we address deficiencies in a prioritized manner. Many of the necessary solutions require a sustained effort over several years to address systemic challenges.

The implementation of the Defense Enterprise Accounting and Management System (DEAMS) will help the Air Force achieve a favorable audit opinion. DEAMS is a Standard Financial Information Structure compliant enterprise resource support system which will improve the timeliness and accuracy of financial management information. During FY 2018 the Air Force deployed DEAMS to Pacific Air Forces and U.S. Air Forces in Europe installations. In FY 2019 and beyond we will increase DEAMS functionality and complete system upgrades.

As we look back at a successful FY 20 I 8 and look forward to FY 2019 and beyond, we will continue to provide resources, financial services, and decision support to deliver, air, space and cyber capabilities to our nation. Air Force financial managers are the ultimate force multipliers using innovation to finance the fight.

John P. Roth

GENERAL FUND

The Department of the Air Force General Fund Principal Statements and related notes are presented in the format prescribed by the Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* and the Department of Defense Financial Management Regulation *7000.14-R, Volume 6B*. The statements and related notes summarize financial information for individual activity groups and activities within the General Fund for the fiscal year ended September 30, 2018 and are presented on a comparative basis with information previously reported for the fiscal year ended September 30, 2017. 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's Circular A-136, "Financial Reporting Requirements."

The following statements comprise the Department of the Air Force General Fund Principal Statements:

Consolidated Balance Sheets
The Consolidated Balance Sheets, as of September 30, 2018 and 2017, represents 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 Changes in Net Position
The Consolidated Statements of Changes in Net Position presents 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 fiscal years ended September 30, 2018 and 2017.

Combined Statement of Budgetary Resources
The Combined Statements of Budgetary Resources presents the budgetary resources available to the Air Force during FYs 2018 and 2017, the status of these resources at September 30, 2018 and 2017, and the outlays of budgetary resources for the fiscal years ended September 30, 2018 and 2017.

Consolidated Statements of Net Cost
The Consolidated Statements of Net Cost presents the net cost of the Air Force's operations for the fiscal years ended September 30, 2018 and 2017. 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.

Air Force General Fund
CONSOLIDATED BALANCE SHEET
As of September 30, 2018 and 2017

($ in Thousands)

		2018 (unaudited)		2017 (unaudited)
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	144,110,635	$	124,996,744
Investments (Note 4)		7		355
Accounts Receivable (Note 5)		589,401		587,392
Other Assets (Note 6)		123,059		158,111
Total Intragovernmental Assets	$	144,823,102	$	125,742,602
Cash and Other Monetary Assets (Note 7)	$	89,512	$	57,825
Accounts Receivable, Net (Note 5)		230,172		226,403
Operating Material & Supplies, Net (Note 8)		51,181,074		55,240,648
General Property, Plant and Equipment, Net (Note 9)		140,390,559		148,060,921
Other Assets (Note 6)		23,422,168		21,674,149
TOTAL ASSETS	$	360,136,587	$	351,002,548
STEWARDSHIP PROPERTY, PLANT & EQUIPMENT (Note 9)				
LIABILITIES (Note 10)				
Intragovernmental:				
Accounts Payable (Note 11)	$	2,617,439	$	2,200,761
Other Liabilities (Note 13 & 14)		1,302,020		951,351
Total Intragovernmental Liabilities	$	3,919,459	$	3,152,112
Accounts Payable (Note 11)	$	4,175,187	$	3,121,854
Military Retirement and Other Federal Employment Benefits (Note 15)		1,013,170		1,027,796
Environmental and Disposal Liabilities (Note 12)		12,375,694		11,167,963
Other Liabilities (Note 13 and Note 14)		9,941,553		10,561,519
TOTAL LIABILITIES	$	31,425,063	$	29,031,244
COMMITMENTS AND CONTINGENCIES (NOTE 14)				
NET POSITION				
Unexpended Appropriations - Other Funds		153,326,272		135,697,230
Cumulative Results of Operations - Dedicated Collections (Note 21)		27,305		24,380
Cumulative Results of Operations - Other Funds		175,357,947		186,249,694
TOTAL NET POSITION	$	328,711,524	$	321,971,304
TOTAL LIABILITIES AND NET POSITION	$	360,136,587	$	351,002,548

Air Force General Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2018 and 2017

($ in Thousands)

		2018 (unaudited)		2017 (unaudited)
UNEXPENDED APPROPRIATIONS				
Beginning Balances (Includes Funds from Dedicated Collections - See Note 21)	$	135,697,230	$	124,168,615
Beginning balances, as adjusted		135,697,230		124,168,615
Budgetary Financing Sources:				
Appropriations received		190,147,759		171,036,242
Appropriations transferred-in/out		104,381		842,482
Other adjustments (+/-)		(3,715,745)		(5,384,521)
Appropriations used		(168,907,353)		(154,965,588)
Total Budgetary Financing Sources (Includes Funds from Dedicated Collections - See Note 21)		17,629,042		11,528,615
Total Unexpended Appropriations (Includes Funds from Dedicated Collections - See Note 21)		153,326,272		135,697,230
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances		186,274,074		150,404,479
Prior Period Adjustments:				
Changes in accounting principles (+/-)		(2,033,401)		37,344,977
Beginning balances, as adjusted (Includes Funds from Dedicated Collections - See Note 21)		184,240,673		187,749,456
Appropriations used		168,907,353		154,965,588
Nonexchange revenue		8,319		2,797
Donations and Forfeitures of Cash and Cash Equivalents		4,721		5,031
Transfers-in/out without reimbursement		58,996		0
Transfers-in/out without reimbursement (+/-)		(238,849)		(1,623,550)
Imputed financing from costs absorbed by others		790,529		587,303
Other (+/-)		626,435		745,387
Total Financing Sources (Includes Funds from Dedicated Collections - See Note 21)		170,157,504		154,682,556
Net Cost of Operations (+/-) (Includes Funds from Dedicated Collections - See Note 21)		179,012,925		156,157,938
Net Change		(8,855,421)		(1,475,382)
Cumulative Results of Operations (Includes Funds from Dedicated Collections - See Note 21)		175,385,252		186,274,074
Net Position	$	328,711,524	$	321,971,304

Air Force General Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2018 and 2017

($ in Thousands)

	2018 (unaudited)	2017 (unaudited)
Budgetary Resources:		
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 36,325,787	$ 35,676,238
Appropriations (discretionary and mandatory)	189,701,583	170,303,268
Spending Authority from offsetting collections (discretionary and mandatory)	9,179,083	8,397,442
Total Budgetary Resources	$ 235,206,453	$ 214,376,948
Status of Budgetary Resources:		
New obligations and upward adjustments (total)	$ 193,052,669	$ 180,977,006
Unobligated balance, end of year:		
Apportioned, unexpired accounts	36,361,083	27,226,333
Exempt from apportionment, unexpired accounts	14,458	13,203
Unapportioned, unexpired accounts	3,159	3,158
Unexpired unobligated balance, end of year	36,378,700	27,242,694
Expired unobligated balance, end of year	5,775,084	6,157,248
Unobligated balance, end of year (total)	42,153,784	33,399,942
Total Budgetary Resources	$ 235,206,453	$ 214,376,948
Outlays, net		
Outlays, net (total) (discretionary and mandatory)	167,672,059	156,678,148
Distributed offsetting receipts (-)	(339,645)	(64,658)
Agency Outlays, net (discretionary and mandatory)	$ 167,332,414	$ 156,613,490

Air Force General Fund
CONSOLIDATED STATEMENT OF NET COST
For the years ended September 30, 2018 and 2017

($ in Thousands)

	2018 (unaudited)	2017 (unaudited)
Program Costs		
	$	$
Military Personnel	36,829,310	35,707,662
Operations, Readiness & Support	55,891,675	58,192,753
Procurement	55,643,670	45,311,469
Research, Development, Test & Evaluation	36,147,929	28,036,345
Family Housing & Military Construction	2,732,165	461,768
Gross Costs	187,244,749	167,709,997
(Less: Earned Revenue)	(8,231,824)	(11,552,059)
Net Cost of Operations	$ 179,012,925	$ 156,157,938

Fiscal Year 2018

GENERAL FUND

Notes to the Principal Statements

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. Significant Accounting Policies

1.A. <u>Mission of the Reporting Entity</u>
The United States 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 United States.

1.B. <u>Basis of Presentation</u>
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, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the 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; the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*; 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. Due to OMB A-136 updates in 2018, the format of the SBR changed from FY17 to FY18. The presentation of FY17 financial information in the SBR has been updated to reflect this new required format.

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 Circular No. A-136, due to limitations of financial and nonfinancial 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 nonfinancial 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 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. During the current year, the Air Force determined its accounting for such contracts does not always reflect the specific Air Force allocation of contract cost. Collections, obligations and outlays of the Air Force are misstated by the difference between Air Force expenditures and the Air Force actual specific allocations of contract cost. The Air Force cannot currently estimate the amount of misstatement, but has concluded it may be material.

The Air Force has not completed the process of evaluating the effects that will result from adopting the below pronouncements to the Federal Accounting Standards Advisory Board (FASAB) Handbook of Accounting Standards and Other Pronouncements, as Amended. These pronouncements are expected to have an impact on our 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: For periods beginning after September 30, 2017. USAF 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 USAF SFFAS 47 analysis is not complete. The consolidation decisions related to that analysis when complete could have a material impact on the USAF financial statements.

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

   The Air Force plans to utilize deemed cost to value beginning balances for inventory and related property (I&RP), as permitted by SFFAS 48. The Air Force has valued some of its I&RP using Deemed Cost methodologies as described in SFFAS 48. However, systems required to account for historical cost for I&RP in accordance with SFFAS 3 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: For periods beginning after September 30, 2018. Early adoption is permitted.

4) SFFAS 50: Establishing Opening Balances for General Property, Plant, and Equipment. Issued on: August 4, 2016. Effective Date: For periods beginning after September 30, 2016.

   The Air Force plans to utilize deemed cost to value beginning balances for general property, plant and equipment (GPP&E), as permitted by SFFAS 50. The Air Force has valued some of its GPPE using Deemed Cost methodologies as described in SFFAS 50. However, systems required to account for historical cost for GPP&E in accordance with SFFAS 6 are not yet fully in place. Therefore, the Air Force is not making an unreserved assertion with respect to this line item.

5) SFFAS 53: Budget and Accrual Reconciliation, Amending Statement of Federal Financial Accounting Standards (SFFAS) 7, SFFAS 22 and SFFAS 24: Issued on: October 27, 2017: Effective Date: reporting periods beginning after September 30, 2018. Early adoption is permitted.

6) 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 Date: April 17, 2018: Effective Date: reporting periods beginning after September 30, 2020. Early adoption is not permitted.

7) SFFAS 55: Amending Inter-entity Cost Provisions: Issued on May 31, 2018: Effective Date: reporting periods beginning after September 30, 2018. Early adoption is permitted.

8) 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.

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 18: Implementation Guidance for Establishing Opening Balances; Issued on October 2, 2017, Effective Date: upon issuance.

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 and Effective Date: Upon issuance.

1.C. 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 liabilities, year-end accruals of accounts payable, general equipment and real property deferred maintenance, and actuarial liabilities related to workers' compensation.

1.D. Appropriations and Funds
The Air Force receives appropriations and funds as general, trust, and special funds. The Air Force uses these appropriations and funds to execute its missions and subsequently report on resource usage.

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

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as 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.

The Air Force is a party to allocation transfers with other federal agencies as a 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.

The accounts used to prepare the financial statements are categorized as either entity or nonentity. 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. Nonentity 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. The following is a list of the major Air Force account numbers and titles (all accounts are entity accounts unless otherwise noted):

AF Account Number	Title
57 * 0704	Family Housing, Air Force
57 * 0740	Family Housing Construction, Air Force
57 * 0745	Family Housing Operation and Maintenance, Air Force
57 * 0810	Environmental Restoration, Air Force
57 * 1007	Medicare Eligible Retiree Health Fund Contributions, Air Force
57 * 1008	Medicare Eligible Retiree Health Fund Contributions, Reserve Personnel, Air Force
57 * 1009	Medicare Eligible Retiree Health Fund Contributions, National Guard, Air Force
57 * 3010	Aircraft Procurement, Air Force
57 * 3011	Procurement of Ammunition, Air Force
57 * 3020	Missile Procurement, Air Force
57 * 3024	Tanker Replacement Transfer Fund, Air Force
57 * 3080	Other Procurement, Air Force
57 * 3300	Military Construction, Air Force
57 * 3400	Operations and Maintenance (O&M), Air Force
57 * 3500	Military Personnel, Air Force
57 * 3600	Research, Development, Test, and Evaluation (RDT&E), Air Force
57 * 3700	Reserve Personnel, Air Force
57 * 3730	Military Construction, Air Force Reserve
57 * 3740	Operations and Maintenance (O&M), Air Force Reserve
57 * 3830	Military Construction, Air National Guard
57 * 3840	Operations and Maintenance (O&M), Air National Guard
57 * 3850	National Guard Personnel, Air Force
57 X 5095	Wildlife Conservation, etc., Military Reservations, Air Force
57 X 5616	Support of Athletic Programs, Air Force
57 X 8418	Air Force Cadet Fund
57 X 8928	Air Force General Gift Fund
57 * 3XXX (Nonentity)	Budget Clearing Accounts
57 * 6XXX (Nonentity)	Deposit Fund Accounts
57 **** (Nonentity)	Receipt Accounts

1.E. Basis of Accounting

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 is 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 compliance with legal requirements and controls over the use of Federal funds.

The Department's continued effort towards full compliance with U.S. GAAP for the accrual method of accounting is encumbered by various systems limitations and the sensitive nature of Departmental 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 nonfinancial 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'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), nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated 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.

1.F. Revenues and Other Financing Sources

The Air Force receives congressional appropriations as financing sources for general funds, and on occasion, will also receive congressional appropriations for Working Capital Funds. These funds either expire annually, on a multi-year basis, or do not expire. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The 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.* In some instances, revenue is recognized when bills are issued.

In accordance with SFFAS 7 "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financing Accounting," the Air Force recognizes nonexchange 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 Note 19, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.G. 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 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, as required by U.S. GAAP. The Department has issued guidance under which Federal entities may expense OM&S using the purchase method of accounting rather than the consumption method. The Air Force uses the consumption method to recognize expense for Operating Materiel and Supplies (OM&S). OM&S are expensed when consumed.

1.H. Accounting for Intragovernmental Activities

The Treasury Financial Manual 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 in order to prevent overstatement for 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 DoD to correctly report, reconcile, and eliminate intragovernmental balances.

The Treasury Financial Manual Part 2-Chapter 4700, “Agency Reporting Requirements for the Financial Report of the United States Government,” provides guidance for reporting and reconciling intragovernmental balances. Imputed financing represents the cost paid on behalf of the Air Force by another Federal entity for business-type activity. The Air Force recognizes imputed costs for (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; and (3) losses in litigation proceedings.

The DoD’s proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD’s financial statements do not report any public debt, interest, or source of public financing, whether from issuance of debt or tax revenues.

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

1.I. 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, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the Federal Government. Payment in U.S. dollars is required in advance.

1.J. 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 Service (DFAS), the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State’s financial service centers process the majority of the 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.

In addition, 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 (FBWT) account.

1.K. Cash and Other Monetary Assets

Cash is the total of cash resources under the control of DoD 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 purchased and nonpurchased foreign currencies held in foreign currency fund accounts. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

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

The 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 operation and maintenance; and (5) family housing construction. The gains and losses are calculated as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Air Force does not separately identify currency fluctuation transactions.

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

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 nonmarketable 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.

1.M. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. The DoD 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.

A. Public accounts receivable are presented net of allowances, based upon factors such as: aging of accounts receivable, debtor's ability to pay, and payment history.

1.N. Operating Material & Supplies

The Air Force 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 self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in the Air Force's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The Air Force holds materiel based on military need and support for contingencies. The DoD is currently developing a methodology to be used to account for "inventory held for sale" and "inventory held in reserve for future sale."

All General Fund Inventory and Related property is classified as OM&S. OM&S are valued using the moving average cost method. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. Many high-dollar items, such as aircraft engines, are categorized as OM&S rather than general equipment. The Air Force determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category.

The Air Force when applicable, will continue to adopt SFFAS No. 48, "Opening Balances for Inventory, Operating Materiel and Supplies, and Stockpile Materials" permitting alternative methods in establishing opening balances.

1.O. General Property, Plant and Equipment

The Air Force generally records at the estimated historical cost for valuing equipment. To establish a baseline, the Air Force accumulated information related to program funding and associated equipment, equipment useful life, program acquisitions, and disposals. The equipment baseline was updated using expenditure, acquisition and disposal information. The Air Force when applicable, will continue to adopt SFFAS No. 50, "Establishing Opening Balances for General Property, Plant, and Equipment" permitting alternative methods in establishing opening balances.

The Air Force General Fund capitalizes General PP&E acquisitions that are $1 million and greater, per DoD developed policy. The capitalization threshold for information technology equipment, internally developed software and real property is $250 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 thousand for equipment and $20 thousand for real property). The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

The Air Force provides government property to contractors to complete contract work, and the contractors are responsible for the control and accountability of these. The Air Force either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E meets or exceeds the DoD capitalization threshold, federal accounting standards require that it be reported on the Air Force's Balance Sheet.

1.P. Advances and Prepayments

Payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The Air Force has not fully implemented this policy primarily due to system limitations.

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, the Air Force records the applicable asset as though it was purchased with an offsetting liability and depreciates 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 and leases entered into by the Air Force are the largest component of operating leases and are based on costs gathered from existing leases, General Services Administration (GSA) bills, and interservice support agreements. Future year projections use the Consumer Price Index.

1.R. Other Assets

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments 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 Regulations, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

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

1.S. Contingencies and Other Liabilities

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

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

Other liabilities also arise as a result of anticipated disposal costs for Air Force assets. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Based on DoD's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government," nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. In addition DoD recognizes nonenvironmental disposal liabilities for military equipment 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 nonenvironmental disposals due to immateriality.

1.T. Accrued Leave

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

1.U. Net Position

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

1.V. Treaties for Use of Foreign Bases

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

1.W. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported disbursements and collections have corroborating documentation for summary level adjustments made to accounts payable and accounts receivable. Unsupported disbursements and collections do not have supporting documentation for the transactions and most likely would not meet audit scrutiny. However, both supported and unsupported adjustments may have been made to the Air Force accounts payable and receivable trial balances prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD generally cannot determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable and accounts receivable at the time accounting reports are prepared. Accordingly, the DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements and collections are also applied to reduce accounts payable and receivable accordingly.

1.X. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment and disposition by the 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. Fiduciary activities are reported on the financial statement Note 22, Fiduciary Activities.

Note 2. Non-entity Assets

As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
1. Intragovernmental Assets		
Fund Balance with Treasury	$ 542,516	$ 553,659
Total Intragovernmental Assets	$ 542,516	$ 553,659
2. Nonfederal Assets		
Cash and Other Monetary Assets	$ 89,512	$ 57,825
Accounts Receivable	3,424	7,125
Total Nonfederal Assets	$ 92,936	$ 64,950
3. Total Non-entity Assets	$ 635,452	$ 618,609
4. Total Entity Assets	$ 359,501,135	$ 350,383,939
5. Total Assets	$ 360,136,587	$ 351,002,548

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 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.

Nonfederal 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 the Air Force Disbursing Officers as agents of the U.S. Treasury. The Nonfederal Cash and Other Monetary assets represent a fiduciary capacity held by Air Force Disbursing Officers as agents for U.S. Treasury and are not available for use in operations.

Nonfederal Accounts Receivable consists of amounts associated with cancelled year appropriations, and interest, fines and penalties due on debt. Generally, 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		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
Status of Fund Balance with Treasury				
1. Unobligated Balance				
Available	$	36,375,543	$	27,239,537
Unavailable		5,778,246		6,160,407
2. Obligated Balance not yet Disbursed	$	101,636,792	$	91,460,445
3. Non-budgetary FBWT	$		$	
Deposit funds		542,516		553,660
Suspense accounts		(222,462)		(417,305)
4. Total	$	144,110,635	$	124,996,744

Status of Fund Balance with Treasury

The 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 balances with treasury consists of appropriation accounts, revolving funds, trust accounts, special funds and other fund types.

The Status of Fund Balance with Treasury (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.

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 unavailable balance consists primarily of funds invested in U.S. Treasury securities that are temporarily precluded from obligation by law. Certain unobligated balances are restricted for future use and are not apportioned for current use. Unobligated balances for trust fund accounts are restricted for use by the public law that established the funds.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods and services but not paid. The balance also includes accounts receivable and the unfilled orders without advance from customers.

Non-budgetary FBWT includes accounts without budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts and nonentity FBWT.

Other Information

In FY 2018 the Air Force reports a reconciling net difference of $23.5 million with the U.S. Treasury between the Air Force's financial statement records and Treasury. This includes net allocation transfers of $26.4 million as well as fiduciary activities of $2.8 million. In FY 2017, the Air Force's reconciling net difference was $20.5 million and consisted of allocation transfers of $22.3

million and fiduciary activities of $1.8 million. The Air Force received allocation transfers as the "child entity." As "parent entity," the Air Force issued allocation transfers to other DoD or Federal Government agencies for execution on behalf of the Air Force. For additional information, refer to Note 1, Significant Accounting Policies, Section 1D. Additionally, Fiduciary Activities are not reported in FBWT in accordance with *SFFAS 31*, *"Accounting for Fiduciary Activities".*

The following adjustments were necessary for the Air Force to reconcile their general ledger to the U.S. Treasury: $1.3 million in undistributed collections, $1.2 million in unsupported undistributed collections, $1.1 billion in undistributed disbursements, and $1.5 million in unsupported undistributed disbursements. These undistributed amounts have not yet posted to the proper account at year-end due to timing.

The Air Force has $3.2 billion of funds in expired appropriations that were returned to Treasury at the end of FY18.

Note 4. Investments and Related Interest, Net

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

As of September 30	2017 (unaudited)				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
(Amounts in thousands)					
Intragovernmental Securities					
Nonmarketable, Market-Based					
Other Funds	354		0	354	354
Total Nonmarketable, Market-Based	354		0	354	354
Accrued Interest	1			1	1
Total Intragovernmental Securities	$ 355		$ 0	$ 355	$ 355

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 from the standpoint of the Federal Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements.

The U.S. Treasury securities provide the 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 5. Accounts Receivable, Net

As of September 30	2018 (unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
1. Intragovernmental Receivables	$ 589,401	N/A	$ 589,401
2. Nonfederal Receivables (From the Public)	$ 275,836	$ (45,664)	$ 230,172
3. Total Accounts Receivable	$ 865,237	$ (45,664)	$ 819,573

As of September 30	2017 (unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
1. Intragovernmental Receivables	$ 587,392	N/A	$ 587,392
2. Nonfederal Receivables (From the Public)	$ 251,024	$ (24,621)	$ 226,403
3. Total Accounts Receivable	$ 838,416	$ (24,621)	$ 813,795

Accounts receivable represent 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 Intragovernmental Business Rules.

In accordance with Statement of Federal Financial Accounting Standards (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 should be individually analyzed to determine the loss allowance. For group analysis, receivables should be 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. Secondary analysis may be performed on individual receivable balances greater than $100,000. Based on the analysis, the component can either (1) completely remove the balance (full or partial) from the percentage calculation or (2) adjust the ending balance.

Note 6. Other Assets

As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
1. Intragovernmental Other Assets		
Advances and Prepayments	$ 123,059	$ 158,111
Total Intragovernmental Other Assets	$ 123,059	$ 158,111
2. Nonfederal Other Assets		
Outstanding Contract Financing Payments	$ 23,417,983	$ 21,669,808
Advances and Prepayments	4,185	4,341
Total Nonfederal Other Assets	$ 23,422,168	$ 21,674,149
3. Total Other Assets	$ 23,545,227	$ 21,832,260

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

Outstanding Contract Financing Payments includes $20.0 billion in contract financing payments and $3.4 billion in estimated future payments to contractors upon delivery and government acceptance. The estimated future payments to contractors is related to the contingent liabilities reported in Note 13, Other Liabilities.

Note 7. Cash

As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in Thousands)		
1. Cash	$ 63,632	$ 38,969
2. Foreign Currency	25,880	18,856
3. Total Cash & Foreign Currency	$ 89,512	$ 57,825

The amount reported as cash and foreign currency consists of cash held by Disbursing Officers. The foreign currency amount reported is valued at U.S. Treasury's prevailing exchange rate, which is the most favorable rate available to the Government for foreign exchange transactions. Foreign currency is primarily used to make vendor disbursements and to exchange U.S. dollars for military personnel.

Cash and foreign currency are nonentity assets and, as such, considered restricted assets that are held by the Air Force but are not available for use in its operations. These assets are held by Air Force Disbursing Officers as agents of U.S. Treasury. The total balance of $89.5 million is restricted. The Air Force has $25.2 million in cash held from dedicated collections. Refer to Note 21, Funds from Dedicated Collections.

Note 8. Operating Materiel & Supplies, Net

As of September 30	2018 (unaudited)		
	OM&S Gross Value	Revaluation Allowance	OM&S, Net
(Amounts in thousands)			
1. OM&S Categories			
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	N/A	13,436,880
Excess, Obsolete, and Unserviceable	351,300	(351,300)	0
Total OM&S	$ 51,532,374	$ (351,300)	$ 51,181,074

As of September 30	2017 (unaudited)		
	OM&S Gross Value	Revaluation Allowance	OM&S, Net
(Amounts in thousands)			
1. OM&S Categories			
Held for Use	$ 42,409,678	$ N/A	$ 42,409,678
Held in Reserve for Future Use	926,253	N/A	926,253
Held for Repair	11,904,717	N/A	11,904,717
Excess, Obsolete, and Unserviceable	104,088	(104,088)	0
Total OM&S	$ 55,344,736	$ (104,088)	$ 55,240,648

General Composition of OM&S

The Operating Materiel and Supplies (OM&S) consist 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 those assets that are cost-effective to repair and consist of High-value Munitions, Cruise Missiles, Spare Engines, Uninstalled Missile Motors, Aerial Targets. Consumables are those assets that are not cost-effective to repair and consist of 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.

The Air Force cannot disclose an Allowance for Repair as required by SFFAS 3 and is currently working to implement a corrective action to properly report this amount.

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 category Held for Use includes all materiel available for issuance. OM&S classified as such is marked within each supply or inventory system.

The category Held in Reserve for Future Use includes all materiel that are maintained because they are not readily available in the market and there is more than a remote chance that they will eventually be needed.

The category 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). The category Held for Repair represents suspended, unserviceable (but repairable) items recorded at Moving Average Cost (MAC) or standard price.

The category Held as Excess, Obsolete, and Unserviceable includes all materiel that managers determine to be more costly to repair than to replace. Items retained for management purposes which are beyond economic repair are coded "condemned." These items are held until proper disposal can be made. Excess, Obsolete, and Unserviceable are valued at zero. This allowance results in a zero value to the Air Force.

Operating Materiel and Supplies (OM&S) Value

The OM&S data reported on the financial statements is derived from logistics systems designed for materiel management purposes. Some of these systems do not maintain the historical cost data necessary to comply with the valuation requirements of the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property."

In general, the Air Force uses the consumption method of accounting for OM&S, since OM&S is defined in SFFAS No. 3 as materiel that has not yet been issued to the end user. Once issued, the materiel is expensed. A material exception to this rule would be accounting for in transit OM&S. The Air Force also does not meet the requirements for establishing net realizable value.

The Air Force has valued some of its Inventory and Related Property (I&RP) using Deemed Cost methodologies as described in SFFAS 48. However, systems required to account for historical cost for I&RP in accordance with SFFAS 3 are not yet fully in place. Therefore, the Air Force is not making an unreserved assertion with respect to this line item.

The Air Force has used the deemed cost method to record Munitions, Spare Engines, Uninstalled Missile Motors, Aerial Targets, and Cruise Missiles according to the principles of SFFAS 48. Munitions was valued using standard price (selling price) or fair value based on the Federal Logistics Information System catalog value. Spare Engines and Aerial Targets were valued according to actual costs and historical costs. Uninstalled Missile Motors and Cruise Missiles were valued according to estimated historic costs. However, systems required to account for historical cost for I&RP in accordance with SFFAS 3 are not fully in place. Therefore, the Air Force is not making an unreserved assertion with respect to this line item.

The FY2018 Air Force Statement of Assurance currently includes one material weakness associated with OM&S. The Air Force reports $51.2 billion of OM&S on the Balance Sheet. SFFAS No. 3, "Accounting for Inventory and Related Property", requires that OM&S be valued using a historic cost method. The DoD FMR goes further to require that all Inventory and Related Property use the moving-average-cost (MAC) method to value all OM&S.

The Comprehensive Engine Maintenance System (CEMS) calculates a moving-average-cost (MAC) balance for Spare Engines. The Reliability and Maintainability Information Systems (REMIS) calculates a MAC balance for Cruise Missiles and Aerial Targets. Legacy systems and not having a complete Universe of Assets prevents the Air Force from recording C-ICP and Spare Parts using 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 the MAC on the date of the actual transaction. This new process, initiated in FY17, 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.

Other Air Force Disclosures

Contractor Managed and Possessed OM&S represents $10.3 billion of Air Force OM&S. The Air Force cannot maintain a complete population of Programs that contain contractor managed and possessed OM&S. Currently, 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 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 Defense Finance and Accounting Service can only report the net change between prior period ending balances and the values reported as current period ending balance.

The Air Force is currently tracking and reporting C-ICP but acknowledged that the current population is incomplete and is executing procedures to correct the situation.

Note 9. General PP&E, Net

As of September 30	2018 (unaudited)							
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life		Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value
1. Major Asset Classes								
Buildings, Structures, and Linear Structures	S/L	20, 40 Or 45		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	S/L	15-37		261,193,730		(191,002,787)		70,190,943
Satellites	S/L	3-14		50,312,211		(32,287,287)		18,024,924
Other	S/L	Various		30,868,032		(27,923,919)		2,944,113
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

As of September 30	2017 (unaudited)							
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life		Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value
1. Major Asset Classes								
Land	N/A	N/A	$	442,297		N/A	$	442,297
Buildings, Structures, and Linear Structures	S/L	20, 40 Or 45		85,283,639	$	(47,449,411)		37,834,228
Leasehold Improvements	S/L	lease term		75,268		(24,324)		50,944
Software	S/L	2-5 Or 10		629,185		(436,840)		192,345
General Equipment	S/L	Various		336,806,460		(236,793,435)		100,013,025
Aircraft	S/L	10-35		260,137,757		(187,392,893)		72,744,864
Satellites	S/L	3-14		49,341,356		(23,590,405)		25,750,951
Other	S/L	Various		27,327,347		(25,810,137)		1,517,210
Construction-in-Progress	N/A	N/A		9,528,082		N/A		9,528,082
Military Equipment				6,648,547		N/A		6,648,547
Real Property				2,879,535		N/A		2,879,535
Total General PP&E			$	432,764,931	$	(284,704,010)	$	148,060,921

Legend for Valuation Methods:
S/L = Straight Line N/A = Not Applicable
Other General Equipment is inclusive of support equipment, government furnished equipment, ground control stations, vehicles, intercontinental ballistic missiles, mine resistant ambush protected vehicles, communications security equipment, and information technology hardware.

General Property, Plant and Equipment (PP&E)

The Air Force classifies its PP&E in three major asset classes: real property, general equipment, and software. Real property consists of land, buildings, structures, facilities, and leasehold improvements. General equipment consists of military equipment/weapons systems, and equipment other than software.

The Air Force has valued some of its PP&E using Deemed Cost methodologies as described in SFFAS 50. However, systems required to account for historical cost for PP&E in accordance with SFFAS 6 are not yet fully in place. Therefore, the Air Force is not making an unreserved assertion with respect to this line item.

Land

Land and Land Rights include not only the land but also the rights to it, such as easements. In FY 2018 the Air Force applied the “deemed cost” alternative valuation method to the opening balance of land in accordance with Statement on Federal Financial Accounting Standards (SFFAS) 50, “Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, 10, and 23, and Rescinding SFFAS 35”. The Air Force reported $0 opening balance for land in FY 2018 and will expense land acquisitions in future periods. The resulting adjustments to the respective beginning balances constitutes a Change in Accounting Principle as defined in SFFAS 21 “*Reporting Corrections of Errors and Changes in Accounting Principles”.* The Air Force has ongoing efforts to validate land acreage.

Buildings, Structures, and Linear Structures

As of FY 2018, the Air Force was not able to support the reported balance for buildings, structures, and facilities. In a future period the Air Force plans to apply the “deemed cost” alternative valuation method to the opening balances of buildings, structures, and facilities in accordance with SFFAS 50.

Leasehold improvements

The Air Force has ongoing efforts to validate the leasehold improvement balance.

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 2018, the Air Force was not able to support the reported balance for IUS. In a future period, the Air Force plans to implement the applicable provisions of SFFAS 50 to adjust its recorded IUS balance.

General Equipment

General equipment comprises multiple asset types such as military equipment, support equipment and communication hardware. Military equipment represents the most significant portion of these assets and is further delineated into the following sub asset classes: aircraft, satellites, intercontinental ballistic missiles, pods and mine resistant ambush protected vehicles. In FY 2018, the Air Force applied the “deemed cost” alternative valuation method to establish beginning balances for military equipment in accordance with SFFAS 50.

Construction-in-Progress

The Air Force constructs real property and general equipment and works closely with other military departments and private sector entities for design and construction. As of FY 2018, the Air Force was not able to support the reported balance for real property and reported partial balances for general equipment. The Air Force is coordinating with all relevant stakeholders to establish consistent and repeatable processes for construction-in-progress.

Software in Development is not itemized due to known data integrity issues with the Internal Use Software Accountable Property System of Record. The Air Force is migrating that legacy system to a new system environment in FY19 while also developing a process to estimate a supportable software in development balance.

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 of the continental United States. 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 United States.

Other Air Force Disclosures

The value of General PP&E personal property major asset class of Software and Equipment does not include all of the General PP&E above the DoD capitalization threshold in the possession of contractors. The Air Force does not report the value of equipment purchased directly by the contractor. The Inspector General, DoD, and the Air Force are developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes in compliance with generally accepted accounting principles.

Heritage Assets

HERITAGE ASSETS For Fiscal Year Ended September 30, 2018					
(a)	**(b)**	**(c)**	**(d)**	**(e)**	**(f)**
Heritage Asset Categories	**Measurement Quantity**	**As of 9/30/17**	**Additions (+)**	**Deletions (-)**	**As of 9/30/18**
Buildings and Structures	Each	5,010	1,430	0	6,440
Archaeological Sites	Sites	1,986	155	0	2,141
Museum Collection Items (Objects, Not Including Fine Art)	Each	135,477	321	469	135,329
Museum Collection Items (Fine Art)	Each	15,106	23	85	15,044

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 stewardship land in its daily activities and includes the buildings on the Balance Sheet as multi-use heritage assets.

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 fly, fight, and win in air, space, and cyberspace. As this mission has been executed, Air Force has become a large-scale owner of historic buildings, structures, archaeological sites and artifacts, aircraft, other cultural resources, and stewardship land. The protection of the nation's heritage assets and stewardship land is an important aspect of the Air Force's mission.

Heritage Assets are PP&E of historical, natural, cultural, educational or artistic significance (e.g. aesthetic); or with significant architectural characteristics. Heritage Assets and Stewardship Land are resources that protect, restore, enhance, modernize, preserve and sustain mission capability within the Air Force through effective planning and management of natural and cultural resources to guarantee access to air, land, and water. These assets are resources that are managed to provide multiple-use activities for the public benefit. This includes actions to comply with requirements such as federal laws, Executive Orders, policies, final governing standards, and other binding agreements. Air Force policy is to promote and preserve indefinitely the identifiable human, environmental or civic value of these assets.

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

- Buildings and Structures are listed, or eligible for listing, on the National Register of Historic Places, including multi-use heritage assets.
- Archaeological 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.

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

Buildings and Structures

Buildings and Structures that are listed on, or eligible for listing on the National Register of Historic Places (NRHP), including multi-use facilities, are Heritage Assets. These facilities are maintained in accordance with the National Historic Preservation Act (NHPA), and "The Secretary of Interior's Standards for The Treatment of Historic Properties" by each base's civil engineering group, as part of their overall responsibility. The Air Force reported 5,010 buildings and structures on Air Force installations and sites to be Heritage Assets as of 30 Sep 2017. The number of buildings/structures considered Heritage Assets at EOY FY18 is 6,440, an increase of 1,430 historic facilities. The total reflects a large increase in building and structure evaluations for eligibility for listing on the National Register in FY17 and FY18, 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 are maintained by each base civil engineering group and are considered to be in good condition. 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 and 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. Some are part of National Environmental Policy Act reviews.

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 CFR Part 60.4. The Air Force reported 1,986 archaeological sites were Heritage Assets as of Sep 2017. The AF has not yet collected FY18 data on the number of archaeological Heritage Assets, and so herein reports the FY17 number, 2,041. This cohort of archaeological Heritage Assets is a subset of over 24,000 archaeological sites recorded on Air Force controlled and owned lands in the USA and its Territories. The total of recorded archaeological sites increased by over 1,000 in FY17, but the number determined eligible for the National Register increased by only 155. The AF collects previous FY archaeological Heritage Asset data in the annual Defense Environmental Program Annual Report to Congress (DEPARC) in December of the following FY. The FY18 data will be known at that time, well after the RSI Report due date.

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 1 October 2017 – 30 September 2018 there have been 321 objects added to the collection. These additions are a result of private donations, transfers from Air Force or other federal entities, curatorial administrative actions, and the continued documentation of newly reported artifacts at Air Force activities worldwide. 469 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. As part of the NMUSAF's active collection management process, the accession and deaccession of objects is continuous. The overall condition of the historical collection, which is primarily located at the NMUSAF, is very good as a result of both the professional care from trained conservators and ever improving exhibit/storage conditions. During FY2018 along with continued preventive maintenance on the aircraft collection, detailed restoration work continued on the iconic B-17F "Memphis Belle" as well as extensive conservation work on the 221 artifacts selected for the Memphis Belle exhibit, the Rocket Fuel Handlers exhibit, and the Red Eagles 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 Collection (SAF/AFAPO) numbering 989 items. Containing original oils, drawings, sketches and sculptures these fine art holdings are in direct support of NMUSAF exhibit requirements. The Air Force Art Program (SAF/AAO) also contains a collection of art work. The art collection contains original oils, drawing, sketches and sculptures. These paintings were in direct result of the artists visiting bases and operations throughout the Air Force. This represents 23 additions into the Air Force Art Program. The Art Program did not include any additions or deletions from the National Museum of the United States Air Force holdings. The collection is maintained and kept in good condition. Each year during the annual inventory, Air Force Art assesses the condition of the paintings as well.

Stewardship Land

STEWARDSHIP LAND
For Fiscal Year Ended September 30, 2018
(Acres in Thousands)

(a)	(b)	(c)	(d)	(e)	(f)
Facility Code	Facility Title	As of 9/30/17	Additions	Deletions	As of 9/30/18
9110	Government Owned Land	1,561	12	-	1,573
9111	State Owned Land	-	-	-	-
9120	Withdrawn Public land	6,271	-	651	5,620
9130	Licensed and Permitted Land	738	8	-	746
9140	Public Land	.192	-	-	.192
9210	Land Easement	162	-	5	157
9220	In-leased Land	103	-	1	102
9230	Foreign Land	297	-	-	297
				Grand Total	8,495

Stewardship Land represents land rights owned by the Federal Government, but not acquired for, or in connection with, items of General Property, Plant, and Equipment (PP&E). “Acquired for or in connection with” is defined as including land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E. Without exception, all land provided to the Air Force from the public domain, or at no cost, shall be classified as Stewardship Land, regardless of its use. The table above outlines the Air Force’s mission-essential Stewardship Land under its administration.

The significant change from FY17 to FY18 Real Property Land Acres is due to an APSR database cleanup effort. The Air Force has ongoing efforts to validate land acreage, which has identified instances in which installations were double counting out-granted easements, thereby overstating acreage. All stewardship land, as reported, is in acceptable condition, based on designated use.

Note 10. Liabilities Not Covered by Budgetary Resources

As of September 30		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
1. Intragovernmental Liabilities				
Federal Employees' Compensation Act (FECA)		189,951		201,754
Other		33,971		36,869
Total Intragovernmental Liabilities	$	223,922	$	238,623
2. Nonfederal Liabilities				
Accounts Payable	$	244,613	$	133,513
Military Retirement and Other Federal Employment Benefits		1,005,921		1,022,962
Environmental and Disposal Liabilities		11,457,633		10,231,674
Other Liabilities		3,150,139		4,964,821
Total Nonfederal Liabilities	$	15,858,306	$	16,352,970
3. Total Liabilities Not Covered by Budgetary Resources	$	16,082,228	$	16,591,593
4. Total Liabilities Covered by Budgetary Resources	$	15,342,835	$	12,439,651
5. Total Liabilities	$	31,425,063	$	29,031,244

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.

Other Nonfederal 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 years' appropriations.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities primarily consist of 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 15, 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 12, Environmental and Disposal Liabilities.

Note 11. Accounts Payable

As of September 30	2018 (unaudited)		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
1. Intragovernmental Payables	$ 2,617,439	$ N/A	$ 2,617,439
2. Nonfederal Payables (to the Public)	4,175,184	3	4,175,187
3. Total	$ 6,792,623	$ 3	$ 6,792,626

As of September 30	2017 (unaudited)		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
1. Intragovernmental Payables	$ 2,200,761	$ N/A	$ 2,200,761
2. Nonfederal Payables (to the Public)	3,121,938	(84)	3,121,854
3. Total	$ 5,322,699	$ (84)	$ 5,322,615

Accounts Payable include amounts owed to federal and nonfederal entities for goods and services received by Air Force.

Note 12. Environmental and Disposal Liabilities

As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
1. Environmental Liabilities--Nonfederal		
A. Accrued Environmental Restoration Liabilities		
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 7,343,776	$ 7,059,020
Active Installations—Military Munitions Response Program (MMRP)	320,798	326,150
B. Other Accrued Environmental Liabilities—Non-BRAC		
Environmental Corrective Action	979,209	52,908
Environmental Closure Requirements	362,545	301,740
Asbestos	1,031,740	1,694,501
C. Base Realignment and Closure Installations		
Installation Restoration Program	2,201,726	1,590,959
Military Munitions Response Program	8,540	5,057
Environmental Corrective Action / Closure Requirements	696	556
Asbestos	570	54
D. Environmental Disposal for Military Equipment/ Weapons Programs		
Non-Nuclear Powered Military Equipment	126,094	137,018
2. Total Environmental Liabilities	$ 12,375,694	$ 11,167,963

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.

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

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. The Air Force does this in coordination with regulatory agencies and, if applicable, with other responsible parties. The Air Force is also required to recognize closure, post closure and disposal costs for its General Property, Plant and Equipment (PP&E) and environmental corrective action costs for current operations. The Air Force is responsible for tracking and reporting all required environmental information related to environmental restoration and corrective action, closure and disposal costs of General PP&E, and environmental costs related to BRAC actions that have taken place in prior years.

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 (SARA)
- Clean Water Act
- Safe Drinking Water Act
- Clean Air Act
- Resource Conservation and Recovery Act (RCRA)
- Toxic Substances Control Act (TSCA)
- 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 reports a $0 balance in two scenarios: (1) Where another DoD Entity serves as the DoD Lead Agent or Executive Agent, or (2) When the processes in place to assess a specific sub-category of Environmental & Disposal Liabilities validates that the $0 should be reported as of September 30 for that financial reporting period. 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: Department of Navy is the Lead Agent for Nuclear Powered General Equipment and Spent Nuclear Fuel, Department of the Army is the Executive Agent for Chemical Weapons Disposal Program, and the United States Army Corps of Engineers is the Lead Agent for Formerly Used Defense Sites (FUDS). FUDS sites include locations that used to be part of the DoD real property footprint (e.g., training areas created and used to support wartime activities), but does not include any installations explicitly outlined in Base Realignment and Closure (BRAC) actions enacted by Congress.

The Air Force has clean up requirements for the Defense Environmental Restoration Program (DERP) sites at active installations, 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 clean-up efforts are performed in coordination with regulatory agencies, other responsible parties, and current property owners.

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 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. Cleanup costs not eligible for DERP funding are reported under Environmental Corrective Action. As of September 30, 2018, The Air Force has 23,421 IRP and BD/DR sites and 1,361 MMRP sites across 137 active installations funded by Defense Environmental Restoration Program (DERP). As of September 30, 2018, the Air Force estimated and reported $7.7 billion for Accrued Environmental Restoration Liabilities. This amount includes $7.4 billion in Active Installations – IRP and BD/DR and $0.3 billion in Active Installations – MMRP.

Other Accrued Environmental Liabilities – Non-BRAC
The Air Force has costs to remediate cleanup sites that are not eligible for funding, inclusive of Air National Guard sites no longer eligible for DERP funding, and environmental liabilities associated with Environmental Response at Operational Ranges (EROR). The Air Force has 172 Environmental Corrective Action (ECA) sites not funded DERP and 55,843 General PP&E assets with an estimated environmental liability of $2.4 billion for fiscal year (FY) 2018. As of September 30, 2018, the Air Force reported liabilities of $979.2 million for ECA, $362.5 million for Environmental Closure Requirements (ECR), and $1,031.7 million for Asbestos. Environmental conditions that result from current operations and require immediate cleanup (e.g., oil spills or routine hazardous waste removal) are not considered environmental liabilities and are part of current operating expenses, if fully remediated within the current fiscal year.

BRAC
The Air Force BRAC environmental cleanup cost estimate is based on 951 IRP and 13 MMRP sites across 40 BRAC installations. As of September 30, 2018, the Air Force estimated and reported $2,211.5 million for environmental restoration liabilities. This amount is comprised of $2,201.7 million in IRP liabilities, $8.5 million in MMRP liabilities, $0.7 million in Environmental Corrective Action / Closure Requirements and $0.6 million in Asbestos liabilities.

Environmental Disposal for General Equipment / Weapons Programs
The Air Force only reported liabilities for the environmental disposal of 6,617 fixed-wing aircraft, totaling $126 million, as of September 30, 2018. The Air Force determined that no future outflows of cash exist for the environmental disposal of satellites, thus no liability was reported in either FY2017 or FY2018. As of FY2018, the Air Force did not record an environmental disposal liability for all other forms of aircraft, pods, Intercontinental Ballistic Missiles (ICBMs), and Mine-Resistant Ambush Protected (MRAP) vehicles 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.

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

The Air Force utilizes Remedial Action Cost Engineering and Requirements (RACER) software to develop cost-to-complete (CTC) estimates for Accrued Environmental Restoration Liabilities, ECA, and ECR, and BRAC. In addition to pre-set values included in the RACER software, the Air Force can add User Defined Costs (UDC) to customize and refine estimate outcomes within RACER. RACER is validated in accordance with DoDI 5000.61, *"DoD Modeling and Simulation (M&S) Verification, Validation, and Accreditation (VV&A)."* The Air Force complies with accounting standards to assign costs to current operating periods. Based on an analysis of accreting expenses or recording a full environmental liability, the Air Force determined that no amounts will require accretion and balances will reflect the full environmental liability for FY2018. The Air Force will re-evaluate the determination to accrete or fully record environmental liabilities annually.

As outlined in DoD Financial Management Regulation (FMR), Volume 4, Chapter 13, estimating software such as RACER should be supported by an annual comparison of actual cleanup costs against estimated values resulting from software use. The Air Force does not currently have processes in place to perform these annual comparisons, but an initial approach is under development with an intent to validate and finalize that approach in FY 2019.

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 produce 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 performed for the full duration of IRP and BD/DR, and MMRP, inclusive of program management costs. For projects with an undefined duration, a rolling 30-year period is used. 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 produce 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 ECA, inclusive of program management costs. For projects with an undefined duration, a rolling 30-year period is used. 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. 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 a military range from the definition of solid waste until a formal decision to close the range occurs or the munitions discharge migrates off the military range. Therefore, these military munitions do not meet the criteria of an environmental liability. As of September 30, 2018, the Air Force does not have any ongoing activities to address confirmed off-range migration of munitions constituents (MCs) resulting from range operations that would represent an environmental liability. Therefore, the Air Force does not record a liability for EROR at this time. In the event that an off-range migration of MCs is confirmed, the Air Force would report the liability within ECA. These environmental liabilities are not associated with an asset having a useful life, thus the total estimated cleanup cost would be recognized upon identification of the liability.

Environmental Closure Requirements:
The Air Force uses one or more of the following approaches to generate estimates for ECR liabilities, including: cost estimating software (e.g., RACER), historical costs, and engineering estimates. Estimates leverage industry-standard cost factors or comparable historical projects, bids, and expenditures. The Air Force has reviewed the environmental liability estimates for FY2018 and determined that the amount that would be recorded if the liability were accreted over the useful life (or physical capacity usage for closure costs, in the case of Non-Hazardous Waste Landfills) of the assets would not be materially different from recording the entire environmental liability. Therefore, the Air Force determined that as of fiscal

year-end 2018, no amounts will require accretion and all ECR categories reporting a balance will reflect the full environmental liability. The Air Force will re-evaluate the determination to accrete or fully record environmental liabilities for each ECR asset category on an annual basis. As of fiscal year-end 2018, the Air Force is reporting the total estimated environmental liability balances for the following ECR asset categories: Petroleum, Oil, Lubricants (POL) Underground Storage Tanks (USTs), Hazardous Material, and Hazardous Waste Aboveground Storage Tanks (ASTs), Non-Hazardous Waste Landfills, Wastewater Lagoons and Ponds, and Septic Tanks.

Recycling Centers and Composting Units were identified as asset categories with potential environmental liabilities; however, the environmental liability for FY2018 is $0. While these asset categories may be subject to federal, state, and/or local regulatory closure requirements, the type of materials stored at Air Force installations do not have environmental closure requirements as of fiscal year-end 2018. Additionally, the Air Force has no assets records associated with Composting Units, or Class V Injection Wells, Cesspools, and Other Dry Wells, as of the fiscal year-end 2018. Thus, environmental liabilities for this asset category cannot be estimated for FY2018 and a $0 balance is reported. One Solid Waste Incinerator was identified in 2018, but the incinerator is identified as a heritage asset, is expected to be maintained in perpetuity, and the environmental liability for FY18 is $0.

Asbestos:
Asbestos liabilities are generated using two separate cost estimation methodologies: 1) a power equation to estimate survey costs; and 2) look-up tables abatement costs using building size, age, and type. 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 NEXGEN) to isolate the potentially asbestos containing (PAC) asset population. As of fiscal year-end 2018, the Air Force is reporting the total estimated environmental liability balances for only building specific asset records to which the survey and abatement cost estimation methodologies are applied to generate the reported asbestos liability.

Material Changes in Total Estimated Cleanup Costs and the Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, Plans, or Applicable Laws and Regulations

Estimated environmental liabilities are adjusted each year for price growth (inflation) and increases in labor rates and materials. As of September 30, 2018, 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.

An inflation factor of 1.02 was applied to Accrued Environmental Restoration Liabilities, Environmental Corrective Action, and Environmental Closure Requirements cost estimates generated using the most recently released version of RACER to bring costs forward to current-year dollars. This inflation factor is in accordance with the OUSD(C) memorandum, *"Inflation Guidance - Fiscal Year (FY) 2018 President's Budget"* (March 13, 2017) for Operations and Maintenance (O&M) and Department of the Air Force memorandum for record, *"Use of Escalation of Remedial Action Cost Engineering and Requirements (RACER) 11.4"* (November 6, 2017). This inflation factor is also applied to Asbestos to bring historical costs forward to reflect current-year dollars for FY2018.

An inflation factor of 1.019 was applied to Base Realignment and Closure cost estimates generated using the most recently released version of RACER to bring costs forward to FY 2018 cost basis. Additionally, projects that have negotiated payment schedules with escalation built in to the cost, and prior projects going back as far as FY16 are also de-escalated or escalated with the applicable inflation factor to report all costs in FY 2018 cost basis. The inflation factors are in accordance with the OUSD (C) memorandum, "*Inflation Guidance – Fiscal Year 2019 President's Budge*t*"* (December 22, 2017) for Military Construction (MILCON). Since BRAC has a small program, the rates released in the December/January timeframe are used prior to developing cost estimates.

For Non-Nuclear Powered General Equipment, the Air Force applies the published FY2018 hourly labor rate for the disposal preparation performed at the Aerospace Maintenance and Regeneration Group (AMARG). These rates are published annually around June for the following fiscal year (i.e., the FY2018 rates were published in FY2017). The rate of $119.44 was agreed upon by the Air Force for FY2018.

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

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 materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. Liabilities can further be affected if an environmental site investigation reveals contamination levels differing from estimated parameters. In addition, there are instances where Air Force information and accounting systems do not currently provide sufficient reliable information to calculate an environmental liability estimate, therefore no liability is reported. For example, Other Environmental Liabilities (i.e., asset-driven liabilities) are dependent upon the completeness and accuracy of real property asset records included in the Air Force's Real Property Accountable Property System of Record. These include liabilities for: Hazardous Waste Storage Facilities (HWSF); Pipelines and Piping; Underground Oil Water Separators (OWSs); Above-Ground OWSs; Wastewater Treatment Tanks and Basins; Water Supply Wells; Polychlorinated biphenyl (PCB) Transformers; Demolition and Burn Facilities; PAC structures; and PAC linear structures. There is also uncertainty regarding emerging contaminants, Perfluorooctanoic Acid (PFOA) and Perfluorooctane Sulfonic Acid (PFOS), due to the lack of promulgated cleanup standards at some installations and limited information.

Unrecognized Costs

The Air Force may have unrecognized costs due to either 1) the Air Force is accreting the environmental disposal liability over the estimated useful life of the associated assets, or 2) The Air Force does not yet have the valuation approach to estimate a liability for the associated assets.

Unrecognized costs due to the accretion of the liability: The Air Force has does not have unrecognized costs due to the accretion of the liability. The Air Force has evaluated there are no such liabilities requiring the accretion method that would be materially significant to the overall environmental liability. Therefore, all environmental liabilities have been fully accrued for the CTC as of fiscal year-end 2018.

Unrecognized costs due to the lack of a valuation approach: The Air Force has an unrecorded liability for the following ECR asset categories and asbestos assets for which there is a lack of reliable information to calculate an estimated environmental liability. The Air Force is continuing to implement corrective action plans (CAPs) to address the ability to assess the eight remaining ECR asset categories (HWSF, Pipelines and Piping, Underground OWSs, Above-Ground OWSs, Wastewater Treatment Tanks and Basins, Water Supply Wells, PCB Transformers, Demolition and Burn Facilities) as well as structures and linear structures 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. The Air Force also has an unrecorded environmental liability for the following general equipment and weapons systems assets (rotary-wing aircraft, remotely piloted aircraft, mine resistant ambush protected vehicles, satellites, ICBMs, and pods). The Air Force is currently developing CAPs to address the lack of cost models for these asset classes.

Other Disclosures

Year-over-year Changes

Accrued Environmental Restoration Liabilities

The total Air Force Accrued Environmental Restoration Liabilities increased by a total of 3.7% (IRP and BD/DR = 3.9% and MMRP = -1.7%) from FY2017 to FY2018. The increase in the IRP programming is mostly due to preliminary investigations of the emerging contaminants PFOS/PFOA. The bulk of the preliminary assessments (PAs) and site inspections (SIs) for PFOS/PFOA are nearly complete but additional investigation will be required to fully delineate drinking water contamination above EPA's Lifetime Health Advisory of 70 parts per trillion. Results from SIs will verify the locations that will need to progress to more in-depth studies, which are referred to as expanded SIs, which in turn will lead to better cost to complete estimates. As for the decrease in MMRP programming, this was mostly due to removing MMRP ANG cost that is either Defense Environmental Restoration Account (DERA) ineligible or pending OSD eligibility determination.

On November 28, 2017, the Assistant Secretary of Defense (Energy, Installations, and Environment) (OASD(EI&E)) issued a memorandum for the Assistant Secretary of the Air Force (Installations, Environment, Energy) stating the results of a funding review by the DoD Office of General Counsel (OGC). As part of the review, ANG sites were evaluated for DERP funding eligibility. The DoD OGC concluded that DERP appropriations should not be used to fund restoration activities at State-owned and operated facilities, where the DoD was not the "owner or operator" under CERCLA. As a result, the Office of the Deputy Assistant Secretary of Defense for Environment, Safety and Occupational Health (ODASD(ESOH)) developed a transition plan requiring ANG sites to obtain OSD approval for DERP eligibility. The memorandum also directed that new obligations after October 1, 2017, be charged to the ANG O&M account, as appropriate. As of September 30, 2018, 360 ANG sites were pending approval or ineligible for DERP funding, thus the CTC for those sites were excluded from the Accrued Environmental Restoration Liabilities and instead, $951.5 million for these sites were included within the Environmental Corrective Actions.

Other Accrued Environmental Liabilities – Non BRAC
The total Air Force Other Accrued Environmental Liabilities – Non-BRAC increased by a total of 15.8% (ECA = 1750.8%, ECR = 20.2%, and Asbestos = -39.1%) from FY2017 to FY2018, 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 $979.2 million in FY2018. This was an increase of $926.3 million over the $52.9 million reported in FY2017. In FY2018, the DoD updated Note 12, Line 1.B.1 to include EROR, which continued to report a $0 balance. For FY2018, Environmental Corrective Action included ANG sites pending approval or no longer eligible for DERP funding based on the November 28, 2017, OASD(EI&E) memorandum. This resulted in an additional 360 sites and a $951.5 million increase in Environmental Corrective Action with corresponding decrease in Accrued Environmental Restoration Liabilities.

Environmental Closure Requirements:
The Air Force reported an estimated environmental liability for ECR assets of $362.5 million in FY2018. This was an increase of $57.3 million over the $301.7 million reported in FY2017. In FY2018, environmental liabilities were reported for nine asset categories (USTs, ASTs, Non Hazardous Waste Landfills, Wastewater Lagoons / Ponds, Septic Tanks, Recycling Centers, Composting Units, and Class V Injection Wells, Cesspools, and Other Dry Wells, and Solid Waste Incinerators). CAP implementation was ongoing for eight asset categories (HWSF, Pipelines and Piping, Underground OWSs, Above-Ground OWSs, Wastewater Treatment Tanks and Basins, Water Supply Wells, PCB Transformers, and Demolition and Burn Facilities). In FY2018, revisions to ECR asset category cost estimation methodologies were made, including: updated cost factors (e.g., to adjust for inflation), inclusion of Real Property Installed Equipment (RPIE) to more accurately capture all asset records in the APSRs that have associated ECR and closure assumptions. Additionally, changes in the Real Property inventory resulted in a 50.8% increase in assets with an ECR, partially driven by ongoing Real Property corrective action plan implementation efforts to de-bundle assets (e.g., USTs and ASTs).

Asbestos:
The Air Force reported an estimated environmental liability for Asbestos of $1,031.7 million in FY2018. This was a decrease of $662.8 million from the $1,694.5 million reported in FY2017. In FY2018, revisions to the cost estimation methodology (e.g., changes to business rules and exclusion criteria to identify asset populations), narrowed scope and application of the cost estimation methodology to only include asbestos survey and abatement data for buildings similar in age, size, and type. In FY2017, cost estimates were generated across a broader range of PAC assets for survey costs. For FY2018, the survey cost estimation methodology was more judiciously applied to a smaller sub-set of assets, resulting in a $356.7 million decrease in survey costs. Further refinements to the exclusion criteria used to identify the PAC asset population resulted in an additional decrease of $202.3 million in survey and abatement costs. The inflation factor applied to historical data resulted in an increase of $141.1 million in FY2018. Additionally, fluctuations in the Real Property inventory, resulted in a 12.0% decrease in assets with asbestos. For FY2018, environmental liabilities for 47.7% PAC asset population are reported. The remaining 52.3% of PAC assets were not estimable for FY2018 due to ongoing CAP implementation focused on obtaining sufficient reliable information to develop cost estimation methodologies for structures and linear structures.

BRAC
Environmental liabilities reported in BRAC increased by $614.9 million (38.4%) from FY2017 to FY2018.

BRAC IRP:
This line increased by $610.8 million from 2017. Of the $610.8M increase, $481M is due to a change in programming business rules for PFOS and PFOA. In the previous cycle investigations were programmed based on the results of Preliminary Assessments and initial Site Inspections. During this reporting cycle groundwater restoration was programmed based on the results of the Site Inspections. The second largest contributor is $86.7M due to the progress of performance-based remediation (PBR) contracts at BRAC installations. A majority of the increase due to PBR contracts are at the former Pease, Williams, Kelly, McClellan, Eaker, and Mather AFB, and are mainly caused by informal disputes with regulators that drive delays in cleanup schedules and updated approaches, contamination levels are greater than anticipated requiring

additional remediation activities, and the discovery of new contamination. Additionally, $43.1M is attributed to Department of Defense State Memorandum of Agreement (DSMOA) due to additional remedial actions executed in order to address emerging contaminants, PFOS/PFOA.

The BRAC MMRP:
This line increased by $3.5 million (68.9%) from 2017. This increase is due to the following: skeet range cleanup actions at the former Bergstrom AFB after lead shot and clay debris were identified in 2016; additional cleanup activities at two MMRP sites at the former Eaker AFB; and, new requirements for former George MMRP site after unearthing 145 live 22mm rounds.

The BRAC Environmental Corrective Action / Closure Requirements:
This line increased by $0.2 million (25.2%) from 2017, as the following projects continued to be liquidated during 2018: requirements at the former George AFB to remove a previously unknown oil water separator and underground storage tank; soil removal at the former March AFB; and, removal of an underground storage tank at the former Mather AFB, and lead based paint soil removal at former Williams AFB.

Asbestos:
Increased by $0.5 million (955.6%) from 2017, due to the discovery of additional asbestos requiring abatement at former Chanute AFB Base.

Environmental Disposal for General Equipment / Weapons Programs

Non-Nuclear Powered General Equipment:
The Environmental Disposal for Military Equipment/Weapons, Non-Nuclear Powered Military Equipment decreased to $126.5 million from $137.0 million in fiscal year 2017 due to a decrease of fixed-wing aircraft in FY2018.

Ongoing Corrective Action Impacts

Accrued Environmental Restoration Liabilities
ANG sites categorized as Defense Environmental Restoration Account (DERA) ineligible, or pending decision, will be re-evaluated beginning in FY2019. ANG sites determined DERA eligible will be reabsorbed into the DERP program.

Other Accrued Environmental Liabilities (OEL) – Non BRAC
The Air Force understands that additional assets on active installations with environmental closure requirements and asbestos liabilities exist, but are not yet reported due to ongoing implementation of corrective actions. These CAPs are focused on assessing the remaining ECR and Asbestos assets. There are eight remaining asset categories with ECR: Hazardous Waste Support Facilities, Pipelines/Piping; Underground OWSs; Above-Ground OWSs; Wastewater Treatment Tanks and Basins; Water Supply Wells; PCB Transformers, and Demolition and Burn Facilities. For FY2018, the Air Force had a total of 921 different category codes (CATCODEs) in the Real Property Categorization System. Asbestos estimates were generated for 466 CATCODEs. Corrective actions are ongoing to assess the remaining 455 CATCODEs for asbestos exemption or inclusion. 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 using subject matter specialists and current real property inventories to make these determinations. For Asbestos, CAPs are being implemented to assess and estimate PAC structures and linear structures.

While business rules have been developed governing the use of RACER for estimating ERA, ECA, and ECR, corrective action efforts are ongoing to collect actual cost data to demonstrate the reasonableness of RACER estimates.

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 in FY2019 and potentially beyond. Until full implementation of these programmatic changes is complete, balances will reflect only a portion of the liabilities at year end.

Emerging Contaminants

In 2015, the DERP program identified PFOS and PFOA as contaminants requiring time and non-time-critical removal action drinking water due to the threat of adversely affecting human health and the environment. PFOS and PFOA are compounds found in Aqueous Film-Forming Foam (AFFF), which was used by the Air Force to suppress petroleum fires from 1970 to 2016. The chemicals are found in all media types and generally resistant to environmental degradation processes. In 2015, AFCEC/CZ awarded an enterprise-wide project to assess the occurrence of PFOS and PFOA, particularly in groundwater, at Air Force locations where AFFF may have been released. In 2016, the Air Force awarded several projects to conduct site inspections for the presence of PFOS and PFOA and began mitigating their occurrence in drinking water at Eielson, Dover, Joint Base Cape Cod, and Wright Patterson AFBs. In 2017, The Air Force completed testing for PFOS and PFOA in drinking water at all installations and continued the investigation phase and mitigation actions at those installations with contaminated drinking water. By the end of fiscal year 2018, the Air Force had completed 100% of the drinking water testing, 99% of all preliminary assessments, 38% of the site inspections, and has mitigation actions underway for drinking water at 19 installations.

For BRAC, there are 30 installations expected to complete site inspection phase that will require follow-on investigation (RI/FS), and 6 of those installations require mitigation. Drinking water mitigation efforts are underway at the following BRAC installations: K.I. Sawyer, March, Pease, Plattsburgh, Reese, and Wurtsmith.

The results of the analysis will provide a basis for estimating increases to future liability estimates over the next several years as investigation results are obtained and more detail is known around the remedies required across the Air Force.

Note 13. Other Liabilities

As of September 30	2018 (unaudited)		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
1. 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
FECA 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
2. Nonfederal			
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 Nonfederal Other Liabilities	$ 6,074,384	$ 3,867,169	$ 9,941,553
3. Total Other Liabilities	$ 7,269,831	$ 3,973,742	$ 11,243,573

As of September 30	2017 (unaudited)		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
1. Intragovernmental			
Advances from Others	$ 982,531	$ 0	$ 982,531
Deposit Funds and Suspense Account Liabilities	(417,316)	0	(417,316)
Disbursing Officer Cash	60,393	0	60,393
Judgment Fund Liabilities	22,517	0	22,517
FECA Reimbursement to the Department of Labor	93,284	108,470	201,754
Custodial Liabilities	0	4,556	4,556
Employer Contribution and Payroll Taxes Payable	82,489	0	82,489
Other Liabilities	14,427	0	14,427
Total Intragovernmental Other Liabilities	$ 838,325	$ 113,026	$ 951,351
2. Nonfederal			
Accrued Funded Payroll and Benefits	$ 1,418,062	$ 0	$ 1,418,062
Advances from Others	201,591	0	201,591
Deposit Funds and Suspense Accounts	553,671	0	553,671
Accrued Unfunded Annual Leave	2,562,104	0	2,562,104
Contract Holdbacks	110,970	0	110,970
Employer Contribution and Payroll Taxes Payable	255,325	0	255,325
Contingent Liabilities	0	5,459,799	5,459,799
Other Liabilities	(3)	0	(3)
Total Nonfederal Other Liabilities	$ 5,101,720	$ 5,459,799	$ 10,561,519
3. Total Other Liabilities	$ 5,940,045	$ 5,572,825	$ 11,512,870

Intragovernmental Other Liabilities primarily consists of unemployment compensation liabilities.

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

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.

Disbursing Officers 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.

For information on Judgment Fund Liabilities, see Note 14, Commitments and Contingencies.

FECA Reimbursement to the Department of Labor represents liabilities due under the Federal Employee Compensation Act. Billed amounts payable in Fiscal Years 2018 and 2019 and unbilled amounts for both incurred and estimated accrual amounts are included. However, see Note 15, 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 Contributions 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.

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.

Contingent Liabilities includes $3.4 billion related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The Air Force is under no obligation to pay contractors for amounts in excess of progress payments authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid are estimable, the Air Force has recognized a contingent liability for the estimated unpaid costs considered conditional for payment pending delivery and government acceptance.

Total contingent liabilities for progress payments based on cost represent the difference between the estimated costs incurred to date by contractors and amounts authorized to be paid under progress payments based on cost provisions within the FAR.

Estimated contractor-incurred costs are calculated by dividing the cumulative unliquidated progress payments based on cost by the contract-authorized progress payment rate. The balance of unliquidated progress payments based on cost is deducted from the estimated total contractor-incurred costs to determine the contingency amount.

The abnormal balance in Intragovernmental Deposit Funds and Suspense Account Liabilities of $222.5 million for fiscal year 2018 and $417.3 million for 2017 is due to a change in reporting. In the 4th Quarter, FY 2016, the Air Force began moving various withholdings from clearing suspense accounts to deposit fund accounts. While the transition is in process, intransit collections are being reported in the deposit funds which are mapped to a different line on Note 13- Nonfederal Deposit Funds and Suspense Accounts. The offsetting intransits are residing in the suspense accounts, which are mapped to Intragovernmental Deposit Funds and Suspense Account Liabilities. This change in process is creating an abnormal balance as they are mapped to different lines on Note 13.

Note 14. Commitments and Contingencies

The Air Force is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests.

The Air Force has accrued contingent liabilities for legal actions where the Secretary of the Air Force General Counsel (SAF/GC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The Air Force includes contingent liabilities in Note 13, Other Liabilities.

Contingencies may include claims that derive from treaties or international agreements. Treaties and international agreements should be reviewed to determine whether they give rise to financial obligations other than amounts already recognized, and if so, the resulting contingencies or commitments must be disclosed.

Based on past history with similar claims, USAF claims and litigation from Civil Law having a reasonably possible liability are estimated at $431.3 million. Since monetary judgments paid to civil litigants come from a judgment fund administrated by U.S. Treasury, it is uncertain that claims will become a liability to the Air Force.

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 fairly present Air Force commitments and contingencies.

In addition, Air Force recognized the total estimated probable liability for claims and litigation against the Air Force, handled by the Civil Law and Litigation Directorate, as of Sept 30, 2018, valued at $595.9 million, included in Nonfederal Contingent Liabilities. As of Sept 30, 2018, the Air Force was party to 2,977 claims and litigation actions. This liability dollar amount recorded in the financial statements is an estimate based on the weighted average payout rate for the previous three years. There are only two types of cases where U.S. Treasury will seek reimbursements from the affected agency, the Contract Dispute Act cases and select Federal Government personnel disciplinary matters.

In cases where SAF/GC disclosed that a judgment has been awarded against the Air Force, these amounts were reported on the Balance Sheet and within Note 13.

Note 15. Military Retirement and Other Federal Employment Benefits

As of September 30	2018 (unaudited)		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in thousands)			
1. Other Benefits			
FECA	$ 1,005,921	$ 0	$ 1,005,921
Other	7,249	7,249	0
Total Other Benefits	$ 1,013,170	$ 7,249	$ 1,005,921
2. Total Military Retirement and Other Federal Employment Benefits:	$ 1,013,170	$ 7,249	$ 1,005,921

As of September 30	2017 (unaudited)					
		Liabilities		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
(Amounts in thousands)						
1. Other Benefits						
FECA	$	1,022,963	$	0	$	1,022,963
Other		4,833		4,833		0
Total Other Benefits	$	1,027,796	$	4,833	$	1,022,963
2. Total Military Retirement and Other Federal Employment Benefits:	$	1,027,796	$	4,833	$	1,022,963

Programs for which actuarial benefits are computed include the Federal Employees' Compensation Act (FECA); the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases; and a component for incurred but not reported claims.

FECA liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to present value using the Office of Management and Budget's economic assumptions for 10-year U.S. Treasury notes and bonds.

Interest rate assumptions utilized for discounting were as follows:

Discount Rates

For wage benefits:
2.716% in Year 1 and Years thereafter;
For medical benefits:
2.379% in Year 1 and Years thereafter.

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors [Cost of Living Adjustment (COLA)] and medical inflation factors [Consumer Price Index Medical (CPIM)] were applied to the calculation of projected future benefits. The actual rates for these factors for the charge-back year (CBY) 2016 were also used to adjust the methodology's historical payments to current-year constant dollars.

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

CBY	COLA	CPIM
2018	N/A	N/A
2019	1.31%	3.21%
2020	1.51%	3.48%
2021	1.89%	3.68%
2022	2.16%	3.71%
2023 and thereafter	2.21%	4.09%

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 2016 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 2017 projection to the average pattern for the projections of the most recent three years.

The Air Force's actuarial liability for workers' compensation benefits is developed and provided by Department of Labor at the end of each fiscal year. There is no change on a quarterly basis.

Other Federal Employment Benefits is comprised of additional post-employment benefits due and payable to military personnel.

Note 16. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue				
As of September 30		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
Military Personnel				
1. Gross Cost	$	36,829,310	$	35,707,662
2. Less: Earned Revenue		(531,001)		(552,272)
Total Net Cost	$	36,298,309	$	35,155,390
Operations, Readiness & Support				
1. Gross Cost	$	55,891,675	$	58,192,753
2. Less: Earned Revenue		363,068		(31,607)
Total Net Cost	$	56,254,743	$	58,161,146
Procurement				
1. Gross Cost	$	55,643,670	$	45,311,469
2. Less: Earned Revenue		(4,317,785)		(7,909,856)
Total Net Cost	$	51,325,885	$	37,401,613
Research, Development, Test & Evaluation				
1. Gross Cost	$	36,147,929	$	28,036,345
2. Less: Earned Revenue		(3,732,001)		(3,040,906)
Total Net Cost	$	32,415,927	$	24,995,439
Family Housing & Military Construction				
1. Gross Cost	$	2,732,165	$	461,768
2. Less: Earned Revenue		(14,105)		(17,418)
Total Net Cost	$	2,718,060	$	444,350
Consolidated				
1. Gross Cost	$	187,244,749	$	167,709,997
2. Less: Earned Revenue		(8,231,824)		(11,552,059)
Total Net Cost	$	179,012,925	$	156,157,938

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 DoD's current processes and systems capture costs based on appropriations 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) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 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 nonfederal 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 nonfinancial feeder systems adjusted to record known accruals for major items such as payroll expenses, accounts payable and environmental liabilities.

Note 17. Disclosures Related to the Statement of Changes in Net Position

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 $446.2 million because of the items noted in the tables below.

Year Ended September 30, 2018 (unaudited) Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations Received on the Statement of Changes in Net Position		(Dollars In thousands)
Appropriations, Statement of Budgetary Resources	$	189,701,583.0
Less: Appropriations Received, Statement of Changes in Net Position		190,147,759.0
Total Reconciling Amount	**$**	**(446,176.0)**
Items Reported as Reductions to Appropriations, Statement of Budgetary Resources		
Permanent and Temporary Reductions	**$**	(520,345.0)
Items Reported in Appropriations, Statement of Budgetary Resources		
Transfers		64,891.0
Trust and Special Fund Receipts		9,278.0
Total Reconciling Items	**$**	**(446,176.0)**

Funds from Dedicated Collections are presented on a combined basis. The tables below 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.

Year Ended September 30, 2018 (unaudited) *(Dollars in thousands)*
Reconciliation of Combined Dedicated Collections and Other Funds to Consolidated Dedicated Collections and Other Funds

Consolidating Net Position	Combined	Consolidating Eliminations	Consolidated
Unexpended Appropriations – Dedicated Collections	$ -	$ -	$ -
Unexpended Appropriations – Other Funds	$ 26,365.0	$ 939.0	$ 27,304.0
Cumulative Results of Operations – Dedicated Collections			
Cumulative Results of Operations – Other Funds	$ 3,811.3	$ (643.0)	$ 3,168.3
Total Net Position	**$ 30,176.3**	**$ 296.0**	**$ 30,472.3**

Year Ended September 30, 2017 (unaudited) Reconciliation of Combined Dedicated Collections and Other Funds to Consolidated Dedicated Collections and Other Funds			*(Dollars in thousands)*
Consolidating Net Position	**Combined**	**Consolidating Eliminations**	**Consolidated**
Unexpended Appropriations – Dedicated Collections	$ -	$ -	$ -
Unexpended Appropriations – Other Funds	$ 21,195.6	$ 3,184.2	$ 24,379.8
Cumulative Results of Operations – Dedicated Collections			
Cumulative Results of Operations – Other Funds	$ 6,006.4	$ (1,972.1)	$ 4,034.3
Total Net Position	**$ 27,202.0**	**$ 1,212.1**	**$ 28,414.1**

Note 18. Disclosures Related to the Statement of Budgetary Resources

As of September 30		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
1. Intragovernmental Budgetary Resources Obligated for Undelivered Orders:				
Unpaid		24,919,775		22,884,570
Prepaid/Advanced		880,925		873,328
Total Intragovernmental	$	25,800,700	$	23,757,898
2. Nonfederal Budgetary Resources Obligated for Undelivered Orders:				
Unpaid		69,964,998		63,959,868
Prepaid/Advanced		20,052,565		18,617,066
Total Nonfederal	$	90,017,563	$	82,576,934
3. Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$	115,818,263	$	106,334,832

Intraentity Transactions

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

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.

	Category A	Category B	Exempt
Direct	$100.7 billion	$81.9 billion	$4.1 million
Reimbursable	$4.9 billion	$4.6 billion	$0.0 million
Total	$105.6 billion	$86.5 billion	$4.1 million

Permanent Indefinite Appropriations

Permanent indefinite appropriations are as follows (reference Note 21 for additional information):

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

Wildlife Conservation Fund [16 USC 670]

Air Force Cadet Fund [37 USC 725(s)]

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)

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 17, Disclosures Related to the Statement of Changes in Net Position for additional details.

Note 19. Reconciliation of Net Cost of Operations to Budget

As of September 30		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
Resources Used to Finance Activities:				
Budgetary Resources Obligated:				
1. Obligations incurred	$	193,052,669	$	180,977,006
2. Less: Spending authority from offsetting collections and recoveries (-)		(15,204,609)		(14,531,572)
3. Obligations net of offsetting collections and recoveries	$	177,848,060	$	166,445,434
4. Less: Offsetting receipts (-)		(339,645)		(64,658)
5. Net obligations	$	177,508,415	$	166,380,776
Other Resources:				
6. Transfers in/out without reimbursement (+/-)		(238,849)		(1,623,550)
7. Imputed financing from costs absorbed by others		790,529		587,303
8. Other (+/-)		626,436		745,387
9. Net other resources used to finance activities	$	1,178,116	$	(290,860)
10. Total resources used to finance activities	$	178,686,531	$	166,089,916
Resources Used to Finance Items not Part of the Net Cost of Operations:				
11. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:				
11a. Undelivered Orders (-)	$	(9,483,432)	$	(11,628,623)
11b. Unfilled Customer Orders		429,774		548,472
12. Resources that fund expenses recognized in prior Periods (-)		(741,752)		(35,869)
13. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		241,707		(46,431)
14. Resources that finance the acquisition of assets (-)		(18,210,386)		(18,851,469)
15. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		(373,329)		845,281
16. Total resources used to finance items not part of the Net Cost of Operations	$	(28,137,418)	$	(29,168,639)
17. Total resources used to finance the Net Cost of Operations	$	150,549,113	$	136,921,277

As of September 30		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
18. Increase in annual leave liability	$	90,467	$	57,660
19. Increase in exchange revenue receivable from the public (-)		(1,570)		(27,736)
20. Other (+/-)		123,692		3,040,015
21. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	$	212,589	$	3,069,939
Components not Requiring or Generating Resources:				
22. Depreciation and amortization	$	9,244,759	$	(22,902,664)
23. Revaluation of assets or liabilities (+/-)		9,423,377		4,023,449
24. Other (+/-)				
24a. Cost of Goods Sold		2,276,998		0
24b. Operating Materiel and Supplies Used		29,755,256		37,399,564
24c. Other		(22,449,167)		(2,353,627)
25. Total Components of Net Cost of Operations that will not Require or Generate Resources	$	28,251,223	$	16,166,722
26. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	$	28,463,812	$	19,236,661
27. Net Cost of Operations	$	179,012,925	$	156,157,938

Due to Air Force financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. This difference is a previously identified deficiency. The amount of the adjustment to the note schedule to bring it into balance with the Statement of Net Cost is $5.5 million in the Other Components Not Requiring or Generating Resources category.

Other Resources Used to Finance Activities consists of other gains to adjust intragovernmental transfers in.

Other Resources Used to Finance Items Not Part of the Net Cost of Operations include adjustments to net obligated resources that do not affect the Net Cost of Operation such as net transfers in and out without reimbursement, and other gains and losses to adjust intragovernmental transfers in.

Other Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period consist of expenses due to Air Force Active Operations and Maintenance and Military Personnel.

Other Components not Requiring or Generating Resources include expenses for Operations and Maintenance, Procurement, and Military Construction.

In 2017, Budgetary Offsetting Collections and Receipts that do not affect Net Cost of Operations was abnormal in the amount of $46.4 million. This was attributed to the Deposit Account for Other Federal Payroll Withholding Allotments. Beginning in 4th Quarter, FY 2016, the Air Force has begun moving various withholdings from clearing suspense accounts to deposit fund accounts. While this transition is in process, intransit collections are being reported in the deposit funds. The offsetting intransits are residing in the suspense accounts. This change in processes is creating an abnormal balance as suspense accounts are not mapped to these lines on Footnote 19.

In 2017, Depreciation and Amortization is showing an abnormal balance of $22.9 billion due to adjustments made in several asset accountable property systems of record as a result of the FIAR Valuation effort to report asset balances more accurately.

In 2018, Undelivered Orders is abnormal due to positive undelivered order transactions interfacing into the general ledger from the Bases. The appropriations of Operations and Maintenance and Aircraft Procurement saw the largest abnormal transactions from the MAJCOMs.

Note 20. Disclosures Related to Incidental Custodial Collections

The Air Force collected $45.7 million of incidental custodial revenues generated primarily from collection of accounts receivable related to cancelled accounts. These funds are not available for use by Air Force. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.

Note 21. Funds from Dedicated Collections

BALANCE SHEET As of September 30 (Amounts in thousands)	2018 (unaudited)				
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Eliminations	Consolidated Total
ASSETS					
Fund Balance with Treasury	$ 15,918	$ 2,463	$ 6,807	$ 0	$ 25,188
Investments	7	0	0	0	7
Accounts and Interest Receivable	1	0	0	0	1
Other Assets	1,340	0	0	0	1,340
Total Assets	$ 17,266	$ 2,463	$ 6,807	$ 0	$ 26,536
LIABILITIES and NET POSITION					
Accounts Payable and Other Liabilities	96	(140)	216	(271)	(99)
Total Liabilities	$ 96	$ (140)	$ 216	$ (271)	$ (99)
Cumulative Results of Operations	17,170	2,603	6,592	940	27,305
Total Liabilities and Net Position	$ 17,266	$ 2,463	$ 6,808	$ 669	$ 27,206
STATEMENT OF NET COST As of September 30 (Amounts in thousands)					
Program Costs	$ 2,916	$ 907	$ (12)	$ (643)	$ 3,168
Net Program Costs	$ 2,916	$ 907	$ (12)	$ (643)	$ 3,168
Net Cost of Operations	$ 2,916	$ 907	$ (12)	$ (643)	$ 3,168

STATEMENT OF CHANGES IN NET POSITION As of September 30 (Amounts in thousands)	2018 (unaudited)				
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Eliminations	Consolidated Total
Net Position Beginning of the Period	$ 15,662	$ 2,376	$ 3,158	$ 0	$ 21,196
Net Cost of Operations	2,916	907	(12)	(643)	3,168
Budgetary Financing Sources	4,721	1,136	3,420	0	9,277
Other Financing Sources	(297)	0	0	297	0
Change in Net Position	$ 1,508	$ 229	$ 3,432	$ 940	$ 6,109
Net Position End of Period	$ 17,170	$ 2,605	$ 6,590	$ 940	$ 27,305

BALANCE SHEET As of September 30 (Amounts in thousands)	2017 (unaudited) General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Eliminations	Consolidated Total
ASSETS					
Fund Balance with Treasury	$ 14,184	$ 2,256	$ 3,159	$ 0	$ 19,599
Investments	355	0	0	0	355
Other Assets	1,341	0	0	0	1,341
Total Assets	$ 15,880	$ 2,256	$ 3,159	$ 0	$ 21,295
LIABILITIES and NET POSITION					
Accounts Payable and Other Liabilities	218	(119)	0	(39)	60
Total Liabilities	$ 218	$ (119)	$ 0	$ (39)	$ 60
Cumulative Results of Operations	15,662	2,375	3,159	3,184	24,380
Total Liabilities and Net Position	$ 15,880	$ 2,256	$ 3,159	$ 3,145	$ 24,440
STATEMENT OF NET COST As of September 30 (Amounts in thousands)					
Program Costs	$ 4,594	$ 1,412	$ 0	$ (1,972)	$ 4,034
Net Program Costs	$ 4,594	$ 1,412	$ 0	$ (1,972)	$ 4,034
Net Cost of Operations	$ 4,594	$ 1,412	$ 0	$ (1,972)	$ 4,034

STATEMENT OF CHANGES IN NET POSITION As of September 30 (Amounts in thousands)	2017 (unaudited)				
	General Gift Fund	Wildlife Conservation Fund	Air Force Cadet Fund	Eliminations	Consolidated Total
Net Position Beginning of the Period	$ 16,433	$ 2,757	$ 0	$ 0	$ 19,190
Net Cost of Operations	4,594	1,412	0	(1,972)	4,034
Budgetary Financing Sources	5,035	1,030	0	0	6,065
Other Financing Sources	(1,212)	0	3,159	1,212	3,159
Change in Net Position	$ (771)	$ (382)	$ 3,159	$ 3,184	$ 5,190
Net Position End of Period	$ 15,662	$ 2,375	$ 3,159	$ 3,184	$ 24,380

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.

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

The Department of 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 U.S. 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 nonconsumptive 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 nonappropriated funding, this fund gives installation commanders the authority to collect fees from the sale of hunting and fishing permits.

Air Force Cadet Fund [37 USC 725 (s)]

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 22. Fiduciary Activities

Schedule of Fiduciary Activity

For the year ended September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
1. Fiduciary net assets, beginning of year	$ 1,833	$ 1,493
2. Contributions	7,317	2,481
3. Distributions to and on behalf of beneficiaries	(6,370)	(2,142)
4. Increase/(Decrease) in fiduciary net assets	$ 947	$ 339
5. Fiduciary net assets, end of period	$ 2,780	$ 1,832

Schedule of Fiduciary Net Assets

For the year ended September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
FIDUCIARY ASSETS		
1. Cash and cash equivalents	$ 2,780	$ 1,833
2. TOTAL FIDUCIARY NET ASSETS	$ 2,780	$ 1,833

A fiduciary relationship may exist anytime a Federal Government entity collects or receives, and holds or makes disposition of assets in which a non-federal individual or entity has an ownership interest that the Federal Government 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 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 23. Other Disclosures

As of September 30	2018 (unaudited) Asset Category			
	Land and Buildings	Equipment	Other	Total
(Amounts in thousands)				
1. Intragovernmental Operating Leases				
Future Payments Due				
Fiscal Year				
2019	3,132	0	0	3,132
2020	3,132	0	0	3,132
2021	266	0	0	266
2022	266	0	0	266
2023	266	0	0	266
After 5 Years	266	0	0	266
Total Intragovernmental Future Lease Payments Due	$ 7,328	$ 0	$ 0	$ 7,328
2. Nonfederal Operating Leases				
Future Payments Due				
Fiscal Year				
2019	4,696	0	16,708	21,404
2020	66	0	16,924	16,990
2021	2,204	0	16,927	19,131
2022	1,613	0	17,256	18,869
2023	420	0	17,515	17,935
After 5 Years	365	0	17,735	18,100
Total Nonfederal Future Lease Payments Due	$ 9,364	$ 0	$ 103,065	$ 112,429
3. Total Future Lease Payments Due	$ 16,692	$ 0	$ 103,065	$ 119,757

Leases in the Land and Buildings category include costs for the operating leased facilities for the active Air Force in the United States and overseas. Land and Buildings consist mostly of housing facilities as well as other mission critical assets.

Leases in the Other category are made up of commercial vehicle leases. Commercial leases are leases made by the Air Force with the general public. These would include leases with dealerships, rental car companies, or any such entity that provides car leasing services.

Note 24. Disclosure Entities and Related Parties

Effective in 2018, SFFAS 47 “Reporting Entity” requires agencies to disclosure 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. When 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.

This Page Intentionally Left Blank

Fiscal Year 2018

GENERAL FUND

Required Supplementary

Stewardship Information

STEWARDSHIP INVESTMENTS

Stewardship investments are substantial investments made by 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 (Nonfederal Physical Property) and federally financed research and development (Research and Development).

NONFEDERAL PHYSICAL PROPERTY

Nonfederal 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. The expenses include the costs identified for major additions, alterations and replacements, purchases of major equipment, and purchases or improvements of other nonfederal assets. In addition, Nonfederal Physical Property Investments include federally owned physical property transferred to state and local governments.

NONFEDERAL PHYSICAL PROPERTY
Yearly Investment in State and Local Governments
For the Current and Four Preceding Fiscal Years
($ in millions)

Categories	FY 2018	FY 2017	FY 2016	FY 2015	FY 2014
1. Transferred Assets:					
National Defense Mission Related	0	0	0	0	0
2. Funded Assets:					
National Defense Mission Related	$ 16.4	$ 15.5	$ 17.2	$ 13.9	$ 12.7
Totals	$ 16.4	$ 15.5	$ 17.2	$ 13.9	$ 12.7

The Air National Guard investments in Nonfederal 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 Nonfederal Physical Property outlays (expenditures). Outlays are used because current DoD systems are unable to capture and summarize costs in accordance with the Federal GAAP requirements.

INVESTMENTS IN RESEARCH AND DEVELOPMENT
Yearly Investment in Research and Development
For the Current and Four Preceding Fiscal Years
($ in millions)

Categories	FY2018	FY2017	FY2016	FY2015	FY2014
1. Basic Research	$492	$521	$510	$539	$503
2. Applied Research	$1,454	$1,314	$1,241	$1,089	$1,127
3. Development:					
Advanced Technology Development	$827	$785	$675	$614	$632
Advanced Component Development and Prototypes	$4,962	$2,831	$1,555	$939	$948
System Development and Demonstration	$4,347	$3,858	$3,791	$3,274	$4,375
Research, Development, Test and Evaluation Management Support	$3,491	$1,691	$1,512	$1,497	$1,408
Operational Systems Development	$22,442	$17,257	$15,915	$14,880	$14,742
4. Totals	$38,015	$28,257	$25,199	$22,832	$23,735

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 and productivity rather than the development of hardware for service use. Employs demonstration activities intended to prove or test a technology or method.

2. Advanced Component Development and Prototypes 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 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 Air Force Research Laboratory (AFRL) have created the world's lightest wireless flying robot. Weighing in at 190 mg, it is only slightly larger than an actual fly. Previously, insect-sized flying machines need to be tethered to the ground in order to deliver the power required for flight. This new flying robot powered by a laser beam using a photovoltaic cell and an on-board circuit boosts the power generated by the cell to power the wings. The circuit also contains a microcontroller which controls the movement of the wings, which enable the microcontroller to acts like a real fly's brain telling wing muscles when to fire.

AFRL funded researchers have developed the world's most efficient semiconductor material for thermal management. The new material, defect-free boron arsenide, draws heat away from hotspots much faster than current materials. Managing heat in electronics has increasingly become one of the biggest challenges in optimizing performance due to the decreasing size of transistors. This new material has a record-high thermal conductivity, more than three-times faster at conducting heat than currently used materials, and could potentially revolutionize thermal management designs for computer processors and other electronics.

Applied Research:

AFRL research is enabling next-gen flexible, wireless communications. By optimizing just six atoms one ten-thousandth the width of a human hair, AFRL experts discovered a new way to grow and transfer Gallium Nitride (GaN)-a material revered for its exceptional ability to power communications systems-laying the groundwork for 5th generation, high speed, agile communication systems of the future. GaN is the basis for many communication devices and is often used in high-performance amplifiers or as a component of a radar or wireless system. AFRL demonstrated the ability to grow and place the material on a flexible substrate, enabling the potential to power wearable devices or electronic devices that are not necessarily flat. This is the first group ever to demonstrate a flexible radio frequency transistor device based on GaN that actually performs under strain and is flexible.

AFRL successfully developed and published the Open Seeker Architecture (OSA) v1.0 standard, and the first Software Development Kit to support single weapon integration. This new architecture enables extensions to collaborative GPS-denied navigation and cooperative target acquisitions, and is a critical aspect of rapidly upgrading software functionality in future weapon seekers, as well as breaking "vendor lock" on legacy weapon seeker solutions. Some of these future open-standard concepts have been developed for the Gray Wolf Cruise Missile S&T Demonstration, in conjunction with DARPA and Office of Naval Research (ONR).

AFRL completed efforts in Airframe Digital Twin to develop an integrated system of data, models, and analysis tools that enable better decisions regarding fleet lifecycle management and sustainment. AFRL validated Individual Aircraft Tracking structural damage methods on two F-15 wings in-house. In addition, AFRL completed development of engineered residual stress methods (laser peening) for airframe life extension which will be used as part of a F-15 C/D Program Office life extension program.

AFRL's Fiber Laser Beam Combination program reached a world record 4.5kW per narrow gain fiber amplifier. Once packaged commercially, this will enable the scaling of high energy laser power from the current 60kW to over 150kW which opens up a much wider target set for high energy laser weapons.

Advanced Technology Development:

AFRL recently identified, evaluated, and fully qualified two non-chromium outer moldline coating systems for use on the KC-46, thereby aiding in the estimated savings of $2M a year on chromium abatement and control. The two systems are Skydrol hydraulic fluid resistant, removable with DoD-approved chemical strippers, and galvanic corrosion-resistant. No appropriate non-chromium coatings systems had been previously qualified to the outer moldline specifications. The use of chromium-based coatings causes health and environmental concerns, and leads to excessive worker hours spent on HAZMAT-related activities. The safer, newly-qualified systems are being transitioned to depots, and all KC-46 aircraft will be required to use non-chromium systems on outer moldlines.

AFRL awarded contracts to Lockheed Martin and Northrop Grumman to begin work on Spiral 1 of the Gray Wolf Cruise Missile S&T demonstration, which will result in a baseline cruise missile design incorporating an open-systems, modular and "clean-sheet" design to enable a low-cost, easily upgradeable, and effective swarming cruise missile concept. AFRL is partnering with DARPA and the Navy to incorporate in-development semi-autonomous software into the Gray Wolf construct, and has been engaged with Air Combat Command (ACC), Indo-Pacific Command (INDO-PACOM), and European Command (EUCOM) to refine potential employment concepts and tactics for this next-generation air-dominance enabling technology.

AFRL and Wright State Research Institute Unmanned Aerial Systems (UAS) researchers conducted integration and risk reduction flight tests to demonstrate a common interface for multiple vehicles and sensor payloads. This team is chartered to enable multi-UAS command and control by a single operator using AFRL's Vigilant Spirit Control Station™. The team demonstrated command and control of the vehicle and connectivity to the sensor payload, as well as sensor control for road following and sensor slaving to a fixed target.

Tactical High Power Microwave Operational Responder (THOR) counter-Unmanned Aerial Vehicle system is undergoing operational experimentation evaluation at White Sands Missile Range in late October 2018. System will demonstrate effectiveness versus swarm UAS in conjunction with ground based High Energy Laser systems.

Advanced Component Development and Prototypes (ACD&P):

Technology Transition

Efforts under Technology Transition include Air Force Experimentation and Prototyping. The Air Force Experimentation FY18 accomplishments include conducting Phase II of the Light Attack Experiment which was a continuation of the Air Force's assessment of the capabilities of off-the-shelf attack aircraft to explore new operational concepts and candidate capabilities which could be rapidly and affordably fielded. Phase II allowed the Air Force to examine logistics and maintenance requirements, weapons, sensors, communications networking, future interoperability with partner forces, and to complete items not completed in Phase I. During Phase II, the Air Force also experimented with rapidly building and operating an exportable, affordable communications network to enable aircraft to communicate with joint and multi-national forces, as well as command-and-control nodes. Acquisition alternatives for a rapid acquisition are in development.

The Air Force Prototyping FY18 accomplishments include successful testing demonstrations under the Adaptive Engine Transition Program (AETP). During FY18, the AETP continued advanced component testing, made significant progress in detailed design and next generation suitability study efforts. This incorporated successful compressor, fan, and core rig tests and is progressing the adaptive engine design toward final DDR next year accomplishments include successful testing demonstrations under the Adaptive Engine Transition Program (AETP).

Additional FY18 Prototyping accomplishments include two Hypersonics Rapid Prototyping (Sec 804) efforts, Air-Launched Rapid Response Weapon (ARRW) and Hypersonic Conventional Strike Weapon (HCSW).

The ARRW rapid prototyping effort will "push the art-of-the-possible" by leveraging the technical base established by the Air Force/DARPA partnership with a goal to provide an early operational capability in FY21-22. The ARRW effort is a hypersonic weapon designed to engage time sensitive targets, while improving the survivability of Air Force systems. ARRW offers the potential for military operations from longer ranges with shorter response times and enhanced effectiveness compared to current military systems.

- In May 2018, SAF/AQ signed the ARRW Acquisition Decision Memorandum (ADM) designating ARRW as a rapid prototyping effort under Section 804 of the FY16 National Defense Authorization Act
- In May 2018, ARRW conducted a successful preliminary design review
- In Aug 2018, the ARRW effort awarded a not-to-exceed $480,000,000 undefinitized contract to Lockheed Martin Missiles and Fire Control, Orlando, Florida, for critical design review, test and production readiness support to facilitate fielded prototypes.
- Continued to develop and execute test and manufacturing readiness activities in support of the early operational capability by FY21-22.

HCSW conducted a contract source selection, and awarded an indefinite delivery, indefinite quantity contract in May 2018 to allow learning to occur earlier in the effort in order to inform subsequent decisions. This Section 804 (Rapid Prototyping) effort defined requirements for an air-launched hypersonic weapon, determined hypersonic vehicle choice by leveraging proven technology and subsystems, and started development of a common motor to support current and future hypersonic systems and started integration work on Air Force platforms. The HCSW weapon will provide an ability to strike targets quickly at long ranges and through anti-access/area denial environments with an early operational capability by FY21-22.

Long Range Stand Off (LRSO) Weapon

The LRSO effort will develop a new nuclear cruise missile to maintain the capabilities of the Air Launched Cruise Missile. The LRSO weapon system will be capable of penetrating and surviving advanced integrated air defense systems from significant standoff range to prosecute strategic targets in support of the Air Force's global attack capability and strategic deterrence core function.

- On 23 August 2017, the program awarded Technology Maturation and Risk Reduction (TMRR) contracts to Lockheed Martin and Raytheon to compete their respective designs for the LRSO cruise missile.
- In conjunction with Department of Energy, the program developed the missile to warhead interface control document to ensure the cruise missile and warhead designs are synchronized for integration into the LRSO weapon.

Military Global Positioning System User Equipment Increment 1

Military GPS User Equipment (MGUE) Increment 1 is responsible for the development of standard modernized receiver form factors and the integration and test of these form factors in service-nominated lead platforms identified in the Joint Requirements Oversight Council (JROC)-approved MGUE Capabilities Development Document (CDD). MGUE will deliver significantly improved capability for Global Positioning System (GPS) receivers to counter emerging positioning, navigation and timing (PNT) threats and enable military operations in GPS-denied and Navigation Warfare (NavWar) environments where current legacy receiver performance would be compromised.

MGUE Increment 1 is in the Engineering and Manufacturing Development phase and received its Milestone B on 18 Jan 2017. Increment 1 continued its development of ground and aviation/maritime receiver cards. The first ground card completed delta security certification and qualification test activities in 2018. Security certification marks the approved configuration as "unclassified when keyed" which is necessary for integration and testing in an unclassified lab prior to fielding.

Space Security and Defense Program

The Space Security and Defense Program (SSDP) is a Joint Department of Defense (DoD) and Office of the Director of National Intelligence (ODNI) organization established to function as the center of excellence for options and strategies (materiel, non-materiel, cross-community, cross-domain) leading to a more resilient and enduring National Security Space (NSS) Enterprise. In FY16, SSDP completed efforts resulting in the delivery and implementation of specific cyber and materiel solutions to emergent capability needs. Examples include:

- Chartered by OSD-CAPE to conduct the analysis for the 2106 Space Strategic Portfolio Review. This analysis and out-brief specifically addressed Battle Management Command and Control architectures and mission gaps as well as recommendations going forward for the investments made in the joint DoD and ODNI communities.
- Provided policy-makers specialized technical assistance, protection-specific data/findings, and validated recommendations regarding the impacts that policy/strategy changes may have on our protection of NSS capabilities.
- Supported wargames and exercises to refine Tactics, Techniques, and Procedures (TTPs) and Concept of Operations (CONOPS) for space-protection tenets, and developed/integrated rapid prototyping capabilities for key mission areas.
- Developed and delivered validated response options to Combatant Commanders (CCMDRs) for various threats.
- Provided strategic messages for a variety of key DoD and Intelligence Community (IC) activities.

Ground Based Strategic Deterrent (GBSD)

The Ground Based Strategic Deterrent (GBSD) acquisition program is a recapitalization for the Minuteman III (MMIII) Intercontinental Ballistic Missile (ICBM) Weapon System (WS). This includes a new missile system, new WS Command and Control (WSC2) systems, new ground systems, and the restoration and modernization of the MMIII silos and Launch Control Centers (LCCs). Specific FY18 accomplishments include:

- Continued to assess fielding requirements and matured flight system, weapon system command and control, cybersecurity, and associated ground system technologies, defined requirements and modular architectures through trade studies, prototyping, and demonstration and analysis.
- Continued to mature the weapon system preliminary design and reduce integration risk by conducting trade studies, system engineering, test activities, and system modeling and simulation.
- Completed System Requirements Review, Cost Capability Trade Studies, and began validation of Capability Development Document (CDD).
- Refined and issued an upgraded Security Classification Guide.
- Commenced planning for the Engineering and Manufacturing Development Request for Proposal (RFP).

System Development and Demonstration:

KC-46

The KC-46 is the next generation Aerial Refueling Tanker and will replace approximately one third of the aging Legacy Tanker fleet. The aircraft is a militarized commercial derivative of the Boeing 767-200. The KC-46 will provide aerial refueling support to the Air Force, Navy, and Marine Corps as well as allied nation coalition force aircraft, plus increased capabilities for cargo and aeromedical evacuation. Significant FY2018 accomplishments include:

- Engineering & Manufacturing Design (EMD) Aircraft: All four EMD aircraft will continue testing in support of military type certification, specification verification, and developmental test completion report closure.
- Low Rate Initial Production (LRIP): Awarded LRIP lot 4 (18 aircraft) in January of 2017 A total of 52 production aircraft are now on contract.
- Testing: Completed several key milestones including Amended Type Certification testing, Supplemental Type Certification testing and receiver certification testing for the A-10, KC-135, C-17, and F-16 aircraft.

Advanced Extremely High Frequency

The Advanced Extremely High Frequency (AEHF) System is a joint service satellite communications system that will provide survivable, global, secure, protected, and jam-resistant communications for high-priority military ground, sea and air assets. AEHF will allow the National Security Council and Unified Combatant Commanders to control their tactical and strategic forces at all levels of conflict through general nuclear war and supports the attainment of information superiority. The AEHF System is the follow-on to the Milstar system, augmenting and improving on the capabilities of Milstar, and expanding the MILSATCOM architecture.

On 28 July 2015, the Commander of Air Force Space Command declared Initial Operational Capability (IOC) for the AEHF program. IOC includes mission supported, active networks and two separate satellites operating in the AEHF mode. The operational control segment consists of one fixed and one transportable control element and an operational communications management system. Mission Planning Element (MPE) Increment 7.6 was delivered to the government in June 2015 and Operational Acceptance was achieved in January 2016. Follow-on increments (MPE Increments 8.0-8.2) were awarded to Lockheed Martin annually since 2015. MPE Increment 8.3 was awarded to Lockheed Martin on 29 Jun 2018 to enhance the ground mission control segment by providing greater mission planning responsiveness in a contested environment and to provide full International Partner functionality. In Aug 2018, the first phase of AEHF Operational Resiliency was awarded to Lockheed Martin to deliver new spacecraft resilience features and enhanced user recovery during/after conflict.

Space Based Infrared System (SBIRS)

The Space Based Infrared System (SBIRS) is an integrated, incrementally-deployed system of satellites that provides initial warning of ballistic missile attack on the U.S., its deployed forces, or its allies. SBIRS supports the missile warning, missile defense, battlespace awareness, and technical intelligence mission areas. It is a more-capable successor to the Defense Support Program (DSP).

GEO-1 and GEO-2 satellites were accepted for missile warning operations in November 2013, joining the previously certified HEO-1 and -2 payloads as part of the SBIRS constellation, providing greater capabilities than legacy systems. The HEO-3 and 4 payloads are now on orbit awaiting transition into the Integrated Tactical Warning and Attack Assessment (ITW/AA) The SBIRS GEO-4 satellite, referred to as GEO Flight-3, was successfully launched in January 2017 and SBIRS GEO-3 satellite, referred to as GEO Flight-4, was successfully launched in January 2018. GEO 5 and 6 satellites continue in production with system-level Critical Design Review (CDR) held Sep 2017.

Operational acceptance of the Block 10 ground system consolidated legacy Defense Support Program (DSP), SBIRS HEO, and SBIRS GEO satellite ground systems from three locations into one primary location and a backup. The primary operations location is the Mission Control System-2 (MCS-2) at Buckley AFB, CO, and the secondary operations location is the Mission Control System Backup-2 (MCSB-2) at Schriever AFB, CO. The consolidation provides a significant reduction in manpower requirements and allows for improvements in mission processing capabilities. Operational Acceptance of the Block 10 ground system occurred in December 2016. Increment 2 (Block 20) Operations Acceptance projected in fall of 2019 for full satisfaction of KPPs.

Space Modernization Initiative (SMI) invests in sustaining, enhancing and evolving Next Generation Overhead Persistent Infrared (OPIR). SMI improves performance of the current system and matures technologies for insertion into Next Generation satellites and payloads. SMI is ameliorating parts obsolescence, improving ground processing and intelligence integration of SBIRS on-orbit data, and developing improved sensor technologies. In an effort to exploit data from the new OPIR Battlespace Awareness Center system, the Tools, Applications, and Processing (TAP) Lab opened its doors in April 2016 and serves as a “sandbox” for developers to try out the unimaginable with this wealth of data and to transition the most promising capabilities to operations at Buckley or elsewhere. The Lab ultimately is about innovating to gain maximum exploitation and dissemination of the data. Ensuring 100% government data ownership made the TAP Lab possible with data access to a much broader base of Industry, Academia, and other government agencies.

Space Fence

Space Fence is a system of ground-based sensors to improve upon the former Air Force Space Surveillance System, a Very High Frequency radar operational from 1961 to 2013. The Space Fence will provide a more accurate and timely detection capability of smaller orbiting objects, primarily in low-earth orbit. The system will use higher frequency S-band radars at globally dispersed sites. As a result, it will greatly expand the uncued detection and tracking capability of the Space Surveillance Network from around 20,000 to up to 100,000+ objects, while working in concert with other network sensors. Increment 1/Initial Operational Capability (IOC) will consist of successful operations at the first radar site located in the Kwajalein Atoll and the Space Fence Operations Center (SOC) at Huntsville, AL. Ground breaking took place on Kwajalein Atoll in February 2015 and construction is underway, with IOC currently planned for late 3QFY19. Increment 2 will include completion of the second OCONUS radar, pending funding determinations and negotiations with the proposed host nation.

B-2 Defensive Management System

The Defensive Management System Modernization (DMS-M) program enhances the B-2 direct attack capability by addressing emerging and future 21st century threats and robust modern Integrated Air Defense Systems (IADS). By leveraging “state-of-the-art” electronic warfare antennae, processors, controllers and displays, B-2 aircrews will realize unprecedented situational battlespace awareness and dynamic, real-time threat avoidance in the most complex radio frequency emitter environments. The B-2 DMS program entered into Milestone B in 1QFY16 and awarded the EMD contract in March 2016. During development, the engineering baseline will be finalized and production representative kits will be procured to support DT/OT&E, a pre-Milestone C Operational Assessment, as well as B-2 Nuclear Certification testing.

B-52 Commercial Engine Replacement Program

The Commercial Engine Replacement Program (CERP) will replace current B-52 TF-33 engines that are deemed unsustainable past 2030. The TF-33 has been on the aircraft since it was designed in the 1950s. Integrating 21st century engines on 20th century aircraft will require changes to engine controls and displays, changes to engine pods and modifications to gearbox and pneumatic system. CERP completed a Materiel Development Decision in May 2018 and had the acquisition strategy approved in September 2018. The program has also been designated as an FY16 NDAA Section 804 Rapid Prototyping program. Utilization of rapid prototyping authorities reduces the schedule by 39 months. Savings are realized through streamlined documentation, use of commercial-based engineering practices, and use of a two 'block' flight test program focusing first on operational capability demonstration and then performance characteristics allowing the Air Force to make decisions earlier. The prototype efforts will culminate in operational aircraft modifications to add 21st century engines and associated aircraft integration. The Air Force will purchase 8 engines per aircraft for all 76 aircraft and will begin production in 2025. The program is on track to release request for proposal to engine vendors in 3QFY19.

B61-12 Tailkit Assembly

The B61-12 Life Extension Program (LEP) is a joint Department of Defense and Department of Energy (DOE) modernization program for a portion of the Nation's airborne leg of the nuclear triad. The B61-12 LEP consolidates four legacy B61 variants (mods 3,4,7 & 10) into one variant (mod 12), provides a digital weapon interface, and maintains current weapon capability by adding a guided tailkit. Under the joint effort, the DoD, through the Air Force Nuclear Weapons Center, is responsible for the B61-12 Tailkit Assembly (TKA) development, All-Up-Round (AUR) integration, and aircraft integration. The DOE, through the National Nuclear Security Administration, is responsible for the B61-12 Bomb Assembly (BA). The Bomb Assembly (BA) design agencies are Sandia and Los Alamos National Laboratories, and the TKA is developed by The Boeing Corporation.

The B61-12 TKA program entered the EMD phase after a successful Milestone B decision on 19 Nov 2012. The program completed developmental testing in June 2018, and is on track for a Milestone C decision in October 2018.

The B61-12 is slated to become the only nuclear gravity weapon in the U.S. arsenal as outlined in the Nuclear Weapons Council 3+2 strategy.

Combat Rescue Helicopter

The Combat Rescue Helicopter (CRH) will replace the aging HH-60G helicopter. The CRH will provide Personnel Recovery (PR) forces with a vertical takeoff and landing aircraft that is quickly deployable and capable of main base and austere location operations for worldwide PR missions.

The CRH will be capable of employment day or night, in adverse weather, and in a variety of threat spectrums from terrorist attacks to chemical, biological, radiological, and nuclear threats. The CRH can also conduct other collateral missions inherent in their capabilities to conduct PR, such as non-conventional assisted recovery, national emergency operations, civil search and rescue, international aid, emergency aero medical evacuation, disaster and humanitarian relief, counter drug activities, support of National Aeronautics and Space Administration flight operations, and insertion/extraction of combat forces.

Sikorsky Aircraft Corporation is working to meet the 69-month schedule incentive and is on track to deliver 112 aircraft designated as the HH-60W. Significant FY 2018 accomplishments include:

- Engineering & Manufacturing Development (EMD) Aircraft: EMD aircraft production and live fire test and evaluation continued through 2018. First flight of EMD aircraft is scheduled to occur in early FY 2019.
- System Demonstration Test Articles (SDTA) Aircraft: SDTA aircraft production was started in FY 2018 with deliveries starting in FY 2019.

Program Events: The air vehicle and training systems production continued through fiscal year 2018 to support contractor and government developmental testing in fiscal year 2019.

Contracting Information Technology

Contracting Information Technology (CON-IT) consolidates all contract writing, management, and reporting capabilities into a single solution to manage contracts from inception to closeout. As the Air Force's core contract management system, CON-IT provides standardized and integrated processes to comply with laws, regulations, and policies.

The program will initially replace two existing legacy systems with contract writing capability for the operational and contingency contracting community. Future increments will replace two more legacy systems by implementing acquisition contract writing requirements and automating pre- and post-contract award activities. CON-IT has adopted agile development as a program cornerstone and uses the methodology to decompose requirements to deliver functionality in weeks versus months or years.

- Program migrated eight operational sites (AFMETCAL, Altus AFB, Buckley, Ellsworth, Little Rock, Minneapolis AFRC, and Seymour Johnson) in 4th quarter FY18 to reduce risk for a larger deployment 1st quarter FY19 and legacy contract writing system at those 8 sites has been shut down.
- Decision point to deploy to 96 remaining sites completed on 26 Sep 2018; site migration begins on 10 Oct 2018 and will continue to ramp-up through December 2018.

Program Budget Enterprise System

Program Budget Enterprise System (PBES) is a software development effort that will deliver modernized budgeting and programming capability for the Air Force. PBES makes the budget formulation process more efficient, increases confidence in Air Force budget submissions, and ensures traceability of financial data for the Air Force's Planning, Program, Budget, and Execution (PPBE) processes. When complete, PBES will consolidate three legacy systems we use today into one system.

PBES is using agile-like methods to rapidly deliver capability to the user. Key accomplishments:

- The program management team has hit all their goals to fast-track a solution to support the FY20 budget build.
- Milestone B and System integrator contract award (December 2017)
- Hosting environments (train, test, pre-production, production) (December 2017)
- Deployed to Air Staff to shadow FY20 budget build (March 2018)

In June 2018, the program accelerated planning capability development from FY19 into FY18 due to gained efficiencies with using the system. Each element of the budget formulation passed to the next step. Some foundational planning elements were accelerated with planned delivery in January 2019. Complex functionality will be completed later in FY20.

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 FY18 accomplishments include the development of an algorithm to aggregate signals of opportunity from various radio frequency sources and provide a complementary, backup source of positioning, navigation and timing. The algorithm is used to determine a position based on the time difference of arrival of those signals, which do not operate on the same frequency as GPS, offering a counter to GPS jamming threats. Echo Ridge, LLC and the AFRL Sensors Directorate recently completed a field test of a prototype of the device at Fort Bragg, North Carolina.

Spawned by a continued small business collaboration in FY18, the Air Force and aerospace industry now have a more environmentally-friendly and lower-cost option to protect a key aircraft system. With support from the Air Force's SBIR/STTR program, Utah-based ES3 developed a process for plating steel aircraft landing gear components with Low Hydrogen Embrittlement Zinc-Nickel. Along the way, ES3 worked closely with a unit of prime contractor Boeing, as well as coating manufacturer Dipsol of America, to make the technology a reality. An LHE Zinc-Nickel plating line has been installed at Hill Air Force Base, where the 309th Commodities Maintenance Group is using the new method to overhaul an increasing number of landing gear components. Early financial assessments projected the new line would yield a multi-million dollar savings on hazardous waste disposal.

The Air Force is taking aim at its multi-billion dollar aircraft corrosion challenges through a partnership with a Virginia-based small business. Luna Innovations Inc., with support from the SBIR/STTR Program, developed technology that improves upon the laboratory evaluation of aerospace coatings and provides service-life estimates for coatings in actual environments. Having a better way to measure the effectiveness of coatings that protect aircraft structures from corrosion and environmentally-produced cracks will allow the Air Force to accelerate the adoption of new coatings while reducing the risk associated with their integration.

The Development Planning FY18 accomplishments include conducting the Multi-Domain Command and Control (MDC2) Enterprise Capability Collaboration Team (ECCT). The MDC2 ECCT formed an Air Force enterprise-wide multidisciplinary team that conducted a gap analysis on the MDC2 mission effects framework and developed a campaign plan to organize the effort the Air Force needs to accomplish to develop the operational concepts, enabling technologies, and support structures to effectively command and control forces in the future.

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.

The Test & Evaluation (T&E) Management Support effort includes operations at Arnold Engineering Development Complex (AEDC) at Arnold AFB TN, the 412 Test Wing (TW) at Edwards AFB CA, the 96 TW at Eglin AFB FL and the 704th Test Group (TG) at Holloman AFB NM. The 704th TG is the new designation of the 96th TG and now falls organizationally under AEDC.

In FY18 Developmental T&E (DT&E) continued to fully support F-35, KC-46, SDB II, F-22 and all legacy modernization programs. Following an increase in FY16, USAF Test Pilot School production was again increased to address projected shortfalls in trained test personnel. New funding and manpower earmarked for Cyber was utilized to expand the Cyber Test Group at Eglin AFB. F-15 modernization programs continued to experience test program delays due to insufficient test aircraft availability and funding. Two loaner aircraft were provided but late arrival and the aircraft modification time needed to instrument for test made them unavailable for most of the year. An additional authorization for one of two aircraft requested by AFMC in the FY19 POM was granted for FY20. The aircraft arriving in FY20 is an F-15E and will improve test capacity for F-15 modernization; at least one more F-15C is required to support existing programs. In addition, necessary test infrastructure improvements to support F-15 security requirements represent a significant disconnect. Minimal AFTC and F-15 program funds have been used to address the shortfall but they are insufficient to solve the problem. Flying hour funding for one B-1 was secured, but a second will leave service in FY19, cutting capacity by 50%. B-52 test capacity requirements are expected to lag capacity and allocations starting in FY18, with the future of the B-52 test fleet depending on program funds and aircraft loans. Civilian Pay for FY17 was predicted to be short by $6.6M, a ~$4M shortfall was realized. It was fixed by sourcing funds from reduced travel, training, equipment purchases, spare parts and Depot Level Repairables, deferred instrumentation and diagnostic upgrades and maintenance.

Major efforts began at all three locations to recapitalize aging test infrastructure by restoring and modernizing major components and systems at all three test bases. Work began on three service life extension projects at Arnold Engineering Development Complex on wind tunnel and engine test capabilities. The Benefield Anechoic Facility at Edwards AFB began work on restoring and modernizing the deteriorated anechoic surface material and McKinley Climatic Lab started work to modernize its heat lamp and small test cell capabilities. Despite these efforts, three significant mishaps were experienced by three major test facilities within AEDC, including the Engine Test Facility, McKinley Climatic Lab and National Full-Scale Aerodynamic Complex. All three mishaps were classed as Class A due to the estimated cost to repair the damage to the systems. Near-term fixes will allow both facilities to operate at less than full capability, with studies initiated to define concepts for restoring full capability beginning in FY18.

In 2017 for the Electronic Warfare area, the 96 TW continued development of hardware and software upgrades to its 5-axis IR threat simulator capabilities at the Guided Weapons Evaluation Facility. The 412 TW continued to develop and validate architecture and simulation upgrades, including improvements to command and control, sensor reactivity, and jamming models of the Digital Integrated Air Defense System environment simulator. The 412th also continued development, procurement and integration of new state-of-the-art stimulators and threat signal generation capabilities for the Advanced Warfare Test and Evaluation Capability at the BAF. AEDC's 704th TG continued facility upgrades to consolidate and enhance operations efficiency and improve RCS measurement accuracy of Low Observable platforms and antennas, including design studies of next generation radar and RCS metrology requirements.

Under the general test infrastructure improvement and modernization area, the 412TW continued the Common Range Integrated Instrumentation System production Lot 1 procurement and fielding of increment 2 pods, aircraft internal mounts and ground test support infrastructure. The Common Airborne Networked Instrumentation System (CANIS) project continued supporting and complementing the iNET Program by implementing the airborne solutions. FY18 activity included completing the implementation of spirals 0, 1, and 2 of the CANIS acquisition approach. Spiral 0 modifies telemetry policies and procedures and makes use of tier 1 waveforms; Spiral 1 implements multi-band and C-Band transmitter and transceiver conversions; and Spiral 2 establishes a test asset networked data gathering package. The Modular Mission Control Room Upgrade continued to support the hardware integration (spiral 1), situational awareness integration (spiral 2), and applications migration of the MMCRU implementation. Finally, the Voice Communication System Upgrade program completed requirements definition and took receipt of initial test lab equipment.

The 96 TW completed work on the Combined High Speed High Resolution Electro-Optical/IR Imaging system implementation to use on their B-70 and C-72 range complexes; the effort completes implementation of autonomous designs to acquire and modernize mobile optical tracking systems; complete evaluation of ultra-high speed camera options for hypersonic speed tests on the Holloman High-Speed Test Track. Next Generation Munitions Test Environment continued upgrading aging gun and munitions test infrastructure, developed and procured common data instrumentation and acquisition systems, and replaced environmental test chambers/facilities supporting gun and arena test capabilities. The Cyber Defense Test Capability project completed the study to develop a detailed implementation methodology for the DoD cybersecurity T&E process, identified manpower requirements and developed a test investment roadmap. The Improved C2 Test Operations Center project continued C4ISR test network upgrades to C4ISR system hardware and software, and replaced outdated network infrastructure.

AEDC completed work on its Mid-Pressure Arc Heaters, the Advanced Large Military Engine Capability and Test Instrumentation Data Systems and Control systems. They continued work on the Improved Transonic Test Capability and Improved Plant Reliability and Efficiency/Transonic Aero Test Capability where they are restoring the capabilities of the main drive motors (rewind main drive motors M1 and M4), C1 compressor (replace both C1 compressor rotor blades and spacers), main drive motor sub-systems (refurbish/replace), C1 compressor sub-systems (refurbish/replace), and the electrical support systems (refurbish/replace primary Propulsion Wind Tunnel (PWT) facility main drive electrical utilities) to original specifications. They also continued upgrades on the Next Generation Turbine Engine Test Capability exhaust coolers, compressor in-bleed segments and power and thermal management systems. The 704TG explored Land Gear Test Facility modernization program options to begin contract actions. Finally, the Holloman High Speed Test Track Gantry Crane project is nearing completion, delivery and integration of the new gantry crane, expected to be done in FY18.

Operational System Development:

Minuteman III (MM III)

The Air Force has increased investment in the MM III weapon system ensuring its safe, secure and reliable operation until replacement by the GBSD. These efforts span 450 missile launch facilities and missiles, 45 launch control centers, and flight test, training and support equipment. The MM III weapon system has been in operation since the 1970's as a critical, ground-based leg of the U.S. nuclear triad. The most significant development effort is replacement of the Mk21/W87 warhead fuze in cooperation with similar Navy fuze development efforts employing Sandia National Laboratories as the design agent. The W87 replacement fuze first production unit (FPU) will be available in 2023 for use on MM III and expected to be used within the future GBSD solution.

Small Diameter Bomb II

Shrinking force structure, increased tasking, evolving threats, and collateral damage avoidance will drive a demand for a precision strike capability with a mission planned datalink equipped weapon. Small Diameter Bomb (SDB) II will provide strike aircraft with a capability to attack stationary and mobile targets through the weather with standoff capability while retaining miniature munition type weapon attributes (effective day/night, adverse weather, increased load-out, focused logistics, etc.) plus the capability to attack a range of stationary targets across the combat arena. Testing during EMD is structured in a phased Test and Evaluation (T&E) approach with Phase I supporting verification of Normal Attack, Coordinate Attack, and Laser Illuminated Attack modes on the F-15E. Phase II supports integration of the full SDB II capability on the F-35B and F-35C. Operational testing began in June 2018. The Low Rate Initial Production (LRIP) contract was awarded in June 2015, and four contract options have been exercised to date: a 144-weapon Lot 1 production contract option in June 2015, a 250-weapon Lot 2 production contract option in Sep 2016 and a 312-weapon Lot 3 production contract option in Jan 2017 and a 660-weapon Lot 4 production contract option in Jan 2018. Production will continue through FY25.

Advanced Medium Range Air-to-Air Missile (AMRAAM)

AMRAAM is a radar-guided, air-to-air missile with capability in both the beyond visual-range and within visual-range arenas. The latest AMRAAM variant, the AIM-120D, delivers improved performance via Global Positioning System (GPS)-aided navigation, a two-way datalink capability for enhanced aircrew survivability and improved network compatibility, and incorporates new guidance software which improves kinematic performance and weapon effectiveness. The Air Force and Navy completed FOT&E of the AIM-120D Advanced Medium-Range Air-to-Air Missile (AMRAAM) in July 2014 and fielded the system in January 2015. Both services continue to develop AMRAAM improvements to counter existing and emerging air vehicle threats operating at high or low altitude, and having advanced Electronic Attack (EA) capabilities. The development program also enables AMRAAM compatibility with advanced fighters, enhances AMRAAM capability and operational flexibility against current and projected threats, incorporates high payoff technology development, performs risk reduction activities, and investigates new variants and/or alternate missions which may use AMRAAM attributes. To keep the existing inventory as effective as possible, the Air Force and Navy also develop, test, and field improvements that are implemented via software upgrades reprogrammed into fielded AMRAAMs, and/or hardware upgrades inserted into production units.

Joint Air-to-Surface Standoff Missile – Extended Range

This project provides a long range (over twice the range of baseline JASSM), conventional air-to-surface, autonomous, precision-guided, low observable, standoff cruise missile compatible with fighter and bomber aircraft. The requirement for JASSM-ER is given in JASSM-ER Capability Production Document (CPD), dated 16 Apr 2010. Aircraft integration of JASSM-ER is complete on the B-1B F-15E, and B-52H. Objective aircraft are F-16C/D (Block 40-52) and B-2. JASSM-ER provides the capability to attack a variety of high value fixed or relocatable targets with precision, through preplanned missions or target-of-opportunity, deeper into enemy territory than JASSM Baseline while minimizing the threat to launch aircraft.

The Air Force developed JASSM-ER based on a contractor-developed, government- approved System Performance Specification (SPS). The program continues its development/integration efforts on the Intelligent Telemetry Instrumentation Kit (ITIK), the Electronic Safe and Arm Fuze (ESAF), and the Military Code (M-Code) receiver. Added is Wing Replacement/ Chine Development/ Integration, and Warfighting Capability Enhancement (Software) to enhance the aerodynamic performance against emerging threats. Future efforts include Anti-Radiation Homing System (ARHS), improved Data Link capability for relocatable target attack, alternate payloads, and improved Guidance Navigation Control (GNC). The program is also evaluating Diminishing Manufacturing Sources Material Shortages (DMSMS) and reviewing obsolescence issues. This program is in Budget Activity 7, Operational System Development because this budget activity includes development efforts to upgrade systems that have been fielded or have received approval for full rate production and anticipate production funding in the current or subsequent fiscal year.

Joint Space Operations Center Mission Systems

The Joint Space Operations Center (JSpOC) is the command and control (C2) center that enables the Joint Functional Component Command for Space (JFCC SPACE) to integrate space forces for global military operations. JSpOC Mission Systems (JMS) replaced the legacy Space Defense Operations Center (SPADOC) with sustainable hardware, open and evolvable software architecture, and best-of-breed Space Situational Awareness tools. This multi-year effort plans to incrementally deliver a Space Situational Awareness (SSA) and Space C2 capability for the Commander of JFCC SPACE.

JMS lays the groundwork for a predictive battle management and command & control system with continuously evolving space operator roles and responsibilities, sensor integration and data delivery, threat warning, and rapid response capabilities. JMS is broken into multiple increments. Increment 1 entered operations in Nov 2012 and delivered a User Defined Operating Picture (UDOP) and Service Oriented Architecture as a basis for Increment 2, which is currently in operation at the JSpOC. Future capability in Increment 2 will provide the capabilities necessary to migrate off the legacy system. Enterprise Space BMC2 (formerly Increment 3) will focus on emerging threats and operational priorities that drive the need for a space battle management and C2 capability. The following is a list of technologies completed or furthered as a result of JMS:

- Modular Infrastructure & UDOP
- Space Order of Battle / Force Status / Sensor Management
- Initial Space Catalog Administration
- Initial Orbital Conjunction & Maneuver Reporting
- High Accuracy Catalog
- Conjunctions / Maneuver / Breakup / Re-Entry
- Launch Processing
- Message Processing / Tasking

F-22 Raptor Program

The Air Force's Operational System Development efforts include projects that support upgrades for the F-22 Raptor. FY19 activities will be the largest Post-Production modernization effort, supporting seven concurrent activities that will enhance the Raptor's capabilities and enable the program to maintain its role as enabler of joint air dominance for years to come. In September 2018, TACKLink16, TACMAN, and GPS M-code programs were combined under a "Capability Pipeline" concept utilizing an agile software approach and approved as a Section 804 program. Vital to sustaining Air Superiority, this approach enables Raptor to field capabilities faster than the traditional acquisition model and out-pace adversaries. TACKLink16 enables Fifth- to Fifth and Fifth- to Fourth Generation Aircraft communications enhancing the F-22's combat capability.

TACMAN will deliver Mode 5 Identification, Friend or Foe Transmit and Interrogate, while M-code enables Embedded GPS/Inertial Navigation system Modernization (EGI-M) capabilities. Increment 3.2B, builds on previous lethality increments and adds full capability AIM-9X, AIM-120D missiles and improved Geo-2, Electronic Protection, and IFDL capabilities. Operational Flight Program, (OFP) Update 6, fielding in FY19, will meet future NSA crypto requirements and enhance Link16 interoperability functionality. Raptor's Pilot System program continues risk mitigation and hardware maturation for the future integration of a Helmet Mounted Cueing System (HMCS). Specifically, these modernization programs enhance the air vehicle, engine, and training systems which will improve F-22 weapons, communications, and Intelligence Surveillance Reconnaissance (ISR) capabilities and further expand Global Strike capabilities. Finally, Sensor Enhancements, an FY19 new start, will improve battlespace situational awareness and increase the air vehicle's lethality.

F-15 Eagle Passive/Active Warning and Survivability System (EPAWSS)

The Air Force's F-15 EPAWSS program is an MDAP that will develop, integrate, procure, and install a new electronic warfare self-protection suite for the F-15. EPAWSS replaces the technologically and operationally obsolete legacy system that was fielded in the 1970s. There are two increments. Increment 1, funded for deployment on the F-15E, is an internal radar warning receiver, a jammer, and a chaff/flare dispenser. The Increment 1 is currently in development/integration with a planned completion in FY2021. Increment 2 consists of a towed decoy, and is not currently funded.

This Page Intentionally Left Blank

Fiscal Year 2018

GENERAL FUND

Required Supplementary Information

Department of the Air Force
STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
For the years ended September 30, 2018 and 2017
($ in Thousands)

	Research, Development, Test & Evaluation	Procurement	Military Personnel
Budgetary Resources:			
Unobligated balance from prior year budget authority, net	6,947,187	19,761,956	1,207,098
Appropriations (discretionary and mandatory)	37,946,740	51,120,100	36,494,536
Spending Authority from offsetting collections (discretionary and mandatory)	4,053,809	599,215	546,881
Total Budgetary Resources	$ 48,947,736	71,481,271	38,248,515
Status of Budgetary Resources:			
New obligations and upward adjustments (total)	39,460,234	47,408,704	37,243,151
Unobligated balance, end of year			
Apportioned	9,185,347	22,784,947	47,170
Exempt from apportionment, unexpired accounts	0	0	0
Unapportioned, unexpired accounts	0	0	0
Unexpired unobligated balance, end of year	9,185,347	22,784,947	47,170
Expired unobligated balance, end of year	302,155	1,287,620	958,194
Unobligated balance, end of the year (total)	9,487,502	24,072,567	1,005,364
Total Budgetary Resources	$ 48,947,736	71,481,271	38,248,515
Outlays, Net:			
Outlays, net (discretionary and mandatory)	31,314,548	43,297,356	35,508,870
Distributed offsetting receipts (-)	0	0	0
Agency Outlays, net (discretionary and mandatory)	$ 31,314,548	43,297,356	35,508,870

Family Housing & Military Construction	Operations, Readiness & Support	2018 Combined	2017 Combined
3,012,803	5,396,745	36,325,789	35,676,239
2,674,198	61,466,012	189,701,583	170,303,271
0	3,979,177	9,179,082	8,397,441
$ 5,687,001	70,841,934	235,206,454	214,376,951
1,416,853	67,523,728	193,052,668	180,977,007
4,118,567	225,053	36,361,084	27,226,334
0	14,458	14,458	13,203
0	3,159	3,159	3,159
4,118,567	242,670	36,378,701	27,242,696
151,580	3,075,536	5,775,085	6,157,248
4,270,147	3,318,206	42,153,786	33,399,944
$ 5,687,001	70,841,934	235,206,454	214,376,951
1,058,134	56,493,153	167,672,061	156,678,146
0	(339,645)	(339,645)	(64,658)
$ 1,058,134	56,153,508	167,332,416	156,613,488

DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES

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.

Real Property Deferred Maintenance and Repair For Fiscal Year 2018 (Excludes Military Family Housing) (In Millions of Dollars)						
	Current Fiscal Year (FY 18)			Prior Fiscal Year (FY 17)		
	1. Plant Replace-ment Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage (Required Work/Plant Replacement Value)	1. Plant Replace-ment Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage (Required Work/Plant Replacement Value)
Active Real Property						
1. Category Buildings, Structures, and Linear Structures (Enduring Facilities)	$288,931	$31,791	11.00%	$264,315	$30,994	11.73%
2. Category Buildings, Structures, and Linear Structures (Heritage Assets)	$46,238	$1,305	2.82%	$35,657	$1,530	4.29%
Inactive Real Property						
3. Category Buildings, Structures, and Linear Structures (Excess Facilities or Planned for Replacement)	$129	$0	0.00%	$1,449	$18	1.24%

Condition Assessment Survey Method - The deferred maintenance figures in column 2 consist of SMS generated, predicted, or known maintenance and repair requirements needed to correct facility deficiencies in the Air Force inventory.

Required SMS development is estimated to finish in 2020. Currently, BUILDER SMS is the only SMS that possesses the capability to generate the FCI. PAVER does not have the capability of generating FCI, but can generate deferred maintenance and repair estimates. UTILITIES SMS is under development. Utilities data was not available for each RPUID, but was available on an aggregated level. Simplified statistical methods, or age based predictive calculations, were used to predict the deferred maintenance where SMS data was not available.

Real Property Deferred Maintenance and Repair Military Family Housing For Fiscal Year 2018 (In Millions of Dollars)						
	Current Fiscal Year (FY 18)			Prior Fiscal Year (FY 17)		
	1. Plant Replace-ment Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage (Required Work/Plant Replacement Value)	1. Plant Replace-ment Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage (Required Work/Plant Replacement Value)
Active Real Property						
1. Category Buildings, Structures, and Linear Structures (Enduring Facilities)	$11,413	$731	6.40%	$10,427	$714	6.85%
2. Category Buildings, Structures, and Linear Structures (Heritage Assets)	$84	$4	4.76%	$126	$4	3.17%
Inactive Real Property						
3. Category Buildings, Structures, and Linear Structures (Excess Facilities or Planned for Replacement)	0	0	0.00%	$0	$0	0.00%

Equipment Deferred Maintenance and Repairs For Fiscal Year Ended September 30, 2018 (In Millions of Dollars)				
Major Categories	**PY DM&R**	**PB-61 Amounts**	**Adjustments**	**Totals**
1. Aircraft	$106.35	$12,472.10	($12,365.67)	$106.43
2. Automotive Equipment		$37.07	($37.07)	$0
3. Combat Vehicles		$92.33	($92.33)	$0
4. Construction Equipment				$0
5. Electronics and Communications Systems	$38.00	$3,196.51	($3,186.27)	$10.24
6. Missiles	$0.07	$616.10	($613.01)	$3.10
7. Ships				$0
8. Ordnance Weapons and Munitions		$148.45	($148.45)	$0
9. General Purpose Equipment		$156.81	($156.53)	$0.29
10. All Other Items Not Identified to above Categories		$122.52	($122.52)	$0
Total	**$144.42**	**$16,841.89**	**($16,721.83)**	**$120.05**

Weapon System Sustainment (WSS)

Deferred Maintenance and Repairs (M&R) for Fiscal Year 2018

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 (PP&E).

Defining and Implementing M&R Policies in Practice

As permitted under Statements of Federal Financial Accounting Standards (SFFAS) 42, Deferred Maintenance and Repairs, amending SFFAS 6, 14, 29 and 32, several different Basis of Estimate methodologies 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 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 be executed 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-up 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 (OOC) 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 M&R 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 during the 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

The total projected deferred requirements of $120.05M is due to deferring:

- A-10 – $4M: One aircraft due to delayed completion of repairs of other aircraft.
- Aircraft Survivability – $2M: Software maintenance due to contract award delay.
- Armament Sustainment – $.62M: Missile repairs due to funding shortfall.
- C-17 – $11.07M: Software maintenance due to contract award delay.
- C-5 – $9.27M: Software maintenance due to contract award delay.
- CV-22 – $.18M: Software maintenance due to contract award delay.
- F-16 – $6.84M total:
    - $2.49M: 12 aircraft PDMs due to depot availability and aircraft availability concerns.
    - $3.45M: Training system software maintenance due to CRA funding restrictions and contract award delay.
    - $0.90M: 7 F-16 inductions pushed into FY19 due to capacity issues caused by over and above work beyond expected requirements.
- ICBM – $2.49M total:
    - $1.12M: Four Missile Transporter Trailers maintenance due to PDM prototype delay.
    - $.56M: Three Propulsion System Rocket Engine maintenance due to prototyping delay.
    - $.05M: Mechanical Code Unit Encoder Drawer maintenance due to funding shortfall.
    - $.1M: Three Propulsion System Rocket Engine Trainer due to trainers not being turned in for repair.
    - $.66M: Software maintenance due to funding shortfall.
- Loaders – $.29M: Halverson overhaul due to increased costs causing funds shortfall.
- KC-135 – $70.13M: 20 F108-100 engines were not inducted due to parts constraints and stoppage of engine line due and will be moved to later years.
- HH-60G - $4.94M: 1 HH-60G deferred to FY19 due to aircraft damage and availability.
- ATCALS - $8.24M: 2 TRN-48 and one MPN-14 radar pushed into FY19 due to replacement availability.

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category	2018 Ending Balance DM&R	2018 Beginning Balance DM&R
General PP&E	$0	$0
Total	$120.05M	$0

This Page Intentionally Left Blank

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

November 14, 2018

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 Report on the U.S. Air Force General Fund Financial Statements and Related Notes for FY 2018 (Project No. D2018-D000FT-0028.000, Report No. DODIG-2019-014)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the U.S. Air Force General Fund FY 2018 Financial Statements and related notes as of September 30, 2018, and for the year then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. 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/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008.[1] 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 U.S. Air Force General Fund financial statements. As a result, EY could not conclude whether the financial statements and related notes were fairly presented in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the U.S. Air Force General Fund FY 2018 Financial Statements and related notes.

[1] In June 2018, the Government Accountability Office issued an updated Financial Audit Manual. EY updated its audit procedures to be in accordance with the updates issued in the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018.

EY's separate report on "Internal Control Over Financial Reporting" discusses 11 material weaknesses related to U.S. Air Force General Fund internal controls over financial reporting. Specifically, EY found material weaknesses including: Integration and Reconciliation of Financial Systems; General Property, Plant and Equipment; Property and Materials Held By Others; Fund Balance With Treasury; Accumulating and Preparing Financial Statements; Oversight and Monitoring of Internal Control; Contingent Liabilities; DoD Accounting Policies and Procedures; Establishing Opening Balances for Assets and Related Liabilities; Establishing Opening Budgetary Balances; and Financial Information Systems. EY's additional report on "Compliance and Other Matters" discusses two instances of noncompliance with applicable laws and regulations.

In connection with the contract, we reviewed EY's report and related documentation and discussed the audit results with EY representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the U.S. Air Force General Fund FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control, conclusions on whether the U.S. Air Force's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the U.S. Air Force General Fund complied with laws and regulations.

EY is responsible for the attached reports, dated November 14, 2018, and the conclusions expressed in these reports. However, our review disclosed no instances in which EY did not comply, in all material respects, with GAGAS.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945.

Lorin T. Venable

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

Attachments:
As stated

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
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 sheet as of September 30, 2018 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, 2018, and the related notes to the financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 the 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. 19-01, *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.B., collections, obligations and outlays presented in the financial statements are misstated for the activity related to joint procurement programs and shared access vendor contracts. Further as described in Note 1.B, 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 for the year ended September 30, 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

Prior Year Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990", required the Department of Defense Office of the Inspector General (DoD OIG) to audit the consolidated balance sheet as of September 30, 2017 and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the financial statements. In their report dated November 13, 2017, DoD OIG issued a disclaimer of opinion as the DoD OIG was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the USAF's basic 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 basic financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the basic 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 14, 2018 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 are 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 14, 2018

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

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. 19-01, *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, 2018 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, 2018, and the related notes to the financial statements and have issued our report thereon dated November 14, 2018. 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, 2018 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. 19-01. 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 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 IT control environments. As a first year audit, our emphasis and findings were heavily focused on the beginning balances for FY 2018. Many of the material weaknesses relate to the one time efforts to establish an auditable starting point for financial reporting in accordance with Generally Accepted Accounting Principles (GAAP). Although those material weaknesses are important contributors to the scope limitations causing our disclaimer of opinion, the material weaknesses related to recording of current financial activities, in the long run, will be more important to the improvement of the effectiveness and efficiency of financial operations and transparency. The efforts related to all the required remediation must include substantial design, education and enforcement activities beyond the normal day-to-day financial management routines.

Further details regarding each of these matters are described 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 GAFS-R general ledger system. 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 a new enterprise resource planning system (ERP), Defense Enterprise Accounting and Management System (DEAMS), which is currently being deployed. 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 information/data from processing without significant manual intervention.

EY
Building a better working world

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
- Continued development of DEAMS controls is needed
- Transactions not recorded in accordance with the United States Standard General Ledger (USSGL)
- Inability to maintain and/or provide sufficient documentation in a timely manner

II. 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, USAF 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
- Insufficient procedures in place to record all construction in progress (CIP)
- Process to assign value to newly acquired GPP&E needs improvement

III. Property and materials held by others – USAF has shared service arrangements with other branches of the military, other defense organizations 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 operating materials and supplies (OM&S) managed by US Army and the Defense Logistics Agency (DLA)
- Insufficient oversight of government furnished property and other materials held by contractors

IV. 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 although key review controls achieved reconciliation of differences between USAF and Treasury balances and recorded the necessary adjustments to FBwT, those procedures did not always achieve a complete analysis of, or proper adjustment to, the non-FBWT side of the correcting entry.

Building a better working world

ONGOING FINANCIAL REPORTING

V. 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

VI. 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.

The next significant step in the evolution of USAF's financial control environment is the inclusion of a multi-layer analysis, review, repair and remediation cycle into the normal course of accounting processes and the financial statement compilation and review process. These analyses and remedial actions should be performed by knowledgeable supervisory personnel trained to recognize anomalies and unusual relationships. The timing and nature of the reviews and required subsequent actions should be built into the standard financial policies and procedures

We identified the following:

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

Building a better working world

VII. Contingent Liabilities – 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.

VIII. Department of Defense Accounting Policies and Procedures – The DoD Financial Management Regulation (DoD FMR), developed by the DoD Under Secretary of Defense (Comptroller) (OUSD(C)), directs statutory and regulatory financial management requirements, systems and functions. The DoD FMR applies to entities within the DoD, including USAF, as it is DoD policy that a single DoD-wide financial management regulation be used by all DoD components for accounting, budgeting, finance and financial management education and training. USAF has indicated that amounts presented in the financial statements related to joint procurement programs and shared access vendor contracts may not be materially stated. 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. Additionally, intragovernmental transactions cannot always be identified by customer because USAF systems do not track the buyer and seller data needed to match related transactions. As a result, USAF could not fully reconcile intragovernmental transactions with all Federal partners, which resulted in adjustments that could not be fully supported.

We identified the following:

- Accounting for joint procurement programs and shared access vendor contracts may not be in accordance with US GAAP
- Unsupported trading partner adjustments

BEGINNING BALANCES

IX. 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 is requiring a very 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:

- 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
- Valuation of opening balances for OM&S cannot be supported

X. Establishing opening budgetary balances – The processes to establish the open budgetary account balances of USAF that were initiated by appropriations occurring in prior years have not been completed. This is requiring a very substantial reconciliation process including the gathering of documentation from years past that is difficult to obtain if it still exists.

FINANCIAL INFORMATION SYSTEMS

XI. 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 following:

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

Significant Deficiencies

During our audit, we also noted the following matters involving internal control over financial reporting and its operation that we consider to be significant deficiencies.

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

We identified the following:
- Process to value and record newly acquired OM&S needs improvement
- Enhanced procedures are needed to record ongoing OM&S activity

II. 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.

Building a better working world

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

Building a better working world

Status of Prior Year Findings

In their report on the FY 2017 financial statements dated November 13, 2017, the DoD OIG identified material weaknesses and significant deficiencies in internal control over financial reporting. The chart below summarizes the current status of the prior year weaknesses:

MATERIAL WEAKNESSES		
Issue Area	**Summary Control Issue**	**FY 2018 Status**
Financial Management Systems	• Financial management systems did not substantially comply with Federal financial management system requirements.	Modified repeat conditions Part of the **Integration and Reconciliation of Financial Systems**, **Accumulating and Preparing Financial Statements,** and **Financial Information Systems** material weaknesses for FY 2018
Statement of Net Cost (SNC)	• SNC was not presented by major organization and program • Cost information was not accumulated in accordance with GAAP.	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** material weakness for FY 2018
General Property, Plant and Equipment	• Inability to validate acquisition cost, accumulated depreciation and construction in progress.	Modified repeat condition Part of the **General Property, Plant and Equipment** and **Establishing Opening Balances for Assets Used in Operations** material weaknesses for FY 2018
Intragovernmental Eliminations	• Lack of sufficient identification of intragovernmental transactions and balances by customer • Lack of sufficient reconciliation with DoD and other Federal trading partners.	Modified repeat condition Part of the **DoD Accounting Policies and Procedures** material weakness for FY 2018
Operating Materials and Supplies	• USAF could not assert that OM&S balances as reported in the financial statements were accurate.	Modified repeat condition Part of the **Establishing Opening Balances for Assets Used in Operations** material weakness and **Operating Materials and Supplies** significant deficiency for FY 2018
Contractor-Managed/Possessed Property-Operating Materials and Supplies	• USAF could not validate existence and completeness of government-furnished property (OM&S) in the possession of contractors • Contractor-managed property was not accounted for in an APSR.	Modified repeat condition. Part of the **Property and Materials Held by Others** material weakness for FY 2018
Government Property in the Possession of Contractors	• The balance reported for Government property did not include the cost of all Government-furnished material in the possession of contractors.	Modified repeat condition. Part of the **Property and Materials Held by Others** material weakness for FY 2018

Building a better working world

MATERIAL WEAKNESSES		
Issue Area	**Summary Control Issue**	**FY 2018 Status**
	• Value of property and material in the possession of contractors was not reliably reported.	
Environmental Liabilities	• Environmental cleanup liabilities was not always reported. • Supporting documentation for all environmental sites was not always maintained. • Active environmental liabilities lack consistency and standardization of business practice.	Modified repeat condition. Part of the **Establishing Opening Balances for Assets Used in Operations** material weaknesses for FY 2018
Reconciliation of Net Cost of Operations to Budget	• USAF was not always able to reconcile the resources obligated to the net cost of operations.	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** material weakness for FY2018
Accounting Entries (Journal Vouchers)	• Material journal vouchers were not always supported with sufficient documentation. • Material transactions were not properly recorded in the accounting records.	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** and **Integration and Reconciliation of Financial Systems** material weaknesses for FY2018
Financial Reporting	• USAF did not detect and evaluate abnormal balances • Lack of sufficient centralized financial statement analytical and review functions • Inability to validate the completeness of transactions underlying the financial statements.	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** and **Integration and Reconciliation of Financial Systems** material weaknesses for FY2018
Oversight and Monitoring	• Lack of sufficient supporting documentation • Inability to provide complete flowcharts and narratives depicting USAF processes and internal controls.	Modified repeat condition Part of the **Oversight and Monitoring of Internal Controls** material weakness for FY2018
Multi-Service Contact Accounting	• USAF does not always allocate progress payments and recoupments on multi-service contractors in a GAAP-compliant manner.	Modified repeat condition Part of the **DoD Accounting Policies and Procedures** material weakness for FY2018
Air Force Policies and Procedures	• Recoveries are not always identified and recorded properly in the accounting system • MORDs are inaccurate • Progress payments and advances are not always correctly recorded.	Modified repeat condition Part of the **Integration and Reconciliation of Financial Systems** material weakness for FY2018

Building a better working world

SIGNIFICANT DEFICIENCIES		
Issue Area	**Summary Control Issue**	**FY 2018 Status**
Fund Balance with Treasury	• Unresolved reconciling items that were outstanding in excess of Treasury requirements.	Modified repeat condition Part of the **Fund Balance with Treasury** material weakness for FY2018
Accounts Receivable	• Lack of sufficient reconciliation and support for the Accounts Receivable line item	Modified repeat condition Part of the **Financial Reporting** and Oversight, **DoD Accounting Policies and Procedures** and **Monitoring of Internal Control** material weaknesses for FY2018
Accounts Payable	• Lack of sufficient reconciliation and support for the Accounts Payable line item	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** and Oversight, **DoD Accounting Policies and Procedures** and **Monitoring of Internal Control** material weaknesses for FY2018
Reimbursable Programs	• Reimbursable programs may not recover all billable costs incurred in the fulfillment of reimbursable orders	Modified repeat condition Part of the **Reimbursable Programs** significant deficiency for FY2018

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 14, 2018, 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 14, 2018

Building a better working world

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

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 GAFS-R and will be held pending further analysis. These excluded transactions are a significant cause to 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, 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.

DEAMS is currently a significant feeder system to GAFS-R. DEAMS is expected to replace GAFS-R as the USAF General Ledger in the future. Similar unmatched transactions occur in DEAMS and reconciliation procedures are performed to 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 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 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 GAFS-BQ, variances are not remediated on a timely basis. Additionally, there is not currently a process to perform a reconciliation between MOCAS and DEAMS.

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. 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:

- Incorrect formulas utilized within the reconciliation result in the failure to consistently summarize the APSR system data
- Failure to reconcile the complete APSR data population
- Lack of sufficient evidence of review of the reconciliations.

(b) Inconsistent execution of MORD policy

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. In accordance with Section 2.1 of USAF's MORD guidance, this "does not alleviate the requirement to have a written binding agreement in place prior to obligating the MORD."

During our testing of MORDs, we identified the following conditions where USAF MORD policy was not followed:

- Obligations and unfilled customer orders 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.
- Lack of sufficient monitoring over Negative MORDs that have been outstanding for a lengthy period. As negative MORDs (a negative obligation) increase budgetary authority, USAF's

Building a better working world

policy requires approval by the Air Force Accounting and Finance Office (AFAFO) and should only be valid for 90 days pending further approvals.

- MORDs are often used to record estimates, such as the MORD estimate for Centralized Asset Management (CAM) Flying Hour Program for Working Capital Fund Depot Level Reparables and Consumables. Estimates represent risks, particularly related to valuation, as accounting estimates can vary widely in complexity and degree of uncertainty associated with determining the amount. In our testing of MORDs, we identified instances where USAF could not fully support how estimates were determined, including assumptions used in the calculation.

Given the significant usage of MORDs throughout the organization for varied purposes, USAF lacks the 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.

(c) Continued development of DEAMS controls is needed

As mentioned above, USAF is in the process of deploying DEAMS, an ERP system designed to manage the USAF General Fund. Currently DEAMS is a sub-ledger of GAFS-R, however the intent is for DEAMS to ultimately replace GAFS-R. In the meantime, while a reconciliation is prepared to assess the match rates between DEAMS and GAFS-R, there is not a sufficient review over unmatched populations to detect possible material misstatements to the financial statements.

Additionally, we have identified several conditions which indicate that USAF needs to continue to develop the DEAMS control environment as it moves towards becoming USAF's system of record, including the following:

- Insufficient DEAMS trial balance reconciliation
- Lack of monitoring over DEAMS reject files
- Insufficient monitoring over DEAMS posting logic compliance with the USSGL and TFM
- Lack of a complete and accurate reconciliation between the DEAMS sub-ledger to DEAMS general ledger.

USAF has communicated the intent to focus on DEAMS, as it will replace GAFS-R. As a result, certain conditions identified in previous audits related to GAFS-R have not been remediated. This includes the use of non-compliant GAFS-R posting logic, as is discussed further below.

(d) Transactions not recorded in accordance with the USSGL

USAF's posting logic utilizes postings and accounting that are not compliant with the USSGL and Standard Financial Information Structure (SFIS) posting logic. Examples of accounting that are not compliant with the USSGL noted during our testing of transactions 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 posting logic rules, we were unable to confirm compliance with the US Treasury Financial Manual (TFM) for approximately 890 posting rules due to the lack of sufficient supporting documentation.

(e) 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 documentation, 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
- 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.
- Improve compliance with MORD policies:
    - Perform an analysis on the MORD population to determine the pervasiveness of the conditions noted above
    - 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
    - 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.
- 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.

Building a better working world

- Implement necessary data elements to allow all reimbursable obligations to be entered in the general ledger utilizing reimbursable budget authority.
- 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.
    - 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. GENERAL PROPERTY, PLANT & EQUIPMENT

The following deficiencies aggregated into this material weakness:

(a) Enhanced processes are needed to record GPP&E activity

USAF's Real Property (RP) consists of land, buildings, structures and linear structures. The Real Property Officer (RPO) and the Real Property Accountability Officer (RPAO) are responsible for the complete and accurate reporting of RP assets within a specific installation. However, ongoing operations that support this accurate reporting involves multiple groups and individuals that comprise the Civil Engineer (CE) Squadron, such as the Engineering Flight or Operations Flight, as well as the Base Civil Engineer.

During our testing, we identified instances across all installations in which the USAF real property accountable property systems of record (i.e., ACES-RP and NEXGEN-IT) 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 throughout the year.

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.

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.

(a) Insufficient procedures in place to record real property 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.

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 Construction Agent's data.
- Air Force has not yet commenced the appropriate procedures to evaluate the completeness and accuracy of CIP categories other than MILCON.

(b) Insufficient procedures in place to record weapon system program CIP

USAF has not established sufficient processes to accumulate and report CIP for all military equipment CIP categories.

(c) Process to assign value to newly acquired 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 USAF does not have sufficient processes for assuring newly acquired 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. 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:

- Assess if updates to policy or guidance are needed to clarify the respective roles and responsibilities of all applicable CE parties (i.e., RPO, Engineering Flight, Operations Flight, BEC) 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 individual installation's execution of the aforementioned controls.
- 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.
- Establish procedures for weapon system program CIP categories to assure that complete and accurate reporting of USAF costs of these programs are reported timely and accurately.
- Add additional monitoring and oversight controls over the recording of CIP.

- Amend current processes to comply with SFFAS 6 by better matching expenditures to capital assets, other than CIP, within the APSR.

III. 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 $25 billion of munitions. Of that balance, the U.S. Army performs munitions inventory management services for approximately $8 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.

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 other materials held by contractors

USAF has government property in the custody of contractors. This includes government furnished equipment, materials 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 complete population for contractor inventory control points (C-ICP). OM&S assets managed at C-ICP locations are weapon system spares. USAF has identified 95 total C-ICP programs, but only 36 programs are currently reported.
- Lack of timely updates to accountable property records for financially reportable events.

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.
  - 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.

IV. FUND BALANCE WITH TREASURY

Fund Balance with Treasury 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 statements of budgetary resources. Several deficiencies which resulted in a material weakness in the design and operation of internal control for Fund Balance with Treasury were noted as listed below.

- Each month USAF 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, USAF had identified differences between activity posted by Treasury and that posted in GAFS-R of $2.1 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 GAFS-R (the “undistributed JVs”) so that the financial statements of USAF reflect the balance reported by Treasury. Some of the undistributed JVs cannot be supported at the voucher detail level.

- The undistributed JVs to adjust for the differences between GAFS-R and Treasury impact various general ledger accounts including accounts payable, accounts receivable, and related budgetary accounts. In one instance, a JV was posted that decreased accounts payable to adjust for a disbursement made by Treasury but not recorded in the accounting system. This JV was related to an $800 million dollar MOCAS payment disbursed on 9/21, but not recorded to the accounting system until October 18, 2018. We found that the JV erroneously decreased accounts payable as no accrual for the MOCAS payment was previously recorded. This caused an abnormal balance in Accounts Payable and Delivered Orders, Unpaid.
- USAF is not adequately performing reconciliations of the USSGL 1010. USAF reconciliations do not include causes of differences at the voucher detail level and do not clear aged undistributed items within 60 days.

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.

Building a better
working world

ONGOING FINANCIAL REPORTING

V. ACCUMULATING AND PREPARING FINANCIAL STATEMENTS

The following deficiencies aggregated into this material weakness:

(a) Lack of sufficient centralized financial statement analytical and review functions

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. USAF currently performs a UTB to ATB reconciliation at the summary trial balance level and identifies JVs which explain the variance. USAF performs its UTB to ATB reconciliation by manually reconciling the GAFS-R, DDRS-B, and DDRS-AFS trial balances at a summary level. All variances are researched and explained by identifying the JVs which equate to the variance amount between each TB. This method, however, lacks a focus on detailed transaction data and does not consider the full population of JV activity for the period. EY performed the UTB to ATB reconciliation using the full UoT detail data and JV logs and identified several variances. USAF was not able to timely identify and reconcile these variances.

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
- Approval of journal vouchers
- 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 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.

Building a better working world

(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 the Federal Accounting Standards Advisory Board (FASAB) which are already effective. The effect on the financial statements amounts involved is not currently determinable by USAF 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 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. USAF does not have a robust process for the preparation and review of its AFR. In performing our procedures on the AFR, we found numerous instances in pre-issuance drafts of the AFR of disclosures that were not well formed, erroneous or were inconsistent with the financial statements. Specifically, we identified instances of the following:

- Inaccurate balances reported in the financial statements and notes
- 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 USAF should reassess its process for preparing the report and should add significantly more internal review requirements to decrease the probability of error and increase the usefulness of the AFR as a mechanism to communicate to the public the successes, plans and annual results of USAF.

In addition, in accordance with section II.3.4 of OMB Circular A-136, *Financial Reporting Requirements*, and paragraphs 86-99 of 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
- Develop a 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 GAFS-R to the financial statements.
- 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.

Building a better working world

- 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

VI. 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 2018 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). During FY 2018, USAF further expanded its tests of design and operating effectiveness of controls for certain assessable units (AUs), as well as performed trainings at major commands (MAJCOM) on internal control and improved financial reporting practices. While these actions represent progress, USAF's A-123 program is not yet fully in effect.

(b) Lack of sufficient monitoring of third-party service providers

For several business processes, including financial reporting, military and civilian payroll, and disbursing and receiving, 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 started to lay the foundation for monitoring third party service providers and the CUECs identified in associated SSAE-18 reports. For example, USAF has started to compile all applicable CUECs and map them to their own internal control environment to identify existing gaps. In addition, they have continued to evaluate specific reports and CUECs such as those related to the DFAS Military Pay Service. 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.

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.
- Continue to invest further resources and move forward in implementing the Service Provider CUEC monitoring and sustainment strategy.
- Implement a risk-based monitoring program for evaluating identified CUECs to verify operating effectiveness.
- Continue to work with service organizations on an ongoing basis to verify the CUECs identified are the most accurate representation of control ownership between USAF and the service organization.

VII. CONTINGENT LIABILITIES

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.

Recommendations:

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

- Implement policies to ensure that legal claims are assessed in accordance with GAAP and determined as probable, reasonably possible or remote.
- Update policies as necessary to ensure that the contingent liabilities are only being recognized when counsel has determined the likely outcome as probable.

VIII. DEPARTMENT OF DEFENSE ACCOUNTING POLICIES AND PROCEDURES

The following deficiencies aggregated into this material weakness:

(a) 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 materially stated. 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 of USAF 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 DoD-wide comprehensive financial management policies related to these activities, the accounting treatment in some instances is not in accordance with GAAP. Coordination efforts between USAF and OUSD(C) began in FY 2017 to identify and implement corrective actions to address this condition.

(b) Unsupported trading partner adjustments

In the Intragovernmental Eliminations material weakness of the FY 2018 Air Force Statement of Assurance, USAF self-identified a material weakness related to trading partner adjustments/eliminations. Defense Finance and Accounting Services (DFAS) personnel stated that they are following the DoD FMR guidance (Volume 6b Chapter 13) that states: "For intra-DoD accounts receivable, revenues, and advances from others ("unearned revenue") it is presumed that the amounts reported by the seller are more accurate than the corresponding amounts reported by the buyer. As a result, DFAS and DoD reporting entities use information from 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") as the basis for reporting most of its intra-DoD balances. For DoD reporting entities that are not waived from elimination adjustments, intra-DoD accounts payable, expenses, advances, and assets (where the information is available) must be adjusted to match the seller records."

In accordance with DoD guidance, DFAS-Indianapolis obtains the seller-side data from USAF's trading partners in order to make adjustments. DFAS-Columbus compares the seller-side data obtained from DFAS-Indianapolis to the General Accounting and Finance System (GAFS) trial balance data at the appropriation level by trading partner. That difference is the basis for the adjustments. There is 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.

Recommendations:

EY recognizes that the ultimate resolution for these conditions will not occur without DoD-wide changes. USAF should continue to coordinate with the OUSD(C), OUSD for Acquisition, Technology and Logistics (AT&L), and others as appropriate, to address these weaknesses at the Department-level and devise next steps towards remediation. This process may ultimately lead to revision of DoD policies as contained in the DoD FMR.

In addition to the above, EY recommends that USAF consider the following corrective actions related to the conditions described above:

- Accounting for joint procurement programs and shared access vendor contracts
  - USAF should implement monitoring procedures over recorded disbursements and collections to validate they represent transactions incurred by USAF.
  - USAF should continue to coordinate with OUSD(C), OUSD AT&L and DFAS 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 the Defense Enterprise Accounting and Management System (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.

Building a better working world

BEGINNING BALANCES

IX. ESTABLISHING OPENING BALANCES FOR ASSETS (AND RELATED LIABILITIES) USED IN OPERATIONS

The following deficiencies aggregated into this material weakness:

(a) Valuation of opening balances of 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 MEV valuation 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 tested six 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.

For example:

- C-17A: utilized a contract-based approach, wherein the program office located all existing key supporting documents
- F-22A: utilized a contract-based approach, but used the ConData repository to identify acquisition costs and did not supply us copies of original contracts and other supporting documents
- NS-7 GPS Satellite: used the budgetary method, carrying forward the effort of a previous OUSD AT&L valuation that predates SFAS 50 without documentation of how the methodology complies with the newer accounting standard.

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:

- 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 Operating Materials and Supplies (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

The DoD currently estimates plant replacement value (PRV), which is based on cost factors such as averages of contractual cost data, commercially available cost data and model using general price information. While PRV had traditionally not been used for financial reporting purposes, SFFAS 50 allows, and USAF will be utilizing, PRV to be used as a starting point in establishing alternative cost estimates for real property.

We performed a very limited review of USAF's implementation of PRV as an alternative valuation method. That review involved a cursory review of the model used and inquiry and limited review

Building a better working world

in regards to the data sources of the key inputs to the model. Key inputs to PRV include, but are not limited to, facility quantity, replacement unit cost and area cost factors. Of those the input most prone to judgment is the replacement unit cost. The Facility Analysis Code (FAC) is a key driver in the determination of the replacement unit cost factor. A FAC is a grouping of real property assets that have a common unit of measure and equivalent costs based on that unit of measure. USAF facilities are assigned facility category codes (CATCODEs) upon entry to the APSR. In the PRV model the CATCODEs drive the determination of FAC which, in turn drives the selection of replacement unit cost. 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. For example, for similar facilities, some were assigned CATCODE of Miscellaneous Outdoor Recreation Facility (750581) while others were assigned CATCODE of Recreation Pavilion (750371). In some of these instances, the CATCODEs map to different FAC codes thereby effecting the replacement unit cost for that facility.

Additionally, EY was informed that the Real Property Information Model (RPIM) version integrated within the USAF accountable property systems of record (APSR) (ACES-RP and NextGen-IT) is not currently structured to use the proper elements of the calculation of PRV to be used in the determination of RP opening balances in accordance with SFFAS 50.

(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 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 CE group. The above factors creates 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 risk of 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 installations 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 Key Supporting Documents (KSD). 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-inserviced-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 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. While USAF has excluded land from their balance sheet, USAF currently has not disclosed acreage information as required by SFFAS 50. USAF has not completed its acreage reconciliation efforts to the APSR as controls have not yet been 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. 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 12 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. Currently, only fixed-wing aircraft has a liability reported as of September 30, 2018. USAF has not yet completed their assessment to appropriately estimate the ED&L for the major military equipment asset categories.

Building a better working world

(e) Valuation of opening balances 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 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.

During our testing, we identified the following:

- Inability to provide sufficient documentation to support valuation for 11 of 15 types of uninstalled missile motors.
- Exceptions covering 94 Type Model Series Modifications (TMSM) comprising approximately 3,400 total engines, including:
    - Lack of any or sufficient supporting documentation.
    - Differences between source documents and amounts recorded.
- Inability to provide sufficient documentation to support valuation for cruise missiles engines.

Munitions are valued using Moving Average Cost (MAC). MAC is determined using munitions data from various systems, such as CAS (USAF munitions APSR) and Army's Logistics Modernization Program (LMP). New values are calculated using the pricing information from the Defense Logistics Agency's Web Federal Logistics Information System (WebFLIS). During our testing of beginning balances for munitions, we identified:

- Insufficient validation of WebFLIS as a reliable source of actual unit cost.
- Significant unexplained differences between MAC and WebFLIS. For example, EY observed a NIIN with a MAC value in CAS of $.01 as of September 30, 2018, while the WebFLIS value was $87,500.

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.
    - Assess if updates to policy or guidance are needed to clarify the respective roles and responsibilities of all CE parties (i.e. the RPO, Engineering Flight, Operations Flight, BEC) for the timely and accurate identification, communication and subsequent reporting of a change in a facilities use (i.e. CATCODE).
    - Consider refinement of the current CATCODE book utilized by RPOs to more clearly define the criteria used in determining a facilities' appropriate usage.
    - Entity level monitoring and oversight controls should be developed at the appropriate level to ensure consistent and appropriate application of CATCODEs across installations.
- 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 BEC to effectively monitor the updates made to GIS maps to more effectively identify, record and monitor RP assets. These control should address the execution of a reconciliation process between the APSR data and GIS maps.

- Valuation of opening balances 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
  - USAF should validate the unit pricing of munitions assets in WebFLIS on an annual basis or when there is a significant differences with the recorded value in USAF APSR
- 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 consistency establish and subsequently monitor E&DL estimates
  - Evaluate the appropriateness of current E&DL cost estimation models to accurately estimate environmental disposal costs

X. ESTABLISHING OPENING BUDGETARY BALANCES

The processes to establish the opening budgetary account balances of USAF that were initiated by appropriations occurring in prior years have not been completed. USAF does not have detailed GAFS-R transactional data available to support beginning budgetary balances prior to FY13. This results in an unreconciled, unsupported beginning balance amount.

Recommendations:

EY recommends that USAF consider the following corrective action related to the conditions described above:

- Design/implement a risk analysis of the unsupported detail to assess the impact on the financial statements, including evaluating other data sources that may be available to support balances at a point in time.

Building a better working world

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.
- Contingency planning controls provide reasonable assurance that the system and its data can be recovered to minimize impact to operations.

An internal control environment which lacks any one of the above may be susceptible to the associated system risks that arise from their absence. 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

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 Complementary User Entity Controls (CUECs).

(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:

- 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.

(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.

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.

Building a better working world

(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.
- 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.
  - 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.
- 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.

- 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.

Building a better
working world

Appendix B – Significant Deficiencies

I. OPERATING MATERIALS AND SUPPLIES

USAF does not have systems in place to account for inventory and related property under SFFAS 3, *Accounting for Inventory and Related Property*, and does not have a definitive timeline for completion of this effort.

OM&S is classified on the balance sheet 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). 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, which determines the USSGL account to be used for financial reporting purposes. During our testing, we identified the following:

- USAF lacks sufficient policies and procedures to account and report for EOU as well as allowances for repairs.
- In-transit inventory—approximately 70 uninstalled missile motors where the condition codes as indicated on the UMM did not correspond with the condition code as listed in the APSR. In the majority of instances, the UMMs were tagged as unserviceable reparable (condition code F), but were classified as OM&S Held for use (condition code A) in the APSR. The status of those UMM were not updated on a timely manner after identifying them as assets that required repair, overhaul or reconditioning.

Improper use of supply codes, as well as lack of sufficient policies to account for repairs and EOU could result in misstatements to the financial statements.

EY identified instances where USAF did not have a complete and accurate population of its OM&S assets as a result of the following:

- Eight missile motors were inaccurately recorded as uninstalled and therefore should not have been included as part of the OM&S balance as of the date of testing
- Munitions are not recognized in the APSR until they are physically received at an Air Force location, although they have been previously accepted by 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. USAF has previously self-identified this issue and indicated that this is an enterprise issue that may also affect other OM&S asset categories. EY also identified in-transit inventory conditions as part of our testing of OM&S base possessed.

EY
Building a better working world

Recommendations:

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

- Establish formalized plan and timeline for completion of efforts to account for inventory and related property under SFFAS 3.
- Additional training for maintenance staff on how and when to update the Logistic Supply Condition Codes. Determine whether physical inventory procedures assess asset condition versus condition codes as listed in the system.
- Establish accounting policies and procedures to determine repair and revaluation allowances. Adjust recorded values once that effort is complete.
- Develop and implement controls to ensure in-transit inventory is appropriately accounted for timely in the financial records.
- Increase communication between the personnel who initiate and record transactions.

II. 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 Miscellaneous Obligation/Reimbursement Documents (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 unfilled customer orders 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. Additionally, the lack of identifiers within the data can result in improper, system-generated recoveries and abnormal balances, for which USAF is not performing sufficiently precise reviews. These balances misstate the quarter-end Standard Form (SF) 133s, *Reports on Budget Execution and Budgetary Resources,* and have to be reversed by the end of the year.

(b) Lack of sufficient reviews over reimbursable activity

One of the primary systems that USAF uses for reimbursable activity is the Job Order Cost Accounting System II (JOCAS). In this system, 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.

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 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.
    - 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 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 from 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.

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

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. 19-01, *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, 2018, and the related consolidated statement of net costs, consolidated statement of changes in net position and combined statement of budgetary resources for the year ended September 30, 2018, and the related notes to the financial statements and have issued our report thereon dated November 14, 2018. 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, 2018 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. 19-01, 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. 19-01, 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.

Building a better working world

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) 2018 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 confirmed 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 user access, configuration management/change controls, segregation of duties and interfaces. 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 2018 USAF Statement of Assurance and Note 1.B. 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 2018 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.

Building a better working world

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 2018 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 14, 2018 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 14, 2018. 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 14, 2018

This Page Intentionally Left Blank

WORKING CAPITAL FUND

The Department of the Air Force Working Capital Fund Principal Statements and related notes are presented in the format prescribed by the Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* and the Department of Defense Financial Management Regulation *7000.14-R, Volume 6B*. The statements and related notes summarize financial information for individual activity groups and activities within the General Fund for the fiscal year ended September 30, 2018 and are presented on a comparative basis with information previously reported for the fiscal year ended September 30, 2017. 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's Circular A-136, "Financial Reporting Requirements."

The following statements comprise the Department of the Air Force Working Capital Fund Principal Statements:

Consolidated Balance Sheets
The Consolidated Balance Sheets, as of September 30, 2018 and 2017, represents 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).

Combined Statements of Budgetary Resources
The Combined Statements of Budgetary Resources presents the budgetary resources available to the Air Force during FYs 2018 and 2017, the status of these resources at September 30, 2018 and 2017, and the outlay of budgetary resources for the fiscal years ended September 30, 2018 and 2017.

Consolidated Statements of Changes in Net Position
The Consolidated Statements of Changes in Net Position presents 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 fiscal years ended September 30, 2018 and 2017.

Consolidated Statements of Net Cost
The Consolidated Statements of Net Cost present the net cost of the Air Force's operations for the fiscal years ended September 30, 2018 and 2017. 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.

Air Force Working Capital Fund
CONSOLIDATED BALANCE SHEET
For the years ended September 30, 2018 and 2017
(Amounts in thousands)

		2018 Consolidated (unaudited)		2017 Consolidated (unaudited)
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	1,445,895	$	1,862,661
Accounts Receivable (Note 4)		730,932		760,030
Other Assets (Note 5)		124,161		163,756
Total Intragovernmental Assets	$	2,300,988	$	2,786,447
Accounts Receivable,Net (Note 4)		3,871		667
Inventory and Related Property,Net (Note 6)		28,890,092		23,311,136
General Property, Plant and Equipment,Net (Note 7)		1,549,902		1,567,647
Other Assets (Note 5)		140,791		134,392
TOTAL ASSETS	$	32,885,644	$	27,800,289
LIABILITIES (Note 8)				
Intragovernmental:				
Accounts Payable (Note 9)	$	149,749	$	220,094
Other Liabilities (Note 10 & 11)		55,581		55,134
Total Intragovernmental Liabilities	$	205,330	$	275,228
Accounts Payable (Note 9)	$	456,135	$	397,315
Military Retirement and Other Federal Employment Benefits (Note 12)		197,332		190,435
Other Liabilities (Note 10 & Note 11)		449,900		403,774
TOTAL LIABILITIES	$	1,308,697	$	1,266,752
COMMITMENTS AND CONTINGENCIES (NOTE 11)				
NET POSITION				
Unexpended Appropriations - Other Funds		33,158		47,941
Cumulative Results of Operations - Other Funds		31,543,789		26,485,596
TOTAL NET POSITION	$	31,576,947	$	26,533,537
TOTAL LIABILITIES AND NET POSITION	$	32,885,644	$	27,800,289

Air Force Working Capital Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2018 and 2017
(Amounts in thousands)

	2018 Combined (unaudited)	2017 Combined (unaudited)
BUDGETARY RESOURCES:		
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 1,271,915	$ 1,424,846
Appropriations (discretionary and mandatory)	66,461	63,967
Contract Authority (discretionary and mandatory)	10,947,080	10,227,928
Spending Authority from offsetting collections (discretionary and mandatory)	6,794,693	6,496,313
Total Budgetary Resources	$ 19,080,149	$ 18,213,054
STATUS OF BUDGETARY RESOURCES:		
New obligations and upward adjustments (total)	$ 17,786,636	$ 16,882,143
Unobligated balance, end of year:		
Apportioned, unexpired accounts	1,293,513	1,330,911
Unexpired unobligated balance, end of year	1,293,513	1,330,911
Unobligated balance, end of year (total)	1,293,513	1,330,911
Total Budgetary Resources	$ 19,080,149	$ 18,213,054
OUTLAYS, NET		
Outlays, net (total) (discretionary and mandatory)	424,231	(374,439)
Agency Outlays, net (discretionary and mandatory)	$ 424,231	$ (374,439)

Air Force Working Capital Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2018 and 2017
(Amounts in thousands)

	2018 Consolidated (unaudited)	2017 Consolidated (unaudited)
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 47,941	$ 26,253
Beginning balances, as adjusted	47,941	26,253
Budgetary Financing Sources:		
Appropriations transferred-in/out	66,462	63,967
Appropriations used	(81,245)	(42,279)
Total Budgetary Financing Sources	(14,783)	21,688
Total Unexpended Appropriations	33,158	47,941
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	26,485,596	26,261,469
Beginning balances, as adjusted	26,485,596	26,261,469
Budgetary Financing Sources:		
Appropriations used	81,245	42,279
Nonexchange revenue	(4)	(4)
Transfers-in/out without reimbursement	(58,996)	0
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(14,584)	10,809
Imputed financing from costs absorbed by others	199,650	135,668
Other (+/-)	31,882	(175,632)
Total Financing Sources	239,193	13,120
Net Cost of Operations (+/-)	(4,819,000)	(211,007)
Net Change	5,058,193	224,127
Cumulative Results of Operations	31,543,789	26,485,596
Net Position	$ 31,576,947	$ 26,533,537

Air Force Working Capital Fund
CONSOLIDATED STATEMENT OF NET COST
For the years ended September 30, 2018 and 2017
(Amounts in thousands)

	2018 Consolidated (unaudited)	2017 Consolidated (unaudited)
PROGRAM COSTS		
Gross Costs	$ 7,855,683	$ 12,040,803
Operations, Readiness & Support	7,855,683	12,040,803
(Less: Earned Revenue)	(12,674,683)	(12,251,810)
Net Cost before Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	(4,819,000)	(211,007)
Net Program Costs Including Assumption Changes	(4,819,000)	(211,007)
Net Cost of Operations	$ (4,819,000)	$ (211,007)

Fiscal Year 2018

WORKING CAPITAL FUND

Notes to the Principal Statements

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. Significant Accounting Policies

1.A. Mission of the Reporting Entity

The United States Air Force was created on September 18, 1947, by the National Security Act of 1947. The National Security Act Amendments of 1949 established the DoD and made the Air Force a department within the DoD. The overall mission of the United States Air Force is to fly, fight and win...in air, space and cyberspace. Our priorities are: (1) continue to strengthen the nuclear enterprise, (2) partner with Joint and Coalition team to win today's fight, (3) develop and care for Airmen and their families, (4) modernize our air and space inventories, organizations, and training, and (5) recapture acquisition excellence.

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 Section 2208. The revolving funds were established as a means to more effectively control the cost of work performed by DoD. The DoD began operating under the revolving fund concept on July 1, 1951.

Air Force Working Capital Fund 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 more than 74 thousand items that are generally related to weapon systems and ground support, and include both depot level reparables 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 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 nearly 1.1 million 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 nearly 9 thousand different 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.

1.B. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the AFWCF, as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the 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 No. A-136, "Financial Reporting Requirements"; and the Department of Defense (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 Circular No. A-136, due to limitations of financial and nonfinancial management processes and systems that support the financial statements. The AFWCF derives reported values and information for major asset and liability categories largely from nonfinancial 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.

The Air Force has not completed the process of evaluating the effects that will result from adopting the below pronouncements to the Federal Accounting Standards Advisory Board Handbook of Accounting Standards and Other Pronouncements, as Amended. These pronouncements are expected to have an impact on our 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 and budgetary activity when such pronouncements are adopted.

1) Statement of Federal Accounting Standards (SFFAS) 47: Reporting Entity. Issued on: December 23, 2014. Effective Date: For periods beginning after September 30, 2017. USAF 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 USAF SFFAS 47 analysis is not complete. The consolidation decisions related to that analysis when complete could have a material impact on the USAF financial statements.

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

   The Air Force 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 are not yet fully in place.

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

4) SFFAS 50: Establishing Opening Balances for General Property, Plant, and Equipment. Issued on: August 4, 2016. Effective Date: For periods beginning after September 30, 2016.

   The Air Force plans to utilize deemed cost to value beginning balances for general property, plant and equipment (GPP&E), as permitted by SFFAS 50. However, systems required to account for historical cost for GPP&E in accordance with SFFAS 6 are not yet fully in place.

5) SFFAS 53: Budget and Accrual Reconciliation, Amending Statement of Federal Financial Accounting Standards (SFFAS) 7, SFFAS 22 and SFFAS 24: Issued on: October 27, 2017: Effective Date: reporting periods beginning after September 30, 2018. Early adoption is permitted.

6) SFFAS 55: Amending Inter-entity Cost Provisions: Issued on May 31, 2018: Effective Date: reporting periods beginning after September 30, 2018. Early adoption is permitted.

7) 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.

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 18: Implementation Guidance for Establishing Opening Balances; Issued on October 2, 2017. Effective Date: upon issuance.

11) 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 and Effective Date: Upon issuance.

1.C. Use of Estimates
The AFWCF management makes assumptions and reasonable estimates in the preparations 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, accounts payable, and actuarial liabilities related to workers' compensation.

1.D. Appropriations and Funds
The AFWCF receives appropriations and funds as general and working capital (revolving) funds. The AFWCF uses these appropriations and funds to execute its missions and subsequently report on resource usage.

Working Capital Funds (WCF) received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations and transactions that flow through the fund. 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 supplement WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

1.E. Basis of Accounting
The AFWCF presents the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position on a consolidated basis which is the summation of the Components less the

Eliminations. The Statement of Budgetary Resources is 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 compliance with legal requirements and controls over the use Federal funds.

The Department of Defense's continued effort towards full compliancy with U.S. GAAP for the accrual method of accounting is encumbered by various systems limitations and the sensitive nature of Departmental activities.

The AFWCF is unable to meet all full accrual accounting requirements. This is primarily because many of the AFWCF's financial and nonfinancial 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 financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of AFWCF sub-entities. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), from nonfinancial feeder systems, and accruals made for major items such as "Flying Hour" revenue, payroll expenses, and accounts payable.

1.F. Revenues and Other Financing Sources

The CSAG Maintenance Division recognizes revenue according to the percentage of completion method. The CSAG Supply Division and SMAG-R recognize revenue based on flying hours executed and the sale of inventory items.

1.G. 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. In the case of Operating Materiel & Supplies (OM&S), the consumption method is used. Under the consumption method, OM&S is expensed when consumed.

1.H. Accounting for Intragovernmental Activities

The Treasury Financial Manual 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 intraentity activity and balances from consolidated financial statements to prevent overstatement for 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 accounting offices. The DoD is implementing replacement systems and a standard financial information structure incorporating the necessary elements to enable DoD to correctly report, reconcile, and eliminate intragovernmental balances.

Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government, provides guidance for reporting imputed financing. Imputed financing represents the costs paid on behalf of the AFWCF by another Federal entity. The AFWCF recognizes imputed costs for (1) employee pension, post-retirement health, and life insurance benefits; and (2) post-employment benefits for terminated and inactive employees to include unemployment and workers compensation under the Federal Employees' Compensation Act.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements do not report any public debt, interest or source of public financing, whether from issuance of debt or tax revenues.

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

1.J. Funds with the U.S. 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 Service (DFAS), the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the 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.

In addition, 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 (FBWT) account.

1.K. Accounts Receivable
Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon factors such as: aging of accounts receivable, debtor's ability to pay, and payment history. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies as receivables from other federal agencies are considered to be inherently collectible. 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.

1.L. Inventories and Related Property
The AFWCF values its resale inventory using the moving average cost method. The Department, when applicable, will continue to adopt *SFFAS No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials"* permitting alternative methods in establishing opening balances.

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 ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in 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.

Related property includes OM&S which is valued at moving average cost. 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 pending development of an effective means of valuing such materiel.

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

1.M. General Property, Plant and Equipment

The AFWCF General Property, Plant and Equipment (PP&E) assets are capitalized in accordance with SFFAS No. 6, “Accounting for Property, Plant and Equipment,” as amended by SFFAS No. 10, “Accounting for Internal Use Software.” The AFWCF capitalizes assets when it has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization thresholds. The AFWCF capitalizes improvements to existing General PP&E assets if the improvement equals or exceeds the capitalization threshold, extends the useful life of the underlying asset or increases the size, efficiency, or capacity of the asset. The AFWCF depreciates all General PP&E, other than land, on a straight-line basis in accordance with SFFAS No. 6. The AFWCF's General PP&E capitalization threshold is $250 thousand. The 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 thousand for equipment and $20 thousand for real property) and are carried at the remaining net book value.

Since the AFWCF operates as a business-type activity, all General PP&E is categorized as General PP&E whether or not it meets the definition of any other General PP&E category.

The AFWCF provides government property to contractors to complete contract work, and the contractors are responsible for the control and accountability of these assets. The AFWCF owns such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor procured General PP&E meets or exceeds the DoD capitalization threshold, federal accounting standards require that it be reported on AFWCF’s Balance Sheet.

1.N. Advances and Prepayments

Payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD’s policy is to expense and/or properly classify assets when the related goods and services are received. The AFWCF has implemented this policy.

1.O. Other Assets

Other assets includes those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on 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, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

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

1.P. Contingencies and Other Liabilities

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

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

1.Q. Accrued Leave

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

1.R. Net Position

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

1.S. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported disbursements and collections have corroborating documentation for the summary level adjustments made to accounts payable and receivable. Unsupported disbursements and collections do not have supporting documentation for the transactions and most likely would not meet audit scrutiny. However, both supported and unsupported adjustments may have been made to the AFWCF's accounts payable and receivable trial balances prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD generally cannot determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, the DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements and collections are also applied to reduce accounts payable and receivable accordingly.

Note 2. Nonentity Assets

As of September 30	2018 (unaudited)		2017 (unaudited)	
(Amounts in thousands)				
1. Nonfederal Assets				
Accounts Receivable		1		5
2. Total Nonentity Assets	$	1	$	5
3. Total Entity Assets	$	32,885,643	$	27,800,284
4. Total Assets	$	32,885,644	$	27,800,289

Asset accounts are categorized as either entity or nonentity. Entity accounts consist of resources that are available for use in the operations of the entity.

Nonentity assets are not available for use in the AFWCF's normal operations. The AFWCF has stewardship accountability and reporting responsibility for nonentity assets.

These nonentity assets consist of amounts associated with interest, fines and penalties due on debt. Generally, AFWCF 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		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
Status of Fund Balance with Treasury				
1. Unobligated Balance Available	$	1,293,514	$	1,330,911
2. Obligated Balance not yet Disbursed	$	8,961,963	$	7,727,450
3. Non-FBWT Budgetary Accounts	$	(8,809,582)	$	(7,195,700)
4. Total	$	1,445,895	$	1,862,661

In FY 2018 the AFWCF has a $526.6 million reconciling net difference between the Fund Balance with Treasury (FBWT) as reflected in the AFWCF's general ledger accounts and the balance in the U.S. Treasury account. The difference represents the FBWT for the United States Transportation Command (USTC), which is reported by the U.S. Treasury as part of the AFWCF. However, for the purposes of Audited Financial Statements (AFS), USTC is included with the Other Defense Organizations Working Capital Funds reporting which is separate from the AFWCF. Therefore, USTC funds are not included in the AFWCF AFS.

The Treasury records cash receipts and disbursements on the AFWCF's behalf and are available only for the purposes for which the funds were appropriated. The AFWCF's FBWT consists of appropriation accounts, and revolving funds.

The following adjustments were necessary for the AFWCF to reconcile their general ledger to the U.S. Treasury: $7.3 million in undistributed collections, $0.7 thousand in unsupported undistributed collections, $313.5 million in undistributed disbursements, and $1.7 million in unsupported undistributed disbursements. Only the current year undistributed activity can be supported, all prior year activity is unsupported, thus the total undistributed amount is considered unsupported. These undistributed amounts represent transactions that have not yet posted to the proper account at year-end due to timing.

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.

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. Certain unobligated balances are restricted for future use and are not apportioned for current use. The AFWCF has no restrictions on unobligated balances.

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

Note 4. Accounts Receivable

As of September 30	2018 (unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
1. Intragovernmental Receivables	$ 730,932	N/A	$ 730,932
2. Nonfederal Receivables (From the Public)	$ 3,982	$ (111)	$ 3,871
3. Total Accounts Receivable	$ 734,914	$ (111)	$ 734,803

As of September 30	2017 (unaudited)		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
1. Intragovernmental Receivables	$ 760,030	N/A	$ 760,030
2. Nonfederal Receivables (From the Public)	$ 706	$ (39)	$ 667
3. Total Accounts Receivable	$ 760,736	$ (39)	$ 760,697

Accounts receivable represent the AFWCF's 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 Intragovernmental Business Rules.

The method used to estimate the allowance for uncollectible amounts is a two- step process that consists of a group analysis and an individual analysis. Group Analysis is based on 36 months of data in order to develop a factor to be applied to each aged category balance to determine the allowance amount. Accounts that represent significant amounts are individually analyzed to determine the amount.

Note 5. Other Assets

As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
1. Intragovernmental Other Assets		
A. Other Assets	124,161	163,756
B. Total Intragovernmental Other Assets	$ 124,161	$ 163,756
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 140,062	$ 126,082
B. Advances and Prepayments	217	7,746
C. Other Assets (With the Public)	512	564
D. Total Nonfederal Other Assets	$ 140,791	$ 134,392
3. Total Other Assets	$ 264,952	$ 298,148

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

The $124.2 million in Intragovernmental Other Assets - Other Assets 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.

Outstanding Contract Financing Payments includes $128.2 million in contract financing payments and an additional $11.9 million in estimated future payments to contractors upon delivery and government acceptance. The Contract Financing Payment asset is related to the Contingent Liabilities reported in Note 10, Other Liabilities.

The $512 thousand in Nonfederal Other Assets – Other Assets (With the Public) is primarily comprised of the Consolidated Sustainment Activity Group's labor costs that have been recorded in the Time and Attendance logistical system, but have not yet updated the appropriate labor account in the accounting system.

Note 6. Inventory and Related Property

As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
1. Inventory, Net	$ 28,761,838	$ 23,180,258
2. Operating Materiel & Supplies, Net	128,254	130,878
3. Total	$ 28,890,092	$ 23,311,136

Inventory, Net

As of September 30	2018 (unaudited)						
(Amounts in thousands)		Inventory, Gross Value		Revaluation Allowance	Inventory, Net	Valuation Method
1. Inventory Categories						
A. Inventory Held for Sale	$	16,103,509	$	(763)	16,102,746	MAC, LAC
B. Inventory Held for Repair		17,671,972		(5,017,740)	12,654,232	MAC, LAC
C. Work in Process		4,860		0	4,860	MAC
D. Excess, Obsolete, and Unserviceable Inventory		289,520		(289,520)	0	NRV
E. Total Inventory, Net	$	34,069,860	$	(5,308,022)	28,761,838	

As of September 30	2017 (unaudited)					
(Amounts in thousands)		Inventory, Gross Value		Revaluation Allowance	Inventory, Net	Valuation Method
1. Inventory Categories						
A. Inventory Held for Sale	$	12,012,998	$	0	12,012,998	MAC, LAC
B. Inventory Held for Repair		15,571,151		(4,417,888)	11,153,263	MAC,LAC
C. Work in Process		13,997		0	13,997	MAC
D. Excess, Obsolete, and Unserviceable Inventory		275,530		(275,530)	0	NRV
E. Total Inventory, Net	$	27,873,677	$	(4,693,419)	23,180,258	

Legend for Valuation Methods:
MAC = Moving Average Cost
LAC = Latest Acquisition Cost
NRV = Net Realizable Value

The net $5.6 billion increase in inventory and related property can be attributed to an inventory reconciliation, and the reversal of duplicate transactions of inventory transfers. Throughout FY 2018 the logistic system to financial system reconciliation identified $3.7 billion in inventory within the logistic system that was not recorded in the accounting system. Due to the inventory impact from the system reconciliation, an inventory working group, consisting of both financial and logistics personnel, has been established to review and evaluate all inventory reconciliations and identify any required corrective actions. An additional $2.1 billion increase can be attributed to a correction of a systemic issue that resulted in the duplicate posting of transactions of inventory transfers.

Restrictions

There are no restrictions on the use, sale, or disposition of inventory except for War Reserve Materiel and nuclear related spare parts.

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, or to be consumed in the production of goods for sale or in the provision of services for a fee.

Definitions

Inventory Available and Purchased for Resale includes consumable and reparable parts owned and managed by AFWCF.

Inventory Held for Repair is damaged inventory that requires repair to make it suitable for sale. The Revaluation Allowance represents the estimated repair cost (Material, Labor & Overhead) to bring the impaired asset back to a serviceable condition. Many of the inventory items are more economical to repair than to procure. In addition, because 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 a ready, mobile, and armed military force.

Excess, Obsolete, and Unserviceable inventory consists of obsolete, excess to requirements, or items that cannot be economically repaired and are awaiting disposal.

Work in Process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead, and other direct costs. Work in Process also includes the value of finished products or completed services pending the submission of bills to the customer.

Operating Materiel and Supplies, Net

As of September 30	2018 (unaudited)			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
(Amounts in thousands)				
1. OM&S Categories				
A. Held for Use	$ 128,254	$ 0	$ 128,254	MAC
B. Total OM&S	$ 128,254	$ 0	$ 128,254	

As of September 30	2017 (unaudited)			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
(Amounts in thousands)				
1. OM&S Categories				
A. Held for Use	$ 130,878	$ 0	$ 130,878	MAC
B. Total OM&S	$ 130,878	$ 0	$ 130,878	

Legend for Valuation Methods:
MAC = Moving Average Cost
NRV = Net Realizable Value

Restrictions

There are no restrictions on the use, sale, or disposition of OM&S.

General Composition of Operating Materiel and Supplies

OM&S includes consumable parts and supplies used to remanufacture spare parts and repair weapons systems.

Definition

Held for Use includes consumable parts and supplies.

Note 7. General PP&E, Net

As of September 30	2018 (unaudited)							
	Depreciation/ Amortization Method	Service Life		Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value
(Amounts in thousands)								
1. Major Asset Classes								
A. Buildings, Structures, and Facilities	S/L	20 Or 40	$	1,512,038	$	(896,459)	$	615,579
B. Software	S/L	2-5 Or 10		1,158,176		(1,119,474)		38,702
C. General Equipment	S/L	Various		3,391,739		(2,718,296)		673,443
D. Construction-in-Progress	N/A	N/A		222,178		N/A		222,178
E. Total General PP&E			$	6,284,131	$	(4,734,229)	$	1,549,902

As of September 30	2017 (unaudited)							
	Depreciation/ Amortization Method	Service Life		Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value
(Amounts in thousands)								
1. Major Asset Classes								
B. Buildings, Structures, and Facilities	S/L	20 Or 40	$	1,465,445	$	(861,563)	$	603,882
B. Software	S/L	2-5 Or 10		1,157,552		(1,114,863)		42,689
C. General Equipment	S/L	Various		3,300,534		(2,597,907)		702,627
D. Construction-in-Progress	N/A	N/A		218,449		N/A		218,449
E. Total General PP&E			$	6,141,980	$	(4,574,333)	$	1,567,647

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

AFWCF does not have any restrictions on the use or convertibility of General PP&E.

Note 8. Liabilities Not Covered by Budgetary Resources

As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Other	37,263	37,558
B. Total Intragovernmental Liabilities	$ 37,263	$ 37,558
2. Nonfederal Liabilities		
A. Military Retirement and Other Federal Employment Benefits	197,332	190,435
B. Total Nonfederal Liabilities	$ 197,332	$ 190,435
3. Total Liabilities Not Covered by Budgetary Resources	$ 234,595	$ 227,993
4. Total Liabilities Covered by Budgetary Resources	$ 1,074,102	$ 1,038,759
5. Total Liabilities	$ 1,308,697	$ 1,266,752

The $37.3 million in Intragovernmental Liabilities - Other Liabilities is comprised of the portion of the total Air Force Federal Employee's Compensation Act (FECA) liability allocated to the AFWCF.

Military Retirement and Other Federal Employment Benefits consists of FECA actuarial liabilities not due and payable during the current fiscal year. Refer to Note 12, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Note 9. Accounts Payable

As of September 30	2018 (unaudited)		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
1. Intragovernmental Payables	$ 149,749	$ N/A	$ 149,749
2. Nonfederal Payables (to the Public)	456,135	0	456,135
3. Total	$ 605,884	$ 0	$ 605,884

As of September 30	2017 (unaudited)		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
1. Intragovernmental Payables	$ 220,094	$ N/A	$ 220,094
2. Nonfederal Payables (to the Public)	397,315	0	397,315
3. Total	$ 617,409	$ 0	$ 617,409

Accounts Payable include amounts owed to federal and nonfederal entities for goods and services received by AFWCF.

Note 10. Other Liabilities

As of September 30	2018 (unaudited)		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
1. Intragovernmental			
A. FECA Reimbursement to the Department of Labor	16,618	20,645	37,263
B. Custodial Liabilities	1	0	1
C. Employer Contribution and Payroll Taxes Payable	18,317	0	18,317
D. Total Intragovernmental Other Liabilities	$ 34,936	$ 20,645	$ 55,581
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 224,118	$ 0	$ 224,118
B. Advances from Others	156,906	0	156,906
C. Contract Holdbacks	12,631	0	12,631
D. Contingent Liabilities	0	11,887	11,887
E. Other Liabilities	44,358	0	44,358
F. Total Nonfederal Other Liabilities	$ 438,013	$ 11,887	$ 449,900
3. Total Other Liabilities	$ 472,949	$ 32,532	$ 505,481

As of September 30	2017 (unaudited)		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
1. Intragovernmental			
A. Advances from Others	$ 1	$ 0	$ 1
B. FECA Reimbursement to the Department of Labor	17,365	20,192	37,557
C. Custodial Liabilities	5	0	5
D. Employer Contribution and Payroll Taxes Payable	17,571	0	17,571
E. Total Intragovernmental Other Liabilities	$ 34,942	$ 20,192	$ 55,134
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 204,367	$ 0	$ 204,367
B. Advances from Others	134,503	0	134,503
C. Contract Holdbacks	12,611	0	12,611
D. Contingent Liabilities	0	8,778	8,778
E. Other Liabilities	43,515	0	43,515
F. Total Nonfederal Other Liabilities	$ 394,996	$ 8,778	$ 403,774
3. Total Other Liabilities	$ 429,938	$ 28,970	$ 458,908

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

The FY 2018 FECA Reimbursement to the Department of Labor represents liabilities due under the Federal Employee Compensation Act. Billed amounts payable in 2019 and unbilled amounts for both incurred and estimated accrual amounts are included. However, see Note 12, 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 AFWCF is acting on behalf of another Federal entity.

Employer Contributions 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.

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 FY 2018 Contingent liabilities include $11.9 million related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractors’ work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The AFWCF is under no obligation to pay contractors for amounts in excess of progress payments authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid are estimable, the AFWCF has recognized a contingent liability for the estimated unpaid costs considered conditional for payment pending delivery and government acceptance.

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

The $44.4 million balance in the FY 2018 Nonfederal Other Liabilities – Other Liabilities primarily consist of accrued liabilities established in the Consolidated Sustainment Activity Group (CSAG) Supply as an offset to the asset established when foreign governments provide funds to buy their respective share of inventory that is owned and managed by the Air Force under a Cooperative Logistics Supply Support Agreement (CLSSA).

Note 11. Commitments and Contingencies

The AFWCF is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests. The AFWCF's Office of the General Counsel considers the possibility of the AFWCF sustaining any losses on these legal actions to be remote.

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, AFWCF's automated system processes have limited capability to capture these potential liabilities; 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.

Note 12. Military Retirement and Other Federal Employment Benefits

As of September 30	2018 (unaudited)		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in thousands)			
1. Other Benefits			
A. FECA	$ 197,332	$ 0	$ 197,332
B. Total Other Benefits	$ 197,332	$ 0	$ 197,332
2. Total Military Retirement and Other Federal Employment Benefits:	$ 197,332	$ 0	$ 197,332

Federal Employees Compensation Act (FECA)

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

Discount Rates
2.716% in Year 1
2.379% in Year 2
and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors Cost of Living Adjustments (COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2018 were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2018	N/A	N/A
2019	1.31%	3.21%
2020	1.51%	3.48%
2021	1.89%	3.68%
2022	2.16%	3.71%
2023 and thereafter	2.21%	4.09%

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case severity) in CBY 2017 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2018 projection to the average pattern for the projections of the most recent three years.

As of September 30	2017 (unaudited)		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in thousands)			
1. Other Benefits			
A. FECA	$ 190,435	$ 0	$ 190,435
B. Total Other Benefits	$ 190,435	$ 0	$ 190,435
2. Total Military Retirement and Other Federal Employment Benefits:	$ 190,435	$ 0	$ 190,435

Note 13. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue As of September 30	2018 (unaudited)	2017 (unaudited)
(Amounts in thousands)		
Operations, Readiness & Support		
1. Gross Cost	$ 7,855,683	$ 12,040,803
2. Less: Earned Revenue	(12,674,683)	(12,251,810)
Total Net Cost	$ (4,819,000)	$ (211,007)

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the AFWCF 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 DoD's current processes and systems capture costs based on appropriations 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) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 55, "Amending Inter-Entity Cost Provisions."

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 U.S. GAAP. These estimates reverse as actual costs or revenues are recorded.

The $4.8 billion decrease in gross costs can be attributed to the gains recorded in the Statement of Net Costs resulting from the net $5.6 billion increase in inventory and related property. Throughout FY 2018 the logistic system to financial system reconciliation identified $3.7 billion in inventory within the logistic system that was not recorded in the accounting system, thus resulting in $3.7 billion in inventory gains. An additional $2.1 billion gain was the result of a correction of a systemic issue that resulted in the duplicate posting of transactions of inventory transfers. See Note 6 for additional details.

Note 14. Disclosures Related to the Statement of Changes in Net Position

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 $66.5 million difference is due to additional resources that were transferred from the Defense Working Capital Fund are included in the Appropriation line item on the Statement of Budgetary Resources. Refer to Note 15, Disclosures Related to the Statement of Budgetary Resources for further information.

Note 15. Disclosures Related to the Statement of Budgetary Resources

As of September 30		2018 (unaudited)
(Amounts in thousands)		
1. Intragovernmental Budgetary Resources Obligated for Undelivered Orders:		
A. Unpaid		1,922,741
B. Prepaid/Advanced		0
C. Total Intragovernmental	$	1,922,741
2. Nonfederal Budgetary Resources Obligated for Undelivered Orders:		
A. Unpaid		5,856,673
B. Prepaid/Advanced		128,392
C. Total Nonfederal	$	5,985,065
3. Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$	7,907,806
4. Available Borrowing and Contract Authority at the End of the Period	$	0

The face of the Statement of Budgetary Resources has changed to comply with the requirements within the OMB Circular A-136 guidance. As such, the footnote table only presents the current fiscal year.

The AFWCF reported $66.5 million in direct obligations and $17.7 billion in reimbursable obligations in category B.

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

The Appropriations on the Statement of Budgetary Resources (SBR) does not agree with Appropriations Received on the Statement of Changes in Net Position (SCNP). The $66.5 million difference is due to additional resources that were transferred from the Defense Working Capital Fund are included in the Appropriation line item on the Statement of Budgetary Resources. Refer to Note 14, Disclosures Related to the Statement of Changes in Net Position for additional details.

Note 16. Reconciliation of Net Cost of Operations to Budget

As of September 30		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
Resources Used to Finance Activities:				
Budgetary Resources Obligated:				
1. Obligations incurred	$	17,786,636	$	16,882,143
2. Less: Spending authority from offsetting collections and recoveries (-)		(16,637,663)		(17,040,837)
3. Net obligations	$	1,148,973	$	(158,694)
Other Resources:				
4. Transfers in/out without reimbursement (+/-)		(14,584)		10,809
5. Imputed financing from costs absorbed by others		199,650		135,668
6. Other (+/-)		31,882		(175,632)
7. Net other resources used to finance activities	$	216,948	$	(29,155)
8. Total resources used to finance activities	$	1,365,921	$	(187,849)
Resources Used to Finance Items not Part of the Net Cost of Operations:				
9. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:				
12a. Undelivered Orders (-)	$	(1,224,533)	$	(459,579)
12b. Unfilled Customer Orders		549,994		336,518
10. Resources that fund expenses recognized in prior Periods (-)		(296)		(3,241)
11. Resources that finance the acquisition of assets (-)		(5,569,260)		(5,366,904)
12. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:				
12a. Other (+/-)		(17,298)		164,824
13. Total resources used to finance items not part of the Net Cost of Operations	$	(6,261,393)	$	(5,328,382)
14. Total resources used to finance the Net Cost of Operations	$	(4,895,472)	$	(5,516,231)

As of September 30		2018 (unaudited)		2017 (unaudited)
(Amounts in thousands)				
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
15. Increase in exchange revenue receivable from the public (-)		105		10,985
16. Other (+/-)		6,897		0
17. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	$	7,002	$	10,985
Components not Requiring or Generating Resources:				
18. Depreciation and amortization	$	180,953	$	179,250
19. Revaluation of assets or liabilities (+/-)		(8,523,711)		(3,184,963)
20. Other (+/-)				
20a. Cost of Goods Sold		14,568,954		14,182,454
20b. Operating Material and Supplies Used		4,396		2,172
20c. Other		(6,161,122)		(5,884,674)
21. Total Components of Net Cost of Operations that will not Require or Generate Resources	$	69,470	$	5,294,239
22. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	$	76,472	$	5,305,224
23. Net Cost of Operations	$	(4,819,000)	$	(211,007)

Due to the AFWCF’s financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. This difference is a previously identified deficiency.

A $155.3 million adjustment was made to the Revaluation of Assets or Liabilities in order to align the note schedule with the amount reported on the Statement of Net Cost.

Resources Used to Finance Activities, Other, and Resources Used to Finance Items not Part of the Net Cost of Operations, Other, is primarily comprised of other gains and losses totaling $31.9 million due to the reclassification of intragovernmental transfers in or out without reimbursement for which Air Force could not determine the trading partners.

Components Requiring or Generating Resources in Future Period, Other, represents the change in the accounting estimate for the actuarial FECA liability.

Components not Requiring or Generating Resources, Other, is primarily comprised of $6.8 billion for Consolidated Sustainment Activity Group - Maintenance Division work-in-process offsets.

The $5.3 billion increase in the Revaluation of assets or liabilities can be attributed to the gains recorded in the Statement of Net Costs resulting from the $5.6 billion increase in inventory and related property. Throughout FY 2018 the logistic system to financial system reconciliation identified $3.7 billion in inventory within the logistic system that was not recorded in the accounting system, thus resulting in $3.7 billion in inventory gains. An additional $2.1 billion gain was the result of a correction of a systemic issue that resulted in the duplicate posting of transactions of inventory transfers. See Note 6 and Note 13 for additional details.

Note 17. Disclosures Related to Incidental Custodial Collections

The AFWCF collected $7.9 thousand of incidental custodial revenues generated primarily from nonentity 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 U.S. Treasury.

Note 18. Disclosure Entities and Related Parties

Effective in 2018, SFFAS 47 “Reporting Entity” requires agencies to disclosure 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. When 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.

This Page Intentionally Left Blank

Fiscal Year 2018

WORKING CAPITAL FUND

Required Supplementary Information

Air Force Working Capital Fund
STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES
For the years ended September 30, 2018 and 2017
($ in Thousands)

	Operations, Readiness & Support	2018 Combined	2017 Combined
Budgetary Resources:			
Unobligated balance from prior year budget authority, net	1,271,915	1,271,915	1,424,846
Appropriations (discretionary and mandatory)	66,461	66,461	63,967
Contract Authority	10,947,080	10,947,080	10,227,928
Spending Authority from offsetting collections (discretionary and mandatory)	6,794,693	6,794.693	6,496,313
Total Budgetary Resources	$ 19,080,149	19,080,149	18,213,054
Status of Budgetary Resources:			
New obligations and upward adjustments (total)	17,786,636	17,786,636	16,882,143
Unobligated balance, end of year			
Apportioned, unexpired accounts	1,293,513	1,293,513	1,330,911
Unexpired unobligated balance, end of year	1,293,513	1,293,513	1,330,911
Unobligated balance, end of the year (total)	1,293,513	1,293,513	1,330,911
Total Budgetary Resources	$ 19,080,149	19,080,149	18,213,054
Outlays, Net:			
Outlays, net (discretionary and mandatory)	424,231	424,231	(374,439)
Agency Outlays, net (discretionary and mandatory)	$ 424,231	424,231	(374,439)

This Page Intentionally Left Blank

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

November 14, 2018

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 Report on the U.S. Air Force Working Capital Fund Financial Statements and Related Notes for FY 2018 (Project No. D2018-D000FT-0029.000, Report No. DODIG-2019-015)

We contracted with the independent public accounting firm of Ernst & Young LLP (EY) to audit the U.S. Air Force Working Capital Fund FY 2018 Financial Statements and related notes as of September 30, 2018, and for the year then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. 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/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008.[1] 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 U.S. Air Force Working Capital Fund financial statements. As a result, EY could not conclude whether the financial statements and related notes were fairly presented in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the U.S. Air Force Working Capital Fund FY 2018 Financial Statements and related notes.

[1] In June 2018, the Government Accountability Office issued an updated Financial Audit Manual. EY updated its audit procedures to be in accordance with the updates issued in the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018.

EY's separate report on "Internal Control Over Financial Reporting" discusses 12 material weaknesses related to U.S. Air Force Working Capital Fund's internal controls over financial reporting. Specifically, EY found material weaknesses including: Integration and Reconciliation of Financial Systems; Inventory Held By U.S. Air Force Working Capital Fund; Inventory Held By Others; Earned Revenue; General Property, Plant and Equipment; Fund Balance with Treasury; Accumulating and Preparing Financial Statements; Oversight and Monitoring of Internal Control; DoD Accounting Policies and Procedures; Establishing Opening Balances for Assets Used in Operations; Establishing Opening Budgetary Balances; and Financial Information Systems. EY's additional report on "Compliance and Other Matters" discusses two instances of noncompliance with applicable laws and regulations.

In connection with the contract, we reviewed EY's report and related documentation and discussed the audit results with EY representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the U.S. Air Force Working Capital Fund FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control, conclusions on whether the U.S. Air Force's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the U.S. Air Force complied with laws and regulations.

EY is responsible for the attached reports, dated November 14, 2018, and the conclusions expressed in these reports. However, our review disclosed no instances in which EY did not comply, in all material respects, with GAGAS.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945.

Lorin T. Venable

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

Attachments:
As stated

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
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 Working Capital Fund (AFWCF), which comprise the consolidated balance sheet as of September 30, 2018 and the consolidated statement of net cost, consolidated statement of changes in net position and combined statement of budgetary resources for the year ended September 30, 2018, and the related notes to the financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 the 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. 19-01, *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.

Departure from U.S. Generally Accepted Accounting Principles

As described in Note 1.B, AFWCF has not implemented certain accounting standards related to accounting issues for the Department of Defense and the Federal government. The effect on the financial statements 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 for the year ended September 30, 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

Prior Year Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990", required the Department of Defense Office of the Inspector General (DoD OIG) to audit the AFWCF consolidated balance sheet as of September 30, 2017, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the financial statements. In their report dated November 13, 2017, DoD OIG issued a disclaimer of opinion as the DoD OIG was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Required Supplementary Information

Accounting principles generally accepted in the United States require that the Management's Discussion and Analysis 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 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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the AFWCF's basic 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 basic financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the basic 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 14, 2018 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 are 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 14, 2018

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

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. 19-01, *Audit Requirements for Federal Financial Statements*, the consolidated financial statements of the Department of the Air Force Working Capital Fund (AFWCF), which comprise the consolidated balance sheet as of September 30, 2018, the consolidated statement of net cost, the consolidated statement of changes in net position and the combined statement of budgetary resources for the year ended September 30, 2018, and the related notes to the consolidated financial statements and have issued our report thereon dated November 14, 2018. 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 consolidated financial statements as of and for the year ended September 30, 2018 and the related notes to the consolidated financial statements.

Internal Control Over Financial Reporting

In connection with our engagement to audit the consolidated 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 consolidated 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. 19-01. 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 IT control environments. As a first year audit, our emphasis and findings were heavily focused on the beginning balances for FY 2018. Many of the material weaknesses relate to the one time efforts to establish an auditable starting point for financial reporting in accordance with Generally Accepted Accounting Principles (GAAP). Although those material weaknesses are important contributors to the scope limitations causing our disclaimer of opinion, the material weaknesses related to recording of current financial activities, in the long run, will be more important to the improvement of the effectiveness and efficiency of financial operations and transparency. The efforts related to all the required remediation must include substantial design, education and enforcement activities beyond the normal day-to-day financial management routines.

Further details regarding each of these material weaknesses are described 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 Accounting and Finance Systems Re-engineered (GAFS-R) general ledger system. 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

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 on 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
- 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

IV. Earned revenue – Our testing of earned revenue determined that AFWCF is incorrectly applying the percentage of completion revenue recognition method per SFFAS 7, *Accounting for Revenue and Other Financing Sources* (SFFAS 7). Currently, the AFWCF does not have a system in place to routinely monitor and update total estimated costs of a project.

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

Building a better working world

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 value and record newly acquired GPP&E needs improvement

VI. Fund Balance with Treasury (FBwT) – Fund Balance with Treasury 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 statements of budgetary resources and have been determined to not be operating effectively.

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 function to identify and respond to posting errors, missing data or unusual activity
- 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

Building a better working world

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.

The next significant step in the evolution of the AFWCF's financial control environment is the inclusion of a multi-layer analysis, review, repair and remediation cycle into the normal course of accounting processes and the financial statement compilation and review process. These analyses and remedial actions should be performed by knowledgeable supervisory personnel trained to recognize anomalies and unusual relationships. The timing and nature of the reviews and required subsequent actions should be built into the standard financial policies and procedures.

We identified the following:

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

IX. Department of Defense Accounting Policies and Procedures – The DoD Financial Management Regulation (DoD FMR), developed by the DoD Under Secretary of Defense (Comptroller) (OUSD(C)), directs statutory and regulatory financial management requirements, systems and functions. The DoD FMR applies to entities within the DoD, including AFWCF, as it is DoD policy that a single DoD-wide financial management regulation be used by all DoD components for accounting, budgeting, finance and financial management education and training. AFWCF has indicated that amounts presented in the financial statements related to joint procurement programs and shared access vendor contracts may not be materially stated. 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 GAAP. Intragovernmental transactions cannot always be identified by customer because AFWCF systems do not track the buyer and seller data needed to match related transactions. As a result, AFWCF could not fully reconcile intragovernmental transactions with all Federal partners, which resulted in adjustments that could not be fully supported.

<u>BEGINNING BALANCES</u>

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 very substantial effort to establish the completeness of the population of those assets and liabilities and gathering documentation supporting the value of the population identified or using recently established accounting guidance to estimate those values.

EY
Building a better working world

We identified the following:

- Valuation of opening balances of assets used in operations cannot be supported
- Lack of sufficient identification of beginning balance population for inventory
- Valuation of opening balances for equipment cannot be supported

XI. Establishing opening budgetary balances – The processes to establish the open budgetary account balances of AFWCF that were initiated by appropriations occurring in prior years have not been completed. This requires a very substantial reconciliation process including the gathering of documentation from years past that is difficult to obtain if it still exists.

FINANCIAL INFORMATION SYSTEMS

XII. 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 have identified the following:

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

Status of Prior Year Findings

In their report on the FY 2017 financial statements dated November 13, 2017, the DoD OIG identified material weaknesses and significant deficiencies related to internal control over financial reporting. The chart below summarizes the current status of the prior year weaknesses:

Issue Area	Summary Control Issue	FY 2018 Status
MATERIAL WEAKNESSES		
Financial Management Systems	• Financial management systems did not substantially comply with Federal financial management system requirements	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** and **Financial Information Systems** material weaknesses for FY 2018
Inventory	• The AFWCF's inventory management systems did not provide sufficient audit trails to value the in-transit	Modified repeat condition Part of the **Inventory Held by AFWCF** material weakness for FY 2018

Issue Area	Summary Control Issue	FY 2018 Status
MATERIAL WEAKNESSES		
	inventory included as part of inventory held-for-sale on the Balance Sheet.	
General Property, Plant, and Equipment	• Adequate data was not maintained to support general property, plant and equipment amounts recorded.	Modified repeat condition Part of the **General Property, Plant and Equipment** material weakness for FY 2018
Subsidiary Ledgers and Special Journals	• Resource managers do not maintain adequate documentation to support recorded trial balance accounts.	Modified repeat condition Part of the **Integration and Reconciliation of Financial Systems** material weaknesses for FY 2018
Intragovernmental Eliminations	• Lack of sufficient identification and elimination of intragovernmental transactions and balances by customer	Modified repeat condition Part of the **Department of Defense Accounting Policies and Procedures** material weakness for FY 2018
Accounting Entries (Journal Vouchers)	• Material journal vouchers were not always supported with sufficient documentation.	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** and **Integration and Reconciliation of Financial Systems** material weaknesses for FY 2018
Spending Authority from Offsetting Collections Earned and Collected	• Insufficient reconciliations of amounts reported on the Statement of Budgetary Resources with transactional details • Inability to reconcile cash collections to supporting transactional details for wholesale and retail supply.	Modified repeat condition Part of the **Accumulating and Preparing Financial Statements** and **Integration and Reconciliation of Financial Systems** material weaknesses for FY 2018
SIGNIFICANT DEFICIENCIES		
Accounts Receivable	• Lack of sufficient reconciliation and support for the Accounts Receivable line item	Modified repeat condition Part of the **Integration and Reconciliation of Financial Systems** and **Oversight and Monitoring of Internal Control** material weaknesses for FY2018
Accounts Payable	• Lack of sufficient reconciliation and support for the Accounts Payable line item	Modified repeat condition Part of the **Integration and Reconciliation of Financial Systems** and **Oversight and Monitoring of Internal Control** material weaknesses for FY2018

Building a better
working world

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 14, 2018, 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 consolidated 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 14, 2018

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 AFWCF does not have a process narrative documenting the entity's 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 FY18. AFWCF and DFAS indicated that these reconciliations will be part of the Statement of Budgetary Resources Automated Reconciliation Tool (SBR-ART) in FY19.
- 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.

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) Lack of Monitoring over Posting Logic Compliance with 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 application takes 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.

We identified the following across nearly all testing areas:

- Improper documentation, management and retention of supporting documentation.
- Lack of consistent implementation of documentation standards for maintaining complete records.
- Inability to provide supporting documentation to auditors in a timely manner.

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.

Recommendations:

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

- Develop a narrative addressing USAF's universe of transactions that contains information such as the following:
  - Flowchart of applicable feeder systems that are used to produce the AFWCF financial statements, including the materiality of each system
  - Key controls over the feeder systems, including reconciliations performed to ensure data is complete and accurate.
- 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.
- 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, USAF 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.

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 2018 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 Material 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

Building a better working world

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 Standard Operating Procedure (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 Air Force Material Command (AFMC) to ensure material errors do not exist within the inventory records.
- The AFWCF has a formal policy and SOP in place for annual physical count procedures for individual bases with base possessed inventory; however, the timing of an annual count should be conducted consistently around year-end and this is not included in the policy. Currently, individual bases determine their count dates which are being performed throughout the entirety of the fiscal year instead of at or around year-end.
- While the result of inventory counts (including identified errors and findings) are reviewed at a base level, they are not reviewed centrally by Air Force Material Command (AFMC) to ensure material or pervasive errors do not exist within the consolidated inventory records.

(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 had 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. Ninety two percent of the total dollar value of AFWCF inventory is valued using the automated MAC process within its FIABS and ILS-S systems. MAC values inventory on a perpetual basis; as receipt of property is inducted into the Logistics Readiness Squadron (LRS), ILS-S automatically computes MAC for the General Support Division (GSD) of the AFWCF. 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 current year procedures, we had the following observations related to the MAC calculation process:

- AFWCF does not have insight into which contracting systems do not 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 used as an input into the daily MAC calculation within FIABS.
- 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 transactions is currently taking place.
- 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.
- Supply inventory within the AFWCF is assigned value based on the MAC of an inventory item. The value is applied to the units on hand to determine the extended value of inventory at a given date. During our current year procedures, 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.

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.
- The inventory allowance for LRC is relieved only upon completion of the repair process. For repairs that take an extended period overlapping 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 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 determined to be 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.

(c) 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 they are re-recorded in the supply systems. The AFWCF is unable to identify and value in-transit inventory. This was identified as a material weakness in the prior year internal control report issued by the DoD OIG and is included within the Status of Prior Year Findings section of this report. In the current year the AFWCF remains unable to quantify and track in-transit inventory, likely causing misstatements to inventory balances. During our current year 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 the 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 recording the actual quantity of the asset 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
- 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.
- 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.

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.

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.

  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, 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.

(b) Insufficient oversight of inventory managed by contractors

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 the various inventory feeder systems and the data which ultimately flows to the inventory subledger. As a result of this reconciliation, AFWCF identified that there are material differences between the inventory subledger and the identified feeder systems.

AFWCF was unable to provide sufficient supporting documentation to substantiate inventory managed and/or possessed by third party contractors 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 inventory are rectified by adjusting AFWCF records, but not within the feeder systems.

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.
- Provide greater oversight and monitoring of contractor and depot maintenance inter-service managed 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.

IV. EARNED REVENUE

The AFWCF recognizes revenue for large scale long-term maintenance projects using a percentage of completion calculation. Our testing of earned revenue identified a deficiency which resulted in a material weakness in the design and operation of internal control for the use of the percentage of completion calculation in the determination of revenue for large scale long-term maintenance projects. The AFWCF is incorrectly applying the percentage of completion calculation per SFFAS 7, *Accounting for Revenue and Other Financing Sources*. Currently, the 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, the AFWCF is incorrectly matching revenues to expenses in the reporting period.

Building a better working world

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.

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. 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 fact that the assets have been removed from service. 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.

AFWCF's real property (RP) 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) and are tracked and maintained as a single population of assets by each installations 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 newly acquired 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 sufficient process for assuring newly acquired 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. AFWCF currently does not have a definitive timeline for completion of this effort.

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.
- Amend current processes to better connect expenditure for capital assets other than construction with additions to APSR and compliance with SFFAS 6.

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 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 GAFS-R to their balance as reported by Treasury and records an adjustment to bring those balances into agreement. At year end, USAF has identified differences between activity posted by Treasury and that posted in GAFS-R of $313.5 million. 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 GAFS-R (the "undistributed JVs") so that the financial

statements of USAF 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 funding years 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

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 CCAS.
- 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.
- 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.

Building a better working world

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 of journal vouchers
- Improper budgetary to proprietary tie-point balancing

In addition, EY identified several accounting or posting logic errors, which were previously discussed, and could have been detected and corrected prior to reporting had an effective monitoring process been in place. Similarly, we were not fully able to reconcile the unadjusted trial balance to adjusted trial balance (UTB-ATB) due to insufficient monitoring and ability to address variances in a timely manner.

AFWCF does not have sufficient data analytics infrastructure or unique data elements to timely perform monitoring 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 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. AFWCF does not have a robust process for the preparation and review of its AFR. In performing our procedures on the AFR, we found numerous instances in pre-issuance drafts of the AFR of disclosures that were not well formed, erroneous or were inconsistent with the financial statements. Specifically, we identified instances of the following:

- Inaccurate balances reported in the financial statements and notes
- 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 reassess its process for preparing the report and should add significantly more internal review requirements to decrease the probability of error and increase the usefulness of the AFR as a mechanism to communicate to the public the successes, plans and annual results.

In addition, in accordance with section II.3.4 of OMB Circular A-136, *Financial Reporting Requirements*, and paragraphs 86-99 of 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 under one category, operations, readiness and support and not by major organization and programs as required.

EY
Building a better working world

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
- 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 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 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 2018 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 was no 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.

(b) Oversight and monitoring of third-party service providers

For several business processes, including financial reporting, 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., USAF). The application of these controls by user entities is necessary to achieve certain control objectives within the service organization reports. AFWCF has started to lay the foundation for monitoring third party service providers and the CUECs identified in associated SSAE-18 reports. For example, AFWCF has started to compile all applicable CUECs and map them to their own internal control environment to identify existing gaps. In addition, they have continued to evaluate specific reports and CUECs. 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.

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

- Continue to invest further resources and move forward in implementing the Service Provider CUEC monitoring and sustainment strategy.
- Implement a risk-based monitoring program for evaluating identified CUECs to verify operating effectiveness.
- Continue to work with service organizations on an ongoing basis to verify the CUECs identified are the most accurate representation of control ownership between AFWCF and the service organization.

IX. DEPARTMENT OF DEFENSE ACCOUNTING POLICIES AND PROCEDURES

In the Intragovernmental Eliminations material weakness of the FY 2018 Air Force Statement of Assurance, AFWCF self-identified a material weakness related to trading partner adjustments/eliminations. Defense Finance and Accounting Services (DFAS) personnel stated that they are following the DoD FMR guidance (Volume 6b Chapter 13) that states: “For intra-DoD accounts receivable, revenues, and advances from others (“unearned revenue”) it is presumed that the amounts reported by the seller are more accurate than the corresponding amounts reported by the buyer. As a result, DFAS and DoD reporting entities use information from 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”) as the basis for reporting most of its intra-DoD balances. For DoD reporting entities that are not waived from elimination adjustments, intra-DoD accounts payable, expenses, advances, and assets (where the information is available) must be adjusted to match the seller records.”

In accordance with DoD guidance, DFAS-Indianapolis obtains the seller-side data from AFWCF’s trading partners in order to make adjustments. DFAS-Columbus compares the seller-side data obtained from DFAS-Indianapolis to the GAFS-R trial balance data at the appropriation level by trading partner. That difference is the basis for the adjustments. There is 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.

Recommendations:

EY recognizes that the ultimate resolution for these conditions will not occur without DoD-wide changes. AFWCF should continue to coordinate with the OUSD(C) and others as appropriate, to address these weaknesses at the Department-level and devise next steps towards remediation. This process may ultimately lead to revision of DoD policies as contained in the DoD FMR.

In addition to the above, EY recommends that AFWCF consider the following corrective actions related to the conditions described above:

- Evaluate trading partner adjustments, prioritize based on dollar value and risk and begin a reconciliation process at the document level.
- Implement document level reconciliations with trading partners and develop a process for resolving differences at the document level.

Building a better working world

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 assets used in operations cannot be supported

AFWCF has not developed policies and procedures or maintained sufficient support pertaining to the valuation of opening balances of general equipment 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), Organic Maintenance (Org MX), and DLA DSS, and the data which ultimately flows to FIABS. As a result of this reconciliation, AFWCF identified that there are material differences between FIABS and the identified feeder systems. Specifically, AFWCF has identified $1.5 billion of inventory within the FIABS system that cannot be traced back to a feeder system. At this time, AFWCF is not able to validate the originating feeder system(s) to support beginning balances and current activity, nor determine the cause of the $1.5 billion irreconcilable balance.

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 as 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:

- EY selected multiple NSNs related 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 an 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) within the last year, 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.

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 $1.5 billion variance within FIABS resulting from the lack of identified feeder systems. 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.

XI. ESTABLISHING OPENING BUDGETARY BALANCES

AFWCF is unable 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.

Recommendations:

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

- Update AFWCF policies and procedures to ensure its internal controls provide adequate support for material amounts on the basic consolidated financial statements.
- Establish reconciliation procedures between feeder systems and the general ledger to assure that transaction level detail agrees with summary level trial balance amounts.
- Provide trainings and implement guidance on any procedures on documentation requirements to ensure consistent application of procedures including:
    - Ensure documentation standards are clear including supporting documentation that is complete, accurate, and prepared timely.
    - Ensure process owners understand how to obtain key supporting documentation.
    - Establish a common repository process for documents supporting financial events and recordation.
    - Establish a key supporting document retention policy that will support the timeframe consistent with the periods under audit.
- Establish an understanding of the necessary key supporting documentation and its required retention period with service organizations.

Building a better working world

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
- Contingency planning controls provide reasonable assurance that the system and its data can be recovered to minimize impact to operations

An internal control environment which lacks any one of the above may be susceptible to the associated system risks that arise from their absence. AFWCF 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 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).

(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.

(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.

(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 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:

Building a better working world

- 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.
- 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.
- 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.

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Building a better working world

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. 19-01, *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, 2018, and the related consolidated statement of net cost, consolidated statement of changes in net position, and combined budgetary resources for the year ended September 30, 2018, and the related notes to the financial statements and have issued our report thereon dated November 14, 2018. 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, 2018 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. 19-01, 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. 19-01, 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.

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") 2018 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 confirmed 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 user access, configuration management/change controls, segregation of duties and interfaces. 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 2018 AFWCF Statement of Assurance and Note 1.B. to the financial statements, AFWCF self-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 2018 USAF Statement of Assurance, AFWCF self-identified that the design of legacy financial systems does not allow AFWCF 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.

Building a better working world

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 AFWCF provided a FY 2018 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 14, 2018 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 14, 2018. 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 14, 2018

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

OFFICE OF THE ASSISTANT SECRETARY

NOV 14 2018

SAF/FM
1130 Air Force Pentagon
Washington DC 20330-1130

Mr. Robert Shope
Partner, Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

Dear Mr. Shope:

I would like to thank Ernst & Young LLP (EY) for your efforts with the Independent Audit Reports on the financial statements for the General Fund and Working Capital Fund of the Department of the Air Force for Fiscal Year (FY) 2018. We concur with your conclusions and appreciate the professionalism exhibited by your staff during the audit.

In each of these reports, you identified certain deficiencies in the areas of ongoing accounting processes, ongoing financial reporting, beginning balances and financial information systems. Within our established priorities, we continue to resolve the deficiencies identified in the audit reports.

The Air Force has made significant strides to address audit and internal control remediation efforts across our organization, and continued efforts to validate the completeness and accuracy of transactions underlying the financial statements in FY 2018. Our highest priority is supporting the Air Force critical missions with reliable financial information to enable increased transparency, accountability, and decision-making.

This year was the first full financial statement audit which included a significant increase to the previous audit scope. Following the Schedule of Budgetary Activity audit, Air Force continues to make progress, including corrective action implementation, internal control and process cycle memorandum updates, and sustainment of progress made to date. Additionally, specific focus was spent this year on the Air Force's mission critical assets. The Air Force continues to make existence and completeness, valuation, and construction-in-progress for all mission critical asset categories a primary focus across the acquisition, logistics, and financial management organizations. In FY 2018, the Air Force reported new or adjusted financial statement balances resulting from an increased focus on inventory reconciliation efforts and enhanced valuation and construction in progress reporting processes.

The Air Force systems environment is complex, with many legacy or standalone systems and an enterprise resource planning (ERP) system in the process of being deployed. Management continues to prioritize its efforts on implementing those corrective actions that would have the most impact in the short-term and establish long-term corrective actions for enterprise-wide issues. Key areas of improvement and focus include account management and interfaces, with the majority of systems having developed or revised policies around granting access, recertification, and management of annual recertification.

Air Force will continue to work to enhance and mature the design and operating effectiveness of its internal controls to improve the reliability of the financial statements. Air Force leadership is committed to working collaboratively with EY and Office of Inspector General to improve our stewardship of taxpayer funds.

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

OTHER INFORMATION

Fraud Reduction Report

The Air Force has multiple Financial Management fraud prevention and fraud detection measures in place. These include:

- Quality Assurance Program
- Management Internal Control Toolset
- OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control.*

Fraud prevention and detection is the highest priority in the Air Force Quality Assurance (QA) Program. There is a Quality Assurance Manager (QAM) at each Air Force installation who is responsible for administering the QA Program. The QAM is the focal point for fraud prevention and awareness. The QA Program will be enhanced to integrate and improve on-going anti-fraud evaluations, anti-fraud controls, ethics training/communication, and compliance program. The QA Program also serves as a centralized repository for testing, training, documented communication, automated process tools, deficiency tracking, metrics, and reporting. Fraud vulnerability is addressed within the QA Program control monitoring activities. The Financial Services Officer (FSO) at each base, with assistance from the QAM at each base, is responsible for conducting Pay Record Accessibility audits in the areas of military pay, civilian pay, and travel pay.

The Air Force Office of Inspector General administers the Management Internal Control Toolset (MICT). The field operating units perform operational risk assessments for each assessable unit by self-reporting all control testing activities that have been completed within the last year. This includes the results of unit inspections, safety inspections, and other operations-based control reviews.

In FY2018, the Air Force made progress toward the implementation of an effective OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* program. A Planning Memorandum that outlined the nature, timing, and extent of testing to be performed was published.

The Air Force developed test plans to complete a formal review of control design by inquiry, observation, examination, and re-performance to document key controls, as well as primary and compensating controls. Business process controls were documented via cycle memos, process flows, and risk control matrices, which will be updated to provide Air Force management with a snapshot of whether the enterprise is compliant with current laws, regulations, policies, and procedures and whether proper supporting documentation exists to support financial management transactions. Controls which are designed properly will be tested for effectiveness. All controls including Complementary User Entity Controls (CUECs), as they are documented, will be monitored and incorporated into MICT.

Periodic evaluations are performed at least annually and include Test of Design (ToD) and Test of Effectiveness (ToE) on internal controls across most of the Air Force's assessable units (AUs). This includes anti-fraud related service provider Complementary User Entity Controls (CUECs), as stated on the Statement on Standards for Attestation Engagements Nos. 16 and 18. High risk assessable units for fraud, waste, abuse, and mismanagement include, but are not limited to Civilian Pay, Military Pay, Mechanization of Contract Administrative Services (MOCAS), Vendor Pay, Travel, and Mission Critical Assets (MCA).

Risk assessments are conducted, documented, and updated annually as part of the Air Force's OMB Circular A-123 assessment phases. The test plans for each assessable unit include a risk assessment analysis where results are consolidated on a Risk Control Matrix (RCM).

The Air Force has controls, policies, and procedures in place to ensure compliance with laws and regulations that may have a material effect on the financial statements. The implementation and effectiveness of these controls are tested at the Air Force-wide level, where each AU team is responsible for documenting the business processes and sub-processes of the field, including the policies and procedures that the field is using that guide their daily activities. This information is captured in the ‘Laws, Policies, and Regulations’ section within the Cycle Memo for the business process.

If the AU team identifies that there is a lack of policy governing a specific sub-process or the field is not adhering to existing guidance, the AU team documents a control gap within the appropriate section of the cycle memo. The control gap is addressed with a Self-Identified Deficiency that discusses the root cause of the control gap. After this the AU team creates a Corrective Action Plan (CAP) to begin remediating the control gap. All CAPs are tracked by the Air Force monthly.

The Air Force A-123 governance structure identifies the Senior Management Control Council (SMCC), also acting as the Risk Management Council (RMC), with overall responsibility to:

- Define objectives clearly to build a risk strategy, enable the identification of risks, establish a risk profile, and define risk tolerances
- Identify, analyze, and respond to risks related to achieving the defined objectives
- Consider the potential for fraud when identifying, analyzing, and responding to risks
- Identify, analyze, and respond to significant changes that could impact the internal control system.

In FY 2018, additional testing for internal control operating effectiveness was conducted. Training will continue in the form of AU Lead Bootcamp training and MAJCOM site visits to promote internal control awareness and A-123 governing body responsibilities. Sound internal controls and effective risk management will give our financial statement auditors confidence that the information presented on our financial statements is complete and accurate.

Anti-Deficiency Act

As of September 30, 2018, Air Force has 8 open Anti-deficiency Act (ADA) Cases. We began FY 2018 with 13 open ADA Cases; during the year, we opened an additional 5 new cases, for a total of 18 open cases in FY 2018. Air Force was able to close 10 of these cases, none of which resulted in a reportable ADA Violation, thereby resulting in the remaining number of 8 opens cases at year end. Of the remaining 8 cases, 4 are expected to close as No ADA Violation, once corrective actions are complete. The other 4 cases, remain under investigation with the outcome yet to be determined.

For more information or to contact us:

Assistant Secretary of the Air Force for
Financial Management and Comptroller
SAF/FMFA (Financial Reporting)
1500 West Perimeter Rd, Suite 3100
Joint Base Andrews, Maryland 20762
www.saffm.hq. af.mil