



# DEPARTMENT OF THE NAVY ANNUAL FINANCIAL REPORT

Fiscal Year 2005 *Combat and Compassion*



For cover photo credits see pages 288-289.

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**THE HONORABLE GORDON R. ENGLAND**  
SECRETARY OF THE NAVY



**THE SECRETARY OF THE NAVY**  
WASHINGTON DC 20350 - 1000



November 2005

During Fiscal Year 2005, the Department of the Navy has remained actively engaged in Iraqi Freedom, Enduring Freedom and elsewhere in the Global War on Terror. In addition, natural disasters, like the devastating tsunami in South East Asia, the earthquake in Pakistan and India and the powerful hurricanes at home, especially Katrina, required a rapid and robust response from our forces.

In combat and in performing humanitarian acts of compassion, the men and women of the United States Navy and Marine Corps, in conjunction with their sister services, have performed magnificently. The tenacity, flexibility, agility and adaptability of Naval Forces have again demonstrated their unique capability to perform effectively a wide spectrum of missions from the sea and with speed and staying power. Whether Navy or Marine, active or reserve, the men and women of the Sea Services have performed with professionalism and pride. The civilian members of the Naval team and all the Navy families are active partners in achieving mission accomplishment in this critical time in our Nation's history.

This Department of the Navy's Fiscal Year 2005 Annual Financial Report provides performance results that enable Congress, the President and taxpayers to assess the performance of the Department in achieving its mission and the stewardship of resources. The Navy is working to meet a primary objective – spending the taxpayers' money wisely and providing value for our citizens and for our Nation. The Department of the Navy continues to emphasize tooth-to-tail efficiencies in support to the warfighter.

A handwritten signature in black ink, appearing to read "Robert England", with a long horizontal flourish extending to the right.



**THE HONORABLE RICHARD GRECO, JR.**  
THE ASSISTANT SECRETARY OF THE NAVY  
(FINANCIAL MANAGEMENT AND COMPTROLLER)



THE ASSISTANT SECRETARY OF THE NAVY  
(FINANCIAL MANAGEMENT AND COMPTROLLER)  
1000 NAVY PENTAGON  
WASHINGTON, DC 20350-1000

November 2005

The Department of the Navy made significant advances in financial management and reporting during Fiscal Year 2005, incorporating best practices in corporate governance and linking together financial, business, and information systems. We presented to Congress and inaugurated a long-term Financial Improvement Program, supporting the development of business processes that are well-documented; they are also controlled in a way that when implemented throughout the Department will ultimately support a favorable audit opinion on the totality of our financial statements. The program implements internal controls similar to those prescribed by the Sarbanes-Oxley Act for private sector corporations.

During Fiscal Year 2005 we established the first-ever Audit Committee for the Department. Membership includes Secretariat leadership, the Department's Auditor General, and outside observers such as the Department of Defense Inspector General. We are moving away from a date-driven clean audit effort to a strategy that focuses on achieving audit of realistically manageable portions of our financial statements. The Committee is implementing a work plan that will result in a near-term favorable audit of the Marine Corps and several majority asset and liability lines such as Military Equipment, Real Property, and Environmental Liabilities.

In Fiscal Year 2005 our financial management team made other meaningful advancements in the areas of human capital, business practices, and customer communications. We have sought to move beyond our traditional technical roles of finance officers, comptrollers, budgeters, and analysts to be independent and objective business partners within the Department, providing added-value in strategy, operations, and performance. We developed a financial efficiency index, FEI, a comprehensive measure of how well the Department is executing the budget. This is the first genuine attempt to integrate an *ex-post* performance measure and *ex-ante* operational decision making. We also began to implement a detailed plan to achieve "just-in-time" cash management in the Navy Working Capital Fund. And we are developing a portfolio analysis capability, based on emerging private sector analytical techniques, which will allow us to evaluate simultaneously a complex menu of program investment options, optimizing the efficiency of our financial resources. In order to maintain our well-qualified financial management workforce, we enhanced our recruiting and retention programs, expanding, in particular, the financial management trainee program. All these initiatives, and more, are described on our new financial management website, [www.finance.hq.navy.mil](http://www.finance.hq.navy.mil).

The Department of the Navy's Fiscal Year 2005 Annual Report, *Combat and Compassion*, reflects the progress we have made in financial management and reporting, and our commitment to the efficient and effective stewardship of resources entrusted to us by the American public. We are committed to being agents of transformation, adopting proven best practices, and leveraging lessons learned today so that we can help our Navy and Marine Corps leaders win tomorrow.

The Department of the Navy financial management team confidently embraces the challenges that lie ahead, desiring to enhance our position as a world-class organization, shaping a culture of excellence and achieving continuous improvement in transparency and accountability to the American taxpayer.

*Richard Russo, Jr.*





# MANAGEMENT'S DISCUSSION AND ANALYSIS

2005





*“The challenge for the future is ensuring we are maintaining the proper investment balance between the needs of today and the requirements of tomorrow.”*

-- The Honorable Gordon R. England, Secretary of the Navy, February 2005

## INTRODUCTION

The Department of the Navy continues to invest in its transformation efforts while responding to a full spectrum of military operations. The Department has used financial resources appropriated by Congress to significantly increase its operational readiness, to finance new research and development, to begin the procurement of new classes of ships and aircraft, and to advance its Human Capital Strategy goals. Additionally, the Department's joint war-fighting team, the U.S. Navy and U.S. Marine Corps, has continued to answer the nation's call in the Global War on Terror and to perform essential global stability and security operations.

The costs of new weapon systems, operations and maintenance, and personnel are rising, however, and the Department must find the proper investment balance to serve both its immediate needs and the requirements of tomorrow. Our challenge today is to achieve the appropriate readiness posture at the right cost to win the Global War on Terror, to support the military's needs, and to continue the naval transformation that will enable the Navy-Marine Corps team to fight and win tomorrow's battles.

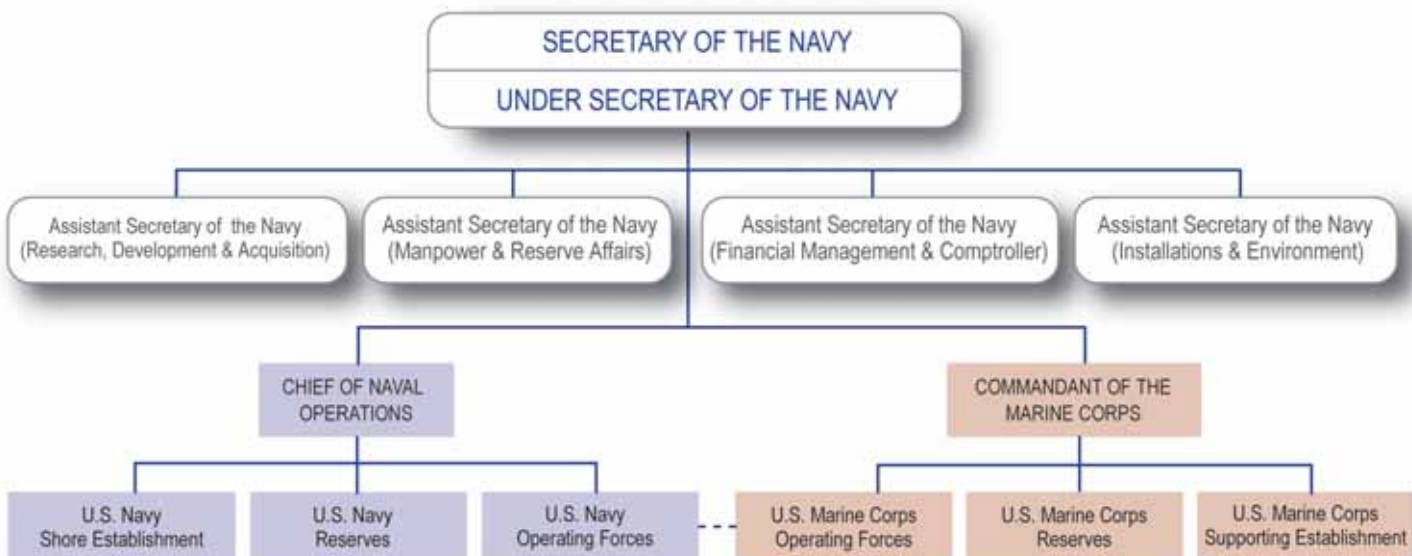
## ORGANIZATION AND MISSION

The Department of the Navy (DON) is organized under the Secretary of the Navy. It operates under the authority, direction, and control of the Secretary of Defense (Section 5011, Title 10 U.S. Code). The chart below provides a simplified illustration of the DON organizational structure. The full structure is shown online at <http://www.navy.mil/palib/organization/org-top.html>.

**THE DEPARTMENT OF THE NAVY**  
*Founded 30 April 1798*

**Our Mission:**

- Control and maintain freedom of the seas
- Project power beyond the sea
- Influence events and advance U.S. interests across the full spectrum of military operations



\* Dashed line signifies collaboration of the U.S. Navy and the U.S. Marine Corps operating forces.

## NAVAL LEADERSHIP

Three key leaders within the Department of the Navy are the Secretary of the Navy, the Chief of Naval Operations, and the Commandant of the Marine Corps. Below is a brief description of their leadership roles.

Secretary of the Navy. The Secretary of the Navy is mandated under Title 10 of the U.S. Code to conduct all of the affairs of the Department of the Navy, consistent with the national security policies and objectives established by the President and the Secretary of Defense.

Chief of Naval Operations. The Chief of Naval Operations is responsible to the Secretary of the Navy for the command of the Navy shore establishment and operating forces. He is responsible also for the operating efficiency of those forces and for their utilization of resources.

Commandant of the Marine Corps. The Commandant of the Marine Corps is responsible to the Secretary of the Navy for the performance of the Marine Corps, including the administration, discipline, internal organization, training, efficiency, and readiness of the service and for meeting all of its resource requirements.

## NAVAL OPERATING FORCES: PART OF THE TOTAL JOINT FORCE

The Department of the Navy provides naval forces, including fleet and Marine Corps forces, to the five Geographic and four Functional Commands - the Unified Commands.

The map on the right shows the areas of responsibility of the five Unified Commands that are defined by geographic region and the naval forces that support them.

UNITED STATES NAVY	UNITED STATES MARINE CORPS
<p><b>THE NAVY SHALL BE ORGANIZED, TRAINED, AND EQUIPPED PRIMARILY FOR PROMPT AND SUSTAINED COMBAT INCIDENT TO OPERATIONS AT SEA. IT IS RESPONSIBLE FOR THE PREPARATION OF NAVAL FORCES NECESSARY FOR THE EFFECTIVE PROSECUTION OF WAR EXCEPT AS OTHERWISE ASSIGNED AND, IN ACCORDANCE WITH INTEGRATED JOINT MOBILIZATION PLANS, FOR THE PEACETIME COMPONENTS OF THE NAVY TO MEET THE NEEDS OF WAR. (SECTION 5062, TITLE 10 U.S. CODE)</b></p> <p><b>FOUNDED 13 OCTOBER 1775</b>  <a href="http://www.navy.mil">http://www.navy.mil</a></p>	<p><b>THE MARINE CORPS SHALL BE ORGANIZED, TRAINED, AND EQUIPPED TO PROVIDE FLEET MARINE FORCES OF COMBINED ARMS, TOGETHER WITH SUPPORTING AIR COMPONENTS, FOR SERVICE WITH THE FLEET IN THE SEIZURE OR DEFENSE OF ADVANCED NAVAL BASES AND FOR THE CONDUCT OF SUCH LAND OPERATIONS AS MAY BE ESSENTIAL TO THE PROSECUTION OF A NAVAL CAMPAIGN. (SECTION 5063, TITLE 10 U.S. CODE)</b></p> <p><b>FOUNDED 10 NOVEMBER 1775</b>  <a href="http://www.usmc.mil">http://www.usmc.mil</a></p>



1. **U.S. Northern Command (USNORTHCOM):** USNORTHCOM has few permanently assigned forces. However, naval personnel (civilians and uniformed services) are among the civil service employees and uniformed service members at USNORTHCOM headquarters (Peterson Air Force Base, Colorado). [www.northcom.mil](http://www.northcom.mil)
2. **U.S. European Command (USEUCOM):** U.S. Naval Forces Europe and 6th Fleet ([www.naveur.navy.mil](http://www.naveur.navy.mil)); U.S. Marine Corps Forces, Europe ([www.mfe.usmc.mil](http://www.mfe.usmc.mil))
3. **U.S. Pacific Command (USPACOM):** U.S. Pacific Fleet, 3rd and 7th Fleets ([www.cpf.navy.mil](http://www.cpf.navy.mil)); U.S. Marine Corps Forces, Pacific and Fleet Marine Force, Pacific ([www.mfp.usmc.mil](http://www.mfp.usmc.mil))
4. **U.S. Central Command (USCENTCOM):** U.S. Naval Forces Central Command and 5th Fleet ([www.cusnc.navy.mil](http://www.cusnc.navy.mil)); U.S. Marine Corps Forces Central Command ([www.marcent.usmc.mil](http://www.marcent.usmc.mil))
5. **U.S. Southern Command (USSOUTHCOM):** U.S. Naval Forces Southern Command ([www.cusns.navy.mil](http://www.cusns.navy.mil)); U.S. Marine Corps Forces, South ([www.mfs.usmc.mil](http://www.mfs.usmc.mil))

Additionally, the Department of the Navy provides naval forces to support the missions of the four Functional Commands, as illustrated below.

U.S. JOINT FORCES COMMAND	U.S. STRATEGIC COMMAND
U.S. Fleet Forces Command and 2nd Fleet ( <a href="http://www.cffc.navy.mil">www.cffc.navy.mil</a> )	Ballistic Missile Submarines ( <a href="http://www.chinfo.navy.mil">www.chinfo.navy.mil</a> )
U.S. Marine Corps Forces, Atlantic ( <a href="http://www.marforlant.usmc.mil">www.marforlant.usmc.mil</a> )	U.S. Marine Corps Forces, Strategic Command ( <a href="http://www.marforlant.usmc.mil">www.marforlant.usmc.mil</a> )
U.S. SPECIAL OPERATIONS COMMAND	U.S. TRANSPORTATION COMMAND
U.S. Naval Special Warfare Command ( <a href="http://www.navsoc.navy.mil">www.navsoc.navy.mil</a> )	Military Sealift Command ( <a href="http://www.msc.navy.mil">www.msc.navy.mil</a> )



*The guided missile destroyers USS Fitzgerald (DDG 62) (in foreground) and USS John Paul Jones (DDG 53) underway in the Coral Sea in support of Exercise Talisman Sabre 2005. Talisman Sabre is an exercise jointly sponsored by the U.S. Pacific Command and Australian Defence Force Joint Operations Command. The exercise focuses on crisis action planning and execution of contingency response operations.*

## REPORTING ENTITIES

For financial reporting purposes, the Department of the Navy is organized into two reporting entities: the Department of the Navy General Fund and Navy Working Capital Fund. The General Fund is the larger of the two reporting entities, accounting for 94 percent of total Department of the Navy assets in fiscal year (FY) 2005. (See "Financial Reporting Results" for a discussion of the FY2005 financial performance of the Department of the Navy General Fund and the Navy Working Capital Fund.) The next two sections provide more information on these reporting entities.

## DON GENERAL FUND

The DON General Fund supports overall Department operations, including the operations of the major commands. Direct appropriations from Congress comprise the DON General Fund account structure. Examples of DON General Fund appropriations include military personnel; operation and maintenance; and procurement. (For a complete list of DON General Fund appropriations, see "General Fund Other Accompanying Information.")

### MAJOR COMMANDS

The U.S. Navy and U.S. Marine Corps together comprise DON's joint war-fighting team. Both services have numerous major commands that operate under the authority and responsibility of a commander or other designated official and that typically support a network of subordinate commands. Each major command has a clearly defined mission that supports the overall Department mission.

There are four groupings of major commands within the General Fund: the Secretariat, Navy Operating Forces, Navy Shore Establishment, and the Marine Corps Organization. The following section provides a brief outline of the mission, organization, and recent major initiatives or accomplishments of representative commands within each grouping. The breadth and depth of the DON organization precludes discussion here of every command. Full details of all commands are available online at <http://www.navy.mil>.

## SECRETARIAT

### ORGANIZATION AND MISSION

The Secretariat is comprised of the offices of the four Assistant Secretaries of the Navy (see below) and includes the Assistant for Administration to the Under Secretary of the Navy, which performs administrative functions for the Secretary of the Navy, the Under Secretary of the Navy, the Assistant Secretaries of the Navy, and the General Counsel.

- Office of the Assistant Secretary of the Navy (Research, Development and Acquisition) (ASN(RD&A)). The Office of the ASN(RD&A) is responsible for the development and acquisition of Navy and Marine Corps platforms and weapon systems. <http://www.hq.navy.mil/rda/>
- Office of the Assistant Secretary of the Navy (Manpower and Reserve Affairs) (ASN(M&RA)). The Office of the ASN(M&RA) provides leadership to the DON in recruiting, developing, and retaining individuals for military and civilian service. <http://www.hq.navy.mil/mra/>

- Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN(FM&C)). The Office of the ASN(FM&C) directs and manages the financial activities of the DON by overseeing the management of the annual budget and supporting processes, and providing informed recommendations to DON senior leadership regarding the efficient and effective allocation of assets, consistent with the national security priorities of the President and the Secretary of Defense. <http://www.finance.hq.navy.mil/fmc/>
- Office of the Assistant Secretary of the Navy (Installations and Environment) (ASN(I&E)). The Office of the ASN(I&E) is responsible for the formulation of DON-wide policies and procedures and for overseeing all DON functions and programs relating to the environment ashore and afloat, real property, housing, and other facilities. <http://www.hq.navy.mil/ie/main.html>

Unique to the Secretariat is the Office of Naval Research (ONR). The ONR reports to the Chief of Naval Research, who operates under the authority, direction, and control of the Assistant Secretary of the Navy (Research, Development, and Acquisition). The mission of the ONR is to coordinate, execute, and promote science and technology programs of the U.S. Navy and the U.S. Marine Corps through schools, universities, government laboratories, and nonprofit and for-profit organizations; to provide technical advice to the Chief of Naval Operations and the Secretary of the Navy; and to work with industry to improve technology manufacturing processes.

## ORGANIZATIONAL CHANGES

The Office of General Counsel realigned its personnel to establish the Navy Litigation Office. This new office consists of high-level attorneys and support staff who handle major DON litigation in the principal areas of contracts, environmental and civilian personnel law, including bankruptcy and fraud cases.

Additionally, the DON established the Naval Acquisition Integrity Office to bolster efforts in deterring, detecting, and monitoring procurement fraud. The responsibilities of this new office include coordination of the naval procurement fraud program, delivery of procurement fraud training, dissemination of procurement fraud guidance, and collaboration with other Department of Defense entities that have established similar fraud programs.



*The Office of Naval Research vessel YP-679, Afloat Lab, prepares to dock at the South Street Seaport in preparation for New York City's 18th annual Fleet Week.*



## WORKFORCE TRENDS

The Naval Criminal Investigative Service has seen an increase in personnel as a result of the Global War on Terror. In FY2005, the Naval Criminal Investigative Service gained 140 personnel and anticipates an additional 190 personnel in FY2006. These increases support requirements such as deployable/protective operations, technical surveillance countermeasures, and force protection for DON port visits.

In contrast, the Office of Naval Research faces workforce attrition in the next five years, with 46 percent of its civilian workforce eligible for retirement. The average age of the command's civilian workforce is 50 years; only three percent of its civilian workforce is under the age of 30.

## MAJOR INITIATIVES AND ACCOMPLISHMENTS

The Marine Corps, in collaboration with the Office of Naval Research, has sponsored research in next-generation protective coatings for Marine Corps equipment, weapons, and vehicles. These new coatings will provide better camouflage and protection from chemical warfare agents and will be easier to apply than previous coatings. They also will contain none of the volatile organic chemicals that have in the past been linked to respiratory disorders, such as asthma.

Additionally, the Office of Naval Research has funded research to counter the phenomenon of increasing bacterial resistance to antibiotics. Several types of bacteria, such as those that cause tuberculosis, typhoid fever, and pneumonia, have evolved to resist conventional treatment, a fact that represents one of the major threats to health in the United States. The research indicates that interfering with certain of the proteins present in the bacteria may prevent their further evolution; work is underway to develop new antibiotics that can act against these bacterial proteins.



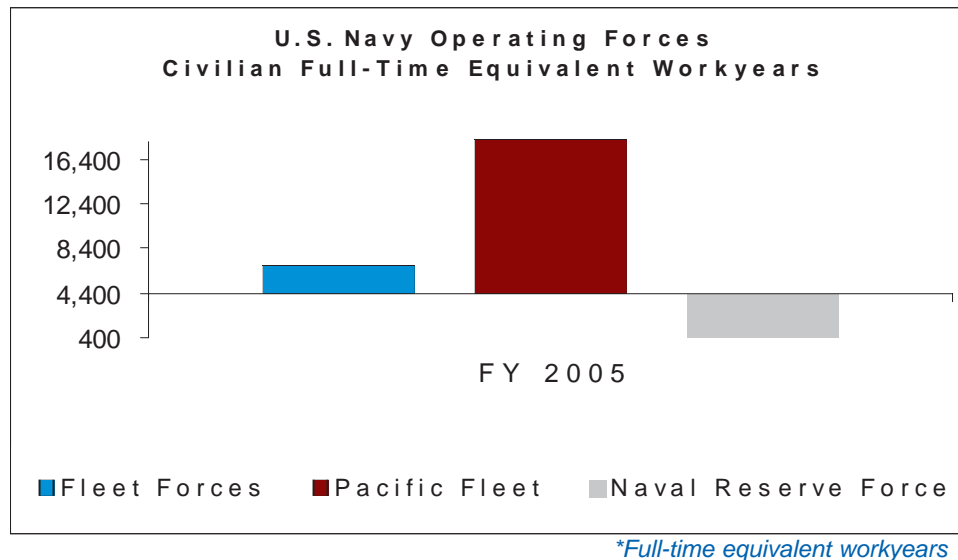
For Navy members and their families affected by Hurricane Katrina.

*The hospital ship USNS Comfort (T-AH 20) moored pier side in New Orleans on September 28, 2005 to assist in the Hurricane Katrina relief efforts. Comfort's medical staff worked alongside local civilian physicians to treat over 1,800 patients.*

# NAVY OPERATING FORCES

## ORGANIZATION AND MISSION

The Navy Operating Forces ("the Fleet") embody forward presence, crisis-response, and fighting power in support of the Unified Combatant Commanders. Representative examples include the Fleet Forces Command, Pacific Fleet Command, and Naval Reserve Force Command. (NOTE: The Commander, Fleet Forces has dual responsibility as Commander, Atlantic Fleet.)



### FLEET FORCES COMMAND

**Mission:** To organize, man, train, and equip Navy forces and provide planning support to the Combatant Commanders; to deter, detect, and defend against homeland maritime threats; and to articulate Fleet war-fighting and readiness capabilities to the Chief of Naval Operations.

<http://www.cffc.navy.mil/>

### PACIFIC FLEET COMMAND

**Mission:** To support the U.S. Pacific Command's theater strategy, and to provide interoperable, trained, and combat-ready naval forces to the Fleet and other U.S. Unified Commanders.

<http://www.cpf.navy.mil/>

### NAVAL RESERVE FORCE COMMAND

**Mission:** To provide mission-capable units and individuals to the Navy-Marine Corps Team throughout the full range of operations from peace to war.

<http://navyreserve.navy.mil/>



*A pilot assigned to the "Gladiators" of Strike Fighter Squadron One Zero Six (VFA-106) smiles as he watches squadron personnel perform pre-flight checks on his F/A-18F Super Hornet on the flight deck aboard USS Harry S. Truman (CVN 75).*

## ORGANIZATIONAL CHANGES

The Fleet continued to improve organizational alignment in FY2005. Some examples of organizational changes appear below.

Fleet Forces Command. The Fleet Forces Command restructured its organization to achieve effectiveness and efficiency in naval capabilities. Some of these changes included establishment of regional maintenance centers and the disestablishment of field activities and detachments. The Fleet Forces Command is planning similar changes in FY2006.

Pacific Fleet Command. The Pacific Fleet Command restructured its organization to respond to the increased importance of the Pacific Rim to world economics and domestic security. During FY2005, the command considered several different staffing models to organize a staff structure that could effectively command the Fleet over more than 100 million square miles. With the new staff organization in place, current operations and training are now under one director to ensure tactical and real-time lessons learned can be quickly incorporated into daily Fleet operations.

## WORKFORCE TRENDS

The Fleet Forces Command continued its military-to-civilian conversions in FY2005 in support of Department-wide efforts to reduce military end strength. Military-to-civilian conversions involve the transfer of civilian-related duties performed by military personnel to the civilian workforce. This conversion allows military personnel to return to more traditional war fighting roles. The command plans to continue military-to-civilian conversions through FY2008.

## MAJOR INITIATIVES AND ACCOMPLISHMENTS

The Fleet implemented a broad range of initiatives in FY2005 to increase naval capabilities. Some examples of initiatives and accomplishments appear below.

Fleet Forces Command. The Fleet Forces Command reviewed the maintenance and training schedules of non-deployed naval forces to determine whether higher levels of training and material readiness could be sustained. This review reflects a refinement of the Fleet Response Plan (see "Strategic Management, Combat Capability" for more information on the Fleet Response Plan).

Pacific Fleet Command. The Pacific Fleet Command provided an immediate response to the December 26, 2004 earthquake and tsunami that struck Southeast Asia. Within hours, the command had ordered naval forces to move toward the affected areas, with the USS Abraham Lincoln (CVN 72) Carrier Strike Group arriving on the scene less than one week after the incident.

The USS Bohomme Richard (LHD 6) and USS Essex (LHD 2) Expeditionary Strike Groups joined the effort shortly thereafter. None of the groups had humanitarian assistance and disaster relief as their primary mission areas, yet they were able to bring relief and aid to hundreds of thousands of people across the region.

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Naval Reserve Force Command. The Naval Reserve Force Command, in collaboration with the Fleet Forces Command, continued efforts toward Active Reserve Integration (ARI). ARI is an initiative directed by the Chief of Naval Operations that will fully integrate the Naval Reserve Force with the active force to create a more cohesive, surgeable, ready force. The Fleet Forces Command and Naval Reserve Force Command have been engaged in a comprehensive zero-based review of naval reserve capabilities. As more progress is made toward ARI, the need for a large reserve infrastructure will decrease, as manpower functions shift to the Navy Personnel Command and training and readiness requirements shift to active commands.



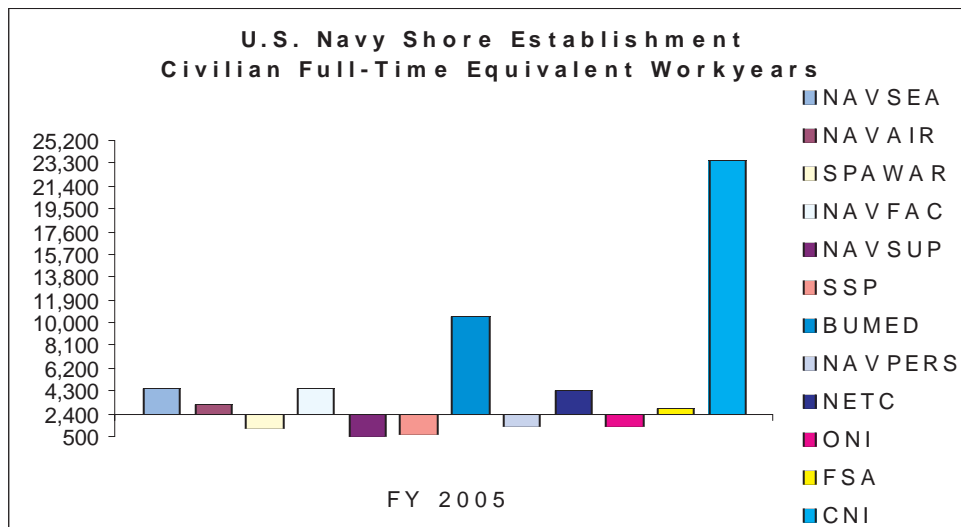
*Members of Explosive Ordnance Disposal Mobile Unit 11 Detachment Nine participate in a fast rope exercise from an HH-60H Seahawk helicopter aboard the USS Carl Vinson (CVN 70). The Carl Vinson Carrier Strike Group is deployed to the 6th Fleet area of operations.*

# NAVY SHORE ESTABLISHMENT

## ORGANIZATION AND MISSION

The Navy Shore Establishment provides support to the Navy operating forces in the form of personnel, bases, activities, equipment, and facilities. Examples of major commands within the shore establishment include:

- Naval Sea Systems Command (NAVSEA),
- Naval Air Systems Command (NAVAIR),
- Space and Naval Warfare Systems Command (SPAWAR),
- Naval Facilities Engineering Command (NAVFAC),
- Naval Supply Systems Command (NAVSUP),
- Strategic Systems Programs (SSP),
- Bureau of Medicine and Surgery (BUMED),
- Navy Personnel Command (NAVPERS),
- Naval Education and Training Command (NETC),
- Office of Naval Intelligence (ONI),
- Field Support Activity (FSA), and
- Navy Installations Command (CNI).



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### NAVAL SEA SYSTEMS COMMAND

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**Mission:** To keep America's Navy #1 in the world by providing the Navy operationally superior and affordable ships, systems, and ordnance throughout their lifecycle...for today, tomorrow, and the Navy after next.

<http://www.navsea.navy.mil>

### NAVAL AIR SYSTEMS COMMAND

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**Mission:** To provide sustainment (current readiness), systems acquisition (future readiness), decision support; and to make the Navy more capable, ready, and affordable in a joint environment.

<http://www.navair.navy.mil>

### SPACE AND NAVAL WARFARE SYSTEMS COMMAND

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**Mission:** To provide the warfighter with knowledge superiority by developing, delivering, and maintaining effective, capable, and integrated command, control, communications, computer, intelligence, and surveillance systems.

<http://www.spawar.navy.mil>

### NAVAL FACILITIES ENGINEERING COMMAND

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**Mission:** To manage the planning, design, construction, contingency engineering, real estate, environmental, and public works support for U.S. Navy shore facilities around the world; and to provide the Navy's forces with the operating, expeditionary, support, and training bases they need.

<http://www.navfac.navy.mil>

### NAVAL SUPPLY SYSTEMS COMMAND

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**Mission:** To provide U.S. Naval, Joint, and Allied forces with quality supplies and services on a timely basis with "One Touch Supply."

<http://www.navsup.navy.mil>

### STRATEGIC SYSTEMS PROGRAMS

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**Mission:** To serve our nation by providing credible and affordable sea-based deterrent missile systems.

(No website available)

### BUREAU OF MEDICINE AND SURGERY

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**Mission:** To provide a comprehensive healthcare delivery system of shore-based treatment facilities and operating forces for the Navy and Marine Corps; and to ensure the provision of medical and dental care and services for Navy and Marine Corps personnel, other uniformed services personnel, and eligible beneficiaries authorized by law or regulation.

<http://navymedicine.med.navy.mil>

### NAVY PERSONNEL COMMAND

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**Mission:** To support the needs of the Navy by providing the Fleet with the right person in the right place at the right time; and to satisfy our Sailors' quality of service by providing them with meaningful and rewarding career opportunities, promoting and retaining the best, and ensuring fair and equitable treatment of all hands at all times.

<http://www.npc.navy.mil>

### **NAVAL EDUCATION AND TRAINING COMMAND**

**Mission:** To educate and train those who serve by providing the tools and opportunities that ensure fleet readiness and mission accomplishment, enhance professional and personal growth and development, and enable life-long learning.

<https://www.cnet.navy.mil/index.asp>

### **OFFICE OF NAVAL INTELLIGENCE**

**Mission:** To provide products and services to meet Navy, Department of Defense, and national maritime intelligence requirements, and to perform such other functions and tasks as may be assigned by higher authority.

(No website available)

### **FIELD SUPPORT ACTIVITY**

**Mission:** To initiate action in matters pertaining to the provision of funds, manpower, and facilities to assigned unified commands, Navy headquarters and activities; and to evaluate the utilization of such resources and initiate or recommend appropriate corrective action.

(No website available)

### **NAVY INSTALLATIONS COMMAND**

**Mission:** To enable and enhance Navy combat power by providing the most effective, efficient and cost-wise shore services and support.

<http://www.cni.navy.mil>



*A Damage Controlman 2nd Class, assigned to the guided missile destroyer USS Mustin (DDG 89), receives a final brief before conducting Maritime Security Operations in the Persian Gulf.*





*A Landing Craft, Air Cushion (LCAC) assigned to Assault Craft Unit Four (ACU-4), exits the well deck of the amphibious assault ship USS Kearsarge (LHD 3).*

## ORGANIZATIONAL CHANGES

Shore Establishment commands continued to improve organizational alignment in FY2005. Some examples of organizational changes appear below.

Space and Naval Warfare Systems Command (SPAWAR). SPAWAR successfully executed a reorganization of its C4I (Command, Control, Communication, Computers and Intelligence) and space program office in FY2005. The new organizational structure reduces the total number of program offices and combines functional and platform-based capabilities to more coherently drive the acquisition process and to facilitate development and delivery of integrated C4I capabilities across naval and joint platforms.

Naval Facilities Engineering Command (NAVFAC). NAVFAC continued the transformation of its worldwide organization. In coordination with the Navy Installations Command, Naval Supply Systems Command, and Headquarters, U.S. Marine Corps, NAVFAC is aligning its component commands into Facilities Engineering Commands. This alignment will enable NAVFAC to improve accountability and responsiveness to Regional Commanders, and to create savings that can be reinvested by Navy and Marine Corps senior leadership. NAVFAC anticipates completion of this structural alignment by FY2006.

Naval Supply Systems Command (NAVSUP). NAVSUP, in collaboration with the Commander, Fleet and Industrial Supply Centers, continued its organizational transformation. Specifically, NAVSUP initiated the transfer of selected industrial logistics operations from Naval Air Systems Command, Naval Sea Systems Command, and the Space and Naval Warfare Systems Command to the Fleet and Industrial Supply Centers. Also, NAVSUP began a worldwide movement of supply chain management and contracting responsibilities from Commander, Navy Installations to the Fleet and Industrial Supply Centers. The benefits of these initiatives will allow for the leveraging of enterprise-wide capabilities, streamlining of delivery models, and elimination of duplicate tasks.

Strategic Systems Programs (SSP). SSP completed the reorganization and downsizing of its program management offices. The purpose of these changes is to improve efficiency, better align field activity support, consolidate common functional activities, and leverage core competencies.

Bureau of Medicine and Surgery (BUMED). BUMED continued the realignment of its organization. Specifically, the military command of the Chief, BUMED is now responsible for all Navy medical and dental commands. Also, BUMED is centralizing policy functions at headquarters level and transferring execution functions to the regional commands. BUMED plans to complete its decentralization initiative by fiscal year-end 2006.

Navy Personnel Command (NAVPERS). The Office of the Chief of Naval Operations integrated the mission and functions of the Director, Naval Education and Training and the Deputy Chief of Naval Operations (Manpower and Personnel) to create a single resource sponsor for manpower and training - Deputy Chief of Naval Operations (Manpower, Personnel, Training and Education).

Naval Education and Training Command (NETC). NETC continued its organizational transformation under the Revolution in Training (RIT) initiative. The purpose of this initiative is to improve the development and delivery of naval education and training. Formal implementation of this initiative began in November 2002 with the Secretary of the Navy's approval of six learning centers. Since then, several NETC organizational changes have occurred, including the disestablishment of training centers in San Diego, California; Mayport, Florida; and Norfolk, Virginia.



*A U.S. Navy Aviation Warfare Systems Operator 1st Class checks on the lowered search and rescue swimmer during a search and rescue mission over New Orleans.*

### Field Support Activity (FSA)

- **Naval Legal Service Command.** The Commander, Navy Installations and the Judge Advocate General executed a Memorandum of Agreement that establishes regional legal services offices. The goal of this organizational change is to improve legal service support. The memorandum will serve as a charter for additional regional legal services offices in subsequent fiscal years.
- **Naval Historical Center.** The Vice Chief of Naval Operations Corporate Board directed realignment of all Navy museums under the Director of Naval History. The purpose of this realignment is to provide increased visibility and accountability for the Navy's museums.
- **Naval Safety Center.** The Naval Safety Center completed an internal reorganization to better align resources to customer needs and to focus on areas where the greatest risk of loss exists.
- **U.S. Naval Academy.** The Naval Academy created an Officer Development System (ODS) to strengthen and align all officer development functions for midshipmen. ODS was created through the internal reorganization of the Character Development staff and the Department of Leadership, Ethics and Law under one Navy Captain, the Director of Officer Development.

Navy Installations Command (CNI). CNI has begun to establish a Financial Management Center of Excellence that will provide support to all CNI regions and activities worldwide. As a result, CNI expects a decrease in manning requirements in FYs 2006 and 2007.

## WORKFORCE TRENDS

Workforce trends vary among the Shore Establishment commands. Some examples of these trends appear below.

Naval Air Systems Command (NAVAIR). NAVAIR's future workforce will likely be the result of an extensive human capital strategy that it has begun to develop. The command has been examining all areas of human capital, including diversity, workforce aging, and skill mix.

Naval Facilities Engineering Command (NAVFAC). NAVFAC's civilian and contractor workforce has declined over the last three fiscal years due to its ongoing transformation initiative. NAVFAC expects further reductions in workforce, including military personnel, as it continues to streamline its organization.

Naval Supply Systems Command (NAVSUP). NAVSUP's civilian workforce has declined nearly 70 percent from 1,517 personnel to 500 personnel over the past few years. This decline is primarily due to shifting some employees at the Fleet and Industrial Supply Centers from the General Fund (Operation and Maintenance, Navy appropriation) to the Navy Working Capital Fund.

Strategic Systems Programs (SSP). SSP workforce demographics remained unchanged over the last four years, with approximately forty percent in the age bracket of 50-59 years. Nine percent of SSP personnel are 60 years or older.

Bureau of Medicine and Surgery (BUMED). BUMED increased its efforts over the last three years to recruit and retain Navy Medicine civilian practitioners in areas such as nursing and pharmacy due to competition from the private and public sectors. Recruitment and retention incentives, flexible hiring authorities, special salary rates and appeals to patriotism have made it possible to replace clinical staff that the command has lost to the private sector and to other federal government health care providers, such as the Veterans Administration and National Institutes of Health. However, over the next six years, BUMED anticipates an upward trend in its Navy Medicine civilian workforce due to military-to-civilian conversions.

Naval Education and Training Command (NETC). NETC's civilian and military workforce has declined since FY2004 due to its Revolution in Training initiative. NETC expects further reductions in workforce due to organizational realignments under Base Realignment and Closure 2005.

Office of Naval Intelligence (ONI). ONI anticipates an increase in its civilian workforce in FY2006 due to reinstatement of civilians under reimbursable appropriations.

Field Support Activity (FSA)

- **Naval Legal Service Command.** The command plans to reduce its military workforce in FY2006 under the military-to-civilian conversion program. Replacement of enlisted personnel with civilians will generate savings for the Navy due to lower personnel costs.
- **Naval Historical Center.** The center's workforce remained steady over the last three fiscal years while the fleet's demand for history steadily increased. The center anticipates an increase in workload after FY2005 due to records, artifacts, and artwork from deactivating units and installations.
- **Naval Safety Center.** The Naval Safety Center reduced its civilian workforce in FY2004 and plans to disestablish a reserve detachment in FY2006, which will result in a reduction in military personnel.
- **U.S. Naval Academy.** Shortfalls in funding have resulted in insufficient funds to replace retiring full-time tenure track faculty members with other full-time tenure track candidates. As a result, the percentage of part-time adjunct faculty members has doubled, from 8.15 percent in FY2002 to 16.05 percent in FY2005. This trend has a direct negative impact on the quality of academic education at the Naval Academy. Navy leadership has addressed this funding shortfall and the trend should begin to reverse in FY2006.

Navy Installations Command (CNI). With the migration of many regions and their activities under CNI, the command faces inherent Navy concerns of an aging workforce and the potential loss of continuity and expertise.

### MAJOR INITIATIVES AND ACCOMPLISHMENTS

Shore Establishment commands implemented a broad range of initiatives in FY2005 to increase naval capabilities and to improve command organizations and business practices. Some examples of initiatives and accomplishments appear below.

Naval Sea Systems Command (NAVSEA). NAVSEA Program Executive Offices, in collaboration with the NAVSEA Comptroller's Office, initiated a project designed to streamline the funding document process by using Lean Six Sigma methods. NAVSEA successfully conducted five concurrent pilots. The command will continue to identify efficiencies that will improve the effectiveness of the funding document process.

Naval Air Systems Command (NAVAIR). NAVAIR applied Lean Six Sigma methods in a pilot project designed to improve its funding document process. As a result, NAVAIR was able to reduce the cycle time of document reviews while maintaining the fiscal integrity of the process.

Space and Naval Warfare Systems Command (SPAWAR). SPAWAR accelerated progress in network centric warfare by developing a comprehensive Command, Control, Communication, Computers and Intelligence (C4I) Integrated Roadmap. This roadmap will become the path to FORCENet, the operational construct and architectural framework for integrating network centric warfare capabilities across the naval enterprise, the Department of Defense, and coalition partners.

Naval Facilities Engineering Command (NAVFAC). NAVFAC continued to exceed Department of Defense environmental cleanup goals. For the fourth consecutive year, NAVFAC completed more environmental cleanup than expected, reducing cost of completion by \$500 million.

Naval Supply Systems Command (NAVSUP). NAVSUP channeled its business transformation efforts toward improving the quality of its products and services. The command has begun implementing Lean Six Sigma methods to achieve this goal.

Strategic Systems Programs (SSP). SSP continued to demonstrate effective management of the Trident II (D5) program. Trident II is an intercontinental ballistic missile launched from nuclear-powered Ohio-class submarines. Trident II (D5) met and, in some cases, exceeded Commander, U.S. Strategic Command confidence and reliability requirements.

Bureau of Medicine and Surgery (BUMED). BUMED achieved greater responsibility in the Operation Iraqi Freedom medical mission. This responsibility includes the field hospital in Kuwait and support of intra-theater air evacuation capabilities.

Office of Naval Intelligence (ONI). ONI broadened its sphere of influence in community, theater, and fleet intelligence. Specifically, the command increased its level of contribution, virtual and physical presence, and participation in intelligence products, services, and system architecture development.



*A Tactical Tomahawk Block IV cruise missile.*

Field Support Activity (FSA)

- **Naval Legal Service Command.** The Judge Advocate General (JAG) gained more decision-making authority over JAG Corps requirements. This was the direct result of a JAG Corps realignment authorized by the Chief of Naval Operations.
- **Naval Historical Center.** The Director of Naval History gained more decision-making authority over museum operations. This was the direct result of a museum realignment authorized by the Vice Chief of Naval Operations Corporate Board.
- **Naval Safety Center.** The Naval Safety Center broadened its sphere of influence within the Department. Specifically, the command, in collaboration with the Naval Education and Training Command, established a presence on the Navy Knowledge Online, a learning portal.
- **U.S. Naval Academy.** The Naval Academy graduated a total of 976 graduates, of which 973 were commissioned graduates. The commissioned graduates will enter service with an accredited Bachelor of Science degree that includes a core curriculum of math, science, and engineering.

Navy Installations Command (CNI). CNI progressed toward its goal of financial management competence. Specifically, the command issued a professional development guide that includes a matrix of recommended training courses and other professional development vehicles that can assist personnel in obtaining financial knowledge and expertise.



*Pilots and Maintenance Personnel assigned to the Blue Angels Maintenance and Support Team stand at parade rest in front of their F/A-18 Hornets at Boeing air field, following the first day of practice for Seattle's Seafair air show.*

# MARINE CORPS ORGANIZATION

## ORGANIZATION AND MISSION

The Marine Corps Organization is comprised of headquarters offices, operating forces, reserves, and supporting establishment.



## HEADQUARTERS, U.S. MARINE CORPS

Headquarters, U.S. Marine Corps is comprised of the Commandant of the Marine Corps and staff offices and commands that advise and assist in discharging his responsibilities. This includes the administration, discipline, internal organization, training requirements, efficiency, and readiness of the service.



*A formation of Marines assigned to Marine Forces Pacific, Hawaii perform the ceremonial “Rifle Volley Salute” during the 60th Anniversary of the end of World War II held aboard the USS Missouri (BB 63) Memorial.*

## OPERATING FORCES

Renowned as the "First to Fight," the Marine Corps Operating Forces - the heart of the Marine Corps - comprise the forward-presence, crisis-response, and fighting power that the Corps makes available to U.S. Unified Combatant Commanders. The Marine Corps has established two combatant command level component commands: Marine Corps Forces Atlantic and Marine Corps Forces Pacific.

### MARINE CORPS FORCES ATLANTIC

During peacetime the Marine Corps Forces Atlantic provide the II Marine Expeditionary Force to the Commander, U.S. Joint Forces Command. When directed by the Secretary of Defense, forces are assigned for contingency planning to the geographic combatant commands.

### MARINE CORPS FORCES PACIFIC

Marine Corps Forces Pacific provide the I and III Marine Expeditionary Forces to the Commander, U.S. Pacific Command. Marine Forces are apportioned to the geographic combatant commands when directed by the Secretary of Defense and assigned for contingency planning.

## RESERVES

The Marine Corps Reserves are responsible for providing trained units and qualified individuals to be mobilized for active duty in time of war, national emergency, or contingency operations and provide personnel and operational temporary relief for active component forces in peacetime. Marine Corps force expansion is made possible by activation of the Marine Corps Reserves, which like the active forces, consist of a combined-arms force with balanced ground, aviation, and combat service support units. Organized under the Commander, Marine Forces Reserve, units are located at 185 training centers in 47 states, Puerto Rico, and the District of Columbia. The reserve component has been closely integrated with the active component under the Marine Corps Total Force concept. The ethos for Marine Forces Reserve is mobilization and combat readiness. This ensures the men and women of the Reserve stand ready, willing, and able to answer the nation's call at home and abroad at a moment's notice.



*Marines assigned to the 26th Marine Expeditionary Unit (MEU) practice fast roping from the back ramp of an CH-46 Sea Knight helicopter on the flight deck.*



### SUPPORTING ESTABLISHMENT

The Marine Corps Supporting Establishment consists of those personnel, bases, and activities that support the Marine Corps operating forces, and provides the necessary infrastructure for enabling combat-ready operating forces. This infrastructure primarily consists of 15 major bases and stations in the U.S. and Japan, as well as the personnel, equipment, and facilities to operate them. Included are the Marine Corps Recruiting Command, the Marine Corps Combat Development Command, the Marine Corps Logistics Command, and the Marine Corps Systems Command.

#### MARINE CORPS RECRUITING COMMAND

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**Mission:** To procure qualified individuals, in sufficient numbers to meet the established personnel strength levels, officer and enlisted, of the Marine Corps.

#### MARINE CORPS COMBAT DEVELOPMENT COMMAND

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**Mission:** To develop Marine Corps war-fighting concepts and to determine associated required capabilities in the areas of doctrine, organization, training and education, equipment, support, and facilities to enable the Marine Corps to field combat-ready forces; and participate in and support other major processes of the Combat Development System.

#### MARINE CORPS LOGISTICS COMMAND

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**Mission:** To provide worldwide, integrated logistics/supply chain and distribution management; depot level maintenance management; and strategic prepositioning capability in support of the operating forces and other supported units to maximize their readiness and sustainability and to support enterprise and program level Total Life Cycle Management.

#### MARINE CORPS SYSTEMS COMMAND

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**Mission:** To serve as the Commandant's principal agent for acquisition and sustainment of systems and equipment used by the Operating Forces to accomplish their warfighting mission. The Marine Corps Systems Command has charted a course to world-class status in acquisition services. Its innovative business processes will serve as the cornerstones of mission achievement to provide and expertly manage the life cycle of quality systems and equipment for the operating forces. We envision a high-performance staff operating in a professional environment based on our guiding principles of integrity, mutual respect, accountability, excellence, innovation, teamwork, customer-focus, and open communication.

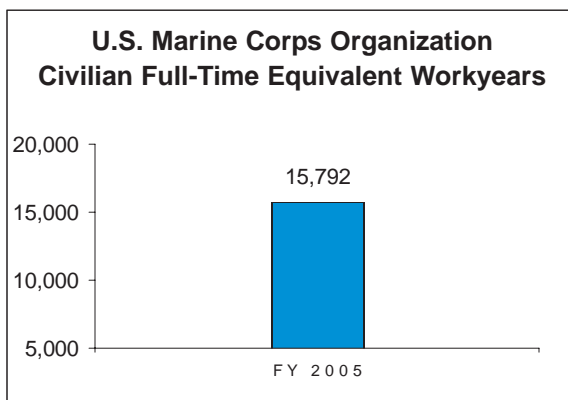
### WORKFORCE TRENDS

Marine Corps demographics remained relatively unchanged over the last three years. The majority of Corps officers (at least 50 percent) are between the ages of 26 and 35 years. Nearly 50 percent of enlisted personnel are 19 to 22 years of age.

## MAJOR INITIATIVES AND ACCOMPLISHMENTS

The Marine Corps continued to play a vital role in restoring stability and security in Iraq. Most notably, the Corps has been helping the Iraqi people rebuild their national infrastructure and providing humanitarian assistance. Other notable achievements include the Marine Corps Financial Improvement Initiative and establishment of the Marine Corps Business Enterprise Office. The Marine Corps Financial Improvement Initiative provides an integrated financial management roadmap for implementing corrective actions, with the goal of achieving accurate, timely, reliable, and auditable financial information in support of the warfighter. To achieve this goal, the Marine Corps developed a coherent and realistic strategic plan that integrates its financial improvement initiatives. Key characteristics of the plan include well-defined objectives, results-oriented performance measures, and improved visibility of resource utilization to support the Marine Corps mission. Also, the plan addresses business processes in five key strategic areas: Information Systems, Management Control, Policies and Procedures, Organization and Infrastructure, and People. The plan is a "living" document that enables the Marine Corps to assign accountability and responsibility for improving financial operations. The Marine Corps will adapt the plan as required to changing environments and business practices to achieve data integrity and to produce auditable financial statements.

Additionally, the Marine Corps established a Business Enterprise Office to ensure that its business processes provide effective support to the warfighter, Marines, and family members without consuming any unnecessary resources. The Marine Corps Business Enterprise Office crosses all organizational boundaries and includes all resources, processes, and products and services that support the warfighter. The Marine Corps is aggressively pursuing business initiatives to drive innovation and change, initiating end-to-end process improvements, and developing the business skills and capabilities of Marines and Civilian Marines to accomplish Corps objectives. (See "Strategic Management, Improved Business Practices" for more information on the Marine Corps Business Enterprise Office.)



*Commandant of the Marine Corps, General Michael Hagee recognizes selected Marines for their sustained superior performance during a ceremony on the flight deck aboard the amphibious assault ship USS Kearsarge (LHD 3).*

## NAVY WORKING CAPITAL FUND

In contrast to the DON General Fund (discussed in the preceding section), the second DON reporting entity - the Navy Working Capital Fund - is a revolving fund established to meet the diverse requirements of the Navy and Marine Corps operating forces. Under the revolving fund concept, an appropriation or a transfer of funds finances initial Navy Working Capital Fund (NWCF) operations; payments from customers for goods delivered or services performed subsequently replenish this initial working capital and enable a continuous cycle of operations, negating the need for annual appropriations by Congress.

The goal of the NWCF is to break even over time by matching revenues earned to costs incurred. Achievement of this goal is occasionally complicated by the requirement that NWCF business areas maintain stable prices for goods and services, to protect their customers from unforeseen price fluctuations.

### BUSINESS AREAS AND RELATED ACTIVITIES

NWCF has five business areas: Supply Management, Depot Maintenance, Research and Development, Transportation, and Base Support. Each business area is responsible for one or more business activities (see illustration).

**NAVY WORKING CAPITAL FUND BUSINESS ACTIVITIES BY BUSINESS AREA**



The NWCF business areas use specific performance measures to assess the effectiveness and efficiency of operations. Examples of these performance measures include average customer wait time (Supply Management); direct labor indicators (Depot Maintenance, Research and Development, and Base Support); and readiness (Transportation).

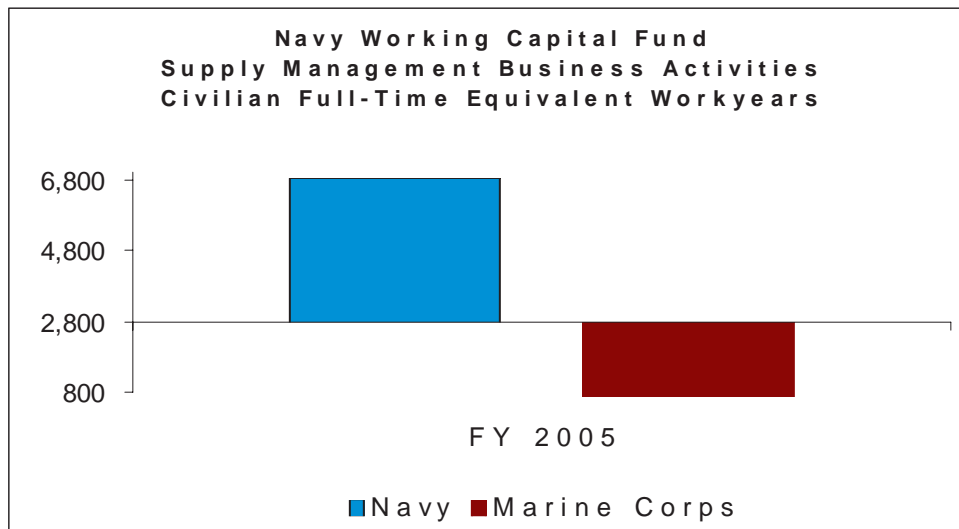
NWCF customers include primarily the Navy and Marine Corps operating forces but also include the Departments of the Air Force and Army, Department of Defense agencies, and other Federal agencies.

Below is a brief discussion of each NWCF business area, identifying the mission, number of personnel, and major initiatives or accomplishments of that business area for FY2005.

## SUPPLY MANAGEMENT

### ORGANIZATION AND MISSION

Supply Management, Navy operates under the purview of the Naval Supply Systems Command. Supply Management, Marine Corps operates under the purview of the Marine Corps Logistics Command.



#### SUPPLY MANAGEMENT, NAVY

**Mission:** To provide Navy, Marine Corps, Joint and Allied Forces quality supplies and services on a timely basis.

#### SUPPLY MANAGEMENT, MARINE CORPS

**Mission:** To perform inventory management functions that result in sale of consumable and reparable items to support both the Department of Defense and other government agencies.

### ORGANIZATIONAL CHANGES

Supply Management, Navy. Fleet and Industrial Supply Center (FISC) Sigonella, Italy was officially established in March 2005, becoming the seventh and newest FISC to join the Commander, Fleet & Industrial Supply Centers (COMFISCS) worldwide network.

Supply Management, Marine Corps. At fiscal year-end 2005, the Direct Support Stock Control in Twentynine Palms, California will no longer be included within the supply management business area. The General Services Administration will become the supply source for this operation.

### WORKFORCE TRENDS

Supply Management, Navy. The civilian workforce has grown from 5,743 actual end strength in FY2003 to 6,993 end strength in FY2005. The growth is attributable to functional transfers that took place in FY2005, such as the Navy Regional Contracting Center and Portsmouth Naval Shipyard supply and contracting functions, and the change in categorizing some FISC employees from the General Fund (Operations and Maintenance, Navy) to NWCF. Additionally, in FY2006 there will be significant growth in the civilian workforce (approximately 1,000 civilian personnel) due to implementation of the Material Support Integration effort at COMFISCS. This effort also includes personnel transfers resulting from the stand-up of FISC Sigonella.

Supply Management, Marine Corps. The civilian workforce has declined since FY2004 due to cost reduction efforts. The Marine Corps anticipates civilian workforce to remain constant after FY2005.



*Sailors assigned to the underway replenishment detail aboard the Nimitz class aircraft carrier USS Harry S. Truman (CVN 75) heave in a line while preparing to receive relief supplies.*

## MAJOR INITIATIVES AND ACCOMPLISHMENTS

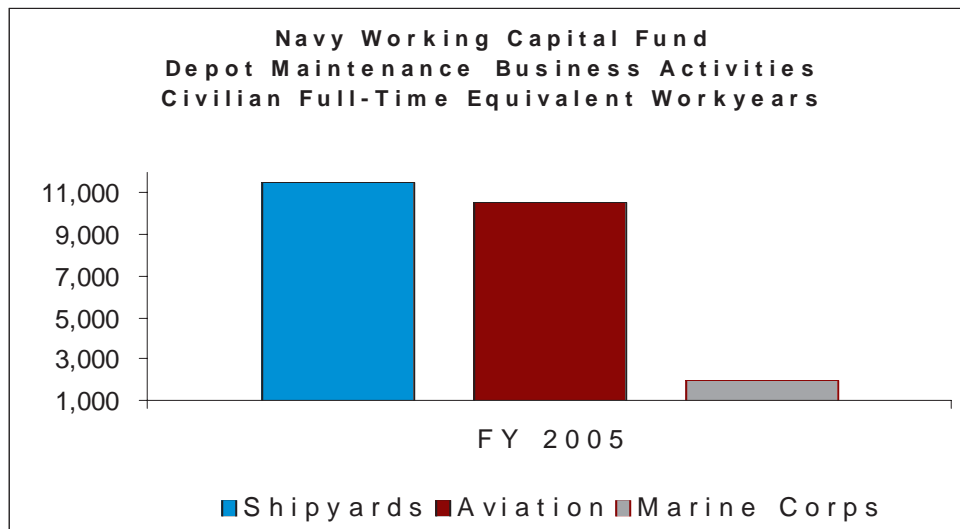
Supply Management, Navy. The Naval Supply Systems Command and Naval Air Systems Command (NAVAIR) Supply Maintenance Aviation Reengineering Team (SMART) Enterprise Resource Planning (ERP) pilot was a success. The SMART ERP Pilot, which was retired in April 2005, was able to integrate the supply, maintenance, and financial processes for both wholesale and retail material into a single database. These achievements helped pave the way for the larger Navy Converged ERP.

Supply Management, Marine Corps. The Marine Corps continued to focus on the transformation of distribution and maintenance systems as outlined in the Logistics Modernization plan. The purpose of the plan is to improve the processes and technology supporting Marine Air Ground Task Force (MAGTF) operations. These business process re-engineering efforts are enhancing managers' knowledge of customers' operational requirements and enabling more efficient and effective budget forecasting.

## DEPOT MAINTENANCE

The Depot Maintenance activities operate under the purview of their respective commands:

- Depot Maintenance, Shipyards - Naval Sea Systems Command
- Depot Maintenance, Aviation - Naval Air Systems Command
- Depot Maintenance, Marine Corps - Marine Corps Logistics Command



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### DEPOT MAINTENANCE, SHIPYARDS

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**Mission:** To provide logistics support for assigned ships and service craft; perform authorized work in connection with construction, overhaul, repair, alteration, drydocking and outfitting of ships and craft as assigned; perform design, manufacturing, refit and restoration, research and development, test work, and provide services and material to other activities and units as directed by competent authority.

### DEPOT MAINTENANCE, AVIATION

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**Mission:** To provide responsive worldwide maintenance, engineering, and logistics support to the Fleet and ensure a core industrial resource base essential for mobilization; repair aircraft, engines, and components, and manufacture parts and assemblies; provide engineering services in the development of hardware design changes, and furnish technical and other professional services on maintenance and logistics problems.

### DEPOT MAINTENANCE, MARINE CORPS

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**Mission:** To provide the quality products and responsive maintenance support services required to maintain a core industrial base in support of mobilization, surge, and reconstitution requirements.

## ORGANIZATIONAL CHANGES

Depot Maintenance activities did not undergo organizational changes in FY2005.

## WORKFORCE TRENDS

Depot Maintenance, Shipyards. Civilian end strength and workyear estimates have been matched to workload and reflect continued streamlining of shipyard processes and increased productivity.

Depot Maintenance, Marine Corps. The Marine Corps plans to reduce the current depot maintenance workforce in FYs 2006 and 2007. This will be accomplished through the release of the majority of temporary employees hired to support the combat effort. The remaining workforce will consist of permanent personnel augmented by temporary personnel.

The Marine Corps Maintenance Centers are working toward maintaining a permanent workforce that is appropriately sized for years when workload is reduced to a minimum. Due to declining Marine Corps customer funding levels, it will be imperative to seek additional workload in order to maintain the expertise of more than 70 different skill sets of personnel. Having trained personnel readily available to perform work will ensure there is no impact to the readiness levels of the critical war fighting assets. This will also enable the Maintenance Centers to meet any unplanned requirements for reconstitution of battle-damaged equipment that materializes.

## MAJOR INITIATIVES AND ACCOMPLISHMENTS

Depot Maintenance, Shipyards. "One Shipyard" is a new maintenance concept to support the Fleet as it transitioned from rotational force to a surge force. One Shipyard initially focused on resource and infrastructure sharing among the shipyards, both public and private, through partnerships and flexible contracting vehicles to meet Fleet Response Plan requirements. The concept has evolved over the last year and a half to focus on standardizing and improving shipyard processes for efficiency and effectiveness, in support of Sea Enterprise objectives.

The Shipyard Lean Transformation represents NAVSEA's means of achieving the Naval Shipyard Intelligent Target Savings under One Shipyard. These savings commence in FY2006.

Depot Maintenance, Aviation. The Naval Air Systems Command depots at Cherry Point, North Carolina; Jacksonville, Florida; and North Island, California received numerous awards in FY2005. Examples of awards include: the Chief of Naval Operations Environmental Quality Award given to NAVAIR Depots Cherry Point and North Island; and the Secretary of the Navy Safety and Occupational Health Shore Safety Award given to NAVAIR Depot Jacksonville.

Depot Maintenance, Marine Corps. The Marine Corps Maintenance Centers in both Albany, Georgia and Barstow, California have been focusing on refining and expanding the already successful implementation of the Theory of Constraints (TOC) and the application of Lean Thinking to eliminate wasteful steps in shop-level procedures. TOC is the result of a successful partnership between production theories and better business practices. The success of this merger has representatives from the Army and Air Force depots traveling to Albany to see an exceptional example of a highly proficient, productive, and profitable depot. This also provides justification for continued implementation of TOC and Lean Thinking at the Maintenance Center in Barstow.

The registration of the Marine Corps Maintenance Centers under the International Organization for Standardization (ISO 9002) resulted from successful implementation of efforts such as Compass Contract, Manufacturing Resource Planning, and Earned Value Management. This has guaranteed the Maintenance Centers to be a viable participant to share business revenues with ISO-registered civilian contractors.



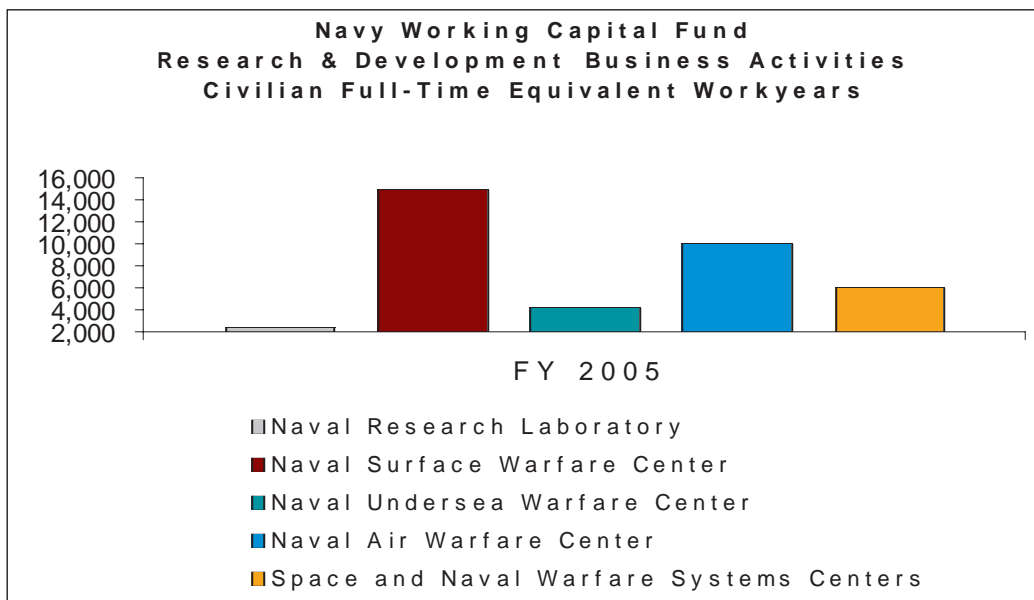
*Rear Admiral Michael P. Nowakowski, Commander Amphibious Group Two, addresses the crew and Marines of the Second Marine Expeditionary Brigade (2nd MEB) saying, "When you look in the mirror, you are looking at a hero."*



## RESEARCH AND DEVELOPMENT

The Research and Development business area consists of the Naval Research Laboratory and four naval warfare centers, all of which operate under the purview of their respective commands:

- Naval Research Laboratory - Chief of Naval Research, Assistant Secretary of the Navy (Research, Development, and Acquisition)
- Naval Surface Warfare Centers and Naval Undersea Warfare Centers - Naval Sea Systems Command
- Naval Air Warfare Centers - Naval Air Systems Command
- Space and Naval Warfare Systems Centers - Space and Naval Warfare Systems Command



### NAVAL RESEARCH LABORATORY

**Mission:** To operate the Navy's full spectrum corporate laboratory, conducting a broadly based multidisciplinary program of scientific research and advanced technological development directed toward maritime applications of new and improved materials, techniques, equipment, systems and ocean, atmospheric, and space sciences and related technologies.

### NAVAL SURFACE WARFARE CENTERS

**Mission:** To operate the Navy's full spectrum research, development, test and evaluation, engineering and fleet support center for ship hull, mechanical, and electrical systems, surface combat systems, coastal warfare systems, and other offensive and defensive systems associated with surface warfare.

### NAVAL UNDERSEA WARFARE CENTERS

**Mission:** To operate the Navy's full spectrum research, development, test and evaluation, engineering and fleet support center for submarines, autonomous underwater systems, and offensive and defensive weapons systems associated with undersea warfare.

## NAVAL AIR WARFARE CENTERS

### AIRCRAFT DIVISION

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**Mission:** To operate the Navy's principal research, development, test and evaluation, engineering, and fleet support activity for naval aircraft engines, avionics, and aircraft support systems and ship/shore/air operations.

### WEAPONS DIVISION

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**Mission:** To operate as the Navy's full spectrum research, development, test and evaluation in-service engineering center for air warfare weapons systems (except anti-submarine warfare systems), missiles and missile subsystems, aircraft weapons integration, and assigned airborne electronic warfare systems; and as the DON's air, land, and sea test ranges.

### SPACE AND NAVAL WARFARE SYSTEMS CENTERS

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**Mission:** To operate the Navy's full spectrum research, development, test and evaluation, engineering, and fleet support centers for command, control, and communication systems and ocean surveillance and the integration of those systems that overarch multiple platforms.



*Sailors assigned to the Weapons Department, G-1 division aboard the aircraft carrier USS Abraham Lincoln (CVN 72), watch as an HH-60H Seahawk brings ordnance aboard.*

### ORGANIZATIONAL CHANGES

Naval Air Warfare Centers. The Naval Air Warfare Centers established Centers of Excellence for Budgeting (Aircraft Division) and Accounting (Weapons Divisions). The Centers of Excellence have enabled the Naval Air Warfare Centers to further streamline their budgeting and accounting processes and reduce institutional costs.

### WORKFORCE TRENDS

Naval Research Laboratory (NRL). The NRL workforce remained fairly stable with approximately 2,500 civilian employees, of which over 1,700 are scientists, engineers, and technicians. At least 1,100 personnel have post-graduate degrees, with over 800 holding doctorate degrees. Given that science and technology funding levels are anticipated to remain steady, NRL does not expect major changes in its workforce.

Space and Naval Warfare Systems Centers (SSCs). Like many naval organizations, the SSCs have a high proportion of the current workforce that is eligible to retire in the near future. The SSCs will continue their efforts to attract and retain talented professionals to revitalize the workforce.

### MAJOR INITIATIVES AND ACCOMPLISHMENTS

Naval Research Laboratory (NRL). NRL continued to maintain a balanced research and development program that invests in: (1) a broad spectrum of new science and technology initiatives that have the potential to significantly enhance the future war fighting capabilities of the Navy and Marine Corps; and (2) more focused development work intended to rapidly transition recent research results and technological developments into both existing and developmental military systems. Some examples of recent accomplishments include:

- **New flexible arm and leg protective armor for ground troops.** The armor is designed to reduce the likelihood of severe injuries by protecting against the large number of smaller blast fragments generated by lethal explosive devices. The armor is already in production so that it can be provided to Marine Corps combat units in Iraq.
- **Self-decontaminating ultra-thin materials coating.** The coating neutralizes toxins on contact leaving no hazardous residue, making it ideal for use in protective clothing, water purification filters, and chemical-spill clean-up wipes.
- **Universal Communication Interface Module (UCIM).** UCIM provides a standardized Command, Control, Communications, Computers, and Intelligence (C4I) network architecture that can be implemented across multiple Marine Corps and Navy platforms. The UCIM is a team effort involving NRL, the Office of Naval Research, and the Marine Corps Systems Command's PM Communications.

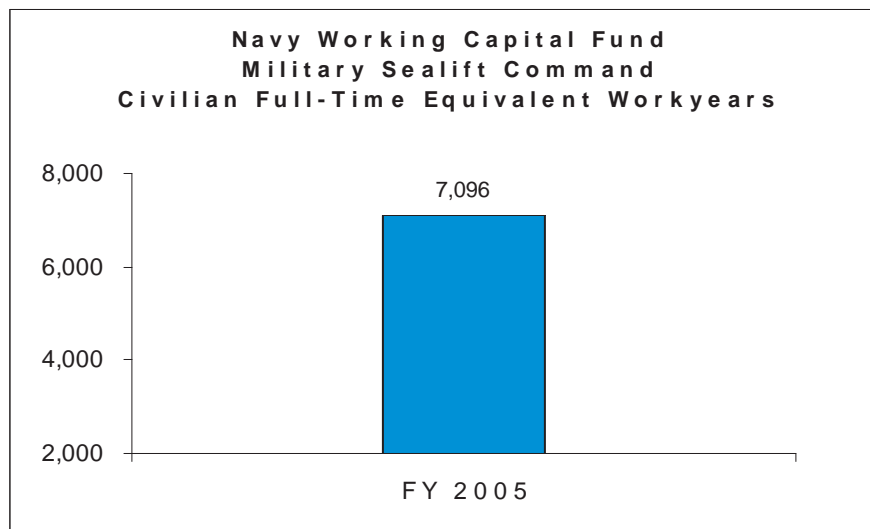
Naval Surface Warfare Centers (NSWCs). NSWCs have launched a major initiative to implement Lean Six Sigma principles. The ultimate goal is to be able to perform assigned work with fewer resources - people, capital, inventory, and contractor support.

Space and Naval Warfare Systems Centers (SSCs). SSC-Charleston updated the FORCEnet Implementation Baseline (FIBL) tool in 2005. FIBL provides the Navy with a collaborative decision support environment to facilitate migration to FORCEnet, the operational construct and architectural framework for integrating network centric warfare capabilities across the naval enterprise, the Department of Defense, and coalition partners. Similarly, in support of FORCEnet, SSC-Charleston developed the Naval Tool for Interoperability Risk Assessment (NTIRA) and Global Engineering Methodology Initiative for Naval Integration and Interoperability (GEMINII). NTIRA is a decision support tool that facilitates improvements to FORCEnet capabilities. GEMINII is a methodology for delivering network centric warfare capabilities across the FORCEnet enterprise.

## TRANSPORTATION

At the heart of the Transportation business area is the Military Sealift Command, which has dual reporting responsibilities to the DON as an NWCF activity, and to the U.S. Transportation Command. As an NWCF activity, the command supports three distinct ship programs:

- **Naval Fleet Auxiliary Force.** The NFAF provides fuel, food, ammunition, spare parts, and other supplies to enable the Navy fleet to operate at the highest possible tempo.
- **Special Mission Ships.** These ships provide oceanographic and hydrographic surveys, underwater surveillance, missile flight data collection and tracking services, acoustic research and submarine support, and other support for Department of Defense sponsors.
- **Afloat Pre-Positioning Force Ships - Navy.** These ships provide military equipment and supplies in key ocean areas for operating forces that later may be forward-deployed to those areas.



### MILITARY SEALIFT COMMAND

**Mission:** To provide ocean transportation of equipment, fuel, supplies, and ammunition to sustain U.S. forces worldwide during peacetime and in war for as long as operational requirements dictate.



*The Military Sealift Command (MSC) ammunition ship USNS Shasta (T-AE 33) underway following an ammunition transfer with the conventionally powered aircraft carrier USS Kitty Hawk (CV 63).*

## ORGANIZATIONAL CHANGES

The Military Sealift Command (MSC) has been working diligently to become a more efficient and effective organization. Under its organizational transformation initiative, MSC has been realigning its area commands with the Navy fleet commands to engender more war-fighting efficiency and synergy. Organizational changes include the following:

- MSC Atlantic merged with Navy Logistics Squadron Two to become the Sealift Logistics Command Atlantic.
- MSC assumed Navy Region Northwest's combat logistics force mission and operationally realigned with Commander, 3rd Fleet, MSC Pacific to become Sealift Logistics Command Pacific/Task Force 33.
- MSC Europe merged with Task Force 63, Sixth Fleet to become Commander, Task Force 63, Sixth Fleet. Similar organizational paradigms will result from mergers between the Fifth Fleet and MSC Central, and the Seventh Fleet and MSC Far East.

Beginning in FY2006, MSC will establish a new type of command in the Tidewater area of Virginia: Military Sealift Fleet Support Command (MSFSC). This new command will crew, train, maintain and equip MSC's civil service mariner-crewed, government-owned/government-operated ships worldwide. Similarly, in support of fleet customers, MSC will establish MSFSC Ship Support Units in Singapore, Italy, Japan, Guam, Bahrain, and San Diego, California to coordinate ship husbanding, maintenance, and repair services for government-owned/government-operated ships.

## WORKFORCE TRENDS

MSC anticipates military end strength to decrease by fiscal year-end 2005 primarily due to the elimination of USNS Capable (T-AGOS 16) military detachment and the transfer of communications function for the USNS Zeus (T-ARC 7) from military to civilian mariner operation.

MSC civilian mariner end strength increased by approximately 356 personnel primarily due to increases in ships such as the USNS Kilauea (T-AE 26) and the USNS Zeus (T-ARC 7). However, MSC had a decrease in civilian ashore end strength of 40 personnel by fiscal year-end 2005 due to organizational transformation.

## MAJOR INITIATIVES AND ACCOMPLISHMENTS

Many of MSC's more than 140 ships were heavily involved in providing humanitarian assistance and disaster relief to the people of Southeast Asia in response to the December 26, 2004 tsunami. Some examples of MSC's involvement appear below.

- The medical staff of MSC hospital ship, USNS Mercy (T-AH 19) treated more than 9,500 patients ashore and afloat.
- Six MSC maritime prepositioning ships collectively transported equipment and supplies to support 15,000 Marines for 30 days.
- Two MSC fleet replenishment oilers, USNS Tippecanoe (T-AO 199) and USNS John Ericsson (T-AO 194), provided fuel to Navy ships.
- Combat stores ship, USNS San Jose (T-AFS 7) and fast combat support ship, USNS Rainier (T-AOE 7) provided fuel and other supplies to Navy ships and activities ashore.
- Two MSC oceanographic ships, the USNS Mary Sears (T-AGS 65) and USNS John McDonnell (T-AGS 51) conducted hydrographic surveys of the ocean bottom where the 9.0 magnitude earthquake occurred.

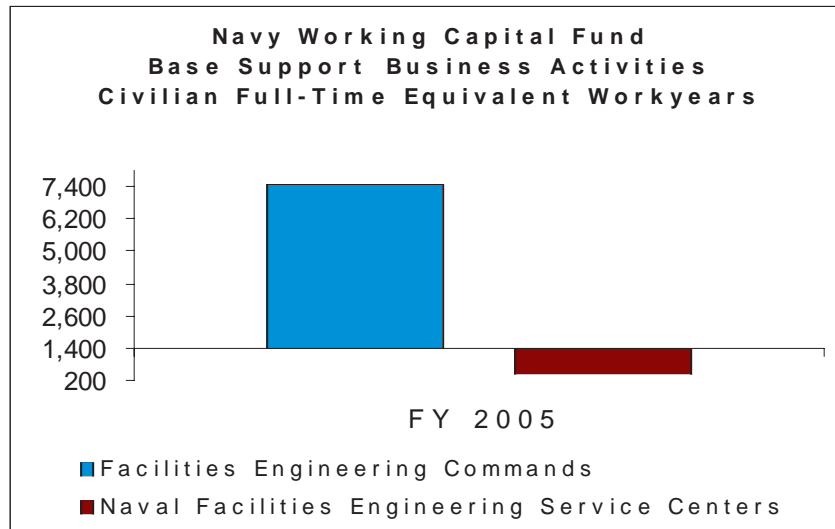
Additionally, MSC has implemented cost-efficient measures that enable Sailors to focus on their primary mission of war-fighting. Specifically, MSC assigned civil service mariners aboard the USS Coronado (AGF 11) and USS Mount Whitney (LCC 20) with ship operation functions, such as navigation and engineering. This has enabled Sailors aboard these ships to shift their focus to combat systems and command, control, communication, computer system and intelligence missions.



*Military Sealift Command (MSC) underway replenishment oiler USNS Walter S. Diehl (T-AO 193) provides fuel and supplies.*

## BASE SUPPORT

The Base Support business area consists of the Facilities Engineering Commands and the Naval Facilities Engineering Engineering Service Centers, operating under the purview of the Naval Facilities Engineering Command (NAVFAC).



### FACILITIES ENGINEERING COMMANDS

**Mission:** To provide the Department of Navy and other Defense and Federal clients with quality public works support and services, including utilities services, facilities maintenance, transportation support, engineering services, environmental services, and shore facilities planning support required by afloat and ashore operating forces and other activities.

### NAVAL FACILITIES ENGINEERING SERVICE CENTERS

**Mission:** To provide the Department of Navy and other Federal and Defense Agencies with quality specialized engineering and technology products and services for Energy and Utilities, Amphibious and Expeditionary Systems, Environment, Shore, Ocean, and Waterfront Facilities.



An artist's rendering shows the final design proposal for the Presidential Helicopter (VXX) Program Support Facility that will support the test and evaluation of a new helicopter fleet for the President.

## ORGANIZATIONAL CHANGES

In FY2005, Base Support activities continued Phase I of the Public Works Departments transition to Facilities Engineering Commands (FECs). Specifically, Base Support activities established an FEC at each of the former Public Works Centers Guam, Pearl Harbor, and San Diego. New names for these organizations are FEC Marianas, FEC Hawaii, and FEC Southwest, respectively. Phase II will begin in FY2006 in coordination with the Navy Installations Command (CNI). All remaining Public Works Departments in the continental U.S. will transition to FECs during Phase II. Public Works Departments in Europe will transition to FECs in FY2008.

## WORKFORCE TRENDS

Base Support activities have experienced fluctuations in workforce over the last three fiscal years. These fluctuations are due in part to management streamlining initiatives, workforce reshaping, and Installation Claimant Consolidation (ICC2). Base Support activities expect the workforce to increase with Public Works Departments transition and implementation.

## MAJOR INITIATIVES AND ACCOMPLISHMENTS

The Naval Facilities Engineering Service Centers established a wind farm at Naval Station Guantanamo Bay, Cuba. The wind/diesel hybrid is one of the DON's largest renewable energy projects to date. It is expected to save the Navy \$1.2 million in energy costs annually.

Additionally, the Naval Facilities Engineering Service Centers are working with the Bureau of Reclamation to test, evaluate, and document innovative water desalinization technologies. This project will help identify more energy efficient, cost-saving methods for generating drinking water from seawater for the Navy and Marine Corps team.



*Chief of Naval Operations, Admiral Mike Mullen in his office at the Pentagon.*



## STRATEGIC MANAGEMENT

*“The Navy and Marine Corps Team has embraced a culture of transformation that will enable us to develop new weapons systems, realign infrastructure, establish new concepts of operations, and streamline our business practices.”*

**The Honorable Gordon R. England, Secretary of the Navy, February 2005**

The DON has defined its vision for the near-term development of the Navy - Marine Corps Team in *Naval Power 21*. This vision elevates and enhances naval combat and operational capabilities in assuring sea-based access; projecting power, defense, and influence beyond the sea; and in support of continual transformation. Complementary strategies, the Navy's *Sea Power 21* and *Marine Corps Strategy 21*, support this vision by reinforcing and expanding operational concepts, such as sea basing and expeditionary maneuver warfare, that will advance our Navy - Marine Corps Team into the future as part of a joint force and that will ensure our team's dominance and success on tomorrow's battlefields. Other complementary strategies include those issued by the Assistant Secretaries of the Navy.

The Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN (FM&C)) issued a new strategic plan for the DON financial management community in April 2005 - *Transforming Today to Win Tomorrow*. The plan focuses on three critical areas: the long-term development of human capital, the continuous improvement of business practices, and the transparent communication of results to core constituents, especially the American taxpayer.

The ASN (FM&C) plan identifies the development of a cohesive and high-performing workforce as the first step toward more effective and efficient financial management, with retraining and new recruitment efforts seen as essential to ensure that the Department realizes a dynamic human resource capability. Second, internal business practices are to be improved to achieve accurate financial accounting and to ensure that managers have timely and accurate program cost information to inform their decision-making. The inclusion of performance assessment measures will become a routine part of funding and management decisions, to ensure that programs achieve their expected results. Finally, communication with customers is to be improved, with the twin objectives of ensuring that they are properly informed of DON activities and that the Department is properly responsive to their needs. In this area, e-government initiatives in particular will be critical. (A copy of the ASN(FM&C) plan is available at <http://www.finance.hg.navy.mil/fmc/>.)

Linking *Naval Power 21* and the complementary naval strategies are the DON's annual priority objectives, as issued by the Secretary of the Navy and included in the annual guidance of the Chief of Naval Operations and the Commandant of the Marine Corps. The 2005 priority objectives included prosecuting the Global War on Terror, advancing the DON Human Capital Strategy, and leveraging the 2005 Quadrennial Defense Review to influence the strategic direction of the Department of Defense and the DON.

To measure performance relative to strategic goals and objectives, the DON uses the Balanced Scorecard method and the related balanced scorecard for risk management. More information on DON performance measurement can be found in section, "Managing Risk - Performance Results."

## BALANCED SCORECARD

The DON Balanced Scorecard addresses four areas: People, Combat Capability, Technology Insertion, and Improved Business Practices. Objectives and selected achievements in these areas are discussed below.

## PEOPLE

*“A top priority of the DON is people — how they work, how they fight, how they live.”*

**Lead Statement, Office of the Assistant Secretary of the Navy (Manpower and Reserve Affairs) Vision**

The DON is striving to become a more efficient and effective organization. In the past three fiscal years, the Department has resized and realigned its organizational structure, in particular by reducing its civilian personnel levels and by converting military positions over to civilian staffing. It also has begun to develop a Human Capital Strategy that will provide a new framework for assessing, training, and developing its personnel, and for ensuring that they are appointed to positions in which they can work most effectively. This strategy is aligned with the Department of Defense’s Human Capital Initiative and has been made in accordance with the President’s Management Agenda and the priorities of the Secretary of Defense. Reshaping an organization as large and diverse as the DON is a long-term effort to which the Department is strongly committed.



*A Sailor assigned to the amphibious dock landing ship USS Duluth (LPD 6) hugs his son after returning from a six-month deployment in Southeast Asia and the Persian Gulf.*

We also are committed to the safety, welfare, and development of our people. As outlined below, we are working hard to protect our naval forces, to enhance the quality of life of our personnel and their families, and to empowering our Sailors, Marines, and civilian workforce through the use of new technologies.

## PROTECTING OUR NAVAL FORCES

The growth of international terrorism and the changing nature of the modern battlefield have made force protection a critical concern. Naval personnel on duty in Iraq and Afghanistan are particularly exposed to the dangers that this implies, and Sailors and Marines deployed to these regions are issued personal protective equipment. The Marine Corps Systems Command additionally has procured several thousand Armor Protection Enhancement Systems to augment this personal protective equipment. The DON seeks constantly to improve its technology and hardware. For example, the Marine Corps Systems Command and the Marine Corps Warfighting Lab, working in conjunction with the Army Developmental Test Command, have tested a range of materials for use in vehicle hardening, and several thousand vehicles already have been hardened. Other force protection efforts underway by the Department include the use of unmanned aerial and ground vehicles, language translation devices, and counter-sniper technology.

## SUPPORTING OUR NAVAL FORCES AND THEIR FAMILIES

The Department offers an array of services to enhance the quality of life of our Sailors and Marines and their families. In October 2004, the Commander, Navy Installations and Commander, Navy Personnel joined forces to establish a single Navy Personnel Support division. This collaborative relationship will ensure the best possible community support programs for our Navy community. The Marine Corps Community Services (under the Personal and Family Readiness Division under the Deputy Commandant for Manpower and Reserve Affairs) provides active duty, reserve, and retired Marine Corps personnel and their families with sports and physical fitness activities, child development and youth programs, and a variety of food and beverage services.



*A Marine Sergeant, Arabic linguist with the 2nd Radio Battalion, II Marine Expeditionary Force, spends a happy moment with his son after arriving at Camp Lejeune from a 10-month deployment in Iraq.*

## EMPOWERING OUR NAVAL FORCES

In addition to providing training specific to their duties it is essential that the Navy also provide opportunities for its Sailors and Marines to pursue their personal development. To this end, the DON has been expanding the range and availability of the educational and training opportunities that it offers. For example, in November 2004 the Navy migrated Navy E-Learning, a distance learning system, to the Navy Knowledge Online website (<http://nko.navy.mil>). Navy E-Learning makes available and tracks and manages nearly 4,000 different E-Learning courses, offered at no cost to the user. Approximately 1.2 million active duty Sailors, Marines, DON civilian employees, Reservists, retirees, and family members are enrolled in the Defense Enrollment Eligibility Reporting System (DEERS) and are eligible for these courses. As another example, in May 2005 the Marine Corps Center for Advanced Operational Cultural Studies began operations online, at <http://www.tecom.usmc.mil/caocl/#CAOCLWebsite>. In response to the emerging requirements of the Global War on Terror and associated stability and support operations, the Marine Corps has set up this center to ensure that Marines and Marine units are equipped with the knowledge and skills needed to successfully navigate the “cultural terrain” of the new environments in which we are operating. The center addresses cultural factors such as religion, ethnicity, language, and customs.

## EMPOWERING OUR CIVILIAN WORKFORCE

In FY2005 the Department of Defense began the first of three phases that will see civil service employees transition to the National Security Personnel System. Navy civilians at the Human Performance Center (under the Naval Education and Training Command) were among those selected to participate in this first transition phase. Mandated by the FY2004 National Defense Authorization Act, the National Security Personnel System is a management system covering staffing, workforce shaping, recruitment, compensation (pay banding), and performance management (pay for performance).



*Marines attached to the 15th Marine Expeditionary Unit (Special Operations Capable) stand clear of an explosion during demolitions training. The 15th MEU (SOC) is training in Kuwait to maintain their combat readiness.*

## COMBAT CAPABILITY

*“The Navy is first and foremost a fighting, sea-going service – always has been. The weapons and technology change. The ships, aircraft, and submarines...improve over time, but the job remains the same: to take the fight to the enemy so that he cannot take it to us.”*

Admiral Michael G. Mullen, Chief of Naval Operations, July 2005

*“We remain the nation’s premier expeditionary combat force-in-readiness....We project Marine forces from land or sea bases for operations as part of a joint or combined force.”*

General Michael W. Hagee, Commandant of the Marine Corps, April 2005

The Navy–Marine Corps team is evolving into a more agile force, capable of conducting the full spectrum of operational activities. In addition to combat, security, and force protection missions in Iraq and Afghanistan, for example, the Navy performed a major role in providing assistance and relief to the people of Indonesia, Sri Lanka, Thailand and other nations affected by the devastating Indian Ocean earthquake and tsunami in December 2004. The humanitarian operations in this area were led by forces from the USS Abraham Lincoln (CVN 72) Carrier Strike Group and the USS Bonhomme Richard (LHD 6) Expeditionary Strike Group, and included Marines from the 15th Marine Expeditionary Unit.

In addition to humanitarian operations in Southeast Asia, the Navy performed a major role in providing assistance and relief to the people of Mississippi and Louisiana after Hurricane Katrina ravaged the gulf coast on August 29, 2005. For example, twenty-four hours after Hurricane Katrina came ashore in New Orleans, Naval Facilities Engineering Command (NAVFAC) Damage Assessment Teams were en route to the gulf coast naval installations with structural and mechanical engineers, architects, roofing specialists and construction contract specialists. Fleet and Family Support Center staff in Mississippi and Florida assisted displaced military, civilian employees, family members, and civilian evacuees. Also, the USNS Comfort (T-AH 20), one of the largest trauma facilities in the United States, sailed from its home port in Baltimore, Maryland to assist in the relief effort.

The Navy–Marine Corps team continues to pursue readiness transformation under the Fleet Response Plan. This plan requires that the Navy become capable at all times of the immediate deployment of six forward-deployed or ready-to-surge Carrier Strike Groups, and that it be able to deploy within 90 days two additional Carrier Strike Groups from the basic training phase. In April 2005 the USS Boxer (LHD-4) amphibious assault ship demonstrated our ability to meet the requirements of the Fleet Response Plan, deploying for the third time in three years. The Boxer had previously deployed in January 2003 in support of Operation Iraqi Freedom, returning in July 2003; and again in January 2004, in support of the Operation Iraqi Freedom force rotation, returning in late April that year.

The Navy–Marine Corps team must continue to innovate and adapt to new ways of fighting. The framework within which the team will transform its core capabilities is that of sea basing. Sea basing capabilities will provide joint force commanders with global command and control capability, and will extend integrated logistical support to the Army and Air Force. In FY2005 we took a significant step closer to full sea basing capability with the construction of the first Littoral Combat Ship and the commissioning of the first nuclear-powered Virginia-class fast attack submarine, the USS Virginia (SSN 774).



*The amphibious assault ship USS Boxer (LHD 4) leaves her homeport of San Diego, California for her third deployment in three years.*



*Sailors board the newly commissioned USS Virginia (SSN 774), the first nuclear-powered fast attack Virginia-class submarine.*

## TECHNOLOGY INSERTION

*“Continued technology improvements will ensure Naval forces’ ability to project offensive power, defend the homeland, and sustain operational independence around the world.”*

The Honorable Gordon R. England, Secretary of the Navy, February 2005

The DON continues to develop and deploy new technology in support of the National Military Strategy. One outstanding recent innovation is the FSF-1 Sea Fighter, or X-Craft. Launched in February 2005, the Sea Fighter is a high-speed aluminum catamaran that will allow the Navy and Marines to conduct a variety of missions in near-shore waters, such as battle force protection, anti-submarine warfare, and amphibious assault support. The Marine Corps Warfighting Laboratory also continues to investigate new and potentially valuable technologies, evaluating their potential impact on the ways in which the Marine Corps organizes, equips, and trains to fight. The laboratory is studying, for example, command and control shared data environments, landing force technologies, and assault vehicles.



*The Littoral Surface Craft-Experimental (X-Craft), christened Sea Fighter (FSF 1), at Whidbey Island, Washington.*

## IMPROVED BUSINESS PRACTICES

*“...we have been faced with the challenge of making the Naval Team more efficient in order to develop a more effective fighting force....Our recent performance indicates the business initiatives we are pursuing are on the right track....”*

The Honorable Gordon R. England, Secretary of the Navy, February 2005

## DON BUSINESS TRANSFORMATION

Since the inception of the Chief Financial Officers Act of 1990, the DON has undertaken numerous initiatives to improve its financial management. Building on the lessons learned from this work, the Department, in conjunction with the Office of the Under Secretary of Defense (Comptroller), has developed a Financial Improvement Program with the goal of improving the quality, timeliness, and accuracy of its financial information. The program is a departure from the previous initiative, the Mid-Range Financial Improvement Plan, in that it does not take as its primary objective the achievement by FY2007 of an unqualified audit opinion. Progress toward a clean audit nonetheless will remain the outcome measure used by the DON to evaluate the efforts taken to improve its financial management.

The framework for the DON business transformation comprises four key components:

- **Blueprint.** *Department of Defense Business Enterprise Architecture.* A primary product of the Department of Defense Business Management Modernization Program, the Business Enterprise Architecture is a set of rules, standards, and principles that will guide selection of future business systems in support of internal control and interoperable business processes.
- **Cornerstone.** *Navy Enterprise Resource Planning Program.* The Navy Enterprise Resource Planning Program is a key enabler for Sea Enterprise, which aims to transform business processes and to generate enterprise-wide efficiency savings in support of the recapitalization of naval forces. At the center of this program is the Navy Enterprise Resource Planning System. This system will integrate Navy business processes, such as procurement, supply chain, and finance, to improve accessibility across the Department to real-time data and information. The system is scheduled to become operational in FY2006.
- **Transition Tool.** *Functional Area Management.* Use of the Functional Area Management construct, in conjunction with information technology portfolio management, will help the DON to select the optimal mix of information technology investments.



- **Integrating Plan.** *Department of the Navy Financial Improvement Program.* The DON Financial Improvement Program is a business transformation initiative to integrate business processes and related process enhancements, systems initiatives, and internal controls. At the core of the program is the DON Financial Improvement Plan, which is organized into sets of projects that are primarily linked to financial statement line items.

### MARINE CORPS BUSINESS ENTERPRISE INITIATIVES

The Marine Corps is focused on optimizing its resources at every level to enable greater investment in core combat capabilities. To this end, the Corps has established a Business Enterprise Office to improve its business practices. A recently approved product of this office is the Marine Corps Business Enterprise Strategic Plan, to map the end-to-end assessment and improvement of Marine Corps business processes through FY2012. The objectives of the plan include the regionalization, competitive sourcing, process reengineering, divestiture, or elimination of non-core functions.



*U.S. Navy and U.S. Marine Corps personnel load food into a CH-46 Sea Knight helicopter in support of Operation Unified Assistance – the humanitarian effort in the wake of the tsunami that struck Southeast Asia on December 26, 2004*

## MANAGING RISK – PERFORMANCE RESULTS

The DON is committed to accomplishing its mission in a way that delivers the best value to the nation. It expects also to be fully accountable for its results. To this end, the Department has brought together the objectives and performance management goals of the President's Management Agenda with the four tenets of Department of Defense risk management—Force Management Risk, Operational Risk, Future Challenges Risk, and Institutional Risk—to form a balanced scorecard for risk management (<http://navweb.secnav.navy.mil>). These four tenets of risk management align with the four focus areas of the DON Balanced Scorecard: People, Combat Capability, Technology Insertion, and Improved Business Practices. This alignment provides the Department with a means of measuring, evaluating, and improving its strategic performance consistent with the goals of defense policy (<http://www.defenselink.mil>) and the President's Management Agenda (<http://www.whitehouse.gov/omb>).

Following are representative examples of cascading performance metrics/outcomes for each Department of Defense risk tenet for FY2004 and FY2005.

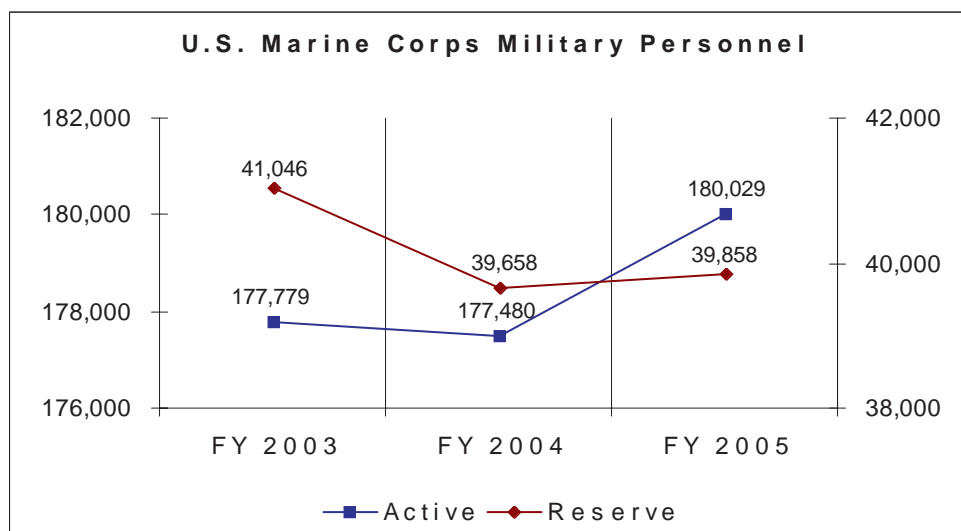
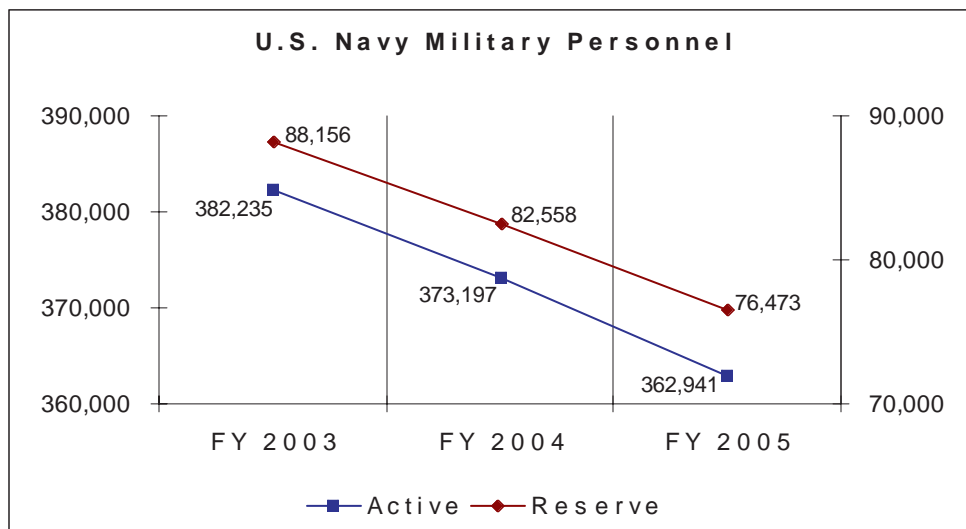


*Sailors assigned to USS Ashland (LSD 48) inspect the sprinklers and valves of the chemical, biological, and radiological wash down system on the ship's flight deck.*

## PEOPLE (FORCE MANAGEMENT RISK)

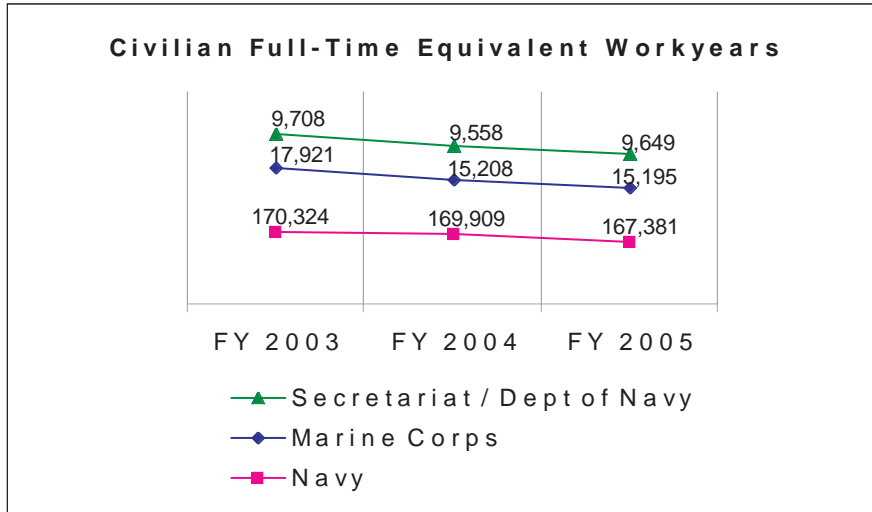
### Ensure Sustainable Military Tempo

The DON sustains a force structure capable of meeting the deployment requirements of the Global War on Terror and other military operations. Its active duty and reserve personnel levels have been steadily declining over the past three fiscal years, but the Navy has been able to accomplish its assigned missions by changing its force structure, utilizing technology to become more efficient, altering the workforce mix, and adopting new manning practices. The active duty and reserve personnel levels of the Marine Corps have remained steady since FY2004. By realigning its force structure through military-to-civilian conversions, the Corps nonetheless has been able to improve the scalability and interoperability of its forces.



**Maintain Reasonable Force Costs**

The DON is committed to becoming a leaner, more efficient organization. Over the past three fiscal years, DON has reduced civilian personnel levels and increased military-to-civilian conversions to improve operational efficiency.

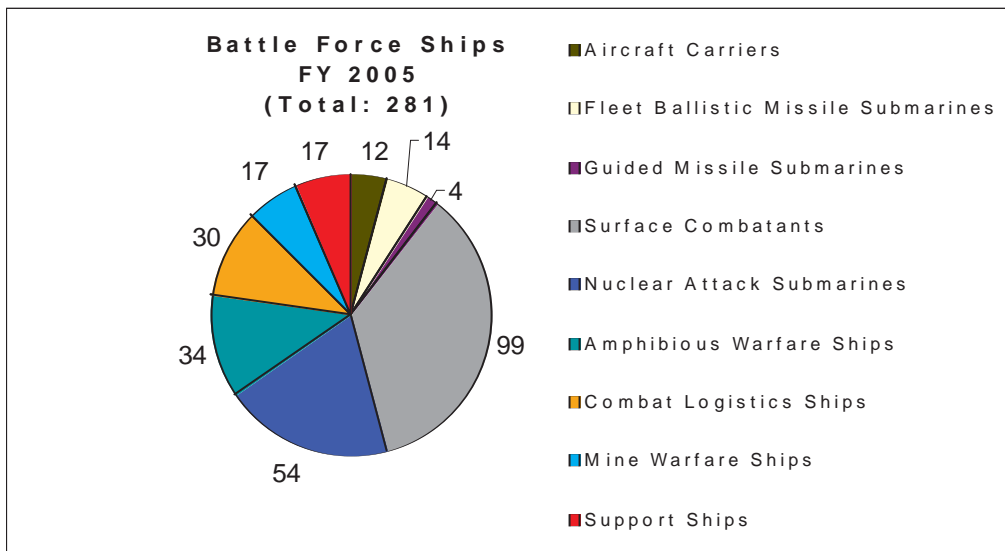


**COMBAT CAPABILITY (OPERATIONAL RISK)**

**Ensure Force Levels**

The DON is committed to maintaining the operational levels necessary to ensure that it can conduct the full spectrum of joint military activities. In FY2005, battle force ships and Marine Corps land forces continued to provide the combat capabilities required to shape the international environment and to respond to the full spectrum of crises.

For a complete description of the roles and characteristics of U.S. Navy ships, see “Fact File” at <http://www.navy.mil>.

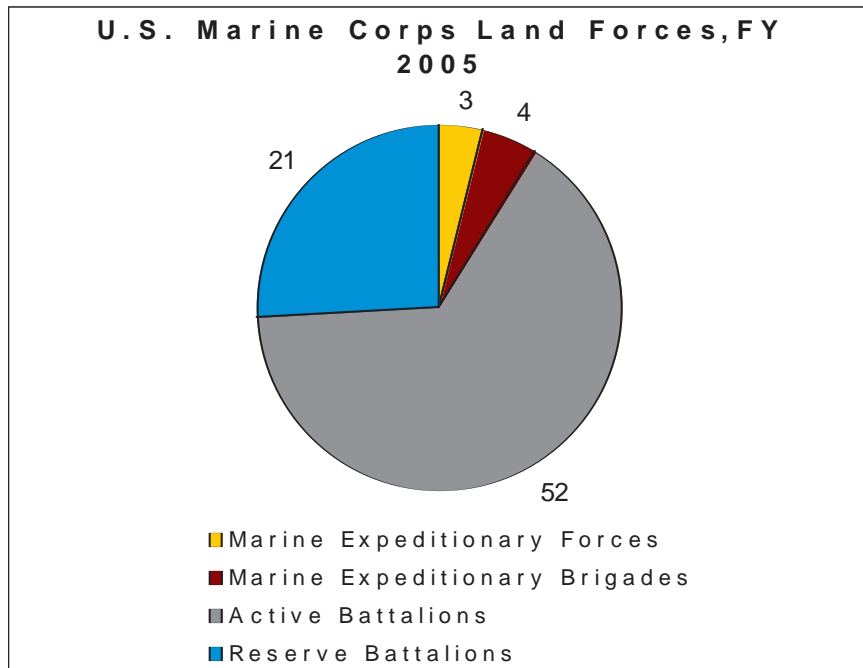




*Sailors man the rails and render honors to the USS Arizona Memorial as the Nimitz-class aircraft carrier USS Ronald Reagan (CVN 76) pulls into Naval Station Pearl Harbor, Hawaii.*



*The Los Angeles-class nuclear-powered fast attack submarine USS Salt Lake City (SSN 716) is underway after departing Naval Submarine Base Point Loma, California to conduct routine exercises in the Pacific Ocean.*



**Marine Expeditionary Force:** the largest Marine air-ground task force, with as many as 90,000 personnel.

**Marine Expeditionary Brigade:** a Marine air-ground task force that is larger than a Marine Expeditionary Unit (comprises approximately 2,000 personnel), but smaller than a Marine Expeditionary Force.

**Battalion:** a tactical unit of a Marine Expeditionary Force, Marine Expeditionary Brigade, or a Marine Expeditionary Unit, with as many as 1,200 personnel.

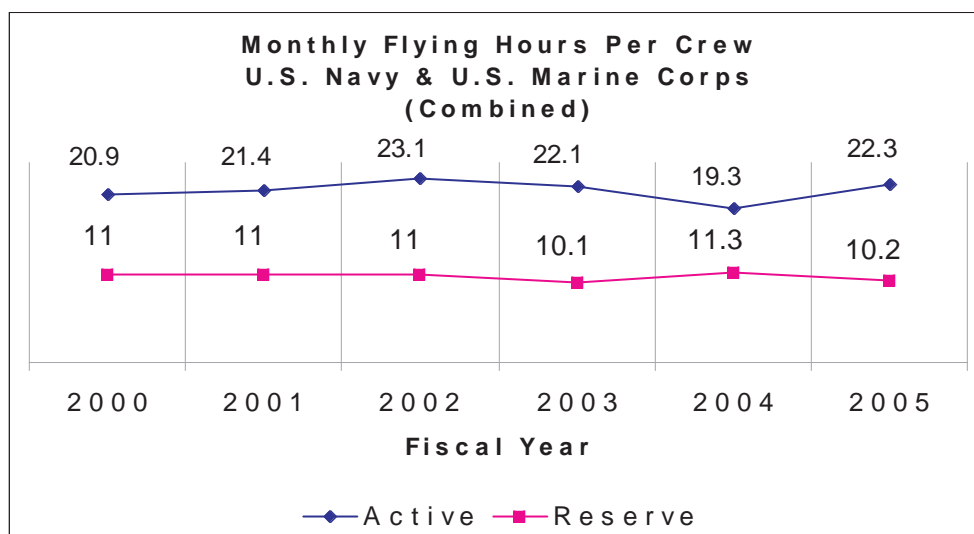
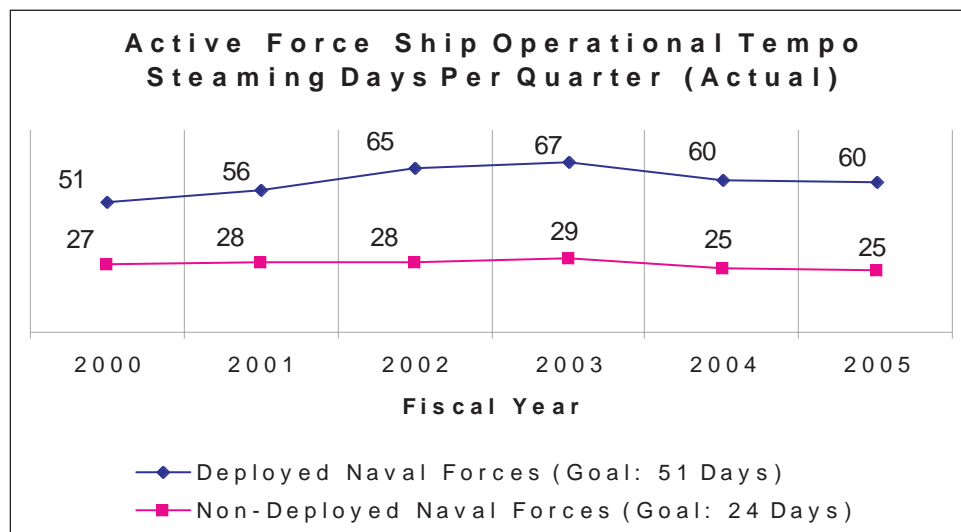
For more information on U.S. Marine Corps forces, see "Units" at <http://www.usmc.mil>.



*A U.S. Marine, assigned to 3rd Battalion, 2nd Marine Regiment, radios in to confirm the destruction of a hostile vehicle during Operation Spear in the city of Karabilah, Iraq.*

**Ensure Force Readiness**

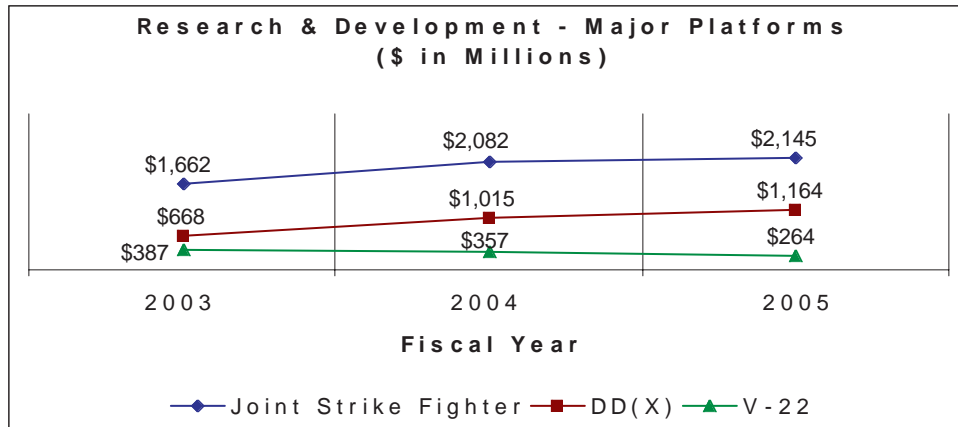
The increasingly diverse threats of the 21st century mean that the Navy–Marine Corps team must be able simultaneously to provide homeland defense, to deploy a force forward, and to surge with overwhelming and decisive combat power. In FY2005 the Navy–Marine Corps team continued to demonstrate its readiness. Measures of force readiness include steaming days per quarter (the number of days that ships are away from their home port) and monthly flying hours per crew.



## TECHNOLOGY INSERTION (FUTURE CHALLENGES RISK)

### Define and Develop Transformational Capabilities

The DON continues to invest in transformational capabilities that will define and develop the Navy–Marine Corps team of the future. Representative examples of major platforms funded by the DON Research, Development, Test, and Evaluation appropriation include the Joint Strike Fighter, DD(X), and V-22.



- Joint Strike Fighter. An aircraft that in its different configurations meets the needs of the Navy, Marine Corps, Air Force, and allied forces. The timetable for delivery of the Joint Strike Fighter Program has been set back to ensure that there is sufficient time available for key technology challenges to be properly addressed.
- DD(X). A family of advanced multi-mission warships capable of long-range firepower in support of forces ashore. Advance procurement funding has been budgeted for FY2006 to support a lead ship detail design and construction contract award in FY2007.
- V-22. A joint aircraft program designed to meet the amphibious/vertical assault needs of the Marine Corps and the strike rescue needs of the Navy, and to supplement the special mission aircraft. The Department will maintain production at a minimum rate of 12 aircraft in FY2006, pending completion of operational testing.



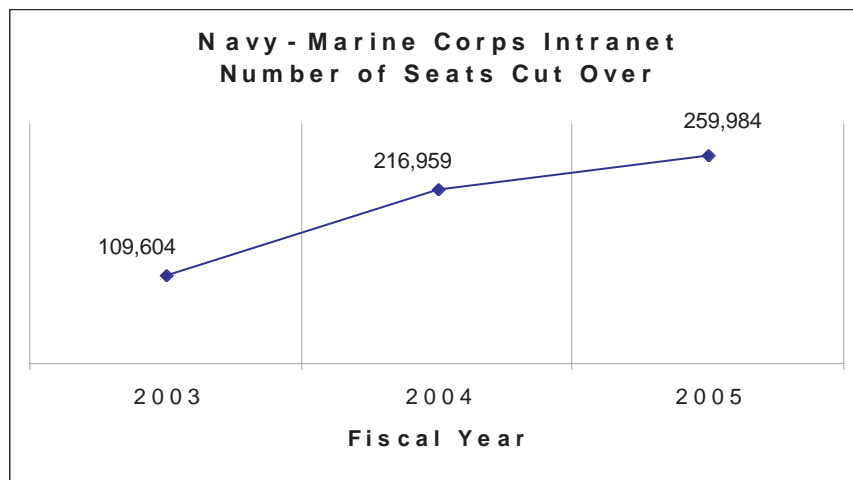
An F/A-18C Hornet prepares to make an arrested landing aboard the Nimitz-class aircraft carrier USS Harry S. Truman (CVN 75).



## IMPROVED BUSINESS PRACTICES (INSTITUTIONAL RISK)

### Streamline Decision Processes; Drive Financial Management; Acquisition Excellence

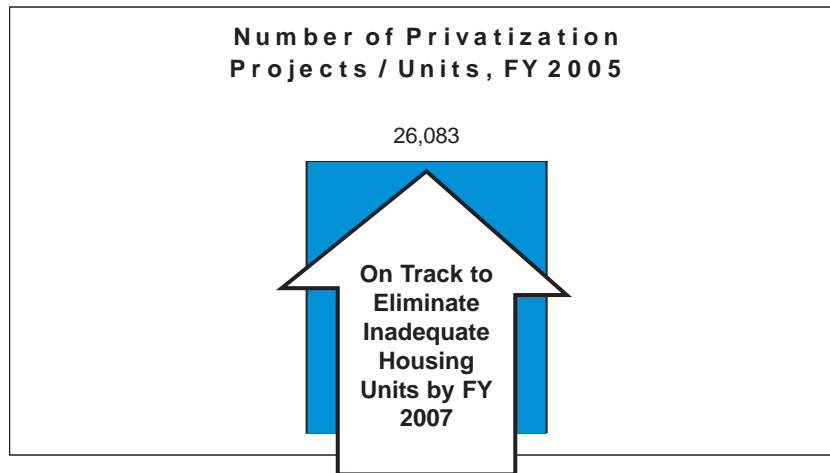
The DON is transforming its business processes, as exemplified by the Navy–Marine Corps Intranet (NMCI). NMCI is a comprehensive, enterprise-wide initiative that will make the full range of network-based information services available to Sailors and Marines on a daily basis and in times of war. In FY2005 the Department increased connectivity to NMCI, as demonstrated by the rise in seats cut over (that is, the number of desk tops on which NMCI is installed); enhancements in network security; the expansion of knowledge sharing across the globe; and an improvement in systems reliability.



*An E-2C+ Hawkeye increases performance and safety along with better maintenance techniques. Other improvements to the airframe include the Group II Mission Computer Replacement Program, which speeds up the Hawkeye’s computers eight times faster than the older models.*

## Readiness and Quality of Key Facilities

DON facilities slated for improvement notably include the housing units it provides for Sailors and Marines and their families. The Department has accelerated improvement of its family housing stock by engaging in public-private ventures that leverage private-sector capital and expertise to build and manage family housing units.



## MANAGEMENT INTEGRITY

Commanders and managers throughout the DON must ensure the integrity of their programs and operations. Part of this responsibility entails compliance with laws and regulations, including in particular the 1982 Federal Managers Financial Integrity Act and the 2002 Improper Payments Information Act. A discussion of these two statutes and the Department's compliance with them appears below.

### FEDERAL MANAGERS FINANCIAL INTEGRITY ACT

The 2002 passage of the Sarbanes-Oxley Act, which applies to publicly traded companies, provided the impetus for the federal government to reevaluate its internal control policies under the 1982 Federal Managers Financial Integrity Act. Consequently, in December 2004 the Office of Management and Budget (OMB) issued a revised version of Circular A-123, entitled *Management's Responsibility for Internal Control*. Effective in FY2006, the revised circular includes updated internal control standards and new requirements for assessing the effectiveness of internal control over financial reporting. In the interim, federal agencies, including the DON, must continue to follow Circular A-123 of June 1995, *Management Accountability and Control*.

## 2005 Annual Financial Report

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As required by Circular A-123 and related implementing guidance from the Department of Defense, the DON annually must evaluate its system of internal accounting and administrative controls (that is, its management controls). The objective of this evaluation is to determine whether reasonable assurance exists that:

- obligations and costs are in compliance with applicable laws;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial, and statistical reports and to maintain accountability over assets.

In FY2005, DON issued a qualified statement of assurance, citing material weaknesses in management controls that preclude an unqualified statement. Specifically, DON's system of internal accounting and administrative controls in effect during the 12-month period ending June 30, 2005, taken as a whole, provides reasonable assurance that DON can execute its mission effectively and protect its critical assets, with the exception of material weaknesses reported. The basis for reasonable assurance includes an established control environment, continued emphasis on risk assessment, specific control activities, continuous communication and flow of information, and monitoring performed by both command management and the audit/inspection community. Additionally, the effective execution of missions during recent military actions confirms the strength of DON's management controls.



*Three Catapult Officers simultaneously launch an F/A-18F Super Hornet, assigned to the "Bounty Hunters" of Strike Fighter Squadron VFA-2, aboard the Nimitz-class aircraft carrier USS Abraham Lincoln (CVN 72).*

DON reported seven uncorrected material weaknesses in FY2005. The first six weaknesses are new for FY2005. A description of the weaknesses can be found in the FY2005 statement of assurance, which is available at the Assistant Secretary of the Navy (Financial Management and Comptroller) website, <http://www.finance.hq.navy.mil/fmc>.

1. Top Secret / Sensitive Compartmented Information Requirements Process
2. Certification and Accreditation of DON Information Technology Systems
3. Accurate and Complete Reporting of Accounts Payable, DON General Fund
4. Identification and Reporting of Environmental Disposal Liabilities
5. Reporting of Military Equipment
6. Valuation of Inventory and Operating Materials and Supplies
7. Navy and Marine Corps Intranet (NMCI) Continuity of Operations Plan

## **IMPROPER PAYMENTS INFORMATION ACT**

One component of the President's Management Agenda is an initiative to reduce improper payments. Improper payments are those which should not have been made or that were made in incorrect amounts under statutory, contractual, administrative, or other legally applicable requirements. Examples of improper payments include overpayments, underpayments, duplicate payments, and payments for services not received.

DON programs and activities that are susceptible to erroneous payments include primarily those for which the Department has the responsibility for calculating entitlements or the responsibility for disbursing government funds. Examples of two such activities include Personnel Support Activities and Detachments, which are responsible for calculating travel payments, and Disbursing Officers, aboard ships and at other isolated locations, that are responsible for the disbursement of government funds. (Note that the Defense Finance and Accounting Service performs the vast majority of the Department's entitlement computation and disbursement functions.)

As required by implementing guidance from the OMB under the 2002 Improper Payments Information Act, the DON identified \$3.6 million of improper payments in FY2005. This amount is significantly less than the OMB threshold of \$10 million. The Department has instituted internal controls to reduce the occurrence of improper payments in the future.



Assistant Secretary of the Navy (Financial Management and Comptroller), Richard Greco, Jr. speaks to Marines of the 1st Reconnaissance Battalion at Camp Pendleton, California.

## FINANCIAL REPORTING RESULTS

*“We must accurately account for the taxpayers’ money and give our managers timely and accurate program cost information to inform management decisions and control costs.”*

The Honorable Richard Greco, Jr., Assistant Secretary of the Navy (Financial Management and Comptroller), July 2005

In support of the DON Financial Improvement Program, the DON General Fund and Navy Working Capital Fund financial statements provide the scorecard mechanisms by which the Department evaluates progress toward improving the quality, timeliness, and accuracy of financial information. Examples of progress made in FY2004 and FY2005 include:

- Validation of balance sheet line items for audit readiness
  - Investments (DON General Fund)
  - Debt (Navy Working Capital Fund)
- Identification and evaluation of deficiencies in the DON General Fund balance sheet line items
  - Other assets
  - Environmental liabilities (Defense Environmental Restoration Program (DERP) and Base Realignment and Closure (BRAC))
  - Other liabilities

The Navy and the Marine Corps Financial Improvement Plans provide other examples of progress made. Specifically, on June 30, 2005 the Navy and Marine Corps issued new Financial Improvement Plans to the Office of the Under Secretary of Defense (Comptroller) for review. The Marine Corps will execute its plan as a pilot for the implementation of the overall DON Financial Improvement Program.

A discussion follows of financial performance relative to the DON General Fund and Navy Working Capital Fund financial statements for FY2004 and FY2005.

## DON GENERAL FUND

Discussion of the financial performance of the DON General Fund focuses on two principal statements: the Consolidated Balance Sheet and the Combined Statement of Budgetary Resources. The balance sheet is similar to that used within the private sector, presenting assets, liabilities, and net position (stockholder's equity in the private sector). The private sector does not use a statement of budgetary resources.

## ASSET COMPOSITION

The Consolidated Balance Sheet as of September 30, 2005 presents total assets of \$312 billion, which represents an increase of \$16 billion (or five percent) from FY2004. The increase in total assets is primarily attributed to changes in significant line items described below.

Fund Balance with Treasury. Fund Balance with Treasury (FBWT) is an account that reflects available spending authority for the DON. In FY2005, FBWT increased by \$3.9 billion (or five percent). This increase is the result of a \$7 billion increase in appropriations received for FY2005. See Note 3, DON General Fund Notes to the Principal Statements, for more information on FBWT.

Accounts Receivable. Accounts Receivable represents amounts owed to the DON for goods and services ordered by other federal government entities (intragovernmental) and by the public (nonfederal). In FY2005, Intragovernmental Accounts Receivable increased by \$30 million (or 12 percent). This increase is primarily attributed to a \$54 million increase with the Department of Homeland Security (specifically, the Federal Emergency Management Agency) for customer orders related to Hurricane Katrina relief efforts.

Additionally, Nonfederal Accounts Receivable increased by \$372 million (or 13 percent) in FY2005. This increase is primarily attributed to a change in the DON's methodology for determining the estimated amount of uncollectible accounts receivable. See Note 5, DON General Fund Notes to the Principal Statements, for more information on Intragovernmental and Nonfederal Accounts Receivable.

General Property, Plant and Equipment (PP&E). General PP&E consists of real property, military and general equipment, internal use software, and construction-in-progress. In FY2005, General PP&E increased by \$6.6 billion (or four percent). The majority of this increase is the result of:

- \$6 billion in additional military equipment,
- \$1 billion in new buildings and structures due to the completion of several large military construction projects, and
- \$781 million decrease in construction-in-progress due to the completion of several military construction projects.

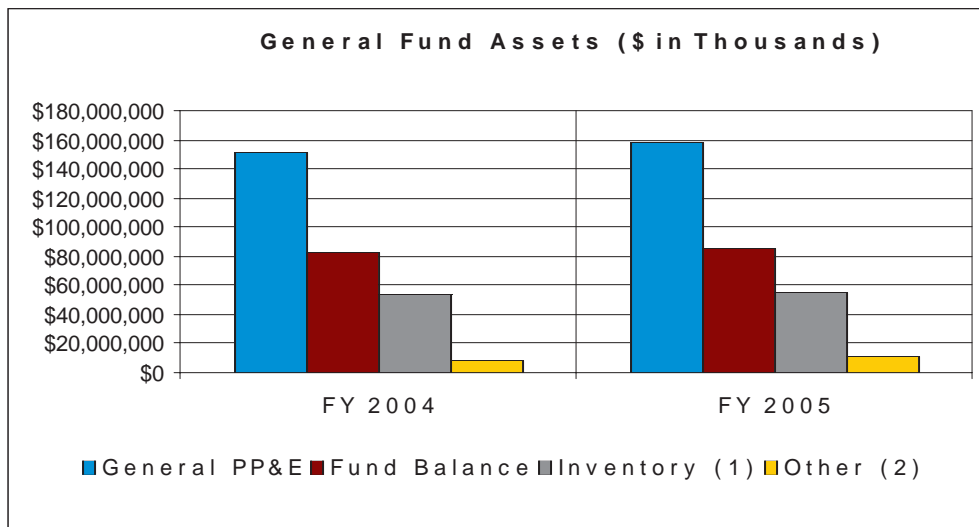
See Note 10, DON General Fund Notes to the Principal Statements, for more information on General PP&E.

Other Assets. Other Assets consists of advances, prepayments, and outstanding contract financing payments. In FY2005, Other Assets increased by \$2 billion (or 45 percent). The majority of this increase is due to:

## 2005 Annual Financial Report

- \$4 million increase in advances and prepayments from other federal government entities (Intragovernmental Other Assets), and
- \$2 billion increase in outstanding contract financing payments (Nonfederal), primarily related to the Aircraft and Weapons Procurement programs.

See Note 6, DON General Fund Notes to the Principal Statements, for more information on Other Assets.



**NOTE:**

- (1) "Inventory" includes operating materials and supplies, held for use.
- (2) "Other" includes investments, accounts receivable, other assets, and cash and other monetary assets.

### ACCOUNTS RECEIVABLE METRIC

As part of the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) Financial Indicators Program, the DON must track delinquent intragovernmental and public (nonfederal) accounts receivable. Accounts receivable are deemed "delinquent" when payment has not been received within 30 days of the date specified in the initial demand letter (<http://www.dod.mil/comptroller/fmr/>). The purpose of this metric is to ensure proper stewardship of public funds and cash management.

OUSD(C) has established a Department of Defense-wide goal of a 25 percent reduction in the total amount of delinquent intragovernmental and public accounts receivable. In FY2005, the DON missed this goal by \$1 million primarily due to new reporting of delinquent accounts receivable from the Enterprise Resource Planning (ERP) program. DON began tracking delinquent ERP accounts receivable in June 2005, and therefore had not included delinquent ERP accounts receivable in the original baseline.

## LIABILITY COMPOSITION

The Consolidated Balance Sheet as of September 30, 2005 presents total liabilities of \$29 billion, which represents an increase of \$812 million (or three percent) from FY2004. The increase in total liabilities is primarily attributed to changes in significant line items described below.

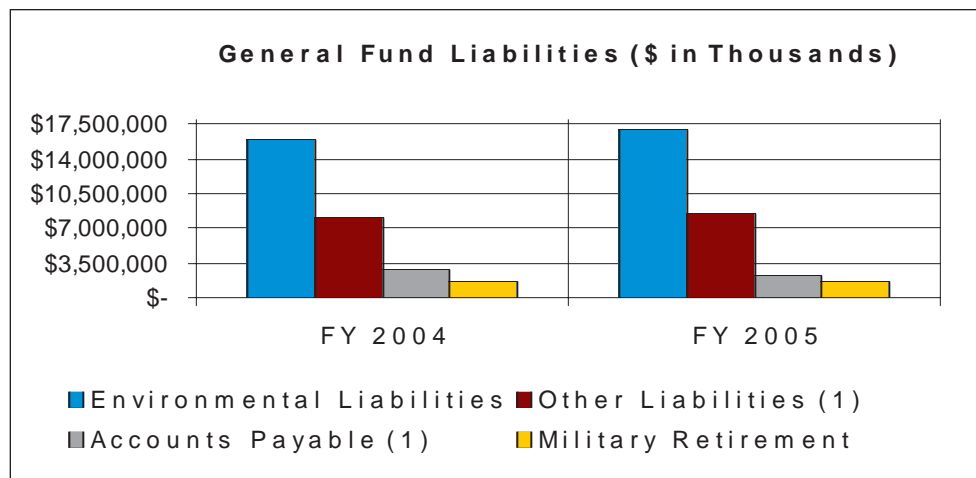
**Environmental Liabilities.** Environmental Liabilities includes Defense Environmental Restoration Program (DERP), Base Realignment and Closure, and environmental disposal of weapons systems. In FY2005, Environmental Liabilities increased by \$1 billion (or six percent). The majority of this increase is the result of:

- \$1.3 billion increase in the environmental disposal of nuclear-powered aircraft carriers and submarines due to labor rate increases and program growth, and
- \$203 million decrease in DERP liabilities due to completion of cleanup projects.

See Note 14, DON General Fund Notes to the Principal Statements, for more information on Environmental Liabilities.

**Accounts Payable.** Accounts Payable represents amounts owed by the DON to other federal government entities (intragovernmental) and to the public (nonfederal) for goods and services ordered and received but not yet paid. In FY2005, Intragovernmental Accounts Payable decreased by \$227 million (or 16 percent). This decrease is based upon intragovernmental elimination adjustments recorded at the Department of Defense component level.

Additionally, Nonfederal Accounts Payable decreased by \$480 million (or 34 percent) in FY2005. This decrease is primarily attributed to a decrease in the Military Personnel, Marine Corps account. See Note 12, DON General Fund Notes to the Principal Statements, for more information on Intragovernmental and Nonfederal Accounts Payable.



NOTE:

(1) "Other Liabilities" and "Accounts Payable" include intragovernmental debt.



## BUDGETARY RESOURCES, OBLIGATIONS, AND OUTLAYS

The statement of budgetary resources has three primary components: budgetary resources, obligations, and outlays, as follows:

- **Budgetary resources.** Budgetary resources include budget authority, such as appropriations received. Budget authority is the authority provided by law to enter into financial obligations that will result in immediate or future outlays involving federal government funds.
- **Status of budgetary resources.** Obligations incurred for the reporting period are included in the status of budgetary resources. Obligations incurred represent amounts of orders placed, contracts awarded, services received, and similar transactions during a given period that require payments during the same or future period.
- **Relationship of obligations to outlays.** The relationship of obligations to outlays is essentially a reconciliation of the obligated balance at the beginning and end of the reporting period. Included in the reconciliation are outlays. Outlays occur when a federal agency issues checks, disburses cash, or electronically transfers funds to liquidate an obligation. Outlays also occur when interest on the Treasury debt held by the public accrues; the federal government issues bonds, notes, or other cash-equivalent instruments; or a direct or guaranteed loan is disbursed.

Below is a discussion of budgetary resources, obligations incurred, and outlays reported by the DON in FYs 2004 and 2005.

Total budgetary resources. In FY2005, the DON reported \$131 billion in budget authority, which represents 78 percent of total budgetary resources. FY2005 budget authority represents an increase of \$7 billion (or six percent) from FY2004. This increase is the result of continuing efforts to accomplish the overall DON mission.

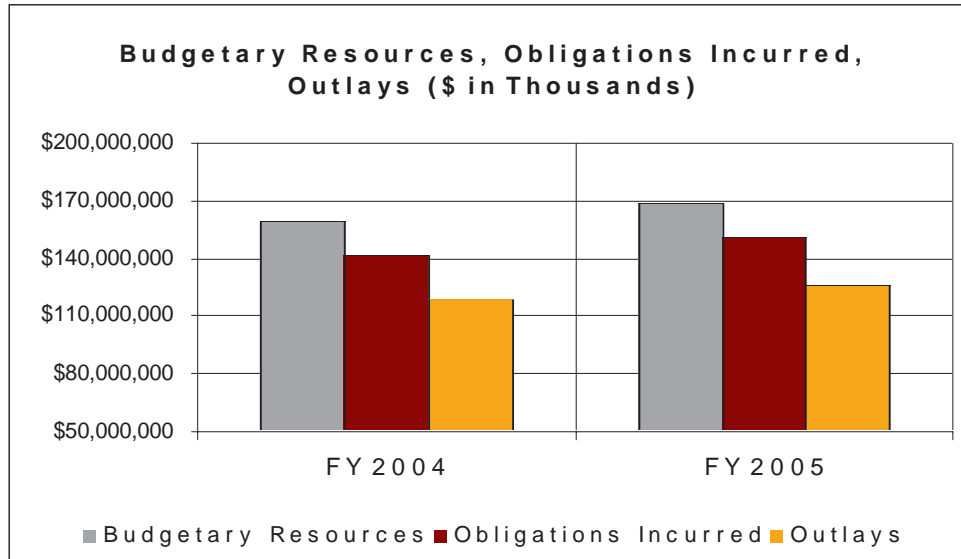
Total obligations incurred. In FY2005, the DON incurred obligations of \$151 billion, representing an increase of seven percent from FY2004. This increase is the result of increased funding for procurement accounts.

Total outlays. In FY2005, the DON reported outlays of \$126 billion, representing an increase of six percent from FY2004. This increase is the result of increased funding for procurement and research and development accounts.

See Note 21, DON General Fund Notes to the Principal Statements, for more information on the FY2005 statement of budgetary resources.



*Secretary of the Navy, Gordon R. England answers questions from a live audience, as he outlines the processes the Department of Defense team is using to develop the National Security Personnel System.*



*A Navy Band member performs during a change of command ceremony aboard the aircraft carrier USS Nimitz (CVN 68) in San Diego, California.*

## NAVY WORKING CAPITAL FUND

Discussion of financial performance for the NWCF focuses on cash management at the Department level and on the net cost of operations for the NWCF as a whole and by NWCF business area. (Note that the net cost of operations for NWCF as a whole includes the five NWCF business areas, ordnance, and the NWCF component level.)

### CASH MANAGEMENT

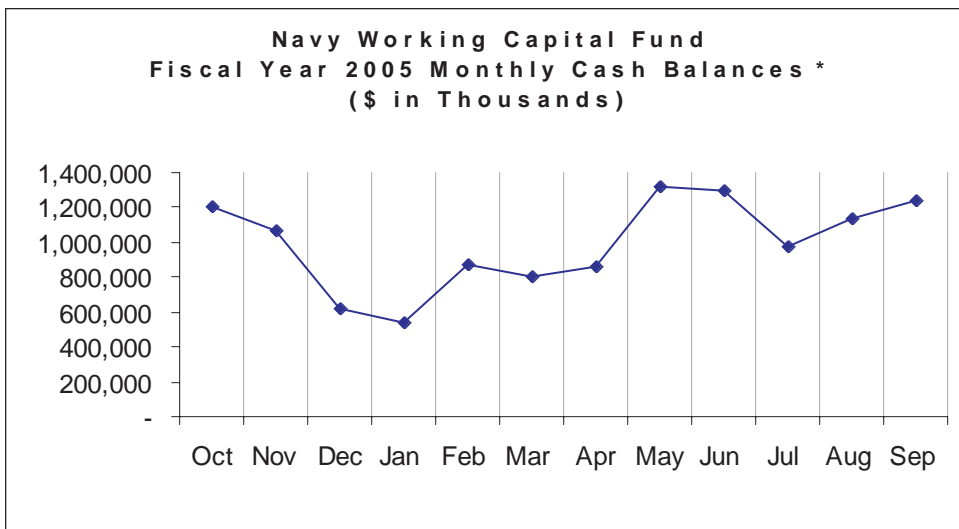
The DON manages working capital fund cash at the Departmental level. It must maintain cash levels at seven to ten days of operational costs, and be sufficient to meet six months of capital outlays, as required by the Department of Defense Financial Management Regulation (<http://www.dod.mil/comptroller/fmr/>). For FY2005, the seven-day cash requirement was \$762 million and the ten-day requirement was \$1,036 million.

For the second quarter of FY2005, the DON had projected NWCF cash balances to fall below \$200 million. When weekly cash balances during February 2005 dipped to \$97 million, the DON initiated advance billing of \$279 million. Advance billing enabled the DON to sustain an NWCF cash balance sufficient to meet monthly obligations. Supplemental appropriations received during FY2005 also bolstered NWCF cash. Appropriations received were as follows:

- \$200 million to finance the increased cost of Depot Maintenance, Aviation for the Global War on Terror;
- \$67 million for increased Defense Logistics Agency fuel rates for Military Sealift Command ships;
- \$20.1 million for 2004 hurricane damages; and
- \$7.2 million for 2005 hurricane damages.

Given the fluctuations in FY2005 cash flow (see chart), the NWCF ended the fiscal year with a three percent increase of \$34,087 million in cash. This increase is primarily attributed to the following:

- \$79 million in advance billing;
- \$200 million from the sale of Supply Management consumables; and
- \$271 million for payroll accrued during the last 13 days of September.



**\*NOTE:** Cash balances above represent the combined total of monthly cash balances for the five NWCF business areas, ordnance, and the NWCF component level.

The FY2005 NWCF ending cash balance also reflects the Congressionally directed transfer of \$150 million from NWCF to the Operation and Maintenance, Navy appropriation, which was completed in September 2005.

As part of the DON Financial Management Strategic Plan business transformation effort, a team is reviewing NWCF cash "as is" forecasting and execution practices in an effort to standardize business processes and tailor cash balances for each NWCF business area.

## NET COST OF OPERATIONS

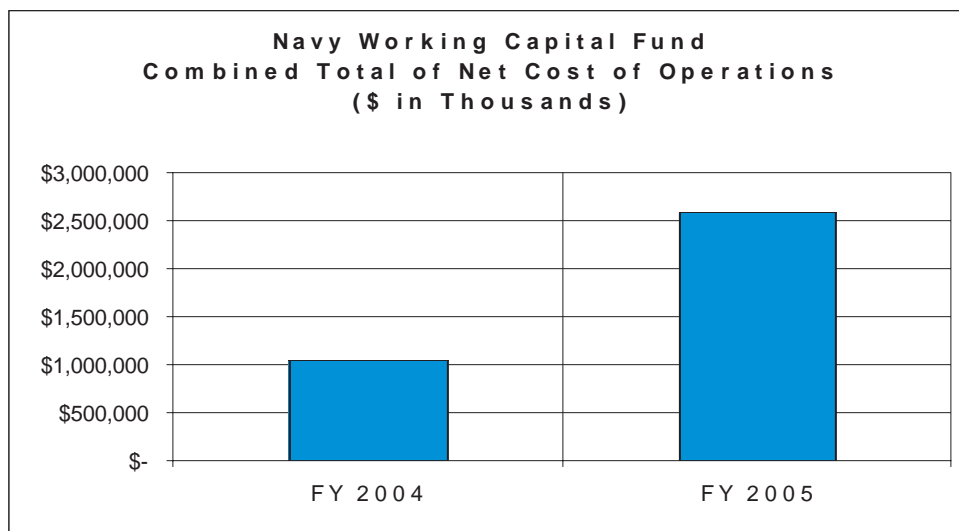
Net cost of operations is the "bottom line" on the federal sector's statement of net cost. It is similar to the private sector's net income (or net loss) on the income statement (also known as "the profit and loss statement"). Both the statement of net cost and the income statement present revenues earned and costs (or expenses) incurred for the reporting period. However, to arrive at the bottom line the federal sector calculates costs incurred less revenues earned, whereas the private sector calculates revenues earned less expenses incurred.

In FY2005, net cost of operations for the five NWCF business areas, ordnance, and NWCF component level increased by \$1.5 billion (or 149 percent). This increase is primarily attributed to:

- Supply Management, Navy, which reported an increase in cost of goods sold as a result of the Depot Level Repairable carcass reconciliation, and
- Transportation (Military Sealift Command), which incurred an increase in fuel consumption costs.

To view the combined total of program costs and earned revenue for the five NWCF business areas, ordnance, and the NWCF component level, see the NWCF Consolidated Statement of Net Cost. Supporting details for this statement are in the NWCF Consolidating Statement of Net Cost.

See Note 18, NWCF Notes to the Principal Statements, for more information on the FY2005 statement of net cost.

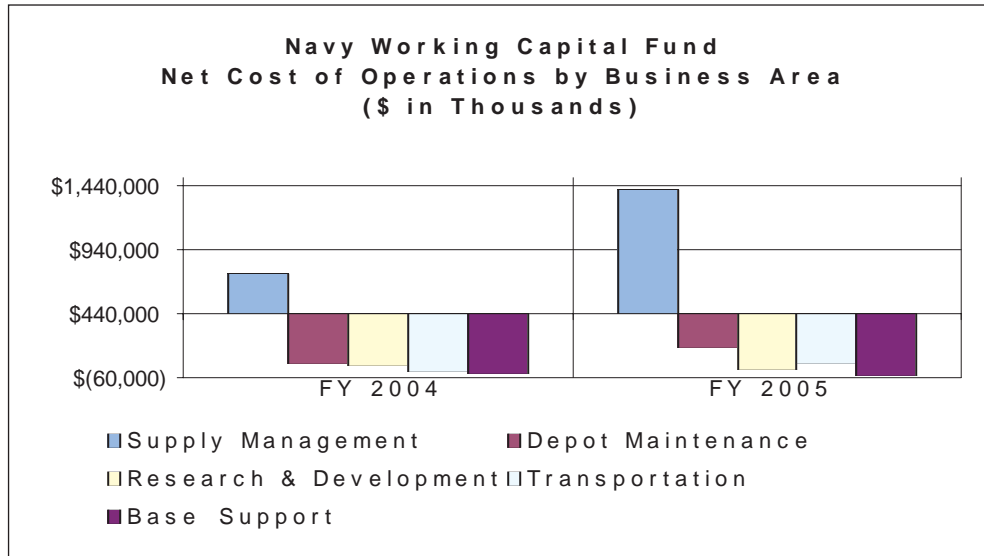


**NOTE:**

Totals above represent the combined total of net cost of operations for the five NWCF business areas, ordnance, and the NWCF component level.

### NET COST OF OPERATIONS BY BUSINESS AREA

In FY2005, the total net cost of operations for the five NWCF business areas was \$1.6 billion. This represents 62 percent of the combined total of net cost of operations for the five NWCF business areas, ordnance, and the NWCF component level. In contrast, the total net cost of operations for the five NWCF business areas in FY2004 was \$815 billion. This represented 79 percent of the combined total of net cost of operations for the five NWCF business areas, ordnance, and the NWCF component level.



The T-6 Texan training aircraft takes off from the flight line at Naval Air Station (NAS) Pensacola. Only one model of aircraft will be used for training Air Force and Navy pilots, as part of the Department of Defense’s effort to streamline military training operations, reduce costs, while increasing efficiency.



*The T-34B Mentor trainer aircraft hangs in the North Atrium of the newly renovated Chevalier Hall building at the Naval Air Technical Training Center (NATTC) on board Naval Air Station Pensacola, Fla. Chevalier Hall was rebuilt after being devastated with heavy damage from Hurricane Ivan in September 2004. Chevalier Hall is the home of aviation technical schools where new Sailors receive their initial training before being assigned to the Fleet.*

DEPARTMENT OF THE NAVY

**GENERAL FUND  
PRINCIPAL STATEMENTS**

2005



GENERAL FUND  
PRINCIPAL STATEMENTS

## **LIMITATIONS TO THE FINANCIAL STATEMENTS**

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

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

To the extent possible, the financial statements have been prepared in accordance with federal accounting standards. At times, the Department is unable to implement all elements of the standards due to financial management systems limitations. The Department continues to implement system improvements to address these limitations. There are other instances when the Department's application of the accounting standards is different from the auditor's application of the standards. In those situations, the Department has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent.

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



## *2005 Annual Financial Report*

### **PRINCIPAL STATEMENTS**

The FY 2005 Department of the Navy, General Fund Principal Financial Statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the General Fund for the fiscal year ending September 30, 2005, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2004.

The following statements are included in the Department of the Navy, General Fund Principal Statements:

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

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, as amended by the Government Management Reform Act of 1994.

The accompanying notes should be considered an integral part of the Principal Statements.

Department of Defense  
 Department of the Navy  
**CONSOLIDATED BALANCE SHEET**  
 As of September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>ASSETS (Note 2)</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 85,734,659	\$ 81,874,818
Nonentity Seized Iraqi Cash	0	0
Nonentity - Other	344,546	219,095
Investments (Note 4)	9,519	9,457
Accounts Receivable (Note 5)	281,304	250,703
Other Assets (Note 6)	672,257	272,723
Total Intragovernmental Assets	<u>\$ 87,042,285</u>	<u>\$ 82,626,796</u>
Cash and Other Monetary Assets (Note 7)	305,440	234,865
Accounts Receivable (Note 5)	3,267,657	2,895,966
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	55,584,837	53,340,667
General Property, Plant and Equipment (Note 10)	158,328,847	151,679,503
Investments (Note 4)	0	0
Other Assets (Note 6)	6,988,791	5,000,348
<b>TOTAL ASSETS</b>	<u><u>\$ 311,517,857</u></u>	<u><u>\$ 295,778,145</u></u>
<b>LIABILITIES (Note 11)</b>		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 1,208,702	\$ 1,437,616
Debt (Note 13)	0	0
Other Liabilities (Note 15 & Note 16)	3,826,048	3,984,802
Total Intragovernmental Liabilities	<u>\$ 5,034,750</u>	<u>\$ 5,422,418</u>
Accounts Payable (Note 12)	1,180,034	1,395,008
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities (Note 17)	1,532,819	1,575,815
Environmental Liabilities (Note 14)	17,050,451	16,031,979
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	4,459,836	4,020,826
<b>TOTAL LIABILITIES</b>	<u><u>\$ 29,257,890</u></u>	<u><u>\$ 28,446,046</u></u>
<b>NET POSITION</b>		
Unexpended Appropriations	\$ 89,739,876	\$ 79,161,774
Cumulative Results of Operations	192,520,091	188,170,325
<b>TOTAL NET POSITION</b>	<u><u>\$ 282,259,967</u></u>	<u><u>\$ 267,332,099</u></u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u><u>\$ 311,517,857</u></u>	<u><u>\$ 295,778,145</u></u>

The accompanying notes are an integral part of these statements.

## 2005 Annual Financial Report

Department of Defense  
Department of the Navy

### CONSOLIDATED STATEMENT OF NET COST

For the years ended September 30, 2005 and 2004  
(\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Program Costs</b>		
Intragovernmental Gross Costs	\$ 39,245,021	\$ 39,171,720
(Less: Intragovernmental Earned Revenue)	<u>(3,480,213)</u>	<u>(3,272,860)</u>
Intragovernmental Net Costs	\$ <u>35,764,808</u>	\$ <u>35,898,860</u>
Gross Costs With the Public	\$ 84,365,786	\$ 96,846,251
(Less: Earned Revenue From the Public)	<u>(4,700,935)</u>	<u>(3,302,708)</u>
Net Costs With the Public	\$ <u>79,664,851</u>	\$ <u>93,543,543</u>
Total Net Cost	\$ 115,429,659	\$ 129,442,403
<b>Costs Not Assigned to Programs</b>	0	0
<b>(Less: Earned Revenue Not Attributable to Programs)</b>	<u>0</u>	<u>0</u>
<b>Net Cost of Operations</b>	\$ <u><u>115,429,659</u></u>	\$ <u><u>129,442,403</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense

Department of the Navy

**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Cumulative Results of Operations</b>		
<b>Beginning Balances</b>	\$ 188,170,325	\$ 222,565,239
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles	0	0
Correction of Errors	0	(25,913,750)
<b>Beginning Balances, as adjusted</b>	<u>\$ 188,170,325</u>	<u>\$ 196,651,489</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	119,015,668	120,198,147
Nonexchange revenue	205	0
Donations and forfeitures of cash and cash equivalents	29,518	0
Transfers in/out without reimbursement (+/-)	150,000	166,000
Other budgetary financing sources (+/-)	0	0
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(1,652)	11,883
Imputed financing from costs absorbed by others	585,686	585,209
Other (+/-)	0	0
<b>Total Financing Sources</b>	<u>\$ 119,779,425</u>	<u>\$ 120,961,239</u>
<b>Net Cost of Operations (+/-)</b>	<u>115,429,659</u>	<u>129,442,403</u>
<b>Net Change</b>	<u>4,349,766</u>	<u>(8,481,164)</u>
<b>Ending Balances</b>	<u><u>\$ 192,520,091</u></u>	<u><u>\$ 188,170,325</u></u>

The accompanying notes are an integral part of these statements.

## 2005 Annual Financial Report

Department of Defense

Department of the Navy

### CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Unexpended Appropriations</b>		
<b>Beginning Balances</b>	\$ 79,161,774	\$ 50,781,179
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles	0	0
Correction of Errors	0	25,913,750
<b>Beginning Balances, as adjusted</b>	<u>\$ 79,161,774</u>	<u>\$ 76,694,929</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 130,972,538	\$ 123,917,983
Appropriations transferred in/out (+/-)	164,674	455,059
Other adjustments (rescissions, etc) (+/-)	(1,543,442)	(1,708,050)
Appropriations used	(119,015,668)	(120,198,147)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
<b>Total Financing Sources</b>	<u>\$ 10,578,102</u>	<u>\$ 2,466,845</u>
<b>Net Cost of Operations (+/-)</b>	<u>0</u>	<u>0</u>
<b>Net Change</b>	<u>10,578,102</u>	<u>2,466,845</u>
<b>Ending Balances</b>	<u><u>\$ 89,739,876</u></u>	<u><u>\$ 79,161,774</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense  
 Department of the Navy  
**COMBINED STATEMENT OF BUDGETARY RESOURCES**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005 Combined</u>	<u>2004 Combined</u>
<b>BUDGETARY FINANCING ACCOUNTS</b>		
<b>BUDGETARY RESOURCES</b>		
Budget Authority:		
Appropriations Received	\$ 131,002,361	\$ 123,948,477
Borrowing Authority	0	0
Contract Authority	0	0
Net transfers (+/-)	361,305	425,109
Other	0	0
Unobligated Balance:		
Beginning of period	18,027,994	14,695,238
Net transfers, actual (+/-)	(46,631)	195,950
Anticipated Transfers Balances	0	0
Spending Authority from Offsetting Collections:		
Earned	0	0
Collected	8,830,640	7,706,650
Receivable from Federal sources	696,667	(360,284)
Change in unfilled customer orders	0	0
Advances received	147,708	56,010
Without advance from Federal sources	(636,393)	467,506
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Transfers from trust funds	0	0
Subtotal	<u>\$ 9,038,622</u>	<u>\$ 7,869,882</u>
Recoveries of prior year obligations	\$ 11,446,435	\$ 13,756,981
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(1,543,442)	(1,708,789)
<b>Total Budgetary Resources</b>	<u><u>\$ 168,286,644</u></u>	<u><u>\$ 159,182,848</u></u>
<b>STATUS OF BUDGETARY RESOURCES</b>		
Obligations Incurred:		
Direct	\$ 137,694,376	\$ 132,268,522
Reimbursable	13,463,789	8,886,330
Subtotal	<u>\$ 151,158,165</u>	<u>\$ 141,154,852</u>
Unobligated balance:		
Apportioned	\$ 15,607,505	\$ 13,973,108
Exempt from apportionment	0	0
Other available	0	0
Unobligated Balances Not Available	1,520,974	4,054,888
<b>Total, Status of Budgetary Resources</b>	<u><u>\$ 168,286,644</u></u>	<u><u>\$ 159,182,848</u></u>

The accompanying notes are an integral part of these statements.

## 2005 Annual Financial Report

Department of Defense

Department of the Navy

### COMBINED STATEMENT OF BUDGETARY RESOURCES

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Combined</u>	<u>2004 Combined</u>
<b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>		
Obligated Balance, Net-beginning of period	\$ 63,856,224	\$ 63,520,894
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, net-end of period:		
Accounts Receivable	(1,234,226)	(537,560)
Unfilled customer order from Federal sources	(2,166,588)	(2,802,982)
Undelivered Orders	68,731,014	63,723,755
Accounts Payable	3,362,173	3,473,010
Outlays:		
Disbursements	134,815,308	126,955,319
Collections	(8,978,348)	(7,762,660)
Subtotal	\$ 125,836,960	\$ 119,192,659
Less: Offsetting receipts	(115,805)	(115,027)
<b>Net Outlays</b>	<u>\$ 125,721,155</u>	<u>\$ 119,077,632</u>

The accompanying notes are an integral part of these statements.

Department of Defense  
 Department of the Navy  
**CONSOLIDATED STATEMENT OF FINANCING**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005</u> <u>Consolidated</u>	<u>2004</u> <u>Consolidated</u>
<b>Resources Used to Finance Activities:</b>		
Budgetary Resources Obligated		
Obligations Incurred	\$ 151,158,165	\$ 141,154,852
Less: Spending Authority from offsetting collections and recoveries (-)	<u>(20,485,056)</u>	<u>(21,626,865)</u>
Obligations net of offsetting collections and recoveries	\$ 130,673,109	\$ 119,527,987
Less: Offsetting receipts (-)	<u>(115,805)</u>	<u>(115,027)</u>
Net obligations	<u>\$ 130,557,304</u>	<u>\$ 119,412,960</u>
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(1,652)	11,883
Imputed financing from costs absorbed by others	585,686	585,209
Other (+/-)	<u>0</u>	<u>0</u>
Net other resources used to finance activities	<u>\$ 584,034</u>	<u>\$ 597,092</u>
<b>Total resources used to finance activities</b>	<u>\$ 131,141,338</u>	<u>\$ 120,010,052</u>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	\$ (13,332,332)	\$ 1,796,210
Unfilled Customer Orders	(488,685)	523,516
Resources that fund expenses recognized in prior periods	(269,715)	(115,122)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		
Cost of Operations	0	0
Resources that finance the acquisition of assets	(14,697,475)	(12,412,218)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund Receipts Related to Exchange in the entity's budget (-)	0	0
Other (+/-)	<u>1,652</u>	<u>(11,883)</u>
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<u>\$ (28,786,555)</u>	<u>\$ (10,219,497)</u>
<b>Total resources used to finance the Net Cost of Operations</b>	<u>\$ 102,354,783</u>	<u>\$ 109,790,555</u>

The accompanying notes are an integral part of these statements.



## 2005 Annual Financial Report

Department of Defense  
Department of the Navy

### CONSOLIDATED STATEMENT OF FINANCING

For the years ended September 30, 2005 and 2004  
(\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	\$ 170,047	\$ 188,260
Increase in environmental and disposal liability	1,028,763	427,489
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	<u>69,091</u>	<u>193,243</u>
Total components of Net Cost of Operations that will require or generate resources in future periods	<u>\$ 1,267,901</u>	<u>\$ 808,992</u>
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 15,844,303	\$ 17,475,862
Revaluation of assets and liabilities (+/-)	(1,785,299)	1,114,040
Other (+/-)		
Trust Fund Exchange Revenue	(10)	(30,297)
Cost of Goods Sold	0	0
Operating Material & Supplies Used	(2,244,170)	270,967
Other	<u>(7,849)</u>	<u>12,284</u>
Total components of Net Cost of Operations that will not require or generate resources	<u>\$ 11,806,975</u>	<u>\$ 18,842,856</u>
<b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b>	<u>\$ 13,074,876</u>	<u>\$ 19,651,848</u>
<b>Net Cost of Operations</b>	<u>\$ 115,429,659</u>	<u>\$ 129,442,403</u>

The accompanying notes are an integral part of these statements.



**GENERAL FUND  
NOTES TO THE PRINCIPAL STATEMENTS**

2005



GENERAL FUND PRINCIPAL STATEMENTS

## NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

### 1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON), as required by the "Chief Financial Officers (CFO) Act of 1990," expanded by the "Government Management Reform Act (GMRA) of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the DON in accordance with the "Department of Defense Financial Management Regulation" (DoD FMR), the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements," and to the extent possible, Federal Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which the DON is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. In addition to the DON financial statements, and pursuant to OMB directives, financial reports are also prepared by the DON that are used to monitor and control the DON's use of budgetary resources.

The DON is unable to fully implement all elements of Federal GAAP and the OMB Circular A-136 due to limitations of its financial management processes and systems, including feeder systems and processes. Reported values and information for the DON's major asset and liability categories are derived largely from feeder systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with Federal GAAP. As a result, the DON cannot currently implement every aspect of Federal GAAP and OMB Circular A-136. The DON continues to implement process and system improvements addressing the limitation of its financial and feeder systems. A more detailed explanation of these financial statement elements is provided in the applicable note.

Fiscal Year (FY) 2005 represents the tenth year that the DON has prepared audited financial statements as required by the CFO Act and the GMRA.

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

The DON was created on April 30 1798 by an act of Congress (1 Stat. 533; 5 U.S.C. 411-12). The overall mission of DoD is to organize, train, and equip armed forces to deter aggression and, if necessary, defeat aggressors against the United States and its allies.

### 1.C. Appropriations and Funds

The DON's appropriations and funds are divided into the general, revolving, trust, special, and deposit funds. These appropriations and funds are used to fund and report how the resources have been used in the course of executing the DON's missions.

General funds are used for financial transactions arising under Congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and construction accounts.

Revolving funds receive their initial working capital through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders. The National Defense Sealift Fund is the DON's only revolving fund.

Trust funds represent the receipt and expenditure of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

## 2005 Annual Financial Report

Special funds account for receipts of the government that are earmarked for a specific purpose.

Deposit funds generally are used to (1) hold assets for which the DON is acting as an agent or a custodian or whose distribution awaits legal determination, or (2) account for unidentified remittances.

The asset accounts used to prepare the statements are categorized as either entity or nonentity. Entity accounts consist of resources that the agency has the authority to use, or where management is legally obligated to use funds to meet entity obligations. Nonentity accounts are assets that are held by an entity but are not available for use in the operations of the entity.

### ENTITY ACCOUNTS:

#### General Accounts

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1105	Military Personnel, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps
17 1109	Procurement, Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1235	Military Construction, Naval Reserve
17 1236	Payments to Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17 1319	Research and Development, Test and Evaluation, Navy
17 1405	Reserve Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17 1611	Shipbuilding Conversion
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement

#### Revolving Funds

17 4557	National Defense Sealift Fund, Navy
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#### Trust Funds

17X8008	Office of Naval Records and History Fund
17X8716	Department of the Navy General Gift Fund
17X8723	Ships Stores and Profits, Navy
17X8730	United States Naval Academy Museum Fund
17X8733	United States Naval Academy General Gift Fund

#### Special Funds

17X5095	Wildlife Conversion, etc., Military Reservations, Navy
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17X5185 Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy  
17X5429 Rossmoor Liquidating Trust Settlement Account  
17X5562 Ford Island Improvement Account

**Non Entity Accounts**

17 3XXX Receipt Accounts  
17X6XXX Deposit Funds  
17 47X0535 Embassy Security, Construction and Maintenance, State  
17 11 1081 International Military Education and Training Funds, appropriated to the President (fiscal year)  
17 11X1081 International Military Education and Training Funds, appropriated to the President  
17 11 1082 Foreign Military Financing Program, Funds appropriated to the President (fiscal year)  
17 12X1105 State and Private Forestry, Forest Service

**1.D. Basis of Accounting**

The DON generally records transactions on a budgetary basis and not an accrual accounting basis as is required by Federal GAAP. For FY 2005, DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the DON's financial and feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP. The DON has undertaken efforts to determine the actions required to bring its financial and feeder systems and processes into compliance with all elements of Federal GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until such time as all of the DON's financial and feeder systems and processes are updated to collect and report financial information as required by Federal GAAP, the DON's financial data will be based on budgetary transactions (obligations, disbursements, and collections), and transactions from feeder systems, adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities. However, when possible, the financial statements are presented on the accrual basis of accounting as required. One example of information presented on the budgetary basis is the data on the Statement of Net Cost. Much of this information is based on obligations and disbursements and may not always represent accrued costs.

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

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

Financing sources for general funds are provided primarily through congressional appropriations that are received on both an annual and a multiyear basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The DON recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Revenue is recognized when earned under the reimbursable order process.

The DON does not include non-monetary support provided by U.S. Allies for common defense in mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has agreements with foreign countries that include both direct and indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in port. DoD is reviewing these types of financing and costs

## 2005 Annual Financial Report

reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the financial statements in accordance with generally accepted accounting principles. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

### 1.F. Recognition of Expenses

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

### 1.G. Accounting for Intragovernmental Activities

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

The DON's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The DON's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

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

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

To prepare reliable financial statements, transactions occurring between components or activities within the DON must be eliminated. However, the DON, as well as the majority of the federal government, cannot consistently and accurately identify all intragovernmental transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of the DON. For FYs 1999 and beyond seller entities within DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have

been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intragovernmental balances were then eliminated.

The Department of the Treasury, Financial Management Services (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In September 2004, the FMS issued the "Federal Intragovernmental Transactions Accounting Policies Guide." The Department was not able to fully implement the policies and procedures in this guide related to reconciling intragovernmental assets, liabilities, revenues, and expenses for non-fiduciary transactions. The DON, however, was able to implement the policies and procedures contained in the "Intragovernmental Fiduciary Transactions Accounting Guide" as updated by the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide," revised July 1, 2005, for reconciling intragovernmental transactions. It can be found at <http://www.fms.treas.gov/irri/>. These transactions pertain to investments in Federal securities, borrowings from the Department of the Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the OPM.

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

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of this Act, DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Customers may be required to make payments in advance.

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

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

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the DON's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at Note 3.

#### **1.J. Foreign Currency**

The DON conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations (Operations and Maintenance, Military Personnel, Military Construction, Family Housing Operations and Maintenance, and Family Housing Construction.) The gains and losses are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustment to the original obligation amount at the time of payment. These currency fluctuations are not separately identified.

#### **1.K. Accounts Receivable**

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowance for doubtful accounts are based upon analysis of collection experience by fund type. The Department does not recognize an allowance for doubtful accounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies. Material disclosures are provided at Note 5.



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### 1.L. Loans Receivable

Not Applicable.

### 1.M. Inventories and Related Property

The DON uses the Latest Acquisition Cost method as its inventory systems were designed for material management rather than accounting purposes. The systems provide accountability for and visibility over inventory items. The systems do not maintain the historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Neither can they directly produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). DoD is transitioning to a Moving Average Cost methodology for valuing inventory and OM&S that when fully implemented will allow the DON to comply with SFFAS No. 3.

SFFAS No. 3 distinguishes between "inventory held for sale" and "inventory held in reserve for future sale." There is no management or valuation difference between the two USSGL accounts. Further, the DoD manages only military or government-specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD material management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DoD holds material based on military need and support for contingencies. Therefore, the DON does not attempt to account separately for items held for current or future use.

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

DoD implemented new policy in FY 2002 to account for condemned material (only) as "Excess, Obsolete, and Unserviceable." The net value of condemned material is zero, because the costs of disposal are greater than the potential scrap value. Material that can be potentially redistributed, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

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

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

For the Trust Funds, investments in U.S. Treasury securities are reported at cost, net of unamortized premiums or discounts. Premium or discounts are amortized into interest income over the term of the investment using the effective interest rate method or other methods if similar results are obtained. The DON's intent is to hold investments to maturity; unless they are needed to finance claims or otherwise sustain operations. Consequently, no provision is made for unrealized gains or losses on these securities.

The DON invests in non-marketable securities. The two types of non-marketable securities are par value and market based Intragovernmental securities. The Bureau of Public Debt issues non-marketable Par Value Intragovernmental Securities. Non-marketable, Market Based Intragovernmental Securities mimic marketable securities, but are not traded publicly. See Note 4 for material disclosures.

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

General PP&E, exclusive of Military Equipment, is capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of \$100,000. Improvement costs over the DoD capitalization threshold of \$100,000 for General PP&E must also be capitalized. DON depreciates all General PP&E, other than land, on a straight-line basis. Land is not depreciated.

When it is in the best interest of the government, the DON provides government property to contractors when deemed necessary to complete contracted work. Such property is either owned or leased by the DON, or purchased directly by the contractor for the government based on contract terms. When the value of contractor procured General PP&E exceeds the DoD capitalization threshold, such PP&E is required to be included in the value of General PP&E reported on the DON's Balance Sheet. DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the DON currently reports only government property in the possession of contractors that is maintained in the DON's property systems.

To bring the DoD into fuller compliance with federal accounting standards, DoD has issued new property accountability and reporting regulations that require the DoD Components to maintain, in DoD Component property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards. Material disclosures are provided at Note 10.

### **1.P. Advances and Prepayments**

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

### **1.Q. Leases**

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

### **1.R. Other Assets**

DON conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the DON provides financing payments for certain contracts. One type of financing payment that the DON makes, for real property, is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as Construction-in-Progress and are reported on the General PP&E line and in Note 10, General PP&E, Net.

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

DoD has completed a review of all applicable federal accounting standards; applicable public laws on contract financing; FAR Parts 32, 49, and 52; and the OMB guidance in 5 Code of Federal Regulations Part 1315, "Prompt Payment." DoD concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering what further action is appropriate.

### 1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable and the amount of loss 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 that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The DON's loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the DON's assets. This type of liability has two components: non-environmental and environmental. Recognition of an anticipated environmental disposal liability begins when the asset is placed into service, consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment." Based upon the DON's policies and consistent with SFFAS No.5 "Accounting for Liabilities of Federal Government," a non-environmental disposal liability is recognized for an asset when management makes a decision to dispose of the asset. The DON has agreed to the recognition of non-environmental disposal liability for nuclear powered assets when the asset is placed in service. Such amounts are developed in conjunction with and not easily identifiable separately from environmental disposal costs. Material disclosures are provided at Notes 14 and 15.

### 1.T. Accrued Leave

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

### 1.U. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not yet been incurred.

Cumulative results of operations represent the difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains).

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

The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements is retained by the host country. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Department. Therefore, in the event treaties or other agreements are terminated whereby use of the foreign bases is no longer allowed, losses will be recorded for the value of any non-retrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

#### **1.W. Comparative Data**

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2005. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater than 10 percent between FY 2005 and FY 2004 are explained within the Notes to the Financial Statements.

#### **1.X. Unexpended Obligations**

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

#### **1.Y. Undistributed Disbursements and Collections**

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

The Department of Defense policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The DON follows this procedure.

#### **1.Z. Data Collection Approach**

The DON financial statements include information from both financial systems and feeder systems. The Defense Finance and Accounting Service, Cleveland (DFAS-CL) and Kansas City (DFAS-KC) collect the financial system information and incorporate it into the financial statements. The DON collects financial information from feeder systems through a data call process and submits it to DFAS-CL & KC for incorporation into the financial statements. For FY 2005, the DON utilized a web-based data collection instrument (DCI) that captures all required financial information from feeder systems for the General Fund (GF) statements. This is the seventh year DON has used the DCI to collect information from feeder systems. The DON DCI identifies the information requirements to the source provider, provides an audit trail, and integrates into the financial statement preparation process.

**NOTE 2. NONENTITY ASSETS**

As of September 30,	2005	2004
<i>(Amounts in thousands)</i>		
<b>1. Intragovernmental Assets:</b>		
A. Fund Balance with Treasury	\$ 344,546	\$ 219,095
B. Investments	0	0
C. Accounts Receivable	0	0
D. Other Assets	0	0
E. Total Intragovernmental Assets	<u>\$ 344,546</u>	<u>\$ 219,095</u>
<b>2. Nonfederal Assets:</b>		
A. Cash and Other Monetary Assets	\$ 305,440	\$ 234,865
B. Accounts Receivable	2,538,987	2,755,331
C. Loans Receivable	0	0
D. Inventory & Related Property	0	0
E. General Property, Plant and Equipment	0	0
F. Investments	0	0
G. Other Assets	0	0
H. Total Nonfederal Assets	<u>\$ 2,844,427</u>	<u>\$ 2,990,196</u>
<b>3. Total Nonentity Assets</b>	<u>\$ 3,188,973</u>	<u>\$ 3,209,291</u>
<b>4. Total Entity Assets</b>	<u>308,328,884</u>	<u>292,568,854</u>
<b>5. Total Assets</b>	<u><u>\$ 311,517,857</u></u>	<u><u>\$ 295,778,145</u></u>

**Fluctuation and/or Abnormalities**

Intragovernmental Assets.

Fund Balance with Treasury (Line 1.A): DON reported an increase of \$125,451 thousand, 57 percent, in FY 2005. Nonentity Fund Balance with Treasury was affected by a reclassification of the majority of the 3000 series Treasury Suspense accounts from Nonentity to Entity. This reclassification was done to bring DON's categorization of the Suspense accounts into alignment with DoD's treatment. The reclassification had a net effect of \$76,805 thousand. Had the reclassification not occurred, the reported balance of \$344,546 thousand would have been \$267,741 thousand. Remaining in Nonentity are the 6000 series Deposit accounts which hold items such as withheld state and local taxes and payroll savings allotments and several of the 3000 series. See Note 1C for a complete listing of the entity and nonentity account symbols.

In previous years, aged transactions in the Treasury Suspense accounts were cleared at year-end by transferring the balances to the primary appropriation accounts. In FY 2005, in accordance with new DoD and Treasury guidance, the process to clear the aged transactions from the Treasury Suspense accounts was not performed.

Nonfederal Assets.

The overall increase of \$70,575 thousand, 30 percent, in Cash and Other Monetary Assets is due to an increase of \$101,521 thousand in Foreign Currency, related to the Marine Corps Expeditionary Forces, Camp Lejeune, Disbursing Officer depositing money into a Limited Depository Account. This Limited Depository Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds and is reported as a nonentity account. The increase in Foreign Currency was offset by a decrease of \$30,947 thousand, 13 percent, in Cash held by various Disbursing Officers.

## Information Related to Nonentity Assets

### Definitions

Assets are categorized as:

#### Entity accounts.

Assets that the DON has the authority to use or that management is legally obligated to use to meet entity obligations.

#### Nonentity accounts.

Assets held by an entity, but are not available for use in the operations of the entity.

### Other Disclosures

#### Nonentity Assets.

As of FY 2005, DON holds \$3,188,973 thousand nonentity assets. These assets are not available for use by the DON in its day-to-day operations but the DON maintains stewardship accountability and reporting responsibility. There are three categories of significant nonentity assets held by the DON: (1) the Intragovernmental Fund Balance with Treasury, (2) the Nonfederal Cash and Other Monetary Assets, and (3) the Nonfederal Accounts Receivable.

#### Nonentity Nonfederal Accounts Receivable (Public).

As of FY 2005, nonentity nonfederal accounts receivable contains principal of \$1,333,494 thousand in advance payments made to contractors that remains in litigation and \$1,187,906 thousand in associated accrued interest. These balances are being reported in nonentity accounts receivable since the original appropriation year has been cancelled, and any funds collected as a result of this litigation would go to the Department of the Treasury and not be available for the DON's use in normal operations. See Note 5 for additional information.

### Reference

For Additional Line Item discussion, see:

Note 3, Fund Balance with Treasury

Note 4, Investments

Note 5, Accounts Receivable

Note 6, Other Assets

Note 7, Cash and Other Monetary Assets

Note 8, Direct Loans and/or Loan Guarantee Programs

Note 9, Inventory and Related Property, Net

Note 10, General Property, Plant, and Equipment (PP&E), Net

For regulatory discussion on Nonentity and Entity Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

For regulatory discussion on Limited Depository Accounts, see Department of Defense Financial Management Regulation, Volume 5, Chapter 14.

**NOTE 3. FUND BALANCE WITH TREASURY**

As of September 30, <i>(Amounts in thousands)</i>	2005	2004
<b>1. Fund Balances:</b>		
A. Appropriated Funds	\$ 83,215,340	\$ 79,826,096
B. Revolving Funds	2,501,771	2,024,355
C. Trust Funds	14,564	18,245
D. Special Funds	2,984	0
E. Other Fund Types	344,546	225,217
F. Total Fund Balances	<u>\$ 86,079,205</u>	<u>\$ 82,093,913</u>
<b>2. Fund Balances Per Treasury Versus Agency:</b>		
A. Fund Balance per Treasury	\$ 86,922,093	\$ 83,080,322
B. Fund Balance per DON	86,079,205	82,093,913
<b>3. Reconciling Amount</b>	<u>\$ 842,888</u>	<u>\$ 986,409</u>

**Explanation of Reconciliation Amount:**

*(Amounts in thousands)*

Receipt Accounts in Treasury Unavailable to DON	\$ 50,633
Canceling Years	792,297
Invalid Program Years	(42)
Total Reconciling Amount	<u>\$ 842,888</u>

**Fund Balance Per Treasury Calculation**

*(Amounts in thousands)*

Undisbursed Appropriation Account Trial Balance (FMS 6654)	\$ 86,826,953
Receipt Account Trial Balance (FMS 6655 - IAS 613)	125,063
Less: 6655 Trust Funds Balances included in 6654	(29,659)
Less: 6655 Special Funds Balances included in 6654	(264)
Fund Balance Per Treasury	<u>\$ 86,922,093</u>

The Financial Management Service (FMS) 6653, which is the Undisbursed Appropriation Account Ledger, includes the current month's transactions and cumulative balances for any appropriation that had financial activity during the month. FMS 6653 is systematically interfaced with the Standard Accounting and Reporting System (STARS) for posting expenditure transactions. FMS 6654, which is the Undisbursed Appropriation Account Trial Balance, includes any activity and the cumulative balances for all appropriations regardless of whether they had activity for the month. Since the FMS 6654 is all-inclusive, this report is used to calculate FBWT. FMS 6655 is the Receipt Account Trial Balance.

#### 4. Other Information

##### **Fluctuation and/or Abnormalities**

Appropriated funds (Line 1.A) increased by \$3,389,242 thousand, 4 percent. This increase is in line with the 6 percent increase in appropriations received.

The only DON Revolving Fund (Line 1.B) is the National Defense Sealift Fund, Navy. The increase of \$477,416 thousand, 24 percent, is a result of additional funding to cover the increase in approved stabilized rates for the Surge Program and the hospital ship program, and for construction of combat logistics ships.

The Trust Fund balance (Line 1.C) decreased \$3,681 thousand, 20 percent, primarily due to a construction project capital outlay at the Naval Academy.

Special Funds (Line 1.E) increased by \$2,984 thousand, 100 percent,. This line includes the 5000 series of Treasury accounts. Amounts were reclassified from Other Fund Types (Line 1.E).

Other Fund types (Line 1.E) increased by \$119,330 thousand, 53 percent. Included in this line are the Treasury Suspense and Clearing accounts. There were substantial efforts to clear negative balances, primarily in Disbursing Officers suspense account 3885 and Interfund/IPAC suspense account 3875.

##### **Information Related to Fund Balance with Treasury**

##### **Other Disclosures**

###### Check Issue Discrepancies.

To deal with reconciliation of check issue discrepancies and deposit differences that are aged 90 days or greater, the following actions are being taken: (1) follow-up action with disbursing officers on the status of their resolving transactions listed on their statement of differences; (2) weekly teleconferences with the field sites and site visits, and (3) improving training.

###### Deposits Differences.

Deposit Statements of Difference result when the deposit amount reported by the Disbursing Office on its monthly Statement of Accountability submission to the Department of the Treasury does not equal the amount of deposit information reported by the banking network to the Department of the Treasury for the monthly period.

###### Intragovernmental Payments and Collections.

The Intragovernmental Payment and Collections (IPAC) Statements of Difference result when the amount reported by the Disbursing Office on its monthly Statement of Accountability report to the Department of the Treasury does not equal the amount of the details reported through the Treasury's IPAC system, which is one of the major components of the Government On-Line Accounting Link System II (GOALS II). The IPAC application's primary purpose is to provide a standardized interagency fund transfer mechanism for Federal Program Agencies (FPAs). IPAC facilitates the intragovernmental transfer of funds, with descriptive data from one FPA to another.

##### **Reference**

See Note Disclosure 1.I. - Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Funds with the U.S. Treasury.

See Note 2, Nonentity Assets for further discussions on Fund Balance with Treasury.



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For regulatory discussion on Fund Balance with Treasury, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

Status of Fund Balance With Treasury				
As of September 30,	2005		2004	
<i>(Amounts in thousands)</i>				
<b>1. Unobligated Balance</b>				
A. Available	\$	15,607,505	\$	16,336,308
B. Unavailable		1,520,974		1,691,688
<b>2. Obligated Balance Not Yet Disbursed</b>		72,093,187		67,196,764
<b>3. Non-Budgetary FBWT</b>	\$	267,741		219,095
<b>4. Non-FBWT Budgetary Accounts</b>		(3,410,202)		(3,349,942)
<b>5. Total</b>	\$	<u>86,079,205</u>	\$	<u>82,093,913</u>

### Other Information Related to Status of Fund Balance With Treasury

#### Fluctuation and/or Abnormalities

Unobligated, Available represents budget authority that is currently available for new obligations. Unobligated, Available (Line 1.A) decreased \$728,803 thousand, 4 percent, in FY 2005. Unobligated, Unavailable represents budget authority that is expired and not generally available for new obligations. Unobligated, Unavailable (Line 1.B) decreased \$170,714 thousand, 10 percent, in FY 2005. Line 5, Total Fund Balance with Treasury, increased \$3,985,292 thousand, 5 percent, in line with the increase in appropriations received and prior year unobligated balances brought forward.

#### Other Disclosures

Unobligated, Available includes annual funds that are subject to the quarterly apportionment rule. They will become available for obligation in subsequent periods as they are apportioned. Generally, unless special multi-year annual funds have been received via supplemental appropriations, there are no Unobligated, Available funds at year-end. For FY 2005, there are no annual funds subject to subsequent period apportionment.

Disclosures Related to Suspense/Budget Clearing Accounts				
As of September 30,	2003	2004	2005	(Decrease)/ Increase from FY 2004 to 2005
<i>(Amounts in thousands)</i>				
<b>Account</b>				
F3875	\$ (262,678)	\$ (253,211)	\$ (27,725)	\$ 225,486
F3880	(3,631)	2,453	3,946	1,493
F3882	(4,172)	(37,698)	32,891	70,589
F3885	(412,370)	(133,156)	(53,025)	80,131
F3886	(2)	9	429	420
<b>Total</b>	\$ (682,853)	\$ (421,603)	\$ (43,484)	\$ 378,119

**Other Disclosures**

Other Information Related to Suspense/Budget Clearing Account.

The DON, in conjunction with DFAS, has made a concerted effort to reduce balances in the suspense and budget clearing accounts as evidenced by the reductions disclosed in the table above. Additionally, the DON is establishing policies and procedures to ensure accurate and consistent use of these accounts.

The suspense accounts F3875/3885/3886 temporarily hold collections or disbursements until they can be assigned or identified to the proper appropriation. Each suspense account represents a specific source of transactions, i.e. Disbursing Officer's (DO) suspense (F3875), Interfund/IPAC (F3885), and Payroll (TSP) (F3886) suspense.

Clearance of Treasury Account Transactions.

Public Law 107-314, HR4546, Section 1009, "Clearance of Certain Transactions Recorded in Treasury Suspense Accounts and Resolution of Certain Check Issuance Discrepancies" issued December 2, 2002 allows for the cancellation of certain transactions. In order for transactions to qualify for cancellation, there must have been efforts made to locate documentation necessary to identify the appropriation to be charged or credited.

In FY 2005, \$95,601 thousand net and \$135,426 thousand absolute value were cancelled in accordance with this legislation.

**Definitions**

Absolute Value is the sum of the positive values of debit and credit transactions without regard to the sign.

**Note Reference**

See Note Disclosure 1.I. Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Funds with the U.S. Treasury.

**Disclosures Related to Problem Disbursements and In-transit Disbursements**

As of September 30, <i>(Amounts in thousands)</i>	2003	2004	2005	(Decrease)/ Increase from 2004 to 2005
<b>1. Total Problem Disbursements, Absolute Value</b>				
A. Unmatched Disbursements (UMDS)	\$ 144,000	\$ 183,570	\$ 1,313,996	\$ 1,130,426
B. Negative Unliquidated Obligations (NULO)	42,000	32,110	17,086	(15,024)
<b>2. Total In-transit Disbursements, Net</b>	\$ (11,621)	\$ (23,714)	\$ 857,860	\$ 881,574

**Definitions**

Unmatched Disbursements.

Unmatched Disbursements (UMDs) occur when payments do not match to a corresponding obligation in the accounting system.

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### Negative Unliquidated Obligations.

Negative Unliquidated Obligations (NULOs) occur when payments have a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments use available funds for valid receiving reports on delivered goods and services under valid contracts.

### In-Transit Disbursements, Net.

In-Transit Disbursements, Net represents the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity but not yet posted in an accounting system. Of the \$857,860 thousand reported for DON General Fund, \$54,487 thousand, 6 percent, is over 30 days old.

### **Other Disclosures**

UMDs, NULOs, and In-transit Disbursements, Net represent disbursements of DON funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. For the most part, these payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts. The elimination of both Problem Disbursements and In-transits is one of the highest financial management priorities of the OUSD(C). Problem Disbursements and In-transits represent a significant financial management concern since: (1) accuracy of accounting reports is affected; (2) availability of funds is more difficult to determine, and (3) the required research and resolution process becomes much more labor intensive as the age of the problem disbursements increase. As a result, the DON has efforts underway to improve the systems and to resolve all previous problem disbursements and process all in-transit disbursements.

In 2nd Quarter FY 2005, DFAS-Cleveland expanded the scope of the definition of a UMD. Formerly, transactions that had not yet reached an accounting station were defined as undistributed. Now these transactions are being defined as an UMD. This change in practice is the primary driver behind the \$1,130,426 thousand increase reported in UMDs.

## **NOTE 4. INVESTMENTS AND RELATED INTEREST**

As of September 30, (Amounts in thousands)	2005					2004
	Par Value/Cost	Amortization Method	Unamortized (Premium/Discount)	Investments, Net	Market Value Disclosure	Investments, Net
<b>1. Intragovernmental Securities:</b>						
A. Non-Marketable, Market-Based	\$ 9,421	N/A	\$ (2)	\$ 9,419	\$ 9,419	\$ 9,409
B. Accrued Interest	100		0	100	100	48
C. Total Intragovernmental Securities	\$ 9,521		\$ (2)	\$ 9,519	\$ 9,519	\$ 9,457
<b>2. Other Investments:</b>	None					

**Fluctuation and/or Abnormalities**

The DON reported an increase of \$52 thousand, 108 percent, in Accrued Interest. This increase is reflective of the increase in interest rates over the past twelve months.

**Other Disclosures**

The two DON Trust Funds holding interest-bearing securities are the Naval Academy General Gift Fund and the Navy General Gift Fund, which have a total Investment net value of \$9,519 thousand (including \$100 thousand of accrued interest). These investments are Non-Marketable Market-Based securities reported at cost, net of amortized premiums and discounts.

**Reference**

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

For regulatory discussion on Investments, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**NOTE 5. ACCOUNTS RECEIVABLE**

	2005			2004
	Gross Amount Due	Allowance For Doubtful Accounts	Accounts Receivable, Net	Accounts Receivable, Net
<b>As of September 30.</b> <i>(Amounts in thousands)</i>				
<b>1. Intragovernmental Receivables</b>	\$ 281,304	N/A	\$ 281,304	\$ 250,703
<b>2. Nonfederal Receivables (From the Public):</b>	\$ 3,278,967	\$ (11,310)	\$ 3,267,657	\$ 2,895,966
<b>3. Total Accounts Receivable:</b>	\$ 3,560,271	\$ (11,310)	\$ 3,548,961	\$ 3,146,669

**Information Related to Accounts Receivable**

**Fluctuation and/or Abnormalities**

Intragovernmental Receivables.

The DON reported an increase of \$30,601 thousand, 12 percent, in Intragovernmental Receivables in FY 2005. The majority of the increase was due to a \$54,078 thousand increase with the Department of Homeland Security (Level One).

The increase was offset by the following trading partners:

Trading Partner	Level	Amounts (in thousands)
Other Defense Organizations General Funds	Two	\$15,173
Other Defense Organizations Working Capital Funds	Two	7,586

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The DON General Fund (GF) acts as a seller of goods and services to other Federal agencies (DON GF's Level One trading partners) and other organizations within DoD (DON GF's Level Two trading partners). Receipt of customer orders, the resulting billing of receivables, and the collection of those receivables from other agencies, does not consistently follow a predictable pattern. This revenue cycle is subject to the business conditions and requirements of DON's trading partners. The value of accounts receivable is also subject to the processes used for billing and collection.

After Hurricane Katrina devastated the Gulf Coast, the Federal Emergency Management Agency (FEMA), an agency under the Department of Homeland Security, requested assistance from the Department of Defense, via the Joint Chiefs of Staff, for humanitarian relief efforts. As of September 30, 2005, the DON has recognized approximately \$60 million in customer orders from FEMA related to Hurricane Katrina. These orders were for diverse missions such as helicopter search and rescue operations, medical assistance provided by the hospital ship USNS Comfort, and food, water, and other supplies. When invoices are rendered to FEMA, and collections are received and posted to the appropriate customer orders, the intragovernmental receivables related to FEMA will be liquidated.

### Nonfederal Receivables.

Nonfederal receivables increased \$371,691 thousand, 13 percent, primarily as a result of a change in the Allowance Method used. See discussion below. Also, an increase in accrued interest of \$59,164 thousand related to litigation was recognized.

### **Allowance Method**

Based upon an extensive analysis of historic Treasury Report on Receivables (TROR) data, DON revised the methodology for determining the allowance for estimated doubtful accounts receivable in FY 2005. The allowance for FY 2005 is \$11,310 thousand. For comparison purposes, the allowance in FY 2004 was \$307,659 thousand. This change in estimated doubtful accounts added \$296,349 thousand to nonfederal receivables.

### **Intragovernmental Accounts Receivable Adjustments**

#### Allocation of Undistributed Collections.

Undistributed collections are allocated between federal and nonfederal categories based on the percentage of federal and nonfederal Accounts Receivable as submitted in the field level general ledgers. This allocation was suggested as appropriate in a DFAS Arlington memorandum dated October 4, 2000, which required disclosure to the audit community of the applicable methodology used to allocate undistributed. For FY 2005 \$388,077 thousand in undistributed collections was allocated to accounts receivable.

#### Elimination Adjustments.

The DON's accounting systems do not consistently capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the DON was unable to reconcile intragovernmental accounts receivable balances with its trading partners. Through the ongoing Business Management Modernization Program (BMMP), the Department intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations. The Intragovernmental Transaction System (IGTS) is one solution being designed to address the Trading Partner elimination issue.

Intrafund transactions are eliminated based upon trading partner information obtained from the Naval Personnel Command, the Standard Accounting and Reporting System - Field Level (STARS-FL), and the Standard Accounting and Reporting System - Headquarters Module (STARS-HQ). The elimination data obtained from these systems included seller appropriation, grantor (buyer) appropriation, grantor subhead, grantor code, reimbursable source code, accounts receivable, revenue, unearned revenue, and amount collected.

**Other Disclosures**

Nonfederal Receivables (from the Public) includes nonentity nonfederal account receivables and entity nonfederal account receivables.

Nonentity Nonfederal Accounts Receivables (from the Public) includes the following:

As of September 30, 2005	
<i>(Amounts in thousands)</i>	
Contract Litigation Principal and Interest	\$ 2,521,400
CDS/MOCAS system debts	11,311
Penalties, Fines and Admin. Fees and Interest	6,913
Gross Nonentity Nonfederal A/F	<u>\$ 2,539,624</u>
Less Allowance	<u>(637)</u>
Nonentity Nonfederal Receivables, Net	\$ 2,538,987
Entity Nonfederal Receivables, Net	<u>728,670</u>
Nonfederal Receivables (From the Public), Net	<u><u>\$ 3,267,657</u></u>

The contract litigation includes principal of \$1,333,494 thousand, and accrued interest receivable of \$1,187,906 thousand, which represents an increase in accrued interest of \$59,164 thousand from FY 2004.

**Definitions of debt system acronyms:**

CDS is the Contractor Debt System that manages debts owed by contractors.

MOCAS is the Mechanization of Contract Administration System that manages debts owed by contractors.

Entity accounts.

Assets that the DON has the authority to use or that management is legally obligated to use to meet entity obligations.

Nonentity accounts.

Assets held by an entity, but are not available for use in the operations of the entity.

Abnormal Account Balances.

Abnormal Accounts Receivable balances may occur for two primary reasons: 1) the application of undistributed collections and 2) as a result of the intragovernmental transaction elimination process. DFAS Arlington provided guidance in a memorandum dated March 1, 2001 to record accruals, for financial statement presentation purposes, to correct abnormal balances resulting from these conditions.

In accordance with the DoD FMR, Volume 6B, Chapter 13, adjustments are recorded, at the appropriation level, to bring the DON's intragovernmental accounts receivable into agreement with its trading partners' intragovernmental accounts payable.

**Reference**

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

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For regulatory discussion on Accounts Receivable, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

See Note Disclosure 1.Y - Undistributed Disbursements and Collections for the definition of Undistributed Collections.

### NOTE 6. OTHER ASSETS

As of September 30, (Amounts in thousands)	2005	2004
<b>1. Intragovernmental Other Assets:</b>		
A. Advances and Prepayments	\$ 672,257	\$ 272,723
B. Total Intragovernmental Other Assets	<u>\$ 672,257</u>	<u>\$ 272,723</u>
<b>2. Nonfederal Other Assets:</b>		
A. Outstanding Contract Financing Payments	\$ 6,859,367	\$ 4,694,420
B. Other Assets (With the Public)	129,424	305,928
C. Total Nonfederal Other Assets	<u>\$ 6,988,791</u>	<u>\$ 5,000,348</u>
<b>3. Total Other Assets:</b>	<u><u>\$ 7,661,048</u></u>	<u><u>\$ 5,273,071</u></u>

#### 4. Other Information:

##### Fluctuation and/or Abnormalities

###### Intragovernmental Other Assets.

The DON reported an increase of \$399,534 thousand, 146 percent, in Advances and Prepayments, (Line 1.A), in FY 2005. The balances reported are determined by the Intragovernmental elimination process as submitted by DON's trading partners. In processing the elimination data, increases to Advances and Prepayments are recorded to compensate for the unresolved differences when needed. Furthermore, using historical data as a baseline, DON recorded an overall Level One estimate for advances in the amount of \$357,464 thousand.

Increase - The majority of the increase was with the following trading partners:

<u>Trading Partner</u>	<u>Level</u>	<u>Amounts (in thousands)</u>
Navy Working Capital Fund	Two	\$180,959
Department of Transportation	One	95,578
Department of Interior	One	40,209
Office of Personnel Management	One	33,830

###### Nonfederal Other Assets.

###### Outstanding Contract Financing Payments.

DON reported an increase of \$2,164,947 thousand, 46 percent, in Outstanding Contract Financing Payments (Line 2.A) in FY 2005.

Increase - The majority of the increase was in the following programs:

<u>Program</u>	<u>Amounts (in thousands)</u>
Aircraft Procurement	\$1,463,711
Weapons Procurement	291,875

Other Assets (With the Public).

DON reported a decrease of \$176,504 thousand, 58 percent, in Other Assets (With the Public) (Line 2.B.) in FY 2005. \$148,253 thousand in Marine Corps Procurement advances to contractors has been reclassified to Outstanding Contract Financing Payments per an audit recommendation. Travel advances in the Navy Military Personnel accounts decreased by \$30,174 thousand, 33 percent.

**Information Related to Other Assets**

**Other Disclosures**

Intragovernmental Other Assets - Advances and Prepayment.

The buyer-side advances to others amounts were adjusted to agree with seller-side advances from others on the books of other DoD reporting entities (Level Two trading partners). Additionally, the buyer-side prepayment balances were adjusted to agree with seller-side deferred credits on the books of other DoD reporting entities. Advances and prepayments to Other Federal Agencies (Level One trading partners) were estimated since DON accounting systems are unable to identify the agency that is being advanced money from the buyer side perspective. The estimates were based upon historical trading partner data obtained from the Intragovernmental Review and Analysis System (IRAS).

Nonfederal Other Assets - Outstanding Contract Financing Payments.

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

The following table displays the Outstanding Contract Financing Payments attributed by program. Of note for FY 2005 is an increase of \$1,463,711 thousand, 50 percent, in the Aircraft Procurement program, primarily related to the V-22 Osprey and F/A-18 Hornet programs, and 291,875 thousand, 41 percent, in the Weapons Procurement account related to the requirement to replenish stocks of weapons and ammunitions.

As of September 30, 2005	
<i>(Amounts in thousands)</i>	
Aircraft Procurement	\$ 4,378,635
Shipbuilding and Conversion	270,777
Weapons Procurement	1,002,682
Procurement, Marine Corps	274,754
Other Procurement	793,293
Other (O&M, RDT&E)	139,226
Total	\$ 6,859,367



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### Reference

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

For regulatory discussion on Other Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

### NOTE 7. CASH AND OTHER MONETARY ASSETS

As of September 30, (Amounts in thousands)	2005	2004
1. Cash	\$ 201,999	\$ 232,946
2. Foreign Currency (non-purchased)	103,441	1,919
3. Total Cash, Foreign Currency, & Other Monetary Assets	\$ 305,440	\$ 234,865

#### Fluctuation and/or Abnormalities

The overall increase of \$70,575 thousand, 30 percent, in Total Cash (Line 3) is reflective of an increase of \$101,522 thousand in Foreign Currency (Line 2) related to the Marine Corps Expeditionary Forces, Camp Lejeune, depositing money into a Limited Depository Account. This Limited Depository Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds. The increase in Foreign Currency was offset by a decrease of \$30,947 thousand, 13 percent, in Cash held by various Disbursing Officers.

#### Definitions

Cash - the total of cash resources under the control of the DON, which includes coin, paper currency, purchased foreign currency, negotiable instruments, and amounts on deposit in banks and other financial institutions. Cash available for agency use should include petty cash funds and cash held in revolving funds, which will not be transferred into the U.S. Government General Fund.

Foreign Currency - consists of the total U.S. dollar equivalent of non-purchased foreign currencies held in foreign currency fund accounts. Non-purchased foreign currency is limited to the Treasury Index 97X7000 fund account (formerly called FT accounts).

Other Monetary Assets - includes gold, special drawing rights, and U.S. Reserves in the International Monetary Fund. This category is principally for use by the Department of the Treasury.

Restriction on Cash - all cash and other monetary assets reported are classified as nonentity, which means that the assets are not available for the DON's use in normal operations.

#### Other Disclosures

Cash and Foreign Currency reported consists primarily of cash held by Disbursing Officers to carry out their payment, collection, and foreign currency accommodation exchange mission. The primary source of the amounts reported is the Standard Form 1219, Statement of Accountability reported by DoD Disbursing Officers.

The DON translates foreign currency to U.S. dollars utilizing the Department of the Treasury Prevailing Rate of Exchange. This rate is the most favorable rate that would legally be available to the U.S. Government's acquisition of foreign currency for its official disbursement and accommodation of exchange transactions.

**Reference**

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

For regulatory discussion on Cash and Other Monetary Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**NOTE 8. DIRECT LOAN AND/OR LOAN GUARANTEE PROGRAMS**

Not Applicable.

**NOTE 9. INVENTORY AND RELATED PROPERTY**

Operating Materials and Supplies, Net					
As of September 30, (Amounts in thousands)	2005			2004	Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	
<b>1. OM&amp;S Categories:</b>					
A. Held for Use	\$ 51,202,582	\$ 0	\$ 51,202,582	\$ 49,608,556	LAC, MAC, SP, AC, O
B. Held for Repair	6,490,388	(2,108,133)	4,382,255	3,732,111	LAC, MAC, SP, AC, O
C. Excess, Obsolete, and Unserviceable	1,227,767	(1,227,767)	0	0	NRV
D. Total	<u>\$ 58,920,737</u>	<u>\$ (3,335,900)</u>	<u>\$ 55,584,837</u>	<u>\$ 53,340,667</u>	

**Legend for Valuation Methods:**

SP = Standard Price                      NRV = Net Realizable Value  
 AC = Actual Cost                        O = Other  
 MAC = Moving Average Cost        Adjusted LAC = Latest Acquisition Cost adjusted for holding gains

**2. Restrictions on Operating Materials and Supplies (OM&S): None**

**3. Other Information Related to Operating Materials and Supplies**

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### Fluctuation and/or Abnormalities

The DON reported an increase of \$650,144 thousand, 17 percent, for OM&S, Held for Repair (Line 1.B) in FY 2005. The majority of the increase is due to:

- Increase of \$471,986 thousand in Sponsor Owned Material (SOM) Held for Repair
- Gains and losses in physical inventory
- Price adjustments in revaluation allowance for OM&S Held for Repair

### Information Related to Operating Material and Supplies, Net

General Composition of Operating Materials and Supplies (OM&S).

OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The general composition of OM&S is as follows:

	As of September 30, 2005
<i>(Amounts in thousands)</i>	
Ammunition and Munitions	\$ 33,312,811
Appropriation Purchase Account (APA)	
Principal End Item	8,679,424
Sponsor Owned Material	10,493,632
APA Secondary Inventory	1,131,140
Real-time Reutilization Asset	
Management (RRAM)	1,583,393
Other	384,437
Total	<u>\$ 55,584,837</u>

### Balances.

In addition to the account balances shown in Table 9.B., the Statement of Federal Financial Accounting Standards (SFFAS) No. 3 "Accounting For Inventory and Related Property" requires disclosure of the amount of OM&S held for "Future Use." This information is not captured by current OM&S systems which were designed for material management rather than accounting purposes.

### Decision Criteria For Identifying The Category To Which Operating Materials And Supplies Are Assigned.

In order to standardize reporting of the categories Held for Use, Held for Repair, and Excess, Obsolete, Unserviceable, DON implemented the Under Secretary of Defense (Comptroller) (USD(C)) condition code crosswalk as defined in the memorandum "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies" dated August 12, 2002. In addition, the condition code crosswalk was amended to include code "V" in the Excess, Obsolete, Unserviceable category in September 2002. OM&S was reported as follows:

OM&S Category	Condition Codes
Held for Use	A, B, C, D
Held for Repair	E, F, G, J, K, L, M, N, R
Excess, Obsolete, Unserviceable	P, H, S, V

Valuation Method for OM&S.

On July 6, 2001, the OUSD(C) issued a memo requiring Moving Average Cost (MAC) as the approved valuation method for Inventory Held for Sale and Operating Materials and Supplies. "Each Military Department and Defense Agency responsible for material amounts of inventory or operating materials and supplies shall implement the moving average cost valuation method as systems are renovated or replaced." The DON is participating in the DoD Business Management Modernization Program that is currently reviewing and designing the Business Enterprise Architecture (BEA). The BEA provides for a master plan that includes guidance on transition plan strategy concepts, considerations, processes, and principles. MAC will be implemented as systems are renovated or replaced. Until then, the DON continues to value OM&S using different valuation methodologies such as standard purchase price or actual cost. These valuation methodologies vary by system.

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

Generally, the value of the DON's GFM and CAM in the hands of contractors is not included in the OM&S values reported above. DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in other existing logistics systems.

**Other Disclosures**

Ammunition and Munitions.

Ammunition and Munitions are maintained and valued in the Conventional Ammunition Integrated Management System Open System Environment (CAIMS-OSE).

APA Principal End Items.

Principal End Items includes OM&S items such as shipboard hull, mechanical and electronic equipment, and uninstalled aircraft engines. Principal End Items are items of such importance that central inventory control is required. They normally possess one of the following characteristics: (a) essential for combat or training; (b) high dollar value; (c) difficult to procure or produce; or (d) critical basic materials or components.

Sponsor Owned Material (SOM).

SOM is defined as "programmatic material required in support of Program Manager mission requirements for production, life cycle maintenance, and installation of systems and equipment consistent with the mission charter". The material usage may involve, but is not limited to: item fabrication, assembly, testing, manufacture, development, repair, or research and development.

Real-time Reutilization Asset Management (RRAM).

Material maintained and valued in RRAM is considered excess to the owner, but may not be excess to the Navy. Standard price is used to value all stock-numbered items. Part-numbered items are valued by best available information.

Other Operating Materials & Supplies.

Other OM&S totaled \$384,437 thousand as of FY 2005. The majority of Other OM&S consists of \$330,295 thousand in Fleet Hospitals and \$43,471 thousand in materials for War Reserves in possession of the U.S. Coast Guard. During FY 2005, \$53,014 thousand of Civil Engineering Support Equipment was issued from the Fleet Hospital and War Reserve program, which accounts for the decrease in the overall value of the Other OM&S on hand.

**Reference**

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

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For regulatory discussion on OM&S, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

### NOTE 10. GENERAL PP&E, NET

	2005					2004
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Net Book Value
As of September 30, (Amounts in thousands)						
<b>1. Major Asset Classes:</b>						
A. Land	N/A	N/A	\$ 616,579	N/A	\$ 616,579	\$ 567,889
Facilities	S/L	20 - 40	35,398,692	\$ (21,295,949)	14,102,743	12,853,775
C. Leasehold Improvements	S/L	lease term	7514	(384)	7,130	210
D. Software	S/L	2-5 Or 10	3,071	(2,866)	205	1,949
E. General Equipment	S/L	5 Or 10	2,618,492	(2,123,230)	495,262	517,749
F. Military Equipment	S/L	Various	447,870,000	(307,590,000)	140,280,000	134,130,000
Lease <sup>[1]</sup>	S/L	lease term	0	0	0	202
H. Construction-in-Progress	N/A	N/A	2,826,928	N/A	2,826,928	3,607,729
I. Other			0	0	0	0
<b>2. Total General PP&amp;E</b>			<b>\$ 489,341,276</b>	<b>\$ (331,012,429)</b>	<b>\$ 158,328,847</b>	<b>\$ 151,679,503</b>

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

Legend for Valuation Methods:

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

#### Fluctuation and/or Abnormalities

##### Land.

The increase of \$48,690 thousand, 9 percent, in land in FY 2005 is attributed to two factors: DON purchasing additional acreage at the Marine Corps Logistics Base (MCLB), Albany, Georgia and at the MCLB site at Blount Island, Jacksonville, Florida; and the recognition in FY 2005 of previously unreported land rights and condemned land.

##### Buildings, Structures and Facilities.

The increase of \$1,248,968 thousand, 10 percent, in buildings, structures, and facilities in FY 2005 is attributed to several large military construction projects being completed prior to the projected date due to positive weather conditions.

While positive weather conditions facilitated military projects being completed earlier than scheduled, Hurricanes Katrina and Rita caused damage to real property at several DON installations. Department of the Navy Damage Assessment Teams consisting of structural and mechanical engineers, architects, roofing specialists and construction contract specialists were deployed to the Gulf Coast area of the United States to assess damage caused by Hurricanes Katrina and Rita.

The DON Damage Assessment Teams are providing support to local facilities management teams. Among the installations that the DON Damage Assessment Teams are providing engineering damage assessment are Naval Air Station/Joint Reserve Base New Orleans; Naval Support Activity New Orleans; Naval Station Gulfport, Mississippi; Naval Station Pascagoula, Mississippi; and Stennis Space Center, Mississippi. The DON Damage Assessment Teams will deal with three broad categories of buildings, structures, and utilities: (1) facilities that only have cosmetic/minor damage and therefore repair costs; (2) facilities that have major damage that it makes more economic sense to build new rather than repair and therefore new military construction; and (3) structures that have significant damage, but it makes more economic sense to repair them than to build new and therefore capitalized improvements. Once the assessments are completed and decisions are made, over time the values of the buildings, structures, and utilities on the financial statements will either increase due to new construction and capital improvements or values adjusted downward because they were demolished by the Hurricanes and/or require demolition.

Leasehold Improvements.

The DON reported an increase of \$6,920 thousand, 3,295 percent, in Leasehold Improvements in FY 2005. The increase is due to the Office of Naval Research relocating to newly leased space, where major improvements were made to the site to accommodate their operations.

Software.

The DON reported a decrease of \$1,744 thousand, 89 percent, in Software in FY 2005. The decrease is due to recognizing accumulated depreciation for the first time plus current depreciation.

Assets Under Capital Lease.

The DON reported a decrease of \$202 thousand, 100 percent, in Capital Leases, net in FY 2005. The decrease is due to the expiration of three leases during FY 2005.

Construction-in-Progress (CIP).

The DON reported a decrease of \$780,801 thousand, 22 percent, in CIP, net in FY 2005. This decrease is a result of the completion of a large number of projects since year-end FY 2004. Some of the projects include:

		Cost of Project
<i>(Amounts in thousands)</i>		
<b>Project</b>		
JTF Military Command Complex	\$	48,100
Bachelor Enlisted Quarters Congress		47,240
Berthing Wharf-Phase 1 Congress		40,760

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

Military Equipment.

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards No. 23, Eliminating the Category National Defense Property, Plant, and Equipment, in May 2003. This standard, which is effective for accounting periods beginning after September 30, 2002, establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

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The Department of Defense (DoD) has determined that it is not practicable at this time to accumulate from internal records the information necessary to value military equipment in accordance with generally accepted accounting principles, because DoD is currently working to revise its accounting processes and systems to support the informational needs of management and compliance with generally accepted accounting principles. In the interim, DoD will base the value of military equipment for financial statement presentation purposes on data provided by the Bureau of Economic Analysis (BEA), Department of Commerce.

The data provided by BEA consists of investment and net book valuation data for 84 groups of equipment such as aircraft, ships and combat vehicles. BEA uses DoD budget, expenditure, and delivery data to calculate DoD's annual investment in equipment, after recognizing any equipment transfers or war losses. The DoD adjusts BEA data to eliminate equipment items that are not accounted for as military equipment, such as spares, munitions, and inventory items, which are accounted for and reported as Inventory and Related Property.

The DoD is completing a project to value military equipment in accordance with generally accepted accounting principles. The DoD will complete this project in Fiscal Year 2006 at which time the DoD will discontinue use of BEA information and report military equipment in accordance with the foregoing principles.

For the DON, the BEA analysis provided for an Acquisition value of \$447,870,000 thousand for military equipment, less an Accumulated Depreciation value of \$307,590,000 thousand giving a Net Book Value of \$140,280,000 thousand for military equipment as of FY 2005.

### Property in the Possession of Contractors.

The value of the DON's General PP&E real property in the possession of contractors is included in the values reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E above the DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. Per the DoD FMR Volume 6B Chapter 10, DON is not supplementing General PP&E information with values from the Defense Contract Management Agency's CPMS (DD Form 1662) database. In accordance with an approved strategy with OMB, the GAO and the Inspector General, DoD, the DoD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with Federal GAAP.

### **Other Disclosures**

#### Real Property.

The Internet Naval Facility Asset Database Store (iNFADS) provides real property values for financial statement reporting purposes.

#### Leasehold Improvements.

The DON's real property system (iNFADS) does not track leasehold improvements as a separate component of a building's total value. However, the DON is surveying commands to determine the value of leasehold improvements and began recognizing those values in 3rd Quarter FY 2004.

#### Software.

The DON uses the Defense Property Accountability System (DPAS) to capture costs associated with Internal Use Software.

#### Construction-in-Progress (CIP).

CIP balances were obtained from the Facilities Information System (FIS). Data on construction that is performed for

the benefit of non-DON customers, such as Air Force and several of the Defense Agencies, is provided to Air Force, the Defense Agencies, and the Defense Finance and Accounting Service; such work for others is not included in DON CIP balances.

**Preponderant Use.**

Per the DoD FMR, Volume 4, Chapter 6, legal ownership is not always the determinant factor when establishing which DoD Component recognizes a particular General PP&E asset for accounting and reporting purposes. If the following four criteria are met, the preponderant user should report the property regardless of legal ownership or funding source:

The asset embodies a probable future benefit;

The DoD Component that reports the asset obtains the benefit and controls access to the benefit inherent in the asset;

The transaction or event giving the Component the right to, and control over, the benefit has already occurred; and

The predominantly used assets, taken as a whole, are material to the Component's financial statements.

Per the Office of the Under Secretary of Defense (Comptroller) memo of July 5, 2005, the military departments and DoD activities meeting the criteria of preponderant user are responsible for reconciliation of preponderant use property. As reconciliations are completed and documented, DON General Fund will make the adjustments to the General Property, Plant and Equipment line.

**Reference**

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

For regulatory discussion on General PP&E, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

Assets Under Capital Lease		
As of September 30,	2005	2004
<i>(Amounts in thousands)</i>		
<b>1. Entity as Lessee, Assets Under Capital Lease:</b>		
A. Land and Buildings	\$ 0	\$ 0
B. Equipment	0	432
C. Other	0	0
D. Accumulated Amortization	0	(230)
E. Total Capital Leases	\$ 0	\$ 202

**2. Description of Lease Arrangements**

Leased assets consist primarily of personal property reported in the DPAS system. Disclosures pertaining to future payments due are provided at Note 15.

**3. Other Information Related to Assets Under Capital Lease**



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### Fluctuation and/or Abnormalities

The DON reported a decrease of \$202 thousand, 100 percent, in Equipment Leases, net in FY 2005. The decrease is due to the expiration of three leases during FY 2005.

### Reference

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

## NOTE 11. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30, (Amounts in thousands)	2005	2004
<b>1. Intragovernmental Liabilities:</b>		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	3,162,676	3,438,795
<b>D. Total Intragovernmental Liabilities</b>	<b>\$ 3,162,676</b>	<b>\$ 3,438,795</b>
<b>2. Nonfederal Liabilities:</b>		
A. Accounts Payable	\$ 28,049	\$ 89,472
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,532,819	1,575,816
C. Environmental Liabilities	16,513,000	16,031,979
D. Loan Guarantee Liability	0	0
E. Other Liabilities	3,550,457	3,478,823
<b>F. Total Nonfederal Liabilities</b>	<b>\$ 21,624,325</b>	<b>\$ 21,176,090</b>
<b>3. Total Liabilities Not Covered by Budgetary Resources:</b>	<b>\$ 24,787,001</b>	<b>\$ 24,614,885</b>
<b>4. Total Liabilities Covered by Budgetary Resources:</b>	<b>4,470,889</b>	<b>3,831,161</b>
<b>5. Total Liabilities</b>	<b>\$ 29,257,890</b>	<b>\$ 28,446,046</b>
<b>6. Other Information Related to Liabilities Not Covered by Budgetary Resources</b>		

### Fluctuation and/or Abnormalities

#### Intragovernmental Liabilities.

No fluctuation and/or abnormalities need to be explained.

#### Nonfederal Liabilities.

Accounts Payable (Line 2.A) The DON reported a decrease of \$61,423 thousand, 69 percent, in Accounts Payable, in FY 2005. The decrease is a result of a net of Accounts Receivable and Accounts Payable for the FY 2000 canceling year. The amounts recorded for Cancelled Year Accounts Payable are derived from the SF-133 Report on Budget Execution.

Unfunded leave, a component of Other Liabilities (Line 2.E) increased by \$186,887 thousand, 8 percent. Past practice was that an annual estimate was used for unfunded leave; now the accounting systems are beginning to update the estimate on a quarterly basis and thus the increase.

An explanation of fluctuations and abnormalities for Total Liabilities Covered by Budgetary Resources is included in the specific note for that liability. See Notes 12 through 17.

**Definitions**

Liabilities Covered by Budgetary Resources are those that are incurred by the reporting entity, which are covered by realized budgetary resources as of the balance sheet date. Budgetary resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year.

Realized budgetary resources include:

- New budget authority
- Spending authority from offsetting collections (credited to an appropriation or fund account)
- Recoveries of unexpired budget authority through downward adjustments of prior year obligations
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and
- Permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

Conversely, Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date. Budgetary Authority to satisfy these liabilities is expected to be provided in a future Defense Appropriations Act. When that future budgetary authority is provided, these respective liabilities will be recorded as Covered by Budgetary Resources with an associated funded expense. To prevent overstatement on the Balance Sheet and Statement of Net Cost, the liabilities previously recorded as Not Covered by Budgetary Resources and the associated unfunded expenses are reversed.

**Other Disclosures**

Intragovernmental Liabilities - Other (Not Covered by Budgetary Resources) (Line 1.C.) includes the following:

As of  
September 30, 2005

(Amounts in thousands)

Federal Employees	
Compensation Act (FECA)	\$ 554,282
Unemployment	69,338
Liabilities to Treasury	2,539,056
Total	<u>\$ 3,162,676</u>

**Liabilities to Treasury**

Unliquidated progress payments and associated accrued interest receivables for contractor debt in litigation is reported as an unfunded liability to Department of the Treasury. Collections on this debt will be due and payable to Treasury as the appropriations are in a cancelled status. See Notes 2 and 5 for further disclosure.

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Nonfederal Liabilities - Other (Not Covered by Budgetary Resources) (Line 2.E.) includes the following:

	As of September 30, 2005
<i>(Amounts in thousands)</i>	
Annual Leave	\$ 2,650,747
Capital Lease Liabilities	0
Military Equipment (Nonnuclear Nonenvironmental Disposal Liabilities)	665,022
Disposal Liabilities for Excess/Obsolete Structures	182,114
Contract Incentive	52,574
<b>Total</b>	<b>\$ 3,550,457</b>

### Reference

For additional line item discussion, see:

- Note 8, Direct Loans and/or Loan Guarantee Programs
- Note 12, Accounts Payable
- Note 13, Debt
- Note 14, Environmental Liabilities and Disposal Liabilities
- Note 15, Other Liabilities
- Note 16, Commitments and Contingencies
- Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities

## NOTE 12. ACCOUNTS PAYABLE

As of September 30,	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
<i>(Amounts in thousands)</i>				
<b>1. Intragovernmental Payables:</b>	\$ 1,208,702	N/A	\$ 1,208,702	\$ 1,437,616
<b>2. Nonfederal Payables (to the Public):</b>	1,180,033	0	1,180,033	1,395,008
<b>3. Total</b>	<b>\$ 2,388,735</b>	<b>\$ 0</b>	<b>\$ 2,388,735</b>	<b>\$ 2,832,624</b>

### 4. Other Information Related to Accounts Payable

#### Fluctuation and/or Abnormalities

##### Intragovernmental Payables.

The DON reported a decrease of \$228,913 thousand, 16 percent, in Intragovernmental payables in FY 2005. These balances are largely driven by the trading partner process. Upon receipt of accounts receivable data reported by our trading partners, DON records compensating accounts payable. For agencies that do not provide account receivable data, DON records accounts payable estimates based upon historical data. The total Level One Intragovernmental accounts payable amount recorded in FY 2005 was \$430,290 thousand.

Decrease - the majority of the decrease was with the following trading partners:

<u>Intragovernmental Entities</u>	<u>Level</u>	<u>Amounts (in thousands)</u>
Navy Working Capital Fund	Two	\$181,589
Other Defense Organizations		
Working Capital Funds	Two	128,605
General Services Administration	One	21,507

Increase - the decreases above were offset by increases with the following trading partners:

<u>Intragovernmental Entities</u>	<u>Level</u>	<u>Amounts (in thousands)</u>
Air Force General Fund	Two	\$38,423
Department of Transportation	One	36,728
Department of Treasury	One	35,520

To implement new Treasury guidance, Judgment Fund Liabilities were recorded as Accounts Payable beginning in FY 2005, rather than Other Liabilities. This change in policy added \$35,567 thousand to reported balances in Intragovernmental Payables.

Nonfederal Payables.

DON reported a decrease of \$214,975 thousand, 15 percent, in Nonfederal Accounts Payable in FY 2005. Payables, more than any other liability, are subject to the vagaries of the business cycle and variances from the previous reporting period are expected.

**Definitions**

Intragovernmental Accounts Payable.

This line consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Interest, penalties and administrative fees are not applicable to intragovernmental payables.

Nonfederal Payables (to the Public).

This line represents amounts owed to nonfederal government entities and individuals.

Undistributed Disbursements.

Undistributed Disbursements are the difference between disbursements recorded at the detailed level to a specific obligation or payable in the activity field records versus those reported by the Department of the Treasury. This should agree with the undistributed disbursements reported on monthly accounting reports. Generally, timing issues between systems cause undistributed disbursements. In-transit disbursements are payments that have been made by other agencies, entities, or systems that have not yet been recorded in the DON's accounting records. For FY 2005, total supported undistributed disbursements were \$2,678,771 thousand.

Intragovernmental Elimination.

Regarding inter-agency purchases; DON accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the DON was unable to fully reconcile intragovernmental accounts payable to the related intragovernmental accounts receivable, on another agencies' records that generated the payable.

Therefore, the DoD summary level seller accounts receivables were compared to the DON's accounts payable. An adjustment was posted to the DON's accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to the DON.

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DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished with existing or foreseeable resources. In the interim, DFAS is leading an effort to identify alternative means of capturing and recognizing buyer side trading partner data.

### Other Disclosures

#### Abnormal Account Balances.

Abnormal Accounts Payable balances may occur because 1) the DON does not consistently record Accounts Payable upon receipt and acceptance of goods and services; 2) the application of undistributed disbursements, and 3) as a result of the intragovernmental transaction elimination process. Per DoDFMR Vol. 6B, Ch. 13, when an abnormal balance is created, an adjustment to Accounts Payable and Expense should be made accordingly to recognize the shortfall.

Intragovernmental elimination adjustments are recorded at the component level, to bring the DON's intragovernmental accounts payable into agreement with its trading partners' intragovernmental accounts receivable. These elimination process adjustments may also result in abnormal accounts payable.

#### Judgment Fund Liabilities.

The DON must reimburse the Department of the Treasury for payments made from the Judgment Fund on its behalf. These payments are a result of claims being resolved under the Contracts Dispute Act. In addition, the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR) was implemented on Oct 1, 2003. This law requires all agencies to reimburse the Judgment Fund for cases covered by the No FEAR Act. For FY 2005, the DON reported \$263 thousand for No FEAR Act liabilities.

### Reference

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

## NOTE 13. DEBT

Not Applicable.

**NOTE 14. ENVIRONMENTAL LIABILITIES AND DISPOSAL LIABILITIES**

As of September 30, (Amounts in thousands)	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
<b>1. Environmental Liabilities - Nonfederal</b>				
A. Accrued Environmental Restoration (DERP funded) Cost:				
1. Active Installations--Environmental Restoration (EI)	\$ 272,906	\$ 2,393,610	\$ 2,666,516	\$ 2,841,462
2. Active Installations--ER for Closed Ranges	16,458	537,997	554,455	583,001
3. Formerly Used Defense Sites (FUDS) – ER	0	0	0	0
4. FUDS--ER for Transferred Ranges	0	0	0	0
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	0	0	0	0
2. Active Installations--Environmental Closure Requirements	0	0	0	0
3. Active Installations--Environ.Response at Active Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	200,588	878,668	1,079,256	1,110,652
2. BRAC Installations--ER for Transferring Ranges	2,699	62,537	65,236	55,781
3. BRAC Installations--Environmental Corrective Action	0	0	0	0
4. Other	0	0	0	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	6,426,100	6,426,100	5,693,000
2. Nuclear Powered Submarines	42,400	5,794,800	5,837,200	5,188,700
3. Other Nuclear Powered Ships	0	223,900	223,900	287,500
4. Other National Defense Weapons Systems	2,400	195,388	197,788	271,883
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	0	0	0
<b>2. Total Environmental Liabilities:</b>	<b>\$ 537,451</b>	<b>\$ 16,513,000</b>	<b>\$ 17,050,451</b>	<b>\$ 16,031,979</b>

**3. Other Information Related to Environmental Liabilities**

**Fluctuation and/or Abnormalities**

Base Realignment and Closure (BRAC).

DON reported a net increase of \$9,455 thousand, 17 percent, for BRAC Installations Environmental Restoration for Transferring Ranges (Line 1.C.2) in FY 2005. The majority of the net increase is attributed to:

- A net increase in the projects' cost to complete (CTC) estimates resulted in a \$11,489 thousand increase
- A \$99 thousand allocation from FY 2004 to the Munitions Response Program (MRP) program at BRAC installations for environmental restoration at transferring ranges
- The increase was offset by a decrease of \$2,133 thousand in program execution for FY 2005.

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### Environmental Disposal for Weapon Systems.

The DON reported an overall increase of \$733,100 thousand, 13 percent, for Nuclear Powered Aircraft Carriers (Line 1.D.1) in FY 2005. Two factors attributed to the increase in the liability estimate: (1) an increase in the labor rates; and (2) an increase in the cost of materials used in the disposal. The source for labor rates and cost of materials is the annual escalation guidance.

The DON reported an overall increase of \$648,500 thousand, 12 percent, for Nuclear Powered Submarines (Line 1.D.2) in FY 2005. Two factors attributed to the increase in the liability estimate: (1) an increase in the labor rates; and (2) an increase in the cost of materials used in the disposal. The source for labor rates and cost of materials is the annual escalation guidance.

For Other Nuclear Powered Ships (Line 1.D.3), there was an increase in labor rates and cost of materials used in the disposal however the increase was offset by an overall net decrease of \$63,600 thousand, 22 percent, in FY 2005. Two factors attributed to the decrease in the liability estimate: (1) annual review of estimates resulted in decreases in the estimates due to changing disposal methods from a single inactivation/reactor compartment disposal/hull recycling availability to separate inactivation and reactor compartment disposal/hull recycling availabilities and (2) program execution such as disposal of a California class cruiser.

For Other National Defense Weapons Disposal Program (Line 1.D.4) the DON reported an overall decrease of \$74,095 thousand, 27 percent, in FY 2005. The majority of the decrease was due to \$70,418 thousand for the Trident Missile disposal program being reclassified from an environmental disposal liability to a non-environmental disposal liability during this reporting period that is being reported in Note 15. This reclassification was based on a review of U.S. environmental laws, regulations and management decisions by the DON program office responsible for disposal of Trident Missile motors.

### **Additional Information Related to Environmental Liabilities**

Overall, the Department of the Navy has a reasonable level of confidence in the estimates recognized on the face of the financial statements. This reasonable level of confidence in the estimates is based on the fact that the estimates for DERP/BRAC programs are based on the Cost to Complete (CTC) module of the NORM System. A verification, validation, and accreditation was completed by a third party for the CTC module of NORM, while the environmental program managers continue to validate the data. For the Weapons systems, the environmental program managers base their environmental disposal estimates on actual costs for similar projects.

### Accrued Environmental Restoration (DERP Funded) Cost Liabilities.

The DON Environmental Restoration (Department of Defense Environmental Restoration Program) includes those sites that have been identified as legacy cleanup sites. For FY 2005, the DON estimated and reported \$3,220,971 thousand for environmental restoration liabilities. This amount is comprised of \$2,666,516 thousand in Active Installations - Environmental Restoration (ER) liabilities and \$554,455 thousand in Active Installations - ER for Closed Ranges, liabilities, which represents Unexploded Ordnance (UXO). The DoD FMR, Volume 6B, Chapter 10 requires that "any estimate produced must be based on site specific information and use cost models validated in accordance with DoD Instruction 5000.61." The DON is supporting this requirement by continuing to validate its range inventory as well as by pursuing the process of obtaining valid cost estimates for each range.

### Other Accrued Environmental Costs (Non-DERP funds).

The DON defines Non-DERP environmental sites as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retrofill, and/or disposal of PCB transformers, underground storage tank remedial investigation and closure. A component of the DON Financial Improvement Program is to survey, identify, estimate, and provide an inventory of Non-DERP sites

throughout the DON. The milestone for this action is to be completed by 4th Quarter FY 2006. The DON has a preliminary total liability of \$225,038 thousand; however, the DON is currently not reporting this amount within the General Fund financial statements until all the site data and estimates for the Non-DERP costs are completed.

Base Realignment and Closure (BRAC).

BRAC environmental sites are environmental sites at DON installations that are or will be closed under the Base Realignment and Closure process. For FY 2005, the DON estimated and reported \$1,144,492 thousand for BRAC funded environmental restoration liabilities. This amount includes \$1,079,256 thousand for environmental restoration (ER) and \$65,236 thousand for ER transferring ranges, which includes military munitions, chemical residues from military munitions, and munitions scrap at locations on or associated with a military range on a BRAC installation.

Environmental Disposal for Weapons Systems Programs.

Environmental Disposal for Weapon Systems are those estimates associated with the environmental disposal costs for the DON nuclear weapons programs that includes Nuclear Powered Aircraft Carriers, Nuclear Powered Submarines and Other Nuclear Powered Ships and conventional ships. The DON reported an environmental disposal liability for Weapons Systems Programs of \$12,684,988 thousand in FY 2005. This amount includes nuclear powered aircraft carriers of \$6,426,100 thousand, nuclear powered submarines of \$5,837,200 thousand, other nuclear powered ships of \$223,900 thousand and other national defense weapons systems of \$197,788 thousand.

**Methodology Used to Estimate Environmental Liabilities**

Accrued Environmental Restoration (DERP Funded) Costs.

Active Installations - Environmental Restoration (ER): Accrued restoration (cleanup) liabilities represent the cost to correct past environmental areas that are funded under the Defense Environmental Restoration Program in accordance with "Management Guidance for the DERP," and "Accrued Environmental Restoration (Cleanup) Liabilities," Chapter 14 of Volume 4 of the DoD FMR. These liabilities relate to PP&E, including acquired land and Stewardship Land, as those major asset categories are described in Chapter 6 of Volume 4 of the DoD FMR. Environmental restoration activities may be conducted at operating installations, at FUDS, at Closed, Transferred, and Transferring Ranges. Environmental restoration measurements involve the use of cost estimates that consider, on a current cost basis, the anticipated costs of the level of effort required to affect the restoration, as well as applicable legal and/or regulatory requirements. Program management and support costs are included in the estimates. The estimates are based on the DON's cost-to-complete (CTC) module of the DON Normalization of Data System (NORM). Certification of the CTC module was completed early in FY 2002. Such cost estimates are based on the current technology available. Site inventory and estimated cost data prepared for the DERP report to the Congress was used by the DON as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services). The Accrued Environmental Restoration (Cleanup) Costs do not include the costs of environmental compliance; pollution prevention, conservation activities, contamination or spills associated with current operations, or treaty obligations, all of which are accounted for as part of ongoing operations. The Department of the Navy's Environmental Restoration (ER, N) Program includes 3,692 clean-up sites while those installations covered by Base Realignment and Closure (BRAC) funding includes 1,057 clean-up sites.

Active Installations - Environmental Restoration For Closed Ranges: This represents the environmental liabilities associated with the identification, investigation and removal and remedial actions to address environmental contamination at ranges that were closed prior to September 30, 2002. The contamination may include munitions, chemical residues from military munitions and munitions scrap at ranges on active installations that pose a threat to human health or the environment. The amount reported is the portion of the liability that can be estimated based on site level investigations and characterizations. The estimate produced is based on site-specific information and uses cost models validated in accordance with DoD Instruction 5000.61, "DoD Modeling and Simulation (M&S)



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Verification, Validation, and Accreditation (VV&A)" of May 2003. Total liabilities (cost-to-complete) are not estimated until there is sufficient site-specific data available to estimate the total liability. Beginning in FY 2001, the Department began an inventory of closed ranges and transferring ranges under the Military Munitions Response Program (MMRP) or UXO program. The inventory was completed September 2002 and contains 208 closed ranges at active installations and 19 transferring ranges at BRAC sites.

### Additional Disclosures

To execute the DERP/BRAC environmental cleanup program, the DON contracts with environmental vendors to remediate legacy waste. Therefore, there are no DON direct expenditures to report for operating and capital expenditures for remediation of legacy waste.

The DON defines environmental cleanup associated with general property, plant, and equipment as Non-DERP. As part of the action of the DON Financial Improvement Program, the Department contracted with several environmental vendors to survey, estimate, and establish a database of DON sites associated with cleanup associated with general property, plant, and equipment. Therefore, the DON does not have any amount to report for the estimated and the unrecognized portion of the total estimated cleanup costs associated with general property, plant, and equipment for the current period and prior periods. The DON expects to have the estimates completed 4th Quarter, FY 2006.

For the Weapons Systems both current and prior periods, the changes in the estimates were a result of price growth such as increase in labor rates and an increase in the cost of materials used in disposal. However, approximately \$60,000 thousand decrease in environmental liability estimates for weapons systems was a result in a change in technology. Weapons systems disposal methods changed from a single inactivation/reactor compartment disposal/hull recycling availability to separate inactivation and reactor compartment disposal/hull recycling availabilities.

For the DERP/BRAC programs a survey data of the Department of the Navy Environmental Restoration Program cost estimate changes for sites that had over 10 percent change indicated diverse reasons for change in estimates. The reasons for changes include estimation changes (26 percent), regulatory changes (59 percent), and technical changes (15 percent). Reasons for changes in estimation are as follows: cost-to-complete (CTC) overlooked or previously unknown, better site characterization with sampling, cost avoidance rerun CTC, re-estimation based on different assumptions and/or escalation, and re-estimation of costs based on lessons learned. Reasons for changes in the regulatory area include: addition of range rule/munitions requirements, additional or extended long-term monitoring requirements or 5 year reviews, no further action agreement with regulator, and risk based corrective action. Reasons for changes in the technical area include: additional contamination level reduction with sampling, additional or extended remedial action operation, additional sites and incomplete site data, and changes in technical solutions.

### References and Significant Laws

The following is a summary of significant laws that affect the Department's conduct of environmental policy and regulations.

The National Environmental Policy Act (NEPA) of 1970 requires the Department to consider the environmental impacts of proposed actions in the decision making process. Per DON regulations, the action proponent will determine the level or amount of NEPA documentation required. The Resource Conservation and Recovery Act (RCRA) of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984 (HSWA), was the first comprehensive federal effort to deal with safe disposal of all types of hazardous wastes, and provides for "cradle to grave" tracking of hazardous wastes. Permits are required for treatment, storage or disposal. Requirements for underground storage tanks (USTs) are also contained in RCRA.

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), commonly referred to as the Superfund legislation, provided for Federal agencies authority to respond to the release or the substantial threat of release of hazardous substances into the environment. CERCLA was amended several times; one of the amendments was the Community Environmental Response Facilitation Act of 1992. The Department must identify real property on each facility that is not contaminated and that offers the greatest opportunity for expedited reuse and redevelopment. When property is transferred, BRAC or non-BRAC, the Department is still responsible for any remediation or corrective action or any response action found to be necessary after the transfer.

DoD Instruction 5000.61, "DoD Modeling and Simulation (M&S) Verification, Validation, and Accreditation (VV&A)" of May 2003. This Instruction implements policy, assign responsibilities, and prescribe procedures under Directive 5000.59 for the verification, validation, and accreditation of DoD models and simulations and their associated data. It also authorizes publication of DoD 5000.61-G, "DoD Verification, Validation, and Accreditation Guide".

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

For additional information concerning applicable laws and regulations, methodology for assigning estimated cleanup costs, description and location of sites, and technology used for cleanup consult the DON Report for FY's 2004-2008, "Strong Environmental Partners; Our Community, Our Navy", July 2004. The report can be found at <http://5yrplan.nfesc.navy.mil>.

For form and content discussion on Environmental Liabilities, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**NOTE 15. OTHER LIABILITIES**

As of September 30, (Amounts in thousands)	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
<b>1. Intragovernmental:</b>				
A. Advances from Others	\$ 0	\$ 0	\$ 0	\$ 0
B. Deposit Funds and Suspense Account Liabilities	311,227	0	311,227	256,784
C. Disbursing Officer Cash	305,441	0	305,441	234,866
D. Judgment Fund Liabilities	0	0	0	41,833
E. FECA Reimbursement to the Department of Labor	245,145	309,136	554,281	565,884
F. Other Liabilities	2,655,100	0	2,655,100	2,885,435
G. Total Intragovernmental Other Liabilities	\$ 3,516,913	\$ 309,136	\$ 3,826,049	\$ 3,984,802
<b>2. Nonfederal:</b>				
A. Accrued Funded Payroll and Benefits	\$ 566,829	\$ 0	\$ 566,829	\$ 414,999
B. Advances from Others	151,215	0	151,215	0
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	0	0	0	0
E. Temporary Early Retirement Authority	0	0	0	699
F. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	18,491	665,023	683,514	565,796
(2) Excess/Obsolete Structures	53,783	182,114	235,897	343,324
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accrued Unfunded Annual Leave	2,650,745	0	2,650,745	2,463,860
H. Capital Lease Liability	0	0	0	202
I. Other Liabilities	132,917	38,719	171,636	231,947
J. Total Nonfederal Other Liabilities	\$ 3,573,980	\$ 885,856	\$ 4,459,836	\$ 4,020,827
<b>3. Total Other Liabilities:</b>	\$ 7,090,893	\$ 1,194,992	\$ 8,285,885	\$ 8,005,629

**Fluctuation and/or Abnormalities**

Intragovernmental Other Liabilities.

Deposit Funds and Suspense Account Liabilities (Line 1.B): The DON reported an increase of \$54,443 thousand, 21 percent, in FY 2005. The increase is attributed primarily to timing issues in the Withheld State and Local Taxes account 6275, the General Fund Proprietary Receipts account 3210, and clearance of transactions in the Recoveries Under the Foreign Military Sales Program account 3041.

Disbursing Officer Cash (Line 1.C): DON reported an increase of \$70,575 thousand, 30 percent, in FY 2005. The increase is a reflection of a \$101,521 thousand increase in Foreign Currency related to the Marine Corps Expeditionary Forces, Camp Lejeune, depositing money into a Limited Depository Account. This Limited Depository Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds. The increase in Foreign Currency was offset by a decrease of \$30,947 thousand in Cash held by various Disbursing Officers.

Judgment Fund Liabilities (Line 1.D): To implement new Treasury guidance, Judgment Fund Liabilities were recorded as Accounts Payable starting FY 2005, rather than Other Liabilities. Therefore, there is a 100 percent decrease in Judgment Fund Liabilities.

Nonfederal Other Liabilities.

Accrued Funded Payroll and Benefits (Line 2.A): Accrued Funded Payroll and Benefits increased \$151,830 thousand, 37 percent, in FY 2005. The Marine Corps began to report Accrued Payroll in Other Liabilities in FY 2005.

Advances from Others (Line 2.B): Advances from Others increased \$151,215 thousand, 100 percent, in FY 2005 due to a process change whereby DON began recognizing unearned revenue on the balance sheet.

Temporary Early Retirement Authority (Line 2.E): All liabilities related to the TERA program have been satisfied. Therefore, there is a 100 percent decrease in Temporary Early Retirement Authority liability.

Military Equipment (Nonnuclear) (Line 2.F.1): Military Equipment (Nonnuclear) increased \$117,718 thousand, 21 percent, in FY 2005. The increase was due to a \$70,418 thousand for the Trident Missile disposal program being reclassified from an environmental disposal liability to a non-environmental disposal liability during this reporting period and now reported in Note 15. This reclassification was based on a review of U.S. environmental laws, regulations and management decisions by the DON program office responsible for disposal of Trident Missile motors.

Excess/Obsolete Structures (Line 2.F.2): Excess/Obsolete Structures decreased \$107,427 thousand, 31 percent, in FY 2005 which is reflective of revised estimates for demolition costs in future years.

Capital Leases Liability (Line 2.H): Capital Leases Liability decreased \$202 thousand, 100 percent, in FY 2005 due to expiration of three leases in FY 2005.

**Intragovernmental Other Liabilities:**

Judgment Fund (Line 1.D).

To implement the guidance from the Treasury, Judgment Fund Liabilities were recorded as Accounts Payable starting FY 2005, rather than Other Liabilities.

Other Liabilities (Line 1.F.) includes the following:

	As of September 30, 2005
<i>(Amounts in thousands)</i>	
Liability to Treasury & Others	\$ 2,541,177
Unemployment	69,338
Employment Benefit	44,585
Total Intragovernmental Other Liabilities	<u>\$ 2,655,100</u>

With respect to the major fiduciary balances, the DON must reconcile with the Department of Labor and the Office of Personnel Management. In FY 2005, the DON reported the following Intragovernmental Fiduciary liabilities: \$554,281 thousand in FECA, \$69,338 thousand in Unemployment, \$44,585 thousand in Employment Benefit.

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### Nonfederal Other Liabilities:

#### Non-Environmental Disposal Liability Disclosure.

The DON recognizes the Non-Environmental disposal liability for nuclear powered assets when the asset is initially placed in service. The Non-Environmental costs are included with the environmental disposal costs and reported in Note 14. However, the \$683,514 thousand reported is estimated Non-Environmental disposal liability for conventional military equipment.

#### Excess/Obsolete Structures (Line 2.F.2).

The reported amount of \$235,897 thousand is an estimate of disposing excess/obsolete structures at active installations.

Other Liabilities (Line 2.I.) includes \$119,062 thousand Contract Holdbacks and \$52,574 thousand Contract Incentives.

### Reference

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

As of September 30, (Amounts in thousands)	2005				2004
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
<b>1. Future Payments Due:</b>					
A. 2005	\$ 0	\$ 0	\$ 0	\$ 0	\$ 202
B. 2006	0	0	0	0	0
C. 2007	0	0	0	0	0
D. 2008	0	0	0	0	0
E. 2009	0	0	0	0	0
F. After 5 Years	0	0	0	0	0
G. Total Future Lease Payments Due	\$ 0	\$ 0	\$ 0	\$ 0	\$ 202
H. Less: Imputed Interest Executory Costs	0	0	0	0	0
I. Net Capital Lease Liability	\$ 0	\$ 0	\$ 0	\$ 0	\$ 202
<b>2. Capital Lease Liabilities Covered by Budgetary Resources:</b>				\$ 0	\$ 0
<b>3. Capital Lease Liabilities Not Covered by Budgetary Resources:</b>				\$ 0	\$ 202
<b>4. Other Information Related to Capital Lease Liability</b>					

### **Fluctuation and/or Abnormalities**

The DON reported a decrease of \$202 thousand, 100 percent, in Equipment Leases, net in FY 2005. The decrease is due to the expiration of three leases in FY 2005.

### **Other Disclosures**

The liabilities associated with capital leases are captured in legacy systems and are not consistently recorded in the accounting system. The DON has recognized a liability equal to the net value of the assets (i.e. gross value less accumulated amortization). The resulting liability was recorded as a payment due in FY 2005. The proper breakout of future payments to appropriate years will be done when a process for capturing lease liabilities is implemented.

### **Reference**

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

For regulatory discussion on Capital Lease Liability, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

## **NOTE 16. COMMITMENTS AND CONTINGENCIES**

### **Information Related to Commitments and Contingencies:**

#### **Legal Contingencies:**

The Department of the Navy is a party in various administrative proceedings and legal actions, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from the Department's resources, either directly or by reimbursement to the Judgment Fund.

For fiscal years 2005 and 2004, the DON General Fund materiality threshold for reporting litigation, claims, or assessments was \$53.2 million and \$33.3 million, respectively. Legal actions affecting the DON include those for civil and environmental litigation, claims, and assessments. Based on information contained in the Legal Representation Letters, management does not have sufficient reason to believe that it is likely that the Government will be liable for the maximum amounts claimed.

The DON reported a total of 21 cases as of September 30, 2005 that met the materiality threshold. However, DON legal counsel was unable to express an opinion concerning the likely outcome of these cases.

#### **Other Commitments and Contingencies**

No further disclosures required.

#### **Reference**

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

For regulatory discussion on Commitments and Contingencies, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

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### NOTE 17. MILITARY RETIREMENT BENEFITS AND OTHER EMPLOYMENT RELATED ACTUARIAL LIABILITIES

As of September 30, (Amount in Thousands)	2005			2004	
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
<b>1. Pension and Health Benefits:</b>					
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0	\$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Benefits	\$ 0		\$ 0	\$ 0	\$ 0
<b>2. Other</b>					
A. FECA	\$ 1,532,819		\$ 0	\$ 1,532,819	\$ 1,575,815
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Educational Benefits Fund	0		0	0	0
D. Total Other	\$ 1,532,819		\$ 0	\$ 1,532,819	\$ 1,575,815
<b>3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:</b>	\$ 1,532,819		\$ 0	\$ 1,532,819	\$ 1,575,815

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

##### Military Retirement Pensions.

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

##### Military Retirement Health Benefits.

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

##### Federal Employees Compensation Act (FECA).

Actuarial Cost Method Used and Assumptions:

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

##### FY 2005

4.528 percent in Year 1

5.020 percent in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2005 were also used to adjust the methodology's historical payments to current year constant dollars.

CBY	COLA	CPIM
2005	2.20%	4.33%
2006	3.33%	4.09%
2007	2.93%	4.01%
2008	2.40%	4.01%
2009+	2.40%	4.01%

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

The estimate was allocated between General Fund and Navy Working Capital Fund using a percentage based on the number of civilian employees taken from the Navy Budget Tracking System. The following table details the numbers used in support of the allocation:

	Personnel	Allocation %
DON General Fund	111,166	57%
Navy Working Capital Fund	82,712	43%
<b>Total</b>	<b>193,878</b>	<b>100%</b>

Voluntary Separation Incentive (VSI) Program.

The Voluntary Separation Incentive (VSI) Fund (recorded on the books of the Department of the Treasury) is used to accumulate funds to finance, on an actuarially sound basis, the liabilities DoD incurred under this program. The VSI benefit is an annual annuity paid to members who have separated under this program, and is paid for a period of time equal to twice the members' years of service.

DoD Education Benefits Fund.

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

**Reference**

For regulatory discussion on Military Retirement Benefits and Other Employee Related Actuarial Liabilities, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.



**NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF NET COST**

**Fluctuation and/or Abnormalities**

The DON reported a decrease of \$14,012,744 thousand, 11 percent, in the Net Cost of Operations in FY 2005. A decrease of \$13,247,269 was reported in Procurement, and a decrease of \$6,862,725 was reported in Military Construction. These decreases were offset by increases in Military Personnel of \$3,358,701 thousand, reflecting the Marine Corps and Navy's overseas commitments, \$1,563,696 thousand in RDT&E costs due to execution of additional appropriations and \$1,359,718 thousand in the DON's Component account which includes net costs from eliminations.

The Procurement decrease noted above is primarily in the Aircraft Procurement program where costs decreased \$5,419,734 thousand, and in the Shipbuilding and Construction program where costs decreased \$4,680,000 thousand for the capitalization of Military Equipment. Extraordinary depreciation adjustments for Real Property of \$7,269,513 thousand recorded in FY 2004 accounts for the majority of the decrease in the Military Construction account noted above.

Intragovernmental Earned Revenue (Line 1.B) increased \$207,353 thousand, 6 percent, in FY 2005. Earned Revenue from the Public (Line 1.E) increased \$1,398,226 thousand, 42 percent, in FY 2005. This was due to an increase in gains on real property additions of \$2,284,242 thousand and in part from a decrease in reimbursable activity with non-federal customers of \$808,593 thousand. The trading partner identification process captures intragovernmental exchange revenues of the DON. Once intragovernmental revenues are identified, the incremental revenues are reclassified to Public. The relationship of Intragovernmental to Public revenues may vary at different points of the fiscal year depending on the mix and type of programs being executed by DON.

A noteworthy example of the intragovernmental revenue relates to Hurricane Katrina. After the hurricane devastated the Gulf Coast, the Federal Emergency Management Agency (FEMA), an agency under the Department of Homeland Security, requested assistance from the Department of Defense, via the Joint Chiefs of Staff, for humanitarian relief efforts. As of 30 September 2005, the DON has recognized some \$60 million in customer orders (revenue) from FEMA related to Hurricane Katrina. These orders were for diverse missions such as helicopter search and rescue operations, medical assistance provided by the hospital ship USNS Comfort, and food, water, and other supplies. As costs are accumulated against these FEMA customer orders, invoices will be rendered to FEMA, collections posted to the appropriate customer orders, and the intragovernmental receivables related to FEMA will be liquidated.

Current DON accounting systems do not consistently differentiate Public costs from Intragovernmental costs. Therefore, costs have to be controlled at the grand total level and then adjusted for trading partner submissions and other known items. Costs are classified as Public and then allocated to Intragovernmental based upon identification by DON's trading partners through trading partner submissions. The incremental costs then remain classified as Public. Cost comparisons become problematic due to the elimination reclassification process and inability of cost identification in reporting systems.

Intragovernmental Gross Costs (Line 1.A) increased \$73,301 thousand, 0.2 percent, in FY 2005. These costs are driven by DON's trading partners' seller side revenue. Since DON accounting systems cannot necessarily identify expenses as Intragovernmental or Public, a process was developed to match reported expenses to the revenue of DON's seller trading partners.

Gross Costs With the Public decreased \$12,480,465 thousand, 13 percent, in FY 2005. Public Aircraft Procurement costs were abnormally high in FY 2004 because erroneous expenditure data from a previous system conversion was reconciled. Capitalization of Military Equipment assets, based upon estimates provided by the Bureau of Economic Analysis (BEA), decreases costs of operations since expense is reduced when the assets are booked on the financial

statements. See Note 10 for pertinent disclosure. Capitalization of Operating Materials and Supplies (OM&S) decreases operating costs since expense is reduced when the assets are booked on the financial statements. Major drivers behind the decrease of \$12,480,465 thousand are:

	Increase / (Decrease)
<i>(Amounts in thousands)</i>	
Aircraft Procurement Costs	\$ (5,419,734)
Addition of Military Equipment	(4,680,000)
Depreciation Adjustments	(7,269,513)
RDT&E Program Cost Increase	1,638,894
Military Personnel Cost Increase	2,738,073

**Other Disclosures Related to the Statement of Net Cost**

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

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

**NOTE 19. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION**

As of September 30, (Amounts in thousands)	Cumulative Results of Operations 2005	Unexpended Appropriations 2005	Cumulative Results of Operations 2004	Unexpended Appropriations 2004
<b>1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance:</b>				
A. Changes in Accounting Standards	\$ 0	\$ 0	\$ 0	\$ 0
B. Errors and Omissions in Prior Year	0	0	(25,913,750)	25,913,750
C. Other Prior Period Adjustments	0	0	0	0
D. Total Prior Period Adjustments	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ (25,913,750)</u>	<u>\$ 25,913,750</u>
<b>2. Imputed Financing:</b>				
A. Civilian CSRS/FERS Retirement	\$ 232,513	\$ 0	\$ 247,413	\$ 0
B. Civilian Health	319,112	0	296,631	0
C. Civilian Life Insurance	1,038	0	1,020	0
D. Judgment Fund	33,023	0	40,145	0
E. Intra-Entity	0	0	0	0
F. Total Imputed Financing	<u>\$ 585,686</u>	<u>\$ 0</u>	<u>\$ 585,209</u>	<u>\$ 0</u>

**Errors and Omissions in Prior Year Accounting Reports**

Two prior period adjustments were recorded in FY 2004 to the DON financial statements and were recognized as errors and omissions per Statement of Federal Financial Accounting Standards (SFFAS) No. 21, "Reporting Corrections of Errors and Changes in Accounting Principles." The errors occurred in the FY 2003 financial statements. The overall impact of the prior period adjustments warranted the restatement of the FY 2004 DON financial statements for comparative purposes. These adjustments will affect the following financial statements for restatement in the fourth quarter: Balance Sheet (Net Position section) and the Statement of Changes in Net Position. The prior period adjustments were categorized as follows:

(Amounts in thousands)	Cumulative Results of Operations	Unexpended Appropriations
Error in reporting Appropriations Used	\$ <u>(\$25,913,750)</u>	\$ <u>25,913,750</u>

The errors involved the inclusion of disbursement and collection amounts in Appropriations Used, accounts (USSGL 3107 and USSGL 5700) both of which are mapped to the Statement of Changes in Net Position: 3107 to Unexpended Appropriations, and 5700 to Cumulative Results of Operations.

Imputed Financing.

The amounts the Department of Defense remits to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System (CSRS), the Federal Employees' Retirement System (FERS), the Federal Employees' Health Benefits (FEHB) program, and the Federal Employees' Group Life Insurance (FEGLI) program do not fully cover the government's cost to provide these benefits. An imputed cost is recognized as the

difference between the government's cost of providing these benefits to employees and the Agency's contributions for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for the computation of imputed financing costs. These costs are provided by DFAS to the Office of the Under Secretary of Defense (Personnel and Readiness) for validation and approval. The approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Judgment Fund.

Treasury provided information related to amounts paid for Judgment Fund liabilities under the Contracts Dispute Act and the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR Act) on behalf of the DON, which the DON is required to repay. Judgment Fund payments made out of the following Treasury appropriations does not require reimbursement and therefore represent imputed financing to the DON: 20X1740 and 20X1742. Only those payments made from Treasury appropriation 20X1743, and that portion of 20X1741 that is related to the No FEAR Act are required to be repaid by DON.

**NOTE 20. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES**

As of September 30, (Amounts in thousands)	2005	2004
<b>1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period</b>	\$ 76,392,061	\$ 63,059,730
<b>2. Available Borrowing and Contract Authority at the End of the Period</b>	0	0

**3. Other Information Related to the Statement of Budgetary Resources**

The Net Amount of Budgetary Resources Obligated for Undelivered Orders in this note only represents USSGL 4801, Undelivered Orders - Obligations, Unpaid. However, the amount represented on the Statement of Budgetary Resources, line 14 C not only includes USSGL 4801, Undelivered Orders - Obligations, Unpaid but also USSGL 4802, Undelivered Orders - Obligations, Prepaid/Advanced.

The difference of \$29,823 thousand between the SBR Appropriations Received and the Statement of Change of Net Position (SOCNP) Appropriations Received is due to the Trust Funds and Special Receipt Accounts, USSGL 4114, not being included in the Appropriations Received line of the SOCNP.

**Other Disclosures**

A noteworthy component of Reimbursable Program Obligations is \$60 million of reimbursable obligations related to Hurricane Katrina. After the hurricane devastated the Gulf Coast, the Federal Emergency Management Agency (FEMA), an agency under the Department of Homeland Security, requested assistance from the Department of Defense, via the Joint Chiefs of Staff, for humanitarian relief efforts. As of September 30, 2005, the DON has recognized some \$60 million in customer orders (revenue) from FEMA related to Hurricane Katrina. These orders were for diverse missions such as helicopter search and rescue operations, medical assistance provided by the hospital ship USNS Comfort, and food, water, and other supplies.

## 2005 Annual Financial Report

On the SBR: Obligations Incurred includes \$137,694,376 thousand of Direct Program Obligations and \$13,463,789 thousand of Reimbursable Program Obligations.

On the SF-133 Report on Budget Execution:

- Direct Obligations, Category A, amounts apportioned quarterly, are \$85,780,982 thousand.
- Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are \$55,122,057 thousand.
- Total Direct Obligations are therefore \$140,903,039 thousand.
- Category B Reimbursable Obligations, exempt from apportionment, are \$10,146,443 thousand.
  
- SF-133 Total Direct Obligations are \$3,208,663 less than those reported on the SBR.
- SF-133 Total Reimbursable Obligations are \$3,317,346 greater than those reported on the SBR.
- The SF-133 obligation grand total therefore is \$108,683 thousand less than the SBR obligation grand total.

Due to accounting system deficiencies, intragovernmental transactions were not eliminated for the presentation of a Consolidated Statement of Budgetary Resources (SBR).

In FY 2005, DoD treated Foreign Military Sales (FMS) Trust Fund transactions as Non-Federal, and was presented as such in the Balance Sheet (BS) and the Statement of Net Cost. Accounts Receivable and Revenues related to FMS are recognized in the SBR. Therefore, reconciling differences exist between the SBR and the BS. Office of the Under Secretary of Defense (Comptroller) Accounting Policy is currently researching the issue to determine the proper treatment of FMS Trust Fund transactions to ensure proper reporting.

### **DON has two permanent, indefinite appropriations.**

#### National Defense Sealift Fund.

The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet (NDRF) including the acquisition, alteration or conversion of vessels built in U.S. shipyards for the NDRF. In FY 2005, \$10,085 thousand was transferred from the NDSF to the Shipbuilding and Conversion, Navy appropriation and \$924 thousand was transferred to the Department of Energy.

#### Environmental Restoration, Navy.

Environmental Restoration, Navy (ER, N) is a transfer account that funds environmental restoration, reduction and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds are to remain available until transferred, and remain available for the same purpose and same time period as the appropriations to which transferred. In FY 2005, \$265,955 thousand was transferred from ER, N to the Operations and Maintenance, Navy appropriation and \$204 thousand was transferred to the Department of Energy.

## **NOTE 21. DISCLOSURES RELATED TO THE STATEMENT OF FINANCING**

### **Fluctuation and/or Abnormalities**

Budgetary data is not in agreement with proprietary expenses and assets capitalized. This fact causes a difference in net cost between the Statement of Net Cost and the Statement of Financing. Adjustments are posted to the Statement of Financing for these differences. For FY 2005, an adjustment of \$6,012,525 thousand was made to line 15 of the Statement of Financing so that proprietary accounts reconcile with the budgetary accounts. This alignment was made per the Office of the Under Secretary of Defense (Comptroller) guidance.

### **Other Disclosures**

The increase of resources that finance the acquisition of assets is primarily due to the implementation of SFFAS No. 23 "Eliminating the Category of National Defense Property, Plant, and Equipment." Correspondingly, there is also an increase in the reported depreciation for the military equipment.

The Statement of Financing is presented as combined or combining statements rather than consolidated statements due to intragovernmental transactions not being eliminated. Adjustments in funds which are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the "Adjustments" line on the Statement of Budgetary Resources), are not included in "Spending Authority From Offsetting Collections and Adjustments" line on the Statement of Budgetary Resources or on the Statement of Financing.

The Statement of Financing was expanded to further articulate and detail the relationship between new obligations from budgetary accounting and net cost of operations from proprietary accounting.

## **NOTE 22. DISCLOSURES RELATED TO THE STATEMENT OF CUSTODIAL ACTIVITY**

Not Applicable.

**NOTE 23. OTHER DISCLOSURES**

**1. Entity as Lessee - Operating Leases**

As of September 30,	2005			
(Amounts in thousands)	Land and Buildings	Equipment	Other	Total
Future Payments Due				
<u>Fiscal Year</u>				
2006	\$ 19,650	\$ 0	\$ 0	\$ 19,650
2007	20,361	0	0	20,361
2008	21,372	0	0	21,372
2009	22,437	0	0	22,437
2010	22,187	0	0	22,187
After 5 Years	0	0	0	0
Total Future Lease Payments Due	\$ 106,007	\$ 0	\$ 0	\$ 106,007

**Fluctuations and/or Abnormalities**

Although a comparative column is not displayed, the DON reported a decrease of \$218,358 thousand, 67 percent, in Operating Leases Future Payment in FY 2005. The decrease is due to the ongoing effort to validate operating leases throughout the Navy shore establishment.

**Definitions**

Lessee - A person or entity that receives the use and possession of leased property (e.g. real estate or equipment) from a lessor in exchange for a payment of funds.

Operating Lease - A lease that does not substantially transfer all the benefits and risk of ownership. Payments are charged to expense over the lease term as they become payable.

**Other Disclosure**

The values reported for operating leases is derived from the DON data collection process. This process only provides summary level values at this time.





# GENERAL FUND SUPPORTING CONSOLIDATING/COMBINING STATEMENTS

2005



GF SUPPORTING  
CONSOLIDATING/COMBINING STATEMENTS

Department of Defense  
 Department of the Navy  
**CONSOLIDATING BALANCE SHEET**  
 As of September 30, 2005 and 2004  
 (\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
<b>ASSETS (Note 2)</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 77,502,779	\$ 8,231,880
Nonentity Seized Iraqi Cash	0	0
Nonentity-Other	344,546	0
Investments (Note 4)	9,519	0
Accounts Receivable (Note 5)	233,721	62,428
Other Assets (Note 6)	661,043	11,214
Total Intragovernmental Assets	<u>\$ 78,751,608</u>	<u>\$ 8,305,522</u>
Cash and Other Monetary Assets (Note 7)	\$ 109,260	\$ 196,180
Accounts Receivable (Note 5)	3,251,549	16,108
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	55,114,331	470,506
General Property, Plant and Equipment (Note 10)	154,522,006	3,806,841
Investments (Note 4)	0	0
Other Assets (Note 6)	6,695,416	293,375
<b>TOTAL ASSETS</b>	<u><u>\$ 298,444,170</u></u>	<u><u>\$ 13,088,532</u></u>
<b>LIABILITIES (Note 11)</b>		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 1,054,733	\$ 168,814
Debt (Note 13)	0	0
Other Liabilities (Note 15 & Note 16)	3,547,385	278,663
Total Intragovernmental Liabilities	<u>\$ 4,602,118</u>	<u>\$ 447,477</u>
Accounts Payable (Note 12)	\$ 674,085	\$ 505,949
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities (Note 17)	1,321,969	210,850
Environmental Liabilities (Note 14)	17,050,451	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	3,783,131	676,705
<b>TOTAL LIABILITIES</b>	<u>\$ 27,431,754</u>	<u>\$ 1,840,981</u>
<b>NET POSITION</b>		
Unexpended Appropriations	\$ 81,938,228	\$ 7,801,648
Cumulative Results of Operations	189,074,188	3,445,903
<b>TOTAL NET POSITION</b>	<u><u>\$ 271,012,416</u></u>	<u><u>\$ 11,247,551</u></u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u><u>\$ 298,444,170</u></u>	<u><u>\$ 13,088,532</u></u>

## 2005 Annual Financial Report

Department of Defense

Department of the Navy

### CONSOLIDATING BALANCE SHEET

As of September 30, 2005 and 2004

(\$ in thousands)

	Combined Total	Eliminations	2005 Consolidated	2004 Consolidated
<b>ASSETS (Note 2)</b>				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	\$ 85,734,659	\$ 0	\$ 85,734,659	\$ 81,874,818
Nonentity Seized Iraqi Cash	0	0	0	0
Nonentity-Other	344,546	0	344,546	219,095
Investments (Note 4)	9,519	0	9,519	9,457
Accounts Receivable (Note 5)	296,149	14,845	281,304	250,703
Other Assets (Note 6)	672,257	0	672,257	272,723
Total Intragovernmental Assets	<u>\$ 87,057,130</u>	<u>\$ 14,845</u>	<u>\$ 87,042,285</u>	<u>\$ 82,626,796</u>
Cash and Other Monetary Assets (Note 7)	\$ 305,440	\$ 0	\$ 305,440	\$ 234,865
Accounts Receivable (Note 5)	3,267,657	0	3,267,657	2,895,966
Loans Receivable (Note 8)	0	0	0	0
Inventory and Related Property (Note 9)	55,584,837	0	55,584,837	53,340,667
General Property, Plant and Equipment (Note 10)	158,328,847	0	158,328,847	151,679,503
Investments (Note 4)	0	0	0	0
Other Assets (Note 6)	6,988,791	0	6,988,791	5,000,348
<b>TOTAL ASSETS</b>	<u>\$ 311,532,702</u>	<u>\$ 14,845</u>	<u>\$ 311,517,857</u>	<u>\$ 295,778,145</u>
<b>LIABILITIES (Note 11)</b>				
Intragovernmental:				
Accounts Payable (Note 12)	\$ 1,223,547	\$ 14,845	\$ 1,208,702	\$ 1,437,616
Debt (Note 13)	0	0	0	0
Other Liabilities (Note 15 & Note 16)	3,826,048	0	3,826,048	3,984,802
Total Intragovernmental Liabilities	<u>\$ 5,049,595</u>	<u>\$ 14,845</u>	<u>\$ 5,034,750</u>	<u>\$ 5,422,418</u>
Accounts Payable (Note 12)	\$ 1,180,034	\$ 0	\$ 1,180,034	\$ 1,395,008
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,532,819	0	1,532,819	1,575,815
Environmental Liabilities (Note 14)	17,050,451	0	17,050,451	16,031,979
Loan Guarantee Liability (Note 8)	0	0	0	0
Other Liabilities (Note 15 and Note 16)	4,459,836	0	4,459,836	4,020,826
<b>TOTAL LIABILITIES</b>	<u>\$ 29,272,735</u>	<u>\$ 14,845</u>	<u>\$ 29,257,890</u>	<u>\$ 28,446,046</u>
<b>NET POSITION</b>				
Unexpended Appropriations	\$ 89,739,876	\$ 0	\$ 89,739,876	\$ 79,161,774
Cumulative Results of Operations	192,520,091	0	192,520,091	188,170,325
<b>TOTAL NET POSITION</b>	<u>\$ 282,259,967</u>	<u>\$ 0</u>	<u>\$ 282,259,967</u>	<u>\$ 267,332,099</u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u>\$ 311,532,702</u>	<u>\$ 14,845</u>	<u>\$ 311,517,857</u>	<u>\$ 295,778,145</u>

Department of Defense

Department of the Navy

**CONSOLIDATING STATEMENT OF NET COST**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
<b>Program Costs</b>		
<b>Military Personnel</b>		
Intragovernmental Gross Costs	\$ 5,573,645	\$ 2,529,508
(Less Intragovernmental Earned Revenue)	(470,476)	(31,064)
Intragovernmental Net Costs	<u>\$ 5,103,169</u>	<u>\$ 2,498,444</u>
Gross Costs With the Public	\$ 22,635,306	\$ 9,107,224
(Less: Earned Revenue From the Public)	0	0
Net Costs With the Public	<u>\$ 22,635,306</u>	<u>\$ 9,107,224</u>
Net Program Cost	\$ 27,738,475	\$ 11,605,668
<b>Operations and Maintenance</b>		
Intragovernmental Gross Costs	\$ 1,651,550	\$ 255,947
(Less Intragovernmental Earned Revenue)	(4,823,575)	(2,072,747)
Intragovernmental Net Costs	<u>\$ (3,172,025)</u>	<u>\$ (1,816,800)</u>
Gross Costs With the Public	\$ 37,740,645	\$ 7,890,064
(Less: Earned Revenue From the Public)	0	0
Net Costs With the Public	<u>\$ 37,740,645</u>	<u>\$ 7,890,064</u>
Net Program Cost	\$ 34,568,620	\$ 6,073,264
<b>Procurement</b>		
Intragovernmental Gross Costs	\$ (82,486)	\$ 44
(Less Intragovernmental Earned Revenue)	(1,001,335)	(20,953)
Intragovernmental Net Costs	<u>\$ (1,083,821)</u>	<u>\$ (20,909)</u>
Gross Costs With the Public	\$ 18,530,693	\$ 2,016,570
(Less: Earned Revenue From the Public)	(24,454)	(580,764)
Net Costs With the Public	<u>\$ 18,506,239</u>	<u>\$ 1,435,806</u>
Net Program Cost	\$ 17,422,418	\$ 1,414,897
<b>Research, Development, Test &amp; Evaluation</b>		
Intragovernmental Gross Costs	\$ 0	\$ 0
(Less Intragovernmental Earned Revenue)	(382,732)	0
Intragovernmental Net Costs	<u>\$ (382,732)</u>	<u>\$ 0</u>
Gross Costs With the Public	\$ 16,105,552	\$ 0
(Less: Earned Revenue From the Public)	0	0
Net Costs With the Public	<u>\$ 16,105,552</u>	<u>\$ 0</u>
Net Program Cost	\$ 15,722,820	\$ 0

## 2005 Annual Financial Report

Department of Defense

Department of the Navy

### CONSOLIDATING STATEMENT OF NET COST

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Combined Total</u>	<u>Eliminations</u>	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Program Costs</b>				
<b>Military Personnel</b>				
Intragovernmental Gross Costs	\$ 8,103,153	\$ 0	\$ 8,103,153	\$ 7,398,489
(Less: Intragovernmental Earned Revenue)	<u>(501,540)</u>	<u>0</u>	<u>(501,540)</u>	<u>(417,526)</u>
Intragovernmental Net Costs	\$ 7,601,613	\$ 0	\$ 7,601,613	\$ 6,980,963
Gross Costs With the Public	\$ 31,742,530	\$ 0	\$ 31,742,530	\$ 29,004,446
(Less: Earned Revenue From the Public)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Costs With the Public	\$ 31,742,530	\$ 0	\$ 31,742,530	\$ 29,004,446
Net Program Cost	\$ 39,344,143	\$ 0	\$ 39,344,143	\$ 35,985,409
<b>Operations and Maintenance</b>				
Intragovernmental Gross Costs	\$ 1,907,497	\$ 0	\$ 1,907,497	\$ 1,862,693
(Less: Intragovernmental Earned Revenue)	<u>(6,896,322)</u>	<u>0</u>	<u>(6,896,322)</u>	<u>(5,166,255)</u>
Intragovernmental Net Costs	\$ (4,988,825)	\$ 0	\$ (4,988,825)	\$ (3,303,562)
Gross Costs With the Public	\$ 45,630,709	\$ 0	\$ 45,630,709	\$ 44,129,757
(Less: Earned Revenue From the Public)	<u>0</u>	<u>0</u>	<u>0</u>	<u>(47,276)</u>
Net Costs With the Public	\$ 45,630,709	\$ 0	\$ 45,630,709	\$ 44,082,481
Net Program Cost	\$ 40,641,884	\$ 0	\$ 40,641,884	\$ 40,778,919
<b>Procurement</b>				
Intragovernmental Gross Costs	\$ (82,442)	\$ 0	\$ (82,442)	\$ 550
(Less: Intragovernmental Earned Revenue)	<u>(1,022,288)</u>	<u>0</u>	<u>(1,022,288)</u>	<u>(767,223)</u>
Intragovernmental Net Costs	\$ (1,104,730)	\$ 0	\$ (1,104,730)	\$ (766,673)
Gross Costs With the Public	\$ 20,547,263	\$ 0	\$ 20,547,263	\$ 33,100,255
(Less: Earned Revenue From the Public)	<u>(605,218)</u>	<u>0</u>	<u>(605,218)</u>	<u>(248,999)</u>
Net Costs With the Public	\$ 19,942,045	\$ 0	\$ 19,942,045	\$ 32,851,256
Net Program Cost	\$ 18,837,315	\$ 0	\$ 18,837,315	\$ 32,084,583
<b>Research, Development, Test &amp; Evaluation</b>				
Intragovernmental Gross Costs	\$ 0	\$ 0	\$ 0	\$ 0
(Less: Intragovernmental Earned Revenue)	<u>(382,732)</u>	<u>0</u>	<u>(382,732)</u>	<u>(307,534)</u>
Intragovernmental Net Costs	\$ (382,732)	\$ 0	\$ (382,732)	\$ (307,534)
Gross Costs With the Public	\$ 16,105,552	\$ 0	\$ 16,105,552	\$ 14,466,658
(Less: Earned Revenue From the Public)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Costs With the Public	\$ 16,105,552	\$ 0	\$ 16,105,552	\$ 14,466,658
Net Program Cost	\$ 15,722,820	\$ 0	\$ 15,722,820	\$ 14,159,124

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**CONSOLIDATING STATEMENT OF NET COST**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
<b>Program Costs</b>		
<b>Military Construction/Family Housing</b>		
Intragovernmental Gross Costs	\$ 0	\$ 0
(Less: Intragovernmental Earned Revenue)	(723,253)	0
Intragovernmental Net Costs	<u>\$ (723,253)</u>	<u>\$ 0</u>
Gross Costs With the Public	\$ 3,957,738	\$ 0
(Less: Earned Revenue From the Public)	(1,963,352)	0
Net Costs With the Public	<u>\$ 1,994,386</u>	<u>\$ 0</u>
Net Program Cost	\$ 1,271,133	\$ 0
<b>Other</b>		
Intragovernmental Gross Costs	\$ 25,590,597	\$ 3,886,084
(Less: Intragovernmental Earned Revenue)	4,171,814	1,714,240
Intragovernmental Net Costs	<u>\$ 29,762,411</u>	<u>\$ 5,600,324</u>
Gross Costs With the Public	\$ (28,093,406)	\$ (5,524,600)
(Less: Earned Revenue From the Public)	(2,056,662)	(75,703)
Net Costs With the Public	<u>\$ (30,150,068)</u>	<u>\$ (5,600,303)</u>
Net Program Cost	\$ (387,657)	\$ 21
<b>Total Program Costs</b>		
Intragovernmental Gross Costs	\$ 32,733,306	\$ 6,671,583
(Less: Intragovernmental Earned Revenue)	(3,229,557)	(410,524)
Intragovernmental Net Costs	<u>\$ 29,503,749</u>	<u>\$ 6,261,059</u>
Gross Costs With the Public	\$ 70,876,528	\$ 13,489,258
(Less: Earned Revenue From the Public)	(4,044,468)	(656,467)
Net Costs With the Public	<u>\$ 66,832,060</u>	<u>\$ 12,832,791</u>
Net Program Cost	\$ 96,335,809	\$ 19,093,850
<b>Costs Not Assigned to Programs</b>	0	0
<b>(Less: Earned Revenue Not Attributable to Programs)</b>	<u>0</u>	<u>0</u>
<b>Net Cost of Operations</b>	<u><u>\$ 96,335,809</u></u>	<u><u>\$ 19,093,850</u></u>

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### CONSOLIDATING STATEMENT OF NET COST

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Combined Total</u>	<u>Eliminations</u>	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Program Costs</b>				
<b>Military Construction/Family Housing</b>				
Intragovernmental Gross Costs	\$ 0	\$ 0	\$ 0	\$ 0
(Less Intragovernmental Earned Revenue)	(723,253)	0	(723,253)	(741,184)
Intragovernmental Net Costs	<u>\$ (723,253)</u>	<u>\$ 0</u>	<u>\$ (723,253)</u>	<u>\$ (741,184)</u>
Gross Costs With the Public	\$ 3,957,738	\$ 0	\$ 3,957,738	\$ 8,910,371
(Less: Earned Revenue From the Public)	(1,963,352)	0	(1,963,352)	(35,329)
Net Costs With the Public	<u>\$ 1,994,386</u>	<u>\$ 0</u>	<u>\$ 1,994,386</u>	<u>\$ 8,875,042</u>
Net Program Cost	<u>\$ 1,271,133</u>	<u>\$ 0</u>	<u>\$ 1,271,133</u>	<u>\$ 8,133,858</u>
<b>Other</b>				
Intragovernmental Gross Costs	\$ 29,476,681	\$ 159,868	\$ 29,316,813	\$ 29,909,988
(Less Intragovernmental Earned Revenue)	5,886,054	(159,868)	6,045,922	4,126,862
Intragovernmental Net Costs	<u>\$ 35,362,735</u>	<u>\$ 0</u>	<u>\$ 35,362,735</u>	<u>\$ 34,036,850</u>
Gross Costs With the Public	\$ (33,618,006)	\$ 0	\$ (33,618,006)	\$ (32,765,236)
(Less: Earned Revenue From the Public)	(2,132,365)	0	(2,132,365)	(2,971,104)
Net Costs With the Public	<u>\$ (35,750,371)</u>	<u>\$ 0</u>	<u>\$ (35,750,371)</u>	<u>\$ (35,736,340)</u>
Net Program Cost	<u>\$ (387,636)</u>	<u>\$ 0</u>	<u>\$ (387,636)</u>	<u>\$ (1,699,490)</u>
<b>Total Program Costs</b>				
Intragovernmental Gross Costs	\$ 39,404,889	\$ 159,868	\$ 39,245,021	\$ 39,171,720
(Less Intragovernmental Earned Revenue)	(3,640,081)	(159,868)	(3,480,213)	(3,272,860)
Intragovernmental Net Costs	<u>\$ 35,764,808</u>	<u>\$ 0</u>	<u>\$ 35,764,808</u>	<u>\$ 35,898,860</u>
Gross Costs With the Public	\$ 84,365,786	\$ 0	\$ 84,365,786	\$ 96,846,251
(Less: Earned Revenue From the Public)	(4,700,935)	0	(4,700,935)	(3,302,708)
Net Costs With the Public	<u>\$ 79,664,851</u>	<u>\$ 0</u>	<u>\$ 79,664,851</u>	<u>\$ 93,543,543</u>
Net Program Cost	<u>\$ 115,429,659</u>	<u>\$ 0</u>	<u>\$ 115,429,659</u>	<u>\$ 129,442,403</u>
<b>Costs Not Assigned to Programs</b>	0	0	0	0
<b>(Less: Earned Revenue Not Attributable to Programs)</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Net Cost of Operations</b>	<u><u>\$ 115,429,659</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 115,429,659</u></u>	<u><u>\$ 129,442,403</u></u>

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**CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
<b>Cumulative Results of Operations</b>		
<b>Beginning Balances</b>	\$ 185,109,652	\$ 3,060,673
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles	0	0
Correction of Errors	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 185,109,652</u>	<u>\$ 3,060,673</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	99,600,565	19,415,135
Nonexchange revenue	205	0
Donations and forfeitures of cash and cash equivalents	29,518	0
Transfers in/out without reimbursement (+/-)	150,000	0
Other budgetary financing sources (+/-)	0	0
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(1,673)	21
Imputed financing from costs absorbed by others	521,763	63,923
Other (+/-)	0	0
<b>Total Financing Sources</b>	<u>\$ 100,300,378</u>	<u>\$ 19,479,079</u>
<b>Net Cost of Operations (+/-)</b>	<u>96,335,809</u>	<u>19,093,850</u>
<b>Net Change</b>	<u>3,964,569</u>	<u>385,229</u>
<b>Ending Balances</b>	<u><u>\$ 189,074,221</u></u>	<u><u>\$ 3,445,902</u></u>
<b>Unexpended Appropriations</b>		
<b>Beginning Balances</b>	\$ 72,627,291	\$ 6,534,483
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles	0	0
Correction of Errors	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 72,627,291</u>	<u>\$ 6,534,483</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 109,882,769	\$ 21,089,769
Appropriations transferred in/out (+/-)	409,256	(244,582)
Other adjustments (rescissions, etc) (+/-)	(1,380,556)	(162,886)
Appropriations used	(99,600,565)	(19,415,135)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
<b>Total Financing Sources</b>	<u>\$ 9,310,904</u>	<u>\$ 1,267,166</u>
<b>Net Cost of Operations (+/-)</b>	<u>0</u>	<u>0</u>
<b>Net Change</b>	<u>9,310,904</u>	<u>1,267,166</u>
<b>Ending Balances</b>	<u><u>\$ 81,938,195</u></u>	<u><u>\$ 7,801,649</u></u>



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### CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Combined Total</u>	<u>Eliminations</u>	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Cumulative Results of Operations</b>				
<b>Beginning Balances</b>	\$ 188,170,325	\$ 0	\$ 188,170,325	\$ 222,565,239
<b>Prior period adjustments (+/-)</b>				
Changes in Accounting Principles	0	0	0	(25,913,750)
Correction of Errors	0	0	0	\$ 0
<b>Beginning Balances, as adjusted</b>	<u>\$ 188,170,325</u>	<u>\$ 0</u>	<u>\$ 188,170,325</u>	<u>\$ 196,651,489</u>
<b>Budgetary Financing Sources:</b>				
Appropriations Received	\$ 0	\$ 0	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	119,015,700	0	119,015,700	120,198,147
Nonexchange revenue	205	0	205	0
Donations and forfeitures of cash and cash equivalents	29,518	0	29,518	0
Transfers in/out without reimbursement (+/-)	150,000	0	150,000	166,000
Other budgetary financing sources (+/-)	0	0	0	0
<b>Other Financing Sources:</b>				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	(1,652)	0	(1,652)	11,883
Imputed financing from costs absorbed by others	585,686	0	585,686	585,209
Other (+/-)	0	0	0	0
<b>Total Financing Sources</b>	<u>\$ 119,779,457</u>	<u>\$ 0</u>	<u>\$ 119,779,457</u>	<u>\$ 120,961,239</u>
<b>Net Cost of Operations (+/-)</b>	<u>115,429,659</u>	<u>0</u>	<u>239,558,914</u>	<u>129,442,403</u>
<b>Net Change</b>	<u>4,349,798</u>	<u>0</u>	<u>4,349,798</u>	<u>(8,481,164)</u>
<b>Ending Balances</b>	<u><u>\$ 192,520,123</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 192,520,123</u></u>	<u><u>\$ 188,170,325</u></u>
<b>Unexpended Appropriations</b>				
<b>Beginning Balances</b>	\$ 79,161,774	\$ 0	\$ 79,161,774	\$ 50,781,179
<b>Prior period adjustments (+/-)</b>				
Changes in Accounting Principles	0	0	0	0
Correction of Errors	0	0	0	25,913,750
<b>Beginning Balances, as adjusted</b>	<u>\$ 79,161,774</u>	<u>\$ 0</u>	<u>\$ 79,161,774</u>	<u>\$ 76,694,929</u>
<b>Budgetary Financing Sources:</b>				
Appropriations Received	\$ 130,972,538	\$ 0	\$ 130,972,538	\$ 123,917,983
Appropriations transferred in/out (+/-)	164,674	0	164,674	455,059
Other adjustments (rescissions, etc) (+/-)	(1,543,442)	0	(1,543,442)	(1,708,050)
Appropriations used	(119,015,700)	0	(119,015,700)	(120,198,147)
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
<b>Other Financing Sources:</b>				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	0	0
<b>Total Financing Sources</b>	<u>\$ 10,578,070</u>	<u>\$ 0</u>	<u>\$ 10,578,070</u>	<u>\$ 2,466,845</u>
<b>Net Cost of Operations (+/-)</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Net Change</b>	<u>10,578,070</u>	<u>0</u>	<u>10,578,070</u>	<u>\$ 2,466,845</u>
<b>Ending Balances</b>	<u><u>\$ 89,739,844</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 89,739,844</u></u>	<u><u>\$ 79,161,774</u></u>

Department of Defense

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**COMBINING STATEMENT OF BUDGETARY RESOURCES**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

**BUDGETARY FINANCING ACCOUNTS**

	<u>Navy</u>	<u>Marine Corps</u>	<u>2005 Combined</u>	<u>2004 Combined</u>
<b>BUDGETARY RESOURCES</b>				
Budget Authority:				
Appropriations Received	\$ 109,912,592	\$ 21,089,769	\$ 131,002,361	\$ 123,948,477
Borrowing Authority	0	0	0	0
Contract Authority	0	0	0	0
Net transfers (+/-)	343,426	17,879	361,305	425,109
Other	0	0	0	0
Unobligated Balance:				
Beginning of period	15,567,670	2,460,324	18,027,994	14,695,238
Net transfers, actual (+/-)	215,830	(262,461)	(46,631)	195,950
Anticipated Transfers Balances	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned	0	0	0	0
Collected	6,724,626	2,106,014	8,830,640	7,706,650
Receivable from Federal sources	677,916	18,751	696,667	(360,284)
Change in unfilled customer orders	0	0	0	0
Advances received	147,708	0	147,708	56,010
Without advance from Federal sources	(706,814)	70,421	(636,393)	467,506
Anticipated for the rest of year, without advances	0	0	0	0
Previously unavailable	0	0	0	0
Transfers from trust funds	0	0	0	0
Subtotal	<u>\$ 6,843,436</u>	<u>\$ 2,195,186</u>	<u>\$ 9,038,622</u>	<u>\$ 7,869,882</u>
Recoveries of prior year obligations	\$ 6,675,919	\$ 4,770,516	\$ 11,446,435	\$ 13,756,981
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	<u>(1,380,556)</u>	<u>(162,886)</u>	<u>(1,543,442)</u>	<u>(1,708,789)</u>
<b>Total Budgetary Resources</b>	<u><u>\$ 138,178,317</u></u>	<u><u>\$ 30,108,327</u></u>	<u><u>\$ 168,286,644</u></u>	<u><u>\$ 159,182,848</u></u>

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### COMBINING STATEMENT OF BUDGETARY RESOURCES

For the years ended September 30, 2005 and 2004

(\$ in thousands)

#### BUDGETARY FINANCING ACCOUNTS

	Navy	Marine Corps	2005 Combined	2004 Combined
<b>STATUS OF BUDGETARY RESOURCES</b>				
Obligations Incurred:				
Direct	\$ 111,972,460	\$ 25,721,916	\$ 137,694,376	\$ 132,268,522
Reimbursable	11,092,135	2,371,654	13,463,789	8,886,330
Subtotal	<u>\$ 123,064,595</u>	<u>\$ 28,093,570</u>	<u>\$ 151,158,165</u>	<u>141,154,852</u>
Unobligated balance:				
Apportioned	\$ 13,790,902	\$ 1,816,603	\$ 15,607,505	\$ 13,973,108
Exempt from apportionment	0	0	0	0
Other available	0	0	0	0
Unobligated Balances Not Available	1,322,820	198,154	1,520,974	4,054,888
<b>Total, Status of Budgetary Resources</b>	<u><u>\$ 138,178,317</u></u>	<u><u>\$ 30,108,327</u></u>	<u><u>\$ 168,286,644</u></u>	<u><u>\$ 159,182,848</u></u>

#### RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:

Obligated Balance, Net - beginning of period	\$ 59,489,094	\$ 4,367,130	\$ 63,856,224	\$ 63,520,894
Obligated Balance transferred, net (+/-)	0	0	0	0
Obligated Balance, net - end of period:				
Accounts Receivable	(1,118,420)	(115,806)	(1,234,226)	(537,560)
Unfilled customer order from Federal sources	(1,965,432)	(201,156)	(2,166,588)	(2,802,982)
Undelivered Orders	63,047,525	5,683,457	68,730,982	63,723,755
Accounts Payable	2,511,577	850,627	3,362,204	3,473,010
Outlays:				
Disbursements	113,431,418	21,383,890	134,815,308	126,955,319
Collections	(6,872,334)	(2,106,014)	(8,978,348)	(7,762,660)
Subtotal	<u>\$ 106,559,084</u>	<u>\$ 19,277,876</u>	<u>\$ 125,836,960</u>	<u>\$ 119,192,659</u>
Less: Offsetting receipts	(115,805)	0	(115,805)	(115,027)
<b>Net Outlays</b>	<u><u>\$ 106,443,279</u></u>	<u><u>\$ 19,277,876</u></u>	<u><u>\$ 125,721,155</u></u>	<u><u>\$ 119,077,632</u></u>

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**CONSOLIDATING STATEMENT OF FINANCING**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	Navy	Marine Corps	2005 Consolidated	2004 Consolidated
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Resources Used to Finance Activities:</b>				
Budgetary Resources Obligated				
Obligations Incurred	\$ 123,064,595	\$ 28,093,570	\$ 151,158,165	\$ 141,154,852
Less: Spending Authority from offsetting collections and recoveries (-)	<u>(13,519,355)</u>	<u>(6,965,701)</u>	<u>(20,485,056)</u>	<u>(21,626,865)</u>
Obligations net of offsetting collections and recoveries	\$ 109,545,240	\$ 21,127,869	\$ 130,673,109	\$ 119,527,987
Less: Offsetting receipts (-)	<u>(115,805)</u>	<u>0</u>	<u>(115,805)</u>	<u>(115,027)</u>
Net obligations	<u>\$ 109,429,435</u>	<u>\$ 21,127,869</u>	<u>\$ 130,557,304</u>	<u>\$ 119,412,960</u>
Other Resources				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	(1,673)	21	(1,652)	11,883
Imputed financing from costs absorbed by others	521,763	63,923	585,686	585,209
Other (+/-)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net other resources used to finance activities	<u>\$ 520,090</u>	<u>\$ 63,944</u>	<u>\$ 584,034</u>	<u>\$ 597,092</u>
<b>Total resources used to finance activities</b>	<u>\$ 109,949,525</u>	<u>\$ 21,191,813</u>	<u>\$ 131,141,338</u>	<u>\$ 120,010,052</u>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>				
Change in budgetary resources obligated for goods, services and ordered but not yet provided				
Undelivered Orders (-)	\$ (11,549,147)	\$ (1,783,153)	\$ (13,332,300)	\$ 1,796,210
Unfilled Customer Orders	(559,106)	70,421	(488,685)	523,516
Resources that fund expenses recognized in prior periods	(255,577)	(14,138)	(269,715)	(115,122)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0	0	0
Resources that finance the acquisition of assets	(14,697,507)	0	(14,697,507)	(12,412,218)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations				
Less: Trust or Special Fund receipts related to exchange in the Entity's budget (-)	0	0	0	0
Other (+/-)	<u>1,673</u>	<u>(21)</u>	<u>1,652</u>	<u>(11,883)</u>
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<u>\$ (27,059,664)</u>	<u>\$ (1,726,891)</u>	<u>\$ (28,786,555)</u>	<u>\$ (10,219,497)</u>
<b>Total resources used to finance the Net Cost of Operations</b>	<u>\$ 82,889,861</u>	<u>\$ 19,464,922</u>	<u>\$ 102,354,783</u>	<u>\$ 109,790,555</u>

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### CONSOLIDATING STATEMENT OF FINANCING

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>				
Components Requiring or Generating Resources in Future Periods:				
Increase in annual leave liability	\$ 170,047	\$ 0	\$ 170,047	\$ 188,260
Increase in environmental and disposal liability	1,028,763	0	1,028,763	427,489
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0	0
Other (+/-)	<u>47,633</u>	<u>21,458</u>	<u>69,091</u>	<u>193,243</u>
Total components of Net Cost of Operations that will require or generate resources in future periods	<u>\$ 1,246,443</u>	<u>\$ 21,458</u>	<u>\$ 1,267,901</u>	<u>\$ 808,992</u>
Components not Requiring or Generating Resources:				
Depreciation and amortization	\$ 15,659,481	\$ 184,822	\$ 15,844,303	\$ 17,475,862
Revaluation of assets and liabilities (+/-)	(1,206,574)	(578,725)	(1,785,299)	1,114,040
Other (+/-)				
Trust Fund Exchange Revenue	(10)	0	(10)	(30,297)
Cost of Goods Sold	0	0	0	0
Operating Materials and Supplies Used	(2,251,653)	7,483	(2,244,170)	270,967
Other	<u>(1,740)</u>	<u>(6,109)</u>	<u>(7,849)</u>	<u>12,284</u>
Total components of Net Cost of Operations that will not require or generate resources	<u>\$ 12,199,504</u>	<u>\$ (392,529)</u>	<u>\$ 11,806,975</u>	<u>\$ 18,842,856</u>
<b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b>	<u>\$ 13,445,947</u>	<u>\$ (371,071)</u>	<u>\$ 13,074,876</u>	<u>\$ 19,651,848</u>
<b>Net Cost of Operations</b>	<u>\$ 96,335,808</u>	<u>\$ 19,093,851</u>	<u>\$ 115,429,659</u>	<u>\$ 129,442,403</u>



**GENERAL FUND  
REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION**

2005



GF Required Supplementary  
Stewardship Information

**HERITAGE ASSETS**

*For Fiscal Year Ended September 30, 2005*

(a)	(b) Measurement Quantity	(c) As of 10/01/04	(d) Additions	(e) Deletions	(f) As of 9/30/05
Museums	Each	27	0	0	27
Monuments & Memorials	Each	540	4	18	526
Cemeteries	Sites	60	0	0	60
Archeological Sites	Sites	23,262	708	29	23,941
Buildings and Structures	Each	9,092	0	0	9,092
Major Collections (See Supplemental Reporting)					

**Narrative Statement**

The Department of the Navy (DON) is required to report Heritage Assets in accordance with the following public laws and regulations:

- Antiquities Act of 1906
- Historic Sites Act of 1935
- USC 470 National Historic Preservation Act of 1966
- National Environmental Policy Act of 1969
- American Indian Religious Freedom Act of 1978
- Archaeological Resources Protection Act of 1979
- Native American Graves Protection & Repatriation Act of 1990
- Presidential Memorandum for Heads of Executive Departments and Agencies: Government to Government Relations with Native American Tribal Governments Act of 1994
- 36 CFR 79 - Curation of Federally Owned and Administered Archaeological Collections
- 36 CFR 60.4 - National Register of Historic Places
- Federal Accounting Standards Advisory Board (FASAB) Standard 29, "Heritage Assets and Stewardship Land"
- Executive Order 13287 - Preserve America - of 2003
- Executive Order 13327 - Federal Real Property Asset Management - of 2004
- SECNAVINST 5755.1A - Navy Museums - of 1992

In general, the DON defines Heritage Assets as items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic importance, or significant architectural characteristics. Monetary values are not required for Heritage Asset reporting; only physical units of measure are reported.

Explanation for adjustments, additions, and deletions.

In FY 2005 adjustments to monuments were made to reflect assets acquired in prior years that were not previously reported.

Accurate inventories of archaeological artifacts, archaeological sites, and buildings and structures are dependent on full implementation of tracking systems, notably the Internet Naval Facilities Asset Database Store (iNFADS) and the Department of the Navy Heritage Asset Management System (DONHAMS), and related use of historic property data elements for buildings and structures.



## 2005 Annual Financial Report

Process used to define assets as Heritage Assets. The processes used to define items as having heritage significance vary between categories and type of assets being evaluated. Subject matter experts, including historians and curators, play a significant role in the definition process in addition to other criteria such as being listed on the National Register of Historic Places. In all cases, a myriad of federal statutes, service regulations, and other guidelines mandate heritage significance or provide guidance in its determination.

Multi-Use Heritage Assets. Per DoD Financial Management Regulation (FMR) Volume 6B, Form and Content of the Department of Defense Audited Financial Statements, Multi-Use Heritage Assets are reported both as Heritage Assets on the RSSI and on the Balance Sheet as Real Property.

Information Pertaining to the Condition of DON Heritage Assets. The methodology used to report the condition of the heritage assets was a combination of visual assessment of the objects, historic value to the DON collection, and general display and storage standards for historic collections. The overall condition of the collection objects is good.

### Museums

Museums are buildings, places, or institutions devoted to the acquisition, conservation, study, exhibition, and educational interpretation of objects having scientific, historical, or artistic value. Secretary of the Navy Instruction 5755.1A, Navy Museums, defines the scope of the Navy Museum program.

### Monuments and Memorials

Monuments and Memorials have significant monetary and/or historical value to the DON.

### Cemeteries

Cemeteries are government owned burial grounds on which gravesites of prominent historical figures may be located in addition to other gravesites.

### Archaeological Sites

Archeological Sites are lands on which items of significance are located.

### Buildings and Structures

Buildings and Structures are listed as or determined eligible for listing on the National Register of Historic Places, including Multi-Use Heritage Assets. Criteria for evaluating National Register eligibility of these sites may be referenced at 36 CFR 60.4.

Supplemental Reporting. In addition to the data presented in the table above, the following supplemental information was reported as of 9/30/05:

Category	Measurement Quantity	As of 10/01/04	Additions	Deletions	As of 9/30/05
Archeological Artifacts	Cubic Feet	13,756	515	0	14,271
Archival	Linear Feet	97,767	3,079	3,557	97,289
Artwork	Item	38,461	210	193	38,478
Historical Artifacts	Item	1,140,796	5,300	381	1,145,715

### Archaeological Artifacts

The FY 2004 ending balance was adjusted upward by 6 cubic feet resulting in an FY 2004 beginning balance of 13,756 cubic feet. This adjustment was the result of a reclassification of some items from artifacts to archival records.

**Archival**

The FY 2004 ending balance was adjusted upward by 3,551 linear feet resulting in an FY 2004 beginning balance of 97,767 linear feet. This adjustment reflects all archival assets previously reported by the Marine Corps Historical Division located at the Washington Navy Yard having been transferred to the Marine Corps University Archives Branch in Quantico, Virginia as part of a major consolidation of archival matters.

**Artwork**

The FY 2004 ending balance was adjusted upward by 514 items resulting in an FY 2004 beginning balance of 38,461 items. This adjustment reflects the correction of an error in the prior reporting period.

**Historical Artifacts**

The FY 2004 ending balance was adjusted upward by 15,679 items resulting in an FY 2004 beginning balance of 1,140,796 items. This adjustment reflects the correction of an error in the prior reporting period.

**STEWARDSHIP LAND**

*For Fiscal Year Ended September 30, 2005*

(Acres in Thousands)

(a) Land Use	(b) As of 10/01/04	(c) Additions	(d) Deletions	(e) As of 9/30/05
1. Mission	2,026	0	0	2,026
2. Parks & Historic Sites	0	0	0	0
Totals	<u>2,026</u>	<u>0</u>	<u>0</u>	<u>2,026</u>

The DON followed the definition of Stewardship Land per the DoD FMR to include Public Domain, Land Set Aside, and Donated Land. The iNFADS was used to derive acres for Stewardship Land. Within the definition of Stewardship Land, land can be further categorized as Improved, Semi-Improved or in the Other Category of land.

**NONFEDERAL PHYSICAL PROPERTY**

The Department of the Navy does not fund this type of Activity.

## 2005 Annual Financial Report

### INVESTMENTS IN RESEARCH AND DEVELOPMENT

Yearly Investment in Research and Development  
For Fiscal Years 2001 through 2005  
(In Millions of Dollars)

(a) Categories	(b) FY01	(c) FY02	(d) FY03	(e) FY04	(f) FY05
1. Basic Research	\$383	\$378	\$399	\$431	\$437
2. Applied Research	597	647	743	686	692
3. Development					
Advanced Technology Development	738	779	836	967	951
Advanced Component Development And Prototypes	2,418	2,415	2,536	2,361	3,030
System Development and Demonstration	2,086	2,836	4,200	6,115	7,094
Research, Development, Test, and Evaluation					
Management Support	782	838	797	906	955
Operational Systems Development	2,266	2,417	2,385	1,820	3,775
Total	\$9,270	\$10,310	\$11,896	\$13,286	\$16,934

### Narrative Statement

#### Investments in Research and Development

Investment values included in this Report are based on Research and Development (R&D) outlays (expenditures). Outlays are used because current DON systems are unable to fully capture and summarize costs in accordance with FASAB standards.

#### A. Basic Research

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 fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

The following are two representative program examples for the Basic Research category.

#### Studying Dolphins to Improve Sonar Techniques

Navy News Service professionals and students from the University of Hawaii are currently studying dolphin hearing and echolocation to help the Navy improve mining and sonar techniques and make the oceans safer for marine mammals. The research is being conducted through the joint Marine Mammal Research Program at Marine Corps Base, Kaneohe Bay, Hawaii. According to the Program Director there is deep concern about loud ocean sounds and the effects of those sounds on marine mammals. Dolphins' echolocation, or the use of sound waves for vision, is studied for the potential military, scientific, and natural science applications of this capability.

Many sources, both natural and man-made, contribute to the background sound in today's oceans. Experiments are done that look at the acoustics that tell us how a dolphin's bio-sonar operates. The resulting information is passed on to those who build sonar equipment. Recognizing our obligation to protect the natural environment, the Navy has procedures in place, including the suspension of operations when required, to minimize potential harm to marine mammals from sonar use.

The Office of Naval Research provides the majority of the funding and has an agreement to use the research facility on the Navy base. The University of Hawaii provides the program with research staff. The facility is also equipped to handle marine mammals that strand on the beaches around Oahu. Stranded animals receive appropriate medical care to and are eventually released back into the Pacific Ocean. The Navy commits nearly \$10 million annually for this research program.

### **Stress and Mutations - New Method of Fighting Antibiotic Resistance by Stopping Evolution**

A team of scientists at The Scripps Research Institute and the University of Wisconsin have demonstrated a new way of fighting antibiotic resistance: by stopping evolution.

In the June 2005 issue of the Public Library of Science's scientific journal, PLoS Biology, the team describes how a protein called LexA in the bacterium Escherichia Coli promotes mutations and helps the pathogen evolve resistance to antibiotics. The scientists also show that E. coli evolution could be halted in its tracks by subjecting the bacteria to compounds that block LexA. Interfering with this protein renders the bacteria unable to evolve resistance to the common antibiotics ciprofloxacin and rifampicin. The research professor leading the study stated: "evolution is not an unstoppable force, there is a biochemistry underlying it and it is subject to intervention". The Office of Naval Research supported this research work.

### **B. Applied Research**

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

The following are two representative program examples for the Applied Research category.

### **Scientists Create World's Tiniest Organic Particles**

University of North Carolina at Chapel Hill chemists have developed what they believe is a breakthrough method of creating the world's tiniest manufactured particles for delivering drugs and other organic materials into the human body.

Adapting technology pioneered by the electronics industry in fabricating transistors, the team has figured out for the first time how to create particles for carrying genetic material, pharmaceuticals and other compounds of unprecedented small size and uniformity. The tiny bits are so small they can be designed and constructed to measure only a hundred nanometers or so in diameter. A nanometer is a billionth of a meter.

The distinguished professor of chemistry and chemical engineering at the university who leads the team has stated: "we really believe this work will have a profound positive impact down the road on human health care. This includes, but is not limited to, chemotherapy, gene therapy, disease detection and drug delivery". The Office of Naval Research supported this research work into organic particles.

## 2005 Annual Financial Report

### Expeditionary Unit Water Purifier

The Office of Naval Research Expeditionary Warfare Operations Technology Division has awarded contracts to two commercial partners to supply two tactical water purification systems designated as the Expeditionary Unit Water Purifier (EUWP). These water purification systems can be airlifted using a C-130 transport plane to provide potable water for reconstruction, humanitarian aid and disaster relief. In fact the EUWP was most recently deployed to the Biloxi, Mississippi area to generate purified water in the wake of Hurricane Katrina.

EUWP design capacity is 100,000 gallons per day of potable water when treating water from a variety of sources including turbid or saline water, and feed water that has nuclear, biological or chemical contamination.

Naval Facilities Engineering Services Center (NFESC) has received the first EUWP for initial testing and evaluation at the Seawater Desalination Testing Facility in Port Hueneme, California. Then the EUWP will be moved to the Tularosa Basin National Desalination Research Facility in Alamogordo, New Mexico for additional evaluation.

### C. Development

Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development is comprised of five stages defined below:

1. Advanced Technology Development is the systematic use of the knowledge or understanding gained from research directed toward proof of technological feasibility and assessment of operational and producibility 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 Prototype are hardware and software components, or complete weapon systems, ready for operational and developmental testing and field use.
3. System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapons systems finalized for complete operational and development testing.
4. RDT&E Management Support is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the R&D program.
5. Operational Systems Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development, which have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

The following are two representative program examples for the Development category.

**Unmanned Aerial Vehicles Collaborate**

The Joint Operational Test Bed System was initiated by the U.S. Joint Forces Command with the objective of improving the war fighting capabilities of unmanned aerial vehicles by using a communications network between the vehicles and base stations.

The exercises held in February and March 2005 at Fort Huachuca, Arizona, and June 2005 at Cherry Point, North Carolina, were technical demonstrations of the capability for the different unmanned vehicles to communicate with each other and share information at various levels.

**Fast and Flexible, X-CRAFT/ 'Sea Fighter' May Transform Naval Warfare**

As the commanding officer scanned the Pacific Ocean, he announced proudly, "We have just reached 50 knots". For a fast bass boat or any car on the road, 50 knots (about 57 miles an hour) would be unimpressive. But the vessel under sail is nearly the length of a football field and can carry more firepower than a battleship, a dozen or more teams of elite Navy SEALs or a squadron of unmanned helicopters. The Navy's new experimental Sea Fighter looks more like a heavily armored passenger ferry than any conventional warship.

But as the crew demonstrated that week to a group of reporters and dignitaries, the Sea Fighter is anything but simple. This ship is the wave of the future. The Sea Fighter is the first of a new class of Navy ships designed to move quickly in shallow waters with a minimal crew. The new Littoral Combat Ships (LCS) are part of an overall modernization program designed to help the Navy fight modern-day battles in ways that hulking battleships and giant aircraft carriers can not. The new class of ships is designed for patrolling coastlines, dropping mines or sensors, delivering assault teams, and intercepting or outrunning small terrorist boats. At the same time, they are designed to carry enough missiles and other weapons to bombard a good-sized city or support battlefield troops hundreds of miles inland.

Off-the-shelf commercial computer components and other equipment are designed to reduce costs and make the ships more adaptable. They are built to be big and tough enough to withstand rough seas like bigger ships, but also light enough to operate in waters as shallow as 12 feet. "The ship is lighter, it's cheaper, it's more flexible" than anything before it, said the commander of the Office of Naval Research, which oversaw the Sea Fighter design. From the helm, the skipper proudly said that commanding the Sea Fighter is unlike anything he has experienced. What amazed him most on early sea trials was how well a 262-foot ship, controlled by joysticks, handled at nearly 60 miles per hour.

**GENERAL FUND  
REQUIRED SUPPLEMENTARY INFORMATION**

2005



GF Required Supplementary Information

Department of Defense

Department of the Navy

**DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Other</u>	<u>Research, Development, Test &amp; Evaluation</u>	<u>Operation and Maintenance</u>	<u>Procurement</u>
<b>BUDGETARY FINANCING ACCOUNTS</b>				
<b>BUDGETARY RESOURCES</b>				
Budget Authority				
Appropriations Received	\$ 295,982	\$ 17,237,063	\$ 39,714,606	\$ 33,680,129
Borrowing Authority	0	0	0	0
Contract Authority	0	0	0	0
Net transfers (+/-)	(266,159)	(32,699)	575,882	77,090
Other	0	0	0	0
Unobligated Balance:				
Beginning of period	24,492	2,175,582	2,931,296	11,473,500
Net transfers, actual (+/-)	0	45,590	(34,418)	228,105
Anticipated Transfers Balances	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	0	281,685	6,350,270	1,033,222
Receivable from Federal sources	0	101,048	551,753	(10,933)
Change in unfilled customer orders	0	0	0	0
Advances received	0	102,536	564	0
Without advance from Federal sources	0	(10,239)	(637,159)	(632)
Anticipated for the rest of year, without advances	0	0	0	0
Previously unavailable	0	0	0	0
Transfers from trust funds	0	0	0	0
Subtotal	<u>\$ 0</u>	<u>\$ 475,030</u>	<u>\$ 6,265,428</u>	<u>\$ 1,021,657</u>
Recoveries of prior year obligations	<u>\$ 1,664</u>	<u>\$ 573,093</u>	<u>\$ 6,162,412</u>	<u>\$ 4,010,519</u>
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	0	(364,375)	(342,613)	(656,057)
<b>Total Budgetary Resources</b>	<u><u>\$ 55,979</u></u>	<u><u>\$ 20,109,284</u></u>	<u><u>\$ 55,272,593</u></u>	<u><u>\$ 49,834,943</u></u>
<b>STATUS OF BUDGETARY RESOURCES</b>				
Obligations Incurred				
Direct	\$ 305,883	\$ 17,890,459	\$ 44,679,439	\$ 34,249,529
Reimbursable	(273,543)	594,914	9,821,667	2,073,632
Subtotal	<u>\$ 32,340</u>	<u>\$ 18,485,373</u>	<u>\$ 54,501,106</u>	<u>\$ 36,323,161</u>
Unobligated balance				
Apportioned	\$ 23,638	\$ 1,418,243	\$ 45,705	\$ 13,054,346
Exempt from apportionment	0	0	0	0
Other available	0	0	0	0
Unobligated Balances Not Available	0	205,667	725,783	457,436
<b>Total, Status of Budgetary Resources</b>	<u><u>\$ 55,978</u></u>	<u><u>\$ 20,109,283</u></u>	<u><u>\$ 55,272,594</u></u>	<u><u>\$ 49,834,943</u></u>
<b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>				
Obligated Balance, Net - beginning of period:	\$ 65,753	\$ 6,105,616	\$ 13,962,797	\$ 40,468,857
Obligated Balance transferred, net (+/-)	0	0	0	0
Obligated Balance, net - end of period:				
Accounts Receivable	\$ 0	\$ (104,889)	\$ (770,619)	\$ (122,662)
Unfilled customer order from Federal sources	0	(273,043)	(1,218,022)	(10,573)
Undelivered Orders	(804,107)	8,186,726	16,794,874	42,398,395
Accounts Payable	864,144	(305,131)	1,211,361	771,701
Outlays:				
Disbursements	\$ 36,392	\$ 16,423,425	\$ 46,369,303	\$ 29,756,204
Collections	0	(384,221)	(6,350,835)	(1,033,222)
Subtotal	<u>\$ 36,392</u>	<u>\$ 16,039,204</u>	<u>\$ 40,018,468</u>	<u>\$ 28,722,982</u>
Less: Offsetting receipts	(115,805)	0	0	0
<b>Net Outlays</b>	<u><u>\$ (79,413)</u></u>	<u><u>\$ 16,039,204</u></u>	<u><u>\$ 40,018,468</u></u>	<u><u>\$ 28,722,982</u></u>



Department of Defense  
 Department of the Navy  
**DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>Military Personnel</u>	<u>Military Construction / Family Housing</u>	<u>2005 Combined</u>	<u>2004 Combined</u>
<b>BUDGETARY FINANCING ACCOUNTS</b>				
<b>BUDGETARY RESOURCES</b>				
Budget Authority				
Appropriations Received	\$ 38,542,601	\$ 1,531,980	\$ 131,002,361	\$ 123,948,477
Borrowing Authority	0	0	0	0
Contract Authority	0	0	0	0
Net transfers (+/-)	105,862	(98,671)	361,305	425,109
Other	0	0	0	0
Unobligated Balance:				
Beginning of period	476,148	946,976	18,027,994	14,695,238
Net transfers, actual (+/-)	(256,879)	(29,029)	(46,631)	195,950
Anticipated Transfers Balances	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned				
Collected	428,275	737,188	8,830,640	7,706,650
Receivable from Federal sources	73,266	(18,467)	696,667	(360,284)
Change in unfilled customer orders	0	0	0	0
Advances received	0	44,608	147,708	56,010
Without advance from Federal sources	(5,227)	16,864	(636,393)	467,506
Anticipated for the rest of year, without advances	0	0	0	0
Transfers from trust funds	0	0	0	0
Subtotal	<u>\$ 496,314</u>	<u>\$ 780,193</u>	<u>\$ 9,038,622</u>	<u>\$ 7,869,882</u>
Recoveries of prior year obligations	\$ 668,098	\$ 30,649	\$ 11,446,435	\$ 13,756,981
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	(140,373)	(40,024)	(1,543,442)	(1,708,789)
<b>Total Budgetary Resources</b>	<u>\$ 39,891,771</u>	<u>\$ 3,122,074</u>	<u>\$ 168,286,644</u>	<u>\$ 159,182,848</u>
<b>STATUS OF BUDGETARY RESOURCES</b>				
Obligations Incurred				
Direct	\$ 39,228,152	\$ 1,340,914	\$ 137,694,376	\$ 132,268,522
Reimbursable	497,887	749,232	13,463,789	8,886,330
Subtotal	<u>\$ 39,726,039</u>	<u>\$ 2,090,146</u>	<u>\$ 151,158,165</u>	<u>\$ 141,154,852</u>
Unobligated balance				
Apportioned	\$ 74,533	\$ 991,040	\$ 15,607,505	\$ 13,973,107
Exempt from apportionment	0	0	0	0
Other available	0	0	0	1
Unobligated Balances Not Available	91,199	40,889	1,520,974	4,054,888
Total, Status of Budgetary Resources	<u>\$ 39,891,771</u>	<u>\$ 3,122,075</u>	<u>\$ 168,286,644</u>	<u>\$ 159,182,848</u>
<b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>				
Obligated Balance, Net-beginning of period:	\$ 1,764,351	\$ 1,488,850	\$ 63,856,224	\$ 63,520,894
Obligated Balance transferred, net (+/-)	0	0	0	0
Obligated Balance, net-end of period:				
Accounts Receivable	\$ (127,180)	\$ (108,876)	\$ (1,234,226)	\$ (537,560)
Unfilled customer order from Federal sources	5,859	(670,809)	(2,166,588)	(2,802,982)
Undelivered Orders	186,105	1,969,021	68,731,014	63,723,755
Accounts Payable	560,522	259,575	3,362,172	3,473,010
OUTLAYS:				
Disbursements	\$ 40,128,948	\$ 2,101,036	\$ 134,815,308	\$ 126,955,319
Collections	(428,275)	(781,795)	(8,978,348)	(7,762,660)
Subtotal	<u>\$ 39,700,673</u>	<u>\$ 1,319,241</u>	<u>\$ 125,836,960</u>	<u>\$ 119,192,659</u>
Less: Offsetting receipts	0	0	(115,805)	(115,027)
<b>Net Outlays</b>	<u>\$ 39,700,673</u>	<u>\$ 1,319,241</u>	<u>\$ 125,721,155</u>	<u>\$ 119,077,632</u>

**DON GENERAL PROPERTY, PLANT, AND EQUIPMENT**

Real Property Deferred Annual Sustainment and Restoration Tables

As of September 30, 2005

(\$ in Millions)

Annual Sustainment FY 2005			
	Required	Actual	Difference
Navy	\$1,321	\$1,073	\$248
Marine Corps	535	505	30
<b>Building, Structures, and Utilities</b>	\$1,856	\$1,578	\$278

Annual Deferred Sustainment Trend				
	FY 2002	FY 2003	FY 2004	FY 2005
Navy	NAV	NAV	\$488	\$248
Marine Corps	NAV	NAV	24	30
<b>Building, Structures, and Utilities</b>	\$40	\$346	\$512	\$278

NAV = Not available

Restoration and Modernization Requirements			
	End FY 2004	End FY 2005	Change
Navy	-	-	-
Marine Corps	-	-	-
<b>Building, Structures, and Utilities</b>	-	-	-

**Narrative Statement:**

Fiscal Year 2005 represents the fourth year the Facility Sustainment Model (FSM) was utilized for the DON General Fund. Deferred amounts were calculated in accordance with the methodology provided by DoD Financial Management Regulation, Volume 6B, Chapter 12. The output of the Facility Sustainment Model continues to undergo quality checks to ensure its accuracy. Accordingly, utilizing an updated and accurate version of the model provides current requirements for each fiscal year. In FY 2005, FSM Version 5.0 was used for programming and budgeting for facilities sustainment.

The DON General Fund has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

## 2005 Annual Financial Report

### MILITARY EQUIPMENT

Deferred Maintenance Amounts

As of September 30, 2005

(\$ in Thousands)

Major Type	Amount
1. Aircraft	\$54,888
2. Ships	54,206
3. Missiles	58,911
4. Combat Vehicles	26,679
5. Other Weapons Systems	116,471
6. Total	<u>\$311,155</u>

#### Narrative Statement:

##### Aircraft Deferred Maintenance

Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), component repair, and software maintenance. The airframe rework deferred maintenance calculation reflects executable unfunded requirements, which represent aircraft that failed Aircraft Service Period Adjustment (ASPA) or reached fixed Period End Date (PED) at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance cost represents the difference between the validated requirements minus corresponding funding. Aircraft deferred maintenance reflects only executable deferred maintenance. Unexecutable deferred maintenance is not reported for airframe rework, engine rework and component repair, nor is it collected.

Airframe rework and maintenance (active and reserve) is currently performed under both the Standard Depot Level Maintenance (SDLM) and Integrated Maintenance Concept (IMC) programs. Currently, the AV-8B, C-130, C-2, E-2C, E-6, EA-6B, F-5, F/A-18, H-60, H-1, H-46, H-53, P-3, and S-3 aircraft programs have been incorporated under the IMC concept. Descriptions of these aircraft can be found at <http://www.chinfo.navy.mil/navpalib/factfile/ffiletop.html>. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, with smaller work packages, thereby reducing out of service time. The goal of this program is to improve readiness while reducing operating and support costs. The Naval Air Systems Command's (NAVAIR) Industrial Strategy is to maintain the minimum level of organic capacity, consistent with force levels, that is necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR works in partnership with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance.

##### Ship Deferred Maintenance

Fleet Type Commanders provided deferred Ship Maintenance data. Data was collected from the Current Ships' Maintenance Plan (CSMP) database, which captures maintenance actions at all levels (organizational, intermediate, depot), for active and reserve ships. Only depot level deferred maintenance has been provided in this report. This includes maintenance actions deferred from actual depot maintenance work-packages as well as maintenance deferred before inclusion in a work package due to fiscal, operational, or capacity constraints. Although there is a significant amount of deferred maintenance

actions, there are no ships that fall into the category of "unacceptable operating condition". Any ship that would be at risk of being in unacceptable operating condition would receive priority for maintenance funding to maintain acceptable operating condition.

#### **Missile Maintenance**

Four categories are used to determine missile maintenance: missiles, tactical missiles, software maintenance, and other. Deferred maintenance is defined as the difference between the total weapon maintenance requirement as determined by requirements modeling processes and the weapon maintenance that is funded in accordance with the annual budget controls for the Missile Maintenance program. The maintenance requirements model projects the quantity of missiles and missile components per weapon system that are required to be maintained (reworked) annually.

#### **Combat Vehicles**

The combat vehicles category refers to deferred vehicle overhaul maintenance for the active and reserve Marine Corps assets.

#### **Other Weapons System**

The "Other Weapons System" category is comprised of ordnance, end item maintenance for support equipment, camera equipment, landing aids, calibration equipment, air traffic control equipment, target systems, expeditionary airfield equipment, special weapons, target maintenance, and repair of repairable components. Three categories define ordnance maintenance: ordnance maintenance, software maintenance and other. Although the various programs vary in the methodology in defining requirements, all programs define deferred maintenance as the difference between validated requirements and funding.

#### **Software Maintenance**

Software maintenance requirements and deferred maintenance for aircraft, missiles and other equipment are determined using the same methodology and, therefore will not be addressed separately for each Military Equipment Deferred Maintenance reporting categories. Software maintenance includes the operational and system test software that runs in the airborne avionics systems (e.g., mission computer, display computer, radar) and the software that runs the ground based support labs used to perform software sustainment (e.g., compilers, editors, simulation, configuration management). The deferred maintenance reported for the execution year are those requirements below the funding threshold and up to, but not exceeding, the capacity of the Software Support Activity (SSA) in that particular fiscal year.

## 2005 Annual Financial Report

Schedule, Part A DoD Intragovernmental Asset Balances						
(\$ Amounts in Thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		\$1,551			
Department of Commerce	13					\$1,847
Department of the Interior	14		\$164			\$217,616
Department of Justice	15		\$5,445			
United States Postal Service	18		\$20			
Department of State	19		\$1,431			
Department of the Treasury	20	\$86,079,205	\$354		\$9,519	
Army General Fund	21		\$37,536			\$207
Office of Personnel Management	24					\$33,830
Nuclear Regulatory Commission	31		\$33			
International Trade Commission	34		\$0			
Department of Veterans Affairs	36		\$13			
Government Printing Office	4		\$0			
General Service Administration	47		\$6			
National Science Foundation	49		\$424			\$161
Air Force General Fund	57		\$25,208			\$101,858
Environmental Protection Agency	68		\$97			\$1,932
Department of Transportation	69		\$2,316			\$98,221
Homeland Security	70		\$60,539			
Agency for International Development	72		\$2			
Small Business Administration	73					\$200
Department of Health and Human Services	75		\$125			\$24
National Aeronautics and Space Administration	80		\$2,537			\$2,329
Department of Housing and Urban Development	86		\$6			
Department of Energy	89		\$224			\$1,304
Department of Education	91		\$63			
US Army Corps of Engineers	96		\$1,753			
Other Defense Organizations General Funds	97		\$52,334			
Other Defense Organizations Working Capital Funds	97-4930		\$22,810			\$30,196
Army Working Capital Fund	97-4930.001		\$2,053			
Navy Working Capital Fund	97-4930.002		\$63,628			\$180,959
Air Force Working Capital Fund	97-4930.003		\$634			\$1,572
<i>Totals might not match the Principal Statements</i>	<b>Totals</b>	\$86,079,205	\$281,306		\$9,519	\$672,256

Schedule, Part B DoD Intragovernmental Entity Liabilities				
(\$ Amounts in Thousands)	Treasury Index	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Department of Agriculture	12	\$1,106		
Department of Commerce	13	\$299		
Department of the Interior	14	\$2,478		
Department of Labor	16			\$623,620
Department of State	19	\$17,218		
Department of the Treasury	20	\$35,567		
Army General Fund	21	\$62,306		
Office of Personnel Management	24			\$44,585
Federal Communications Commission	27	\$596		
Nuclear Regulatory Commission	31	\$60		
Department of Veterans Affairs	36	\$3,882		
General Service Administration	47	\$205,242		
National Science Foundation	49	\$665		
Air Force General Fund	57	\$43,215		
Tennessee Valley Authority	64	\$559		
Environmental Protection Agency	68	\$268		
Department of Transportation	69	\$36,728		
Homeland Security	70	\$9,552		
Department of Health and Human Services	75	\$38		
National Aeronautics and Space Administration	80	\$6,395		
Department of Energy	89	\$109,401		
US Army Corps of Engineers	96	\$236		
Other Defense Organizations General Funds	97	\$60,426		\$2,119
Other Defense Organizations Working Capital Funds	97-4930	\$207,947		
Army Working Capital Fund	97-4930.001	\$13,783		
Navy Working Capital Fund	97-4930.002	\$386,796		
Air Force Working Capital Fund	97-4930.003	\$3,941		
The General Fund of the Treasury	99			\$3,155,725
<i>Totals might not match the Principal Statements</i>	Totals:	\$1,208,704		\$3,826,049

## 2005 Annual Financial Report

Schedule, Part C DoD Intragovernmental Revenue and Related Costs (\$ Amounts in Thousands)		
	Treasury Index	Earned Revenue
Executive Office of the President	11	\$82,446
Department of Agriculture	12	\$7,694
Department of Commerce	13	\$9,568
Department of the Interior	14	\$682
Department of Justice	15	\$14,249
Department of Labor	16	\$1
United States Postal Service	18	\$23
Department of State	19	\$5,385
Department of the Treasury	20	\$1,218
Army General Fund	21	\$281,890
Nuclear Regulatory Commission	31	\$496
International Trade Commission	34	\$1
Department of Veterans Affairs	36	\$2,684
Government Printing Office	4	\$186
General Service Administration	47	\$515
National Science Foundation	49	\$3,352
Air Force General Fund	57	\$227,438
Environmental Protection Agency	68	\$127
Department of Transportation	69	\$8,652
Homeland Security	70	\$85,093
Agency for International Development	72	\$55
Department of Health and Human Services	75	\$4,780
National Aeronautics and Space Administration	80	\$15,302
Department of Housing and Urban Development	86	\$398
Department of Energy	89	\$3,819
Selective Service System	90	\$9
Department of Education	91	\$5,404
US Army Corps of Engineers	96	\$3,421
Other Defense Organizations General Funds	97	\$757,039
Other Defense Organizations Working Capital Funds	97-4930	\$233,746
Army Working Capital Fund	97-4930.001	\$36,461
Navy Working Capital Fund	97-4930.002	\$1,558,761
Air Force Working Capital Fund	97-4930.003	\$973
DoD Medicare-Eligible Retiree Health Care Func		\$125,788
<i>Totals might not match the Principal Statements</i>	<b>Total:</b>	\$3,477,656

Schedule, Part E DoD Intragovernmental Non-exchange Revenues ( <i>\$ Amounts in Thousands</i> )			
	Treasury Index	Transfers In	Transfers Out
Department of the Treasury	20	\$0	\$0
Air Force General Fund	57	\$21	
Homeland Security	70		\$1,673
Navy Working Capital Fund	97-4930.002	\$150,000	
<i>Totals might not match the Principal Statements</i>	<b>Total:</b>	\$150,021	\$1,673



**GENERAL FUND  
OTHER ACCOMPANYING INFORMATION**

2005



GF OTHER ACCOMPANYING INFORMATION

## APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE PRINCIPAL STATEMENTS

### Entity Accounts

#### General Funds

17X0380	Coastal Defense Augmentation, Navy
17X0703	Family Housing, Navy and Marine Corps
17X0730	Family Housing Construction, Navy and Marine Corps
17X0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17X1105	Military Personnel, Marine Corps
17X1106	Operation and Maintenance, Marine Corps
17X1107	Operation and Maintenance, Marine Corps Reserve
17X1108	Reserve Personnel, Marine Corps
17X1109	Procurement, Marine Corps
17X1205	Military Construction, Navy and Marine Corps
17X1235	Military Construction, Naval Reserve
17X1236	Payments to Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
171319	Research, Development, Test and Evaluation, Navy
171405	Reserve Personnel, Navy
17X1453	Military Personnel, Navy
17X1506	Aircraft Procurement, Navy
17X1507	Weapons Procurement, Navy
17X1508	Procurement of Ammunition, Navy and Marine Corps
17X1611	Shipbuilding Conversion
17X1804	Operation and Maintenance, Navy
17X1806	Operation and Maintenance, Navy Reserve
17X1810	Other Procurement

#### Revolving Funds

17X4557	National Defense Sealift Fund, Navy
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#### Trust Funds

17X8008	Office of Naval Records and History Fund
17X8716	Department of the Navy General Gift Fund
17X8723	Ships Stores and Profits, Navy
17X8730	United States Naval Academy Museum Fund
17X8733	United States Naval Academy General Gift Fund

#### Special Funds

17X5095	Wildlife Conversion, Military Reservations, Navy
17X5185	Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17X5429	Rossmoor Liquidating Trust Settlement Account
17X5562	Ford Island Improvement Account

## **2005 Annual Financial Report**

### **Non Entity Accounts**

17X3XXX	Receipt Accounts
17X6XXX	Deposit Funds
17X47X0535	Embassy Security, Construction and Maintenance, State
17X11 1081	International Military Education and Training Funds, appropriated to the President (fiscal year)
17X11X1081	International Military Education and Training Funds, appropriated to the President
17X11 1082	Foreign Military Financing Program, Funds appropriated to the President (fiscal year)
17X12X1105	State and Private Forestry, Forest Service



DEPARTMENT OF THE NAVY

# NAVY WORKING CAPITAL FUND PRINCIPAL STATEMENTS

2005



## **LIMITATIONS TO THE FINANCIAL STATEMENTS**

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

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

To the extent possible, the financial statements have been prepared in accordance with federal accounting standards. At times, the Department is unable to implement all elements of the standards due to financial management systems limitations. The Department continues to implement system improvements to address these limitations. There are other instances when the Department's application of the accounting standards is different from the auditor's application of the standards. In those situations, the Department has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent.

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

## *2005 Annual Financial Report*

### **PRINCIPAL STATEMENTS**

The FY 2005 Navy Working Capital Fund Principal Financial Statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual activity groups and activities within the Navy Working Capital Fund for the fiscal year ending September 30, 2005, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2004.

The following statements are included in the Navy Working Capital Fund Principal Statements:

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

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, as amended by the Government Management Reform Act of 1994.

The accompanying notes should be considered an integral part of the Principal Statements.

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATED BALANCE SHEET**  
 As of September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>ASSETS (Note 2)</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 977,865	\$ 861,243
Nonentity Seized Iraqi Cash	0	0
Nonentity - Other	0	0
Investments (Note 4)	0	0
Accounts Receivable (Note 5)	494,499	857,519
Other Assets (Note 6)	374	15
Total Intragovernmental Assets	<u>\$ 1,472,738</u>	<u>\$ 1,718,777</u>
Cash and Other Monetary Assets (Note 7)	0	0
Accounts Receivable (Note 5)	29,686	26,190
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	15,610,774	19,239,192
General Property, Plant and Equipment (Note 10)	3,730,522	3,895,542
Investments (Note 4)	0	0
Other Assets (Note 6)	536,741	717,191
<b>TOTAL ASSETS</b>	<u><u>\$ 21,380,461</u></u>	<u><u>\$ 25,596,892</u></u>
<b>LIABILITIES (Note 11)</b>		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 199,606	\$ 243,982
Debt (Note 13)	381,518	506,278
Other Liabilities (Note 15 & Note 16)	457,477	114,851
Total Intragovernmental Liabilities	<u>\$ 1,038,601</u>	<u>\$ 865,111</u>
Accounts Payable (Note 12)	2,152,112	1,862,567
Military Retirement Benefits and Other Employment- Related Actuarial Liabilities (Note 17)	1,192,551	1,168,225
Environmental Liabilities (Note 14)	0	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	3,450,673	5,679,116
<b>TOTAL LIABILITIES</b>	<u><u>\$ 7,833,937</u></u>	<u><u>\$ 9,575,019</u></u>
<b>NET POSITION</b>		
Unexpended Appropriations	\$ 6,286	\$ 0
Cumulative Results of Operations	13,540,238	16,021,873
<b>TOTAL NET POSITION</b>	<u><u>\$ 13,546,524</u></u>	<u><u>\$ 16,021,873</u></u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u><u>\$ 21,380,461</u></u>	<u><u>\$ 25,596,892</u></u>

The accompanying notes are an integral part of these statements.



## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### CONSOLIDATED STATEMENT OF NET COST

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Program Costs</b>		
Intragovernmental Gross Costs	\$ 5,567,551	\$ 5,434,981
(Less: Intragovernmental Earned Revenue)	<u>(20,715,925)</u>	<u>(21,698,935)</u>
Intragovernmental Net Costs	\$ <u>(15,148,374)</u>	\$ <u>(16,263,954)</u>
Gross Costs With the Public	\$ 19,256,819	\$ 17,915,614
(Less: Earned Revenue From the Public)	<u>(1,524,490)</u>	<u>(613,535)</u>
Net Costs With the Public	\$ <u>17,732,329</u>	\$ <u>17,302,079</u>
Total Net Cost	\$ 2,583,955	\$ 1,038,125
<b>Costs Not Assigned to Programs</b>	0	0
<b>(Less: Earned Revenue Not Attributable to Programs)</b>	<u>0</u>	<u>0</u>
<b>Net Cost of Operations</b>	<u>\$ 2,583,955</u>	<u>\$ 1,038,125</u>

The accompanying notes are an integral part of these statements.

Department of Defense  
Navy Working Capital Fund

**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Cumulative Results of Operations</b>		
<b>Beginning Balances</b>	\$ 16,021,873	\$ 18,136,830
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles	0	0
Correction of Errors	0	(1,044,715)
<b>Beginning Balances, as adjusted</b>	<u>\$ 16,021,873</u>	<u>\$ 17,092,115</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (recissions, etc) (+/-)	0	0
Appropriations used	287,964	130,446
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	(84,615)	(287,800)
Other budgetary financing sources (+/-)	0	(419,775)
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	126
Imputed financing from costs absorbed by others	552,597	544,886
Other (+/-)	(653,626)	0
<b>Total Financing Sources</b>	<u>\$ 102,320</u>	<u>\$ (32,117)</u>
<b>Net Cost of Operations (+/-)</b>	<u>2,583,955</u>	<u>1,038,125</u>
<b>Net Change</b>	<u>(2,481,635)</u>	<u>(1,070,242)</u>
<b>Ending Balances</b>	<u><u>\$ 13,540,238</u></u>	<u><u>\$ 16,021,873</u></u>

The accompanying notes are an integral part of these statements.

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Unexpended Appropriations</b>		
<b>Beginning Balances</b>	\$ 0	\$ 0
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles	0	0
Correction of Errors	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 0</u>	<u>\$ 0</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 298,000	\$ 130,446
Appropriations transferred in/out (+/-)	(3,750)	0
Other adjustments (recissions, etc) (+/-)	0	0
Appropriations used	(287,964)	(130,446)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
<b>Total Financing Sources</b>	<u>\$ 6,286</u>	<u>\$ 0</u>
<b>Net Cost of Operations (+/-)</b>	0	0
<b>Net Change</b>	6,286	0
<b>Ending Balances</b>	<u><u>\$ 6,286</u></u>	<u><u>\$ 0</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense  
 Navy Working Capital Fund  
**COMBINED STATEMENT OF BUDGETARY RESOURCES**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

<b>BUDGETARY FINANCING ACCOUNTS</b>	<u>2005 Combined</u>	<u>2004 Combined</u>
<b>BUDGETARY RESOURCES</b>		
Budget Authority:		
Appropriations Received	\$ 298,000	\$ 130,446
Borrowing Authority	0	0
Contract Authority	865,296	355,172
Net transfers (+/-)	(3,750)	0
Other	0	0
Unobligated Balance:		
Beginning of period	2,749,720	4,513,325
Net transfers, actual (+/-)	(84,615)	(287,800)
Anticipated Transfers Balances	0	0
Spending Authority from Offsetting Collections:		
Earned	0	0
Collected	23,151,266	23,926,810
Receivable from Federal sources	(233,654)	249,344
Change in unfilled customer orders	0	0
Advances received	8,239	90,067
Without advance from Federal sources	249,981	(1,724,666)
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Transfers from trust funds	0	0
Subtotal	<u>\$ 23,175,832</u>	<u>\$ 22,541,555</u>
Recoveries of prior year obligations	0	0
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(247,828)	(186,529)
<b>Total Budgetary Resources</b>	<u><u>\$ 26,752,655</u></u>	<u><u>\$ 27,066,169</u></u>
 <b>STATUS OF BUDGETARY RESOURCES</b>		
Obligations Incurred:		
Direct	\$ 0	\$ 0
Reimbursable	23,935,997	24,316,448
Subtotal	<u>\$ 23,935,997</u>	<u>\$ 24,316,448</u>
Unobligated balance:		
Apportioned	2,768,052	2,650,776
Exempt from apportionment	(143,714)	0
Other available	(1)	0
Unobligated Balances Not Available	192,321	98,945
<b>Total Status of Budgetary Resources</b>	<u><u>\$ 26,752,655</u></u>	<u><u>\$ 27,066,169</u></u>

The accompanying notes are an integral part of these statements.

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### COMBINED STATEMENT OF BUDGETARY RESOURCES

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Combined</u>	<u>2004 Combined</u>
<b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>		
Obligated Balance, Net - beginning of period	\$ 4,238,707	\$ 3,274,114
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, net - end of period:		
Accounts Receivable	(356,787)	(590,442)
Unfilled customer order from Federal sources	(7,281,442)	(7,031,461)
Undelivered Orders	7,468,939	6,892,059
Accounts Payable	5,198,377	4,968,550
Outlays:		
Disbursements	23,129,285	24,827,178
Collections	(23,159,504)	(24,016,876)
Subtotal	\$ (30,219)	\$ 810,302
Less: Offsetting receipts	0	0
<b>Net Outlays</b>	<u>\$ (30,219)</u>	<u>\$ 810,302</u>

The accompanying notes are an integral part of these statements.

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF FINANCING**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005</u> <u>Consolidated</u>	<u>2004</u> <u>Consolidated</u>
<b>Resources Used to Finance Activities:</b>		
Budgetary Resources Obligated		
Obligations Incurred	\$ 23,935,997	\$ 24,316,448
Less: Spending Authority from offsetting collections and recoveries (-)	(23,175,830)	(22,541,554)
Obligations net of offsetting collections and recoveries	\$ 760,167	\$ 1,774,894
Less: Offsetting receipts (-)	0	0
Net obligations	<u>\$ 760,167</u>	<u>\$ 1,774,894</u>
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	125
Imputed financing from costs absorbed by others	552,597	544,886
Other (+/-)	(653,626)	0
Net other resources used to finance activities	<u>\$ (101,029)</u>	<u>\$ 545,011</u>
<b>Total resources used to finance activities</b>	<u>\$ 659,138</u>	<u>\$ 2,319,905</u>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	\$ (684,742)	\$ 1,142,521
Unfilled Customer Orders	258,220	(1,634,601)
Resources that fund expenses recognized in prior periods	0	(241,627)
Budgetary offsetting collections and receipts that do not affect Net		
Cost of Operations	0	0
Resources that finance the acquisition of assets	(4,342,345)	(5,045,185)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	653,626	(125)
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<u>\$ (4,115,241)</u>	<u>\$ (5,779,017)</u>
<b>Total resources used to finance the Net Cost of Operations</b>	<u>\$ (3,456,103)</u>	<u>\$ (3,459,112)</u>

The accompanying notes are an integral part of these statements.

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### CONSOLIDATED STATEMENT OF FINANCING

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005</u> <u>Consolidated</u>	<u>2004</u> <u>Consolidated</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	\$ 0	\$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	<u>24,326</u>	<u>0</u>
Total components of Net Cost of Operations that will require or generate resources in future periods	<u>\$ 24,326</u>	<u>\$ 0</u>
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 205,205	\$ 255,203
Revaluation of assets and liabilities (+/-)	1,236,002	42,924
Other (+/-)		0
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	4,574,426	4,160,738
Operating Material & Supplies Used	0	0
Other	<u>99</u>	<u>38,372</u>
Total components of Net Cost of Operations that will not require or generate resources	<u>\$ 6,015,732</u>	<u>\$ 4,497,237</u>
<b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b>	<u>\$ 6,040,058</u>	<u>\$ 4,497,237</u>
<b>Net Cost of Operations</b>	<u>\$ 2,583,955</u>	<u>\$ 1,038,125</u>

The accompanying notes are an integral part of these statements.





# NAVY WORKING CAPITAL FUND NOTES TO THE PRINCIPAL STATEMENTS

2005



## **NOTE 1. SIGNIFICANT ACCOUNTING POLICIES**

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

These financial statements have been prepared to report the financial position and results of operations of the Navy Working Capital Fund (NWCF), as required by the Chief Financial Officers (CFO) 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 NWCF in accordance with the Department of Defense (DoD) Financial Management Regulation, Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements" and to the extent possible Federal Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which the NWCF is responsible except that information relative to classified assets, programs, and operations have been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. The NWCF financial statements are in addition to the financial reports also prepared by the NWCF pursuant to OMB directives that are used to monitor and control the NWCF use of budgetary resources.

The NWCF is unable to fully implement all elements of Federal GAAP and OMB Circular No. A-136 due to limitations of its financial management processes and systems, including feeder systems and processes. Reported values and information for NWCF major asset and liability categories are derived in part from feeder systems, such as inventory systems and logistic systems. These were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with Federal GAAP. The NWCF continues to implement process and system improvements addressing the limitation of its financial and feeder systems. A more detailed explanation of these financial statement elements is provided in the applicable note.

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

The overall mission of the Department of the Navy (DON) is to organize, train, and equip forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies. The NWCF provides goods, services, and infrastructure to DON and other DoD customers to help ensure our military forces are mobile, ready, and have the most advanced technology.

The NWCF has prepared annual financial statements pursuant to the CFO Act of 1990, as amended for the past fifteen years. The Act requires that financial statements be prepared and audited for each revolving fund and account that performed substantial commercial functions, such as those performed by the NWCF.

### **1.C. Appropriations and Funds**

The DON's appropriations and funds are divided into the general, working capital (revolving funds), trust, special, and deposit funds. These appropriations and funds are used to fund and report how the resources have been used in the course of executing the DON's missions.

The NWCF (a revolving fund) received its initial working capital through an appropriation or a transfer of resources from existing appropriations or funds and used those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders. The NWCF operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision making process. The activities provide goods and services on a reimbursable basis. Receipts derived from operations generally are available in their entirety for use without further congressional action.

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### 1.D. Basis of Accounting

The NWCF generally records transactions on an accrual accounting basis as required by Federal GAAP. However, some of the NWCF's financial and feeder systems and processes are not designed to collect and record financial information on the full accrual accounting basis. The NWCF has undertaken efforts to determine the actions required to bring all of its financial and feeder systems and processes into compliance with all elements of Federal GAAP.

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

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

Revenue is recognized according to the percentage of completion method for depot maintenance activities. Research and Development activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Revenue is recognized when an inventory item is sold for supply management activities and at the time service is rendered for base support activities. Revenue for the Transportation Activity Group is recognized on either a reimbursable or per diem basis. That is, revenue is recognized when earned. The preponderance of per diem projects are billed and collected in the month services are rendered. In the case of reimbursables, some per diems, and point-to-point voyages, the revenue is accrued in the month services are rendered and collection is made the following month.

The NWCF does not include non-monetary support provided by U.S. allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has agreements with foreign countries that include both direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port. DoD is reviewing these types of financing and cost reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the financial statements in accordance with GAAP. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

### 1.F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the NWCF's financial and feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and contracts. Expenditures for capital and other long-term assets are not recognized as expenses in the NWCF's operations until depreciated in the case of Property, Plant, and Equipment (PP&E) or consumed in the case of Operating Materials and Supplies (OM&S). Operating expenses were adjusted as a result of the elimination of balances between DoD Components.

### 1.G. Accounting for Intragovernmental Activities

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

The DON's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The NWCF's financial statements, therefore, do not report any portion of the federal government public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

To prepare reliable financial statements, transactions occurring between components or activities within the NWCF must be eliminated. However, the NWCF cannot accurately identify all intragovernmental transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of the NWCF. For FY 1999 and beyond, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intragovernmental balances were then eliminated.

The Department of the Treasury, Financial Management Service is responsible for eliminating transactions between the Department of Defense or Navy and other federal agencies. In September 2000, the Financial Management Service issued the "Federal Intragovernmental Transactions Accounting Policies and Procedures Guide." The Department of the Navy was not able to fully implement the policies and procedures in this guide related to reconciling intragovernmental assets, liabilities, revenues, and expenses for non-fiduciary transactions. The NWCF, however, was able to implement the policies and procedures contained in the "Intragovernmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intragovernmental Transactions Accounting Policies Guide," revised July 1, 2005, for reconciling intragovernmental transactions. It can be found at <http://www.fms.treas.gov/irri>. These transactions pertain to investments in federal securities, borrowings from the United States (U.S.) Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the OPM.

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

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of this Act, DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance.

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

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

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the NWCF's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at Note 3.

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### 1.J. Foreign Currency

Not Applicable.

### 1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for doubtful accounts due from the public are based upon analysis of collection experience by fund type. DoD does not recognize an allowance for doubtful accounts from other federal agencies. Claims against another federal agency are to be resolved between the agencies. Material disclosures are provided in Note 5.

### 1.L. Loans Receivable

Not Applicable.

### 1.M. Inventories and Related Property

The majority of the NWCF inventories are reported at approximate historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The remaining inventory is valued using Moving Average Cost (MAC). The NWCF uses the LAC method because its inventory systems were designed for material management rather than accounting. The systems provide accountability and visibility over inventory items. They do not maintain the historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Neither can they directly produce financial transactions using the U.S. Standard General Ledger (USSGL), as required by the Federal Financial Management Improvement Act of 1996 (Public Law 104-208). DoD is transitioning to a MAC methodology for valuing inventory that when fully implemented will allow the NWCF to comply with SFFAS No. 3.

The SFFAS No. 3 distinguishes between "inventory held for sale" and "inventory held in reserve for future sale." There is no management or valuation difference between the two USSGL accounts. Further, the DoD manages only military or government-specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD material management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DoD holds material based on military need and support for contingencies. Related property includes Operating Materials and Supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The NWCF uses various methods of accounting for OM&S.

The DoD policy is to account for condemned material (only) as "Excess, Obsolete, and Unserviceable." The net value of condemned material is zero, because the costs of disposal are greater than the potential scrap value. Material that can be potentially redistributed, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

In FY 2003, DoD adopted the use of an allowance to reflect impaired assets, i.e., Inventory Held for Repair. Previously, the DoD financial statements have presented its impaired assets at other than historical cost. The NWCF will implement the allowance method in conjunction with the transition to MAC.

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

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

Not Applicable.

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

General PP&E assets and any improvements to the asset are capitalized at historical acquisition cost when the asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of \$100 thousand. Improvement costs over the DoD capitalization threshold of \$100 thousand for General PP&E are required to be capitalized. All General PP&E, other than land, is depreciated on a straight-line basis. Land is not depreciated.

Effective February 20, 2003, Public Law 108-7, the Consolidated Appropriations Resolution, 2003, Section 106 increased the expense/investment unit value threshold from \$100 thousand to \$250 thousand. The revised threshold is not applicable to FY 2002 and other prior fiscal year appropriations. Since the NWCF receives its funds through the Capital Purchases Program (CPP), the threshold for NWCF remains at \$100 thousand.

General PP&E has been capitalized and reported on the NWCF financial statements using the following DoD capitalization thresholds: FY 1996 through FY 2005 - \$100 thousand; FY 1995 - \$50 thousand; FY 1994 - \$25 thousand; and FY 1993 - \$15 thousand.

For NWCF activities, all PP&E used in the performance of their mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E categories. Military Equipment, Heritage Assets and Stewardship Land owned or maintained on a NWCF installation are reported in the Supplemental Stewardship Report of the applicable Military Department. To prevent duplicate reporting of the same Heritage Assets within DON, the total number of DON-wide Heritage Assets are reported in the Required Supplementary Stewardship Information of the Annual Audited Financial Statements of the DON General Funds (Treasury Index 17).

Material disclosures are provided at Note 10.

### **1.P. Advances and Prepayments**

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

### **1.Q. Leases**

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

### **1.R. Other Assets**

The NWCF conducts business with commercial contractors under two primary types of contracts - fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the NWCF provides financing payments. One type of financing payment that the NWCF makes, for real property, is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in Note 10, General PP&E, Net.

## **2005 Annual Financial Report**

In addition, based on the provision of the Federal Acquisition Regulation (FAR), the NWCF makes financing payments under fixed price contracts. The NWCF reports these financing payments as "Other Assets" because the NWCF becomes liable only after the contractor delivers the goods in conformance with the contractual terms. If the contractor does not deliver a satisfactory product, the NWCF is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the NWCF for the full amount of the advance.

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

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the NWCF. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable and the amount of loss 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 that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The NWCF's loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as property damages and contract disputes.

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

Civilian annual leave that has been accrued and not used as of the balance sheet date is reported as a liability. The liability reported at the end of the accounting period reflects the current pay rates.

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

Net Position consists of unexpended appropriations and cumulative results of operations (CRO). Unexpended appropriations represent amounts of authority which are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated but for which legal liabilities for payments have not been incurred.

CRO for the NWCF represents the excess/loss of revenues over expenses less refunds to customers and returns to the U.S. Treasury since fund inception.

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

The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements is retained by the host country. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Department. Therefore, in the event treaties or other agreements are terminated whereby use of the foreign bases is no longer allowed, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

### **1.W. Comparative Data**

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2005. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater than 10 percent between FY 2004 and FY 2005, are explained within the Notes to the Financial Statements.

### **1.X. Unexpended Obligations**

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

### **1.Y. Undistributed Disbursements and Collections**

Unmatched Disbursements (UMDs) occur when payments do not match to a corresponding obligation in the accounting system. Negative Unliquidated Obligations (NULOs) occur when payments have a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments use available funds for valid receiving reports on delivered goods and services under valid contracts. In-transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity but not yet posted in an accounting system.

Unmatched Disbursements, NULOs, and In-Transit Disbursements, Net represent disbursements of the NWCF funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. For the most part, these payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The elimination of both problem disbursements and in-transits is one of the highest financial management priorities of the Office of the Under Secretary of Defense (Comptroller). Problem disbursements and in-transits represent a significant financial management concern since: (1) accuracy of accounting reports is affected; (2) availability of funds is more difficult to determine; and (3) the required research and resolution process becomes much more labor intensive as the age of the problem disbursements increase. As a result, the NWCF has efforts underway to improve the systems and to resolve all previous problem disbursements and process all in-transit disbursements. NWCF problem disbursements continue to decrease from the prior years largely due to improving system functionality and business processes. Additional emphasis on further reducing NWCF problem disbursements has resulted in corresponding efforts to analyze and improve DFAS processes and determine solutions to reduce current inflow and their root causes. Material disclosures are provided at Note 3.

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. In-transit payments are those payments that have been made to other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance. The Department of Defense policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of Federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The NWCF follows this procedure.



**NOTE 2. NONENTITY ASSETS**

As of September 30,	2005	2004
<i>(Amounts in thousands)</i>		
<b>1. Intragovernmental Assets:</b>		
A. Fund Balance with Treasury	\$ 0	\$ 0
B. Investments	0	0
C. Accounts Receivable	0	0
D. Other Assets	0	0
E. Total Intragovernmental Assets	\$ 0	\$ 0
<b>2. Nonfederal Assets:</b>		
A. Cash and Other Monetary Assets	\$ 0	\$ 0
B. Accounts Receivable	2,725	5,141
C. Loans Receivable	0	0
D. Inventory & Related Property	0	0
E. General Property, Plant and Equipment	0	0
F. Investments	0	0
G. Other Assets	0	0
H. Total Nonfederal Assets	\$ 2,725	\$ 5,141
<b>3. Total Nonentity Assets</b>	\$ 2,725	\$ 5,141
<b>4. Total Entity Assets</b>	\$ 21,377,736	\$ 25,591,751
<b>5. Total Assets</b>	\$ 21,380,461	\$ 25,596,892

**6. Information Related to Nonentity and Entity Assets:**

**Fluctuations and/or Abnormalities**

The Total Nonentity Assets decreased \$2,416 thousand, 47 percent, in FY 2005 in nonfederal accounts receivable. This reduction is the result of an increase in the level of collections of outstanding interest, penalties, fines and administrative fees.

**Definitions**

Asset accounts are categorized either as entity or nonentity. Entity accounts consist of resources that the agency has the authority to use, or where management is legally obligated to use funds to meet entity obligations. Nonentity accounts are assets that are held by the entity, but not available for use in the operations of the entity.

**Composition of Nonentity Assets**

The \$2,725 thousand in Nonentity Nonfederal Accounts Receivable represents interest, penalties, fines, and administrative fees. These fees do not belong to the Navy Working Capital Fund and will be submitted to the Department of Treasury.

**Other Disclosures Related to Nonentity Assets**

No further disclosures required.

**Note Reference**

For additional line item discussion on Entity Assets, see Note 3, Fund Balance with Treasury; Note 5, Accounts Receivable; Note 6, Other Assets; Note 9, Inventory and Related Property; and Note 10, General Property, Plant, and Equipment. For regulatory discussion on Entity and Nonentity Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**NOTE 3. FUND BALANCE WITH TREASURY**

As of September 30,	2005	2004
<i>(Amounts in thousands)</i>		
<b>1. Fund Balances:</b>		
A. Appropriated Funds	\$ 0	\$ 0
B. Revolving Funds	977,865	861,243
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	<u>\$ 977,865</u>	<u>\$ 861,243</u>
<b>2. Fund Balances Per Treasury Versus Agency:</b>		
A. Fund Balance per Treasury	\$ 977,865	\$ 861,243
B. Fund Balance per NWCF	<u>977,865</u>	<u>861,243</u>
<b>3. Reconciling Amount</b>	<u>\$ 0</u>	<u>\$ 0</u>

**4. Explanation of Reconciliation Amount:**

No reconciling amount needs to be explained for Fund Balance with Treasury.

**5. Information Related to Fund Balance with Treasury:**

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### Fluctuations and/or Abnormalities

Fund Balance with Treasury (FBWT) increased \$116,622 thousand, 14 percent, in FY 2005. The primary drivers of the net increase in FBWT are summarized as follows:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Aviation Depots	\$ 135,962		In May 2005, an appropriation (PL 109-13) was received in support of the cost incurred from the Global War on Terror in FY 2004 and Tsunami Relief. Additional funding was received in support of the clean-up effort from hurricane Ophelia.
Supply Management, Navy	62,641		The increase results primarily from an appropriation received for the purchase of pipeline spares.
Naval Undersea Warfare Center	31,056		The net increase resulted from an extra billing that was processed at fiscal year end. The extra billing at fiscal year end for the Naval Undersea Warfare Center (NUWC) was a timing issue compared with FY 2004. Due to systems and business process improvements during FY 2005, NUWC was able to process an extra billing cycle in September.
Space and Naval Warfare Systems Center		\$ 87,285	The decrease is primarily due to the cash transfer in September 2005 to Operations and Maintenance, Navy (Section 107 of Public Law 108-287). Other reductions relate to improvements in the cash matching processes.
Supply Management, Marine Corps		36,494	The decrease is primarily due to a cash transfer in February 2005 from the Marine Corps Supply to the Navy Supply.
<b>Totals</b>	<b>\$ 229,659</b>	<b>\$ 123,779</b>	

### Composition of Fund Balance with Treasury

The FBWT of \$977,865 thousand reflects the FY 2004 ending balance of \$861,243 thousand plus current FY 2005 collections, disbursements, and other cash transactions recorded in the Navy Working Capital Fund (NWCF) Treasury sub-limit 97X4930.002. The following table details the amounts recorded as of September 30, 2005.

As of September 30, 2005

(Amounts in thousands)

Collections	\$	23,159,505
Disbursements	\$	(23,129,647)
Other Cash Transactions, Net	\$	86,764

The following table provides a breakout of Other Cash Transactions, Net:

As of September 30, 2005		
<i>(Amounts in thousands)</i>		
<b>Activity</b>		
Shipyards	Public Law 108-287	\$ (25,000)
Ordnance	Public Law 108-287/108-375	(25,000)
Research and Development	Public Law 108-287/108-375	(50,000)
Transportation	Public Law 108-287/108-375	(50,000)
Supply Management, Navy	Public Law 108-287	65,385
Transportation	Principal Payment to FFB	(122,871)
Navy Component	Appropriation Received	3,868
Base Support	Appropriation Received	18,550
Transportation	Appropriation Received	67,000
Research and Development	Appropriation Received	4,624
Aviation Depots	Appropriation Received	200,208
Total		\$ <u>86,764</u>

The principal payment of \$122,871 thousand to the Federal Financing Bank relates to an outstanding debt principal amount reported by the Transportation Activity Group. See Note 6 for additional disclosures.

**Intragovernmental Payment and Collection (IPAC)**

IPAC differences are reconcilable differences that represent amounts recorded by Treasury but not reported by the organization. IPAC differences for the Department of the Navy cannot be differentiated between NWCF and General Funds, therefore no IPAC differences are being reported for the NWCF. All amounts, if applicable, will be reported on the Department of the Navy General Fund statement.

**Other Disclosures Related to Fund Balance with Treasury**

No further disclosures required.

**Note Reference**

See Note 1.I., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Funds with the U.S. Treasury.

For regulatory discussion on Fund Balance with Treasury, see Department of Defense Financial Management Regulation (FMR), Volume 6B, Chapter 10.

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Status of Fund Balance With Treasury		
As of September 30, (Amounts in thousands)	2005	2004
<b>1. Unobligated Balance</b>		
A. Available	\$ 2,624,338	\$ 2,650,777
B. Unavailable	192,321	98,945
<b>2. Obligated Balance Not Yet Disbursed</b>	12,667,320	11,860,610
<b>3. Non-Budgetary FBWT</b>	0	0
<b>4. Non-FBWT Budgetary Accounts</b>	(14,535,420)	(13,778,755)
<b>5. Total</b>	<u>\$ 948,559</u>	<u>\$ 831,577</u>

### 6. Information Related to Status of Fund Balance with Treasury:

#### Fluctuations and/or Abnormalities

Unobligated Balance - Unavailable increased \$93,376 thousand, 94 percent, in FY 2005 in the Navy Supply Management business area. An appropriation was provided partially in November 2004 and the remainder in May 2005 for a total of \$65,385 thousand as a funding mechanism for the purchase of pipeline spares (material-in-transit). The appropriation was posted to Unapportioned Authority.

#### Disclosure of Restrictions

Certain unobligated balances may be restricted to future use and are not apportioned for current use.

#### Information Related to Suspense/Budget Clearing Accounts:

The NWCF Suspense/Budget Clearing Accounts are being reported under Navy General Funds, Index 17.

Disclosures Related to Problem Disbursements and In-Transit Disbursements				
As of September 30,	2003	2004	2005	(Decrease)/Increase from 2004 to 2005
<i>(Amounts in thousands)</i>				
<b>1. Total Problem Disbursements, Absolute Value</b>				
A. Unmatched Disbursements (UMDS)	\$211,270	\$126,000	\$67,703	(\$58,297)
B. Negative Unliquidated Obligations (NULO)	0	0	0	0
<b>2. Total In-Transit Disbursements, Net</b>	\$0	\$0	(\$29,618)	(\$29,618)

**3. Information Related to Disclosures Related to Problem Disbursements and In-Transit Disbursements**

**Fluctuations and/or Abnormalities**

Total Problem Disbursements, Absolute Value - Unmatched Disbursements (UMD) decreased \$58,297 thousand, 46 percent, in FY 2005. The Defense Finance and Accounting Service (DFAS) primarily attributes the decrease in UMDs to the identification of root causes for Report 8. Report 8 is an internal report that provides a breakdown of undistributed costs by its various elements such as in-transits, UMD, and supported vs. unsupported undistributed. The proper categories of total undistributed by various elements based on supported, unsupported, in-transit or problem disbursements etc. were identified. Also, DFAS Field sites have worked to clear undistributed through root cause analysis and process improvements. The culmination of all these efforts has resulted in a decrease to Navy Working Capital Fund (NWCF) problem disbursements.

Total In-Transit Disbursements, Net decreased \$29,618 thousand, 100 percent, in FY 2005. The breakdown of this information was not identifiable and reported in previous years.

**Unmatched Disbursements**

An unmatched disbursement occurs when a payment is not matched to a corresponding obligation in the accounting system.

**Negative Unliquidated Obligations**

A negative unliquidated obligation occurs when a payment is made against a valid obligation. However, the payment is greater than the amount of the obligation recorded in the accounting system.

**In-Transit Disbursements**

In-transit disbursements represent the net value of disbursements and collections made by a Department of Defense disbursing activity on behalf of an accountable activity and have not yet been recorded in the accounting system.

**NOTE 4. INVESTMENTS AND RELATED INTEREST**

Not Applicable.

**NOTE 5. ACCOUNTS RECEIVABLE**

As of September 30, (Amounts in thousands)	2005			2004
	Gross Amount Due	Allowance For Doubtful Accounts	Accounts Receivable, Net	Accounts Receivable, Net
<b>1. Intragovernmental Receivables:</b>	\$ 494,499	N/A	\$ 494,499	\$ 857,519
<b>2. Nonfederal Receivables (From the Public):</b>	\$ 29,688	\$ (2)	\$ 29,686	\$ 26,190
<b>3. Total Accounts Receivable:</b>	<u>\$ 524,187</u>	<u>\$ (2)</u>	<u>\$ 524,185</u>	<u>\$ 883,709</u>

**4. Other Information Related to Accounts Receivable:**

**Fluctuations and/or Abnormalities**

Intragovernmental Accounts Receivable decreased \$363,020 thousand, 42 percent, in FY 2005. The primary drivers of the decrease in Intragovernmental Accounts Receivable are summarized in the table below:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Component		\$208,630	The decrease is the result of the supported undistributed collections for the total Navy Working Capital Fund and the reclassification of Foreign Military Sales (FMS) from intragovernmental to nonfederal.
Supply Management, Navy		70,047	The decrease is attributable to more aggressive collections of reimbursable operations; the fuel business transferred to Defense Logistics Agency (DLA); and the collection of aged outstanding fuel receivables.
Naval Surface Warfare Center		63,719	The decrease is the result of the continuing effort by Defense Finance and Accounting Service (DFAS) and all Naval Surface Warfare Center activities to reduce Accounts Receivable.
<b>Total</b>		<b>\$342,396</b>	

Nonfederal Accounts Receivable increased \$3,496 thousand, 13 percent, in FY 2005. The primary drivers of the increase are attributed to:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Component	\$20,862		This increase is a result of the unsupported undistributed collections for the total Navy Working Capital Fund (NWCF) and the reclassification of Foreign Military Sales (FMS) funding.
Public Works Center	16,138		The increase is due to the increased workload for the new Installation Claimant Consolidation (ICC2) sites, disaster relief, and fuel costs.
Supply Management, Navy	8,462		The increase is a result of the alignment of the trial balance data with the Seller Elimination Report trading partner data to reflect the federal to public ratio received. According to the Trading partner data received by the Navy Supply activities, the trail balance had more federal receivables than what was reported by the activities. Federal accounts receivable were reclassified to nonfederal accounts receivable as a result to match the trading partner data.
Navy Facilities Engineering Services	3,096		There was an abnormal balance in nonfederal accounts receivable in FY 2004, the receivables were eliminated.
Aviation Depots	1,491		The increase is due to the reclassification of the posting of FMS from government to public.
Naval Undersea Warfare Center	1,345		The increase is due to the reclassification of the posting of FMS from government to public. Also, a receivable was established for a Mechanization of Contract Administration Service (MOCAS) payment made in error that will be corrected in October 2005.
Naval Air Warfare Center		\$48,012	The decrease is primarily due to system/process solutions that provided the ability to process collections more efficiently.
<b>Totals</b>	<b>\$51,394</b>	<b>\$48,012</b>	



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### Allowance Method

The Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities", and the Department of Defense (DoD) Financial Management Regulation require that federal agencies establish an allowance for doubtful accounts receivable nonfederal. This account has been established within the Navy Working Capital Fund (NWCF). This amount is low, as the NWCF requires an advance deposit from all nonfederal entities prior to the commencement of work. Therefore, an assumption is made that the amount of doubtful accounts should be negligible. The allowance amount represents a percentage of the total that was billed after the total project cost has been adjusted to reflect the advance deposit.

### Allocation of Undistributed Collections

The DoD policy is to allocate supported undistributed collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts receivable. Supported undistributed collections in the amount of \$257,659 thousand were applied against accounts receivable. Unsupported undistributed collections should be recorded in United States Standard General Ledger account 2400, Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections. The NWCF follows this allocation procedure. This is required because the potential exists that some of these unsupported undistributed collections do not belong to the NWCF and will have to be paid to the appropriate fund holder.

### Trading Partner Data

The NWCF's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the NWCF is unable to reconcile intragovernmental accounts receivable balances with most trading partners. Through an ongoing Business Management Modernization Program, the DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations. The Department of the Navy (DON) is also working on short-term solutions to gather the required information as outlined in the DON Financial Improvement Plan.

### Accounts Receivable Greater than 180 days

The amount of nonfederal and intragovernmental receivables over 180-days old is \$19,945 thousand and \$9,839 thousand, respectively. Significant improvements have continued during FY 2005. When compared with FY 2004, NWCF made \$570 thousand, 3 percent, improvement in collecting nonfederal accounts receivable and \$9,213 thousand, 48 percent, improvement in collecting intragovernmental accounts receivable.

### Nonfederal Refunds Receivable

The total amount of nonfederal refunds receivable does not exceed 10 percent of the nonfederal accounts receivable, net amount on the Balance Sheet.

### Other Disclosures Related to Accounts Receivable

No further disclosures required.

### Note Reference

For additional discussion on financial reporting requirements and DoD policies governing Trading Partner Data and Accounts Receivable, see Notes 1.G. and 1.K, Significant Accounting Policies, respectively.

For regulatory discussion on Accounts Receivable, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**NOTE 6. OTHER ASSETS**

As of September 30,	2005	2004
<i>(Amounts in thousands)</i>		
<b>1. Intragovernmental Other Assets:</b>		
A. Advances and Prepayments	\$ 374	\$ 15
B. Total Intragovernmental Other Assets	\$ 374	\$ 15
<b>2. Nonfederal Other Assets:</b>		
A. Outstanding Contract Financing Payments	\$ 0	\$ 0
B. Other Assets (With the Public)	536,741	717,191
C. Total Nonfederal Other Assets	\$ 536,741	\$ 717,191
<b>3. Total Other Assets:</b>	<u>\$ 537,115</u>	<u>\$ 717,206</u>

**4. Information Related to Other Assets:**

**Fluctuations and/or Abnormalities**

Intragovernmental Other Assets, Advances and Prepayments increased \$359 thousand, 2393 percent, in FY 2005. The primary drivers that attributed to the increase are summarized below:

*(Amounts in thousands)*

Business Activity	Increases	Decreases	Explanations
Component	\$250		This increase is attributed to the posting of buyer-side elimination adjustments in accordance with DoD Financial Management Regulation (FMR), Volume 6B, Chapter 13. The FMR requires the trial balance and trading partner data to reconcile to each other for all federal costs. These buyer-side adjustments are required to reconcile the trial balance data to all of the seller-side trading partner data within the system. This is being addressed as part of the Financial Improvement Plan (FIP).
Depot Maintenance, Marine Corps	58		This is due to an increase in outstanding travel advances.
<b>Total</b>	<b>\$308</b>		

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Nonfederal Other Assets (Other Assets With the Public) decreased \$180,450 thousand, 25 percent, in FY 2005. The primary drivers that attributed to the decrease are summarized below:

*(Amounts in thousands)*

Business Activity	Increases	Decreases	Explanations
Transportation Activity Group		\$122,836	This decrease is the result of outstanding Federal Financing Bank (FFB) debt principal payment.
Naval Shipyards		39,693	This decrease is the due to the transition of Puget Sound Naval Shipyard out of the Navy Working Capital Fund.
<b>Total</b>		<b>\$162,529</b>	

### Advances and Prepayments

The buyer-side advances to others account balances were adjusted to agree with seller-side advances from others account balances as reported on the books of other Department of Defense (DoD) reporting entities. Additionally, the buyer-side prepayment balances were adjusted to agree with seller-side deferred credits as reported on the books of other DoD reporting entities.

### Composition of Other Assets (With the Public)

Other Assets (With the Public) includes an amount of \$375,712 thousand relating to the outstanding debt principal amount reported for the Transportation Activity Group involving Time Charter arrangements made for the long-term use of the Afloat Prepositioning Force - Navy ships. The outstanding debt principal amount is reported in the Navy Working Capital Fund Balance Sheet Other Assets (With the Public). See Note 13 for material disclosures.

### Other Disclosures Related to Other Assets (With the Public)

None.

### Note Reference

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

For regulatory discussion on Other Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

## NOTE 7. CASH AND OTHER MONETARY ASSETS

Not Applicable.

## NOTE 8. DIRECT LOAN AND/OR LOAN GUARANTEE PROGRAMS

Not Applicable.

**NOTE 9. INVENTORY AND RELATED PROPERTY**

As of September 30, (Amounts in thousands)	2005	2004
<b>1. Inventory, Net</b>	\$ 14,888,574	\$ 18,505,475
<b>2. Operating Materials &amp; Supplies, Net</b>	722,200	733,717
<b>3. Stockpile Materials, Net</b>	0	0
<b>4. Total</b>	<u>\$ 15,610,774</u>	<u>\$ 19,239,192</u>

Inventory, Net					
As of September 30, (Amounts in thousands)	2005			2004	Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	
<b>1. Inventory Categories:</b>					
A. Available and Purchased for Resale	\$ 22,897,953	(20,978,965)	\$ 1,918,988	\$ 4,140,012	LAC, MAC
B. Held for Repair	10,746,144	1,811,912	12,558,056	13,893,174	LAC, MAC
C. Excess, Obsolete, and Unserviceable	600,179	(600,179)	0	0	NRV
D. Raw Materials	0	0	0	0	MAC, SP, LAC
E. Work in Process	411,530	0	411,530	472,289	AC
F. Total	<u>\$ 34,655,806</u>	<u>\$ (19,767,232)</u>	<u>\$ 14,888,574</u>	<u>\$ 18,505,475</u>	

**Legend for Valuation Methods:**

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

**2. Information Related to Inventory, Net:**

**Fluctuations and/or Abnormalities**

Inventory Available and Purchased for Resale decreased \$2,221,024 thousand, 54 percent, in FY 2005. The majority of the decrease is attributed to Supply Management, Navy (NAVSUP) and is comprised of an increase in inventory disposals, reduction in purchases at cost, net inventory transfers, and adjustments attributable to the Cost of Goods Sold model.

Inventory Held for Repair decreased \$1,335,118 thousand, 10 percent, in FY 2005. The primary decrease is in the Supply Management, Navy business area and the primary driver of the decrease is a correction in the depot level repairable carcass liability and inventory in-transit accounts. Reconciliation was performed between Material Financial Control System (MFCS) and PR04 (Carcass Tracking). NAVSUP was able to identify process irregularities

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between MFCS and PR04 where the liability and in-transit accounts were not relieved in MFCS. An automated transaction was entered into MFCS correcting the accounts. This reconciliation and automated transaction entry will be performed monthly.

Work in Process (WIP) decreased \$60,759 thousand, 13 percent, in FY 2005. The primary drivers of the fluctuation are listed below:

*(Amounts in thousands)*

Business Activity	Increases	Decreases	Explanations
Naval Shipyards	\$74,425		This is primarily the result of the correction of the WIP balance at Puget Sound Naval Shipyard. The corrections were necessary as part of data "cleanup", as the Puget Sound Naval Shipyard transitioned from a Working Capital Fund activity to the Department of the Navy General Fund.
Space and Naval Warfare Systems Center	3,831		This increase is within the normal fluctuation for the business cycle for this business area. Percentage of change for this business area was less than 10 percent.
Naval Research Laboratory	358		This increase is within the normal fluctuation for the business cycle for this business area.
Aviation Depot		58,639	The majority of the decrease is a result of the final conversion to the Percentage of Completion Revenue Recognition method.  The revenue recognition program is the amount of work performed during the month and is billed at the end of the month.
Naval Air Warfare Center		43,387	The primary reason for the decrease is due to system/process improvements that has allowed for timelier processing in FY 2005.
Naval Surface Warfare Center		19,063	The decrease is primarily due to the clearing of unmatched material in transit.
Naval Undersea Warfare Center		18,026	The decrease is primarily due to the clearing of unmatched material in transit.
<b>Total</b>	<b>\$78,614</b>	<b>\$139,115</b>	

### Changes in Accounting Methods

The Enterprise Resource Planning (ERP) Supply Maintenance Aviation Re-engineering Team (SMART) Pilot was discontinued in April 2005, transferring \$1,876,496 thousand at Latest Acquisition Cost (LAC) into Material Financial Control System (MFCS).

### Restrictions of Inventory Use, Sale, or Disposition

Generally, there are no restrictions with regard to the use, sale, or disposition to applicable Department of Defense (DoD) activities and personnel. Other than certain safety and war reserve levels, inventory may be sold to foreign, state and local governments, private parties and contractors in accordance with DoD and the Department of the Navy (DON) policies and guidance or at the direction of the President.

### **Composition of Inventory**

Except for the Work in Process, all Inventory categories apply to the Supply Management Activities only.

Inventory Categories. Inventory represents property that is (1) held for sale, (2) in the process of production for sale or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.

Inventory Available and Purchased for Resale includes consumable spare and repair parts and repairable items owned and managed by the DON. In some cases, the consumable and repairable items are managed by other Military Services, the Defense Logistics Agency or the General Services Administration. Material available and purchased for resale includes material held due to a managerial determination that it should be retained to support military or national contingencies. Federal Accounting Standards requires disclosure of the amount of Inventory Held for "Future Sale." The Navy Working Capital Fund currently has no Inventory Held for Future Sale reported for FY 2005 in Inventory Held for Sale, Net. All inventory is currently planned for sale next fiscal year. There is no management or valuation difference between the two categories.

Included in Line 1.A., Inventory Available and Purchased for Resale, is an amount of \$169,074 thousand for War Reserve Material for Supply Management, Navy. Supply Management, Marine Corps currently has no War Reserve Material.

Inventory Held for Repair is inventory that requires repair to make suitable for sale. Many of the inventory items are more economical to repair than to procure. In addition, because the DON often relies on weapon systems and machinery no longer in production, the DON supports a process that encourages the repair and rebuilding of certain items. This repair cycle is an essential part of maintaining a ready, mobile, and armed military force.

Excess, Obsolete, and Unserviceable inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal. The DON does not anticipate recovering any significant costs as result of final disposal of these items. Therefore, Excess, Obsolete, and Unserviceable inventory reflects a net realizable value of zero.

Work in Process balances includes costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in Process also includes the value of finished products or completed services pending billing to the customer. The Work in Process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other Government plants for accrued costs of end items of material ordered but not delivered.

### **Inventory Work in Process**

Work in Process at Depot Maintenance activities and Research and Development activities of approximately \$135,531 thousand and \$275,998 thousand, respectively, is included as inventory Work in Process.

This amount represents work that has been completed, expenses incurred, and waiting to be billed to the customer.

### **Other Disclosures Related to Inventory**

The general ledger values in the accounting system do not reconcile with the supporting detail record in the Navy segment of the Supply Management Activity logistics system. Supply Management, Navy (NAVSUP) has determined that program changes must be made to MFCS to correct systemic posting problems, which contribute to a reconciling difference between the systems. Twenty-four (24) reconciliation System Change Requests (SCR) for Phase 2 have been implemented at the NAVSUP field activity. NAVSUP is working with the field activity to determine journal voucher accounts and values. Once that is completed, the journal vouchers will be submitted to the Office of

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Financial Operations (FMO) and the Defense Finance and Accounting Service (DFAS). Once the journal vouchers and the adjustments posting logic SCR is approved, funded and developed, the final adjustments will be made to inventory and financial systems to align data.

### Note Reference

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

For regulatory discussion on Inventory, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

Operating Materials and Supplies, Net					
As of September 30, (Amounts in thousands)	2005			2004	Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	
<b>1. OM&amp;S Categories:</b>					
A. Held for Use	\$ 722,200	\$ 0	\$ 722,200	\$ 733,717	SP, LAC
B. Held for Repair	0	0	0	0	
C. Excess, Obsolete, and Unserviceable	0	0	0	0	
D. Total	<u>\$ 722,200</u>	<u>\$ 0</u>	<u>\$ 722,200</u>	<u>\$ 733,717</u>	

### Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost adjusted for holding gains and losses  
 NRV = Net Realizable Value  
 O = Other  
 SP = Standard Price  
 AC = Actual Cost

### 2. Information Related to Operating Materials and Supplies (OM&S), Net:

#### Fluctuations and/or Abnormalities

None.

#### Restrictions on OM&S

Generally, there are no restrictions with regard to the use, sale, or disposition of OM&S applicable to the Department of Defense (DoD) activities.

#### Composition of OM&S

OM&S Held for Use represents property that is consumed during normal operations and includes consumable spare and repair parts for use on customer work by various activities. The items are recorded using different methodologies including actual, weighted-average and historical cost. Federal Accounting Standards requires disclosure of the amount of OM&S Held for "Future Use." The Navy Working Capital Fund (NWCF) reports that \$14,151 thousand of OM&S is categorized as Held for Future Use.

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

Generally, the values of the NWCF's GFM and CAM in the hands of contractors are not included in the OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in other existing logistics systems in accordance with Volume 6B, Chapter 10 of the DoD Financial Management Regulation (FMR).

**Other Disclosures Related to OM&S**

No further disclosures required.

**Note Reference**

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

For regulatory discussion on OM&S, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**Stockpile Materials**

Not Applicable.

**NOTE 10. GENERAL PP&E, NET**

	2005					2004
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Net Book Value
<b>As of September 30</b>						
<i>(Amounts in thousands)</i>						
<b>1. Major Asset Classes:</b>						
A. Land	N/A	N/A	\$ 45,848	N/A	\$ 45,848	\$ 50,740
B. Buildings, Structures, and Facilities	S/L	20 Or 40	5,805,058	\$ (3,797,074)	2,007,984	2,053,297
C. Leasehold Improvements	S/L	lease term	302	(202)	100	138
D. Software	S/L	2-5 Or 10	442,674	(231,552)	211,122	214,095
E. General Equipment	S/L	5 Or 10	3,289,656	(2,516,121)	773,535	882,988
F. Military Equipment	S/L	Various	0	0	0	0
G. Assets Under Capital Lease	S/L	lease term	0	0	0	0
H. Construction-in- Progress	N/A	N/A	681,761	N/A	681,761	682,665
I. Other			10,172	0	10,172	11,619
<b>2. Total General PP&amp;E</b>			<b>\$ 10,275,471</b>	<b>\$ (6,544,949)</b>	<b>\$ 3,730,522</b>	<b>\$ 3,895,542</b>

**Legend for Valuation Methods:**

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



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### 3. Information Related to General Property, Plant and Equipment (GPP&E):

#### Fluctuations and/or Abnormalities

Although the GPP&E only decreased \$165,020 thousand, 4 percent, in FY 2005, the following categories changed:

- Land transferred from the Naval Surface Warfare Center (NSWC) to Commander Naval Installations (CNI), which resulted in a decrease.
- Leasehold Improvements decreased at the Transportation Activity Group as a result of the annual amortization of the lease.
- General Equipment primarily decreased as a result of the Supply Management, Navy reconciliation and interface of the Defense Property Accountability System (DPAS) with the Defense Business Management System (DBMS) and the Central Data Base (CDB).
- Other GPP&E decreased as a result of an increase at Naval Research Laboratory in Property Awaiting Disposal, as well as a decrease at Naval Air Warfare Center (NAWC). System/process enhancements provided the capability to move assets out of Assets Under Development (AUD) and into production more efficiently at NAWC. The ERP solution implemented in FY 2004 did not include a module for transitioning AUDs into production. This system/process enhancement was implemented in FY 2005. There was an increased value in Other GPP&E in FY 2004 due to the system inability to transition AUD into production. Once this module was implemented prior AUDs were correctly posted in FY 2005.

#### Military Equipment

Military equipment is reported on the books of the Department of Navy General Fund.

#### Contractor Held GPP&E

For those activities with GPP&E real property in the possession of contractors, the value of this real property is included in the values reported for the Major Asset Classes of Buildings, Structures, and Facilities. The value of personal property in Major Asset Classes of Automated Data Processing Software and Equipment does not include all of the GPP&E in the possession of contractors. The net book amount of such property is immaterial in relation to the total GPP&E net book value. In accordance with an approved strategy with the Office of Management and Budget, the Government Accountability Office, and the Inspector General Department of Defense, the Department of Defense is developing new policies and a contractor reporting process to capture GPP&E information for future reporting purposes for compliance with federal-wide accounting standards.

#### Other Disclosures Related to GPP&E

Supply Management, Navy has initiatives underway to identify corrective actions for the reporting of land, buildings, and software during FY 2006. These deficiencies were identified in the Department of the Navy's Financial Improvement Plan.

#### Note Reference

See Note 1.O., Significant Accounting Policies, for additional discussion on financial reporting requirements and the Department of Defense (DoD) policies governing GPP&E.

For regulatory discussion on GPP&E, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**Assets Under Capital Lease**

**Information Related to Assets Under Capital Lease:**

The Navy Working Capital Fund has no assets under capital lease.

**Other Disclosures Related to Assets Under Capital Lease**

No further disclosures required.

**Note Reference**

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

**NOTE 11. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES**

As of September 30,	2005	2004
<i>(Amounts in thousands)</i>		
<b>1. Intragovernmental Liabilities:</b>		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
D. Other	2,725	5,141
<b>D. Total Intragovernmental Liabilities</b>	<b>\$ 2,725</b>	<b>\$ 5,141</b>
<b>2. Nonfederal Liabilities:</b>		
A. Accounts Payable	\$ 0	\$ 0
B. Military Retirement Benefits and Other Other Employment-Related Actuarial Liabilities	1,192,552	1,168,225
C. Environmental Liabilities	0	0
D. Loan Guarantee Liability	0	0
E. Other Liabilities	0	0
<b>F. Total Nonfederal Liabilities</b>	<b>\$ 1,192,552</b>	<b>\$ 1,168,225</b>
<b>3. Total Liabilities Not Covered by Budgetary Resources:</b>	<b>\$ 1,195,277</b>	<b>\$ 1,173,366</b>
<b>4. Total Liabilities Not Covered by Budgetary Resources:</b>	<b>\$ 6,638,660</b>	<b>\$ 8,401,653</b>
<b>5. Total Liabilities</b>	<b>\$ 7,833,937</b>	<b>\$ 9,575,019</b>

**6. Information Related to Liabilities Not Covered and Covered by Budgetary Resources:**

**Fluctuations and/or Abnormalities**

Other intragovernmental liabilities decreased \$2,416 thousand, 47 percent, in FY 2005. This is a result of reduced outstanding refunds receivable and interest. The cause of this decrease is related to collections of interest, penalties, fines, and administrative fees.

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### Definitions

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered as of the balance sheet date.

The Intragovernmental Liabilities, Other amount of \$2,725 thousand represents interest, penalties, fines and administrative fees. These fees do not belong to the Navy Working Capital Fund and will be distributed directly to the Department of Treasury.

### Other Disclosures Related to Liabilities Not Covered by Budgetary Resources

The \$1,192,552 thousand included in Military Retirement Benefits and Other Employment-Related Actuarial Liabilities represents Federal Employees' Compensation Act liabilities.

### Note Reference

For additional line item discussion, see Note 12, Accounts Payable; Note 13, Debt; Note 15, Other Liabilities; Note 16, Commitments and Contingencies; and Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities.

## NOTE 12. ACCOUNTS PAYABLE

	2005			2004
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
<b>As of September 30,</b> <i>(Amounts in thousands)</i>				
<b>1. Intragovernmental Payables:</b>	\$ 199,606	N/A	\$ 199,606	\$ 243,982
<b>2. Nonfederal Payables (to the Public):</b>	\$ 2,152,112	\$ 0	\$ 2,152,112	\$ 1,862,567
<b>3. Total</b>	<u>\$ 2,351,718</u>	<u>\$ 0</u>	<u>\$ 2,351,718</u>	<u>\$ 2,106,549</u>

### 4. Information Related to Accounts Payable:

**Fluctuations and/or Abnormalities**

Intragovernmental Accounts Payable decreased \$44,376 thousand, 18 percent, in FY 2005. The primary drivers of the decrease are summarized below:

*(Amounts in thousands)*

<b>Business Activity</b>	<b>Increases</b>	<b>Decreases</b>	<b>Explanations</b>
Aviation Depots	\$37,420		The increase is attributed to a decrease in undistributed disbursements.
Component	36,517		This increase is the buyer side adjustment to reconcile to trading partner data and a decrease in undistributed disbursements. This is being addressed as part of the Financial Improvement Plan (FIP)
Transportation Activity Group	32,941		This increase relates to the transition from consumption to the purchase method of fuel accounting. Also, fuel purchases from the Defense Energy Supply Center (DESC) are now recorded as intragovernmental.
Space and Naval Warfare System Center	17,423		The increase is attributed to a decrease in undistributed disbursements.
Supply Management, Navy		\$131,299	The decrease is attributable to realigning payables to the cost of war. The costs to support the war effort were transferred to an appropriated fund. Also, an increase in disbursements for operations carried from the previous fiscal year. Abnormal undistributed disbursements increased due to residual clean up in the Defense Business Management System.
Naval Shipyards		20,041	This decrease is the result of posting unmatched disbursements to the accounts payable. This adjustment is temporary and occurred because a Centralized Expenditure Reporting System (CERPS) run was received after month end and was not received in time to post to the appropriate cost accounts.
Naval Air Warfare Center		13,407	The decrease is primarily due to a business process change, which allows for a more timely liquidation of accounts payable.
<b>Total</b>	<b>\$124,301</b>	<b>\$164,747</b>	

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Intragovernmental accounts payable consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Interest, penalties, and administrative fees are not applicable to intragovernmental accounts payables. Nonfederal accounts payable are payments to nonfederal government entities (to the public).

Nonfederal Accounts Payable increased \$289,545 thousand, 16 percent, in FY 2005. The primary drivers of the increase are summarized below.

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Component	\$419,717		The majority of this increase is due to ongoing efforts to validate and reduce unmatched disbursements.
Supply Management, Navy	78,654		An increase in abnormal undistributed disbursements is due to residual clean up.
Naval Surface Warfare Center		\$70,206	A majority of the decrease is due to ongoing efforts to validate and reduce aged accounts payable.
Transportation Activity Group		69,166	This decrease relates to Military Sealift Command transitioning from consumption to the purchase method of fuel accounting. Fuel purchases (Defense Energy Supply Center (DESC) are now recorded as intragovernmental.
Naval Air Warfare Center		57,078	The decrease is primarily due to improved business processes. In addition, the decrease can be attributed to the concentrated effort to process month end transactions, as well as, a change to the posting of accrued labor and fringe benefit amounts in FY 2005.
Space and Naval Warfare Systems Center		16,744	The decrease is attributed to an increase of undistributed disbursements for the current month.
<b>Total</b>	<b>\$498,371</b>	<b>\$213,194</b>	

### Undistributed Disbursements

Undistributed disbursements are the difference between disbursements/collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury via the reconciled DD1329 and DD1400. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on the accounting reports (SF133/AR(M)1307). In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end.

### **Allocation of Undistributed Disbursements**

The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between federal and nonfederal categories based on the percentage of federal and nonfederal Accounts Payable. Supported undistributed disbursements in the amount of \$(1,139,653) thousand have been applied against accounts payable. Unsupported undistributed disbursements have been recorded in United States Standard General Ledger account 2120, Disbursements in Transit. Accounts Payable was adjusted downward by \$738,744 thousand for in-transit payments. The Navy Working Capital Fund (NWCF) follows this allocation policy.

### **Composition of Undistributed Disbursements**

The majority of the undistributed disbursements represent Mechanization of Contract Administration Services (MOCAS) payments, which have not been liquidated. MOCAS payments represent those payments made to contractors for materials or services. Accruals are made when the service is performed and remain in this account until the provider submits an invoice for payment. Therefore, if a copy of the invoice is not received by the NWCF activity prior to the Defense Finance and Accounting Service making payment, the payment will go to undistributed disbursements. The amounts accrued to cover the anticipated materials and services are captured as Contract Accruals on the Other Accrued Expense line (Note 15.A., Other Liabilities, Nonfederal: Other Liabilities) and are not considered accounts payable.

### **Trading Partner Data**

For the majority of intra-agency sales, NWCF's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the NWCF was unable to reconcile the majority of its intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payable. Through an ongoing Business Management Modernization Program, DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations. The Department of the Navy (DON) has outlined some processes for review and implementation in the DON Financial Improvement Plan, which should provide some near-term solutions.

### **Eliminating Adjustments**

The DoD summary level seller accounts receivables were compared to NWCF's accounts payable. An adjustment was posted to the NWCF's accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to the NWCF. As required, adjustments were made to reclassify accounts payable from federal to nonfederal.

### **Other Disclosures Related to Accounts Payable**

No further disclosures required.

### **Note Reference**

See Note 1.G., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Trading Partner Data and Eliminating Adjustments.

**NOTE 13. DEBT**

As of September 30, (Amounts in thousands)	2005			2004
	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
<b>1. Agency Debt:</b>				
A. Debt to the Treasury	\$ 0	\$ 0	\$ 0	\$ 0
B. Debt to the Federal Financing Bank	506,278	(124,760)	381,518	506,278
C. Total Agency Debt	\$ 506,278	\$ (124,760)	\$ 381,518	\$ 506,278
<b>2. Total Debt:</b>	<u>\$ 506,278</u>	<u>\$ (124,760)</u>	<u>\$ 381,518</u>	<u>\$ 506,278</u>

**3. Information Related to Debt:**

**Fluctuations and/or Abnormalities**

Intragovernmental Debt decreased \$124,760 thousand, 25 percent, in FY 2005 as a result of the reduction of the outstanding debt principal amount reported for the Maritime Prepositioning Ships (MPS) loan.

**Other Information Related to Debt**

The Afloat Prepositioning Force - Navy (APF-N) program, with Congressional approval, provides ships for time charter to meet requirements not available in the marketplace. These ships are built or converted by private interim vessel owners using private, non-government financing obtained from various banking institutions. There were no payments made by the government during the building/conversion phase. APF-N time charters are for five years with four option renewal periods of five years each, for a total of 25 years. At the end of the contract, each ship returns to the vessel's owner.

The Federal Financing Bank (FFB) is one of the institutions that provided loans to the vessel owners. The FFB is reporting a debt in the amount of \$381,518 thousand, which represents an outstanding principal balance of \$375,712 thousand and accrued interest payable of \$5,806 thousand, for the Transportation Activity Group. The Transportation Activity Group does not owe this debt to the FFB. This debt is a public debt owed by the private vessel owners. In order to simplify the payments to the FFB and to meet its requirements, the FFB cross-disburses the semi-annual principal and interest payments directly from the Navy Working Capital Fund (NWCF). This is done instead of having the Transportation Activity Group make Capital Hire payments to the vessel owners, who would in turn make its loan obligation payments to the FFB.

The direction of the vessel owner to have the government make payments directly to a bank, in this case the FFB, is not an uncommon practice, and mirrors other time charters where payment is assigned directly to a bank. This occurred when the ownership of these vessels was transferred to private vessel owners; however, FFB when establishing the loan coded the loan as a government debt.

As required by the Under Secretary of Defense (Comptroller) memorandum of January 22, 1999, Transportation Activity Group is correctly recording these payments as an operating expense. The outstanding debt principal amount is reported in the NWCF Balance Sheet as an Other Asset in order to reconcile with the amount reported by FFB. The misclassification by FFB has generated this long-standing reporting problem. See Note 6 for additional disclosures.

As required by the Department of Defense Appropriations Act passed in December 1985, 10 percent of the fifth year termination value of the vessels must be obligated from Operations and Maintenance, Navy funds. This was completed as each vessel was delivered.

**Note References**

See Note 3, Fund Balance with Treasury and Note 6, Other Assets, for additional discussion on the Debt to the Federal Financing Bank.

For regulatory discussion on Debt, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**NOTE 14. ENVIRONMENTAL LIABILITIES AND DISPOSAL LIABILITIES**

Not Applicable.

**NOTE 15. OTHER LIABILITIES**

As of September 30,	2005			2004
	Current Liability	Noncurrent Liability	Total	Total
<i>(Amounts in thousands)</i>				
<b>1. Intragovernmental:</b>				
A. Advances from Others	\$ 416,448	\$ 0	\$ 416,448	\$ 72,509
B. Deposit Funds and Suspense Account Liabilities	0	0	0	0
C. Disbursing Officer Cash	0	0	0	0
D. Judgement Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	0	0	0	0
F. Other Liabilities	41,029	0	41,029	42,342
G. Total Intragovernmental Other Liabilities	<u>\$ 457,477</u>	<u>\$ 0</u>	<u>\$ 457,477</u>	<u>\$ 114,851</u>
<b>2. Nonfederal:</b>				
A. Accrued Funded Payroll and Benefits	\$ 795,598	\$ 0	\$ 795,598	\$ 746,226
B. Advances from Others	141,884	0	141,884	477,383
C. Deferred Credits	11,800	0	11,800	0
D. Deposit Funds and Suspense Accounts	151,206	0	151,206	341,793
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities:				
(1) Military Equipment (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accrued Unfunded Annual Leave	0	0	0	0
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	2,350,178	7	2,350,185	4,113,714
J. Total Nonfederal Other Liabilities	<u>\$ 3,450,666</u>	<u>7</u>	<u>\$ 3,450,673</u>	<u>\$ 5,679,116</u>
<b>3. Total Other Liabilities:</b>	<u>\$ 3,908,143</u>	<u>7</u>	<u>\$ 3,908,150</u>	<u>\$ 5,793,967</u>
<b>4. Information Related to Other Liabilities:</b>				



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### Fluctuations and/or Abnormalities

Total Intragovernmental Other Liabilities had an overall increase of \$342,626 thousand, 298 percent, in FY 2005. The majority this increase is within Intragovernmental Advances From Others.

This increase is primarily attributed to the business areas listed below.

*(Amounts in thousands)*

Business Activity	Increases	Decreases	Explanations
Naval Shipyards	\$77,638		This increase relates to advance billings in February 2005.
Space and Naval Warfare Systems Center	82,395		This increase is a result of increased workload from other agencies associated with the Global War on Terror.
Component	204,857		The increase is related to a reclassification of FY 2004 Intragovernmental Advances to public since trading partner data was not available. The reclassification was not required in FY 2005 since the trading partner data was available due to enhancements of collecting elimination data.
Naval Air Warfare Center		\$17,209	The decrease is due to a system/process fix that provided the capability to liquidate customer advance amounts more efficiently.
<b>Total</b>	<b>\$364,890</b>	<b>\$17,209</b>	

The Total Nonfederal Other Liabilities decreased \$2,228,443 thousand, 39 percent, in FY 2005. The net change is discussed below.

Nonfederal Advances from Others, decreased \$335,499 thousand, 70 percent, in FY 2005. The primary drivers of the decrease in Nonfederal Advances from Others are discussed in the table below:

*(Amounts in thousands)*

Business Activity	Increases	Decreases	Explanations
Component		\$204,857	The decrease is related to a reclassification of FY 2004 Intragovernmental Advances to public since trading partner data was not available. The reclassification was not required in FY 2005 since the trading partner data was available due to enhancements of collecting elimination data.
Space and Naval Warfare Systems Center		73,521	The majority of this decrease is caused by a liquidation of prior year work and a reduced amount of new work.
Naval Air Warfare Center		45,204	The decrease is due to a system/process fix that provided the capability to liquidate customer advance amounts more efficiently.
<b>Total</b>		<b>\$323,582</b>	

Deferred credits increased \$11,800 thousand, 100 percent, in FY 2005 and consists of unfilled customers orders-Advances from Others, Unearned Revenue received by Supply Management, Marine Corps in third quarter FY05. This balance was moved to Nonfederal due to lack of trading partner data.

Deposit Funds and Suspense Accounts decreased \$190,587 thousand, 56 percent, in FY 2005. The Navy and Defense Finance and Accounting Service (DFAS) have been working on better identification of the breakdown of supported vs. unsupported undistributed on the Report 8 to aid in clearing these amounts from the systems. The combined efforts have reduced the unsupported undistributed collections that were reclassified to U.S. Standard General Ledger 2400.

Nonfederal Other Liabilities decreased \$1,763,529 thousand, 43 percent, in FY 2005. The primary driver of the decrease in Nonfederal Other Liabilities is due to a decrease of \$1,670,972 thousand related to the Advanced Depot Level Repairable Carcass Returns for the Supply Management, Navy. This decrease was primarily attributable to identifying processing irregularities and performing reconciliation between the Material Financial Control System (MFCS) and Carcass Tracking. Carcass Tracking does not pass the 'A' condition asset issue transaction back to MFCS to close the liability. A monthly reconciliation and an automated transaction entry will be performed and processed to update the account in MFCS.

**Composition of Other Liabilities**  
**As of September 30, 2005**

*(Amounts in thousands)*

Intragovernmental Other Liabilities represents liabilities of:

Health Benefits	\$	15,404
Life Insurance		351
Retirement Benefits		19,315
Voluntary Separation Incentive Program		3,234
Custodial Liabilities		2,725
	\$	<u>41,029</u>

Nonfederal Deposit Funds and Suspense Account Liabilities include amounts for unsupported undistributed collections.

Nonfederal Other Liabilities includes amounts that are significant portions of the total liabilities presented in the Navy Working Capital Fund (NWCF) Balance Sheet. A breakout of the major components of Nonfederal Other Liabilities follows:

- a. Accrual of Contractual Services represents an accrued liability for direct work performed by contractors or material and supplies purchased for a direct order in which a request for payment has not been received. The accrual is based on the level of effort performed for the direct order on a monthly basis.
- b. Depot Level Repairable Carcass Return Liability represents the value of returned depot level repairable carcasses that have been received by an accountable activity from an end-use activity but an "A" condition (serviceable) asset has not been issued.
- c. In addition, the Other Liabilities amount includes Property Furnished by Others. This account is used to record intra-fund transfers of assets when such transfers are between activities with different reporting systems (e.g. Financial Inventory Reporting activities transfer assets with Transactions Item Reporting activities). The logic currently in place was approved by DFAS upon implementation of Material Financial Control System (MFCS).

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The remainder of the Other Liabilities amount consists of Progress Payments, which are maintained to show the balance of payments taken for accrued costs charged to Work in Process or the value of material procured and held for specific orders received from customers within the DoD.

### **Intragovernmental Reconciliation for Fiduciary Transactions with Department of Labor (DOL)**

With respect to the major fiduciary balances, the NWCF was able to reconcile with the DOL.

### **Other Disclosures Related to Other Liabilities**

No further disclosures required.

### **Note Reference**

See Note 1.S., Significant Accounting Policies, for additional discussion on financial reporting requirements and the DoD policies governing Contingencies and Other Liabilities.

### **Capital Lease Liability**

#### **Information Related to Capital Lease Liability:**

The Navy Working Capital Fund (NWCF) has no capital lease liability.

### **Other Disclosures Related to Capital Lease Liability**

No further disclosures required.

### **Note Reference**

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

For regulatory discussion on Capital Lease Liability, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

## **NOTE 16. COMMITMENTS AND CONTINGENCIES**

### **Information Related to Commitments and Contingencies:**

#### **Legal Contingencies:**

The Navy Working Capital Fund (NWCF) is a party in various administrative proceedings and legal actions, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. In the event of an adverse judgment against the Federal Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from the Department of the Navy's resources, either directly or by reimbursement to the Judgment Fund.

For fiscal years 2005 and 2004, the materiality threshold for reporting litigation, claims, or assessments was \$6.0 million and \$3.5 million, respectively. Legal actions affecting the DON include those for civil and environmental litigation, claims, and assessments. Based on information contained in the Legal Representation Letters, management does not have sufficient reason to believe that it is likely that the Government will be liable for the maximum amounts claimed.

The NWCF reported a total of 8 cases as of September 30, 2005 that met the FY 2005 materiality threshold. However, the Department of Navy legal counsel is unable to express an opinion concerning the likely outcome of these cases.

**Other Disclosures Related to Commitments and Contingencies**

No further disclosures required.

**Note Reference**

See Note 1.S., Significant Accounting Policies, for additional discussion on financial reporting requirements and the Department of Defense (DoD) policies governing Commitments and Contingencies.

For regulatory discussion on Commitments and Contingencies, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.

**NOTE 17. MILITARY RETIREMENT BENEFITS AND OTHER EMPLOYMENT RELATED ACTUARIAL LIABILITIES**

	2005			2004
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability
<b>As of September 30,</b>				
<i>(Amount in Thousands)</i>				
<b>1. Pension and Health Benefits:</b>				
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0
B. Military Retirement Health Benefits	0		0	0
C. Medicare-Eligible Retiree Benefits	0		0	0
D. Total Pension and Health Benefits	\$ 0		\$ 0	\$ 0
<b>2. Other</b>				
A. FECA	\$ 1,192,551		\$ 0	\$ 1,192,551
B. Voluntary Separation Incentive Programs	0		0	0
C. DoD Educational Benefits Fund	0		0	0
D. Total Other	\$ 1,192,551		\$ 0	\$ 1,192,551
<b>3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:</b>	\$ 1,192,551		\$ 0	\$ 1,192,551

**4. Information Related to Military Retirement Benefits and Other Employment Related Actuarial Liabilities:**

**Fluctuations and/or Abnormalities:**

No fluctuations and/or abnormalities need to be explained for Military Retirement Benefits and Other Employment Related Actuarial Liabilities.

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### Actuarial Cost Method Used

The Department of the Navy (DON) actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON at the end of each fiscal year. The liability is distributed between the Navy Working Capital Fund and DON General Fund based upon the number of civilian employees funded in each entity as reported in the Navy Budget Tracking System. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments.

### Assumptions

The projected annual benefit payments are discounted to the present value using OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost-of-living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. The interest rate assumptions used in the discount calculations are as follows for September 30, 2005:

4.528 percent in year 1,  
5.020 percent in year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensations benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2005 were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2005	2.20%	4.33%
2006	3.33%	4.09%
2007	2.93%	4.01%
2008	2.40%	4.01%
2009+	2.40%	4.01%

## NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

### Information Related to the Statement of Net Cost:

#### Fluctuations and/or Abnormalities

No fluctuations and/or Abnormalities need to be explained for:

- Intragovernmental Gross Costs
- Intragovernmental Net Costs

Intragovernmental Earned Revenue decreased \$983,010 thousand, 5 percent, in FY 2005. The primary driver of this decrease is the reclassification of Foreign Military Sales from intragovernmental to nonfederal.

Gross Costs With the Public increased \$1,341,205 thousand, 7 percent, in FY 2005. The primary drivers of this increase is Supply Management, Navy increased material cost of goods sold that was affected by the Depot Level Repairable carcass reconciliation. Transportation Activity Group also reported increased costs due to an increase in fuel consumption cost.

Earned Revenue From the Public increased \$910,955 thousand, 148 percent, in FY 2005. The primary drivers of the increase in Earned Revenue From the Public are discussed below:

*(Amounts in thousands)*

Business Activity	Increases	Decreases	Explanations
Supply Management, Navy	\$766,683		This increase is the result of moving from the Enterprise Resource Planning (ERP) system in April 2005, which valued inventory at the moving average cost (MAC), to Material Financial Control System (MCFS). This resulted in an increase in other gains with the public.
Public Works Center	133,034		This increase is attributed to the establishment of the Installation Claimant Consolidation (ICC2) in the Program Budget Decision 430, December 2003, in the President's budget. ICC2s were funded by a direct reimbursement from Operations and Maintenance, Navy appropriation to the Navy Working Capital Fund.
<b>Total</b>	<b>\$899,717</b>		

**Composition of Statement of Net Cost**

The Navy Working Capital Fund (NWCF) generally records transactions on an accrual basis as required by federal generally accepted accounting principles. Information presented on the Statement of Net Cost represents the net result of post-closing adjustments and eliminating entries made in compiling and consolidating the NWCF financial statements. These entries significantly affected the reported amounts of Intragovernmental Program Cost, Program Cost with the Public, Earned Revenue and Net Program Cost. The post-closing adjustments were made in order to increase or decrease certain NWCF account balances reported as of September 30, 2005 to ensure agreement with related balances reported by other Department of Defense (DoD) and other federal reporting entities. Eliminating entries are required adjustments made as part of the financial process. This process enables the matching of trading partner data recorded at each financial statement consolidation level -- the NWCF, DoD and Federal Government levels.

**Other Disclosures Related to the Statement of Net Cost**

The Statement of Net Cost was impacted by the recording of adjustments, other than the inventory valuation model, in the amount of \$(26,555) thousand as current year transactions. These adjustments were generated in the Navy Activity accounting system as prior period adjustments, but were reclassified to current year operations. These amounts were reclassified, as their individual values did not meet the materiality threshold outlined in the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) memo of June 8, 2003.

**NOTE 19. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION**

As of September 30,	Cumulative Results of Operations 2005	Unexpended Appropriations 2005	Cumulative Results of Operations 2004	Unexpended Appropriations 2004
<i>(Amounts in thousands)</i>				
<b>1. Prior Period Adjustments Increases (Decreases) to Net Position</b>				
A. Changes in Accounting Standards	\$ 0	\$ 0	\$ 0	\$ 0
B. Errors and Omissions in Prior Year				
Accounting Reports	0	0	0	0
C. Other Prior Period Adjustments	0	0	(1,044,715)	0
D. Total Prior Period Adjustments	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ (1,044,715)</u>	<u>\$ 0</u>
<b>2. Imputed Financing:</b>				
A. Civilian CSRS/FERS Retirement	\$ 234,870	\$ 0	\$ 243,406	\$ 0
B. Civilian Health	316,724	0	300,500	0
C. Civilian Life Insurance	1,003	0	980	0
D. Judgment Fund	0	0	0	0
E. Intra-entity	0	0	0	0
F. Total Imputed Financing	<u>\$ 552,597</u>	<u>\$ 0</u>	<u>\$ 544,886</u>	<u>\$ 0</u>

**3. Information Related to the Statement of Changes in Net Position:**

**Fluctuations and/or Abnormalities**

In FY 1995, the Department of the Navy received \$1,044,715 thousand in undistributed Net Outlays from the Office of the Secretary of Defense corporate account. This value was adjusted in FY 2004 to the Navy Working Capital Fund (NWCF) Component business area.

**Composition of Statement of Net Position**

During FY 2004, the \$1,044,715 thousand was treated as a prior period adjustment.

NWCF activities capture prior period adjustments in their accounting systems. These adjustments were reclassified to current year operations in the amount of (\$26,555) thousand. These amounts were reclassified as their individual values did not meet the materiality threshold outlined in the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) memo of June 8, 2003.

Based on OUSD(C) direction, amounts generated as prior period adjustments within the Cost of Goods Sold model were moved to inventory allowance accounts. The amounts are as follows:

As of September 30,	2005	2004
<i>(Amount in thousands)</i>		
Supply Management, Navy	\$ 402,782	\$ (533,848)
Supply Management, Marine Corps	\$ (22,867)	\$ 178,768

The Other Budgetary Financing Sources line on the Statement of Changes in Net Position includes \$4,104,274 thousand for amounts reclassified to Other Gains or Other Losses from Transfers-In and Transfers-Out. Transfers-In amounts are required to agree with Transfers-Out amounts received from seller-side data.

**Imputed Financing**

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System, Federal Employee Retirement System, Federal Employees Health Benefits Program and the Federal Employee Group Life Insurance Program do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employees and contributions made by and for them. OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. DFAS provides the costs to Office of the Under Secretary of Defense (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

**Other Disclosures Related to the Statement of Net Position**

Included in the NWCF's Net Position, Cumulative Results of Operations (CRO) are amounts that were approved by OUSD(C) as a deferral for recovery from, or return to, customers in later fiscal years' billing rates. As of September 30, 2005, the total NWCF amount of CRO-Deferred was (\$415,779) thousand. This amount primarily consists of system development costs incurred during FY 1992-1998 totaling (\$389,533) thousand by the Joint Logistics Service Center (JLSC). With the closure of JLSC, OUSD(C) directed in August 1998 that this JLSC system development cost be deferred from cost recovery. As instructed by the OUSD(C), the Department of the Navy distributed this amount among affected NWCF activities.

**Note Reference**

For regulatory disclosure related to the Statement of Changes in Net Position, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10.



**NOTE 20. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES**

As of September 30, (Amounts in thousands)	2005	2004
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 7,585,850	\$ 6,901,108
2. Available Borrowing and Contract Authority at the End of the Period	<u>6,897,192</u>	<u>6,156,853</u>

**3. Information Related to the Statement of Budgetary Resources:**

The Statement of Budgetary Resources (SBR) is an image of the monthly Report on Budget Execution (Standard Form 133 (SF 133)). These reports should be produced using budgetary accounts. However, the Navy Working Capital Fund (NWCF) uses proprietary accounts because its financial accounting systems were not designed to produce budgetary accounting data. The Department of the Navy and the Defense Finance and Accounting Service continue with the implementation of new accounting systems designed to produce both proprietary and budgetary reports and use the U.S. Standard General Ledger (USSGL). The Defense Industrial Financial Management System (DIFMS) has been fully implemented at all Research and Development (R&D) activities that were scheduled for conversion. R&D activity Space and Naval Warfare Systems Center, San Diego has successfully implemented the Enterprise Resource Planning (ERP) pilot program (Project Cabrillo) thus moving off DIFMS. Also, the Naval Air Warfare Centers (NAWCs) have moved from DIFMS to their ERP pilot program "Sigma". The ERPs are programmed to complete the SBR at the activity level. The Defense Working Capital Fund Accounting System (DWAS) implementations have been completed. Although these legacy systems have been replaced, the capability to produce the SBR and SF 133 is still being developed by the DON.

In FY 2005, the NWCF received appropriations of \$298,000 thousand, of which \$3,750 thousand was transferred and \$287,864 thousand was used. The remaining balance of \$6,286 thousand relates to the direct appropriation (P.L. 109-62) in support of Hurricane Katrina. The NWCF incorrectly reported an appropriation transfer of \$25,200 thousand as Appropriations Received, resulting in an overstatement of Appropriations Received.

Line 3.A.2 of the SBR includes USSGL 4251, Reimbursements and Other income Earned. The amount posted on this line is the ending balance less the beginning balance for the current fiscal year. In this case the ending balance is less than the beginning balance, which nets to a negative balance change for this fiscal year. This is a reflection of the Department of Navy's (DON) aggressive efforts to collect on reimbursable operations; the fuel business transferred to Defense Logistics Agency; collections of aged outstanding fuel receivables and the continuing efforts between the Defense Finance and Accounting Service partnering with the DON to reduce accounts receivable.

As of September 30, 2005, the SBR does not measure the NWCF's budget execution against budgetary resources. Budgetary resources are recorded in the accounting records and reported on the basis of customer orders received and contract authority invoked. On these reports, the spending authority from offsetting collections during the period of execution is based upon the approved President's Budget estimate of anticipated customer orders.

For the SBR, Supply Management's revenue is defined as gross sales less credit returns. For the balance sheet, revenue does not include credit returns because the inventory valuation model considers credit returns as inventory allowances. The difference causes variances in the reports. On these budgetary reports, the net outlays (collections and disbursements) year to date are reported based on the amounts reported to U.S. Treasury from the Defense Cash Accountability System and Centralized Expenditures/Reimbursement Processing System.

As of September 30, 2005, the differences between the U.S. Treasury and the NWCF activity ledgers have been minimal, and the cause is related to timing or the type of transactions. The differences are recorded as undistributed disbursements and collections on the departmental reports. While there may be no impact upon the U.S. Treasury balance, the above differences have created distortions in the accounts receivable and accounts payable from a budgetary reporting perspective on the SBR. Also, problems with undistributed collections and disbursements have created abnormal balances for accounts receivable and accounts payable on the SBR.

**Intra-entity Transactions**

The SBR does include intra-entity transactions, which have not been eliminated because the statements are presented as combined and combining.

**Apportionment Categories**

OMB Circular A-136 requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B and exempt from apportionment. These amounts are as follows:

As of September 30, 2005			
<i>(Amounts in Thousands)</i>			
Obligations Incurred – Direct	Line 8A	\$	0
Obligations Incurred – Reimbursable	Line 8B	\$	23,935,996
Exempt from apportionment	Line 9B	\$	0

**Undelivered Orders**

Undelivered Orders presented in the SBR includes Undelivered Orders-Unpaid for both direct and reimbursable funds.

**Spending Authority from Offsetting Collections**

Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the "Adjustments" line on the SBR), are not included in the Spending Authority from Offsetting Collections and Adjustments line on the SBR or the Spending Authority for Offsetting Collections and Adjustments line on the Statement of Financing.

**Other Disclosures Related to the Statement of Budgetary Resources**

New Contract Authority Guidance was issued by the Office of the Under Secretary of Defense on September 8, 2005. While the guidance was intended to be implemented for FY 2005, DFAS Cleveland (DFAS-CL) and the Navy are unable to adhere to this requirement for FY 2005. After doing multiple departmental level adjustments that did not produce the proper accounting treatment, nor were they properly supported, DFAS-CL with concurrence from their Navy customer made the decision to use the same logic for reporting contract authority that was used last year and throughout FY 2005.

Attempting to implement this guidance without adequate time would only give the appearance that it was implemented properly. This could create additional problems that would have to be addressed the following fiscal year. The budgetary accounts for the Navy Working Capital Fund activities are currently not fully supportable. Adding an additional layer of unsupported values would only hinder the process of correcting the budgetary accounts. DFAS-CL and the Navy will look closely at the guidance and ensure that this guidance is properly implemented for FY 2006. In addition, both parties will develop plans to address any areas of the guidance that the current systems and business practices prevent the proper full implementation of this newly issued guidance.

### **NOTE 21. DISCLOSURES RELATED TO THE STATEMENT OF FINANCING**

#### **Information Related to the Statement of Financing:**

The Statement of Financing is designed to provide information on the total resources used by an entity, to explain how those resources were used to finance orders for goods and services not yet delivered, to acquire assets and liabilities, and to fund the entity's net cost of operations. It is designed to report the differences and facilitate the reconciliation of accrual-based amounts used in the Statement of Net Cost and obligation-based amounts used in the Statement of Budgetary Resources. The computations and presentation of items in the Statement of Financing demonstrate that the budgetary and proprietary information in an entity's financial management system is in agreement.

The Defense Finance and Accounting Service (DFAS), Navy Working Capital Fund (NWCF) accounting systems, and Navy Enterprise Resource Planning include budgetary accounts. However, some of the legacy accounting systems do not. As a result, the Statement of Budgetary Resources (SBR) is generated by DFAS using data extracted from the proprietary accounts.

The detailed level of information required to appropriately complete the SBR is being developed for those activities that cannot provide the data due to system deficiencies. As a result of these system deficiencies, the Statement of Financing line, Resources that Finance the Acquisition of Assets, was adjusted upward by \$1,991,833 thousand at the end of FY 2005.

#### **Other Disclosures Related to the Statement of Financing**

No further disclosures required.

### **NOTE 22. DISCLOSURES RELATED TO THE STATEMENT OF CUSTODIAL ACTIVITY**

Not Applicable.

### **NOTE 23. OTHER DISCLOSURES**

No further disclosures required.



**NAVY WORKING CAPITAL FUND  
SUPPORTING CONSOLIDATING/COMBINING STATEMENTS**

2005



Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING BALANCE SHEET**  
 As of September 30, 2005 and 2004  
 (\$ in thousands)

	<u>Depot Maintenance, Shipyards</u>	<u>Depot Maintenance, Aviation</u>	<u>Depot Maintenance, Marine Corps</u>	<u>Ordnance</u>
<b>ASSETS (Note 2)</b>				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	\$ 391,391	\$ 194,997	\$ (10,870)	\$ 396
Nonentity Seized Iraqi Cash	0	0	0	0
Nonentity - Other	0	0	0	0
Investments (Note 4)	0	0	0	0
Accounts Receivable (Note 5)	6,608	66,261	9,961	32
Other Assets (Note 6)	<u>0</u>	<u>0</u>	<u>70</u>	<u>0</u>
Total Intragovernmental Assets	\$ 397,999	\$ 261,258	\$ (839)	\$ 428
Cash and Other Monetary Assets (Note 7)	0	0	0	0
Accounts Receivable (Note 5)	97	1,836	199	0
Loans Receivable (Note 8)	0	0	0	0
Inventory and Related Property (Note 9)	227,450	436,234	96,765	0
General Property, Plant and Equipment (Note 10)	656,493	334,669	50,524	140
Investments (Note 4)	0	0	0	0
Other Assets (Note 6)	<u>34,626</u>	<u>4,363</u>	<u>0</u>	<u>0</u>
<b>TOTAL ASSETS</b>	<u>\$ 1,316,665</u>	<u>\$ 1,038,360</u>	<u>\$ 146,649</u>	<u>\$ 568</u>
<b>LIABILITIES (Note 11)</b>				
Intragovernmental:				
Accounts Payable (Note 12)	\$ (2,701)	\$ 269,951	\$ 39,441	\$ 550
Debt (Note 13)	0	0	0	0
Other Liabilities (Note 15 & Note 16)	<u>127,875</u>	<u>5,720</u>	<u>6,422</u>	<u>0</u>
Total Intragovernmental Liabilities	\$ 125,174	\$ 275,671	\$ 45,863	\$ 550
Accounts Payable (Note 12)	38,914	20,843	24,347	0
Military Retirement Benefits and Other Employment- Related Actuarial Liabilities (Note 17)	0	0	26,667	0
Environmental Liabilities (Note 14)	0	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0	0
Other Liabilities (Note 15 and Note 16)	<u>281,121</u>	<u>259,398</u>	<u>13,819</u>	<u>0</u>
<b>TOTAL LIABILITIES</b>	<u>\$ 445,209</u>	<u>\$ 555,912</u>	<u>\$ 110,696</u>	<u>\$ 550</u>
<b>NET POSITION</b>				
Unexpended Appropriations	\$ 0	\$ 0	\$ 0	\$ 0
Cumulative Results of Operations	<u>871,456</u>	<u>482,448</u>	<u>35,953</u>	<u>18</u>
<b>TOTAL NET POSITION</b>	<u>\$ 871,456</u>	<u>\$ 482,448</u>	<u>\$ 35,953</u>	<u>\$ 18</u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u>\$ 1,316,665</u>	<u>\$ 1,038,360</u>	<u>\$ 146,649</u>	<u>\$ 568</u>

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### CONSOLIDATING BALANCE SHEET

As of September 30, 2005 and 2004

(\$ in thousands)

	<u>Transportation</u>	<u>Base Support</u>	<u>Research &amp; Development</u>	<u>Supply Management</u>
<b>ASSETS (Note 2)</b>				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	\$ 247,020	\$ 205,496	\$ 1,098,537	\$ (917,117)
Nonentity Seized Iraqi Cash	0	0	0	0
Nonentity - Other	0	0	0	0
Investments (Note 4)	0	0	0	0
Accounts Receivable (Note 5)	93,821	154,952	(15,709)	108,184
Other Assets (Note 6)	0	0	0	0
Total Intragovernmental Assets	<u>\$ 340,841</u>	<u>\$ 360,448</u>	<u>\$ 1,082,828</u>	<u>\$ (808,933)</u>
Cash and Other Monetary Assets (Note 7)	0	0	0	0
Accounts Receivable (Note 5)	324	41,311	11,835	(29,219)
Loans Receivable (Note 8)	0	0	0	0
Inventory and Related Property (Note 9)	3,922	21,446	347,913	14,477,044
General Property, Plant and Equipment (Note 10)	45,054	653,793	1,508,989	480,860
Investments (Note 4)	0	0	0	0
Other Assets (Note 6)	376,909	1,249	10,465	109,233
<b>TOTAL ASSETS</b>	<u><u>\$ 767,050</u></u>	<u><u>\$ 1,078,247</u></u>	<u><u>\$ 2,962,030</u></u>	<u><u>\$ 14,228,985</u></u>
<b>LIABILITIES (Note 11)</b>				
Intragovernmental:				
Accounts Payable (Note 12)	\$ 90,953	\$ 18,505	\$ (86,201)	\$ 472,486
Debt (Note 13)	381,518	0	0	0
Other Liabilities (Note 15 & Note 16)	2,518	4,491	265,329	67,432
Total Intragovernmental Liabilities	<u>\$ 474,989</u>	<u>\$ 22,996</u>	<u>\$ 179,128</u>	<u>\$ 539,918</u>
Accounts Payable (Note 12)	271,772	169,994	581,857	596,850
Military Retirement Benefits and Other Employment- Related Actuarial Liabilities (Note 17)	0	0	0	0
Environmental Liabilities (Note 14)	0	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0	0
Other Liabilities (Note 15 and Note 16)	53,268	89,064	2,115,201	470,595
<b>TOTAL LIABILITIES</b>	<u><u>\$ 800,029</u></u>	<u><u>\$ 282,054</u></u>	<u><u>\$ 2,876,186</u></u>	<u><u>\$ 1,607,363</u></u>
<b>NET POSITION</b>				
Unexpended Appropriations	\$ 0	\$ 0	\$ 2,418	\$ 0
Cumulative Results of Operations	(32,979)	796,193	83,426	12,621,622
<b>TOTAL NET POSITION</b>	<u><u>\$ (32,979)</u></u>	<u><u>\$ 796,193</u></u>	<u><u>\$ 85,844</u></u>	<u><u>\$ 12,621,622</u></u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u><u>\$ 767,050</u></u>	<u><u>\$ 1,078,247</u></u>	<u><u>\$ 2,962,030</u></u>	<u><u>\$ 14,228,985</u></u>

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING BALANCE SHEET**  
 As of September 30, 2005 and 2004  
 (\$ in thousands)

	<u>Component Level</u>	<u>Combined Total</u>	<u>Eliminations</u>
<b>ASSETS (Note 2)</b>			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	\$ (231,985)	\$ 977,865	\$ 0
Nonentity Seized Iraqi Cash	0	0	0
Nonentity - Other	0	0	0
Investments (Note 4)	0	0	0
Accounts Receivable (Note 5)	70,389	494,499	0
Other Assets (Note 6)	304	374	0
Total Intragovernmental Assets	<u>\$ (161,292)</u>	<u>\$ 1,472,738</u>	<u>\$ 0</u>
Cash and Other Monetary Assets (Note 7)	0	0	0
Accounts Receivable (Note 5)	3,303	29,686	0
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property (Note 9)	0	15,610,774	0
General Property, Plant and Equipment (Note 10)	0	3,730,522	0
Investments (Note 4)	0	0	0
Other Assets (Note 6)	(104)	536,741	0
<b>TOTAL ASSETS</b>	<u>\$ (158,093)</u>	<u>\$ 21,380,461</u>	<u>\$ 0</u>
<b>LIABILITIES (Note 11)</b>			
Intragovernmental:			
Accounts Payable (Note 12)	\$ (603,378)	\$ 199,606	\$ 0
Debt (Note 13)	0	381,518	0
Other Liabilities (Note 15 & Note 16)	(22,310)	457,477	0
Total Intragovernmental Liabilities	<u>\$ (625,688)</u>	<u>\$ 1,038,601</u>	<u>\$ 0</u>
Accounts Payable (Note 12)	447,535	2,152,112	0
Military Retirement Benefits and Other Employment- Related Actuarial Liabilities (Note 17)	1,165,884	1,192,551	0
Environmental Liabilities (Note 14)	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	168,207	3,450,673	0
<b>TOTAL LIABILITIES</b>	<u>\$ 1,155,938</u>	<u>\$ 7,833,937</u>	<u>\$ 0</u>
<b>NET POSITION</b>			
Unexpended Appropriations	\$ 3,868	\$ 6,286	\$ 0
Cumulative Results of Operations	(1,317,899)	13,540,238	0
<b>TOTAL NET POSITION</b>	<u>\$ (1,314,031)</u>	<u>\$ 13,546,524</u>	<u>\$ 0</u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u>\$ (158,093)</u>	<u>\$ 21,380,461</u>	<u>\$ 0</u>



## 2005 Annual Financial Report

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING BALANCE SHEET**  
 As of September 30, 2005 and 2004  
 (\$ in thousands)

	<b>2005</b>	<b>2004</b>
	<b>Consolidated</b>	<b>Consolidated</b>
<b>ASSETS (Note 2)</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 977,865	\$ 861,243
Nonentity Seized Iraqi Cash	0	0
Nonentity - Other	0	0
Investments (Note 4)	0	0
Accounts Receivable (Note 5)	494,499	857,519
Other Assets (Note 6)	374	15
Total Intragovernmental Assets	<u>\$ 1,472,738</u>	<u>\$ 1,718,777</u>
Cash and Other Monetary Assets (Note 7)	0	0
Accounts Receivable (Note 5)	29,686	26,190
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	15,610,774	19,239,192
General Property, Plant and Equipment (Note 10)	3,730,522	3,895,542
Investments (Note 4)	0	0
Other Assets (Note 6)	536,741	717,191
<b>TOTAL ASSETS</b>	<u><u>\$ 21,380,461</u></u>	<u><u>\$ 25,596,892</u></u>
<b>LIABILITIES (Note 11)</b>		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 199,606	\$ 243,982
Debt (Note 13)	381,518	506,278
Other Liabilities (Note 15 & Note 16)	457,477	114,851
Total Intragovernmental Liabilities	<u>\$ 1,038,601</u>	<u>\$ 865,111</u>
Accounts Payable (Note 12)	2,152,112	1,862,567
Military Retirement Benefits and Other Employment- Related Actuarial Liabilities (Note 17)	1,192,551	1,168,225
Environmental Liabilities (Note 14)	0	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	3,450,673	5,679,116
<b>TOTAL LIABILITIES</b>	<u><u>\$ 7,833,937</u></u>	<u><u>\$ 9,575,019</u></u>
<b>NET POSITION</b>		
Unexpended Appropriations	\$ 6,286	\$ 0
Cumulative Results of Operations	13,540,238	16,021,873
<b>TOTAL NET POSITION</b>	<u><u>\$ 13,546,524</u></u>	<u><u>\$ 16,021,873</u></u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u><u>\$ 21,380,461</u></u>	<u><u>\$ 25,596,892</u></u>

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING STATEMENT OF NET COST**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005 Total</u>	<u>Eliminations</u>	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Program Costs</b>				
<b>Base Support</b>				
Intragovernmental Gross Costs	\$ 1,124,021	\$ 0	\$ 1,124,021	\$ 985,405
(Less Intragovernmental Earned Revenue)	(1,606,064)	0	(1,606,064)	(1,602,991)
Intragovernmental Net Costs	<u>\$ (482,043)</u>	<u>\$ 0</u>	<u>\$ (482,043)</u>	<u>\$ (617,586)</u>
Gross Costs With the Public	\$ 569,742	0	569,742	595,987
(Less: Earned Revenue From the Public)	(133,034)	0	(133,034)	0
Net Costs With the Public	<u>\$ 436,708</u>	<u>\$ 0</u>	<u>\$ 436,708</u>	<u>\$ 595,987</u>
Net Program Cost	<u>\$ (45,335)</u>	<u>\$ 0</u>	<u>\$ (45,335)</u>	<u>\$ (21,599)</u>
<b>Component Level</b>				
Intragovernmental Gross Costs	\$ (4,065,059)	\$ 0	\$ (4,065,059)	\$ (4,319,029)
(Less Intragovernmental Earned Revenue)	1,779,340	0	1,779,340	2,777,999
Intragovernmental Net Costs	<u>\$ (2,285,719)</u>	<u>\$ 0</u>	<u>\$ (2,285,719)</u>	<u>\$ (1,541,030)</u>
Gross Costs With the Public	\$ 3,287,782	0	3,287,782	2,311,441
(Less: Earned Revenue From the Public)	0	0	0	(539,417)
Net Costs With the Public	<u>\$ 3,287,782</u>	<u>\$ 0</u>	<u>\$ 3,287,782</u>	<u>\$ 1,772,024</u>
Net Program Cost	<u>\$ 1,002,063</u>	<u>\$ 0</u>	<u>\$ 1,002,063</u>	<u>\$ 230,994</u>
<b>Depot Maintenance, Aviation</b>				
Intragovernmental Gross Costs	\$ 1,064,650	\$ 0	\$ 1,064,650	\$ 1,179,235
(Less Intragovernmental Earned Revenue)	(1,759,045)	0	(1,759,045)	(2,218,932)
Intragovernmental Net Costs	<u>\$ (694,395)</u>	<u>\$ 0</u>	<u>\$ (694,395)</u>	<u>\$ (1,039,697)</u>
Gross Costs With the Public	\$ 897,689	0	897,689	1,032,649
(Less: Earned Revenue From the Public)	(59,948)	0	(59,948)	0
Net Costs With the Public	<u>\$ 837,741</u>	<u>\$ 0</u>	<u>\$ 837,741</u>	<u>\$ 1,032,649</u>
Net Program Cost	<u>\$ 143,346</u>	<u>\$ 0</u>	<u>\$ 143,346</u>	<u>\$ (7,048)</u>
<b>Depot Maintenance, Marine Corps</b>				
Intragovernmental Gross Costs	\$ 486,784	\$ 0	\$ 486,784	\$ 331,518
(Less Intragovernmental Earned Revenue)	(474,481)	0	(474,481)	(324,480)
Intragovernmental Net Costs	<u>\$ 12,303</u>	<u>\$ 0</u>	<u>\$ 12,303</u>	<u>\$ 7,038</u>
Gross Costs With the Public	\$ (8,007)	0	(8,007)	(11,652)
(Less: Earned Revenue From the Public)	(5,220)	0	(5,220)	(3,927)
Net Costs With the Public	<u>\$ (13,227)</u>	<u>\$ 0</u>	<u>\$ (13,227)</u>	<u>\$ (15,579)</u>
Net Program Cost	<u>\$ (924)</u>	<u>\$ 0</u>	<u>\$ (924)</u>	<u>\$ (8,541)</u>

## 2005 Annual Financial Report

Department of Defense

Navy Working Capital Fund

### CONSOLIDATING STATEMENT OF NET COST

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>2005 Total</u>	<u>Eliminations</u>	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Program Costs</b>				
<b>Depot Maintenance, Shipyards</b>				
Intragovernmental Gross Costs	\$ 694,618	\$ 0	\$ 694,618	\$ 826,311
(Less Intragovernmental Earned Revenue)	(1,631,113)	0	(1,631,113)	(2,241,48)
Intragovernmental Net Costs	<u>\$ (936,495)</u>	<u>\$ 0</u>	<u>\$ (936,495)</u>	<u>\$ (1,415,16)</u>
Gross Costs With the Public	\$ 992,311	0	992,311	1,482,58
(Less: Earned Revenue From the Public)	(25,252)	0	(25,252)	
Net Costs With the Public	<u>\$ 967,059</u>	<u>\$ 0</u>	<u>\$ 967,059</u>	<u>\$ 1,482,58</u>
Net Program Cost	<u>\$ 30,564</u>	<u>\$ 0</u>	<u>\$ 30,564</u>	<u>\$ 67,411</u>
<b>Ordnance</b>				
Intragovernmental Gross Costs	\$ (12,142)	\$ 0	\$ (12,142)	\$ (8,10)
(Less Intragovernmental Earned Revenue)	0	0	0	
Intragovernmental Net Costs	<u>\$ (12,142)</u>	<u>\$ 0</u>	<u>\$ (12,142)</u>	<u>\$ (8,10)</u>
Gross Costs With the Public	\$ (1)	0	(1)	2
(Less: Earned Revenue From the Public)	0	0	0	
Net Costs With the Public	<u>\$ (1)</u>	<u>\$ 0</u>	<u>\$ (1)</u>	<u>\$ 2</u>
Net Program Cost	<u>\$ (12,143)</u>	<u>\$ 0</u>	<u>\$ (12,143)</u>	<u>\$ (8,08)</u>
<b>Transportation</b>				
Intragovernmental Gross Costs	\$ 519,666	\$ 0	\$ 519,666	\$ 439,171
(Less Intragovernmental Earned Revenue)	(1,951,860)	0	(1,951,860)	(1,792,42)
Intragovernmental Net Costs	<u>\$ (1,432,194)</u>	<u>\$ 0</u>	<u>\$ (1,432,194)</u>	<u>\$ (1,353,25)</u>
Gross Costs With the Public	\$ 1,483,069	0	1,483,069	1,338,02
(Less: Earned Revenue From the Public)	0	0	0	
Net Costs With the Public	<u>\$ 1,483,069</u>	<u>\$ 0</u>	<u>\$ 1,483,069</u>	<u>\$ 1,338,02</u>
Net Program Cost	<u>\$ 50,875</u>	<u>\$ 0</u>	<u>\$ 50,875</u>	<u>\$ (15,23)</u>
<b>Research &amp; Development</b>				
Intragovernmental Gross Costs	\$ 5,714,307	\$ 0	\$ 5,714,307	\$ 5,854,98
(Less Intragovernmental Earned Revenue)	(9,567,348)	0	(9,567,348)	(10,260,46)
Intragovernmental Net Costs	<u>\$ (3,853,041)</u>	<u>\$ 0</u>	<u>\$ (3,853,041)</u>	<u>\$ (4,405,48)</u>
Gross Costs With the Public	\$ 4,318,109	0	4,318,109	4,441,53
(Less: Earned Revenue From the Public)	(469,466)	0	(469,466)	62
Net Costs With the Public	<u>\$ 3,848,643</u>	<u>\$ 0</u>	<u>\$ 3,848,643</u>	<u>\$ 4,442,15</u>
Net Program Cost	<u>\$ (4,398)</u>	<u>\$ 0</u>	<u>\$ (4,398)</u>	<u>\$ 36,67</u>

Department of Defense  
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**CONSOLIDATING STATEMENT OF NET COST**  
For the years ended September 30, 2005 and 2004  
(\$ in thousands)

	<u>2005 Total</u>	<u>Eliminations</u>	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Program Costs</b>				
<b>Supply Management</b>				
Intragovernmental Gross Costs	\$ 40,706	\$ 0	\$ 40,706	\$ 145,488
(Less: Intragovernmental Earned Revenue)	<u>(5,505,354)</u>	<u>0</u>	<u>(5,505,354)</u>	<u>(6,036,154)</u>
Intragovernmental Net Costs	\$ <u>(5,464,648)</u>	\$ <u>0</u>	\$ <u>(5,464,648)</u>	\$ <u>(5,890,666)</u>
Gross Costs With the Public	\$ 7,716,125	0	7,716,125	6,725,024
(Less: Earned Revenue From the Public)	<u>(831,570)</u>	<u>0</u>	<u>(831,570)</u>	<u>(70,813)</u>
Net Costs With the Public	\$ <u>6,884,555</u>	\$ <u>0</u>	\$ <u>6,884,555</u>	\$ <u>6,654,211</u>
Net Program Cost	\$ 1,419,907	\$ 0	\$ 1,419,907	\$ 763,545
<b>Total Program Costs</b>				
Intragovernmental Gross Costs	\$ 5,567,551	\$ 0	\$ 5,567,551	\$ 5,434,981
(Less: Intragovernmental Earned Revenue)	<u>(20,715,925)</u>	<u>0</u>	<u>(20,715,925)</u>	<u>(21,698,935)</u>
Intragovernmental Net Costs	\$ <u>(15,148,374)</u>	\$ <u>0</u>	\$ <u>(15,148,374)</u>	\$ <u>(16,263,954)</u>
Gross Costs With the Public	\$ 19,256,819	0	19,256,819	17,915,614
(Less: Earned Revenue From the Public)	<u>(1,524,490)</u>	<u>0</u>	<u>(1,524,490)</u>	<u>(613,535)</u>
Net Costs With the Public	\$ <u>17,732,329</u>	\$ <u>0</u>	\$ <u>17,732,329</u>	\$ <u>17,302,079</u>
Net Program Cost	\$ 2,583,955	\$ 0	\$ 2,583,955	\$ 1,038,125
<b>Costs Not Assigned to Programs</b>	0	0	0	0
<b>(Less: Earned Revenue Not Attributable to Programs)</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Net Cost of Operations</b>	\$ <u><u>2,583,955</u></u>	\$ <u><u>0</u></u>	\$ <u><u>2,583,955</u></u>	\$ <u><u>1,038,125</u></u>

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Department of Defense  
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### CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION

For the years ended September 30, 2005 and 2004  
(\$ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps	Ordnance
<b>Cumulative Results of Operations</b>				
<b>Beginning Balances</b>	\$ 946,924	\$ 430,901	\$ 24,950	\$ 12,874
<b>Prior period adjustments (+/-)</b>				
Changes in Accounting Principles (+/-)	0	0	0	0
Correction of Errors (+/-)	(661)	(161)	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 946,263</u>	<u>\$ 430,740</u>	<u>\$ 24,950</u>	<u>\$ 12,874</u>
<b>Budgetary Financing Sources:</b>				
Appropriations Received	\$ 0	\$ 0	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	0	200,208	0	0
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	(25,000)	0	0	(25,000)
Other budgetary financing sources (+/-)	0	0	0	0
<b>Other Financing Sources:</b>				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	(19,243)	(5,154)	0	0
Imputed financing from costs absorbed by others	0	0	10,079	0
Other (+/-)	0	0	0	0
<b>Total Financing Sources</b>	<u>\$ (44,243)</u>	<u>\$ 195,054</u>	<u>\$ 10,079</u>	<u>\$ (25,000)</u>
<b>Net Cost of Operations (+/-)</b>	<u>30,564</u>	<u>143,346</u>	<u>(924)</u>	<u>(12,143)</u>
<b>Net Change</b>	<u>(74,807)</u>	<u>51,708</u>	<u>11,003</u>	<u>(12,857)</u>
<b>Ending Balances</b>	<u><u>\$ 871,456</u></u>	<u><u>\$ 482,448</u></u>	<u><u>\$ 35,953</u></u>	<u><u>\$ 17</u></u>
<b>Unexpended Appropriations</b>				
<b>Beginning Balances</b>	\$ 0	\$ 0	\$ 0	\$ 0
<b>Prior period adjustments (+/-)</b>				
Changes in Accounting Principles (+/-)	0	0	0	0
Correction of Errors (+/-)	0	0	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
<b>Budgetary Financing Sources:</b>				
Appropriations Received	\$ 0	\$ 200,208	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	0	(200,208)	0	0
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
<b>Other Financing Sources:</b>				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	0	0
<b>Total Financing Sources</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
<b>Net Cost of Operations (+/-)</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Net Change</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Ending Balances</b>	<u><u>\$ 0</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 0</u></u>	<u><u>\$ 0</u></u>

Department of Defense  
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**CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Transportation</u>	<u>Base Support</u>	<u>Research &amp; Development</u>	<u>Supply Management</u>
<b>Cumulative Results of Operations</b>				
<b>Beginning Balances</b>	\$ (25,760)	\$ 739,848	\$ 153,344	\$ 14,591,004
<b>Prior period adjustments (+/-)</b>				
Changes in Accounting Principles (+/-)	0	0	0	0
Correction of Errors (+/-)	27,073	668	(362)	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 1,313</u>	<u>\$ 740,516</u>	<u>\$ 152,982</u>	<u>\$ 14,591,004</u>
<b>Budgetary Financing Sources:</b>				
Appropriations Received	\$ 0	\$ 0	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	67,000	18,550	2,206	0
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	(50,000)	0	(50,000)	65,385
Other budgetary financing sources (+/-)	0	0	0	0
<b>Other Financing Sources:</b>				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	(416)	(8,207)	(36,384)	(614,859)
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	10,224	0
<b>Total Financing Sources</b>	<u>\$ 16,584</u>	<u>\$ 10,343</u>	<u>\$ (73,954)</u>	<u>\$ (549,474)</u>
<b>Net Cost of Operations (+/-)</b>	<u>50,875</u>	<u>(45,335)</u>	<u>(4,398)</u>	<u>1,419,907</u>
<b>Net Change</b>	<u>(34,291)</u>	<u>55,678</u>	<u>(69,556)</u>	<u>(1,969,381)</u>
<b>Ending Balances</b>	<u>\$ (32,978)</u>	<u>\$ 796,194</u>	<u>\$ 83,426</u>	<u>\$ 12,621,623</u>
<b>Unexpended Appropriations</b>				
<b>Beginning Balances</b>	\$ 0	\$ 0	\$ 0	\$ 0
<b>Prior period adjustments (+/-)</b>				
Changes in Accounting Principles (+/-)	0	0	0	0
Correction of Errors (+/-)	0	0	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
<b>Budgetary Financing Sources:</b>				
Appropriations Received	\$ 67,000	\$ 18,550	\$ 4,624	\$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	(67,000)	(18,550)	(2,206)	0
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
<b>Other Financing Sources:</b>				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	0	0
<b>Total Financing Sources</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 2,418</u>	<u>\$ 0</u>
<b>Net Cost of Operations (+/-)</b>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Net Change</b>	<u>0</u>	<u>0</u>	<u>2,418</u>	<u>0</u>
<b>Ending Balances</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 2,418</u>	<u>\$ 0</u>

## 2005 Annual Financial Report

Department of Defense  
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### CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	Component Level	Combined Total	Eliminations
<b>Cumulative Results of Operations</b>			
<b>Beginning Balances</b>	\$ (852,212)	\$ 16,021,873	\$ 0
<b>Prior period adjustments (+/-)</b>			
Changes in Accounting Principles (+/-)	0	0	0
Correction of Errors (+/-)	(26,557)	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ (878,769)</u>	<u>16,021,873</u>	<u>0</u>
<b>Budgetary Financing Sources:</b>			
Appropriations Received	\$ 0	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0
Appropriations used	0	287,964	0
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers in/out without reimbursement (+/-)	0	(84,615)	0
Other budgetary financing sources (+/-)	0	0	0
<b>Other Financing Sources:</b>			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	684,263	0	0
Imputed financing from costs absorbed by others	542,518	552,597	0
Other (+/-)	(663,850)	(653,626)	0
<b>Total Financing Sources</b>	<u>\$ 562,931</u>	<u>102,320</u>	<u>0</u>
<b>Net Cost of Operations (+/-)</b>	<u>1,002,063</u>	<u>2,583,955</u>	<u>0</u>
<b>Net Change</b>	<u>(439,132)</u>	<u>(2,481,635)</u>	<u>0</u>
<b>Ending Balances</b>	<u>\$ (1,317,901)</u>	<u>\$ 13,540,238</u>	<u>\$ 0</u>
<b>Unexpended Appropriations</b>			
<b>Beginning Balances</b>	\$ 0	\$ 0	\$ 0
<b>Prior period adjustments (+/-)</b>			
Changes in Accounting Principles (+/-)	0	0	0
Correction of Errors (+/-)	0	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
<b>Budgetary Financing Sources:</b>			
Appropriations Received	\$ 7,618	298,000	0
Appropriations transferred in/out (+/-)	(3,750)	(3,750)	0
Other adjustments (rescissions, etc) (+/-)	0	0	0
Appropriations used	0	(287,964)	0
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
<b>Other Financing Sources:</b>			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
<b>Total Financing Sources</b>	<u>\$ 3,868</u>	<u>\$ 6,286</u>	<u>\$ 0</u>
<b>Net Cost of Operations (+/-)</b>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Net Change</b>	<u>3,868</u>	<u>6,286</u>	<u>0</u>
<b>Ending Balances</b>	<u>\$ 3,868</u>	<u>6,286</u>	<u>0</u>

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005</u> <u>Consolidated</u>	<u>2004</u> <u>Consolidated</u>
<b>Cumulative Results of Operations</b>		
<b>Beginning Balances</b>	\$ 16,021,873	\$ 18,136,830
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles (+/-)	0	
Correction of Errors (+/-)	0	(1,044,715)
<b>Beginning Balances, as adjusted</b>	<u>\$ 16,021,873</u>	<u>17,092,115</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 0	0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	287,964	130,446
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	(84,615)	(287,800)
Other budgetary financing sources (+/-)	0	(419,775)
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	126
Imputed financing from costs absorbed by others	552,597	544,886
Other (+/-)	(653,626)	0
<b>Total Financing Sources</b>	<u>\$ 102,320</u>	<u>(32,117)</u>
<b>Net Cost of Operations (+/-)</b>	<u>2,583,955</u>	<u>1,038,125</u>
<b>Net Change</b>	<u>(2,481,635)</u>	<u>(1,070,242)</u>
<b>Ending Balances</b>	<u>\$ 13,540,238</u>	<u>\$ 16,021,873</u>
<b>Unexpended Appropriations</b>		
<b>Beginning Balances</b>	\$ 0	\$ 0
<b>Prior period adjustments (+/-)</b>		
Changes in Accounting Principles (+/-)	0	0
Correction of Errors (+/-)	0	0
<b>Beginning Balances, as adjusted</b>	<u>\$ 0</u>	<u>\$ 0</u>
<b>Budgetary Financing Sources:</b>		
Appropriations Received	\$ 298,000	\$ 130,446
Appropriations transferred in/out (+/-)	(3,750)	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	(287,964)	(130,446)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
<b>Other Financing Sources:</b>		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
<b>Total Financing Sources</b>	<u>\$ 6,286</u>	<u>\$ 0</u>
<b>Net Cost of Operations (+/-)</b>	<u>0</u>	<u>0</u>
<b>Net Change</b>	<u>6,286</u>	<u>0</u>
<b>Ending Balances</b>	<u>\$ 6,286</u>	<u>\$ 0</u>



## 2005 Annual Financial Report

Department of Defense  
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### COMBINING STATEMENT OF BUDGETARY RESOURCES

For the years ended September 30, 2005 and 2004  
(\$ in thousands)

BUDGETARY FINANCING ACCOUNTS BUDGETARY RESOURCES	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps
Budget Authority:			
Appropriations Received	\$ 0	\$ 200,208	\$ 0
Borrowing Authority	0	0	0
Contract Authority	29,712	64,712	4,104
Net transfers (+/-)	0	0	0
Other	0	0	0
Unobligated Balance:			
Beginning of period	368,550	904,894	148,373
Net transfers, actual (+/-)	(25,000)	0	0
Anticipated Transfers Balances	0	0	0
Spending Authority from Offsetting Collections:			
Earned	0	0	0
Collected	1,631,872	1,840,895	482,324
Receivable from Federal sources	(5,448)	(10,213)	(3,058)
Change in unfilled customer orders	0	0	0
Advances received	82,390	4,131	(472)
Without advance from Federal sources	156,357	(12,213)	103,969
Anticipated for the rest of year, without advances	0	0	0
Previously unavailable	0	0	0
Transfers from trust funds	0	0	0
Subtotal	<u>\$ 1,865,171</u>	<u>\$ 1,822,600</u>	<u>\$ 582,763</u>
Recoveries of prior year obligations	0	0	0
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	(3,411)	(29,771)	0
<b>Total Budgetary Resources</b>	<u><u>\$ 2,235,022</u></u>	<u><u>\$ 2,962,643</u></u>	<u><u>\$ 735,240</u></u>

Department of Defense  
 Navy Working Capital Fund  
**COMBINING STATEMENT OF BUDGETARY RESOURCES**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

<b>BUDGETARY FINANCING ACCOUNTS</b>	<b>Depot Maintenance, Shipyards</b>	<b>Depot Maintenance, Aviation</b>	<b>Depot Maintenance, Marine Corps</b>
<b>STATUS OF BUDGETARY RESOURCES</b>	<u>                    </u>	<u>                    </u>	<u>                    </u>
Obligations Incurred:			
Direct	\$ 0	\$ 0	\$ 0
Reimbursable	1,657,668	2,120,182	507,540
Subtotal	<u>\$ 1,657,668</u>	<u>\$ 2,120,182</u>	<u>\$ 507,540</u>
Unobligated balance:			
Apportioned	\$ 602,355	842,461	227,700
Exempt from apportionment	(25,000)	0	0
Other available	(1)	0	0
Unobligated Balances Not Available	0	0	0
<b>Total, Status of Budgetary Resources</b>	<u><u>\$ 2,235,022</u></u>	<u><u>\$ 2,962,643</u></u>	<u><u>\$ 735,240</u></u>
 <b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>			
Obligated Balance, Net - beginning of period	\$ 230,817	\$ 17,541	\$ (78,167)
Obligated Balance transferred, net (+/-)	0	0	0
Obligated Balance, net - end of period:			
Accounts Receivable	(6,060)	(64,229)	(10,160)
Unfilled customer order from Federal sources	(648,320)	(589,757)	(271,179)
Undelivered Orders	395,450	364,221	66,590
Accounts Payable	308,507	540,642	83,887
Outlays:			
Disbursements	1,687,998	1,909,272	459,323
Collections	(1,714,261)	(1,845,026)	(481,852)
Subtotal	<u>\$ (26,263)</u>	<u>\$ 64,246</u>	<u>\$ (22,529)</u>
Less: Offsetting receipts	0	0	0
<b>Net Outlays</b>	<u><u>\$ (26,263)</u></u>	<u><u>\$ 64,246</u></u>	<u><u>\$ (22,529)</u></u>

## 2005 Annual Financial Report

Department of Defense  
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### COMBINING STATEMENT OF BUDGETARY RESOURCES

For the years ended September 30, 2005 and 2004

(\$ in thousands)

BUDGETARY FINANCING ACCOUNTS BUDGETARY RESOURCES	<u>Ordnance</u>	<u>Transportation</u>	<u>Base Support</u>
Budget Authority:			
Appropriations Received	\$ 0	\$ 67,000	\$ 18,550
Borrowing Authority	0	0	0
Contract Authority	0	15,201	18,762
Net transfers (+/-)	0	0	0
Other	0	0	0
Unobligated Balance:			
Beginning of period	47,574	191,461	342,464
Net transfers, actual (+/-)	(25,000)	(50,000)	0
Anticipated Transfers Balances	0	0	0
Spending Authority from Offsetting Collections:			
Earned	0	0	0
Collected	(315)	1,956,460	1,714,777
Receivable from Federal sources	31	(4,353)	10,272
Change in unfilled customer orders	0	0	0
Advances received	0	0	(8,515)
Without advance from Federal sources	0	250,451	(24,680)
Anticipated for the rest of year, without advances	0	0	0
Previously unavailable	0	0	0
Transfers from trust funds	0	0	0
Subtotal	<u>\$ (284)</u>	<u>\$ 2,202,558</u>	<u>\$ 1,691,854</u>
Recoveries of prior year obligations	0	0	0
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	0	(123,030)	(1,594)
<b>Total Budgetary Resources</b>	<u><u>\$ 22,290</u></u>	<u><u>\$ 2,303,190</u></u>	<u><u>\$ 2,070,036</u></u>

Department of Defense  
Navy Working Capital Fund

**COMBINING STATEMENT OF BUDGETARY RESOURCES**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

<b>BUDGETARY FINANCING ACCOUNTS</b>	<b>Ordnance</b>	<b>Transportation</b>	<b>Base Support</b>
<b>STATUS OF BUDGETARY RESOURCES</b>	<u>                    </u>	<u>                    </u>	<u>                    </u>
Obligations Incurred:			
Direct	\$ 0	\$ 0	\$ 0
Reimbursable	(12,882)	2,109,770	1,756,995
Subtotal	<u>\$ (12,882)</u>	<u>\$ 2,109,770</u>	<u>\$ 1,756,995</u>
Unobligated balance:			
Apportioned	\$ 60,172	243,421	313,041
Exempt from apportionment	(25,000)	(50,000)	0
Other available	0	(1)	0
Unobligated Balances Not Available	0	0	0
<b>Total, Status of Budgetary Resources</b>	<u><u>\$ 22,290</u></u>	<u><u>\$ 2,303,190</u></u>	<u><u>\$ 2,070,036</u></u>
 <b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>			
Obligated Balance, Net-beginning of period	\$ 18,918	\$ 256,920	\$ 680
Obligated Balance transferred, net (+/-)	0	0	0
Obligated Balance, net-end of period:			
Accounts Receivable	(33)	(93,964)	(131,790)
Unfilled customer order from Federal sources	0	(381,355)	(214,246)
Undelivered Orders	0	281,701	149,068
Accounts Payable	551	424,317	271,336
Outlays:			
Disbursements	5,486	1,889,893	1,697,713
Collections	315	(1,956,460)	(1,706,262)
Subtotal	<u>\$ 5,801</u>	<u>\$ (66,567)</u>	<u>\$ (8,549)</u>
Less: Offsetting receipts	0	0	0
<b>Net Outlays</b>	<u><u>\$ 5,801</u></u>	<u><u>\$ (66,567)</u></u>	<u><u>\$ (8,549)</u></u>

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### COMBINING STATEMENT OF BUDGETARY RESOURCES

For the years ended September 30, 2005 and 2004

(\$ in thousands)

BUDGETARY FINANCING ACCOUNTS BUDGETARY RESOURCES	Research & Development	Supply Management	Component Level
Budget Authority:			
Appropriations Received	\$ 4,624	\$ 0	\$ 7,618
Borrowing Authority	0	0	0
Contract Authority	128,975	603,830	0
Net transfers (+/-)	0	0	(3,750)
Other	0	0	0
Unobligated Balance:			
Beginning of period	1,395,635	251,037	(900,268)
Net transfers, actual (+/-)	(50,000)	65,385	0
Anticipated Transfers Balances	0	0	0
Spending Authority from Offsetting Collections:			
Earned	0	0	0
Collected	10,054,185	5,470,695	373
Receivable from Federal sources	(54,730)	(165,782)	(373)
Change in unfilled customer orders	0	0	0
Advances received	(69,038)	(257)	0
Without advance from Federal sources	6,120	(230,023)	0
Anticipated for the rest of year, without advances	0	0	0
Previously unavailable	0	0	0
Transfers from trust funds	0	0	0
Subtotal	\$ 9,936,537	\$ 5,074,633	\$ 0
Recoveries of prior year obligations	0	0	0
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	(24,637)	(65,385)	0
<b>Total Budgetary Resources</b>	<b>\$ 11,391,134</b>	<b>\$ 5,929,500</b>	<b>\$ (896,400)</b>

Department of Defense  
 Navy Working Capital Fund  
**COMBINING STATEMENT OF BUDGETARY RESOURCES**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

<b>BUDGETARY FINANCING ACCOUNTS</b>	<b>Research &amp; Development</b>	<b>Supply Management</b>	<b>Component Level</b>
<b>STATUS OF BUDGETARY RESOURCES</b>			
Obligations Incurred:			
Direct	\$ 0	\$ 0	\$ 0
Reimbursable	10,023,085	5,327,962	445,677
Subtotal	<u>\$ 10,023,085</u>	<u>\$ 5,327,962</u>	<u>\$ 445,677</u>
Unobligated balance:			
Apportioned	\$ 1,415,630	409,216	(1,345,944)
Exempt from apportionment	(47,582)	0	3,868
Other available	1	1	(1)
Unobligated Balances Not Available	<u>0</u>	<u>192,321</u>	<u>0</u>
<b>Total, Status of Budgetary Resources</b>	<u><u>\$ 11,391,134</u></u>	<u><u>\$ 5,929,500</u></u>	<u><u>\$ (896,400)</u></u>
<b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>			
Obligated Balance, Net-beginning of period	\$ 218,286	\$ 4,106,472	\$ (532,760)
Obligated Balance transferred, net (+/-)	0	0	0
Obligated Balance, net-end of period:			
Accounts Receivable	19,759	(78,964)	8,654
Unfilled customer order from Federal sources	(4,665,271)	(511,314)	0
Undelivered Orders	2,425,470	3,786,439	0
Accounts Payable	2,536,866	1,124,764	(92,493)
Outlays:			
Disbursements	9,973,157	5,509,315	(2,872)
Collections	(9,985,147)	(5,470,438)	(373)
Subtotal	<u>\$ (11,990)</u>	<u>\$ 38,877</u>	<u>\$ (3,245)</u>
Less: Offsetting receipts	0	0	0
<b>Net Outlays</b>	<u><u>\$ (11,990)</u></u>	<u><u>\$ 38,877</u></u>	<u><u>\$ (3,245)</u></u>

## 2005 Annual Financial Report

Department of Defense

Navy Working Capital Fund

### COMBINING STATEMENT OF BUDGETARY RESOURCES

For the years ended September 30, 2005 and 2004

(\$ in thousands)

BUDGETARY FINANCING ACCOUNTS BUDGETARY RESOURCES	<u>2005 Combined</u>	<u>2004 Combined</u>
Budget Authority:		
Appropriations Received	\$ 298,000	\$ 130,446
Borrowing Authority	0	0
Contract Authority	865,296	355,172
Net transfers (+/-)	(3,750)	0
Other	0	0
Unobligated Balance:		
Beginning of period	2,749,720	4,513,325
Net transfers, actual (+/-)	(84,615)	(287,800)
Anticipated Transfers Balances	0	0
Spending Authority from Offsetting Collections:		
Earned	0	0
Collected	23,151,266	23,926,810
Receivable from Federal sources	(233,654)	249,344
Change in unfilled customer orders	0	0
Advances received	8,239	90,067
Without advance from Federal sources	249,981	(1,724,666)
Anticipated for the rest of year, without advances	0	0
Previously Unavailable	0	0
Transfers from trust funds	0	0
Subtotal	<u>\$ 23,175,832</u>	<u>\$ 22,541,555</u>
Recoveries of prior year obligations	0	0
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(247,828)	(186,529)
<b>Total Budgetary Resources</b>	<u><u>\$ 26,752,655</u></u>	<u><u>\$ 27,066,169</u></u>

Department of Defense  
Navy Working Capital Fund

**COMBINING STATEMENT OF BUDGETARY RESOURCES**

For the years ended September 30, 2005 and 2004  
(\$ in thousands)

<b>BUDGETARY FINANCING ACCOUNTS</b>	<u>2005 Combined</u>	<u>2004 Combined</u>
<b>STATUS OF BUDGETARY RESOURCES</b>		
Obligations Incurred:		
Direct	\$ 0	\$ 0
Reimbursable	23,935,997	24,316,448
Subtotal	<u>\$ 23,935,997</u>	<u>24,316,448</u>
Unobligated balance:		
Apportioned	\$ 2,768,052	2,650,776
Exempt from apportionment	(143,714)	0
Other available	(1)	0
Unobligated Balances Not Available	192,321	98,945
<b>Total, Status of Budgetary Resources</b>	<u><u>\$ 26,752,655</u></u>	<u><u>\$ 27,066,169</u></u>
<b>RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:</b>		
Obligated Balance, Net-beginning of period	\$ 4,238,707	\$ 3,274,114
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, net-end of period:		
Accounts Receivable	(356,787)	(590,442)
Unfilled customer order from Federal sources	(7,281,442)	(7,031,461)
Undelivered Orders	7,468,939	6,892,059
Accounts Payable	5,198,377	4,968,550
Outlays:		
Disbursements	23,129,285	24,827,178
Collections	(23,159,504)	(24,016,876)
Subtotal	<u>\$ (30,219)</u>	<u>810,302</u>
Less: Offsetting receipts	0	0
<b>Net Outlays</b>	<u><u>\$ (30,219)</u></u>	<u><u>\$ 810,302</u></u>



## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### CONSOLIDATING STATEMENT OF FINANCING

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<b>Depot Maintenance, Shipyards</b>	<b>Depot Maintenance, Aviation</b>	<b>Depot Maintenance, Marine Corps</b>
<b>Resources Used to Finance Activities:</b>			
Budgetary Resources Obligated			
Obligations Incurred	\$ 1,657,668	\$ 2,120,182	\$ 507,540
Less: Spending Authority from offsetting collections and recoveries (-)	(1,865,170)	(1,822,600)	(582,763)
Obligations net of offsetting collections and recoveries	\$ (207,502)	\$ 297,582	\$ (75,223)
Less: Offsetting receipts (-)	0	0	0
Net obligations	\$ (207,502)	\$ 297,582	\$ (75,223)
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	(19,243)	(5,154)	0
Imputed financing from costs absorbed by others	0	0	10,079
Other (+/-)	0	0	0
Net other resources used to finance activities	\$ (19,243)	\$ (5,154)	\$ 10,079
<b>Total resources used to finance activities</b>	<b>\$ (226,745)</b>	<b>\$ 292,428</b>	<b>\$ (65,144)</b>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered orders (-)	\$ 7,868	\$ (200,313)	\$ (23,504)
Unfilled Customer Orders	238,747	(8,082)	103,497
Resources that fund expenses recognized in prior periods	0	0	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0	0
Resources that finance the acquisition of assets	(26,170)	(22,882)	(25,545)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations			
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0	0
Other (+/-)	19,243	5,154	0
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<b>\$ 239,688</b>	<b>\$ (226,123)</b>	<b>\$ 54,448</b>
<b>Total resources used to finance the Net Cost of Operations</b>	<b>\$ 12,943</b>	<b>\$ 66,305</b>	<b>\$ (10,696)</b>

Department of the Navy

Department of Defense  
Navy Working Capital Fund

**CONSOLIDATING STATEMENT OF FINANCING**

For the years ended September 30, 2005 and 2004

(\$ in thousands)

	<u>Depot Maintenance, Shipyards</u>	<u>Depot Maintenance, Aviation</u>	<u>Depot Maintenance, Marine Corps</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>			
Components Requiring or Generating Resources in Future Periods:			
Increase in annual leave liability	\$ 0	\$ 0	\$ 0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0
Other (+/-)	0	0	4,302
Total components of Net Cost of Operations that will require or generate resources in future periods	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 4,302</u>
Components not Requiring or Generating Resources:			
Depreciation and amortization	\$ 20,460	\$ 42,064	\$ 3,509
Revaluation of assets and liabilities (+/-)	1,026	0	1,718
Other (+/-)			
Trust Fund Exchange Revenue	0	0	0
Cost of Goods Sold	(3,865)	34,976	243
Operating Material & Supplies Used	0	0	0
Other	0	0	0
Total components of Net Cost of Operations that will not require or generate resources	<u>\$ 17,621</u>	<u>\$ 77,040</u>	<u>\$ 5,470</u>
<b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b>	<u>\$ 17,621</u>	<u>\$ 77,040</u>	<u>\$ 9,772</u>
<b>Net Cost of Operations</b>	<u>\$ 30,564</u>	<u>\$ 143,345</u>	<u>\$ (924)</u>

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### CONSOLIDATING STATEMENT OF FINANCING

For the years ended September 30, 2005 and 2004  
(\$ in thousands)

	<u>Ordnance</u>	<u>Transportation</u>	<u>Base Support</u>
<b>Resources Used to Finance Activities:</b>			
Budgetary Resources Obligated			
Obligations Incurred	\$ (12,882)	\$ 2,109,770	\$ 1,756,995
Less: Spending Authority from offsetting collections and recoveries (-)	284	(2,202,557)	(1,691,854)
Obligations net of offsetting collections and recoveries	\$ (12,598)	\$ (92,787)	\$ 65,141
Less: Offsetting receipts (-)	0	0	0
Net obligations	\$ (12,598)	\$ (92,787)	\$ 65,141
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	0	(416)	(8,207)
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
Net other resources used to finance activities	\$ 0	\$ (416)	\$ (8,207)
<b>Total resources used to finance activities</b>	<b>\$ (12,598)</b>	<b>\$ (93,203)</b>	<b>\$ 56,934</b>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered orders (-)	\$ 442	\$ (254,862)	\$ (82,452)
Unfilled Customer Orders	0	250,451	(33,195)
Resources that fund expenses recognized in prior periods	0	0	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0	0
Resources that finance the acquisition of assets	14	136,682	(13,545)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations			
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0	0
Other (+/-)	0	416	8,207
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<b>\$ 456</b>	<b>\$ 132,687</b>	<b>\$ (120,985)</b>
<b>Total resources used to finance the Net Cost of Operations</b>	<b>\$ (12,142)</b>	<b>\$ 39,484</b>	<b>\$ (64,051)</b>

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING STATEMENT OF FINANCING**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>Ordnance</u>	<u>Transportation</u>	<u>Base Support</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>			
Components Requiring or Generating Resources in Future Periods:			
Increase in annual leave liability	\$ 0	\$ 0	\$ 0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0
Other (+/-)	0	0	0
Total components of Net Cost of Operations that will require or generate resources in future periods	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Components not Requiring or Generating Resources:			
Depreciation and amortization	\$ 0	\$ 11,392	\$ 18,716
Revaluation of assets and liabilities (+/-)	0	0	0
Other (+/-)			
Trust Fund Exchange Revenue	0	0	0
Cost of Goods Sold	0	0	0
Operating Material & Supplies Used	0	0	0
Other	0	0	0
Total components of Net Cost of Operations that will not require or generate resources	<u>\$ 0</u>	<u>\$ 11,392</u>	<u>\$ 18,716</u>
<b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b>	<u>\$ 0</u>	<u>\$ 11,392</u>	<u>\$ 18,716</u>
<b>Net Cost of Operations</b>	<u>\$ (12,142)</u>	<u>\$ 50,876</u>	<u>\$ (45,335)</u>

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund  
**CONSOLIDATING STATEMENT OF FINANCING**  
For the years ended September 30, 2005 and 2004  
(\$ in thousands)

	<u>Research &amp; Development</u>	<u>Supply Management</u>	<u>Component Level</u>
<b>Resources Used to Finance Activities:</b>			
Budgetary Resources Obligated			
Obligations Incurred	\$ 10,023,085	\$ 5,327,962	\$ 445,677
Less: Spending Authority from offsetting collections and recoveries (-)	<u>(9,936,538)</u>	<u>(5,074,632)</u>	<u>0</u>
Obligations net of offsetting collections and recoveries	\$ 86,547	\$ 253,330	\$ 445,677
Less: Offsetting receipts (-)	<u>0</u>	<u>0</u>	<u>0</u>
Net obligations	<u>\$ 86,547</u>	<u>\$ 253,330</u>	<u>\$ 445,677</u>
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	(36,384)	(614,859)	684,263
Imputed financing from costs absorbed by others	0	0	542,518
Other (+/-)	<u>10,224</u>	<u>0</u>	<u>(663,850)</u>
Net other resources used to finance activities	<u>\$ (26,160)</u>	<u>\$ (614,859)</u>	<u>\$ 562,931</u>
<b>Total resources used to finance activities</b>	<u>\$ 60,387</u>	<u>\$ (361,529)</u>	<u>\$ 1,008,608</u>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered orders (-)	\$ (191,054)	\$ 59,133	\$ 0
Unfilled Customer Orders	(62,918)	(230,280)	0
Resources that fund expenses recognized in prior periods	0	0	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations			
Net Cost of Operations	0	0	0
Resources that finance the acquisition of assets	(22,719)	(4,362,024)	(6,156)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations			
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0	0
Other (+/-)	<u>26,160</u>	<u>614,859</u>	<u>(20,413)</u>
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<u>\$ (250,531)</u>	<u>\$ (3,918,312)</u>	<u>\$ (26,569)</u>
<b>Total resources used to finance the Net Cost of Operations</b>	<u>\$ (190,144)</u>	<u>\$ (4,279,841)</u>	<u>\$ 982,039</u>

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING STATEMENT OF FINANCING**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>Research &amp; Development</u>	<u>Supply Management</u>	<u>Component Level</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>			
Components Requiring or Generating Resources in Future Periods:			
Increase in annual leave liability	\$ 0	\$ 0	\$ 0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0
Other (+/-)	0	0	20,024
Total components of Net Cost of Operations that will require or generate resources in future periods	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 20,024</u>
Components not Requiring or Generating Resources:			
Depreciation and amortization	\$ 115,939	\$ (6,875)	\$ 0
Revaluation of assets and liabilities (+/-)	(4,967)	1,238,225	0
Other (+/-)			
Trust Fund Exchange Revenue	0	0	0
Cost of Goods Sold	74,774	4,468,298	0
Operating Material & Supplies Used	0	0	0
Other	0	99	0
Total components of Net Costs of Operations that will not require or generate resources	<u>\$ 185,746</u>	<u>\$ 5,699,747</u>	<u>\$ 0</u>
<b>Total components of Net Costs of Operations that will not require or generate resources in the current period</b>	<u>\$ 185,746</u>	<u>\$ 5,699,747</u>	<u>\$ 20,024</u>
<b>Net Cost of Operations</b>	<u>\$ (4,398)</u>	<u>\$ 1,419,906</u>	<u>\$ 1,002,063</u>

## 2005 Annual Financial Report

Department of Defense  
Navy Working Capital Fund

### CONSOLIDATING STATEMENT OF FINANCING

For the years ended September 30, 2005 and 2004  
(\$ in thousands)

	<u>2005</u> <u>Consolidated</u>	<u>2004</u> <u>Consolidated</u>
<b>Resources Used to Finance Activities:</b>		
Budgetary Resources Obligated		
Obligations Incurred	\$ 23,935,997	\$ 24,316,448
Less: Spending Authority from offsetting collections and recoveries (-)	(23,175,830)	(22,541,554)
Obligations net of offsetting collections and recoveries	\$ 760,167	\$ 1,774,894
Less: Offsetting receipts (-)	0	0
Net obligations	\$ 760,167	\$ 1,774,894
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	125
Imputed financing from costs absorbed by others	552,597	544,886
Other (+/-)	(653,626)	0
Net other resources used to finance activities	\$ (101,029)	\$ 545,011
<b>Total resources used to finance activities</b>	<b>\$ 659,138</b>	<b>\$ 2,319,905</b>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	\$ (684,742)	\$ 1,142,521
Unfilled Customer Orders	258,220	(1,634,601)
Resources that fund expenses recognized in prior periods	0	(241,627)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0
Resources that finance the acquisition of assets	(4,342,345)	(5,045,185)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	653,626	(125)
<b>Total resources used to finance items not part of the Net Cost of Operations</b>	<b>\$ (4,115,241)</b>	<b>\$ (5,779,017)</b>
<b>Total resources used to finance the Net Cost of Operations</b>	<b>\$ (3,456,103)</b>	<b>\$ (3,459,112)</b>

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATING STATEMENT OF FINANCING**  
 For the years ended September 30, 2005 and 2004  
 (\$ in thousands)

	<u>2005 Consolidated</u>	<u>2004 Consolidated</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	\$ 0	\$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	24,326	0
Total components of Net Cost of Operations that will require or generate resources in future periods	<u>\$ 24,326</u>	<u>\$ 0</u>
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 205,205	\$ 255,203
Revaluation of assets and liabilities (+/-)	1,236,002	42,924
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	4,574,426	4,160,738
Operating Material & Supplies Used	0	0
Other	99	38,732
Total components of Net Cost of Operations that will not require or generate resources	<u>\$ 6,015,732</u>	<u>\$ 4,497,597</u>
<b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b>	<u>\$ 6,040,058</u>	<u>\$ 4,497,597</u>
<b>Net Cost of Operations</b>	<u><u>\$ 2,583,955</u></u>	<u><u>\$ 1,038,485</u></u>



DEPARTMENT OF THE NAVY

# NAVY WORKING CAPITAL FUND REQUIRED SUPPLEMENTARY INFORMATION

2005



Navy Working Capital Fund  
 General Property, Plant, and Equipment  
**Real Property Deferred Annual Sustainment and Restoration Tables**  
 As of September 30, 2005  
 (\$ in Millions)

Annual Sustainment FY 2005			
	Required	Actual	Difference
Navy	\$256	\$256	\$0
Marine Corps	4	4	0
<b>Building, Structures, and Utilities</b>	\$260	\$260	\$0

Annual Deferred Sustainment Trend				
	FY 2002	FY 2003	FY 2004	FY 2005
Navy	-	-	-	-
Marine Corps	-	-	-	-
<b>Building, Structures, and Utilities</b>	-	-	-	-

Restoration and Modernization Requirements			
	End FY 2004	End FY 2005	Change
Navy	-	-	-
Marine Corps	-	-	-
<b>Building, Structures, and Utilities</b>	-	-	-

**NARRATIVE STATEMENT:**

Fiscal Year 2005 represents the fourth year the Facility Sustainment Model (FSM) was utilized for the Navy Working Capital Fund (NWCF). Deferred amounts were calculated in accordance with the methodology provided by DoD Financial Management Regulation, Volume 6B, Chapter 12. The output of the Facility Sustainment Model continues to undergo quality checks to ensure its accuracy. Accordingly, utilizing an updated and accurate version of the model provides current requirements for each fiscal year.

In FY 2005, FSM Version 5.0 was used for programming and budgeting for facilities sustainment.

The NWCF has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

## 2005 Annual Financial Report

Schedule, Part A DoD Intragovernmental Asset Balances (\$ Amounts in Thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		183			
Department of Commerce	13		965			
Department of the Interior	14		143			
Department of Justice	15		190			
Navy General Fund	17		386,796			
United States Postal Service	18		52			
Department of State	19		(22)			
Department of the Treasury	20	977,864	(214)			
Army General Fund	21		10,484			
Resolution Trust Corporation	22		4			
Nuclear Regulatory Commission	31		9			
Department of Veterans Affairs	36		6			
Government Printing Office	4		15			
General Service Administration	47		1,477			
Independent Agencies	48		22			
National Science Foundation	49		541			
General Accounting Office	5		31			
Advisory Commission on Intergovernmental Relations	55		2			
Air Force General Fund	57		15,615			
Consumer Product Safety Commission	61		4			
Tennessee Valley Authority	64		21			
Environmental Protection Agency	68		179			
Department of Transportation	69		682			
Homeland Security	70		9,198			
Agency for International Development	72		1			
Small Business Administration	73		4,611			
Department of Health and Human Services	75		66			
Independent Agencies	76		22			
National Aeronautics and Space Administration	80		2,822			
Department of Energy	89		1,830			
US Army Corps of Engineers	96		83			
Other Defense Organizations General Funds	97		36,536			
Other Defense Organizations Working Capital Funds	97-4930		13,159			375
Army Working Capital Fund	97-4930.001		6,634			
Air Force Working Capital Fund	97-4930.003		2,279			
Architect of the Capitol			73			
<i>Totals might not match the Principal Statements</i>	<b>Totals</b>	\$977,864	\$494,499	\$0	\$0	\$375

Department of the Navy

Schedule, Part B DoD Intragovernmental Entity Liabilities (\$ Amounts in Thousands)	Treasury Index	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Executive Office of the President	11			37
Department of Agriculture	12	55		94
Department of Commerce	13	109		125
Department of the Interior	14	6		
Department of Justice	15	10		85,454
Navy General Fund	17	63,628		180,959
United States Postal Service	18	1,159		29
Department of State	19			8,453
Department of the Treasury	20	(232)	381,518	1,899
Army General Fund	21			11
Office of Personnel Management	24	37,303		38,306
Federal Communications Commission	27	860		
Library of Congress	3	25		6,808
Nuclear Regulatory Commission	31			591
John F. Kennedy Center	33			960
Department of Veterans Affairs	36	56		2
Government Printing Office	4	6		
General Service Administration	47	5,151		1,761
National Science Foundation	49	546		22,007
Air Force General Fund	57	1,029		3
Consumer Product Safety Commission	61			90
Department of Transportation	69	45		1,077
Homeland Security	70	122		101,694
Agency for International Development	72			204
Small Business Administration	73			(103)
Department of Health and Human Services	75	(9)		2,135
National Aeronautics and Space Administration	80	329		239
Department of Housing and Urban Development	86			(53)
Department of Energy	89	121		1,531
Department of Education	91			122
Independent Agencies	95			299
Other Defense Organizations General Funds	97	3,579		3
Other Defense Organizations Working Capital Funds	97-4930	76,260		
Army Working Capital Fund	97-4930.001	5,039		
Air Force Working Capital Fund	97-4930.003	4,405		
The General Fund of the Treasury	99			2,729
Architect of the Capitol				13
<i>Totals might not match the Principal Statements</i>	<b>Totals</b>	\$199,602	\$381,518	\$457,479

## 2005 Annual Financial Report

Schedule, Part C DoD Intragovernmental Revenue and Related Costs (\$ Amounts in Thousands)	Treasury Index	Earned Revenue
Executive Office of the President	11	1,081
Department of Agriculture	12	1,072
Department of Commerce	13	14,978
Department of the Interior	14	4,654
Department of Justice	15	150,889
Department of Labor	16	1,572
Navy General Fund	17	18,145,378
United States Postal Service	18	134
Department of State	19	10,909
Department of the Treasury	20	3,450
Army General Fund	21	259,802
Resolution Trust Corporation	22	73
Office of Personnel Management	24	132
National Credit Union Administration	25	2,183
Federal Trade Commission	29	(1)
Library of Congress	3	2,724
Nuclear Regulatory Commission	31	1,102
John F. Kennedy Center	33	2,913
Department of Veterans Affairs	36	763
Government Printing Office	4	2,241
General Service Administration	47	4,398
Independent Agencies	48	21
National Science Foundation	49	15,830
General Accounting Office	5	55
Advisory Commission on Intergovernmental Relations	55	238
Air Force General Fund	57	385,512
Consumer Product Safety Commission	61	7
Tennessee Valley Authority	64	92
Environmental Protection Agency	68	6,554
Department of Transportation	69	5,861
Homeland Security	70	137,701
Agency for International Development	72	48
Department of Health and Human Services	75	13,496
National Aeronautics and Space Administration	80	39,163
Export-Import Bank of the United States	83	1,040
Department of Housing and Urban Development	86	353
Department of Energy	89	33,878
Independent Agencies	95	1,569
US Army Corps of Engineers	96	2,460
Other Defense Organizations General Funds	97	1,170,923
Other Defense Organizations Working Capital Funds	97-4930	86,525
Army Working Capital Fund	97-4930.001	45,872
Air Force Working Capital Fund	97-4930.003	144,981
Architect of the Capitol		899
<i>Totals might not match the Principal Statements</i>	<b>Total</b>	<b>\$20,703,525</b>

Schedule, Part E DoD Intragovernmental Non-exchange Revenues (\$ Amounts in Thousands)	Treasury Index	Transfers In	Transfers Out
Navy General Fund	17		\$150,000
Other Defense Organizations Working Capital Funds	97-4930	\$65,385	
<i>Totals might not match the Principal Statements</i>	<b>Totals</b>	\$65,385	\$150,000

# NAVY WORKING CAPITAL FUND OTHER ACCOMPANYING INFORMATION

2005



## APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE FINANCIAL STATEMENTS

### REPORTING ENTITY

#### Navy Working Capital Fund

#### Fund/Account Treasury Symbol and Title:

97X4930 002

#### Navy Working Capital Fund Activity Group Treasury Symbol and Title:

97X4930.NA1\* Depot Maintenance-Shipyards  
97X4930.NA2\* Depot Maintenance-Aviation  
97X4930.NA4\* Depot Maintenance- Other (Marine Corps)  
97X4930.NA3\* aOrdnance  
97X4930.ND\* Transportation  
97X4930.NE\* \* Base Support  
97X4930.NH\*\* Research and Development  
97X4930.NC\*\* Supply Management

#### Notes

- \* - The "\*" represents alpha or numeric characters which identify an activity or reporting segment of the activity group.
- a - The Ordnance activity group became a part of the DON General Fund in FY 2000. The Ordnance information included in this report represents residual NWCF accounting for this group.



DEPARTMENT OF THE NAVY

**AUDIT OPINIONS**

2005







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

November 8, 2005

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

SUBJECT: Independent Auditor's Report on the Fiscal Year 2005 Department of the Navy  
General Fund Financial Statements (Report No. D-2006-017)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy General Fund Consolidated Balance Sheet as of September 30, 2005 and 2004, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, the Combined Statement of Financing, and the Statement of Custodial Activity for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2005 financial statements of Department of the Navy General Fund because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

### **Disclaimer of Opinion on the Financial Statements**

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies still exist in the Department of the Navy General Fund financial statements. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Department of the Navy has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the principal financial statements.<sup>1</sup> Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

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<sup>1</sup> The annual financial statements include the principal financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

## Summary of Internal Control

In planning our audit, we considered the Department of the Navy internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions,<sup>2</sup> all of which are material, continue to exist in the following areas.

- Accounting and Financial Management Systems
- Fund Balance with Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Environmental Liabilities
- Problem Disbursements

Material weaknesses are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal, assigned functions. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

## Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level, as required under the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Department of the Navy was in compliance with all applicable laws and regulations related to financial reporting. See the attachment for additional details on compliance with laws and regulations.

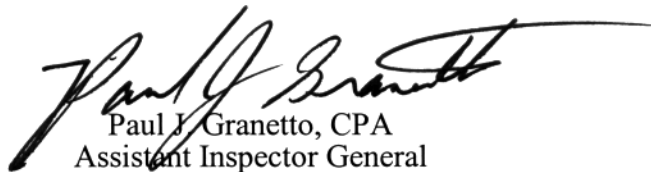
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<sup>2</sup> Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

## Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act of 1982 are met; and
- complying with applicable laws and regulations.



Paul J. Granetto, CPA  
Assistant Inspector General  
Defense Financial Auditing  
Service

Attachment:  
As stated



# Report on Internal Control and Compliance with Laws and Regulations

## Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting.

**Material Weaknesses.** Management acknowledges that previously identified reportable conditions, all of which are material, continue to exist.

**Accounting and Financial Management Systems.** The Department of the Navy financial systems deficiencies include the inability to implement elements of generally accepted accounting principles and inadequate implementation of the U.S. Government Standard General Ledger. Also, adjusting entries were needed to correct errors caused by differences between accounting systems.

**Fund Balance with Treasury.** Deficiencies associated with the Fund Balance with Treasury include: unmatched disbursements and collections; the clearing of “suspense” accounts in a timely manner; check discrepancies; undistributed disbursements, collections, and abnormal balances; and an inability to reconcile Department of Navy records with the Department of Treasury’s records.

**Accounts Receivable.** Intragovernmental accounts receivable may be overstated because of outstanding over-aged reimbursable work orders. Seller-side trading partner data are neither captured nor maintained at a transaction level detail, or may be missing or incomplete because of system deficiencies. Accounts receivable balances with the public may not be complete or accurate. Further, unmatched collections are posted to the accounts receivable account, leaving no audit trail.

**Inventory and Related Property, Net.** The legacy systems currently being used do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards Number 3, “Accounting for Inventory and Related Property.” In addition, completeness issues exist because these legacy systems were not designed to ensure that all of the inventory items are included in the values reported on the Balance Sheet. Some Navy commands have not used the consumption method for expensing Operating Materials and Supplies. Also, some commands are unable to provide Operating Materials and Supplies at the detailed transaction level and only maintain beginning and ending balances.

**General Property, Plant, and Equipment.** Completeness issues still exist associated with recognizing internal use software and leasehold improvements. Trading partner data for capitalizing assets may not always be recorded. Statement of Federal Financial Accounting Standards No. 23, “Eliminating the Category National Defense Property, Plant, and Equipment,” is currently being implemented.

**Accounts Payable.** Intragovernmental accounts payable such as Military Standard Requisition and Issue Procedures, fuel payables, and non-PowerTrack transportation charges are not being recorded timely, completely, or accurately. A lack of sufficient systems, processes, and data does not support reconciliation of buyer-side trading partner information. Accounts payable

Attachment

with the public are not being recorded timely, completely, or accurately. Some existing procedures create abnormal balances.

**Environmental Liabilities.** Non-Defense Environmental Restoration Program liabilities are not being reported and, therefore, the line is not ready for audit.

**Problem Disbursements.** Inaccurate or missing fund accounting codes have resulted in unmatched disbursements and collections requiring use of suspense accounts. The suspense accounts cause difficulty in reconciling Department of the Navy General Fund records with the Department of Treasury's records.

These financial management deficiencies are indications of material weaknesses in internal control that may adversely affect any decision by the Department of the Navy that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by the Department of the Navy also may contain misstatements resulting from these deficiencies.

## Compliance with Laws and Regulations

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

The Department of the Navy is required to comply with financial management systems reporting requirements. For example, the Federal Financial Management Improvement Act of 1996 requires the Department of the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In addition, the Federal Managers' Financial Integrity Act of 1982 requires the Department of the Navy to evaluate the systems and to report annually whether those systems are in compliance with applicable requirements. The Chief Financial Officers Act of 1990 requires the DoD to prepare a 5-year Financial Management Plan describing activities that DoD will conduct during the next 5 years to improve financial management.

The Department of the Navy acknowledged that many of its critical financial management and feeder systems do not comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In an attempt to comply with statutory reporting requirements and applicable financial systems requirements, Department of Defense is developing a Department of Defense-Wide Business Enterprise Architecture. The architecture is intended to provide a "blue print" of the Department's financial management systems and processes to initiate a comprehensive financial management reform effort. Until the architecture is fully developed, the Department of the Navy will be unable to fully comply with the statutory reporting requirements. Therefore, we did not perform tests of compliance for these requirements.



## **Audit Disclosures**

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on November 8, 2005, that the Navy General Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. Therefore, we did not conduct audit work related to deficiencies identified during previous audits of the Department of the Navy.

In addition, we did not perform audit work related to the following selected provisions of laws and regulations: the Antideficiency Act, the Prompt Payment Act, and the Federal Credit Reform Act.

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.





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

November 8, 2005

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

SUBJECT: Independent Auditor's Report on the Fiscal Year 2005 Department of the Navy  
Working Capital Fund Financial Statements (Report No. D-2006-0016)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy Working Capital Fund Consolidated Balance Sheet as of September 30, 2005 and 2004, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, the Combined Statement of Financing, and the Statement of Custodial Activity for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Fiscal Year 2005 financial statements of Department of the Navy Working Capital Fund because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of the audit.

### **Disclaimer of Opinion on the Financial Statements**

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies still exist that could adversely impact the Department of the Navy Working Capital Fund financial statements. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Department of the Navy has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the principal financial statements.<sup>1</sup> Therefore, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

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<sup>1</sup> The annual financial statements include the principal financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Information, and Other Accompanying Information.

## Summary of Internal Control

In planning our audit, we considered the Department of the Navy internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, previously identified reportable conditions,<sup>2</sup> all of which are material, continue to exist in the following areas.

- Accounting and Financial Management Systems
- Fund Balance with Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Other Liabilities

Material weaknesses are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal, assigned functions. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

## Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that many of the financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether the Department of the Navy was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

## Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;

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<sup>2</sup> Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

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



Paul J. Granetto, CPA  
Assistant Inspector General  
Defense Financial Auditing  
Service

Attachment:  
As stated



# Report on Internal Control and Compliance with Laws and Regulations

## Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting.

**Material Weaknesses.** Management acknowledged that previously identified reportable conditions, all of which are material, continue to exist.

**Accounting and Financial Management Systems.** The Department of the Navy financial management systems do not comply fully with generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. As a result, Department of the Navy financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements.

**Fund Balance with Treasury.** The Navy Working Capital Fund activities do not reconcile cash accounts to the Department of Treasury cash account balance on a consistent basis. In addition, system interfaces do not exist between the financial reporting systems causing unmatched disbursements and collections.

**Accounts Receivable.** Department of Navy does not reconcile subsidiary records to corresponding general ledger accounts, resulting in a control weakness and the loss of an audit trail. Navy also posts unmatched collections to accounts receivable using journal vouchers, leaving no audit trail. Trading partner adjustments posted to intragovernmental accounts receivable are not always supported by detailed transactions. Navy also does not always record recognition and collection of public accounts for contract overpayments, travel advances, and employee debt.

**Inventory and Related Property, Net.** Navy Working Capital Fund Supply Management activities record inventory at latest acquisition cost. To comply with generally accepted accounting principles, latest acquisition cost must be converted to approximations of historical cost. Adequate data, processes, and methodologies do not exist to accurately make this conversion.

**General Property, Plant, and Equipment.** Navy Working Capital Fund Supply Management Business Area does not properly record assets and depreciation within its accounting systems. In addition, Navy does not capture or report buyer-side trading partner information.

**Accounts Payable.** This line item is adversely affected by insufficient and inconsistent reconciliations and a lack of direct system interfaces, resulting in matching difficulties, undistributed disbursements, and the inability to capture trading partner information.

**Other Liabilities.** Unsupported, undistributed disbursements need to be resolved. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Defense Finance and Accounting Service Cleveland, and Department of Navy staff need to work this

Attachment

issue jointly, analyzing amounts posted for contract accruals to determine if they are properly recorded in this line item.

These financial management deficiencies are indications of material weaknesses in internal control that may adversely affect any decision by the Department of the Navy that is based, in whole or in part, on information that is inaccurate because of these deficiencies. Financial information reported by the Department of the Navy also may contain misstatements resulting from these deficiencies.

## **Compliance with Laws and Regulations**

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

**Federal Financial Management Improvement Act of 1996.** The Department of the Navy is required to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Department of the Navy acknowledged to us that many of the financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level.

**Federal Managers' Financial Integrity Act of 1982.** The Department of the Navy is required to evaluate its financial systems and to report annually on whether those systems are in compliance with applicable requirements. The DoD is in the process of developing a Business Enterprise Architecture through its Financial Management Modernization Program. The architecture is intended to improve the effectiveness of DoD financial and nonfinancial systems in providing financial information. Until the architecture is fully developed, the Department of the Navy will be unable to fully comply with statutory reporting requirements. Therefore, we did not perform tests of compliance for these requirements.

## **Audit Disclosures**

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on November 8, 2005, that the Department of the Navy Working Capital Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. Therefore, we did not conduct audit work related to deficiencies identified during previous audits of the Department of the Navy.

In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Antideficiency Act, the Prompt Payment Act, and the Federal Credit Reform Act.



This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.

## COVER PAGE PHOTO CREDITS

Top of page, from left to right:

1. New Orleans (Sept. 7, 2005) - A U.S. Navy Chief Aviation Warfare Systems Operator assigned to the "Emerald Knights" of a Helicopter Anti-Submarine Squadron (HS-75) looks out from the cabin of an SH-60 Seahawk helicopter at the flooded streets of New Orleans in the aftermath of Hurricane Katrina. **U.S. Navy photo by Photographer's Mate 3rd Class Kristopher Wilson**
2. Pacific Ocean (June 27, 2005) - A U.S. Marine Corps amphibious assault vehicle assigned to the 3rd Amphibious Assault Battalion travels through the Pacific Ocean after departing the USS Peleliu (LHA 5) for infantry and amphibious training. **U.S. Navy photo by Journalist 2nd Class Zack Baddorf**
3. Udairi Range, Kuwait (May 20, 2005) - Marines from Echo Company, Battalion Landing Team 2nd Bn., 8th Marines, 26th Marine Expeditionary Unit (Special Operations Capable), fire a "battle sight zero" range at Udairi Range, Kuwait, during routine proficiency training. U.S. Marine Corps photo by Sgt. Roman Yurek
4. Persian Gulf (Mar. 1, 2005) - An F/A-18A+ Hornet pilot assigned to the "Silver Eagles" of a Marine Fighter Attack Squadron (VMFA-115) conducts a check of his speed break prior to launch. **U.S. Navy photo by Photographer's Mate Airman Ricardo J. Reyes**
5. Mubarek Military City, Egypt (Sept. 13, 2005) - U.S. Marines assigned to the Expeditionary Strike Group One, 13th Marine Expeditionary Unit disembark a landing craft utility from the USS Tarawa (LHA 1). **U.S. Navy photo by Photographer's Mate 2nd Class Brandon A. Teeples**
6. (Persian Gulf) - Sailors assigned to the "Raging Bulls" of a Fighter Attack Squadron (VFA-37) perform routine maintenance to an F/A-18 Hornet on the USS Harry S. Truman (CVN-75). **US Navy photo by Photographers Mate Airman Ryan O'Connor**
7. Yokosuka, Japan (Mar. 23, 2005) - Members of an Explosive Ordnance Disposal Mobile Unit (EODMU-5) fast rope from an HH-60H Seahawk to the deck of the USS Kitty Hawk (CV 63) during an air power demonstration. **U.S. Navy photo by Photographer's Mate 3rd Class Bo Flannigan**
8. Iraq (Dec. 22, 2004) - A Gunners Mate 2nd Class (left), attached to 31st Marine Expeditionary Unit's Explosive Ordnance Division, scans the area near the Iraqi border. **U.S. Marine Corps Photo by Cpl. Christopher R. Rye**
9. Bahrain (May 10, 2005) - A Hull Maintenance Technician 2nd Class inspects the remaining high explosive material from a disrupted improvised explosive device during a training exercise in Bahrain. **U.S. Navy photo by Photographer's Mate 1st Class Aaron Ansarov**
10. Northern Pakistan (Oct. 17, 2005) - A Pakistani woman watches from the top of a pile of rubble as supplies are unloaded from a U.S. Navy MH-53E Sea Stallion helicopter in northern Pakistan. **U.S. Navy photo by Photographer's Mate 2nd Class Timothy Smith**
11. Pacific Ocean (May 29, 2005) - Crewmembers assigned to the "Red Devils" of a Marine Fighter Attack Squadron (VMFA-232) prepare to load an AIM-9 Sidewinder missile to an F/A-18 Hornet on the USS Nimitz (CVN 68). **U.S. Navy photo by Photographer's Mate Airman Roland Franklin**
12. Persian Gulf (May 05, 2005) - A Senior Chief Aviation Warfare Systems Operator assigned to a Helicopter Anti-Submarine Squadron (HS-8) captures images of a vessel of interest during Maritime Interdiction Operations.

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### U.S. Navy photo by Photographer's Mate Airman Chris M. Valdez

13. Atlantic Ocean (May 21, 2005) - Members of the honor guard aboard the USS Theodore Roosevelt (CVN 71) prepare to perform a 21-gun salute during a burial at sea ceremony. **U.S. Navy photo by Photographer's Mate 2nd Class Matthew Bash**
14. Norfolk, Va. (July 31, 2005) - A Machinist's Mate 2nd Class shares a first hug with his children at pier 14 on board Naval Station Norfolk, during homecoming celebrations for the USS Carl Vinson (CVN 70). **U.S. Navy photo by Journalist Seaman Christopher Okula**
15. Indian Ocean (Mar. 16 2005) - Military Sealift Command hospital ship USNS Mercy (T-AH 19) sits off the coast of Banda Aceh, Indonesia, preparing for its return to the U.S. **U.S. Navy photo by Photographer's Mate 2nd Class Jeffery Russell**
16. Banda Aceh, Sumatra, Indonesia (Jan. 14, 2005) - A local woman and her child express appreciation to Sailors from the USS Abraham Lincoln (CVN-72) and Carrier Air Wing Two (CVW-2), who are distributing food and water in the wake of the December 2004 earthquake and tsunami. **U.S. Navy photo by Photographer's Mate 1st Class John. D. Yoder**
17. San Diego, Calif. (Mar. 23, 2005) - The Los Angeles-class fast attack submarine USS Salt Lake City (SSN 716) underway after departing Naval Submarine Base Point Loma, California, to conduct routine exercises in the Pacific Ocean. **U.S. Navy photo by Photographer's Mate 3rd Class Danielle M. Sosa**
18. Sumatra, Indonesia (Jan. 7, 2005) - Indonesian citizens are delighted as a U.S. Navy air crewman helicopter drops food, cookies, and water to them in their village. **U.S. Navy photo by Photographer's Mate 3rd Class Jacob J. Kirk**
19. Indian Ocean (Feb. 3, 2005) - Military Sealift Command hospital ship USNS Mercy (T-AH 19) navigates alongside USS Abraham Lincoln (CVN 72) after arriving on station near Banda Aceh, Sumatra, Indonesia. **U.S. Navy photo by Photographer's Mate 3rd Class Gabriel R. Piper**
20. Al Anbar, Iraq (May 20, 2005) - U.S. Marines, who had been conducting counter-insurgency operations with Iraqi Security Forces, prepare to leave Border Fort 12 via helicopter. **U.S. Marine Corps photo by Sgt Michael A. Blaha**
21. New Orleans (Sept. 5, 2005) - A U.S. Navy search and rescue swimmer and Aviation Warfare Systems Operator 1st Class retrieves and evacuates a victim of Hurricane Katrina from a rooftop in New Orleans. **U.S. Navy photo by Photographer's Mate 3rd Class Jay C. Pugh**

Special Thanks to **Rear Admiral McCreary**, the Chief of Naval Information; **Chris Madden**, the Director of the Navy Visual News Service; and the **staff of the Office of the Chief of Naval Information** for providing Department of the Navy photographs.

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## **FOR MORE INFORMATION**

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