DEPARTMENT OF THE NAVY FISCAL YEAR 2014 ANNUAL FINANCIAL REPORT

THE NATION'S TOTAL FORCE:

At the Right Place, At the Right Time, All the Time

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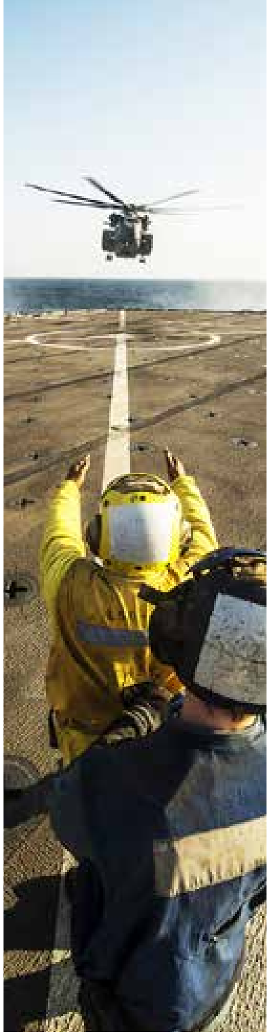

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"Military and civilian leaders alike, continue to strengthen financial and business operations"

NOVEMBER 2014

In today's diverse and dynamic global environment, it is critical that the U.S. maintain a strong naval presence, one that promotes security and stability around the world.

The Department of the Navy continues to meet this challenge through the effective and efficient management of our nation's most important maritime resources: people, platforms, power and partnerships.

As the Navy and Marine Corps team continues to transition from a decade of war and counter-insurgency ashore to a time of increased global uncertainty, the team of individual Sailors, Marines and Civilians remains attentive to the task.

Naval Expeditionary Forces are establishing critical partnerships that enable the projection of power with versatility and flexibility, whether supporting humanitarian assistance and disaster relief operations or conducting counterterrorism strikes. The Department's energy programs are reducing dependency on fossil fuel through the use of more efficient and varied forms of power. Navy and Marine Corps military and civilian leaders are advocating a more gender neutral combat force by removing barriers to combatant occupational specialities for female Sailors and Marines.

While outlining the Department's mission, goals and accomplishments in fiscal year 2014, the DON's Annual Financial Report, *The Nation's Total Force: At the Right Place, At the Right Time, All the Time* conveys the Department's enduring commitment to maintaining efficient, accountable, and transparent financial processes. Military and civilian leaders alike continue to strengthen financial and business operations with a strategic direction grounded in the reality of the nation's fiscal challenges.

I look to the future with confidence knowing we will continue to provide the people, platforms, power and partnerships on which our Nation depends.

Ray Mabus

“Financial audit readiness remains a top Department priority”

NOVEMBER 2014

I’m pleased to present the Department of the Navy’s Annual Financial Report, *The Nation’s Total Force: At the Right Place, At the Right Time, All the Time,* for fiscal year 2014. The Department’s leadership is firmly committed to effectively and efficiently managing the resources entrusted to us, on behalf of the American people, with the highest levels of integrity and dedication.

The Department continued to operate in a challenging fiscal environment throughout fiscal year 2014. As the wars in Iraq and Afghanistan have come to a close, budget constraints have become the new reality, requiring nimble financial management. The Department has continued aggressive initiatives to reduce costs associated with travel, training, major acquisitions and base maintenance. Budgeted ship and aircraft procurements have been altered over the next five years, aligning reduced funding with readiness requirements to ensure the nation’s leaders maintain the capabilities of the world’s greatest naval and expeditionary forces.

Financial audit readiness remains a top Department priority. As we continue to expand the circle of accountability for audit readiness, our top military and civilian leaders place the improvement of financial practices and procedures high in the priority of their daily activities. In December 2013, the Department of Defense Inspector General issued an unqualified audit opinion on the Marine Corps’ fiscal year 2012 Schedule of Budgetary Activity. In 2014, the Department received favorable examination opinions for ship, aircraft, satellite, fleet ballistic missile, and shore-based ordnance accountability.

As the Department moves into the future, Secretary Mabus and I remain dedicated to providing the oversight and leadership necessary to continue improving our financial management performance, leading to greater accountability, transparency and efficiencies.

S. J. Rabern

THE NATION'S TOTAL FORCE:
At the Right Place, At the Right Time, All the Time

MANAGEMENT'S DISCUSSION AND ANALYSIS

An attack submarine surfaces at Ice Camp Nautilus, located on a sheet of ice adrift on the Arctic Ocean, during Ice Exercise (ICEX) 2014. (U.S. Navy photo courtesy of Lockheed Martin by Dr. Amy Sun/Released)

OVERVIEW

The Department of Defense (DoD) includes three military departments (Department of the Army, Department of the Navy, and Department of the Air Force); however, there are four separate service branches (Army, Navy, Marine Corps, and Air Force). Since 1834, the Navy and Marine Corps have been housed together under the Department of the Navy (DON).

The United States Navy was founded on 13 October 1775, and the Department of the Navy was established on 30 April 1798. The Department of the Navy has three principal components: the Navy Department, consisting of executive offices mostly in Washington, D.C.; the operating forces, including the Marine Corps, the reserve components, and, in time of war, the U.S. Coast Guard (in peace, a component of the Department of Homeland Security); and the shore establishment. The Department of the Navy consists of two uniformed Services: the United States Navy and the United States Marine Corps.

The United States Marine Corps was founded by an act of the Continental Congress on 10 November 1775. As the nation's Expeditionary Force in Readiness, the Marine Corps provides power projected from the sea, utilizing the mobility of the U.S. Navy to rapidly deliver combined-arms task forces in coastal regions or emergent global crises. The Marine Corps has evolved into a balanced air-ground task force with significant logistical capabilities to forward deployed and forward engaged areas shaping, training, deterring, and responding to all manner of crises and contingencies.

During fiscal year (FY) 2014, DON personnel continued the traditions of enduring service, sacrifice, and as The *Nation's Total Force: At the Right Place, At the Right Time, All the Time*. Afloat and in the field, Sailors and Marines contributed to overseas contingency operations combating new threats in the Middle East and a wide range of operations including maritime security, stabilization, homeland security, counterterrorism, and disaster relief. At home, civilian workers were subjected to furlough during the government shutdown yet returned to work determined to provide valuable contributions in supporting DON operations.

The DON continues to operate forward across the globe, providing the nation offshore options to deter and defeat aggression today and in the future. The Navy and Marine Corps team provides unique capabilities that will prove crucial as the Nation's strategic focus shifts to the Asia-Pacific region. During FY 2014, the DON participated in the 24th 2014 Rim of the Pacific (RIMPAC) exercise held in and around the Hawaiian Islands and Southern California. RIMPAC provides the Navy and Marine Corps a unique training opportunity to work with twenty-two nations, more than 40 ships and submarines, more than 200 aircraft and 25,000 personnel fostering and sustaining cooperative relationships that are critical to ensuring the safety of sea lanes and security on the world's oceans. The DON also participated in the first Guam Exercise (GUAMEX) with the Japanese Maritime Self-Defense Force to enhance the interoperability of the two navies and strengthen personnel ties between respective forces. These exercises and partnerships are essential to the National Defense strategy and the DON's efforts to strengthen alliances and partnerships in the Asia-Pacific region to advance a common security vision for the future.

The DON has employed strategic partnerships to combat today's extraordinary challenges, showcasing commitment to improving relations throughout the world while protecting independence. With the drawdown of the war in Afghanistan and emerging global threats, the demands for naval crisis response grow. Working together is the only way to protect freedom. The DON will continue its investment in critical alliances such as the North Atlantic Treaty Organization (NATO).

The DON will face additional challenges in meeting its mission, as budget constraints have led to a leaner workforce. In order to prioritize resources, the DON has instituted the 21st Century Sailor and Marine initiative. This initiative defines a set of objectives and policies around a broad definition of wellness to maximize every Sailor and Marine's personal readiness to contribute to the DON's mission. In the second year of implementation, the program has maximized Sailor and Marine personal readiness and built resiliency to improve the most combat-effective force in the history of the Navy and Marine Corps. In an era of budget cuts, the DON has remained focused on maintaining U.S. maritime dominance by having Sailors and Marines continue to promote security, stability, and trust around the world. Together, the DON has provided a persistent forward presence, power projection abroad, and protection of the world's sea lanes.

In FY 2014, the Navy launched the first Zumwalt-class destroyer and deployed the first P-8A Poseidon. Both the USS Zumwalt and the P-8A represent the DON's

Marines throw a heaving line from a combat rubber raiding craft to Sailors in the well deck of an amphibious dock landing ship during an amphibious landing exercise. (U.S. Navy photo by Mass Communication Specialist 2nd Class Amanda R. Gray/Released)

A view of solar panels installed on top of a parking garage at Naval Support Activity Naples Capodichino. (U.S. Navy photo by Mass Communication Specialist Seaman Weston Jones/Released)

commitment to using limited resources effectively as it builds and maintains the world's most advanced and capable naval force. This is an era of continued budget reductions. The Budget Control Act of 2011 mandates a reduction of Federal spending and the DON continues to responsibly cut costs now and in the coming years by reducing the cost of doing business, promoting acquisition excellence, driving innovative transformation, and leading the nation in sustainable energy. While the DON maintains a healthy industrial base to ensure future innovation and technological advances, the DON remains focused on identifying efficiencies to tighten budget execution while better aligning weapon system procurements with future mission requirements.

Readily available energy is essential for deploying Sailors and Marines around the globe in support of the nation's interests. Since operational flexibility and sustainability are directly linked to energy supplies, energy reliability is a strategic concern for the forces. The potential vulnerability of energy supplies could threaten the forces ability to perform on the battlefield and energy costs siphon resources from war fighting requirements. Therefore, the DON is working to develop greater energy independence and conservation ashore and afloat. Energy reform improves the capability and efficiency of ships, aircraft and weapon systems, and ultimately makes better warfighters and ensures the safety of Sailors and Marines. In the fall of 2009, Secretary Mabus set an ambitious energy goal for the Navy and Marine Corps that, by no later than 2020, at least half of all the energy used by the two Services, both afloat and ashore, will come from non-fossil fuel sources. At the same time, at least half of all bases will be net-zero in terms of consumption, and in many cases returning power to the grid rather than pulling from it.

The Navy and Marine Corps continued to make significant progress toward reaching the Secretary's energy goals. During FY 2014, the DON awarded three contracts for the construction and commissioning of biorefineries capable of producing "drop-in" biofuels. These awards support the Administration's goals to boost and diversify the domestic fuel supply base, make American warfighters less bound to volatile oil markets, and strengthen national security. These projects will produce more than 100 million gallons of military grade fuel beginning in 2016 and 2017. The DON continues to improve the efficiency of bases by monitoring electricity usage in buildings, signing contracts for larger uses of solar power, and is considering geothermal, hydrothermal, wave, and wind power. This commitment to changing the way energy is used and produced will help the DON in preserving the environment and planning for and mitigating the harmful effects of climate change. The DON's priorities include developing clear goals and performance assessments that will help to transform the entire department. The DON continues to focus on sustainable energy by offering military contract opportunities to small businesses with sustainable energy programs, pilots, and initiatives. The DON's efforts to support a clean energy economy will make Americans better stewards of the planet.

The DON recognizes the value of investing in audit readiness as part of the Department of Defense mission. The Navy is preparing to undergo its first review of the Schedule of Budgetary Activity in FY 2015, while the Marine Corps continues the Statement of Budgetary Resources (SBR) audit. The path to auditability will result in improved stewardship, reduced cost of business operations, and compliance with Congressional direction. While executing DoD Financial Improvement and Audit Readiness (FIAR) activities, the DON continues to focus efforts to ready people, processes, and business systems for a financial audit. The DON understands fundamental improvements that establish tighter internal controls and more standardized processes are needed within its operations. The DON has employed control gap analysis to identify when a command's process and/or controls differ significantly from suggested controls, allowing the DON to track and address significant deviations.

The DON continues to demonstrate its commitment to effectively managing and mitigating risks while making progress toward desired mission outcomes by establishing objectives for FY 2015 and beyond. Given the current climate of budgetary restrictions and uncertainty, it is critical that the DON tracks progress and monitors change pertaining to the following high priority objectives:

- Take Care of Our People
- Maximize Warfighter Readiness and Avoid Hollowness
- Lead the Nation in Sustainable Energy
- Promote Acquisition Excellence and Integrity
- Proliferate Unmanned Systems
- Drive Innovative Enterprise Transformation

An all-hands call on the flight deck of an amphibious assault ship. (U.S. Navy photo by Mass Communication Specialist Seaman Veronica Mammina/Released)

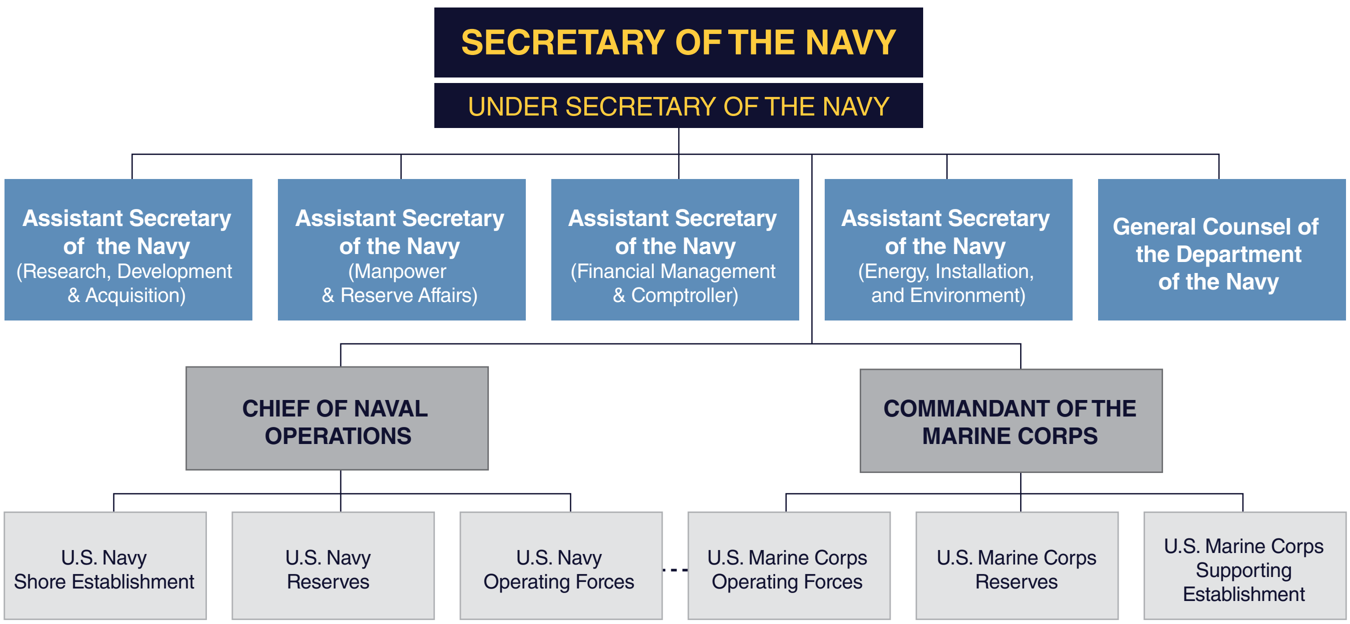
A guided-missile destroyer transits the Black Sea. (U.S. Navy photo by Mass Communication Specialist Seaman Edward Guttierrez III/Released)

To maintain, train, and equip combat-ready Naval forces capable of winning wars, deterring aggression, and maintaining freedom of the seas.

— Department of the Navy Mission

Founded 30 April 1798

Title 10 U.S. Code, Section 5061



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

ORGANIZATION AND MISSION

The Department of the Navy, established on April 30, 1798, has three principal components: the Department headquarters, consisting of executive offices mostly in Washington, DC; the Naval and Marine Corps operating and reserve components, and the shore establishment. In time of war, the U.S. Coast Guard (a component of the Department of Homeland Security during peacetime) is under the operational control of the DON. All are structured to respond to a broad range of mission priorities that preserve the nation's freedom and protect U.S. global interests.

The Secretary of the Navy (SECNAV), a civilian appointed by the President, is responsible for, and has authority under Title 10 of the United States Code, to conduct all the affairs of the DON, including: recruiting, organizing, supplying, equipping, training, mobilizing, and demobilizing. The SECNAV also oversees the construction, outfitting, and repair of naval ships, equipment, and facilities. The SECNAV is responsible for the formulation and implementation of policies and programs that are consistent with the national security policies and objectives established by the President and the Secretary of Defense. Under the purview of the SECNAV are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, the General Counsel, and two key military leaders—the Chief of Naval Operations (CNO), a four-star Admiral, responsible for the command and operating efficiency of the U.S. Navy, and the Commandant of the Marine Corps, a four-star General, responsible for the performance of the U.S. Marine Corps.

The Navy and the Marine Corps have numerous commands that operate under the authority and responsibility of a commander or other designated official and typically support a network of subordinate commands. Each command has a clearly defined mission that supports the overall DON mission in support of the DoD's responsibilities. Both Services provide ready forces to support the U.S. joint military commands in conducting their worldwide missions.

U.S. NAVY

The United States Navy was founded on October 13, 1775. The mission of the Navy is to maintain, train and equip combat-ready Naval forces capable of winning wars, deterring aggression and maintaining freedom of the seas. It is overseen by the CNO, and consists of the Operating Forces and Shore Establishment. The Chief of Naval Operations is the senior military officer in the Navy. The CNO is a member of the Joint Chiefs of Staff, and is the principal naval advisor to the President and SECNAV on the conduct of war. He is also the principal advisor and naval executive to the Secretary on the conduct of naval activities of the DON. The CNO's office is responsible for the command, utilization of resources and operating efficiency of the operating forces of the Navy and of the Navy shore activities assigned by the Secretary. The Navy operating forces commanders and fleet commanders have a dual chain of command. Administratively, they report to the CNO and provide, train, and equip naval forces. Operationally, they provide naval forces and report to the appropriate Unified Combatant Commanders. The Commander of the Fleet Forces Command controls fleet assets on both the Atlantic and Pacific coasts for interdeployment training cycle purposes. As units of the Navy enter the area of responsibility for a particular navy area commander, they are operationally assigned to the appropriate numbered fleet. All Navy units also have an administrative chain of command with the various ships reporting to the appropriate type commander. The shore establishment provides support to the operating forces (known as "the fleet") in the form of: facilities for the repair of machinery and electronics; communications centers; training areas and simulators; ship and aircraft repair; intelligence and meteorological support; storage areas for repair parts, fuel, and munitions; medical and dental facilities; and air bases.

BUREAU OF MEDICINE AND SURGERY

The Navy Bureau of Medicine and Surgery (BUMED) provides high quality health care to beneficiaries in wartime and in peacetime, under the leadership of the Navy Surgeon General. Highly trained Navy Medicine personnel deploy with Sailors and Marines worldwide - providing critical mission support aboard ship, in the air, under the sea and on the battlefield. The Navy Medicine team of physicians, nurses, corpsmen, dentists and mental health providers work in tandem with the Army and Air Force medical personnel and coalition forces to ensure the physical and mental well being of troops and civilians. Navy Medicine's military and civilian health care professionals also provide care for uniformed services' family members and retirees at military treatment facilities around the globe. BUMED has 63,000 active duty personnel and reservists, government civilians and contractors of Navy Medicine engaged in all aspects of expeditionary medical operations in support of the warfighter. BUMED is headquartered in Falls Church, VA.

BUREAU OF NAVAL PERSONNEL

The Bureau of Naval Personnel (BUPERS) provides administrative leadership, policy planning, general oversight, training and education for all Navy personnel. BUPERS strives to support the needs of the DON by providing the fleet with the right person with the right skill set in the right place at the right time, using the most efficient human resource processes possible. BUPERS also provides support services to Sailors and is dedicated to ensuring Sailor readiness and quality of life through its myriad of professional and personal/family focused programs. BUPERS has six subordinate commands: Naval Education Training Command (NETC); Navy Recruiting Command (NRC); Navy Personnel Command (NPC); United States Naval Academy (USNA), Naval Postgraduate School (NPS) and Naval War College (NWC). BUPERS and its subordinate commands have a total of 9,895 authorized full time equivalent (FTE) civilian employees. BUPERS is headquartered in Arlington, VA.

COMMANDER NAVY INSTALLATIONS COMMAND

Commander, Navy Installations Command (CNIC) is responsible for Navy-wide Shore installation management. CNIC enables and sustains naval forces from the Shore by designing, developing and delivering integrated Shore capabilities to our fleet, the fighter and the family. The programs and services launch every shore-based ship, submarine and aircraft and take care of every Sailor and their families. CNIC has 53,000 employees in 11 regions, 69 installations and 123 Naval Operations Support Centers. CNIC has overall

Shore installation management responsibility and authority as the Budget Submitting Office for installation support and the Navy point of contact for installation policy and program execution oversight. CNIC is headquartered in Washington, DC.

COMMANDER, NAVY RESERVE FORCE

Commander, Navy Reserve Force (CNRF), also known as the Commander U.S. Navy Reserve Force, delivers strategic depth and operational capability to the Navy, Marine Corps, and Joint Forces by providing mission-capable units and individuals in support of the full range of operations, from peace to war. The 59,100 personnel of the Navy Reserve represent approximately 10% of the Navy Total Force. The Navy Reserve provides essential warfighting capabilities and expertise, is strategically aligned with mission requirements and valued for readiness, innovation, and agility. The military component of the Navy Reserve represents only 6% of the Navy's total military personnel budget but is a significant force multiplier for Active Component. CNRF is headquartered in Norfolk, VA.

DEPARTMENT OF NAVY ADMINISTRATIVE ASSISTANT

The Department of the Navy Assistant for Administration (DON/AA) provides administrative management and support to the Office of the SECNAV, its approximate 4,600 member Secretariat, staff offices, field activities and supported organizations. The command is comprised of administrative divisions focused on customer service, directives and records management, contract management, executive dining, facilities and support services, financial management, human resources, information technology, and security. The DON/AA has 135 personnel and is headquartered at the Pentagon in Arlington, VA.

FIELD SUPPORT ACTIVITY

Field Support Activity (FSA) establishes, maintains and provides a system of financial services as the Budget Submitting Office (BSO) and Principal Administering Office (PAO) for Navy's assigned unified command (PACOM), Navy Headquarters and activities, the National Defense Sealift Fund, and Department of the Navy Centrally Managed Bills. FSA initiates action in matters pertaining to the provision of funds and manpower; evaluates resource utilization; and initiates or recommends appropriate corrective actions. Additionally, FSA approves/allocates the Official Representation Funds (ORF) for Director, Navy Staff (DNS), and CNO activities, and plans and programs for current and future resource requirements for activities within the DNS sponsorship. FSA has 37 personnel and is headquartered at the Washington Navy Yard in Washington, DC.

MILITARY SEALIFT COMMAND

The Military Sealift Command (MSC) operates approximately 110 noncombatant, civilian-crewed ships that replenish Navy ships at sea, conduct specialized missions, strategically pre-position combat cargo at sea around the world, perform a variety of support services, and move military equipment and supplies to deployed U.S. forces and coalition partners. MSC operates five subordinate commands worldwide that are aligned with the numbered fleet logistics staffs in the Atlantic, Pacific, Europe/Africa, Central and Far East areas. MSC is headquartered in Washington, DC and Norfolk, VA, with approximately 9,500 Department of the Navy civilian employees supporting its mission worldwide.

NAVAL AIR SYSTEMS COMMAND

The Naval Air Systems Command (NAVAIR) has a force of 25,700 personnel focused on research, design, development, and systems engineering, acquisition; test and evaluation; training facilities and equipment; repair and modification; an in-service engineering and logistics support of naval aviation aircraft and weapon systems operated by Sailors and Marines. NAVAIR has military and civilian personnel stationed at eight locations across the continental United States and one site overseas. NAVAIR is organized into eight "competencies" or communities of practice including Program Management, Contracts, Research and Engineering, Test and Evaluation, Logistics and Industrial Operations, Corporate Operations, Comptroller, and Counsel. NAVAIR provides support (people, processes, tools, training, mission facilities, and core technologies) to Naval Aviation Program Executive Officers and their assigned program managers, who are responsible for meeting the cost, schedule, and performance requirements of their assigned programs. NAVAIR is the principal provider for the Naval Aviation Enterprise, while contributing to national security. NAVAIR is headquartered in Patuxent River, MD.

NAVAL FACILITIES ENGINEERING COMMAND

The Naval Facilities Engineering Command (NAVFAC) delivers and maintains quality, sustainable facilities, acquires and manages capabilities for the Navy's expeditionary combat forces, provides contingency engineering response, and enables energy security and environmental stewardship. NAVFAC is a global organization with an annual volume of business in excess of $11 billion. NAVFAC has 18,000 Civil Engineer Corps officers, civilians and contractors who serve as engineers, architects, contract specialists and professionals to manage the planning, design, construction, contingency engineering, real estate, environmental, and public works support for U.S. Navy shore facilities around the world. As a major Navy systems command and an integral member of the Navy and Marine Corps team, NAVFAC delivers timely and effective facilities engineering solutions worldwide. NAVFAC has 13 component commands and is headquartered at the Washington Navy Yard in Washington, DC.

NAVAL SEA SYSTEMS COMMAND

The Naval Sea Systems Command (NAVSEA) has a force of 60,000 civilian and military personnel including personnel assigned at public shipyards and regional maintenance centers where NAVSEA is the operating agent and technical authority. NAVSEA provides material support to the Navy, Marine Corps, and other agencies, as assigned, for ships, submersibles, and other sea platforms, shipboard combat systems and components, and other surface and undersea warfare and weapons systems including ship and aviation interface systems, and surface and submarine expendable ordnance. NAVSEA exercises technical authority and certification authority for ship, submarine, diving, and weapon systems. NAVSEA reports to CNO and the Commandant of the Marine Corps for the execution of logistics sustainment and operating forces responsibilities. The organization is located at the Washington Navy Yard in Washington, D.C. and is responsible for chartering two warfare centers, Naval Surface Warfare Center and Naval Undersea Warfare Center, and 9 working capital fund divisions located throughout the U.S. NAVSEA is also responsible for 9 field activities including 4 Supervisors of Shipbuilding who administer contracts with private sector shipbuilders.

NAVAL SPECIAL WARFARE COMMAND

The Naval Special Warfare Command (NSWC) mission is to man, train, equip, deploy and sustain Naval Special Warfare (NSW) forces for operations and activities abroad in support of combatant commanders and U.S. national interests. The NSW community encompasses the Echelon II headquarters, Naval Special Warfare Command, and seven Echelon III commands (seven NSW Groups and the NSW Center), as well as the Echelon IV commands subordinate to the Echelon IIIs. Echelon IV commands include operational forces i.e. Special Warfare Operators (SEAL) Teams and Special Boat Teams, logistics commands, training commands and detachments, mobile communications teams, NSW Units, and a National Mission Force.

NSWC is comprised of approximately 9,500 total personnel, including 2,600 active-duty SEALs, 700 Special Warfare Boat Operators, 745 reserve personnel, 4,250 support personnel, and more than 1,175 civilians. The NSW Force is organized around 8 SEAL teams, one SEAL Delivery Vehicle Team, three special boat teams and supporting commands which deploy forces worldwide to meet the requirements of theater commanders. NSWC constitutes 11% percent of U.S. Special Operations Forces and less than 2% of Navy forces. NSWC is headquartered in San Diego, CA.

NAVAL SUPPLY SYSTEMS COMMAND

With headquarters in Mechanicsburg, PA, and employing a diverse worldwide workforce of more than 22,500 military and civilian personnel, the Naval Supply Systems Command (NAVSUP) and Navy Supply Corps team share one mission — to deliver sustained global logistics and quality-of-life support to the Navy and joint warfighter. The NAVSUP/ Navy Supply Corps team overseas a diverse portfolio including supply chain management for material support to the Navy, Marine Corps, and joint and coalition partners, supply operations, conventional ordnance, contracting, resale, fuel, transportation, security assistance, and quality of life initiatives for our naval forces including food service, postal service, Navy Exchanges, and movement of household goods. In addition to its headquarters activity, the NAVSUP Enterprise is comprised of four major organizations with 12 commands located worldwide.

OFFICE OF NAVAL INTELLIGENCE

The Office of Naval Intelligence (ONI) is the leading provider of maritime intelligence to the U.S. Navy and joint warfighting forces, as well as national decision makers and other consumers in the Intelligence Community. ONI specializes in the analysis, production and dissemination of vital, timely and accurate scientific, technical, geopolitical and military intelligence information. The command supports a broad range of customers worldwide including the fleet, warfighters, the Navy acquisition community, national intelligence community, law enforcement agencies, foreign and coalition partners, and national decision makers. ONI employs more than 3,000 military, civilian, and mobilized reservists and contractor personnel worldwide, including analysts, scientists, engineers, specialists, and technicians. ONI is headquartered in Suitland, MD.

OFFICE OF NAVAL RESEARCH

Naval science and technology (S&T) delivers new capabilities to the Navy and Marine Corps that ensure continued superiority of U.S. naval forces today and warfighters in the future. In keeping with its mandate, the Office of Naval Research (ONR) plans, fosters, and encourages scientific research in recognition of its paramount importance to future naval power and national security. Led by the Chief of Naval Research, ONR provides technical advice to the Chief of Naval Operations and the Secretary of the Navy and oversees the execution of Naval S&T objectives to support a Navy and Marine Corps that is capable of prevailing in any environment. This is done through focusing on S&T areas with big payoffs, encouraging innovative thinking and business processes, and striving to improve the transition of S&T into acquisition programs in the most cost-effective means possible--striking the right balance between responsive near-term technology insertion and long-term basic research. ONR organization employs approximately 1,050 people, comprising uniformed, civilian and contract personnel. Additional employees staff the Naval Research Lab in Washington, DC. ONR is headquartered in Arlington, VA.

SPACE AND NAVAL WARFARE SYSTEMS COMMAND

The Space and Naval Warfare Systems Command (SPAWAR) is the U.S. Navy's acquisition command responsible for developing, providing, and maintaining communications, network, and information capabilities for the Fleet, keeping warfighters connected anytime and anywhere. SPAWAR pursues cutting-edge research and development for the Navy's growing cyberspace capabilities and provides the hardware and software that support manned and unmanned systems at sea, on land, and in the air. Within the cyber arena SPAWAR supports a full lifecycle of product and service delivery, ranging from initial research and development to acquisition and deployment to operations and logistics. SPAWAR is headquartered in San Diego and employs more than 9,700 military and civilian professionals world-wide dedicated to the research, development, acquisition, and sustainment necessary to operate efficiently and effectively in cyberspace. As one of the Department of the Navy's major acquisition commands, SPAWAR's realm of expertise is in information technology. SPAWAR creates products and services that transform ships, aircraft, and vehicles from individual platforms into integrated warfighting networks, delivering and enhancing information awareness among all key players. These include the Navy, Marines, joint forces, federal agencies, and international allies.

STRATEGIC SYSTEMS PROGRAM

Strategic Systems Programs (SSP) directs the end-to-end effort of the Navy's Strategic Weapons Systems to include training, systems, equipment, facilities and personnel, and fulfill the terms of the United States/United Kingdom Polaris Sales Agreement. SSP's five lines of business include The Strategic Weapons System, Nuclear Weapons System, Guided Missile Submarine (SSGN) Attack Weapons System, Emerging Missions, and Navy Treaty Implementation Program. SSP is headquartered at the Washington Navy Yard in Washington, DC.

U.S. FLEET FORCES COMMAND

The U.S. Fleet Forces Command (COMUSFLTFORCOM) supports both the CNO and Combatant Commanders worldwide by providing responsive, relevant, sustainable Naval forces ready-for-tasking. COMUSFLTFORCOM provides operational and planning support to Combatant Commanders and integrated warfighter capability requirements to the CNO. Additionally, U.S. Fleet Forces Command serves as the CNO's designated Executive Agent for Anti-Terrorism/Force Protection (ATFP), Individual Augmentees (IA), and Sea Basing. In collaboration with U.S. Pacific Fleet, U.S. Fleet Forces Command organizes, mans, trains, maintains, and equips Navy forces, develops and submits budgets, and executes readiness and personnel accounts to develop both required and sustainable levels of fleet readiness. The U.S. Fleet Forces Command has over 120,000 personnel serving around the world. COMUSFLTFORCOM is headquartered in Norfolk, VA.

U.S. PACIFIC FLEET

The Commander, U.S. Pacific Fleet (COMPACFLT) is the world's largest fleet command, encompassing 100 million square miles, more than half the Earth's surface. The Pacific Fleet consists of approximately 180 ships, nearly 2,000 aircraft and 125,000 Sailors, Marines and civilians. U.S. Commands that fall directly under the Pacific Fleet include "type" commands for surface ships, submarines, aircraft, and Navy construction. Operational commands that report directly to the U.S. Pacific Fleet include Third Fleet in the Eastern Pacific and Seventh Fleet in Western Pacific and Indian Ocean. U.S. Pacific Fleet protects and defends the collective maritime interests of the United States and its allies and partners in the Asia-Pacific region. In support of U.S. Pacific Command and with allies and partners, U.S. Pacific Fleet enhances stability, promotes maritime security and freedom of the seas, deters aggression and when necessary, fights to win. The U.S. Pacific Fleet is headquartered at Pearl Harbor, HI.

U.S. MARINE CORPS

The Marine Corps established on November 10, 1775 currently consists of Active Duty Marines, Select Reserve Marines, and Inactive Ready Reserve (IRR). At any given time, approximately 30,000 Marines are forward deployed in operations supporting our nation's defense or Military Operations Other Than War (MOOTW).

Headquarters, U.S. Marine Corps (HQMC) consists of the Commandant of the Marine Corps and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law and higher authority. This includes the administration, discipline, internal organization, training, requirements, efficiency, and readiness of the service. The Marine Corps Headquarters is spread throughout the Washington, DC. metro area, including the Pentagon, Marine Barracks, Quantico, and the Washington Navy Yard.

The Operating Forces are subdivided into four categories: Marine Corps Forces, including all Marine ground, aviation, and combat logistics; Marine Corps Reserves, Marines who support the Active Component by fielding deployable units; Security Forces, which protect key installations, vessels, units, and assets of the United States Government; and Special Activity Forces, who guard U.S. embassies and foreign service posts.

The Supporting Establishment includes all bases, air stations, and installations. They assist in training, sustainment, equipping, and embarkation of deploying Marine Forces.

HEADQUARTERS, U. S. MARINE CORPS

Headquarters, U.S. Marine Corps (HQMC) consists of the Commandant of the Marine Corps and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law. The Commandant is directly responsible to the Secretary of the Navy for the overall performance of the Marine Corps. This includes the administration, discipline, internal organization, training, requirements, efficiency, and readiness of the service. Also, as the Commandant is a member of the Joint Chiefs of Staff, HQMC supports him in his interaction with the Joint Staff. The Commandant also is responsible for the operation of the Marine Corps material support system.

U.S. MARINE CORPS FORCES COMMAND

Located in Norfolk, VA, Commander, U.S. Marine Corps Forces Command (MARFORCOM) is tasked with: commanding Active Component (AC), Marine Corps-retained operating forces; executing force sourcing and synchronization to provide joint commanders with the Marine Corps forces they require; directing deployment planning and the execution of Marine Corps-retained operating forces in support of combatant commander and service requirements; serving as Commanding General, Fleet Marine Forces Atlantic (CGFMFLANT) and commanding embarked Marine Corp forces; coordinating Marine Corps-Navy integration of operational initiatives and advising the Commander, U.S. Fleet Forces Command (USFFC) on Navy support to Marine Corps forces assigned to naval ships, bases, and installations; serving as Commander, Marine Forces Europe.

U.S. MARINE CORPS FORCES, CYBERSPACE COMMAND

Recognizing the significance of the cyberspace domain to national security, the Secretary of Defense directed the establishment of U.S. Cyber Command (CYBERCOM) as a sub-unified command under the U.S. Strategic Command. The primary objective of CYBERCOM is to integrate the computer network operations capabilities of the services and agencies in support of the National Strategy to Secure Cyberspace (NSSC). In response, the Marine Corps established U.S. Marine Corps Forces Cyberspace Command (MARFORCYBER) in October 2009. (This was complemented by the standing up of the Navy's U.S. Tenth Fleet/Fleet Cyber Command in January 2010.) MARFORCYBER's mission is to plan, coordinate, integrate, synchronize, and direct full spectrum Marine Corps cyberspace operations.

U.S. MARINE CORPS FORCES, PACIFIC

U.S. Marine Corps Forces, Pacific (MARFORPAC) has three command roles and responsibilities. The command serves as U.S. Marine Corps component to U.S. Pacific Command (USPACOM), U.S. Marine Corps component to U.S. Forces Korea (USFK), and Fleet Marine Forces Commander to Pacific Fleet. In addition to its service component responsibilities, MARFORPAC could be tasked to act as a joint task force command element. With its headquarters located aboard Camp H. M. Smith, HI, MARFORPAC is the largest field command in the Marine Corps, having control of two-thirds of Marine Corps operational forces. Commander, MARFORPAC commands all U.S. Marine Corps forces assigned to USPACOM operating in a diverse geographic area stretching from Yuma, AZ to Goa, India.

U.S. MARINE CORPS FORCES RESERVE

Headquartered in New Orleans, LA U.S. Marine Corps Forces Reserve (MARFORRES) is responsible for providing trained units and qualified individuals for active-duty service in times of war, national emergency, or in support of contingency operations. Marine Corps force expansion is made possible by activation of the Marine Corps Reserve. As an operational reserve, MARFORRES provides personnel and operational tempo relief for active component forces during times of peace. Like the active component, MARFORRES is a combined-arms force with balanced ground, aviation, and logistics combat support units. MARFORRES capabilities are managed through MARFORCOM as part of its global force management responsibilities for the Commandant. Commander, MARFORRES is also Commander, Marine Forces Northern Command (MARFORNORTH) and serves as the Marine component of NORTHCOM.

U.S. MARINE CORPS FORCES, SPECIAL OPERATIONS COMMAND

U.S. Marine Corps Forces, Special Operations Command (MARFORSOC) was formally established February 23, 2006 and is the Marine Corps component of the U.S. Special Operations Command (USSOCOM). Headquartered at Camp Lejeune, NC, MARFORSOC trains, organizes, equips, and when directed by the Commander USSOCOM, deploys task organized, scalable and responsive Marine Corps Special Operation Forces (SOF) worldwide in support of combatant commanders and other agencies. MARFORSOC includes three subordinate commands: Marine Special Operations Regiment (MSOR); the Marine Special Operations Support Group (MSOSG); and the Marine Special Operations School (MSOS) at Camp Lejeune, NC.

MARINE CORPS INSTALLATIONS COMMAND

Marine Corps Installations Command (MCICOM) is the single authority for all installation matters. MCICOM consists of a headquarters and four subordinate commands: Marine Corps Installations Pacific, Marine Corps Installations West, Marine Corps Installations East, and Marine Corps Installations the National Capital Region. The forces assigned to MCICOM provide timely support to the Marines, Sailors and families from the operating forces and maintenance depots. MCICOM directly supports Marine Corps Operating Forces, individual Marines and family members. They are essential components in the foundation of national defense as they are the force projection platforms that support training, sustainment, mobilization, deployment, embarkation, redeployment, reconstitution, and force protection.

MARINE CORPS LOGISTICS COMMAND

Headquartered in Albany, GA, Marine Corps Logistics Command (LOGCOM) provides worldwide, integrated logistics, supply chain, and distribution management; maintenance management; and strategic prepositioning capability in support of the operating forces and other supported units. The services and support provided by LOGCOM maximize supported unit readiness, synchronize distribution processes, and support Marine Corps enterprise and program-level total lifecycle management. LOGCOM is the Marine Corps Executive Agent for the tactical coordination, planning, and execution of ground equipment reset. LOGCOM is the lead agency for the retrograde and reset of equipment returning from Afghanistan, and continues to expedite, track, and process principal end items and other classes of supply from Operation Enduring Freedom (OEF). LOGCOM manages the enterprise lifecycle maintenance program that resets designated ground weapon systems, and provides critical sustainment logistics support to Marine forces currently deployed to Afghanistan.

U.S. Navy Civilians: 183,696
(Full-time Equivalents)

U.S. Navy Active: 325,584
(Officers, Enlisted, and Midshipmen)

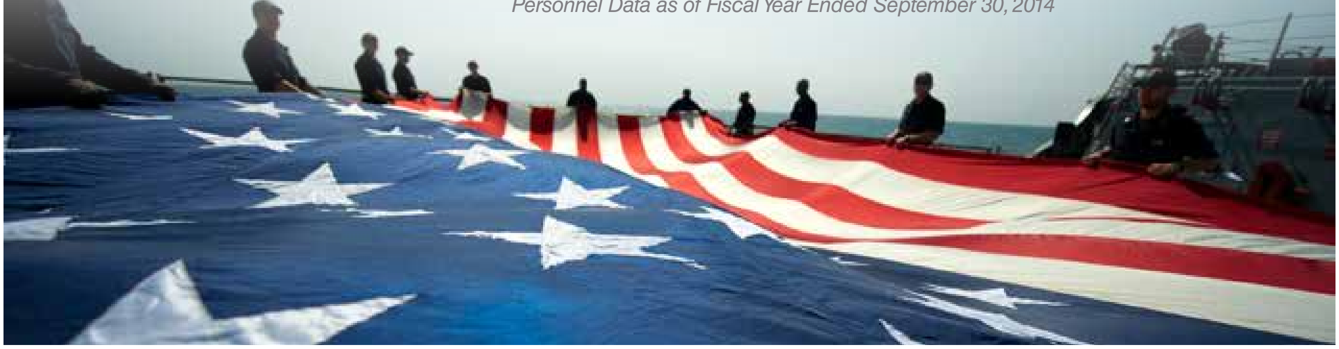
U.S. Navy Reserve: 59,254
(Drilling Reserve and Full-time Support)

U.S. Marine Corps Civilians: 22,562
(Full-time Equivalents)

U.S. Marine Corps Active: 188,058
(Officers and Enlisted)

U.S. Marine Corps Reserve: 39,450
(Drilling Reserve and Full-time Support)

Personnel Data as of Fiscal Year Ended September 30, 2014



Boatswain's mates carry mooring lines as they prepare to organize and repair them on the flight deck of a guided-missile destroyer. (U.S. Navy photo by Mass Communication Specialist 2nd Class Carlos M. Vazquez II/Released)

STRATEGIC MANAGEMENT

The DON is committed to improving core capabilities that support the U.S. maritime strategy, "A Cooperative Strategy for 21st Century Seapower." These core capabilities are critical to U.S. maritime power and reflect an increased emphasis on activities that prevent war and build partnerships — forward presence, deterrence, sea control, power projection, maritime security, humanitarian assistance, and disaster response.

The cooperative strategy, guided by the objectives articulated in the National Strategy for Maritime Security, National Security Strategy, National Defense Strategy, and National Military Strategy, was developed to be a unified and enduring approach that will apply maritime power to the crucial responsibility of protecting vital U.S. interests in an increasingly interconnected and uncertain world. It binds the three maritime services — U.S. Navy, U.S. Marine Corps, and U.S. Coast Guard (during wartime) — closer together than ever before in a mission to more fully safeguard maritime interests at home and abroad.

The DON's six priority objectives support the U.S. maritime strategy by focusing on key efforts that will increase effectiveness and improve the lives of Sailors, Marines, and their families, which results in

An Operations Specialist monitors nearby surface contacts as a Ticonderoga-class guided-missile cruiser is deployed in a multi-mission role. (U.S. Navy photo by Mass Communication Specialist 3rd Class Edward Guttierrez III/Released)

greater security for the nation and U.S. global interests. A summary of key accomplishments by objective begins below.

OBJECTIVE 1: TAKE CARE OF OUR PEOPLE

Sailors, Marines, and civilians are all critical components of the U.S. maritime strategy, and the DON must ensure that it provides them with adequate compensation, medical care, and career training opportunities. These are key factors in attracting and retaining highly motivated and qualified personnel. The DON remains committed to providing a competitive pay and benefits package to aid in recruitment and retention. The package includes basic pay, housing allowances, and incentives for critical specialties in health care, explosive ordnance disposal, and nuclear propulsion.

Today's demanding environment requires the most resilient force that the Navy and Marine Corps has ever fielded. Because of that, the DON continues to deploy the 21st Century Sailor and Marine Initiative as an overarching method of supporting people. The goal is to help Sailors and Marines maximize their personal and professional readiness, and to assist them and their families with the mental, physical and emotional challenges of military service. In particular, the DON is working to counter the challenges of suicide, sexual assault and alcohol-related incidents. These tragic occurrences not only impact the resilience of Sailors and Marines, they also directly impact the discipline of the force and degrade combat effectiveness.

The Navy is committed to a culture of gender respect where no one must suffer the trauma of sexual assault, where victims receive support and protection, and where offenders are held appropriately accountable. During this past year, the Navy sponsored numerous sexual assault prevention programs and delivered the "InterAct" program of live-acted, large-audience, interactive training sessions. The training focuses on bystander interaction strategies that individual Sailors and Marines can employ to safely help prevent sexual assaults.

During the fiscal year, the DON transitioned to the standardized DoD suicide reporting system. The DoD Suicide Event Report standardizes suicide surveillance efforts across the Services to support the DoD's suicide prevention mission. This system ensures success of the world-wide suicide surveillance mission, the ability to analyze and report on suicide factors in real-time, and the opportunity to examine data across DoD.

The Navy recognizes that employees are busy juggling work and family and it is not unusual to encounter issues which impact their quality of life. Therefore, the DON has partnered with the Department of Health and Human Services Federal Occupational Health to provide a new centralized employee assistance and work/life program for employees and their families. The Department of the Navy Civilian Employee Assistance Program provides a wide range of services to employees and their families. Employees can access services 24/7 and the service can provide answers to questions, research information, link employees to a wide variety of qualified local services and provide licensed confidential support to help with difficult issues.

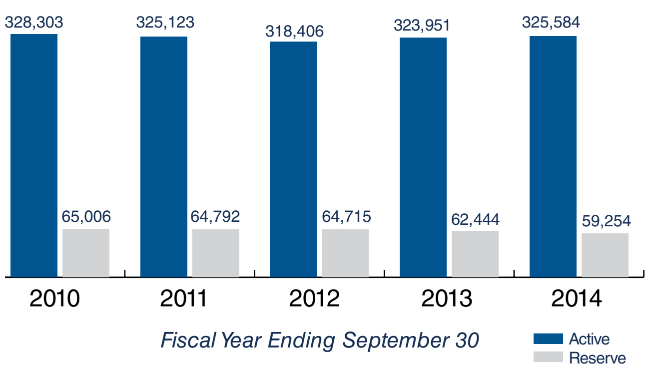
The DON has continued to advocate and remove barriers to promote a gender-neutral combat force by approving and forwarding multiple Navy and Marine Corps requests to open a total of over 23,000 billets to female Sailors and Marines. The Marine Corps Force Integration Plan was also approved in FY 2014 and represents the deliberate, measured, and responsible approach to researching, setting conditions, and integrating female Marines in ground combat arms Military Occupational Specialties and units.

The DON continues to uphold the standards of equality, freedom, and opportunity and has fostered an environment where individuals are safe from prejudice. This is essential to maintaining high morale, good order, discipline, and readiness.

U.S. Navy

The Navy continues to resize and reshape its forces to meet its mission requirements more efficiently and effectively. This is especially important in an environment of limited budgetary resources and rising personnel costs. Over the last five years, the Navy has resized its active and reserve components by -1% and -9%, respectively. The Navy has been able to accomplish all assigned missions at this level because of force structure changes, efficiencies gained through technology, modifications in workforce mix, and new manning practices.

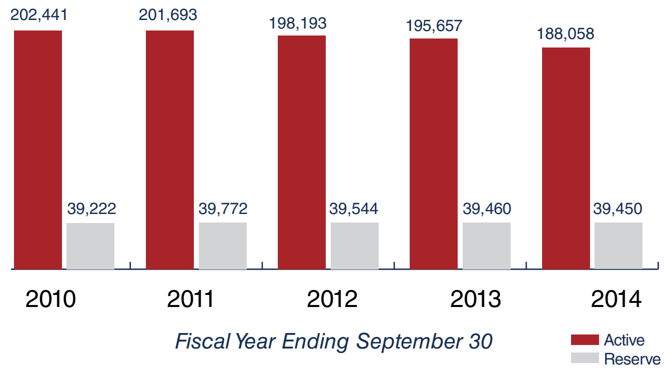
U.S. Navy End Strength



U.S. Marine Corps

The Marines Corps continues to provide a balanced force adequately postured for future National Security Strategy requirements, while supporting operations in a post-Afghanistan security environment requiring greater affordability. The Marine Corps enduring end strength of 182,100 and the corresponding ready and capable force structure will provide a strategically mobile, middleweight force optimized for rapid crisis response and forward-presence. The drawdown of the Marine Corps Active Component end strength from 188,058 to 182,100 will be completed by the end of FY 2016 at a ramp down of approximately 4,000 active duty personnel per year.

U.S. Marine Corps End Strength

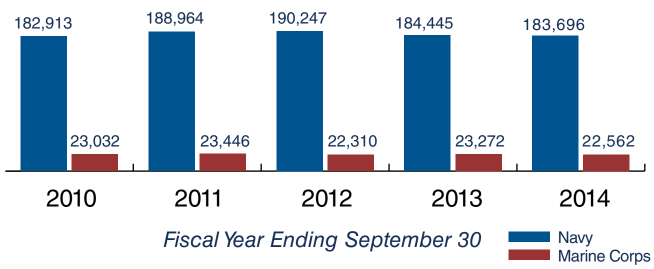


Artillery Marines fire off rounds from M777A2 lightweight 155 mm howitzers. (U.S. Marine Corps photo by Cpl. Lena Wakayama/ Released)

Navy and Marine Corps Civilian Personnel

The size of the civilian workforce, which has increased by 0.4% over the last five fiscal years, continues to support the mission and daily functions of the Navy and Marine Corps. Civilian personnel provide various types of support, such as research and development, engineering, acquisition, depot maintenance, and financial management and budget.

Civilian Personnel (Full-Time Equivalents*)



* Full-time equivalents are the total number of regular straight-time hours (i.e., not including overtime or holiday hours) worked by employees divided by the number of compensable hours applicable to each fiscal year.

OBJECTIVE 2: MAINTAIN WARFIGHTER READINESS AND AVOID HOLLOWNESS

Today's security environment has created new demands for naval forces. This demand includes support for security, stabilization, transition and reconstruction operations, support for homeland security, and continued preparedness for contingency operations. The evolving dynamics of the 21st century security environment require forces to be ready to deploy globally. Although this is an era of reduced budgets, the DON will maintain strong, agile and capable military forces. Operational readiness is the catalyst that brings naval power to bear whenever it is needed. The budget supports requirements for Carrier Strike Groups (CSGs), Expeditionary Strike Groups (ESGs), and Marine Expeditionary Forces (MEFs) to execute the National Military Strategy and respond to persistent as well as emerging threats. The Navy-Marine Corps team has become an integral part of continuing overseas contingency operations. The DON continues funding the necessary requirements to ensure the ability to protect vital U.S. interests and assure and assist friends in crisis situations.

The Navy's top readiness priority is ensuring that forces are fully supported while deployed. In order to do so, the Navy requires a highly educated and trained, highly skilled and disciplined force. Using advanced technologies, the DON has shifted training from the traditional classroom to the use of simulators, trainers, computer-based interactive curriculums, and other media-based approaches. This initiative provides the naval workforce with appropriate training in a more efficient manner and prepares them to better perform mission-critical tasks.

The fleet must be ready to protect freedom while meeting today's extraordinary challenges. Consequently, decisions must be centered on what Sailors and Marines need to perform their jobs effectively and efficiently. The Department has acquired and continues to invest in proven technology that Sailors can use and depend on at sea and ashore. Leadership has used empirical data, such as Board of Inspection and Survey report statistics, to shape decision making that ensures fleet readiness despite reduced funding.

U.S. Marines build a confidence course during Southern Partnership Station 2014. (U.S. Navy photo by Mass Communication Specialist 3rd Class Andrew Schneider/Released)

An Ensign monitors a console in the combat information center aboard a guided-missile destroyer. (U.S. Navy photo by Mass Communication Specialist Seaman Edward Guttierrez III/Released)

Cost Savings through Innovative Technology

The DON has achieved IT cost effectiveness through data center and server consolidation, including system and application rationalization. It has saved approximately $30 million by managing and reducing costs via Enterprise Licenses Agreements. The Department has achieved mobility cost savings of $6.7 million or more a quarter by cancelling service on zero use devices that had not been used in nine months and achieved $25.3 million in cost saving to date with the DON Print Management Initiative started in January 2013. The Department continues to work on new technologies that save money while improving methods to provide Sailors and Marines with the tools they need to be ready.

The DON has developed a component-based approach for facility investment to more accurately define critical-mission facility requirements and provide a better reflection of shore readiness for the overall Navy facilities portfolio. The approach identifies the Facilities Condition Index (FCI) and associated components to guide investment strategies which enable the DON to take an informed level of risk in shore investments to maximize warfighter readiness.

Global Operations Readiness

The DON has completed development of the FY 2015 Global Force Management Allocation Plan (GFMAP), signed by Secretary of Defense in February 2014. It has supported Joint-Staff led efforts to reform the Global Force Management Process to better balance risk to mission against the long term health of the force. The Department has also commenced development of the FY 2016 GFMAP, incorporating a more resource-informed approach to meeting global demand.

In another initiative, the Navy has developed and began implementation of the Optimized Fleet Response Plan to sustainably deploy combat-ready forces into the future, aligning multiple readiness processes. It has continued to deploy combat-ready forces globally in support of named operations and theater campaign plans.

The DON continues to safeguard and protect the Nation's interests by conducting operations to provide maritime security across the globe.

OBJECTIVE 3: LEAD THE NATION IN SUSTAINABLE ENERGY

The DON is committed to improving energy security and environmental stewardship by reducing reliance on fossil fuels. The Navy is actively developing and participating in energy, environmental, and climate change initiatives that will increase use of alternative energy and help conserve the world's resources for future generations.

Reducing the Department's reliance on fossil fuels is critical to national security, environment, and naval capabilities. The nation and Naval forces rely heavily on a finite source of fuel from volatile global regions which creates an obvious vulnerability to our national security. In addition, reliance on fossil fuels affects the naval forces' operational independence, both in terms of the resources required to obtain fuel and to transport it to the ships, aircrafts, equipment, and the Sailors and Marines whose duty it is to protect the ships and convoys moving the fuel.

With these risks in mind, the DON has taken a bolder, more aggressive stance toward energy reform by committing to five energy goals (see chart). These goals require adoption of new fuels and development of new systems and energy efficient practices and techniques over the next 10 years. The Navy's strategy in achieving these goals is centered on energy security, energy efficiency, and sustainability while remaining the preeminent global maritime power.

Reinforcing the Importance of Energy Initiatives

During FY 2014, the Navy formed the Leading Innovation: Energy Application Focus (LIEAF) seminar. LIEAF is intended to influence senior Navy leadership to incorporate energy efficiency into decision making. The course focuses on how the Navy can use energy smartly as well as teaches participants to balance operational capability delivered through energy efficiency against more traditional capabilities.

Also during FY 2014, the Pacific Fleet and United States Fleet Forces held Fleet Energy Training events at Naval Base San Diego and Naval Station Norfolk. These events highlighted the latest developments the Navy is pursuing based on the SECNAV's energy goals, provided training to help Sailors apply best energy practices, and recognized commands that have excelled in energy conservation. The goal of this training was to increase awareness of the need to reduce energy consumption throughout the fleet.

The DON has also provided energy programs that enable a more effective warfighter by creating choices for operational commanders that produce results: security, flexibility, agility, and resiliency. The Navy has been pursuing renewable and alternative energy technology using a "Watch-Partner-Lead" approach: watching industry-led technologies and invest when/where viable and mission allows; partner at all echelons to develop needed technology with key stakeholders; lead the development of mission-critical and game changing technologies.

Advancing the Use of Biofuels

The DON, in conjunction with the USDA, developed the "Farm to Fleet" initiative making biofuel blends part of regular, operational fuel purchase for use by the military. The Navy will begin to add biofuels into its regular domestic purchases of approximately 77 million gallons of jet fuel and diesel each year. Initial fuel contracts will be awarded in 2015 and first deliveries scheduled for mid-year 2015. This initiative is important to advancing a commercial market for advanced biofuel, which will give the Navy an alternative fuel source and help lessen dependence on foreign oil. The Navy's intensifying efforts to use advanced, homegrown fuels to power the military benefits both America's national security and rural communities. Production of these fuels creates jobs in rural America and is cost effective for the military, which is the biggest consumer of petroleum in the nation.

In April 2014, as part of the Navy's Great Green Fleet initiative, the U.S. Navy and the Italian Navy signed a statement of cooperation on the research and use of alternative fuel. This cooperative effort will culminate with an alternative energy demonstration activity at sea in 2016. The interoperability of fuels is paramount for successful combined operations of allied country's naval vessels and aircrafts.

Evaluating solar energy potential at Camp Pendleton, CA. (U.S. Navy photo by John F. Williams/Released)

DEPARTMENT OF THE NAVY ENERGY GOALS
Energy Efficient Acquisition: Evaluation of energy factors will be mandatory when awarding contracts for systems and buildings.
Sail the "Great Green Fleet": DON will demonstrate a Green Strike Group in local operations by 2012 and sail it by 2016.
Reduce Non-Tactical Petroleum Use: By 2015, DON will reduce petroleum use in the commercial fleet by 50%.
Increase Alternative Energy Ashore: By 2020, DON will produce at least 50% of shore-based energy requirements from alternative sources; 50% of DON installations will be net-zero.
Increase Alternative Energy Use DON-Wide: By 2020, 50% of total DON energy consumption will be from alternative sources.

OBJECTIVE 4: PROMOTE ACQUISITION EXCELLENCE AND INTEGRITY

To protect U.S. national interest and achieve the objectives of the 2010 *National Security Strategy* in this environment, the Navy will need to recalibrate its capabilities and make selective additional investments to succeed in its missions. Despite the fact that The Budget Control Act of 2011 mandates the reduction of federal spending, the Navy fleet will be no smaller in the future than it is today. Therefore, as replacement costs of aging ships, aircrafts, and weapons systems continue to rise faster than the procurement budgets' top-line, the Navy must reduce the cost of doing business. This entails improving program execution, rebuilding the acquisition workforce, leveraging strategic sourcing, and promoting competition all while protecting a healthy industrial base.

During FY 2014, the DON continued to follow the DoD's Better Buying Power 2.0 (BBP 2.0) initiative. The initiative strives to implement best practices throughout DoD acquisition services to strengthen the buying power, improve industry productivity, and provide an affordable, value-added military capability to the warfighter. The overall goal of the program is to create a set of fundamental acquisition principles to achieve greater efficiencies through affordability, cost control, elimination of unproductive processes and bureaucracy, and promotion of competition. Beginning in FY 2015, the DON will begin following the DoD's Better Buying Power 3.0, (BBP 3.0), an evolution of BBP 2.0 with a shift in emphasis toward achieving dominant capabilities through innovation and technical excellence.

The DON acquisition community is actively pursuing improvements and efficiencies on a broad front in the way it does business. Following the guidelines of BBP 2.0, the DON signed a multi-year procurement contract for Virginia Class submarines, funding work on two submarines per year from FY 2014 through FY 2018, effectively giving the Navy 10 ships for the price of 9. This year, it increased Defense Acquisition Workforce Improvement Act (DAWIA) certification rates for Business Cost Estimating staff and has increased visibility on information technology (IT) spending from budgeting to execution by improving communication between DON financial tools. In February 2014, the Navy established an agreement with the Navy Marine Corps Intranet Continuity of Services Contract to Next Generation Enterprise Network (NGEN) transition provider, realizing a cost avoidance of $60 million and a projected reduction to the Total Obligation Authority requirement for NGEN by over $1.0 billion across the Future Years Defense Program (FYDP) compared to the current contracting vehicle.

The MQ-4C Triton unmanned aircraft system prepares to land at Naval Air Station Patuxent River, MD. (U.S. Navy photo by Kelly Schindler/Released)

OBJECTIVE 5: PROLIFERATE UNMANNED SYSTEMS

Unmanned systems are vital to the DON's ability to be present and they lessen the risk to Sailors and Marines. These systems allow the Navy to conduct missions that extend beyond the physical limits of pilots and crews or perform high risk tasks. For unmanned systems to become pervasive throughout the Navy and Marine Corps, they must be incorporated with people on manned platforms to create an integrated force.

Operating aircraft platforms independently of a pilot, with growing autonomy, greatly increases the possibilities for what can be done with them in the future. Unmanned planes will save on operating costs such as fuel and maintenance and they don't require flights to maintain pilot proficiency. The operators maintain their skills in the simulator.

The Marine Corps has fielded the vehicle-transportable route reconnaissance and clearance (R2C) robot to combat engineer battalions providing capability in the interrogation, marking, and neutralization of explosive hazards and obstacles. Putting remotely operated robots in harm's way provides troops with tools to counter these hazards and reduce the risks to people.

Across the entire spectrum of military operations, an integrated force of manned and unmanned platforms is the future. During FY 2014, the Navy conducted flight operations testing with an X-47B taking off and landing aboard the USS George H.W. Bush, a first for an unmanned vehicle. These tests included integrated flights with conventional aircraft in the carrier flight pattern. The DON completed another first, seeing the MQ-4C Triton Unmanned Aircraft System (UAS) complete a cross country flight of over 3,000 miles from Palmdale, CA to Naval Air Station Patuxent River in Maryland. These events show that the Navy and Marine Corps are leading the way in technological advances, creating a 21st century force with Sailors and Marines providing the innovative thinking and developing new ideas that are crucial to success. The unmanned systems and platforms being developed today will become a central part of the Navy and Marine Corps of tomorrow and will help ensure the forces continue to be the most powerful expeditionary fighting force the world has ever known.

Unmanned systems are not just being tested for use in the future, they are deployed right now, providing cost effective support to warfighters. In May 2014, the RQ-21A Blackjack Early Operational Capability UAS was deployed into theater to fill an urgent need for tactical Signals Intelligence (SIGINT) while also informing the RQ-21A program of record for pre-full rate production aircraft improvements and modifications. Blackjack will remain in theater performing SIGINT missions primarily by providing full motion video in support of the Marine Expeditionary Brigade until the end of mission in OEF. The Cargo Resupply Unmanned Aircraft Systems (CRUAS) has been operating in Afghanistan since 2011. During its time supporting Marine Forces in theater, the CRUAS has flown over 4.5 million pounds of cargo in 1899 sorties.

OBJECTIVE 6: DRIVE INNOVATIVE ENTERPRISE TRANSFORMATION

The DON continues to value the importance of Innovative Enterprise Transformation to its mission and overall operations. Innovation leads the Navy towards improvements for people, to platforms, and helps every taxpayer dollar go further. The DON Transformation Plan for FY 2014-2016 was completed, and sets forth the transformation priorities for the DON and establishes a clear path forward for both business transformation and institutional reform.

During FY 2014, the Navy reduced data center energy, resource, and real estate costs by closing 39 data centers creating a cost avoidance of $213.7 million. The Navy Working Capital Fund (NWCF) automated the NWCF Flash Cash Daily Report improving the frequency, accuracy, and reliability of the report. This effort introduced efficiencies in a long standing NWCF process and will satisfy upcoming FY 2015 OSD requirements for daily NWCF cash balance reporting.

The DON Financial Improvement and Audit Readiness (FIAR) Program

The DON FIAR Program and the Marine Corps Financial Improvement and Audit Readiness Initiative are multiyear, Department-wide efforts to modernize Navy-Marine Corps financial processes and systems to better serve worldwide operations. The goal of the financial improvement and audit readiness efforts is to produce more timely financial management information with greater accuracy, reliability, and accessibility. With improved information, the DON can allocate resources in a more precise way and move closer to producing auditable DON financial statements.

The FIAR efforts align with the new priorities and associated strategy established by the Under Secretary of Defense (Comptroller) for bringing DoD into a state of financial audit readiness and in compliance with the Chief Financial Officers Act of 1990 (as amended). These priorities focus on improving processes, controls, and systems that support information most often used and relied upon by both civilian and military leaders in daily business operations—budgetary information, as reported on the SBR, and mission critical asset information, such as military equipment and real property, as reported on the Balance Sheet. These priorities demonstrate the value of these financial statements to daily business operations, particularly for funds control and resource utilization.

The DON has asserted that the Major Defense Acquisition Program (MDAP), the DON Transportation of People (TOP), Civilian Pay (CIVPAY), Reimbursable Work Orders Grantor and Performer (RWO G/P), Military Pay, Fund Balance with Treasury (FBWT), Contract Vendor Pay (CVP), and MILSTRIPs segments are audit ready.

For the DON's Existence and Completeness (E&C) efforts, the Navy received unqualified opinions on ships, submarines, intercontinental ballistic missiles, satellites, and aircraft in FY 2012. The DON reasserted ordnance and asserted Navy small boats in FY 2013. The DON asserted Uninstalled Aircraft Engines (UAE), Equipment, and Inventory in FY 2014. Validation for UAE and remaining assertions is expected in FY 2015.

Audit Response and Evaluation

To continue and sustain successes in audit readiness, the DON has created and staffed the Audit Response and Evaluation Division. Building on the DON's success of the Audit Response Center (ARC), and decentralizing Budget Submitting Office support to regional offices, the Audit Response and Evaluation effort ensures continued emphasis on the gains achieved in preparing the DON for full SBR audit. These functions provide the capability for an efficient and secure coordinated audit response to audit inquiries and handling of auditor findings and recommendations. The DON has utilized this system undergoing segment examinations throughout FY 2014 and will employ it in FY 2015 as it undergoes its first Schedule of Budgetary Activity audit.

Continuous Process Improvement

Continuous Process Improvement (CPI) is a primary enabler for managing the effectiveness and efficiency of processes in support of the warfighter and business operations, and a critical path toward financial audit readiness. CPI provides our workforce with proven performance improvement tools, such as Lean Six Sigma and Audit Readiness Training Symposiums, to build a strong warfighter support foundation for improving cycle time and reliability, aligning the work of subordinate organizations to enterprise-wide goals, and optimizing costs. Under the purview of the Deputy Under Secretary of the Navy for Business Operations and Transformation, the Navy is bringing together processes and organizations for the accomplishment of strategic and corporate business objectives.

During FY 2014, the DON implemented several improvements to financial and feeder systems and increased training for systems users aimed at improving auditability. A web-based application was developed and deployed enabling quarterly verification of all DON personnel with execution privileges. The results of the verifications are archived and can be quickly accessed to support audit. The Navy also utilized Program/Budget Initiatives System for Information Technology (PBIS-IT) to enhance and formalize the DON's IT Budget procedures, developing and deploying additional system and application improvements. The DON conducted user training to improve object classification data, increasing standardization and awareness of the relationships between budget and execution. This training led to improved accuracy of obligation data.

A U.S. Coast Guard high endurance cutter and an aircraft carrier transit off the coast of San Diego. (U.S. Navy photo by Mass Communication Specialist 3rd Class Katarzyna Kobiljak/Released)

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

DON commanders, senior leaders, and managers are obligated to safeguard the integrity of their respective programs and operations and adherence to Federal Financial Management Improvement Act (FFMIA) and the Federal Managers' Financial Integrity Act (FMFIA). Statutory requirements support the production of timely, reliable, accurate, and accessible financial information, which facilitates the development and implementation of effective and efficient internal controls. Assessable financial information in conjunction with sufficient controls creates efficiencies to standardize processes and ultimately preserves the DON's limited resources, which is critical to the Department's commitment to national defense and public stewardship.

Included in this section are internal control elements encompassed in the DON's annual Statement of Assurance (SOA), which provides management's FMFIA and FFMIA assessment on the current state of internal controls. The DON's overview of internal controls over non-financial operations, financial reporting, and financial systems are described within the enclosed sections.

Management Assurances

The DON objectives of the systems of internal accounting and administrative control are to provide reasonable assurance that:

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

Internal Control over Non-Financial Operations (ICONO)

The DON Managers' Internal Control Program (MICP) is the administrative vehicle for monitoring ICONO. The MICP is decentralized and encompasses ashore commands and afloat Forces. To mitigate fraud, waste, and misuse of the DON's limited resources, the evaluation and execution of effective and efficient internal controls extends to internal stakeholders and external shared service providers.

Responsibility for program execution and reporting resides within a network of 19 Major Assessable Units (MAU). DON MAUs perform ICONO self-assessments and maintain supporting documentation to support their FMFIA certification statements, which is the primary source for the SECNAV's determination of reasonable assurance.

Complementing the self-identification of control related deficiencies, the DON's Auditor General, in collaboration with the Deputy Assistant Secretary of the Navy, Financial Operations (DASN (FO)), conducts quarterly reviews of audit reports from the Government Accountability Office (GAO), the Department of Defense Inspector General (DoDIG), and the Naval Audit Service (NAVAUDSVC). This review assists in the identification of control deficiencies and utilizes a systematic methodology of determining materiality and potential for inclusion in the DON SOA. The high degree of collaboration and communication between the DASN (FO) MICP administrators and the NAVAUDSVC has resulted in a consistent and comprehensive perspective on the DON's internal control environment.

Outstanding Material Weaknesses FY 2014

INTERNAL CONTROL REPORTING CATEGORY		
CATEGORY	**MATERIAL WEAKNESS**	**TARGET CORRECTION YEAR**
Contract Administration	Contract Management - Service Contracts	FY 2015
Acquisition	Attenuating Hazardous Noise in Acquisition & Weapon System Design	FY 2015
Communications/Intelligence/Security	Management of Communications Security (COMSEC)	FY 2014
Communications/Intelligence/Security	Personally Identifiable Information (PII)	FY 2015
Acquisition	Earned Value Management (EVM)	FY 2014

In addition to the ICONO assessments described above, the DON MICP encompasses Internal Control over Financial Reporting (ICOFR) and Internal Control over Financial Systems (ICOFS) into the Department's annual SOA which supports the Office of the Secretary of Defense (OSD)'s report to Congress and to the President.

Internal Control over Financial Reporting (ICOFR)

The DON continues to implement processes to reach a status of full compliance with Office of Management and Budget (OMB) Circular A-123, Appendix A in conjunction with overall Navy and Marine Corps FIAR efforts. The DON's current focus is on achieving the FIAR objectives relative to budgetary information and mission critical asset information priorities. Through the DON FIAR discovery process, the DON continues to work closely with participating Commands and service providers, such as the Defense Finance and Accounting Service (DFAS), to identify, evaluate, and document the risks and internal controls associated with the end-to-end business processes underlying the financial statements. Attention is focused on remediating material weaknesses which will allow for overall achievement of the DON's assertion goals. Documentation efforts continue as the DON moves toward its objective of asserting audit readiness over all financial reporting segments. In FY 2014, we identified:

- 21 Material Weaknesses in Existence and Completeness, Reimbursable Work Orders – Grantor and Performer, Contract Vendor Pay, Financial Statement Compilation and Reporting, Military Standard Requisitioning and Issue Procedures, and Transportation of Things; and

- 2 Corrected Material Weaknesses in Contract Vendor Pay and Reimbursable Work Orders – Performer.

In FY 2015, the DON plans further discovery and development of corrective actions plans with executable tasks to mitigate the material weaknesses.

The Marine Corps continued improving the documentation of specified business processes to assist stakeholders and auditors in obtaining an understanding of financial processes used by the Marine Corps. Revised descriptions are used to identify which controls and key controls to test. The Marine Corps ICOFR program aims to support the DON FIAR objectives by targeting specific evaluations that strengthen the integrated objectives of the DON SBR assertion. For FY 2014, the Marine Corps reported material weaknesses in Military Equipment, Real Property, Reimbursable Work Orders – Grantor, and Military Standard Requisitioning and Issue Procedures. Efforts are underway to address these material weaknesses via formal corrective action plans pending additional analyses and concurrence by the Marine Corps Senior Assessment Team.

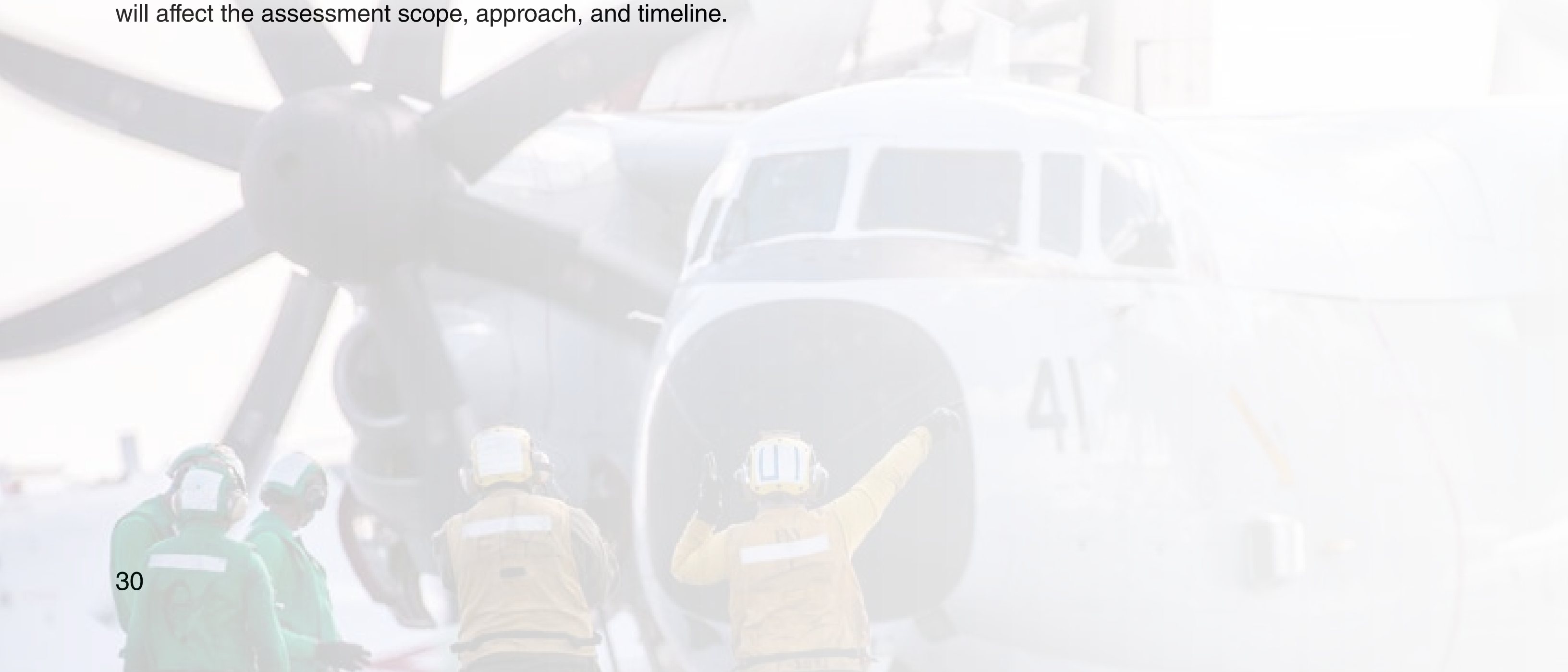
Internal Control over Financial Systems (ICOFS)

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

The DON conducted Federal Information System Controls Audit Manual (FISCAM) assessments on selected IT systems and coordinated with service providers such as DFAS, Defense Logistics Agency (DLA), and Defense Contract Management Agency (DCMA) to identify and prioritize feeder system assessments. The DON continued to refine its strategy for assessing Legacy and Navy Enterprise Resource Planning (ERP) system controls. The DON prioritized IT controls based on FISCAM and FIAR guidance to ensure financial data integrity and reliability. For FY 2014, the DON tracked, updated, and managed identified systems to support the Office of Under Secretary of Defense, Comptroller (OUSD (C)) FIAR identified business segments and financial reporting framework. For the current reporting period, the DON identified nonconformance for 14 of 39 IT systems related to asset management, Statement of Budgetary Activity, and Working Capital Funds.

The Marine Corps conducted a full FISCAM review of the Global Combat Support System – Marine Corps (GCSS-MC) to determine the effectiveness of general and application information technology controls. In addition, as a result of the FY 2010 through FY 2013 SBR and Schedule of Budgetary Activity (SBA) audits, FISCAM test were performed on the Standard Accounting, Budgeting and Reporting System (SABRS) and Marine Corps Total Force System (MCTFS). DoDIG's independent audit team characterized their findings (in aggregate) as material non-compliance with laws and regulations related to FFMIA. The Marine Corps for the reporting period identified five non-conformances. The Marine Corps acknowledges although the system weaknesses create a condition of FFMIA nonconformance, it does not directly imply that the resulting output is inaccurate, incomplete, or unsupported. The Marine Corps continues to develop and execute corrective actions to address internal control system weaknesses and FFMIA nonconformance.

The following is the management assurance letter for FY 2014.



THE SECRETARY OF THE NAVY
WASHINGTON DC 20350-1000

November 5, 2014

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2014

As the Secretary of the Navy, I recognize that the Department of the Navy (DON) is responsible for establishing and maintaining effective internal controls to meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). Tab A provides specific information on how the DON conducted the assessment of operational internal controls, in accordance with Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Control, and provides a summary of the significant accomplishments and actions taken to improve the DON's internal controls during the past year.

I am able to provide a qualified Statement of Assurance (SOA) that operational internal controls of the DON meet the objectives of FMFIA, with the exception of five unresolved material weaknesses described in Tab B. These weaknesses were found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations, as of the date of this memorandum. With an exception of the enclosed material weaknesses, the internal controls were operating effectively.

The DON conducted its assessment of the effectiveness of internal controls over financial reporting in accordance with OMB Circular A-123, Appendix A, Internal Control Over Financial Reporting. Tab A-1 provides specific information on how the DON conducted this assessment. Based on the results of this assessment, the DON is able to provide a qualified SOA that the internal controls over financial reporting as of June 30, 2014, were operating effectively with the exception of the following: DON: 21 material weaknesses and United States Marine Corps (USMC): 5 material weaknesses as noted in Tab C.

The DON also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems. Tab A-1 provides specific information on how the DON conducted this assessment. Based on the results of this assessment, the DON is able to provide a qualified SOA that the internal controls over the integrated financial management systems as of June 30, 2014, are in compliance with FFMIA and OMB Circular A-123, Appendix D, with the exception of the following: DON: 1 non-conformance and USMC: 5 non-conformances as noted in Tab C.

My point of contact is Ms. Erica Gaddy. She may be reached at (202) 685-0791 or erica.gadddy@navy.mil.

Ray Mabus

Sailors assigned to an aircraft carrier load relief supplies onto an MH-60R Sea Hawk helicopter to be airlifted to local villages during Operation Damayan. (U.S. Navy photo by Mass Communication Specialist Seaman Chris Cavagnaro/Released)

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The accompanying financial statements and related disclosures represent the DON's enduring commitment to fiscal accountability and transparency. Through the FIAR plan and related business transformation initiatives discussed earlier, the Department has made significant progress toward improving the quality and timeliness of financial information. However, the DON is currently unable to fully implement all elements of U.S. generally accepted accounting principles and OMB Circular A-136, "Financial Reporting Requirements," due to limitations of financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the DoDIG was unable to express an opinion on the FY 2014 financial statements. It should be noted that these limitations exist primarily in the proprietary accounting processes and less so in the budgetary accounting performed to manage and report on the application of budget authority to the purposes and programs approved in appropriations acts. In fact, the Marine Corps has achieved full audit readiness for its General Fund SBR and the DON revised its strategy to place first priority on its SBR as well. Despite documented material weaknesses and because of compensating measures and close oversight, the DON believes the budgetary information used for decision-making is accurate and reliable.

For financial reporting purposes, the DON is organized into two reporting entities: The DON and Navy Working Capital Fund (NWCF), which include financial information for both the Navy and the Marine Corps. Each reporting entity has a separate set of financial statements and related disclosures.

The Department of the Navy General Fund

The Department's enacted appropriations comprise the majority of the account structure, which includes five major appropriation groups:

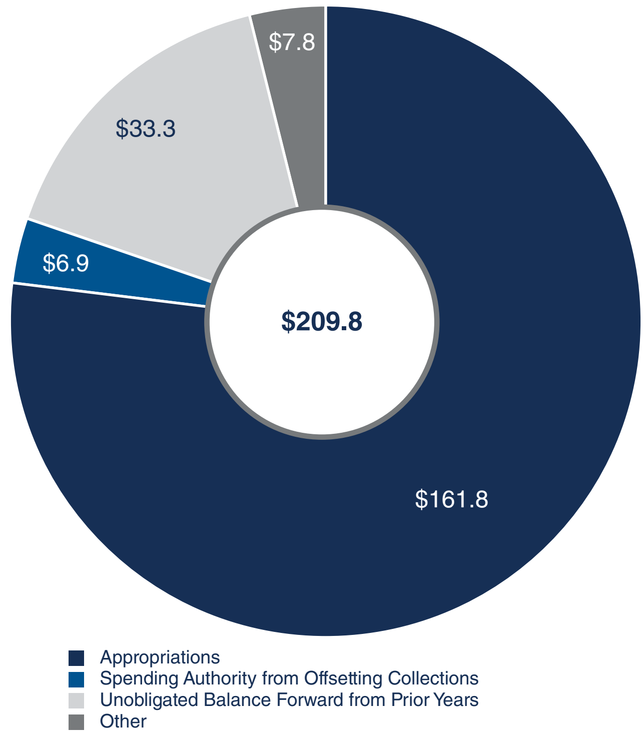
- Operation and Maintenance
- Military Personnel
- Procurement
- Research, Development, Test, and Evaluation
- Military Construction

Enacted appropriations flow through OMB and OSD to the Office of the Secretary of the Navy, where they are allocated to administering offices and commands. The administering offices and commands, which in turn obligate the appropriations to fund operational expenses and capital investments, are required to exercise a system of effective control over financial operations.

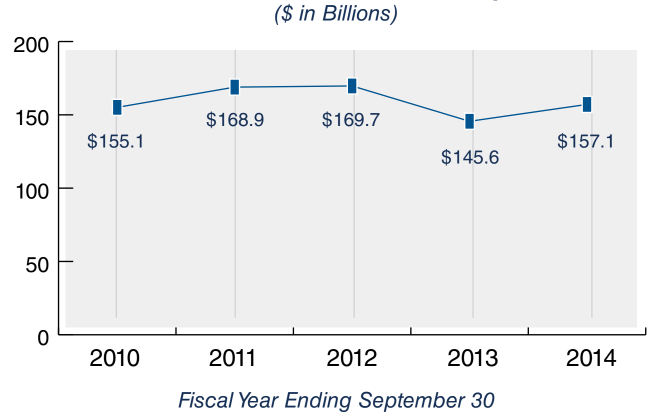
Results of Operations

The Combined SBR presents total budgetary resources of $209.8 billion that were available to the DON during FY 2014 and the status of those resources at fiscal year-end. Total budgetary resources were down $1.9 billion, a 1% decrease in FY 2014 compared to FY 2013. The enacted appropriations of $161.8 billion represent 77.1% of total budgetary resources and remained unchanged from FY 2013. The decrease in total budgetary resources is attributable to the $9.7 billion of recoveries of prior year unpaid obligations, which decreased $2.2 billion compared to FY 2013. The DON obligated $174.6 billion of the $209.8 billion total resources in FY 2014, which is a decrease of $3.7 billion or 2% compared to FY 2013. The Consolidated Statement of Net Cost presents net cost of operations of $157.1 billion during FY 2014. Net cost of operations represents gross costs incurred by the DON less earned revenue. Net cost of operations increased $11.5 billion, which represents a 7.8% increase over FY 2013.

FY 2014 DON Sources of Funds
($ in Billions)



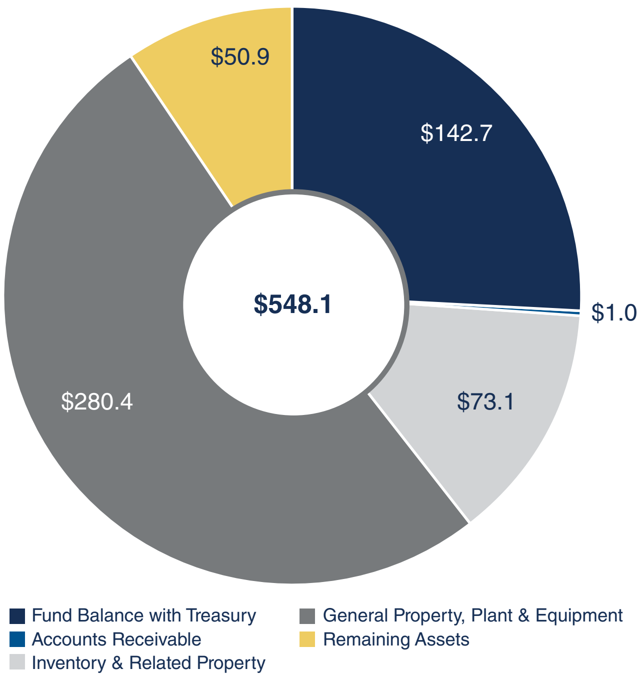
FY 2010 – 2014 DON Net Cost of Operations
($ in Billions)



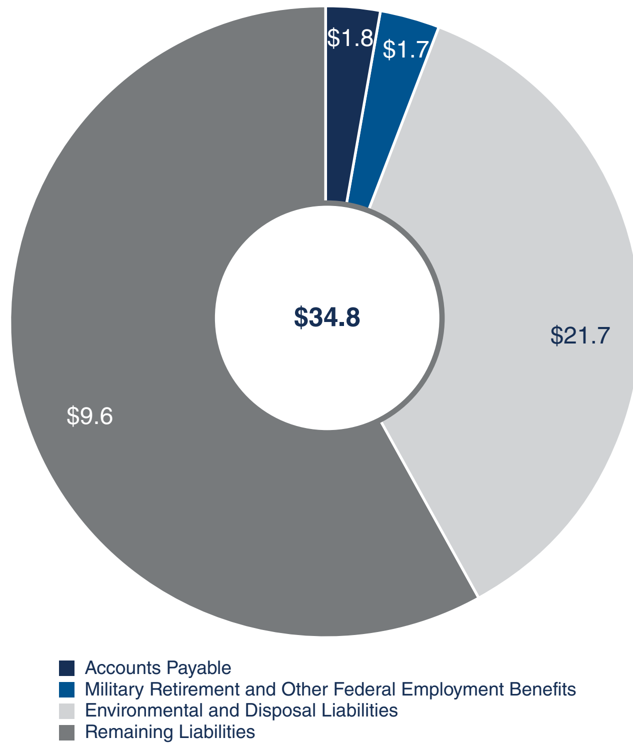
Financial Position

The DON continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. As of September 30, 2014, net position totaled $513.3 billion, which represents a $8.9 billion or 1.8% increase from FY 2013. The overall increase in net position is attributed to increases of $5 billion in total assets and a decrease of $4 billion in total liabilities.

FY 2014 DON Total Assets
($ in Billions)



FY 2014 DON Total Liabilities
($ in Billions)



Navy Working Capital Fund

NAVY WORKING CAPITAL FUND BUSINESS ACTIVITIES BY BUSINESS AREA		
SUPPLY MANAGEMENT Supply Management, Navy *(https://www.navsup.navy.mil)* Supply Management, Marine Corps *(http://www.logcom.usmc.mil)* **DEPOT MAINTENANCE** Depot Maintenance, Aviation *(http://www.navair.navy.mil)* Depot Maintenance, Marine Corps *(http://www.logcom.usmc.mil)*	**BASE SUPPORT** Facilities Engineering Commands *(https://portal.navfac.navy.mil)* Naval Facilities Engineering Service Center *(https://portal.navfac.navy.mil)* **TRANSPORTATION** Military Sealift Command *(http://www.msc.navy.mil)*	**RESEARCH AND DEVELOPMENT** Naval Research Laboratory* *(http://www.nrl.navy.mil)* Naval Surface Warfare Center *(http://www.navsea.navy.mil)* Naval Undersea Warfare Center *(http://www.navsea.navy.mil)* Naval Air Warfare Center *(http://www.navair.navy.mil)* Space and Naval Warfare Systems Centers *(http://spawar.navy.mil)*

*Also see Office of Naval Research (http://www.onr.navy.mil)

NWCF 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 NWCF operations. General or appropriated fund payments from customers for goods delivered or services performed subsequently replenish this initial working capital investment and sustain a continuous cycle of operations, minimizing the need for additional annual appropriations by Congress. The goal of 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 budget-driven prices for goods and services, to protect customers from unforeseen price fluctuations.

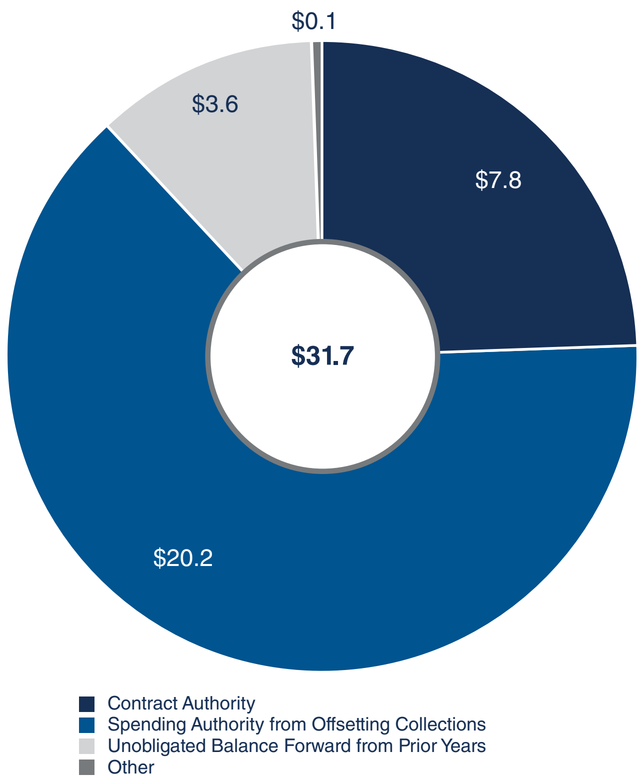
Results of Operations

The Combined SBR presents total budgetary resources of $31.7 billion that were available to NWCF during FY 2014 and the status of those resources at fiscal year-end. Total budgetary resources decreased $0.8 billion, which was a 2.5% decrease over FY 2014. NWCF budget authority is comprised of contract authority and spending authority from offsetting collections of which the latter accounts for 63.7% of total budgetary resources. The majority of the decrease in overall budget authority is due to a $0.5 billion decrease in Other Changes in Unobligated Balance in FY 2014. NWCF business activities obligated $28.4 billion of the $31.7 billion total resources in FY 2014 which represents a decrease of $0.5 billion or 1.7% over FY 2013.

The Consolidated Statement of Net Cost presents net cost of operations of $9.6 billion during FY 2014. Net cost of operations represents gross costs incurred by NWCF less earned revenue. Sources of earned revenue include the DON; Army and Air Force General Funds; Defense Working Capital Funds; other Navy and DoD appropriations; and non-DoD fund sources. The Navy had a decrease of $12 billion in net costs in FY 2014 over FY 2013, which results in a negative net cost of operations.

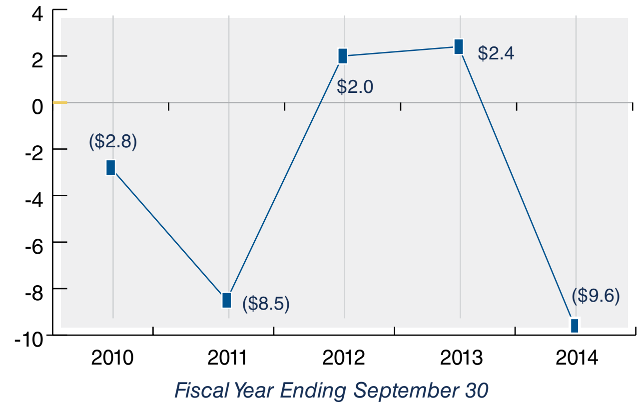
FY 2014 NWCF Sources of Funds

($ in Billions)



NWCF Net Cost of Operations, FY 2010 – 2014

($ in Billions)

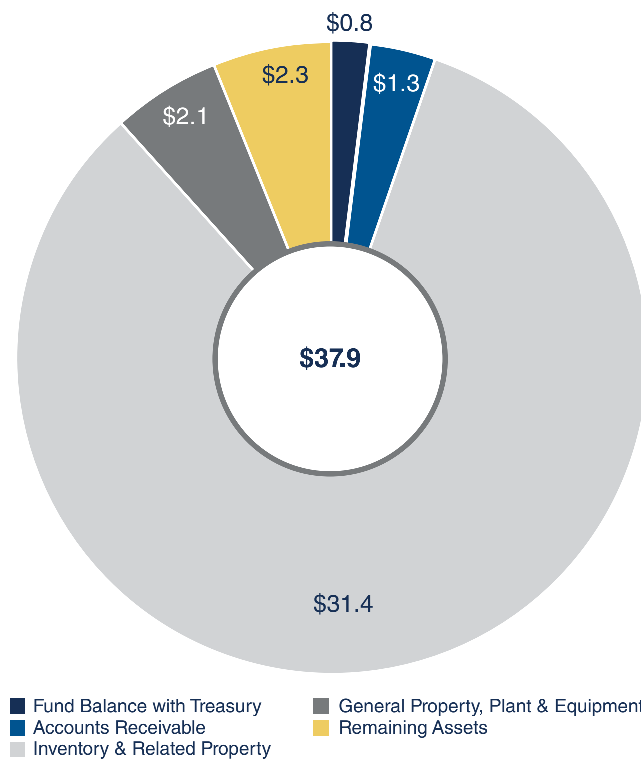


Financial Position

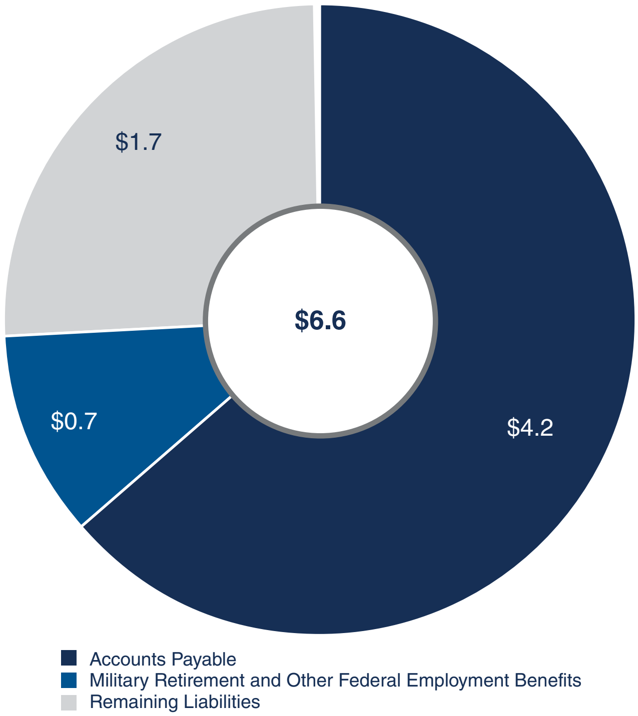
The NWCF continued to report a positive net position in its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. As of September 30, 2014, net position totaled $31.3 billion, which represents an increase of $8.9 billion and a 39.7% increase from FY 2013. An increase of $9.1 billion in total assets and $0.2 billion in total liabilities contributed to the overall increase in net position.

FY 2014 NWCF Total Assets

($ in Billions)



FY 2014 NWCF Total Liabilities
($ in Billions)

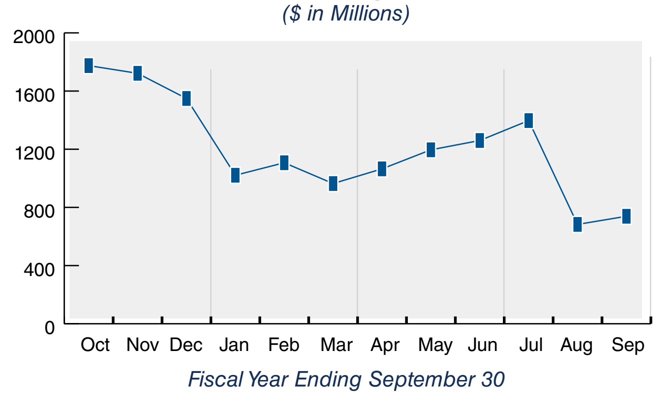


Cash Management

The NWCF manages working capital fund cash at the Departmental level. It must maintain the minimum cash balance necessary to meet operational, capital investment, and other justified requirements, as required by the DoD Financial Management Regulation. The NWCF has established a high and low cash requirement based on business events and activities relevant to its operations.

For FY 2014, the high cash requirement was $1.2 billion and the low cash requirement was $846.1 million.

NWCF Cash Balances
October 1, 2013 to September 30, 2014
($ in Millions)



Sailors man the rails on the flight deck of an amphibious assault ship as it passes under the Coronado Bay bridge. (U.S. Navy photo by Mass Communication Specialist Seaman Christopher Farrington/Released)

LOOKING FORWARD

The DON's achievements during FY 2014 established a firm foundation that will assure future success in executing the mission of the Navy and Marine Corps, and building a sound business operating environment. In FY 2014, the Navy will focus on achieving the DON's objectives outlined in the Strategic Management section. Of those objectives, the priority is to preserve pay and benefits for Sailors, Marines, and their families, train the workforce, maintain equipment, and help build fleet forces for the future.

Personnel

America's naval forces are the finest in the world because of the quality, dedication and motivation of the Sailors, Marines and civilian workforce. The development and retention of quality personnel are vital to meeting the defense strategy goal to be a smaller and leaner yet agile, flexible, ready and technologically advanced all-volunteer force. The Department remains committed to providing the right person with the right skills, at the right time, and at the best value while ensuring the welfare of Sailors, Marines, civilian personnel and their families.

Readiness

The Department will maintain strong, agile, and capable military forces. Operational readiness is the catalyst that brings naval power to bear whenever it is needed. The DON's focus continues to be providing ready naval

Marines assigned embark an amphibious dock landing ship for a scheduled deployment. (U.S. Navy photo by Mass Communication Specialist 2nd Class Raul Moreno Jr./Released)

forces, from individual units to strike groups, which are forward deployed and capable of providing a substantial surge force.

Investment and Development

The DON continues investment in platforms and systems that maintain capability for today's conflicts and transition the force to meet tomorrow's challenges across the full spectrum of operations. Although fiscal constraints have directly impacted the level of acquisition, the Department of the Navy procurement plan sustains the industrial base with proven and versatile platforms. These platforms ensure the DON remains a superior fighting force throughout the full spectrum of conflict now and into the future.

The Department is dedicated to procuring a naval force that is both affordable and meets the Secretary of Defense's strategic guidance. The Navy and Marine Corps forces will sustain a global forward presence with the speed and persistence to provide sovereign sea-based options where it matters, when it matters. This capability based, threat-oriented fleet can be disaggregated and distributed world-wide to deter and defeat aggression or rapidly aggregated to project power despite antiaccess/area denial challenges. The resulting distributed and netted force, operating effectively in cyberspace and working in conjunction with joint and maritime partners, will provide the ability to take action where and when necessary in today's unstable environment.

Infrastructure

Providing Sailors, Marines, and the Department's civilians with high quality facilities, information technology, and an environment to achieve their goals is fundamental to mission accomplishment. The ability to project power through forward deployed naval forces is facilitated by a strong and efficient shore infrastructure.

The Department continues to improve quality of life for Sailors and Marines and improve the safety of their work environment. Continued investment in Facility Sustainment, Restoration and Modernization (FSRM) is necessary to maintain the inventory of installations supporting required capabilities from the Defense Strategic Guidance. The FSRM program ensures the current inventory of facilities is maintained in good working order, while preventing premature degradation of facility condition.

Overseas Contingency Operations

The Navy and Marine Corps are agile and flexible expeditionary forces engaged in a full range of operations around the world. Today over 20,000 Marines, 40,000 Navy personnel, and 128 ships are underway or deployed worldwide creating a safer, more stable, and more prosperous world for the American people, allies, and partners. The Department's global security effort maintains a balance of presence between the Asia-Pacific and Middle East regions. Additionally, Europe remains the principal partner in seeking global and economic security for the foreseeable future. Through partnerships with a growing number of nations, including those in Africa and Latin America, the DON strives for a common vision of freedom, stability, and prosperity.

Financial Operations and Financial Metrics

The Department's drive to provide stronger financial management and increased auditability will strengthen across FY 2015. The ability to efficiently manage the budget is directly related to the ability to properly account for every dollar. The DON continues its commitment to building a performance based culture and has developed process improvements to improve and measure performance.

DON business process improvement involves executing, aligning, and integrating a series of enterprise-wide initiatives which will dramatically transform the Department's ability to execute programs and support it's mission. The result will be improved efficiency, better decision-making, and an organizational culture that is performance-based. Collectively, these initiatives will create an environment that produces more accurate and timely business information and will, over time, be endorsed by a favorable third party financial audit.

The DON has a comprehensive plan to achieve full financial auditability by the end of FY 2017, as required by Congress. This will require business managers to maintain improvements achieved by working toward SBA audit readiness, as well as improving processes and systems used by Working Capital Fund organizations, and improving major asset accountability, including accurate asset valuation. The DON is making steady progress toward this FY 2017 goal, with major challenges ahead.

Opportunity, Growth, and Security Initiatives

DoD will include documentation for a separate Opportunity, Growth, and Security Initiative with the President's Budget for FY 2015. This initiative shows how additional discretionary investments in FY 2015 can spur economic progress, promote opportunity, and strengthen national security. DON activities included in this initiative support the following: Improving DON Facilities, Accelerating Modernization of Key Weapons Systems, and Making Faster Progress toward Restoring Readiness Lost under Sequestration.

LIMITATIONS TO THE FINANCIAL STATEMENTS

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles for Federal entities and 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. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

THE NATION'S TOTAL FORCE:
At the Right Place, At the Right Time, All the Time

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

November 7, 2014

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Department of the Navy General Fund FY 2014 and FY 2013 Basic Financial Statements (Report No. DODIG-2015-021)

Report on the Basic Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990," as amended, requires the DoD Inspector General to audit the accompanying Department of the Navy General Fund consolidated balance sheet as of September 30, 2014 and 2013, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the basic financial statements (basic financial statements).

Management's Responsibility for the Annual Financial Statements

The annual financial statements are the responsibility of Navy management. Management is responsible for (1) preparing financial statements that conform with generally accepted accounting principles in the United States (U.S. GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that they met broad control objectives of Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982" (FMFIA); (3) ensuring that the Navy's financial management systems fully comply with Public Law 104-208, "Federal Financial Management Improvement Act of 1996" (FFMIA) requirements; and (4) complying with applicable laws and regulations.

Auditor's Responsibility

Our responsibility is to express an opinion on the basic financial statements based on conducting the audit in accordance with U.S. generally accepted government auditing standards and the Office of Management and Budget (OMB) Bulletin No. 14-02, "Audit Requirements for Federal Financial Statements," October 21, 2013. However, based on the matters described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Section 1008(d) of the FY 2002 National Defense Authorization Act limits the DoD Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Navy management asserted to us that Department of the Navy General Fund FY 2014 and FY 2013 Basic Financial Statements would not substantially conform to U.S. GAAP and that Navy financial management and feeder systems were unable to adequately support material amounts on the basic financial statements as of September 30, 2014. Accordingly, we did not perform all the auditing procedures required by generally accepted government auditing standards and OMB Bulletin 14-02 to determine whether material amounts on the basic financial statements were presented fairly. We considered the scope limitation in forming our conclusions on the basic financial statements.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we could not obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Department of the Navy General Fund FY 2014 and FY 2013 Basic Financial Statements. Thus, the basic financial statements may have undetected misstatements that are both material and pervasive.

Emphasis of Matter

As discussed in Note 9 to the basic financial statements, the Navy has elected to change its capitalization thresholds for General Property, Plant and Equipment in FY 2014. We did not modify our opinion with respect to this matter.

Other Information in the Annual Financial Statements

We performed our audit to form an opinion on the basic financial statements as a whole. Navy management presented the Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Information for additional analysis as part of the annual financial statements; these elements are not required parts of the basic financial statements. Therefore, we do not express an opinion or provide any assurance on the information. We reviewed the other information for inconsistencies with the audited basic financial statements. Based on our limited review, we did not find any material inconsistencies between the information and the basic financial statements and applicable sections of OMB Circular No. A-136 (Revised), "Financial Reporting Requirements," September 18, 2014, and DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6b, "Form and Content of the Department of Defense Audited Financial Statements."

Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have direct and material effect on the basic financial statements, and compliance with OMB regulations and audit requirements for financial reporting because management represented that instances of noncompliance identified in prior audits continue to exist. Therefore, we did not determine whether the Navy complied with all applicable laws and regulations, contracts, and grant agreements related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations, contracts, and grant agreements was not an objective of our audit, and accordingly, we do not express such an opinion.

See Attachment for additional details on internal control and compliance with legal and other regulatory requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to Navy officials. However, they did not provide comments. Navy officials expressed their continuing commitment to address the problems this report outlines.

This report will be made publicly available pursuant to section 8M, paragraph (b)(1)(A) of the Inspector General Act of 1978, as amended. However, this report is intended solely for the information and use of Congress; the OMB; the U.S. Government Accountability Office; the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD; the Assistant Secretary of the Department of the Navy (Financial Management and Comptroller); and the DoD Office of Inspector General. It is not intended to be used and should not be used by anyone else.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 or (DSN) 329-5945.

Lorin T. Venable

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

Attachment: As stated

Report on Internal Control Over Financial Reporting

Internal Control Compliance

In planning our audit, we considered the Navy's internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances for the purposes of expressing our opinion on the basic financial statements, but not appropriate to the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on internal control over financial reporting.

Management Responsibilities

Management is responsible for implementing and maintaining effective internal control to include providing reasonable assurance that Navy personnel accumulated, recorded, and reported accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

Auditor's Responsibilities

Our purpose was not to express an opinion on internal control over financial reporting, and we do not do so. However, the following material weaknesses exist that could adversely affect the Navy's financial operations.

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continued. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Navy's financial statements will not be prevented, or detected and corrected on a timely basis. The following weaknesses continue to exist.

Financial Management Systems. The Navy's financial management and feeder systems did not comply with Federal financial management system requirements, U.S. GAAP, and the U.S. Standard General Ledger (USSGL).

Financial Reporting of Order to Cash.

Reimbursable Work Order - Performer. The Navy's control environment was not designed or operating effectively to:

- verify whether the amount billed was valid and accurately recorded based on goods or services provided. Navy commands will be required to implement a monthly post-collection validation procedure.

- verify whether year-end accruals were accurately posted. The Navy will develop a central methodology to estimate and post payable accruals across its major commands.

- verify whether undelivered orders and accounts receivables represented valid transactions that were authorized and approved. Navy commands will implement a Triannual Review to monitor the status of dormant reimbursable agreement receivables and unfilled orders to validate whether a bona fide need still exists.

- verify whether unfilled reimbursable orders/authorizations were recorded completely and accurately. Navy commands will perform monthly reconciliations with trading partners to identify and track discrepancies through resolution.

- verify whether collections were processed completely, accurately, and in a timely manner. The Defense Finance and Accounting Service will implement a process to research all unmatched collections identified in the Unmatched Collection Database and resolve appropriately.

Financial Reporting of Operating Materials and Supplies. The Navy could not demonstrate the ability to consistently perform and document annual physical inventories of Operating Materials and Supplies. Additionally, the Navy could not maintain clear audit trails to permit the tracing of transactions from source documentation to comply with well-established policy requiring source documentation for the reported Operating Materials and Supplies dollar values. Half of the Operating Materials and Supplies balance has been asserted to and is undergoing examination. The remaining portion will adhere to the Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness assertion process and undergo discovery and inventory testing.

Additionally, in regard to Global Combat Support System-Marine Corps, multiple information technology control deficiencies were identified during a Federal Information System Controls Audit Manual audit to include application-level general controls, access control, interface, and configuration management controls. The Navy is developing a detailed corrective action plan for the Global Combat Support System-Marine Corps that will identify milestones required to remediate open notices of findings and recommendations.

Financial Reporting of General Equipment. The Navy could not establish or support ownership and valuation of General Equipment or Military Equipment[1] due to lack of supporting documentation, improper interpretation of guidance, underutilization of the Accounting System Record, and system limitations. In addition, the Navy could not substantiate that the Accounting System Record represented a complete inventory of General Equipment or Military Equipment assets. Discovery efforts are ongoing; upon completion of discovery efforts, the Navy will perform existence and completeness testing for inventory.

Financial Reporting of Real Property. The Navy had insufficient standardized internal control and supporting documentation requirements, which ultimately had a direct impact on the timeliness and accuracy of Construction in Progress and Real Property transactions. The Navy will continue to test inventory.

Financial Reporting of Procure to Pay

Reimbursable Work Order - Grantor. The Navy's control environment was not designed or operating effectively to:

- verify that recorded disbursements were recorded and accurate. Navy commands will be required to implement a month-post disbursement validation procedure.
- validate the accuracy of year-end accruals. The Navy will develop a central methodology to estimate and post payable accruals across major commands.

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[1] In a memorandum from the Office of the Secretary of Defense dated September 20, 2013, Military Equipment and General Equipment were combined into a single category titled "General Equipment."

- validate whether recorded reimbursable agreements represented a bona fide need. Navy commands will implement a Triannual Review to monitor the status of dormant reimbursable agreement commitments and obligations to determine if a bona fide need exists.

- validate whether recorded obligations were complete and accurate. Navy commands will perform a monthly reconciliation with trading partners to identify agreement discrepancies. Currently, the Navy executes reconciliations of material feeder systems to the general ledger.

Contract/Vendor Pay. The Navy's control environment was not designed or operating effectively to recognize unpaid accepted goods as a liability; therefore, balances recorded for delivered orders and unliquidated obligations were potentially understated. Navy commands will require authorized Government officials who are validating receipt and acceptance to confirm that appropriate acknowledgment is performed and acceptable supporting documentation is retained for auditability.

Financial Reporting of Military Standard Requisitioning and Issue Procedures

Shipyards. The Navy could not efficiently and accurately reconcile Naval Shipyard transactions to the general ledger. The Navy will perform discovery to address potential risks through the development of remediation timelines.

Visual Inter-fund System Transaction Accountability Validation. The Navy service provider, the Defense Finance and Accounting Service, had insufficient controls in place to validate the effectiveness of Visual Inter-fund System Transaction Accountability system functionality. The absence of these controls affect how a line of accounting is assigned to inter-fund bills that result in Military Standard Requisitioning and Issue Procedures obligations or payables and disbursements on the general ledger. In conjunction with the Defense Finance and Accounting Service, the Navy will review and prioritize Federal Information System Controls Audit Manual control testing for Visual Inter-fund System Transaction Accountability.

Unliquidated Obligations. The Navy internal control reconciliation process for unliquidated obligations was not designed to effectively monitor whether open Military Standard Requisitioning and Issue Procedures commitments and obligations represented a bona fide need. The Navy is creating a comprehensive process to reconcile unliquidated Military Standard Requisitioning and Issue Procedures obligations. This process is designed to allow a review of all dormant transactions, regardless of dollar thresholds or overage criteria.

Financial Reporting of Transportation of Things

Transportation Account Codes Authorization and Funds Validation. The Navy control environment was not designed or operating effectively to prevent unauthorized use of Transportation Account Codes or shipments from occurring. The Navy will continue to collaborate with the Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness working groups to develop solutions.

Access to Key Supporting Documentation. The Navy did not have standardized processes and procedures for Transportation of Things Key Supporting Documentation to support management evaluations, examinations, and audits. The Navy will continue to collaborate with Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness working groups to develop solutions.

Standardization of System and Data Requirements. Navy transportation and financial system interfaces did not support the exchange of all required transactional data. The Navy will continue to collaborate with Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness working groups to develop solutions.

Financial Statement Compilation and Reporting

Adjusting Entries into Command Trial Balances. The Navy's control environment was not designed or operating effectively to ensure all adjustments followed a standardized process. The Navy will implement command-level training to identify controls around journal entries to ensure entries are properly prepared, reviewed and approved, supported, and documented.

Financial System, Schedule of Budgetary Activity. The Navy identified internal control design and operating effectiveness deficiencies in access controls, configuration management, audit and accountability, and identification and authentication. The Navy has developed metrics to monitor and manage system-specific remediation activities, and it's Information Technology Financial Improvement and Audit Readiness assessment team is working closely with its Chief Information Officer to identify the complete inventory of financially relevant systems and remediate identified control deficiencies.

These financial management control deficiencies may cause inaccurate management information. As a result, Navy management decisions based in whole or in part on this information may be adversely affected. Financial information reported by the Navy may also contain misstatements resulting from these deficiencies. Internal control work we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies. We did not identify material weaknesses that were not reported as such in the Navy's FMFIA report.

Report on Compliance with Applicable Provisions of Law, Regulations, Contracts, and Grant Agreements

U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for compliance with existing laws and regulations, contracts, and grant agreements related to financial reporting. Management has also acknowledged to us that previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Navy complied with selected provisions of all applicable laws and regulations, contracts, and grant agreements related to financial reporting. We caution that other noncompliance may have occurred and not been detected. Furthermore, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Because of other scope limitations discussed in this report, we limited our work to determining compliance with selected provisions of the applicable laws and regulations.

Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]), limits the Navy and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Navy or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As required by 31 U.S.C. § 1517 (2004), the Navy and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act, the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2014, the Navy reported four open Antideficiency Act violations.

Compliance With FFMIA Requirements

FFMIA requires the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level. For areas in which an agency is not in compliance, OMB A-136 requires the agency to identify remediation activities planned or underway to bring the systems into substantial compliance with FFMIA. The Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Department of the Navy Chief Information Officer, Department of the Navy commands, Department of the Navy activities, and the Defense Finance and Accounting Service are jointly responsible for implementing and maintaining financial management systems that comply substantially with the Federal financial management system requirements in OMB Circular No. A-127, "Financial Management Systems," applicable U.S. GAAP, and the USSGL at the transaction level. Navy management states the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to comply substantially with the Federal financial management systems requirements, U.S. GAAP, and the USSGL at the transaction level. The Navy has based its assessment on system requirements promulgated by OMB in Circular A-127 and by the Office of the Secretary of Defense through the DoD Business Enterprise Architecture laws, regulations, and policies. Navy staff recognizes that legacy systems were, in some cases, substantively not compliant and therefore did not perform system reviews for selected legacy systems.

For FY 2014, the Navy did not substantially comply with FFMIA. Navy officials acknowledged to us that Navy financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements and that previously identified material weaknesses continue. The financial management and feeder systems did not substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the USSGL at the transaction level as of September 30, 2014. Therefore, based on the representation of the Navy, we did not substantiate whether the Navy complied with FFMIA and OMB implementation guidance.

Recommendations

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

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

November 7, 2014

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Department of the Navy Working Capital Fund FY 2014 and FY 2013 Basic Financial Statements (Report No. DODIG-2015-020)

Report on the Basic Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990," as amended, requires the DoD Inspector General to audit the accompanying Department of the Navy Working Capital Fund consolidated balance sheet as of September 30, 2014 and 2013, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the basic financial statements (basic financial statements).

Management's Responsibility for the Annual Financial Statements

The annual financial statements are the responsibility of Navy management. Management is responsible for (1) preparing financial statements that conform with generally accepted accounting principles in the United States (U.S. GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that they met broad control objectives of Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982" (FMFIA); (3) ensuring that Navy's financial management systems fully comply with Public Law 104-208, "Federal Financial Management Improvement Act of 1996" (FFMIA) requirements; and (4) complying with applicable laws and regulations.

Auditor's Responsibility

Our responsibility is to express an opinion on the basic financial statements based on conducting the audit in accordance with U.S. generally accepted government auditing standards and the Office of Management and Budget (OMB) Bulletin No. 14-02, "Audit Requirements for Federal Financial Statements," October 21, 2013. However, based on the matters described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Section 1008(d) of the FY 2002 National Defense Authorization Act limits the DoD Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Navy management asserted to us that Department of the Navy Working Capital Fund FY 2014 and FY 2013 Basic Financial Statements would not substantially conform to U.S. GAAP and that Navy financial management and feeder systems were unable to adequately support material amounts on the basic financial statements as of September 30, 2014. Accordingly, we did not perform all the auditing procedures required by generally accepted government auditing standards and OMB Bulletin 14-02 to determine whether material amounts on the basic financial statements were presented fairly. We considered the scope limitation in forming our conclusions on the basic financial statements.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we could not obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Department of the Navy Working Capital Fund FY 2014 and FY 2013 Basic Financial Statements. Thus, the basic financial statements may have undetected misstatements that are both material and pervasive.

Emphasis of Matter

As discussed in Note 9 to the basic financial statements, the Navy has elected to change its capitalization thresholds for General Property, Plant, and Equipment in FY 2014. We did not modify our opinion with respect to this matter.

Other Information in the Annual Financial Statements

We performed our audit to form an opinion on the basic financial statements as a whole. Navy management presented the Management's Discussion and Analysis, Required Supplementary Information, and Other Information for additional analysis as part of the annual financial statements; these elements are not required parts of the basic financial statements. Therefore, we do not express an opinion or provide any assurance on the information. We reviewed the other information for inconsistencies with the audited basic financial statements. Based on our limited review, we did not find any material inconsistencies between the information and the basic financial statements and applicable sections of OMB Circular No. A 136 (Revised), "Financial Reporting Requirements," September 18, 2014, and DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6b, "Form and Content of the Department of Defense Audited Financial Statements."

Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have direct and material effect on the basic financial statements, and compliance with OMB regulations and audit requirements for financial reporting because management represented that instances of noncompliance identified in prior audits continue to exist. Therefore, we did not determine whether the Navy complied with all applicable laws and regulations, contracts, and grant agreements related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations, contracts, and grant agreements was not an objective of our audit, and accordingly, we do not express such an opinion.

See Attachment for additional details on internal control and compliance with legal and other regulatory requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to Navy officials. However, they did not provide comments. Navy officials expressed their continuing commitment to address the problems this report outlines.

This report will be made publicly available pursuant to section 8M, paragraph (b)(1)(A) of the Inspector General Act of 1978, as amended. However, this report is intended solely for the information and use of Congress; the OMB; the U.S. Government Accountability Office; the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD; the Assistant Secretary of the Department of the Navy (Financial Management and Comptroller); and the DoD Office of Inspector General. It is not intended to be used and should not be used by anyone else.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 or (DSN) 329-5945.

Lorin T. Venable

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

Attachment: As stated

Report on Internal Control Over Financial Reporting

Internal Control Compliance

In planning our audit, we considered the Navy's internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances for the purposes of expressing our opinion on the basic financial statements, but not appropriate to the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on internal control over financial reporting.

Management Responsibilities

Management is responsible for implementing and maintaining effective internal control to include providing reasonable assurance that Navy personnel accumulated, recorded, and reported accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

Auditor's Responsibilities

Our purpose was not to express an opinion on internal control over financial reporting, and we do not do so. However, the following material weaknesses exist that could adversely affect the Navy's financial operations.

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continued. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Navy's financial statements will not be prevented, or detected and corrected on a timely basis. The following material weaknesses continue to exist.

Financial Management Systems. The Navy's financial management and feeder systems did not comply with Federal financial management system requirements, U.S. GAAP, and the U.S. Standard General Ledger (USSGL).

Financial Reporting of Order to Cash.

Reimbursable Work Order - Performer. The Navy's control environment was not designed or operating effectively to:

- verify whether the amount billed was valid and accurately recorded based on goods or services provided. Navy commands will be required to implement a monthly post-collection validation procedure.

- verify whether year-end accruals were accurately posted. The Navy will develop a central methodology to estimate and post payable accruals across its major commands.

- verify whether undelivered orders and accounts receivables represented valid transactions that were authorized and approved. Navy commands will implement a Triannual Review to monitor the status of dormant reimbursable agreement receivables and unfilled orders to validate whether a bona fide need still exists.

- verify whether unfilled reimbursable orders/authorizations were recorded completely and accurately. Navy commands will perform monthly reconciliations with trading partners to identify and track discrepancies through resolution.

- verify whether collections were processed completely, accurately, and in a timely manner. The Defense Finance and Accounting Service will implement a process to research all unmatched collections identified in the Unmatched Collection Database and resolve appropriately.

Financial Reporting of Operating Materials and Supplies. The Navy could not demonstrate the ability to consistently perform and document annual physical inventories of Operating Materials and Supplies and maintain clear audit trails to permit the tracing of transactions from source documentation to comply with well-established policy requiring source documentation for the reported Operating Materials and Supplies dollar values. Half of the Operating Materials and Supplies balance has been asserted to and is undergoing examination.

Additionally, in regard to Global Combat Support System-Marine Corps, multiple information technology control deficiencies were identified during a Federal Information System Controls Audit Manual audit to include application-level general controls, access control, interface, and configuration management controls. The Navy is developing a detailed corrective action plan for the Global Combat Support System-Marine Corps that will identify milestones required to remediate open notices of findings and recommendations.

Financial Reporting of General Equipment. The Navy could not establish or support ownership and valuation of General Equipment due to lack of supporting documentation, improper interpretation of guidance, underutilization of the Accounting System Record, and system limitations. In addition, the Navy could not substantiate that the Accounting System Record represented a complete inventory of General Equipment assets. Discovery efforts are ongoing; upon completion of discovery efforts, the Navy will perform existence and completeness testing for inventory.

Financial Reporting of Inventory. The Navy could not maintain accurate Moving Average Cost inventory values or clear audit trails by Accounting System Record to permit the tracing of transactions from the source documentation to the reported total dollar values on the Inventory line item on the Navy Working Capital Fund Financial Statements. The Navy implemented and deployed Navy Enterprise Resource Planning Single Supply Solution during FY 2013, and is in ongoing discussions to refine the procurement actions to support proper Moving Average Cost valuation.

Financial Reporting of Real Property. The Navy had insufficient standardized internal control and supporting documentation requirements, which ultimately had a direct impact on the timeliness and accuracy of Construction in Progress and Real Property transactions. The Navy will continue to test inventory.

Financial Reporting of Procure to Pay

Reimbursable Work Order - Grantor. The Navy's control environment was not designed or operating effectively to:

- verify that recorded disbursements were recorded and accurate. Navy commands will be required to implement a month-post disbursement validation procedure.

- validate the accuracy of year-end accruals. The Navy will develop a central methodology to estimate and post payable accruals across major commands.

- validate whether recorded reimbursable agreements represented a bona fide need. Navy commands will implement a Triannual Review to monitor the status of dormant reimbursable agreement commitments and obligations to determine if a bona fide need exists.

- validate whether recorded obligations were complete and accurate. Navy commands will perform a monthly reconciliation with trading partners to identify agreement discrepancies. Currently, the Navy executes reconciliations of material feeder systems to the general ledger.

Contract/Vendor Pay. The Navy's control environment was not designed or operating effectively to recognize unpaid accepted goods as a liability; therefore, balances recorded for delivered orders and unliquidated obligations were potentially understated. Navy commands will require authorized Government officials who are validating receipt and acceptance to confirm that appropriate acknowledgment is performed and acceptable supporting documentation is retained for auditability.

Financial Reporting of Military Standard Requisitioning and Issue Procedures

Visual Inter-fund System Transaction Accountability Validation. The Navy service provider, the Defense Finance and Accounting Service, had insufficient controls in place to validate the effectiveness of Visual Inter-fund System Transaction Accountability system functionality. The absence of these controls affect how a line of accounting to inter-fund bills that result in Military Standard Requisitioning and Issue Procedures obligations or payables and disbursements on the general ledger. In conjunction with the Defense Finance and Accounting Service, the Navy will review and prioritize Federal Information System Controls Audit Manual control testing for Visual Inter-fund System Transaction Accountability.

Unliquidated Obligations. The Navy internal control reconciliation process for unliquidated obligations was not designed to effectively monitor whether open Military Standard Requisitioning and Issue Procedures commitments and obligations represented a bona fide need. The Navy is creating a comprehensive process to reconcile unliquidated Military Standard Requisitioning and Issue Procedures obligations. This process is designed to allow a review of all dormant transactions, regardless of dollar thresholds or overage criteria.

Financial Reporting of Transportation of Things

Transportation Account Codes Authorization and Funds Validation. The Navy control environment was not designed or operating effectively to prevent unauthorized use of Transportation Account Codes or shipments from occurring. The Navy will continue to collaborate with the Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness working groups to develop solutions.

Access to Key Supporting Documentation. The Navy did not have standardized processes and procedures for Transportation of Things Key Supporting Documentation to support management evaluations, examinations, and audits. The Navy will continue to collaborate with Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness working groups to develop solutions.

Standardization of System and Data Requirements. The Navy's transportation and financial system interfaces did not support the exchange of all required transactional data. The Navy will continue to collaborate with Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness working groups to develop solutions.

Financial Statement Compilation and Reporting

Financial System, Schedule of Budgetary Activity. The Navy identified internal control design and operating effectiveness deficiencies in access controls, configuration management, audit and accountability, and identification and authentication. The Navy has developed metrics to monitor and manage system-specific remediation activities, and its Information Technology Financial Improvement and Audit Readiness assessment team is working closely with its

Chief Information Officer to identify the complete inventory of financially relevant systems and remediate identified control deficiencies.

These financial management control deficiencies may cause inaccurate management information. As a result, Navy management decisions based in whole or in part on this information may be adversely affected. Financial information reported by the Navy may also contain misstatements resulting from these deficiencies. Internal control work we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies. We did not identify material weaknesses that were not reported as such in the Navy's FMFIA report.

Report on Compliance With Applicable Provisions of Law, Regulations, Contracts, and Grant Agreements

U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for compliance with existing laws and regulations, contracts, and grant agreements related to financial reporting. Management has also acknowledged to us that previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Navy complied with selected provisions of all applicable laws and regulations, contracts, and grant agreements related to financial reporting. We caution that other noncompliance may have occurred and not been detected. Furthermore, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Because of other scope limitations discussed in this report, we limited our work to determining compliance with selected provisions of the applicable laws and regulations.

Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]), limits the Navy and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Navy or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As required by 31 U.S.C. § 1517 (2004), the Navy and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act, the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2014, the Navy reported four open Antideficiency Act violations.

Compliance With FFMIA Requirements

FFMIA requires the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level. For areas in which an agency is not in compliance, OMB A-136 requires the agency to identify remediation activities planned or underway to bring the systems into substantial compliance with FFMIA. The Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), Department of the Navy Chief Information Officer, Department of the Navy commands, Department of the Navy activities, and the Defense Finance and Accounting Service are jointly responsible for implementing and maintaining financial management systems that comply substantially with the Federal financial management system requirements in OMB Circular No. A-127, "Financial Management Systems," applicable U.S. GAAP, and the USSGL at the transaction level. Navy management states the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to comply substantially with the Federal financial management systems requirements, U.S. GAAP, and the USSGL at the transaction level. Navy has based its assessment on system requirements promulgated by OMB in Circular A-127 and by the Office of the Secretary of Defense through the DoD Business Enterprise Architecture laws, regulations, and policies. Navy staff recognizes that legacy systems were, in some cases, substantively not compliant and therefore did not perform system reviews for selected legacy systems.

For FY 2014, the Navy did not substantially comply with FFMIA. Navy officials acknowledged to us that Navy financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements and that previously identified material weaknesses continue. The financial management and feeder systems did not substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the USSGL at the transaction level as of September 30, 2014. Therefore, based on the representation of the Navy, we did not substantiate whether the Navy complied with FFMIA and OMB implementation guidance.

Recommendations

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

PRINCIPAL STATEMENTS

Department of the Navy General Fund

The fiscal year 2014 Department of the Navy (DON) General Fund principal 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 DON for the fiscal year ending September 30, 2014, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2013.

The following statements comprise the DON principal statements:

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

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.

The Independent Auditor's Report refers to the Department of the Navy (DON) financial statements as the Department of the Navy General Fund financial statements.

*Note that amounts may vary slightly due to rounding.

CONSOLIDATED BALANCE SHEET

As of September 30, 2014 and 2013

($ in Thousands)

	2014 Consolidated	2013 Consolidated
ASSETS:		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 142,729,631	$ 142,685,856
Investments (Note 4)	6,139	8,326
Accounts Receivable (Note 5)	235,932	280,871
Other Assets (Note 6)	500,122	467,313
Total Intragovernmental Assets	143,471,824	143,442,366
Cash and Other Monetary Assets (Note 7)	85,798	98,977
Accounts Receivable, Net (Note 5)	786,738	3,853,141
Inventory and Related Property, Net (Note 8)	73,096,348	75,063,235
General Property, Plant and Equipment, Net (Note 9)	280,388,363	269,951,986
Other Assets (Note 6)	50,306,289	50,709,475
TOTAL ASSETS	$ 548,135,360	$ 543,119,180
Stewardship Property, Plant and Equipment (Note 9) *		
LIABILITIES		
Intragovernmental:		
Accounts Payable (Note 11)	$ 1,856,469	$ 1,897,903
Other Liabilities (Note 13)	1,007,602	4,474,008
Total Intragovernmental Liabilities	2,864,071	6,371,911
Accounts Payable (Note 11)	(95,288)	398,830
Federal employee and Veteran Benefits (Note 15)	1,672,236	1,719,183
Environmental and Disposal Liabilities (Note 12)	21,713,730	21,663,602
Other Liabilities (Note 13)	8,676,235	8,614,364
TOTAL LIABILITIES	34,830,984	38,767,890
Commitments and Contingencies (Note 14) *		
NET POSITION		
Unexpended Appropriations - Other Funds	187,208,169	187,097,659
Cumulative Results of Operations - Dedicated Collections	27,545	27,762
Cumulative Results of Operations - Other Funds	326,068,662	317,225,869
TOTAL NET POSITION	513,304,376	504,351,290
TOTAL LIABILITIES AND NET POSITION	$ 548,135,360	$ 543,119,180

The accompanying notes are an integral part of the statements.
**Disclosure but no value required per Federal Accounting Standards*

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2014 and 2013

($ in Thousands)

	2014 Consolidated	2013 Consolidated
Program Costs		
Gross Costs		
Military Personnel	$ 45,976,699	$ 45,558,971
Operations, Readiness, & Support	58,799,793	60,652,956
Procurement	40,622,794	32,722,780
Research, Development, Test, & Evaluation	15,472,309	16,070,203
Family Housing & Military Construction	1,447,381	1,650,910
Less: Earned Revenue	(5,202,827)	(11,022,888)
Net Cost of Operations	$ 157,116,149	$ 145,632,932

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2014

($ in Thousands)

	2014 Dedicated Collections	2014 Other Funds	2014 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 27,762	$ 317,225,870	$ 317,253,632
Budgetary Financing Sources:			
Appropriations Used	-	159,389,292	159,389,292
Non-exchange Revenue	166	-	166
Donations & Forfeitures of Cash & Cash Equivalents	21,088	379	21,467
Transfers-In/Out without Reimbursement	-	431,514	431,514
Other Financing Sources:			
Donations and Forfeitures of Property	-	1,141	1,141
Transfers-In/Out without Reimbursement	-	(843,837)	(843,837)
Imputed Financing from Costs Absorbed by Others	-	782,721	782,721
Other	(8)	6,176,268	6,176,260
Total Financing Sources	21,246	165,937,478	165,958,724
Net Cost of Operations	21,463	157,094,686	157,116,149
Net Change	(217)	8,842,792	8,842,575
Cumulative Results of Operations	$ 27,545	$ 326,068,662	$ 326,096,207
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ -	$ 187,097,659	$ 187,097,659
Budgetary Financing Sources:			
Appropriations Received	-	164,106,520	164,106,520
Appropriations Transferred-In/Out	-	628,185	628,185
Other Adjustments (Rescissions, etc.)	-	(5,234,903)	(5,234,903)
Appropriations Used	-	(159,389,292)	(159,389,292)
Total Budgetary Financing Sources	-	110,510	110,510
Unexpended Appropriations	-	187,208,169	187,208,169
Net Position	$ 27,545	$ 513,276,831	$ 513,304,376

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2013

($ in Thousands)

	2013 Dedicated Collections	2013 Other Funds	2013 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	$ 29,156	$ 268,432,752	$ 268,461,908
Budgetary Financing Sources:			
Appropriations Used	-	157,318,575	157,318,575
Non-exchange Revenue	210	-	210
Donations & Forfeitures of Cash & Cash Equivalents	22,822	492	23,314
Transfers-In/Out without Reimbursement	-	10,500	10,500
Other Financing Sources:			
Donations and Forfeitures of Property	-	6,897	6,897
Transfers-In/Out without Reimbursement	-	(654,769)	(654,769)
Imputed Financing from Costs Absorbed by Others	-	746,117	746,117
Other	-	36,973,812	36,973,812
Total Financing Sources	23,032	194,401,624	194,424,656
Net Cost of Operations	24,426	145,608,506	145,632,932
Net Change	(1,394)	48,793,118	48,791,724
Cumulative Results of Operations	$ 27,762	$ 317,225,870	$ 317,253,632
UNEXPENDED APPROPRIATIONS			
Beginning Balances	$ -	$ 184,561,909	$ 184,561,909
Budgetary Financing Sources:			
Appropriations Received	-	174,139,345	174,139,345
Appropriations Transferred-In/Out	-	(666,067)	(666,067)
Other Adjustments (Rescissions, etc.)	-	(13,618,953)	(13,618,953)
Appropriations Used	-	(157,318,575)	(157,318,575)
Total Budgetary Financing Sources	-	2,535,750	2,535,750
Unexpended Appropriations	-	187,097,659	187,097,659
Net Position	$ 27,762	$ 504,323,529	$ 504,351,291

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2014 and 2013

($ in Thousands)

	2014 Combined	2013 Combined
Budgetary Resources:		
Unobligated Balance, Brought Forward, October 1	$ 33,316,125	$ 32,549,715
Recoveries of Prior Year Unpaid Obligations	9,670,220	11,866,228
Other Changes in Unobligated Balance	(1,872,092)	(1,955,989)
Unobligated Balance from Prior Year		
Budget Authority, Net	41,114,253	42,459,954
Appropriations	161,825,911	161,841,280
Spending Authority from Offsetting Collections	6,892,986	7,367,629
Total Budgetary Resources	$ 209,833,150	$ 211,668,863
Status of Budgetary Resources:		
Obligations Incurred	$ 174,587,531	$ 178,352,738
Unobligated Balance, End of Year		
Apportioned	29,251,281	28,231,804
Exempt from Apportionment	22,834	20,725
Unapportioned	5,971,504	5,063,596
Unobligated Balance Brought Forward, End of Year	35,245,619	33,316,125
Total Budgetary Resources	$ 209,833,150	$ 211,668,863
Change in Obligated Balance:		
Unpaid Obligations		
Unpaid Obligations, Brought Forward, October 1	$ 112,478,843	$ 112,927,456
Obligations Incurred	174,587,531	178,352,738
Outlays, Gross	(166,730,223)	(166,935,123)
Recoveries of Prior Year Unpaid Obligations	(9,670,220)	(11,866,228)
Unpaid Obligations, End of Year, Gross	110,665,931	112,478,843
Uncollected Payments		
Uncollected Payments from Federal Sources, Brought Forward, October 1	(3,229,494)	(2,629,802)
Change in Uncollected Payments from Federal Sources	(44,761)	(599,692)
Uncollected Payments from Federal Sources, End of Year	(3,274,255)	(3,229,494)
Obligated Balance, Start of Year	109,249,349	110,297,654
Obligated Balance, End of Year	$ 107,391,676	$ 109,249,349
Budget Authority and Outlays, Net:		
Budget Authority, Gross	$ 168,718,897	$ 169,208,909
Actual Offsetting Collections	(6,848,225)	(6,767,937)
Change in Uncollected Payments from Federal Sources	(44,761)	(599,692)
Budget Authority, Net	$ 161,825,911	$ 161,841,280
Outlays, Gross	$ 166,730,223	$ 166,935,123
Actual Offsetting Collections	(6,848,225)	(6,767,937)
Outlays, Net	159,881,998	160,176,186
Distributed Offsetting Receipts	(237,198)	(86,119)
Agency Outlays, Net	$ 159,644,800	$ 160,081,067

The accompanying notes are an integral part of the 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 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 DON in accordance with, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB); the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements;" and the Department of Defense (DoD), Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which DON is responsible unless otherwise noted.

Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernable.

The DON financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance and Accounting Service, Cleveland (DFAS-CL) collects information from the financial system and incorporates it into the financial statements for the DON. The DON collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL for incorporation into the financial statements. On behalf of the DON, DFAS-CL also collects information from multiple sources, such as intragovernmental data from the DON's trading partners, which is incorporated into the financial statements. The Defense Departmental Reporting System Data Collection Module (DDRS DCM) captures certain required financial information from non-integrated systems for the DON financial statements. The DDRS DCM identifies the information requirements to the source provider, and integrates data into the financial statement preparation process.

The DON is unable to fully implement all elements of USGAAP and the OMB Circular No. A-136, due to limitations of its financial and nonfinancial management processes and systems that support the financial statements. The DON derives reported values and information for major asset and liability categories largely from nonfinancial systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with USGAAP. The DON continues to implement process and system improvements addressing these limitations. The DON converted certain legacy systems to Navy Enterprise Resource Planning (ERP) and is developing plans to ensure accurate and complete financial records.

The Department of Defense Inspector General (DoDIG) issued an audit report dated December 9, 2013 and identified 11 financial statement material weaknesses: (1) Financial Management Systems; (2) Fund Balance with Treasury; (3) Accounts Receivable; (4) Other Assets; (5) Operating Materials and Supplies; (6) General Equipment, Real Property, and Military Equipment; (7) Accounts Payable; (8) Statement of Net Cost; (9) Problem Disbursements; (10) Unobligated Balances; (11) Statement of Changes in Net Position.

1.B. Mission of the Reporting Entity

The DON was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The overall mission of the DON is to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression, and maintaining freedom of the seas.

1.C Appropriations and Funds

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

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

These general funds also include supplemental funds enacted by the American Recovery and Reinvestment Act (Recovery Act) of 2009.

The National Defense Sealift Fund is the DON General Fund's only revolving fund. Revolving funds are generally established for carrying out specific activities. Revolving funds are financed through an appropriation or a transfer to establish a corpus and are replenished through charges made for goods or services without fiscal year limitations. The National Defense Sealift Fund receives an annual appropriation and has no corpus.

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

Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as funds from dedicated collections. Funds from dedicated collections are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The DON is required to separately account for and report on the receipt, use and retention of revenues and other financing sources for funds from dedicated collections.

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

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

Additionally, the DON receives allocation transfers from the EOP for the Foreign Military Financing Program (meeting the OMB exception), the International Military Education and Training Program, U.S. Forest Service, and the Federal Highway Administration. The activities for these funds are reported separately from the DoD financial statements and reported to the parent.

The DON receives allocation transfers for the Security Assistance programs that meet the OMB exception for EOP funds. These funds are reported separately from the DoD financial statements based on an agreement with OMB.

1.D. Basis of Accounting

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

Although the DON has not fully implemented accrual accounting, under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Under the budgetary basis, however, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

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

The DoD is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. DON activities currently use USGAAP compliant and non-compliant systems. Until all DON activities use USGAAP compliant systems, some financially reported data will be derived from existing transactional data.

The preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amount of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

1.E. Revenues and Other Financing Sources

The DON receives congressional appropriations as financing sources for general funds that expire annually, on a multi-year basis, or do not expire. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The DON recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full-cost pricing is the DON's standard policy for services provided as required by OMB Circular A-25, User Charges. The DON recognizes revenue when earned within the constraints of its current system capabilities. In some instances, revenue is recognized when bills are issued.

The DON does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 19, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

The DON records donations, in trust funds and special funds as nonexchange revenue in accordance with Statement of Federal Financial Accounting Standards (SFFAS) Number 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting."

1.F Recognition of Expenses

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

1.G. Accounting for Intragovernmental Activities

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

Treasury Financial Manual Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" provides guidance for reporting and reconciling intragovernmental balances. While the DON is unable to fully reconcile intragovernmental transactions with all federal agencies, the DON is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, FECA transactions with the U.S. Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management.

Imputed financing represents the costs paid behalf of the DON by another Federal entity. The DON recognizes imputed costs for (1) employee pension, post-retirement health, and life insurance benefits; (2) post-employment benefits for terminated and inactive employees to include unemployment and workers compensation under the Federal Employees' Compensation Act; (3) losses in litigation proceedings; and (4) military payroll for service members assigned to the DON.

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

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

1.H. Transactions with Foreign Governments and International Organizations

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

1.I Funds with the U.S. Treasury

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

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

1.J. Cash and Other Monetary Assets

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

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

The DON conducts a significant portion of operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations: (1) operations and maintenance; (2) military personnel; (3) military construction; (4) family housing operation and maintenance; and (5) family housing construction. The gains and losses are calculated as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The DON does not separately identify currency fluctuation transactions.

1.K Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. In accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities", the methodology for losses due to uncollectible amounts are based on an individual account analysis and/or group analysis. The analysis is based on three years of receivable data. This data is used to determine the historical percentage of collections in each age category of receivables. The DON does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Treasury Financial Manual Part 2, Chapter 4700, Appendix 10, "Intragovernmental Business Rules."

1.L. Inventories and Related Property

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

The DON uses both the consumption method and the purchase method of accounting for OM&S. The DON OM&S is categorized as operating materials and supplies held for use, operating materials and supplies held in reserve for future use (held for repair) (including munition not held for sale) and excess, obsolete and unserviceable operating material and supplies. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the DON uses the purchase method. Under this method, material and supplies are expensed when purchased. During FY 2014 and 2013, the DON expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the DoD and long-term system corrections are in the process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

DON OM&S assets held for use and held for repair use three cost valuation methods: Standard Price (SP), Latest Acquisition Cost (LAC), and Moving Average Cost (MAC). Excess, obsolete, and unserviceable OM&S are cost valued using Net Realizable Value pending development of an effective means of valuing such material. Currently these items are valued at a NRV of $0. The LAC method is used because legacy logistics systems were designed for material management rather than accounting purposes. Although these systems provide visibility and accountability over inventory and related property items, they do not maintain historical cost data necessary to comply with SFFAS No. 3. Additionally, these legacy inventory systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (FFMIA). The DON is continuing to transition OM&S to the MAC method. Most transitioned balances, however, were not baselined to auditable historical cost, and remain noncompliant with SFFAS No. 3.

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

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

The DON reports investments in accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities". The DON reports U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments using the effective interest rate method or another method obtaining similar results. The DON's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

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

1.N. General Property, Plant and Equipment

General Property, Plant and Equipment (PP&E) assets are capitalized in accordance with SFFAS No. 6, "Accounting for Property, Plant and Equipment", as amended by SFFAS Nos. 10, 23, and 35, when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD's capitalization threshold . The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DON depreciates all General PP&E, other than land and aircraft, on a straight-line basis in accordance with FMR Volume 4 Chapter 6. The DON's General PP&E capitalization threshold is $1 million. The capitalization threshold applies to asset acquisitions and modifications/improvements placed into service after September 30, 2013. PP&E assets acquired prior to October 1, 2013 were capitalized at prior threshold levels ($100 thousand equipment and $20 thousand for real property) and are carried at the remaining book value.

The DON uses a combination of actual expenditure data and program funding to calculate the value for PP&E in accordance with SFFAS No. 35. The DON is developing a process to track and record actual GE costs. The GE value is updated using expenditure, acquisition, and disposal information.

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

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

1.O. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy as prescribed in SFFAS No.1, "Accounting for Selected Assets and Liabilities" is to record advance or prepayments in accordance with USGAAP. As such, payments made prior to the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The DON has not implemented this policy primarily due to system limitations.

Due to inconsistencies in the posting logic for Nonfederal Advances and Prepayments, the DON is noncompliant with the FFMIA, which requires agencies to comply with the Federal financial management system requirements, standards promulgated by the FASAB, and the USSGL at the transaction level.

1.P. Leases

In accordance with SFFAS No. 5, "Accounting for Liabilities of the Federal Government", lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, DON records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The DON records the asset and the liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The DON, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are expensed over the lease term as they become payable.

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

1.Q. Other Assets

Other assets include those assets, such as military and civil service employee pay advances and certain contract financing payments that are not reported elsewhere on the DON's Balance Sheet. The DON maintains this classification in accordance with SFFAS No. 1.

Advances are cash outlays made by DON to its employees, contractors, or others to cover a part or all of the recipients' anticipated expenses. Military pay advances are advance payments authorized for purposes intended to ease hardships imposed by the lack of regular payments when a military member is mobilized, ordered to duty at distant stations, or deployed aboard ships for more than 30 days. Civilian pay advances are payments advanced to full time DON civilians intended to finance unusual employee expenses associated with oversea assignments that are not otherwise reimbursed and to aid foreign assignment recruitment and retention. Travel advances are disbursed to employees prior to business trips. Travel advances are subsequently reduced when travel expenses are actually incurred.

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

1.R. Contingencies and Other Liabilities

The DON is party to various administrative proceedings, legal actions, and claims. Under SFFAS No. 5, "Accounting for Liabilities of the Federal Government", as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation", the Balance Sheet should include estimated liabilities for these items when an adverse decision is probable, reasonably possible, and estimable. When the amount of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is remote, the contingency is not disclosed.

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

Other liabilities also arise as a result of anticipated disposal costs for the DON's assets. Consistent with SFFAS No. 6, "Accounting for Property, Plant and Equipment", recognition of an anticipated environmental disposal liability begins when the asset is placed into service. DON adheres to the DoD's policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of

Federal Government", and states that nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. The DoD recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

1.S. Accrued Leave

Military leave, compensatory and annual leave earned by civilians, but not yet used, is reported as accrued liabilities. The accrued balance is adjusted annually to reflect current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.T. Net Position

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

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

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

1.U. Treaties for Use of Foreign Bases

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

1.V. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported disbursement and collections may be evidenced by the availability of corroborating documentation that would generally support the summary-level adjustments made to accounts payable and receivable. Both supported and unsupported adjustments may have been made to the DON's Accounts Payable and Receivable trial balances prior to validating that the underlying transactions required to establish the Accounts Payable/Receivable were previously made. As a result, misstatements of reported Accounts and Receivables are likely present in the DON's financial statements.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD is generally unable to determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, the DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Both supported and unsupported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly.

1.W. Fiduciary Activities

Fiduciary cash and other assets are not assets of the DON and are not recognized on the balance sheet. Fiduciary activities are reported on the financial statement note schedules in accordance with SFFAS No. 31, "Accounting for Fiduciary Activities".

1.X. Federal Employee and Veteran Benefits

For financial reporting purposes, the DON's actuarial liability for worker's compensation benefits is developed by the Department of Labor and provide to the DON at the end of each fiscal year. Military retirement is accounted for in the audited financial statements of the Military Retirement fund; as the DON does not record any liabilities or obligations for pensions or healthcare retirement benefits.

NOTE 2. NONENTITY ASSETS

As of September 30		2014		2013
(Amounts in thousands)				
Intragovernmental Assets				
Fund Balance with Treasury	$	73,221	$	198,608
Cash and Other Monetary Assets		85,798		98,977
Accounts Receivable		334,280		3,710,658
Total Nonentity Assets	$	493,299	$	4,008,243
Total Entity Assets	$	547,642,061	$	539,110,937
Total Assets	$	548,135,360	$	543,119,180

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

Intragovernmental Fund Balance with Treasury

This nonentity asset category primarily represents amounts in DON's Suspense Funds, Withheld State and Local Taxes Fund, and Withheld Allotment of Compensation for Payment of Employee Organization Dues Fund.

Cash and Other Monetary Assets

This nonentity asset category represents disbursing officers' cash, foreign currency, and undeposited collections as reported on the Disbursing Officer's Statement of Accountability. These assets are held by DON disbursing officers on behalf of other agencies and are not available for DON's use in normal operations.

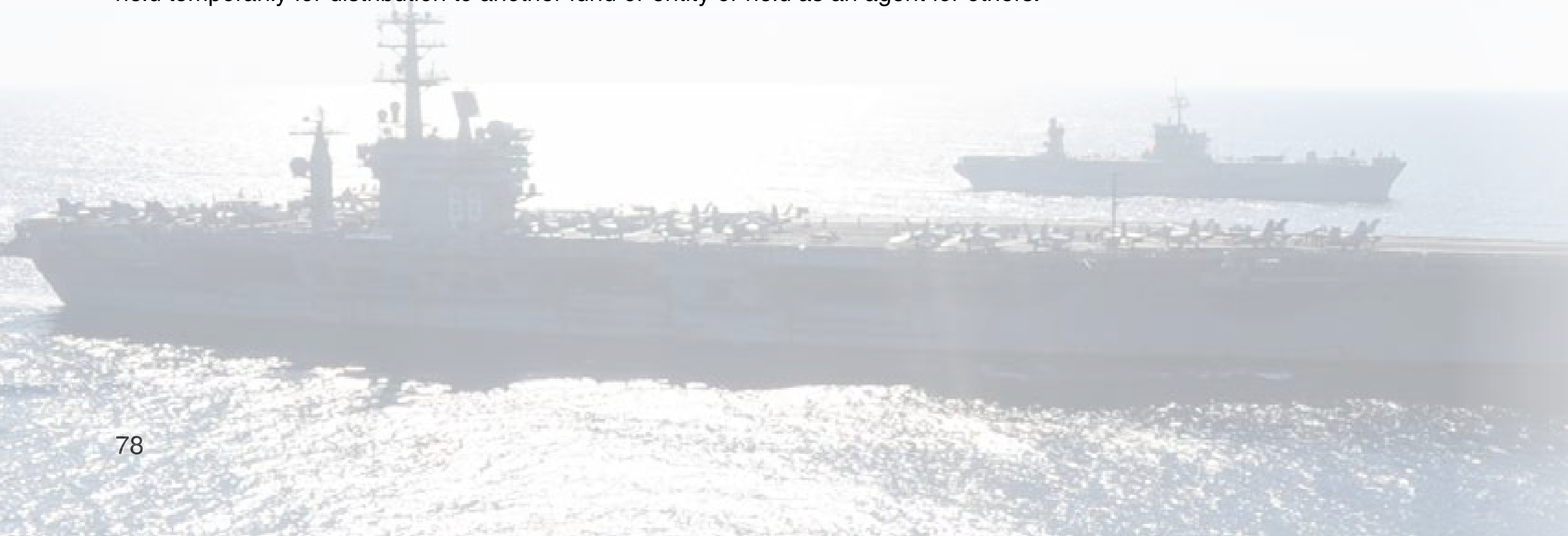
Nonentity Nonfederal Accounts Receivable (Public)

The primary components of nonentity accounts receivable are contractor debts owed to closed general fund accounts. The balance also includes out-of-service employee debts owed to closed general funds accounts, and interest, penalty, and administrative charges for all other public debts.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30		2014		2013
(Amounts in thousands)				
Fund Balances				
Appropriated Funds	$	142,177,547	$	141,795,951
Revolving Funds		429,771		667,591
Trust Funds		22,974		21,535
Special Funds		2,206		2,171
Other Fund Types		97,133		198,608
Total	$	142,729,631	$	142,685,856

Other Fund Types consists primarily of amounts in the following deposit and receipt accounts: General Fund Proprietary Receipts, Pay of the Navy Deposit Fund, and Pay of the Marine Corps Deposit Fund. These funds represent receipts held temporarily for distribution to another fund or entity or held as an agent for others.



STATUS OF FUND BALANCE WITH TREASURY

As of September 30	2014	2013
(Amounts in thousands)		
Unobligated Balance		
Available	$ 29,274,114	$ 28,252,529
Unavailable	5,972,843	5,066,166
Obligated Balance not yet Disbursed	110,665,931	112,478,843
Non-Budgetary FBWT	97,134	126,117
Non-FBWT Budgetary Accounts	(3,280,391)	(3,237,799)
Total	$ 142,729,631	$ 142,685,856

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

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

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

Non-budgetary FBWT includes accounts that do not have budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts and nonentity FBWT. For DON, Non-budgetary FBWT consists of balances in receipt accounts and clearing accounts.

Non-FBWT Budgetary Accounts reduces the Status of FBWT. This amount is comprised of Trust Fund investments in U.S. Treasury securities, unfilled customer orders without advance, and reimbursements receivable. Due to DON systems inability to segregate Budgetary FBWT balances, Non-FBWT Budgetary Accounts are used to reconcile the Status of FBWT.

OTHER

As of September 30	2014	2013
(Amounts in thousands)		
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	$ 142,839,569	$ 144,200,615
Fund Balance per DON	142,729,631	142,685,856
Reconciling Amount	$ 109,938	$ 1,514,759

The total reconciling amount of $110 million in FBWT is due to saving deposit program differences and parent-child transactions. The reconciling difference related to allocation transfers results from instances in which DON allocates to or is allocated funds from various governmental entities. In cases in which DON is allocated funds, the amount is excluded from the Fund Balance per DON, but included in Fund Balance per Treasury. In cases in which DON allocates funds, the amount is included in the Fund Balance per DON, but it is excluded from the Fund Balance per Treasury. See Note 21 Fiduciary Activities for further information regard the deposit funds.

NOTE 4. INVESTMENTS AND RELATED INTEREST

As of September 30	2014			
	Cost	**Amortized (Premium)/Discount**	**Investments, Net**	**Market Value Disclosure**
(Amounts in thousands)				
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	$ 6,140	$ (4)	$ 6,136	$ 6,139
Accrued interest	3	-	3	3
Total	$ 6,143	$ (4)	$ 6,139	$ 6,142

As of September 30	2013			
	Cost	**Amortized (Premium)/Discount**	**Investments, Net**	**Market Value Disclosure**
(Amounts in thousands)				
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	$ 8,333	$ (15)	$ 8,318	$ 8,319
Accrued Interest	8	-	8	8
Total	$ 8,341	$ (15)	$ 8,326	$ 8,327

Other Funds represents DON Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the Navy General Gift Fund. These investments are Nonmarketable Market-Based U.S. Treasury securities reported at cost, net of amortized premiums and discounts. In accordance with the SFFAS No. 27, "Identifying and Reporting Funds from Dedicated Collections", DON Trust Funds are reported as funds from dedicated collections.

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

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

NOTE 5. ACCOUNTS RECEIVABLE

As of September 30	2014		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
Intragovernmental Receivables	$ 235,932	$ N/A	$ 235,932
Nonfederal Receivables (From the Public)	798,751	(12,013)	786,738
Total	$ 1,034,683	$ (12,013)	$ 1,022,670

As of September 30	2013		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
Intragovernmental Receivables	$ 280,871	$ N/A	$ 280,871
Nonfederal Receivables (From the Public)	3,873,235	(20,094)	3,853,141
Total	$ 4,154,106	$ (20,094)	$ 4,134,012

The accounts receivable represent the DON's claim for payment from other entities. Intragovernmental Receivables primarily represents amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules. Refer to Note 2, Nonentity Assets for additional information on Nonfederal Accounts Receivable. Since the DON is at risk of not collecting on these public accounts receivable, the DON is recognizing an allowance for uncollectible amounts. The methodology used in determining the allowance amount is discussed in Note 1.K.

The DON is currently working on an effort to drive compliance with Office of Management and Budget (OMB) Circular A-11, Section 20.4(b)(4). Non-compliance results in unsupported departmental level adjustments which negatively impacts achievement of the DON's audit readiness goals for its Statement of Budgetary Resources. DON is partnering with DFAS to clarify guidance, resolve funding issues and standardize business practices. In addition, the DON and DFAS are aggressively pursuing collection mechanisms for amounts currently due from the public.

NOTE 6. OTHER ASSETS

As of September 30	2014	2013
(Amounts in thousands)		
Intragovernmental Other Assets		
Advances and Prepayments	$ 500,122	$ 467,313
Outstanding Contract Financing Payments	50,001,621	50,425,911
Advances and Prepayments	300,547	269,634
Other Assets (With the Public)	4,121	13,930
Total Nonfederal Other Assets	50,306,289	50,709,475
Total	$ 50,806,411	$ 51,176,788

Intragovernmental and nonfederal Other Assets - Advances and Prepayments

Advances are cash outlays made by a federal entity to cover a part or all of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity receives. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.

Nonfederal Other Assets - Outstanding Contract Financing Payments (OCFP)

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Government that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DON is not obligated to make payment to the contractor until delivery and acceptance. Some of the amounts reported as OCFP may be progress payments based on percentage or stage of completion. However, DON is unable to identify these due to system limitations and all amounts are reported as OCFP.

The balance of OCFP includes $48.5 billion in contract financing payments and an additional $1.5 billion in estimated future payments to contractors upon delivery and government acceptance of a satisfactory product. (See additional discussion in Note 13, Other Liabilities).

Nonfederal Other Assets - Other Assets (With the Public)

Other Assets (With the Public) includes advance pay to DON military personnel, travel advances to military and civilian personnel, and miscellaneous advances to contractors that are not considered outstanding contract financing payments.

NOTE 7. CASH AND OTHER MONETARY ASSETS

As of September 30	2014	2013
(Amounts in thousands)		
Cash	$ 57,400	$ 71,703
Foreign Currency	28,398	27,274
Total	$ 85,798	$ 98,977

Cash and Foreign Currency consist primarily of cash held by DON Disbursing Officers to carry out their payment, collection, and foreign currency accommodation exchange mission. Foreign Currency is also held in overseas banks in support of contingency operations. The primary source of the amounts reported is the Disbursing Officers Statements of Accountability.

Total Cash, Foreign Currency, and Other monetary assets reported are nonentity assets that are not available for DON's use in normal operations. Therefore, the entire Cash and Foreign Currency balance is restricted as to its use.

NOTE 8. INVENTORY AND RELATED PROPERTY

As of September 30	2014	2013
(Amounts in thousands)		
Inventory, Net	$ -	$ 46
Operating Material & Supplies, Net	73,096,348	75,063,189
Total	$ 73,096,348	$ 75,063,235

INVENTORY AND RELATED PROPERTY

As of September 30	2014			
	OM&S Gross Value	**Revaluation Allowance**	**OM&S, Net**	**Valuation Method**
(Amounts in thousands)				
OM&S Categories				
Held for Use	$ 63,477,958	$ -	$ 63,477,958	SP, LAC, MAC
Held for Repair	9,619,497	(1,107)	9,618,390	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,313,347	(1,313,347)	-	NRV
Total	$ 74,410,802	$ (1,314,454)	$ 73,096,348	

As of September 30	2013			
	OM&S Gross Value	**Revaluation Allowance**	**OM&S, Net**	**Valuation Method**
(Amounts in thousands)				
OM&S Categories				
Held for Use	$ 67,741,862	$ (8,704)	$ 67,733,158	SP, LAC, MAC
Held for Repair	7,341,940	(11,909)	7,330,031	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,467,965	(1,467,965)	-	NRV
Total	$ 76,551,767	$ (1,488,578)	$ 75,063,189	

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

The DON assigns OM&S to a category based upon the type and condition of the asset. OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. OM&S Held for Use includes spare and repair parts, clothing and textiles, petroleum products and material held in reserve for future use. OM&S Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal.

The consumption method is applied when accounting for OM&S. Exceptions to the consumption method are provided when (1) the OM&S are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost beneficial to apply the consumption method. In any of these events, the purchase method is allowed. Legacy accounting systems cannot support the consumption method of accounting, thus the various reporting activities are currently using the purchase method. As financial reporting entities begin to purchase material in Navy ERP, the consumption method will be properly applied.

The MAC valuation method using historical cost is used for a majority of the OM&S categories; however actual cost and LAC cost are also valuation methods applied depending on the legacy inventory system used to forecast OM&S cost. The DON is currently using the allowance method of accounting for repairables in the legacy accounting system and the direct method of accounting for repairables in Navy ERP.

Ammunition and Munitions are maintained in the DON Ordnance Information System and valued at latest acquisition cost.

Principal end and secondary items include OM&S such as shipboard hull, mechanical and electronic equipment, and uninstalled aircraft engines. They are items of such importance that central inventory control is required to provide the readiness of the material for the Fleet. These items possess one of the following characteristics: essential for combat or training; high dollar value; difficult to procure or produce; or critical basic material or component parts. Principal end and secondary items are valued at MAC.

Other OM&S consists primarily of material held by the Bureau of Medicine and Surgery Fleet Hospitals and War Reserve material in possession of the U.S. Coast Guard.

NOTE 9. GENERAL PP&E, NET

As of September 30	2014				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
(Amounts in thousands)					
Major Asset Classes					
Land	N/A	N/A	$ 768,543	$ N/A	$ 768,543
Buildings, Structures, and Facilities	S/L	20 or 40	50,660,637	(26,626,008)	24,034,629
Leasehold Improvements	S/L	lease term	6,530	(3,338)	3,192
Software	S/L	2-5 or 10	5,341	(2,758)	2,583
General Equipment	S/L	Various	462,975,102	(221,070,895)	241,904,207
Construction-in-Progress	N/A	N/A	12,799,329	N/A	12,799,329
Other			875,880	-	875,880
Total General PP&E			$ 528,091,362	$ (247,702,999)	$ 280,388,363

As of September 30	2013				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
(Amounts in thousands)					
Major Asset Classes					
Land	N/A	N/A	$ 659,876	$ N/A	$ 659,876
Buildings, Structures, and Facilities	S/L	20 or 40	46,837,512	(25,252,572)	21,584,940
Leasehold Improvements	S/L	lease term	6,530	(3,014)	3,516
Software	S/L	2-5 or 10	5,763	(2,166)	3,597
General Equipment	S/L	5 or 10	17,540,068	(9,981,526)	7,558,542
Military Equipment	S/L	Various	430,595,909	(201,884,661)	228,711,248
Construction-in-Progress	N/A	N/A	10,410,579	N/A	10,410,579
Other			1,019,688	-	1,019,688
Total General PP&E			$ 507,075,925	$ (237,123,939)	$ 269,951,986

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

The DON has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow DON continued use of these properties until the treaties expire. There are no other known restrictions on General PP&E.

As a result of audit readiness efforts, adjustments had to be made to mission critical asset balances that resulted from events that could not be identified to specific accounting periods, and that those adjustments were made against current year gain/loss accounts. Significant accounting adjustments have been made to the DON's mission critical assets as a result of the Department's ongoing audit readiness efforts. These accounting adjustments were recognized in current year gain/loss accounts when auditable data was not available to support restatement of prior period financial statements.

For FY 2014 the DoD combined Military Equipment (ME), previously reported as a separate line item for general property plant and equipment, and General Equipment (GE) into a single category entitled "General Equipment." The capitalization threshold for GE has increased from $100 thousand to $1 million. This change is prospective and applies to asset acquisitions and modifications/improvements placed into service October 1, 2013 and after.

The DON estimates values for Capitalized General Equipment using department internal records such as budgetary information for aircraft and expenditure data for ships. Currently, the DON is not reporting the construction of General Equipment in the appropriate Construction-in-Progress account. The DON is reporting the value of the construction of its General Equipment as an Advance.

Other General PP&E consists of Real Property held in Caretaker Status. Caretaker is defined as those properties that Navy still owns, but which are being held awaiting further disposal action to another entity, such as Defense Base Closure and Realignment Commission (BRAC) property awaiting sale or transfer to another Federal agency. As of

September 30, 2014 the accumulated depreciation related to these assets in Caretaker status are currently included in the total accumulated depreciation of Buildings, Structures and Facilities still in service and is unknown at this time. The DON is researching the dollar value of depreciation expenses related to these assets.

Heritage Assets

As of September 30	Measure Quantity	As of September 30, 2013	Addition	Deletions	As of September 30, 2014
Categories					
Building and Structures	Each	10,035	-	-	10,035
Archaeological Sites	Each	18,534	-	-	18,534
Museum Collection Items (Objects, Not Including Fine Art)	Each	516,114	532	(5,109)	511,537
Museum Collection Items (Objects, Fine Art)	Each	42,642	857	(1)	43,498

As of September 30		As of September 30, 2013	Additions	Deletions	As of September 30, 2014
Facility Code	**Facility Title**				
9110	Government Owned Land	5	-	-	5
9120	Withdrawn Public Land	2,722	-	-	2,722
9130	Licensed and Permitted Land	26	-	-	26
				Grand Total	2,753
				TOTAL - All Other Lands	31
				TOTAL - Stewardship Lands	2,722

Heritage Assets and Stewardship Land

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

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

Buildings and Structures. Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets.

Archeological Sites. Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Historical Places in accordance with Section 110 National Historical Preservation Act.

Museum Collection Items. Items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics.

The Marine Corps continues to make updates to their Heritage Asset beginning balances as a result of audit findings.

The DON's stewardship land consists mainly of mission essential land acquired by donation or devise. The DON held the above acres of land as of September 30, 2014

The overall mission of DON is to control and maintain freedom of the seas, project power beyond the sea, and influence events and advance U.S. interests across the full spectrum of military operations. As this mission has been executed, DON has become a large-scale owner of historic buildings, structures, districts, archeological sites and artifacts, ships, aircraft, other cultural resources, and several hundred installations to include stewardship land. Protection of these components of the nation's heritage assets and stewardship land is an essential part of DON's mission; DON is committed to responsible cultural resources stewardship.

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30	2014	2013
(Amounts in thousands)		
Intragovernmental Other Liabilities	$ 433,485	$ 476,783
Accounts Payable	(16,221)	4,725
Federal Employee and Veteran Benefits	1,671,680	1,718,646
Environmental and Disposal Liabilities	21,713,730	21,663,602
Other Liabilities	4,461,320	4,501,869
Total Liabilities Not Covered by Budgetary Resources	28,263,994	28,365,625
Total Liabilities Covered by Budgetary Resources	6,566,990	10,402,265
Total Liabilities	$ 34,830,984	$ 38,767,890

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through Congressional appropriations or earnings of the entity.

Intragovernmental Other Liabilities consist primarily of unfunded FECA liabilities due to the Department of Labor and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

Nonfederal Liabilities

Accounts payable not covered by budgetary resources is related to cancelled year accounts payable that are not budgeted. Military Retirement and Other Federal Employment Benefits consist of unfunded FECA actuarial liabilities not due and payable during the current fiscal year. Refer to Note 15, Federal Employee and Veteran Benefits, for additional details.

Environmental liabilities are estimates related to future events, and consist of liabilities related to active installations, Defense Base Closure and Realignment Commission sites, equipment and weapons programs, and chemical weapons disposal. See Note 12, Environmental and Disposal Liabilities, for additional details.

Other Liabilities include annual leave, estimated legal contingent liabilities, and the disposal of excess structures that are not currently budgeted for but will become funded as future events occur.

The Nonfederal Liabilities Accounts Payable abnormal balance is attributable to the differences between DCAS and field level disbursements.

NOTE 11. ACCOUNTS PAYABLE

As of September 30	2014		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
Intragovernmental Payables	$ 1,856,469	$ N/A	$ 1,856,469
Nonfederal Payables (to the Public)	(95,328)	40	(95,288)
Total	$ 1,761,141	$ 40	$ 1,761,181

As of September 30	2013		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
Intragovernmental Payables	$ 1,897,903	$ N/A	$ 1,897,903
Nonfederal Payables (to the Public)	398,830	-	398,830
Total	$ 2,296,733	$ -	$ 2,296,733

Accounts Payable includes amounts owed to federal and nonfederal entities for goods and services received by the DON. The DON's systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side accounts payable are adjusted to agree with interagency seller-side accounts receivable. This is accomplished by 1) reclassifying amounts between federal and nonfederal cost categories, 2) accruing additional accounts payable and expenses, and 3) applying both supported and unsupported undistributed disbursements at the reporting entity level.

The Nonfederal Liabilities Accounts Payable abnormal balance is attributable to the differences between DCAS and field level disbursements.

NOTE 12. ENVIRONMENTAL LIABILITIES AND DISPOSAL LIABILITIES

As of September 30	2014	2013
(Amounts in thousands)		
Environmental Liabilities–Nonfederal		
Accrued Environmental Restoration Liabilities		
Active Installations - Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 2,592,934	$ 2,609,056
Active Installations - Military Munitions Response Program (MMRP)	2,008,440	2,041,359
Other Accrued Environmental Liabilities - Non-BRAC		
Environmental Corrective Action	54,664	56,959
Environmental Closure Requirements	381,188	378,647
Environmental Response at Operational Ranges	13,530	13,305
Asbestos	304,423	308,480
Non-Military Equipment	537,247	541,000
Other	733	764
Base Realignment and Closure Installations		
Installation Restoration Program	1,206,824	1,362,309
Military Munitions Response Program	118,540	114,019
Environmental Corrective Action / Closure Requirements	30,403	13,894
Environmental Disposal for Military Equipment/Weapons Programs		
Nuclear Powered Military Equipment / Spent Nuclear Fuel	14,325,374	14,076,334
Other Weapons Systems	139,430	147,476
Total	$ 21,713,730	$ 21,663,602

The above table excludes estimated total cleanup costs associated with General Property, Plant, and Equipment of $2.7 billion for FY 2014 and $2.8 billion for FY 2013.

The Other under Other Accrued Environmental Costs represents an environmental estimate for disposal of Polychlorinated Biphenyls (PCB) transformers located at various Naval installations.

In addition to the liabilities reported above, the DON has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The DON is unable to provide a reasonable estimate at this time because the extent of restoration required is not known.

Applicable Laws and Regulations for Cleanup Requirements

The following is a list of significant laws that affect DON's conduct of environmental policy and regulations:

- The Resource Conservation and Recovery Act of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984
- Superfund Amendments and Reauthorization Act of 1986
- The Clean Water Act of 1977, amended the Federal Water Pollution Control Act
- The Safe Drinking Water Act of 1974
- The Clean Air Act, as amended in 1990
- The Atomic Energy Act of 1954
- The Nuclear Waste Policy Act of 1982
- The Low Level Radioactive Waste Policy Amendments Act of 1986
- The National Environmental Policy Act of 1969
- Comprehensive Environmental Response, Compensation, and Liability Act
- Medical Waste Tracking Act of 1988
- Toxic Substances Control Act of 1976
- Resource Conversation and Recovery Act of 1976

Methods for Assigning Total Cleanup Costs to Current Operating Periods

<u>Active Installations - Defense Environmental Restoration Program (DERP) Funded</u>: Accrued DERP cleanup liabilities represent the cost to correct past releases of hazardous constituents to Property, Plant, and Equipment, including acquired land and Stewardship Land. Environmental cleanup of past releases is funded by DERP and carried out under applicable regulatory laws and procedural guidance.

Environmental restoration activities may be conducted at operating installations under the Installation Restoration Program (IRP) and at Closed, Transferred, and Transferring Munitions Ranges under the Military Munitions Response Program (MMRP). Determining total environmental cleanup cost considers, on a current cost basis, the anticipated actions required to complete the cleanup, as well as applicable legal and/or regulatory requirements. Program management and support costs are also included in the estimates. The estimate produced is based on site-specific information and use of cost models. The cost estimates are developed and maintained in DON's Normalization of Data System (NORM) database. Such cost estimates are based on the current technology available.

MMRP liabilities are specific to the identification, investigation, 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. Cost to Complete (CTC) is not estimated until there is sufficient site-specific data available to estimate the total CTC. However, DON uses the cost of the study as the estimate until the study is completed.

The accrued environmental restoration 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.

Environmental Disposal for Weapons Systems Programs: This area represents environmental liabilities associated with the Nuclear Powered Aircraft Carriers and Submarines, Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. During FY 2006, under the DON Financial Improvement Program (FIP), DON completed a review of the estimating methodology for determining the cost for disposal of ships and submarines. This review resulted in an environmental and non-environmental liability estimate that more accurately reflects the true costs of disposal. The estimating methodology is based on average cost per class of ship rather than an average applied to all ships regardless of class.

Description of the Types of Environmental Liabilities and Disposal Liabilities

Accrued Environmental Restoration Liabilities

The DON environmental cleanup cost estimate was based on 3,919 IRP and 365 MMRP sites at 207 active installations. As of September 30, 2014, DON estimated and reported $4.6 billion for environmental restoration liabilities. This amount is comprised of $2.6 billion in Active Installations-IRP liabilities and $2.0 billion in Active Installations-MMRP liabilities.

Other Accrued Environmental Liabilities – Non-BRAC

The DON defines Non-BRAC environmental units as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retro fill, and/or disposal of PCB transformers, underground storage tank remedial investigation and closure.

Base Realignment and Closure Installations

BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated BRAC process. As of September 30, 2014, DON has estimated and reported $1.3 billion for BRAC funded environmental liabilities. This amount includes $1.2 billion for IRP, $0.1 billion for MMRP, and $0.03 billion for environmental corrective action and closure requirements. MMRP includes military munitions, chemical residues from military munitions, and munitions scrap at locations on a BRAC installation.

Environmental Disposal for Military Equipment / Weapons Programs

Environmental Disposal for Weapons Systems are those estimates associated with the environmental disposal costs for DON Nuclear Weapons Programs that include Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel.

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

Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of September 30, 2014, there are no changes to the environmental liability estimates due to changes in laws, regulations, and agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

Description of the Level of Uncertainty Regarding the Accounting Estimates used to calculate the Reported Environmental Liabilities

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

The DON tangible property, plant, and equipment contains nonfriable asbestos. At this time the DON is unable to reasonably estimate the clean-up costs but is working to estimate these costs.

NOTE 13. OTHER LIABILITIES

As of September 30	2014		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
Intragovernmental			
Advances from Others	$ 110,448	$ -	$ 110,448
Disbursing Officer Cash	87,272	-	87,272
Judgment Fund Liabilities	12,925	-	12,925
FECA Reimbursement to the Dept of Labor	154,276	186,642	340,918
Custodial Liabilities	332,806	-	332,806
Employer Contribution and Payroll Taxes Payable	43,379	-	43,379
Other Liabilities	79,854	-	79,854
Total Intragovernmental	820,960	186,642	1,007,602
Accrued Funded Payroll and Benefits	1,653,698	-	1,653,698
Advances from Others	727,380	-	727,380
Deposit Funds and Suspense Accounts	97,134	-	97,134
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	151,795	73,927	225,722
Excess/Obsolete Structures	63,780	277,424	341,204
Accrued Unfunded Annual Leave	2,997,339	-	2,997,339
Contract Holdbacks	234,931	40	234,971
Employer Contribution and Payroll Taxes Payable	20,866	-	20,866
Contingent Liabilities	22,438	2,338,812	2,361,250
Other Liabilities	16,671	-	16,671
Total Other Liabilities	$ 6,806,992	$ 2,876,845	$ 9,683,837

As of September 30	2013		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
Intragovernmental			
Advances from Others	$ 150,533	$ -	$ 150,533
Disbursing Officer Cash	100,883	-	100,883
Judgment Fund Liabilities	771	-	771
FECA Reimbursement to the Dept of Labor	165,467	193,509	358,976
Custodial Liabilities	3,708,752	-	3,708,752
Employer Contribution and Payroll Taxes Payable	36,736	-	36,736
Other Liabilities	117,357	-	117,357
Total Intragovernmental	4,280,499	193,509	4,474,008
Accrued Funded Payroll and Benefits	1,528,567	-	1,528,567
Advances from Others	526,004	-	526,004
Deposit Funds and Suspense Accounts	198,608	-	198,608
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	161,461	63,107	224,568
Excess/Obsolete Structures	79,243	218,880	298,123
Accrued Unfunded Annual Leave	3,000,903	-	3,000,903
Contract Holdbacks	516,623	-	516,623
Employer Contribution and Payroll Taxes Payable	23,703	-	23,703
Contingent Liabilities	21,115	2,276,229	2,297,344
Other Liabilities	(79)	-	(79)
Total Other Liabilities	$ 10,336,647	$ 2,751,725	$ 13,088,372

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

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

Disbursing Officers Cash represents liabilities for currency on hand, cash on deposit at designated depositories, cash in the hands of depositories, cash in the hands of deputy disbursing officers, cashiers and agents, negotiable instruments on hand, etc.

Custodial Liabilities represent liabilities for collections reported as nonexchange revenues where Don is act on behalf of another Federal entity.

Intragovernmental Other Liabilities consists primarily of Unemployment Compensation unfunded liabilities.

Contingent Liabilities includes $1.5 billion related to contracts authorizing progress payments based on cost as defined in the FAR. In accordance with contract terms, specific rights to the contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. It is DoD policy that these rights should not be misconstrued as rights of ownership. The DON is under no obligation to pay contractors for amounts greater than the amounts of progress payments authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but not yet paid are estimable, the DON has recognized a contingent liability for the estimated unpaid costs that are considered conditional for payment pending delivery and government acceptance.

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

NOTE 14. COMMITMENTS AND CONTINGENCIES

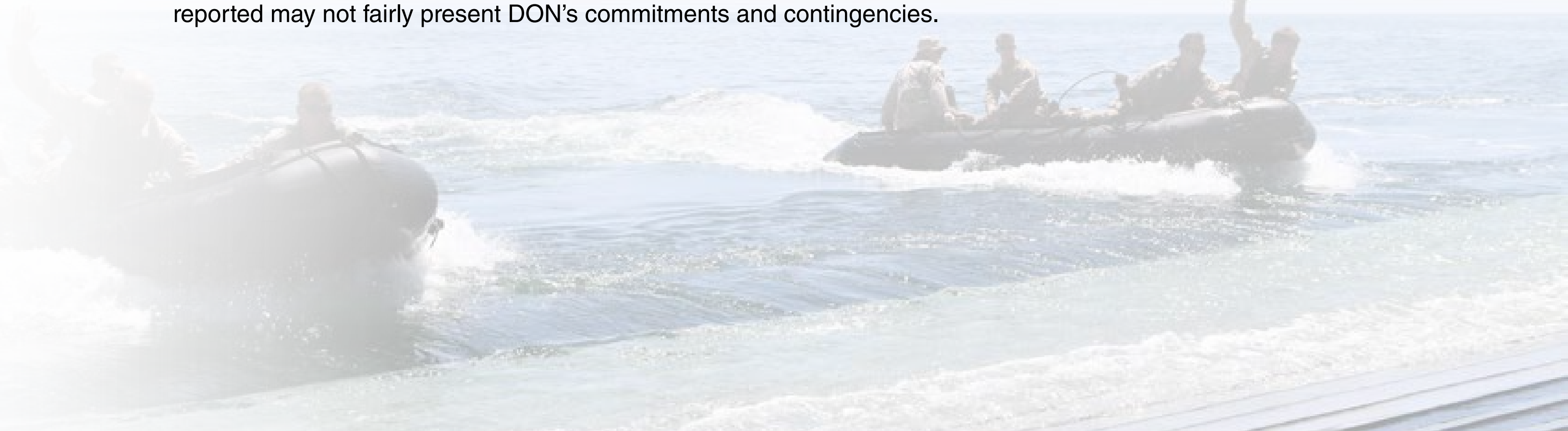
The DON is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown.

The DON has accrued contingent liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Federal Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The DON records contingent liabilities in Note 13, Other Liabilities.

For FY 2014, DON materiality threshold for reporting litigation, claims, or assessments is $60 million. The DON OGC conducts a review of litigation and claims threatened or asserted involving DON to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The DON currently has 13 cases that meet the existing FY 2014 materiality threshold. DON legal counsel was unable to express an opinion concerning the likely outcome on 9 of 13 cases.

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



NOTE 15. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30	2014					
		Liabilities		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
(Amounts in thousands)						
Other Benefits						
FECA	$	1,671,680	$	-	$	1,671,680
Other		556		(556)		-
Total Other Benefits	$	1,672,236	$	(556)	$	1,671,680
Total	$	1,672,236	$	(556)	$	1,671,680

As of September 30	2013					
		Liabilities		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
(Amounts in thousands)						
Other Benefits						
FECA	$	1,718,646	$	-	$	1,718,646
Other		537		(537)		-
Total Other Benefits	$	1,719,183	$	(537)	$	1,718,646
Total	$	1,719,183	$	(537)	$	1,718,646

The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

Actuarial Cost Method Used and Assumptions

The DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON only at the end of each fiscal year.

The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The 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.

NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

As of September 30		2014		2013
(Amounts in thousands)				
Intragovernmental Costs	$	46,055,025	$	46,766,773
Nonfederal Cost		116,263,951		109,889,047
Total Cost	$	162,318,976	$	156,655,820
Intragovernmental Revenue	$	(2,756,334)	$	(2,951,971)
Nonfederal Revenue		(2,446,493)		(8,070,917)
Total Revenue	$	(5,202,827)	$	(11,022,888)
Total Net Cost	$	157,116,149	$	145,632,932

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The DoD's current processes and systems capture costs based on appropriations groups as presented in the schedule above. The lower level costs for major programs are not present as required by the Government Performance and Results Act (GPRA). The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the SFFAS No. 4,"Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 30, "Inter-entity Cost Implementation."

Intragovernmental costs and revenue represent transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity.

The DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP for federal agencies. Most of DON's legacy systems were designed to record information on a budgetary basis and do not track intragovernmental transactions by customer at the transaction level. Considering these systems limitations, DON is unable to accurately compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental trading partners. Buyer-side accounts payable and expenses were adjusted to match seller-side accounts receivable and revenues. This is accomplished by reclassifying amounts between federal and public cost categories, and accruing additional costs when necessary. Intradepartment revenues and expenses are then eliminated.

In conjunction with the DoD, DON has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of USGAAP. One such action is the revision of its accounting systems to record transactions based on the U.S. Standard General Ledger. Until such time as all of the DON's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by USGAAP, DON's financial data will be largely based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

The DON's accounting systems generally do not capture information relative to Heritage Assets separately and distinctly from normal operations. The DON is unable to separately identify the cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets.

NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

Unexpended Appropriations represents the amount of spending authorized as of year-end that is unliquidated or unobligated and has not lapsed, been rescinded, or withdrawn.

Cumulative Results of Operations represents the net results of operations since inception. Included as a reduction in Cumulative Results of Operations are accruals for which related expenses require funding from future appropriations. These future funding requirements include, among others (a) accrued annual leave earned but not taken, (b) expenses for contingent liabilities and (c) expenses for environmental liabilities.

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $2.3 billion is due to certain cash receipts recorded as "Appropriations Received" on the SBR but recognized as exchange or non-exchange revenue (usually in special and trust fund accounts) and reported on the SCNP in accordance with SFFAS 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting". See Note 18, Disclosures Related to the Statement of Budgetary Resources for further information.

Other Financing Sources - Other consists primarily of gains and losses associated with General Equipment, Operating Materials & Supplies, and Real Property.

In accordance with SFFAS 43, "Funds from Dedicated Collection: Amending Statement of Federal Financial Accounting Standards 27, "Identifying and Reporting Earmarked Funds", the Department has elected to display a combined presentation of the nonexchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated with all other funds, see Note 20 Funds from Dedicated Collections for additional discussion regarding dedicated collections.

NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

Intragovernmental Costs and Exchange Revenue *As of September 30*	2014	2013
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 156,501,742	$ 158,004,011

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

Apportionment Categories for Obligations Incurred

The direct and reimbursable obligations under Categories A, B and Exempt from apportionment are reported in the table below. Apportionment categories are determined in accordance with the guidelines provided in Part 4 "Instructions on Budget Execution" of OMB Circular A-11 Preparation, Submission and Execution of the Budget. Category A represents resources apportioned for calendar quarters and Category B represents resources apportioned for other time periods or for activities, projects, objectives or for a combination thereof.

DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30	2014		
	Direct Obligations	Reimbursable Obligations	Total
(Amounts in thousands)			
Obligations Apportioned Under			
Category A	$ 103,643,844	$ -	$ 103,643,844
Category B	63,833,150	7,074,722	70,907,872
Exempt	20,192	-	20,192
Total	$ 167,497,186	$ 7,074,722	$ 174,571,908

As of September 30	2013		
	Direct Obligations	Reimbursable Obligations	Total
(Amounts in thousands)			
Obligations Apportioned Under			
Category A	$ 102,947,024	$ -	$ 102,947,024
Category B	68,493,629	7,116,649	75,610,278
Exempt	23,950	-	23,950
Total	$ 171,464,603	$ 7,116,649	$ 178,581,252

Permanent, Indefinite Appropriations

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 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 U.S.; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet, including the acquisition, alteration or conversion of vessels. There were no transfers in or out of NDSF during this period.

The Environmental Restoration, Navy (ER, N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. There were two transfers from ER, N for $316 million to the Operation and Maintenance, Navy appropriation. There were no transfers into ER, N during this period.

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. Please refer to Note 17, Disclosures Related to the Statement of Changes in Net Position.

NOTE 19. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30	2014	2013
(Amounts in thousands)		
Resources Used to Finance Activities		
Budgetary Resources Obligated:		
Obligations Incurred	$ 174,587,531	$ 178,352,738
Less: Spending Authority from Offsetting Collections and Recoveries	(16,343,807)	(19,223,668)
Obligations Net of Offsetting Collections and Recoveries	158,243,724	159,129,070
Less: Offsetting Receipts	(237,198)	(86,119)
Net Obligations	158,006,526	159,042,951
Other Resources:		
Donations and Forfeitures of Property	1,141	6,897
Transfers In/Out without Reimbursement	(843,837)	(654,769)
Imputed Financing from Costs Absorbed by Others	782,721	746,117
Other	6,176,260	36,973,812
Net Other Resources Used to Finance Activities	6,116,285	37,072,057
Total Resources Used to Finance Activities	$ 164,122,811	$ 196,115,008
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided:		
Undelivered Orders	$ (8,635,773)	$ (3,189,785)
Unfilled Customer Orders	317,991	518,632
Resources that Fund Expenses Recognized in Prior Periods	(435,814)	(730,359)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	237,198	86,119
Resources that Finance the Acquisition of Assets	(12,379,394)	(15,379,331)
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations:		
Other	(5,552,963)	(36,336,129)
Total Resources Used to Finance Items not part of the Net Cost of Operations	$ (26,448,755)	$ (55,030,853)
Total Resources Used to Finance the Net Cost of Operations	$ 137,674,056	$ 141,084,155
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Period:		
Increase in Annual Leave Liability	$ 18,808	$ 50,811
Increase in Environmental and Disposal Liability	193,856	168,218
Increase in Exchange Revenue Receivable from the Public	2,607,419	20,716
Other	121,520	141,273
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	$ 2,941,603	$ 381,018
Components not Requiring or Generating Resources:		
Depreciation and Amortization	$ 2,532,417	$ 3,263,335
Revaluation of Assets or Liabilities	(1,464,937)	(4,940,274)
Other		
Operating Materials and Supplies Used	4,676,267	6,351,889
Other	10,756,743	(507,191)
Total Components of Net Cost of Operations that will not Require or Generate Resources	$ 16,500,490	$ 4,167,759
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$ 19,442,093	$ 4,548,777
Net Cost of Operations	$ 157,116,149	$ 145,632,932

The Reconciliation of Net Cost of Operations to Budget is designed to reconcile the Net Cost of Operations (reported in the Statement of Net Cost) to the current year obligations (reported in the Statement of Budgetary Resources). This reconciliation is required due to the inherent differences in timing and recognition between the accrual proprietary accounting method used to calculate net cost and the budgetary accounting method used to calculate budgetary resources and obligations.

Due to the DON financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. Differences between budgetary and proprietary data are previously identified deficiencies.

The absolute value of the adjustments to the Reconciliation of Net Cost of Operations to Budget to bring it into balance with the Statement of Net Costs is $12.7 billion. The adjustments were recorded in Components of the Net Cost of Operations Not Requiring or Generating Resources in the Current Period.

The Reconciliation of Net Cost of Operations to Budget is presented as a consolidated statement. However, the following lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

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

NOTE 20. FUNDS FROM DEDICATED COLLECTIONS

As of September 30		2014		2013
(Amounts in thousands)				
Assets				
Fund Balance with Treasury	$	24,805	$	23,331
Investments		6,140		8,325
Total Assets	$	30,945	$	31,656
Liabilities and Net Position				
Other Liabilities	$	3,400	$	3,894
Total Liabilities	$	3,400	$	3,894
Cumulative Results of Operations		27,545		27,762
Total Liabilities & Net Position	$	30,945	$	31,656
Statement of Net Cost				
Program Costs	$	21,463	$	24,426
Net Cost of Operations	$	21,463	$	24,426
Statement of Changes in Net Position				
Net Position Beginning of the Period	$	27,762	$	29,156
Net Cost of Operations		21,463		24,426
Budgetary Financing Sources		21,254		23,032
Other Financing Sources		(8)		-
Change in Net Position	$	(217)	$	(1,394)
Net Position End of Period	$	27,545	$	27,762

Funds from Dedicated Collections are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. The DON currently has four funds from dedicated collections, for which a brief description follows below. There have been no changes in legislation during or subsequent to the reporting period that significantly changes the purpose or that redirects a material portion of the accumulated balances of any of these four funds. Generally, revenues for DON's funds from dedicated collections are inflows of resources to the Government.

Special Funds from Dedicated Collections

Wildlife Conservation, Military Reservations, Navy

This fund, authorized by 16 United States Code 670b, provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Proceeds from the sale of fishing and hunting permits are used for these programs at DON installations charging such user fees. These programs are carried out through cooperative plans agreed upon by the local representatives of the Secretary of Defense, the Secretary of the Interior, and the appropriate agency of the State in which the installation is located.

Trust Funds from Dedicated Collections

DON General Gift Fund

This fund is authorized by 10 United States Code 2601. Under the provisions of this statute, the Secretary of the Navy (SECNAV) may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that it be used for the benefit, or in connection with the establishment, operation, or maintenance of a school, hospital, library, museum, cemetery, or other institution under the jurisdiction of DON.

Ships Stores Profit, Navy

This fund is authorized by 10 United States Code 7220. Deposits to this fund are derived from profits realized through the operation of ships' stores and from gifts accepted for providing recreation, amusement, and contentment for enlisted members of the Navy and Marine Corps.

U.S. Naval Academy General Gift Fund

This fund is authorized by 10 United States Code 6973. Under the provisions of this statute, SECNAV may accept, hold, administer, and spend any gift, devise, or bequest of personal property, made on the condition that it be used for the benefit of, or in connection with, the United States Naval Academy, or the Naval Academy Museum, its collections, or its services.

NOTE 21. FIDUCIARY ACTIVITIES

As of September 30	2014	2013
(Amounts in thousands)		
Fiduciary Net Assets, Beginning of Year	$ 24,905	$ 30,812
Contributions	53,582	36,617
Investment Earnings	562	2,335
Distributions to and on Behalf of Beneficiaries	2,510	(44,859)
Increase/(Decrease) in Fiduciary Net Assets	56,654	(5,907)
Fiduciary Net Assets, End of Period	$ 81,559	$ 24,905

FIDUCIARY ASSETS

As of September 30	2014	2013
(Amounts in thousands)		
Cash and Cash Equivalents	$ 81,559	$ 24,905

Fiduciary activities are the collection or receipt, and management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which Non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

The DON's Fiduciary Activity consists of funds in the Savings Deposit Program. Under 10, USC, §1035, and DoD FMR, Volume 7A, Chapter 51, service members of both the Navy and Marine Corps who are on a permanent duty assignment outside the United States or its possessions can earn interest at a rate prescribed by the president, not to exceed 10% a year, on up to $10 thousand deposited into the program. This limitation shall not apply to deposits made on or after September 1, 1966 in the case of those members in a missing status during the Vietnam conflict, the Persian Gulf conflict, or a contingency operation.

A permanent duty assignment is defined as any active duty assignment that contemplates duty in the designated area as a permanent change of station, or more than 30 days on temporary additional duty, temporary duty, or with a deployed ship or unit. This definition of a permanent duty assignment applies specifically to this program, effective as of July 1, 1991. Interest accrual shall terminate 90 days after the member's return to the United States or its possessions. The deposit funds included in the balance are 17X6025 for Navy and 17X6026 for Marine Corps.

NOTE 22. LEASES

As of September 30	2014			
	Land and Buildings	**Equipment**	**Other**	**Total**
(Amounts in thousands)				
Entity as Lessee - Operating Leases				
Future Payments Due				
Fiscal Year				
2015	$ 148,152	$ 142	$ -	$ 148,294
2016	150,999	145	-	151,144
2017	153,907	147	-	154,054
2018	156,878	150	-	157,028
2019	159,915	152	-	160,067
After 5 Years	163,020	155	-	163,175
Total	$ 932,871	$ 891	$ -	$ 933,762

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

Investments in Research and Development
Yearly Investment in Research and Development

For Fiscal Years 2010 through 2014

($ in millions)

Categories	FY14	FY13	FY12	FY11	FY10
Basic Research	$ 552	$ 556	$ 554	$ 547	$ 552
Applied Research	792	776	738	728	752
Development					
Advanced Technology Development	631	653	761	821	859
Advanced Component Development and Prototypes	3,006	3,956	3,950	4,080	3,910
System Development and Demonstration	4,811	4,655	5,382	6,429	7,325
Research, Development, Test, and Evaluation Management Support	1,142	1,061	1,298	1,285	1,293
Operational Systems Development	3,403	3,863	4,137	4,285	4,505
Totals	**$ 14,337**	**$ 15,520**	**$ 16,820**	**$ 18,175**	**$ 19,196**

Investments in Research and Development

Investment values are based on Research and Development (R&D) outlays (expenditures). Outlays are used because currently the DON systems are unable to fully capture and summarize costs in accordance with USGAAP.

R&D programs are classified as Basic Research, Applied Research, and Development. The definition of each R&D category and subcategory is explained below.

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 a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

Basic Research Examples:

Ocean Research:

The Office of Naval Research Global (ONR Global) is collaborating with University of Melbourne on research that will provide new insights into ocean conditions—crucial information for Navy planners involved in tactical and strategic decision-making.

The research improves understanding of conditions in the Indian Ocean, including validating satellite data on salinity, or salt, levels. Confirming satellite findings with actual field-level research is an area scientists have deemed essential to improving the Navy's oceanographic models.

The research is also being done in collaboration with Kenyan and Indian scientific organizations. The major goal of this research is to be able to provide the best information possible on the environmental conditions so that U.S. Navy ships can more easily avoid hurricanes, typhoons and cyclones.

Improved understanding of data from satellites will give Navy planners more confidence in the information received. Satellites are used to study large areas that are not easily covered with a ship.

The need for improved environmental ocean research has long been recognized by the military and civilian seafaring community. Naval researchers point out that insufficient data on water and weather conditions can impact even the largest vessels and recall the tragic losses of ships under Adm. William Halsey in World War II in storms that today would be easier to predict.

As with many ONR Global efforts, there will be a double benefit to the research as the University of Melbourne grant represents increased ties between U.S. and allied scientists. ONR Global scientists work around the world, and its personnel are often referred to as "scientific ambassadors" because of the goodwill created during shared research.

What this research will accomplish:

- Improves understanding of conditions in the Indian Ocean and Navy weather models used for ship movement planning
- Improves collaboration with the University of Melbourne, Kenyan and Indian scientific organizations

Self-Healing Paint:

A new additive will help military vehicles, including the Marine Corps variant of the Joint Light Tactical Vehicle, heal like human skin and avoid costly maintenance as a result of corrosion.

Developed by the Johns Hopkins University Applied Physics Laboratory in partnership with the Office of Naval Research (ONR), polyfibroblast allows scratches forming in vehicle paint to scar and heal before the effects of corrosion ever reach the metal beneath.

Corrosion costs the Department of the Navy billions of dollars each year. Corrosion costs the Marine Corps about $500 million on ground vehicle maintenance, according to the most recent Department of Defense reports. This technology could cut maintenance costs, and more importantly, it could increase the time vehicles are out in the field with Marines.

Polyfibroblast is a powder that can be added to commercial-off-the-shelf paint primers. It is made up of microscopic polymer spheres filled with an oily liquid. When scratched, resin from the broken capsules forms a waxy, water-repellant coating across the exposed steel that protects against corrosion. While many self-healing paints are designed solely for cosmetic purposes, polyfibroblast is being engineered specifically for tactical vehicles used in a variety of harsh environments. In one laboratory experiment, polyfibroblast showed it could prevent rusting for six weeks inside a chamber filled with salt fog.

Development of polyfibroblast in the lab began in 2008 and is nearly ready for full deployment. The partnership between ONR and Program Executive Office (PEO) Land Systems provides a good example of how research can mature quickly into real-world application.

What this research will accomplish:

- Avoid costly maintenance as a result of corrosion
- Increase availability of Marine Ground vehicles
- Applicable to other platforms in high corrosive naval environments

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 the recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and defining their parameters. Major outputs are scientific studies, investigations and research papers, hardware components, software codes, and limited construction of, or part of, a weapon system to include non-system specific development efforts.

Applied Research Examples:

Light Weight Ramp for Joint High Speed Vessel:

ONR successfully demonstrated a new lightweight ramp intended for use on the Navy's Joint High Speed Vessel (JHSV).

The advanced ramp will provide significant improvement over the JHSV's current ramp by allowing the loading or unloading of people and combat vehicles—in rougher ocean conditions than are currently possible—between a JHSV and another ship, pier, mobile landing platform or more.

The knowledge gained in designing the ramp is vital for successful future deployment of personnel and equipment. The Navy and Marine Corps need easy-to-use, lightweight ramps to load and unload materiel in combat or humanitarian situations. This ramp overcame significant engineering challenges in connecting two ships in a simulated seaway, while also allowing a tank, truck and HUMVEE to successfully cross.

JHSV is a new class of all-aluminum swift ships, intended to meet requirements for shallow water deployment of personnel, combat vehicles or other supplies and equipment as needed. The vessels can transport approximately 600 tons at an average speed of 35 knots, and are designed to operate in challenging ports and waterways.

ONR analysis of the ramp design will help determine future ramp requirements for existing JHSVs, as well as for future vessels. The ONR ramp program was done in partnership with the Navy's Strategic Mobility and Combat Logistics office, as well as the Strategic and Theater Sealift program office.

What this research will accomplish:

- Easy-to-use, lightweight ramp design to load and unload materiel in combat or humanitarian situations

Electronic Warfare Battle Management :

Developed by ONR, Electronic Warfare Battle Management (EWBM) for Surface Defense will help Sailors and Marines coordinate electronic countermeasure responses to inbound threats faster than is possible through traditional voice communications, reducing the need to respond with expensive munitions.

With the explosion of digital technologies, control of information in the electromagnetic spectrum is more important than ever when it comes to military campaigns. To achieve information dominance, Navy leaders are emphasizing the use of electronic warfare in which operators can deny or deceive adversary sensors and radars with electronic signals.

Electronic warfare is about controlling and using energy while taking away our adversary's ability to use it. With this system, Sailors and Marines will be able to exchange spectrum and threat information between platforms so they can make more informed decisions in situations where time and accuracy are crucial.

ONR's EWBM system makes it easier for personnel on ships and in aircraft to share information digitally about adversary sensor and radar threats using available communication networks. In turn, naval forces can coordinate countermeasures both onboard and remotely with the help of automation software, adding speed and precision to a process that normally takes place over just radio communications.

ONR will continue to work with partners at the Navy's PEO Integrated Warfare Systems and PEO Command, Control, Communications, Computers and Intelligence to make improvements to the system based on fleet requirements. The system is being developed under ONR's Future Naval Capabilities program, which brings proven technology to military acquisition programs in rapid fashion, going from research and development to delivery in five years.

What this research will accomplish:

- Coordinate electronic countermeasure responses to inbound threats, faster
- Leverages available communication networks to make it easier for personnel on ships and in aircraft to share information digitally about adversary sensor and radar threats

Development Research

Developmental research 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.

Developmental Research Examples:

Port Security:

One very real threat to the U.S. Navy comes from a simple but deadly enemy strategy: small speed boats laden with explosives ramming into ships in harbor. A new maritime security barrier, developed with support from ONR, provides a quantum leap in existing sea-port protection.

The new system is called the Halo Barrier. These barriers offer far greater stopping capacity against speeding attack vessels, require less manpower to operate and could show significant cost avoidances over time compared to existing systems.

In many ports used by Navy vessels, there is not a lot of space between the existing barriers and ships, due to limited water space and the movement of commercial and private vessels. In one test of the current barriers, an attack craft was "caught" by the barrier lines but still got dangerously close to the target ship itself.

The Halo barrier, by contrast, can be deployed closer to ships while providing increased protection capability. In a series of tests, speeding attack crafts were stopped instantly, remaining at a safe distance from the ships.

The cost avoidances from using the Halo barrier come from reduced man-hours needed and lower maintenance costs. It can be operated by only one or two people, versus the current systems that require large teams, long hours and armed protection to open and close barriers for incoming vessels.

The rapid development of the Halo barrier was made possible by the close coordination between ONR and Commander, Naval Installations Command with support from Aberdeen Proving Ground and the Combating Terrorism Technical Support Office.

What this research will accomplish:

- Increase port security and protection for ships and crew
- Reduced man-hours needed to deploy and maintain typical port security

Fleet Integrated Synthetic Training/Testing Facility:

The Office of Naval Research (ONR) developed Fleet Integrated Synthetic Training/Testing Facility (FIST2FAC), an affordable, adaptive way to train Sailors and Marines. It combines a hassle-free setup, software and gaming technology to help naval forces develop strategies for a variety of missions and operations.

With simulation, the Navy can explore endless possibilities without the expense and logistical challenges of putting hundreds of ships at sea and aircraft in the sky. FIST2FAC allows Sailors to interact with artificially intelligent forces in countless settings and train for multiple missions simultaneously.

The system can replicate simple and complex situations involving aircraft carriers, helicopters, lethal and nonlethal weapons, and more.

Located at Ford Island, Hawaii, FIST2FAC can simulate for a ship's crew several fast-attack craft in waters crowded with merchant traffic. Sailors must determine if the boats are hostile and engage them with machine-gun fire from a virtual ship.

FIST2FAC allows Sailors to 'train like they fight' by presenting realistic forces in a visual, tactical and operational environment. Swarming attack boats is one of several tactics Navy leaders hope to overcome through an Anti-Access/Area Denial (A2/AD) strategy to counter threats from adversaries trying to restrict the access and movement of U.S. forces.

In addition to the fast-attack craft threat, FIST2FAC has been used to simulate anti-submarine warfare and strike group operations with aircraft carriers, destroyers and helicopters. Soon, the system will address electronic, mine and anti-air warfare scenarios.

The robust training and affordability of FIST2FAC is the result of partnerships between ONR, the Naval Undersea Warfare Center Keyport Division, U.S. Pacific Fleet and the Naval Warfare Development Command.

What this research will accomplish:

- Combines easy hardware setup, software and gaming technology to help train naval forces and develop strategies for a variety of missions and operations
- Using simulation, users can explore endless possibilities without the expense and logistical challenges of putting hundreds of ships at sea and aircraft in the sky

Marine Corps Examples:

Autonomous Aerial Cargo/Utility System:

Autonomy options for the Marines took a major step forward with the development of the Autonomous Aerial Cargo/Utility System (AACUS) developed by ONR. Two successful helicopter flight demonstrations with unmanned flight capability were conducted at Marine Corps Base Quantico, VA.

AACUS will enable the Marine Corps to rapidly resupply forces on the front lines using cutting-edge technology sponsored by ONR. The system consists of a sensor and software package that will be integrated into rotary wing aircraft to detect and avoid obstacles in unfavorable weather conditions, or to enable autonomous, unmanned flight.

The capability will be an alternative to dangerous convoys, manned aircraft or air drops in threatening weather. With AACUS, an unmanned helicopter can take the supplies from a base, pick out the optimal route and best landing site closest to the warfighters, land, and return to base once the resupply is complete—all with the single touch of a handheld tablet. The AACUS technology is designed to be simple to use; an operator with minimal training can call up the supplies needed and order the flights. In demonstration tests, a Marine with no prior experience with the technology was given a handheld device and 15 minutes of training. The Marine was able to quickly and easily program in the supplies needed and the destination. The helicopters arrived quickly—even autonomously selecting an alternative landing site based on last-second no-fly-zone information added in from the Marine.

The need for this capability surfaced during Marine Corps operations in Afghanistan and Iraq. Cargo helicopters and resupply convoys of trucks bringing fuel, food, water, ammunition and medical supplies to the front lines frequently found themselves under fire from adversaries, or the target of roadside bombs and other improvised explosive devices. In the future, as the technology develops, it could be used for casualty evacuation, bringing supplies to first responders in disaster areas, and more.

What this research will accomplish:

- Enables the Marine Corps to rapidly resupply forces on the front lines using autonomous helicopters
- The AACUS technology is a kit that can be installed an existing helicopters
- Easily controlled with a typical handheld touchpad that requires very little training

New Mortar Sight:

ONR successfully developed and tested a new mortar sight for the handheld mortar. The prototype sight, called a Fire Control Unit (FCU), attaches by hand near the muzzle of a 60mm mortar and provides users with a dramatic increase in target accuracy, most notably at night.

The nighttime capability is precise. Until now, Marines have had to rely on their eyes for aim, looking over the end of the barrel at a given target, resulting in greater inaccuracies. Tests with the new sight were so successful that six prototypes were immediately sent to Marine Corps units in Afghanistan. The sight is designed to easily attach to the upper portion of the barrel, and is small enough to fit in a uniform pocket.

It was developed after a chief warrant officer made a request to ONR's TechSolutions program for a technology that improves the weapon's accuracy. TechSolutions takes requests from Sailors and Marines and works with scientists and engineers to provide technology solutions, usually within a 12 to 18 month timeframe.

In addition to the new sight itself, ONR-funded improvements include a new lightweight sling for easier transport that has a heat shield built into it to protect the user's hands. A lightweight mount is part of the new sling, designed to eliminate the loud clanging that accompanied the old mount as it banged against the mortar in transit—a potentially deadly giveaway of position when on the move.

What this research will accomplish:

- Greatly improves accuracy of existing 60 mm mortar
- Enables precise night mortar fire
- Less shots to hit target reduces costs and saves lives

REQUIRED SUPPLEMENTARY INFORMATION

Department of the Navy
General Property, Plant, and Equipment
Real Property Deferred Maintenance and Repair

For Fiscal Year Ended September 30, 2014

Property Type		1. Plant Replacement Value	2. Required Work (Deferred Maintenance and Repair)	3. Percentage
(Amounts in Thousands)				
Category 1: Enduring Facilities				
Navy	$	167,611,400	38,662,331	23.07%
Marine Corps	$	48,188,762	2,449,712	5.08%
Category 2: Excess Facilities or Planned for Replacement				
Navy	$	1,617,000	818,000	50.59%
Marine Corps	$	23,781	-	0.00%
Category 3: Heritage Assets				
Navy	$	-	-	-
Marine Corps	$	2,397,057	331,289	13.82%

NOTE: In the table above, Navy real property deferred maintenance and repair data represent both Department of the Navy and Navy Working Capital Fund (NWCF). Similarly, Marine Corps real property deferred maintenance and repair data represents both the United States Marine Corps General Fund and NWCF-Marine Corps.

Description of Property Type categories:

- Category 1 – Buildings, Structures, and Utilities that are enduring and required to support an ongoing mission, excluding multi-use Heritage Assets

- Category 2 – Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal, excluding multi-use Heritage Assets

- Category 3 – Buildings, Structures, and Utilities that are Heritage Assets

1. The Navy assesses facility condition using software and facilities inspections that incorporate the Sustainment Management System (SMS) standard process. The Navy's Facility Condition Index (FCI) is calculated using the below formula:

   $$\text{FCI} = \underline{1 - (\text{Requirements}) \times 100}$$
   $$\text{PRV}$$

   The Navy models the "Requirements" value from the condition rating and configuration rating.

   The method used to assess facilities conditions is two-fold. All buildings, paving, bridges, dams and rail assets are inspected using the SMS methodology developed by the US Army Corps of Engineers Civil Engineering (USACOE) Research Laboratory (CERL) which provides a FCI for these assets. Other assets are assessed via local facilities inspections to address the adequacy of the facilities to meet it intended purpose. Assets inspected using both methods takes the FCI to determine the asset's Quality rating (Q-rating) as follows: FCI of 100%-90% Q1 (Good); 90%-80% Q2 (Fair); 80%-60% Q3 (Poor); and less than 60% Q4 (Failing).

2. The Condition Rating is a measure (0 - 100) of an asset's physical condition at a particular point in time. The Navy's condition rating is updated using the SMS process, which combines the results of on-site assessments with modeling software to establish system/component condition ratings. The condition assessment is an 'eyes-on' field assessment that confirms facility component inventory and assesses material condition.

3. The Configuration Rating is a measure (0 - 100) of the asset's capability to support the current occupant or mission with respect to functionality. The Configuration Rating is calculated in the internet Navy Facility Assets Data Store (iNFADS) from an algorithm that weights configuration deficiency codes (code compliance, functional/space criteria, location/siting criteria or inadequate capacity/coverage) collected during Asset Evaluations. Deficiency codes identify impacts to the suitability of spaces for their intended use, including obsolescence of facility components that do not meet new standards.

4. OUSD (AT&L) Facility Sustainment and Recapitalization Memo of 29 April 2014, sets an average of 80 as a minimum inventory-wide FCI goal. With deferred maintenance for the Navy valued at 23.1%, 50.6% and 0% of PRV for categories 1 through 3, respectively, Navy's FCI is 76.7. The

deferred maintenance and repair estimates are based on the facility condition and configuration ratings.

The USMC follows the Office of the Secretary of Defense Installation Strategic Plan goal of having facilities at a Q2 level on average as an acceptable rating. This represents an average level of 15% of Plant Replacement Value (PRV) as an acceptable level of deferred maintenance. The table above shows that deferred maintenance is valued at approximately 5.1% and 13.8% of PRV for categories 1 and 3, respectively. Category 2 is zero because we do not hold deferred maintenance backlogs on facilities to be demolished.

5. In past years, the Navy's Deferred Maintenance and Repair Report only included assets assigned to a CNIC installation and assigned one of the following Maintenance Fund Sources: Operation and Maintenance, Navy; Operation and Maintenance, Navy Reserve; Research, Development, Test, and Evaluation; or Navy Working Capital Fund. The Navy's FY 2014 Deferred Maintenance and Repair Report includes all Navy Activity Unit Identification Codes (UICs). Below are the additional filters used in the Navy's FY 2014 Report:

- Assets assigned Estate Code 31 (PPV) or 33 (Not Owned by Government) are excluded.
- Assets assigned RPA Command Claimant "Marine Corps" are excluded. These assets are included on the Marine Corps' Deferred Maintenance and Repair Report.
- Assets maintained by a Defense Agency are excluded. Only assets assigned a Navy Maintenance UIC are included on the Navy's report.

6. In addition, Category 1 only includes assets assigned an RPA Operational Status Code of "Active","Outgranted", "Semi-Active", or "Non-Functional". Category 2 only includes assets assigned an RPA Operational Status Code of "Excess" or "Surplus". Category 1 excludes assets identified in Categories 2 and 3. Category 3 includes assets that are single-use Heritage Assets. The Navy's Real Property Inventory does not identify any Navy assets as single-use Heritage Assets; therefore, the amounts recorded for this category are zero.

Military Equipment Deferred Maintenance

For Fiscal Year Ended September 30, 2014

($ in thousands)

Major Category	OP30 Amounts	Adjustments	Totals
1. Aircraft	$384,939	($281,187)	$103,752
2. Automotive Equipment	4,363	-	4,363
3. Combat Vehicles	15,273	(28)	15,245
4. Construction Equipment	19,241	4,185	23,426
5. Electronics and Communications Systems	14,356	8,805	23,161
6. Missiles	3,636	45,472	49,108
7. Ships	726,154	(307,344)	418,810
8. Ordinance Weapons and Munitions	11,055	26	11,081
9. All Other Items Not Identified Above	14,321	(509)	13,812
Total	**$1,193,338**	**($530,580)**	**$662,758**

Note: The deferred maintenance amounts reported in the Budget Exhibit Operations (OP) Depot Maintenance (30) that accompanied the most recent President's Budget was used as the basis to identify and report amounts in the Military Equipment Deferred Maintenance. Material amounts of deferred maintenance beyond the scope of the OP-30 Budget Exhibit, that warrant reporting are in the "Adjustments" column.

Aircraft

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 unfunded requirements, which represent aircraft that have reached their Fixed Induction Date (FID) or that have failed an Aircraft Service Period Adjustment (ASPA) inspection at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance represents the difference between the validated requirements minus corresponding funding.

Airframe rework and maintenance (active and reserve) is currently performed under the Integrated Maintenance Concept (IMC) program. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, but 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.

Combat Vehicles

The combat vehicles category refers to deferred vehicle maintenance for the active and reserve Marine Corps assets. The combat vehicle category consists of weapons systems such as the M1A1 Tank, the Amphibious Assault Vehicle, the Hercules Recovery Vehicle, and the Light Armored Vehicle. The total requirement is the planned quantity of combat vehicles that require depot level maintenance in a year as determined by program managers and the operating forces with requirements validated by a modeling process. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Construction Equipment

The construction equipment category refers to deferred equipment maintenance for active and reserve Marine Corps assets. This category consists of maintenance performed on a variety of tractors and earth moving equipment. In part, the equipment includes the Aardvark Tactical, the 277C Multi-Terrain Loader, the Medium Crawler Tractor, the Armored Excavator with Brush Hog, and Bridge Erection equipment. The total requirement is the planned quantity of equipment that requires depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Electronics and Communications Systems

The electronics and communications systems category refers to deferred systems maintenance for active and reserve Navy and Marine Corps assets. This category consists of maintenance performed on a variety of radar, radio, and wire and communications equipment. In part, the systems include or are associated with the Surveillance Towed-Array Sensor System (SURTASS), P-3 Beartrap, satellite subsystems, the Multi-Band Deployable Antenna, the Multi-Mode Inter/Intra Team Radio, and a variety of radio and radar sets used within the Department of the Navy. The total requirement is the planned quantity of systems and their components that require depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is then the difference between the validated requirements and funding received for that fiscal year.

Missiles

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 or reworked annually.

Ships

Fleet Type Commanders provide deferred ship maintenance data. Data is 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 is provided in the calculation of ship deferred maintenance. 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 are some deferred maintenance actions, no ships 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.

Ordnance Weapons and Munitions

Ordnance weapons and munitions are part of a broader category, Other Weapons Systems. This 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.

All Other Items Not Identified Above

This category comprises deferred maintenance for software, arrest gear, lighting and surfacing equipment, and EFTM (external fuel transfer module). The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

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).

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

For the Years Ended September 30, 2014 and 2013

($ in Thousands)

	Research, Development, Test & Evaluation	Procurement	Military Personnel	Family Housing & Military Construction
Budgetary Resources:				
Unobligated Balance, Brought Forward, October 1	$ 2,516,279	$ 20,655,629	$ 1,233,270	$ 2,990,624
Recoveries of Prior Year Unpaid Obligations	787,358	2,970,714	1,755,320	228,304
Other Changes in Unobligated Balance	(165,230)	(594,098)	(237,459)	(85,384)
Unobligated Balance from Prior Year Budget Authority, Net	3,138,407	23,032,245	2,751,131	3,133,544
Appropriations	15,028,523	42,795,135	45,992,906	1,724,461
Spending Authority from Offsetting Collections	182,068	882,250	423,156	756,563
Total Budgetary Resources	$ 18,348,998	$ 66,709,630	$ 49,167,193	$ 5,614,568
Status of Budgetary Resources:				
Obligations Incurred	$ 16,336,439	$ 44,479,767	$ 47,348,578	$ 2,564,724
Unobligated Balance, End of Year				
Apportioned	1,615,392	21,136,668	244,511	2,891,239
Exempt from Apportionment	-	-	-	-
Unapportioned	397,167	1,093,195	1,574,104	158,605
Unobligated Balance Brought Forward, End of Year	2,012,559	22,229,863	1,818,615	3,049,844
Total Budgetary Resources	$ 18,348,998	$ 66,709,630	$ 49,167,193	$ 5,614,568
Change in Obligated Balance:				
Unpaid Obligations				
Unpaid Obligations, Brought Forward, October 1	$ 9,979,824	$ 70,117,096	$ 3,735,462	$ 3,537,053
Obligations Incurred	16,336,439	44,479,767	47,348,578	2,564,724
Outlays, Gross	(15,652,713)	(43,666,741)	(46,069,896)	(2,601,126)
Recoveries of Prior Year Unpaid Obligations	(787,358)	(2,970,714)	(1,755,320)	(228,304)
Unpaid Obligations, End of Year, Gross	9,876,192	67,959,408	3,258,824	3,272,347
Uncollected Payments				
Uncollected Payments from Federal Sources, Brought Forward, October 1	(137,714)	(323,391)	(35,064)	(351,350)
Change in Uncollected Payments from Federal Sources	(26,210)	45,088	588	(89,783)
Uncollected Payments from Federal Sources, End of Year	(163,924)	(278,303)	(34,476)	(441,133)
Obligated Balance, Start of Year	9,842,110	69,793,705	3,700,398	3,185,703
Obligated Balance, End of Year	$ 9,712,268	$ 67,681,105	$ 3,224,348	$ 2,831,214
Budget Authority and Outlays, Net:				
Budget Authority, Gross	$ 15,210,591	$ 43,677,385	$ 46,416,062	$ 2,481,024
Actual Offsetting Collections	(155,858)	(927,338)	(423,744)	(666,780)
Change in Uncollected Payments from Federal Sources	(26,210)	45,088	588	(89,783)
Budget Authority, Net	$ 15,028,523	$ 42,795,135	$ 45,992,906	$ 1,724,461
Outlays, Gross	$ 15,652,713	$ 43,666,741	$ 46,069,896	$ 2,601,126
Actual Offsetting Collections	(155,858)	(927,338)	(423,744)	(666,780)
Outlays, Net	15,496,855	42,739,403	45,646,152	1,934,345
Distributed Offsetting Receipts	-	-	-	-
Agency Outlays, Net	$ 15,496,855	$ 42,739,403	$ 45,646,152	$ 1,934,346

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

For the Years Ended September 30, 2014 and 2013

($ in Thousands)

	Operations, Readiness & Support	2014 Combined	2013 Combined
Budgetary Resources:			
Unobligated Balance, Brought Forward, October 1	$ 5,920,323	$ 33,316,125	$ 32,549,715
Recoveries of Prior Year Unpaid Obligations	3,928,524	9,670,220	11,866,228
Other Changes in Unobligated Balance	(789,921)	(1,872,092)	(1,955,989)
Unobligated Balance from Prior Year Budget Authority, Net	9,058,926	41,114,253	42,459,954
Appropriations	56,284,886	161,825,911	161,841,280
Spending Authority from Offsetting Collections	4,648,949	6,892,986	7,367,629
Total Budgetary Resources	$ 69,992,761	$ 209,833,150	$ 211,668,863
Status of Budgetary Resources:			
Obligations Incurred	$ 63,858,023	$ 174,587,531	$ 178,352,738
Unobligated Balance, End of Year			
Apportioned	3,363,471	29,251,281	28,231,804
Exempt from Apportionment	22,834	22,834	20,725
Unapportioned	2,748,433	5,971,504	5,063,596
Unobligated Balance Brought Forward, End of Year	6,134,738	35,245,619	33,316,125
Total Budgetary Resources	$ 69,992,761	$ 209,833,150	$ 211,668,863
Change in Obligated Balance:			
Unpaid Obligations			
Unpaid Obligations, Brought Forward, October 1	$ 25,109,408	$ 112,478,843	$ 112,927,456
Obligations Incurred	63,858,023	174,587,531	178,352,738
Outlays, Gross	(58,739,747)	(166,730,223)	(166,935,123)
Recoveries of Prior Year Unpaid Obligations	(3,928,524)	(9,670,220)	(11,866,228)
Unpaid Obligations, End of Year, Gross	26,299,160	110,665,931	112,478,843
Uncollected Payments			
Uncollected Payments from Federal Sources, Brought Forward, October 1	(2,381,975)	(3,229,494)	(2,629,802)
Change in Uncollected Payments from Federal Sources	25,556	(44,761)	(599,692)
Uncollected Payments from Federal Sources, End of Year	(2,356,419)	(3,274,255)	(3,229,494)
Obligated Balance, Start of Year	22,727,433	109,249,349	110,297,654
Obligated Balance, End of Year	$ 23,942,741	$ 107,391,676	$ 109,249,349
Budget Authority and Outlays, Net:			
Budget Authority, Gross	$ 60,933,835	$ 168,718,897	$ 169,208,909
Actual Offsetting Collections	(4,674,505)	(6,848,225)	(6,767,937)
Change in Uncollected Payments from Federal Sources	25,556	(44,761)	(599,692)
Budget Authority, Net	$ 56,284,886	$ 161,825,911	$ 161,841,280
Outlays, Gross	$ 58,739,747	$ 166,730,223	$ 166,935,123
Actual Offsetting Collections	(4,674,505)	(6,848,225)	(6,767,937)
Outlays, Net	54,065,243	159,881,998	160,176,186
Distributed Offsetting Receipts	(237,198)	(237,198)	(86,119)
Agency Outlays, Net	$ 53,828,044	$ 159,644,800	$ 160,081,067

The accompanying notes are an integral part of the statements.

THE NATION'S TOTAL FORCE:
At the Right Place, At the Right Time, All the Time

OTHER INFORMATION

TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT

AUDIT OPINION: DISCLAIMER

Restatement: No

Areas of Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Management Systems	1	0	0	0	1
Fund Balance with Treasury	1	0	0	0	1
Accounts Receivable	1	1	0	0	2
Other Assets	1	0	0	0	1
Operating Material and Supplies	1	0	0	0	1
General Property, Plant and Equipment	1	0	0	0	1
Accounts Payable	1	0	0	0	1
Statement of Net Cost	1	0	0	0	1
Statement of Changes in Net Position	0	1	0	0	1
Problem Disbursements	1	0	0	0	1
Unobligated Balances	1	0	0	0	1

TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES

THE DON SUMMARY OF MANAGEMENT ASSURANCES

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)

Statement of Assurance: No Assurance

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Reimbursable Work Orders - Performer, Order-to-Cash	5	0	1	0	0	4
Reimbursable Work Orders - Grantor, Procure-to-Pay	4	0	0	0	0	4
Existence and Completeness	5	0	0	1	0	4
Financial Statement Compilation and Reporting	1	0	0	0	0	1
Contract Vendor Pay	1	2	1	0	0	2
Military Standard Requisitioning and Issue Procedures	3	0	0	0	0	3
Transportation of Things	3	0	0	0	0	3
Total Material Weaknesses	22	2	2	1	0	21

Effectiveness of Internal Control over Operations (FMFIA § 2)

Statement of Assurance: Qualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Service Contracts	1	0	0	0	0	1
Attenuating Hazardous Noise in Acquisition & Weapon System Design	1	0	0	0	0	1
Management of Communications Security (COMSEC) Equipment	1	0	0	0	0	1
Safeguarding Personally Identifiable Information (PII)	1	0	0	0	0	1
Effective Use of Earned Value Management (EVM) Across Shipbuilding Programs	1	0	0	0	0	1
Total Material Weaknesses	5	0	0	0	0	5

Conformance with Financial Management System Requirements (FMFIA § 4)

Statement of Assurance: No Assurance

Nonconformance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Financial System	1	0	0	0		1
Total Nonconformance	1	0	0	0		1

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)

Overall Substantial Compliance: No Assurance

USMC SUMMARY OF MANAGEMENT ASSURANCES

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)

Statement of Assurance: No Assurance

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Military Equipment Assets	1	0	0	0	0	1
Real Property Assets	1	0	0	0	0	1
Reimbursable Work Orders - Grantor, Procure-to-Pay	2	0	0	0	0	2
Military Standard Requisitioning and Issue Procedures	1	0	0	0	0	1
Total Material Weaknesses	5	0	0	0	0	5

Effectiveness of Internal Control over Operations (FMFIA § 2)
Statement of Assurance: Qualified
No Material Weaknesses

Conformance with Financial Management System Requirements (FMFIA § 4)

Statement of Assurance: No Assurance

Nonconformance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Standard Accounting, Budgeting and Reporting System (SABRS)	1	0	0	0	0	1
Marine Corps Total Force System (MCTFS)	1	0	0	0	0	1
Defense Departmental Reporting System (DDRS)	1	0	0	0	0	1
Defense Cash Accountability System (DCAS)	1	0	0	0	0	1
Global Combat Support Systems-Marine Corps (GCSS-MC)	0	1	0	0	0	1
Total Nonconformance	4	1	0	0	0	5

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)

Overall Substantial Compliance: No Assurance

ENTITY ACCOUNTS

General Funds

017X0380	Coastal Defense Augmentation, Navy
017X0513	Ship Modernization, Operations and Sustainment Fund, Navy
017 0703	Family Housing, Navy and Marine Corps
017X0730	Family Housing Construction, Navy and Marine Corps
017 0730	Family Housing Construction, Navy and Marine Corps
017 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
017X0810	Environmental Restoration, Navy
017 1000	Medicare-Eligible Retiree Health Fund Contribution, Navy
017 1001	Medicare-Eligible Retiree Health Fund Contribution, Marine Corps
017 1002	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy
017 1003	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps
017X1105	Military Personnel, Marine Corps
017 1105	Military Personnel, Marine Corps
017X1106	Operation and Maintenance, Marine Corps
017 1106	Operation and Maintenance, Marine Corps
017 1107	Operation and Maintenance, Marine Corps Reserve
017 1108	Reserve Personnel, Marine Corps
017 1109	Procurement, Marine Corps
017 1116	Operation and Maintenance - Recovery Act, Marine Corps
017 1117	Operation and Maintenance - Recovery Act, Marine Corps Reserve
017X1205	Military Construction, Navy and Marine Corps
017 1205	Military Construction, Navy and Marine Corps
017 1206	Military Construction - Recovery Act, Navy and Marine Corps
017 1235	Military Construction, Naval Reserve
017X1236	Payments to Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
017X1319	Research, Development, Test, and Evaluation, Navy
017 1319	Research, Development, Test, and Evaluation, Navy
017 1320	Research, Development, Test and Evaluation - Recovery Act, Navy
017 1405	Reserve Personnel, Navy
017X1453	Military Personnel, Navy
017 1453	Military Personnel, Navy
017 1506	Aircraft Procurement, Navy
017X1507	Weapons Procurement, Navy
017 1507	Weapons Procurement, Navy
017 1508	Procurement of Ammunition, Navy and Marine Corps
017X1611	Shipbuilding and Conversion, Navy
017 1611	Shipbuilding and Conversion, Navy
017X1804	Operation and Maintenance, Navy
017 1804	Operation and Maintenance, Navy
017 1805	Operation and Maintenance - Recovery Act, Navy
017X1806	Operations and Maintenance, Navy Reserve
017 1806	Operation and Maintenance, Navy Reserve
017 1807	Operation and Maintenance - Recovery Act, Navy Reserve
017X1810	Other Procurement, Navy
017 1810	Other Procurement, Navy

Revolving Funds

017X4557	National Defense Sealift Fund, Navy
017 4557	National Defense Sealift Fund, Navy

Special Funds

017X5095	Wildlife Conservation, etc., Military Reservations, Navy
017X5185	Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
017X5562	Ford Island Improvement Account

Deposit Funds

017X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)
017X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)
017X6025	Pay of the Navy, Deposit Fund (T)
017X6026	Pay of the Marine Corps, Deposit Fund (T)
017X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
017X6705	Civilian Employees Allotment Account, Navy
017X6706	Commercial Communication Service, Navy
017 6763	Gains and Deficiencies on Exchange Transactions, Navy
017X6850	Housing Rentals, Navy
017X6999	Accounts Payable, Check Issue Underdrafts, Navy

Trust Funds

017X8716	Department of the Navy General Gift Fund
017X8723	Ships Stores Profits, Navy
017X8733	United States Naval Academy General Gift Fund

PRINCIPAL STATEMENTS

Navy Working Capital Fund

The fiscal year 2014 Navy Working Capital Fund (NWCF) principal 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 NWCF for the fiscal year ending September 30, 2014, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2013.

The following statements comprise the NWCF principal statements:

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

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.

*Note that amounts may vary slightly due to rounding.

CONSOLIDATED BALANCE SHEET

As of September 30, 2014 and 2013

($ in Thousands)

	2014 Consolidated	2013 Consolidated
ASSETS		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 757,326	$ 1,481,951
Accounts Receivable (Note 4)	1,206,541	1,317,180
Other Assets (Note 5)	46	46
Total Intragovernmental Assets	1,963,913	2,799,177
Cash and Other Monetary Assets (Note 6)	2,448	11,664
Accounts Receivable, Net (Note 4)	71,483	64,829
Inventory and Related Property, Net (Note 7)	31,453,485	21,705,416
General Property, Plant and Equipment, Net (Note 8)	2,058,679	2,156,351
Other Assets (Note 5)	2,386,545	2,061,527
TOTAL ASSETS	$ 37,936,553	$ 28,798,964
LIABILITIES		
Intragovernmental:		
Accounts Payable (Note 10)	$ 329,022	$ 192,102
Other Liabilities (Note 11 & Note 12)	332,239	342,043
Total Intragovernmental Liabilities	661,261	534,145
Accounts Payable (Note 10)	3,844,119	3,741,192
Federal Employee and Veteran Benefits (Note 14)	740,686	774,032
Other Liabilities (Note 11 & Note 12)	1,367,027	1,368,691
TOTAL LIABILITIES	6,613,093	6,418,060
Commitments and Contingencies (Note 13)		
NET POSITION		
Unexpended Appropriations - Other Funds	19,613	25,307
Cumulative Results of Operations - Other Funds	31,303,847	22,355,597
TOTAL NET POSITION	31,323,460	22,380,904
TOTAL LIABILITIES AND NET POSITION	$ 37,936,553	$ 28,798,964

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2014 and 2013

($ in Thousands)

	2014 Consolidated	2013 Consolidated
Program Costs		
Gross Costs		
Operations, Readiness, & Support	$ 29,405,197	$ 28,957,181
Less: Earned Revenue	(38,994,539)	(26,590,168)
Net Cost of Operations	$ (9,589,342)	$ 2,367,013

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2014 and 2013

($ in Thousands)

	2014 Consolidated	2013 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balance	$ 22,355,597	$ 21,036,926
Budgetary Financing Sources:		
Appropriations Used	5,694	500
Nonexchange Revenue	(219)	-
Transfers In/Out without Reimbursement	(442,000)	-
Other Budgetary Financing Sources	(98)	-
Other Financing Sources:		
Transfers In/Out without Reimbursement	453,830	461,027
Imputed Financing	544,010	515,872
Other	(1,202,309)	2,708,285
Total Financing Sources	(641,092)	3,685,684
Net Cost of Operations	(9,589,342)	2,367,013
Net Change	8,948,250	1,318,671
Cumulative Results of Operations	$ 31,303,847	$ 22,355,597
UNEXPENDED APPROPRIATIONS		
Beginning Balance	$ 25,307	$ 1,607
Budgetary Financing Sources:		
Appropriations Received	-	24,200
Appropriations Used	(5,694)	(500)
Total Budgetary Financing Sources	(5,694)	23,700
Unexpended Appropriations	19,613	25,307
Net Position	$ 31,323,460	$ 22,380,904

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2014 and 2013

($ in Thousands)

	2014 Combined	2013 Combined
Budgetary Resources:		
Unobligated Balance, Brought Forward, October 1	$ 3,635,290	$ 3,734,497
Recoveries of Prior Year Unpaid Obligations	1,689,418	1,578,395
Other Changes in Unobligated Balance	(1,608,468)	(1,062,445)
Unobligated Balance from Prior Year Budget Authority, Net	3,716,240	4,250,447
Appropriations	-	24,200
Contract Authority	7,755,197	8,112,646
Spending Authority from Offsetting Collections	20,207,180	20,103,185
Total Budgetary Resources	$ 31,678,617	$ 32,490,478
Status of Budgetary Resources:		
Obligations Incurred	$ 28,412,686	$ 28,855,188
Unobligated Balance, End of Year		
Apportioned	3,193,616	3,580,529
Unapportioned	72,315	54,761
Unobligated Balance Brought Forward, End of Year	3,265,931	3,635,290
Total Budgetary Resources	$ 31,678,617	$ 32,490,478
Change in Obligated Balance:		
Unpaid Obligations		
Unpaid Obligations, Brought Forward, October 1	$ 12,937,255	$ 12,494,009
Obligations Incurred	28,412,686	28,855,188
Outlays, Gross	(27,085,691)	(26,833,547)
Recoveries of Prior Year Unpaid Obligations	(1,689,418)	(1,578,395)
Unpaid Obligations, End of Year, Gross	12,574,832	12,937,255
Uncollected Payments		
Uncollected Payments from Federal Sources, Brought Forward, October 1	(13,814,194)	(12,674,305)
Change in Uncollected Payments from Federal Sources	1,059,767	(1,139,889)
Uncollected payments from Federal Sources, End of Year	(12,754,427)	(13,814,194)
Obligated Balance, Start of Year	(876,939)	(180,296)
Obligated Balance, End of Year	$ (179,595)	$ (876,939)
Budget Authority and Outlays, Net:		
Budget Authority, Gross	$ 27,962,377	$ 28,240,031
Actual Offsetting Collections	(26,803,066)	(26,956,716)
Change in Uncollected Payments from Federal Sources	1,059,767	(1,139,889)
Budget Authority, Net	$ 2,219,078	$ 143,426
Outlays, Gross	$ 27,085,691	$ 26,833,547
Actual Offsetting Collections	(26,803,066)	(26,956,716)
Outlays, Net	282,625	(123,169)
Agency Outlays, Net	$ 282,625	$ (123,169)

The accompanying notes are an integral part of the 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), 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, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board, the Office of Management and Budget (OMB) Circular No. A-136, Financial Reporting Requirements; and the Department of Defense (DoD), Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the NWCF is responsible unless otherwise noted.

The NWCF is unable to fully implement all elements of USGAAP and OMB Circular No. A-136 due to limitations of financial and nonfinancial management processes and systems that support the financial statements. The NWCF derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with USGAAP. The NWCF continues to implement process and system improvements addressing these limitations. The DON converted certain legacy systems to Navy Enterprise Resource Planning (ERP) and is developing plans to ensure accurate and complete financial records.

The DoD currently has 13 auditor identified material weaknesses. Of these the NWCF has the following: (1) Financial Management Systems; (2) Fund Balance With Treasury; (3) Accounts Receivable; (4) Financial Reporting of Inventory; (5) Financial Reporting of Operating Materials and Supplies; (6) Financial Reporting of Real Property and General Equipment; (7) Accounts Payable; (8) Intragovernmental Eliminations; (9) Unsupported Accounting Entries; (10) Statement of Net Cost; (11) Reconciliation of Net Cost of Operations to Budget.

1.B. Mission of the Reporting Entity

The DON was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The overall mission of the DON is to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression, and maintaining freedom of the seas. The NWCF provides goods, services, and infrastructure to the DON and other DoD customers to help ensure our military forces are mobile, ready, and have the most advanced technology.

The NWCF is a revolving fund that finances the DON activities providing products and services on a reimbursable basis, based on a relationship between operating units and NWCF support organizations. Customers send funded orders to the NWCF providers who furnish the services or products, pay for incurred expenses, and bill the customers, who in turn authorize payment. NWCF activities strive to break even over the budget cycle. NWCF has five programs: Depot Maintenance, Supply Management, Research and Development, Base Support, and Transportation.

1.C. Appropriations and Funds

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

NWCF received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations which result in transactions that flow through the fund. The NWCF furnishes goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the NWCF as an infusion of cash when revenues are inadequate to cover costs within the corpus. In FY 2013, the NWCF received appropriated dollars for Hurricane Sandy-related expenses.

1.D. Basis of Accounting

The NWCF's financial management systems are unable to meet all full accrual accounting requirements. This is primarily because many of the NWCF's financial and nonfinancial feeder systems and processes were designed prior to the legislative mandate to produce financial statements in accordance with USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis but were designed to record information on a budgetary basis.

Although the accrual basis of accounting is not fully implemented, under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Under the budgetary basis, however, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

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

The DoD is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. NWCF activities currently use USGAAP compliant and non-compliant systems. Until all NWCF activities use USGAAP compliant systems, some financially reported data will be derived from existing transactional data.

The preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

1.E. Revenues and Other Financing Sources

Depot Maintenance NWCF activities recognize revenue according to the percentage of completion method. Supply Management NWCF activities recognize revenue from the sale of inventory items. Research and Development NWCF activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Base Support NWCF activities recognize revenue at the time service is rendered. Transportation NWCF activities recognize revenue on either a reimbursable or per diem basis. The majority of per diem projects are billed and collected in the month services are rendered. The remaining per diem projects accrue revenue in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered.

The NWCF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Note 18, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost-sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

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

1.G. Accounting for Intragovernmental Activities

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

The Treasury Financial Manual Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government", provides guidance for reporting and reconciling intragovernmental balances. While NWCF is unable to fully reconcile intragovernmental transactions with all Federal agencies, NWCF is able to reconcile balances pertaining to FECA transactions with the Department of Labor and benefit program transactions with the Office of Personnel Management.

Imputed financing represents the costs paid on behalf of the NWCF by another Federal entity. The NWCF recognizes imputed costs for (1) employee pension, post-retirement health, and life insurance benefits; (2) post-employment benefits for terminated and inactive employees to include unemployment and workers compensation under the Federal Employees' Compensation Act; and (3) losses in litigation proceedings.

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

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

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

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

1.J. Cash and Other Monetary Assets

Cash is the total of cash resources under the control of NWCF which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions.

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience. In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 1, "Accounting for Selected Assets and Liabilities", the methodology for losses due to uncollectible amounts are based on an individual account analysis and/or group analysis. The analysis is based on three years of receivable data. This data is used to determine the historical percentage of collections in each age category of receivables. The NWCF does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual Part 2, Chapter 4700, Appendix 10, "Intragovernmental Business Rules".

1.L. Inventories and Related Property

The NWCF values approximately 99% of its resale inventory using the Moving Average Cost (MAC) method. The NWCF reports the remaining 1% of resale inventories at an approximation of historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The LAC method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property". Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). The NWCF is continuing to transition the balance of the inventories to the MAC method through the implementation of Navy ERP. Most transitioned balances, however, were not base-lined to auditable historical cost and remain noncompliant with SFFAS No. 3.

The NWCF manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in NWCF's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The NWCF holds materiel based on military need and support for contingencies. The DoD is currently developing a methodology to be used to account for "inventory held for sale" and "inventory held in reserve for future sale" under the provisions of SFFAS No. 3, "Accounting for Inventory and Related Property".

Related property includes OM&S. NWCF OM&S is categorized as operating material and supplies held for use. The OM&S is valued at LAC. The NWCF uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, NWCF uses the purchase method. Under this method, material and supplies are expensed when purchased. During FY 2014 and FY 2013, NWCF expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

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

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

1.M. General Property, Plant and Equipment

Property, Plant and Equipment (PP&E) consists of two categories: General PP&E and Stewardship PP&E. Heritage Assets and Stewardship Land (classifications of Stewardship PP&E) are reported on the financial statements of the DON. The NWCF classifies all PP&E assets in the General PP&E category.

The NWCF's General PP&E capitalization threshold is $250 thousand. The capitalization threshold applies to asset acquisitions and modifications/improvements placed into service after September 30, 2013. PP&E assets acquired prior to October 1, 2013 were capitalized at prior threshold levels ($100 thousand equipment and $20 thousand for real property) and are carried at the remaining net book value.

General PP&E assets are capitalized in accordance with SFFAS No. 6, as amended by SFFAS Nos. 10, 23, and 35 when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD's capitalization threshold. SFFAS 35 amends SFFAS 6 permitting the use of estimated PP&E values when historical cost information is not available. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold for General PP&E and extend the useful life or increase the size, efficiency, or capacity of the asset. The NWCF depreciates all General PP&E, other than land, on a straight- line basis.

When it is in the best interest of the government, the NWCF provides government property to contractors to complete contract work. The NWCF either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E meets or exceeds the DoD capitalization threshold, Federal accounting standards require that it be reported on NWCF's Balance Sheet.

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

NWCF capitalizes all PP&E used in the performance of its mission. These assets are capitalized as General PP&E whether or not they meet the definition of any other PP&E category.

1.N. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy as prescribed in SFFAS No. 1, "Accounting for Selected Assets and Liabilities", is to record advances or prepayments in accordance with USGAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The NWCF has not implemented this policy primarily due to system limitations.

Due to inconsistencies in the posting logic for non-Federal Advances and Prepayments, NWCF is noncompliant with the Federal Financial Management Improvement Act of 1996 (FFMIA),which requires agencies to comply with the Federal financial management systems requirements, standards promulgated by the Federal Accounting Standards Advisory Board (FASAB), and the USSGL at the transaction level.

1.O. Leases

In accordance with SFFAS No. 5, "Accounting for Liabilities of the Federal Government", lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, NWCF records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The NWCF records the asset and the liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The NWCF, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are expensed over the lease term as they become payable.

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

1.P. Other Assets

Other assets include non-Federal advances and prepayments, military and civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on NWCF's Balance Sheet.

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

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

1.Q. Contingencies and Other Liabilities

The DON is party to various administrative proceedings, legal actions, and claims. Under SFFAS No. 5, "Accounting for Liabilities of the Federal Government", as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation", the Balance Sheet should include estimated liabilities for these items, when an adverse decision is probable, reasonably possible, and estimable. When the amount of the potential loss cannot be estimated, or the likelihood of an unfavorable outcome is remote, the contingency is not disclosed.

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

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

1.R. Accrued Leave

Military leave, compensatory and annual leave earned by civilians, but not yet used, is reported as accrued liabilities. The accrued balance is adjusted annually to reflect current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.S. Net Position

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

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

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

1.T. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported disbursements and collections may be evidenced by the availability of corroborating documentation that would generally support the summary level adjustments made to accounts payable and receivable. Both supported and unsupported adjustments may have been made to the NWCF Accounts Payable and Receivable trial balances prior to validating underlying transactions required to establish the Accounts Payable/Receivable. As a result, misstatements of reported Accounts Payable and Receivables are likely present in the NWCF financial statements.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD is generally unable to determine whether undistributed disbursements and collections should be applied to Federal or non-Federal accounts payables/receivables at the time accounting reports are prepared. Accordingly, the DoD policy is to allocate supported undistributed disbursements and collections between Federal and non-Federal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Both supported and unsupported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly.

1.U. Federal Employee and Veteran Benefits

For financial reporting purposes, the DON's 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. Military retirement is accounted for in the audited financial statements of the Military Retirement fund; as such, NWCF does not record any liabilities or obligations for pensions or healthcare retirement benefits.

NOTE 2. NONENTITY ASSETS

As of September 30	2014	2013
(Amounts in thousands)		
Accounts Receivable with the Public	$ 15,974	$ 10,285
Total Entity Assets	$ 37,920,579	$ 28,788,679
Total Assets	$ 37,936,553	$ 28,798,964

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

Nonentity Nonfederal Accounts Receivable (Public)

The nonentity non-Federal accounts receivable amount represents interest, penalties, fines and administrative fees that will be remitted to the U.S. Treasury.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30	2014	2013
(Amounts in thousands)		
Fund Balances		
Revolving Funds	$ 757,326	$ 1,481,951

STATUS OF FUND BALANCE WITH TREASURY

As of September 30	2014	2013
(Amounts in thousands)		
Unobligated Balance		
Available	$ 3,193,617	$ 3,580,527
Unavailable	72,313	54,761
Obligated Balance not yet Disbursed	12,574,833	12,937,256
Non-FBWT Budgetary Accounts	(15,083,437)	(15,090,593)
Total	$ 757,326	$ 1,481,951

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

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable amount primarily relates to Research and Development funding. Certain unobligated balances are restricted for future use and are not apportioned for current use.

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

Non-FBWT Budgetary Accounts reduces the Status of FBWT. This amount is comprised of contract authority, accounts receivable, and unfilled orders without advance from customers for the NWCF. Due to the DON systems inability to segregate Budgetary FBWT balances, Non-FBWT Budgetary Accounts are used to reconcile the Status of FBWT.

OTHER

As of September 30	2014		2013	
(Amounts in thousands)				
Fund Balances Per Treasury Versus Agency				
Fund Balance per Treasury	$	757,326	$	1,481,951
Fund Balance per DON		757,326		1,481,951
Reconciling Amount	$	-	$	-

NOTE 4. ACCOUNTS RECEIVABLE

As of September 30	2014					
	Gross Amount Due		Allowance For Estimated Uncollectibles		Accounts Receivable, Net	
(Amounts in thousands)						
Intragovernmental Receivables	$	1,206,541		N/A	$	1,206,541
Nonfederal Receivables (From the Public)		74,936		(3,453)		71,483
Total	$	1,281,477	$	(3,453)	$	1,278,024

As of September 30	2013					
	Gross Amount Due		Allowance For Estimated Uncollectibles		Accounts Receivable, Net	
(Amounts in thousands)						
Intragovernmental Receivables	$	1,317,180		N/A	$	1,317,180
Nonfederal Receivables (From the Public)		68,466		(3,637)		64,829
Total	$	1,385,646	$	(3,637)	$	1,382,009

The accounts receivable represent the NWCF's claim for payment from other entities. Intragovernmental Receivables primarily represents amounts due from other Federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Claims with other Federal agencies are resolved in accordance with the Intragovernmental Business Rules. Nonfederal Accounts Receivable is mainly held with Naval Facilities Engineering Command and Naval Supply Systems Command. The NWCF only recognizes an allowance for uncollectible amounts from the public. The methodology used in determining the allowance amount is discussed in Note 1.K.

NOTE 5. OTHER ASSETS

As of September 30	2014		2013	
(Amounts in thousands)				
Intragovernmental Other Assets				
Advances and Prepayments	$	46	$	46
Outstanding Contract Financing Payments		646,089		627,322
Advances and Prepayments		1,739,740		1,433,278
Other Assets (With the Public)		716		927
Total Nonfederal Other Assets		2,386,545		2,061,527
Total	$	2,386,591	$	2,061,573

Nonfederal Other Assets - Outstanding Contract Financing Payments consist of contract terms and conditions for certain types of contract financing payments convey certain rights to the NWCF protecting the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance. The NWCF is not obligated to make payment to the contractor until delivery and acceptance. As a result, cash outlays and payments are made by the NWCF to contractors, grantees, or others to cover the recipients' anticipated and periodic expenses before those expenses are incurred. Outstanding Contract Financing Payments are reduced when goods and services are received, contract terms are met, progress is made on a contract, or prepaid expenses expire.

Outstanding Contract Financing Payments includes $593.7 million in contract financing payments and an additional $52.4 million in estimated future funded payments to contractors upon delivery and Government acceptance of a satisfactory product. Refer to Note 12, Other Liabilities, for further information.

Due to reclassification of intragovernmental activity and inaccurate posting logic, nonfederal Advances and Prepayments are recognized within the NWCF.

Nonfederal Other Assets - Advances and Prepayments increased primarily due to Navy Supply Management reclassification of Federal Advances and Prepayments to nonfederal Advances and Prepayments in order to reconcile seller side trading partner data.

Nonfederal Other Assets consists of prepayments made to vendors and travel advances made to employees.

NOTE 6. CASH AND OTHER MONETARY ASSETS

As of September 30	**2014**	**2013**
(Amounts in thousands)		
Cash	$ 2,448	$ 11,664

NWCF Cash consists of coins, paper currency and readily negotiable instruments; such as money orders, checks, and bank drafts on hand or in transit for deposit.

There are no restrictions on cash, or the use, or conversion of foreign currencies.

NOTE 7. INVENTORY AND RELATED PROPERTY

As of September 30	2014	2013
(Amounts in thousands)		
Inventory, Net	$ 31,283,575	$ 21,504,496
Operating Materials & Supplies, Net	169,910	200,920
Total	$ 31,453,485	$ 21,705,416

Inventory, Net

As of September 30	2014						
		Inventory Gross Value		Revaluation Allowance		Inventory, Net	Valuation Method
(Amounts in thousands)							
Inventory Categories							
Available and Purchased for Resale	$	18,071,562	$	80,020	$	18,151,582	MAC, LAC
Held for Repair		13,140,298		(34,792)		13,105,506	MAC, LAC
Excess, Obsolete, and Unserviceable		28,156		(28,156)		-	NRV
Work in Process		26,487		-		26,487	AC
Total	$	31,266,503	$	17,072	$	31,283,575	

As of September 30	2013						
		Inventory Gross Value		Revaluation Allowance		Inventory, Net	Valuation Method
(Amounts in thousands)							
Inventory Categories							
Available and Purchased for Resale	$	8,945,862	$	(987,112)	$	7,958,750	MAC, LAC
Held for Repair		13,709,578		(194,511)		13,515,067	MAC, LAC
Excess, Obsolete, and Unserviceable		667,405		(667,405)		-	NRV
Work in Process		30,679		-		30,679	AC
Total	$	23,353,524	$	(1,849,028)	$	21,504,496	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost NRV = Net Realizable Value MAC = Moving Average Cost
AP = Acquisition Cost LCM = Lower of Cost or Market

As a result of the Department's ongoing audit readiness efforts, significant accounting adjustments have been made to the NWCF's mission critical assets. These accounting adjustments were recognized in current year gain/loss accounts when auditable data was not available to support restatement of prior period financial statements.

General Composition of Inventory

Inventory available and purchased for resale includes consumable spare and repair parts as well as reparable items owned and managed by the NWCF. Inventory includes all materiel available for customer purchase. Inventory is assigned to categories based upon condition of the inventory items, or in the case of raw material and work-in-process based upon stage of fabrication. Inventory held for repair consists of damaged materiel that requires repair to make it usable. Excess inventory includes scrap materials or items that are uneconomical to repair and are awaiting disposal. Work in process 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 the submission of bills to the customer.

Federal Accounting Standards require disclosure of the amount of Inventory Held for "Future Use". The NWCF currently has $637.6 million and $609.9 million reported as of September 30, 2014 and 2013, respectively in Inventory Held for Future Sale, Net.

Inventory Valuation

Navy's inventory is reported using two methods: the approximation of historical cost method and Moving Average Cost (MAC). The approximation of historical cost is calculated by using the Latest Acquisition Cost (LAC) less the allowance for holding gains and losses. MAC is calculated each time costs are incurred for a purchase or a repairable item is remanufactured by dividing the cost of total units available at the time. Legacy inventory systems are designed to capture materiel management information rather than accounting data. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property". The Office of Under Secretary of Defense, Comptroller (OUSD (C)) Cost of Goods Sold Model revalued inventory causing NWCF to be non-compliant with SFFAS No. 3. Navy ERP values inventory at MAC in accordance with USGAAP. As of September 30, 2014, 99% of NWCF inventory was valued at MAC.

For compliance, the revaluation of the inventory to MAC occurred in the field accounting system to be compliant with SFFAS No. 3.

Restrictions on Use of Inventory

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

1) Distributions without reimbursement are made when authorized by DoD directives;

2) War reserve materiel in the amount of $29.8 million includes repair items that are considered restricted; and

3) Inventory, with the exception of safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

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

NWCF previously used the LAC (inventory allowance method) for valuing inventory. Inventory is now valued using the MAC method. This change resulted in a $10 billion gain in FY 2014.

Operating Materials and Supplies, Net

As of September 30	2014			
	OM&S Gross Value	**Revaluation Allowance**	**OM&S, Net**	**Valuation Method**
(Amounts in thousands)				
OM&S Categories				
Held for Use	$ 169,902	$ -	$ 169,902	LAC, MAC
Held for Repair	8	-	8	LAC, MAC
Total	$ 169,910	$ -	$ 169,910	

As of September 30	2013			
	OM&S Gross Value	**Revaluation Allowance**	**OM&S, Net**	**Valuation Method**
(Amounts in thousands)				
OM&S Categories				
Held for Use	$ 200,912	$ -	$ 200,912	LAC, MAC
Held for Repair	8	-	8	LAC, MAC
Total	$ 200,920	$ -	$ 200,920	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost MAC = Moving Average Cost

The NWCF assigns OM&S to a category based upon the type and condition of the asset. OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. OM&S Held for Use includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal.

The consumption method is applied when accounting for OM&S. Exceptions to the consumption method are provided when (1) the OM&S are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost beneficial to apply the consumption method. In any of these events, the purchase method is allowed. Legacy accounting systems cannot support the consumption method of accounting, thus the various reporting activities are currently using the purchase method. As financial reporting entities begin to purchase material in Navy ERP, the consumption method will be properly applied.

The moving average cost valuation method using historical cost is used for a majority of the OM&S categories; however actual cost and latest acquisition cost are also valuation methods applied depending on the legacy inventory system used to forecast OM&S cost. The NWCF is currently using the allowance method of accounting for repairables in the legacy accounting system and the direct method of accounting for repairables in Navy ERP.

Federal Accounting Standards require disclosure of the amount of OM&S Held for "Future Use." The NWCF reports that $0.3 million and $0.2 million of OM&S is Held for Future Use and is included in the "held for use" category as of September 30, 2014 and 2013, respectively. These items are not readily available in the market and there is a more than a remote chance that they will eventually be needed.

NOTE 8. GENERAL PP&E, NET

As of September 30	2014				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
(Amounts in thousands)					
Major Asset Classes					
Land	N/A	N/A	$ 3,235	$ N/A	$ 3,235
Buildings, Structures, and Facilities	S/L	20 or 40	6,159,269	(4,909,608)	1,249,661
Software	S/L	2-5 or 10	383,091	(313,769)	69,322
General Equipment	S/L	5 or 10	2,688,191	(2,204,061)	484,130
Construction-in-Progress	N/A	N/A	252,257	N/A	252,257
Other	N/A	N/A	74	-	74
Total General PP&E			$ 9,486,117	$ (7,427,438)	$ 2,058,679

As of September 30	2013				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
(Amounts in thousands)					
Major Asset Classes					
Land	N/A	N/A	$ 31,272	$ N/A	$ 31,272
Buildings, Structures, and Facilities	S/L	20 or 40	6,735,400	(5,393,651)	1,341,749
Software	S/L	2-5 or 10	368,643	(299,647)	68,996
General Equipment	S/L	5 or 10	2,635,761	(2,146,907)	488,854
Construction-in-Progress	N/A	N/A	225,480	N/A	225,480
Total General PP&E			$ 9,996,556	$ (7,840,205)	$ 2,156,351

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

General Composition of General Property, Plant and Equipment

NWCF General PP&E consists of buildings and structures, lease hold improvements, software, general equipment and construction-in-progress. General PP&E, Other consists of assets awaiting disposal.

General Property, Plant and Equipment Valuation

The acquisition cost for General PP&E is captured and maintained in the applicable accountable property systems of record. The methodology used in capitalizing General PP&E assets is discussed in Note 1.M.

Restrictions on Use of Property, Plant and Equipment

There are no known restrictions on the use or convertibility of General PP&E.

As a result of the Department's ongoing audit readiness efforts, significant accounting adjustments have been made to the NWCF's mission critical assets. These accounting adjustments were recognized in current year gain/loss accounts when auditable data was not available to support restatement of prior period financial statements.

For FY 2014, the capitalization threshold for NWCF General PP&E increased from $100 thousand to $250 thousand. This change is prospective and applies to asset acquisitions and modifications/improvements placed into service October 1, 2013 and after.

NOTE 9. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30	2014	2013
(Amounts in thousands)		
Intragovernmental Liabilities		
Other	$ 151,227	$ 161,761
Federal Employee and Veteran Benefits	740,686	774,032
Total Liabilities Not Covered by Budgetary Resources	891,913	935,793
Total Liabilities Covered by Budgetary Resources	5,721,180	5,482,267
Total Liabilities	$ 6,613,093	$ 6,418,060

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through Congressional appropriations or earnings of the entity.

Intragovernmental Liabilities – Other consists of the unfunded portion of FECA liability due to the Department of Labor and unemployment compensation due to applicable States. These liabilities will be funded by future year's budgetary resources.

Federal Employee and Veteran Benefits consist of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities represent FECA Actuarial liabilities that will be funded in future periods. Refer to Note 14, Federal Employee and Veteran Benefits, for additional details and disclosures.

NOTE 10. ACCOUNTS PAYABLE

As of September 30	2014		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
Intragovernmental Payables	$ 329,022	$ N/A	$ 329,022
Nonfederal Payables (to the Public)	3,844,119	-	3,844,119
Total	$ 4,173,141	$ -	$ 4,173,141

As of September 30	2013		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
(Amounts in thousands)			
Intragovernmental Payables	$ 192,102	$ N/A	$ 192,102
Nonfederal Payables (to the Public)	3,741,192	-	3,741,192
Total	$ 3,933,294	$ -	$ 3,933,294

Accounts Payable includes amounts owed to Federal and nonfederal entities for goods and services received by NWCF. The NWCF's systems do not track intragovernmental transactions by customer at the transaction level. As a result, in the intragovernmental eliminations process, buyer-side accounts payable are adjusted to agree with supportable inter/intraagency seller-side accounts receivable.

NOTE 11. ENVIRONMENTAL LIABILITIES AND DISPOSAL LIABILITIES

The NWCF Environmental Liabilities are reported under the DON financial statements and accompanying Note 12, Environmental Liabilities and Disposal Liabilities.

NOTE 12. OTHER LIABILITIES

As of September 30	2014		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
Intragovernmental			
Advances from Others	$ 134,095	$ -	$ 134,095
FECA Reimbursement to the Dept of Labor	68,511	82,716	151,227
Custodial Liabilities	15,974	-	15,974
Employer Contribution and Payroll Taxes Payable	30,943	-	30,943
Total Intragovernmental	249,523	82,716	332,239
Accrued Funded Payroll and Benefits	1,036,276	-	1,036,276
Advances from Others	273,560	-	273,560
Deposit Funds and Suspense Accounts	49	-	49
Contract Holdbacks	871	-	871
Employer Contribution and Payroll Taxes Payable	4,162	-	4,162
Contingent Liabilities	-	52,402	52,402
Other Liabilities	(293)	-	(293)
Total Other Liabilities	$ 1,564,148	$ 135,118	$ 1,699,266

As of September 30	2013		
	Current Liability	Noncurrent Liability	Total
(Amounts in thousands)			
Intragovernmental			
Advances from Others	$ 142,441	$ -	$ 142,441
FECA Reimbursement to the Dept of Labor	74,364	87,398	161,762
Custodial Liabilities	10,285	-	10,285
Employer Contribution and Payroll Taxes Payable	27,555	-	27,555
Total Intragovernmental	254,645	87,398	342,043
Accrued Funded Payroll and Benefits	1,043,768	-	1,043,768
Advances from Others	276,892	-	276,892
Deposit Funds and Suspense Accounts	99	-	99
Contract Holdbacks	1,647	-	1,647
Employer Contribution and Payroll Taxes Payable	3,212	-	3,212
Contingent Liabilities	-	43,088	43,088
Other Liabilities	(15)	-	(15)
Total Other Liabilities	$ 1,580,248	$ 130,486	$ 1,710,734

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

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

Custodial Liabilities represents liabilities for collections reported as nonexchange revenues where NWCF is acting on behalf of another Federal entity.

Contingent Liabilities includes $52.4 million related to contracts authorizing progress payments based on cost as defined in the FAR. In accordance with contract terms, specific rights to the contractor's work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. It is DoD policy that these rights should not be misconstrued as the rights of ownership. The NWCF is under no obligation to pay the contractor for amounts greater than the amounts of progress payments authorized in the contract until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid are estimable, the NWCF has recognized a contingent liability for the estimated unpaid costs that are considered conditional for payment pending delivery and government acceptance.

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

NOTE 13. COMMITMENTS AND CONTIGENCIES

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

For FY 2014, NWCF materiality threshold for reporting litigation, claims, or assessments is $3.9 million. The NWCF OGC conducts a review of litigation and claims threatened or asserted involving NWCF to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The NWCF currently has 4 cases that meet the existing FY 2014 materiality threshold. NWCF legal counsel was unable to express an opinion concerning the likely outcome on 2 of 4 cases.

The DON is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures.

NOTE 14. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30	2014		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in thousands)			
Other Actuarial Benefits			
FECA	$ 740,686	$ -	$ 740,686

As of September 30	2013		
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
(Amounts in thousands)			
Other Actuarial Benefits			
FECA	$ 774,032	$ -	$ 774,032

The NWCF reports an actuarial liability for the FECA. FECA provides Federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. FECA is administered by the Office of Workers' Compensation Programs. The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

Actuarial Cost Method Used

The NWCF's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to NWCF only at the end of each fiscal year.

The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The 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.

NOTE 15. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Intragovernmental Costs and Exchange Revenue *As of September 30* (Amounts in thousands)	2014	2013
Intragovernmental Costs	$ 5,250,361	$ 5,348,164
Nonfederal Costs	24,154,836	23,609,017
Total Costs	$ 29,405,197	$ 28,957,181
Intragovernmental Earned Revenue	$ (24,167,002)	$ (24,818,135)
Nonfederal Revenue	(14,827,537)	(1,772,033)
Total Revenue	$ (38,994,539)	$ (26,590,168)
Total Net Cost	$ (9,589,342)	$ 2,367,013

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

Intragovernmental costs and revenue represent transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity. Large balances in the public costs and revenue lines are a result of the current process in Navy ERP. The process produces inflated gains and offsetting losses on separate financial statement and note schedule lines, however, the impact on Net Cost is reduced when the gains and losses are combined. The Navy is currently working to resolve the business process that results in daily postings to the gain and loss accounts for intransit inventory.

The NWCF's financial management systems do not track intragovernmental transactions by customer at the transactional level. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between Federal and nonfederal expenses. Intradepartment revenues and expenses are then eliminated.

NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

The Statement of Changes in Net Position reports the change in net position during the reporting period. Net position is affected by changes to its two components: Cumulative Results of Operations and Unexpended Appropriations.

NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30	2014	2013
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 9,564,655	$ 9,498,826

DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

	2014		
As of September 30	Direct Obligations	Reimbursable Obligations	Total
(Amounts in thousands)			
Obligations Apportioned Under			
Category A	$ -	$ -	$ -
Category B	-	28,400,000	28,400,000
Exempt	-	-	-
Total	$ -	$ 28,400,000	$ 28,400,000

	2013		
As of September 30	Direct Obligations	Reimbursable Obligations	Total
(Amounts in thousands)			
Obligations Apportioned Under			
Category A	$ -	$ -	$ -
Category B	24,000	28,800	52,800
Exempt	-	-	-
Total	$ 24,000	$ 28,800	$ 52,800

The table above discloses apportionment categories for obligations incurred as direct and reimbursable obligations in the apportionment category they are under (Category A, B and Exempt from apportionment).

Other Disclosures

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

NOTE 18. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30		2014		2013
(Amounts in thousands)				
Resources Used to Finance Activities				
Budgetary Resources Obligated:				
Obligations Incurred	$	28,412,686	$	28,855,188
Less: Spending Authority from Offsetting Collections and Recoveries		(27,432,715)		(29,674,995)
Net Obligations		979,971		(819,807)
Other Resources:				
Transfers In/Out without Reimbursement		453,830		461,027
Imputed Financing from Costs Absorbed by Others		544,010		515,872
Other		(1,202,309)		2,708,285
Net Other Resources Used to Finance Activities		(204,469)		3,685,184
Total Resources Used to Finance Activities	$	775,502	$	2,865,377
Resources Used to Finance Items not Part of the Net Cost of Operations				
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided:				
Undelivered Orders	$	(65,829)	$	(147,026)
Unfilled Customer Orders		(665,858)		893,775
Resources that Fund Expenses Recognized in Prior Periods		(43,881)		(8,878)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations		-		-
Resources that Finance the Acquisition of Assets		(5,677,013)		(5,376,250)
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations:				
Other		748,478		(3,169,313)
Total Resources Used to Finance Items not part of the Net Cost of Operations		(5,704,103)	$	(7,807,692)
Total Resources Used to Finance the Net Cost of Operations	$	(4,928,601)	$	(4,942,315)
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period				
Components Requiring or Generating Resources in Future Period:				
Other	$	-	$	19,215
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	$	-	$	19,215
Components not Requiring or Generating Resources:				
Depreciation and Amortization	$	265,127	$	288,436
Revaluation of Assets or Liabilities		(10,052,031)		1,885,071
Other				
Cost of Goods Sold		8,382,276		8,486,903
Operating Materials and Supplies Used		1,443		-
Other		(3,257,556)		(3,370,297)
Total Components of Net Cost of Operations that will not Require or Generate Resources		(4,660,741)		7,290,113
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	(4,660,741)	$	7,309,328
Net Cost of Operations	$	(9,589,342)	$	2,367,013

Due to NWCF financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. The difference between budgetary and proprietary data is a previously identified deficiency. As a result of these system limitations, resources that finance the acquisition of assets on the reconciliation of Net Cost of Operations to Budget were adjusted upward by $5.6 billion (absolute amount) as of September 30, 2014 to bring it into balance with the Statement of Net Cost.

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

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

NOTE 19. DISCLOSURES RELATED TO INCIDENTAL CUSTODIAL COLLECTIONS

NWCF collected $22 million of incidental custodial revenues generated primarily from surcharges, interest, penalties, fines and administrative fees. These funds are not available for use by NWCF. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.

REQUIRED SUPPLEMENTARY INFORMATION

The Navy Working Capital Fund real property deferred maintenance and repair information for fiscal year ended September 30, 2014 is reported with the Department of the Navy deferred maintenance and repair. See Department of the Navy Required Supplementary Information.

OTHER INFORMATION

ENTITY ACCOUNTS

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[a]
97X4930.NA2*	Depot Maintenance – Aviation
97X4930.NA4A*	Depot Maintenance – Other, Marine Corps
97X4930.NA3*	Ordnance[b]
97X4930.ND*	Transportation
97X4930.NE*	Base Support
97X4930.NH*	Research and Development
97X4930.NC*	Supply Management
97X4930.NC2A*	Supply Management, Marine Corps

Notes:

- * The "*" represents alpha or numeric characters which identify an activity or reporting segment of the activity group.
- a Depot Maintenance, Shipyards became a part of the DON in FY 2007. The Depot Maintenance, Shipyards information included in this report represents residual NWCF accounting.
- b The Ordnance activity group became a part of the DON in FY 2000. The Ordnance information included in this report represents residual NWCF accounting for this group.

Cover Credits

Sailors aboard the a guided-missile destroyer man the rails during the ship's port visit. (U.S. Navy photo by Chief Mass Communication Specialist Wendy Wyman/ Released)

An amphibious assault ship returns to a shipyard from acceptance trials, where the ship's main propulsion, communications, steering, navigation and radar systems were tested. (U.S. Navy photo by Mass Communication Specialist 1st Class Lewis Hunsaker/Released)

Holding the rammer to push a round into a M777A2 lightweight 155 mm howitzer. (U.S. Marine Corps photo by Cpl. Lena Wakayama/Released)

Preparation of this report cost the Department of the Navy approximately $105,000 in Fiscal Year 2014.
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FOR MORE INFORMATION
Assistant Secretary of the Navy Financial Management and Comptroller
http://www.finance.hq.navy.mil/FMC

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