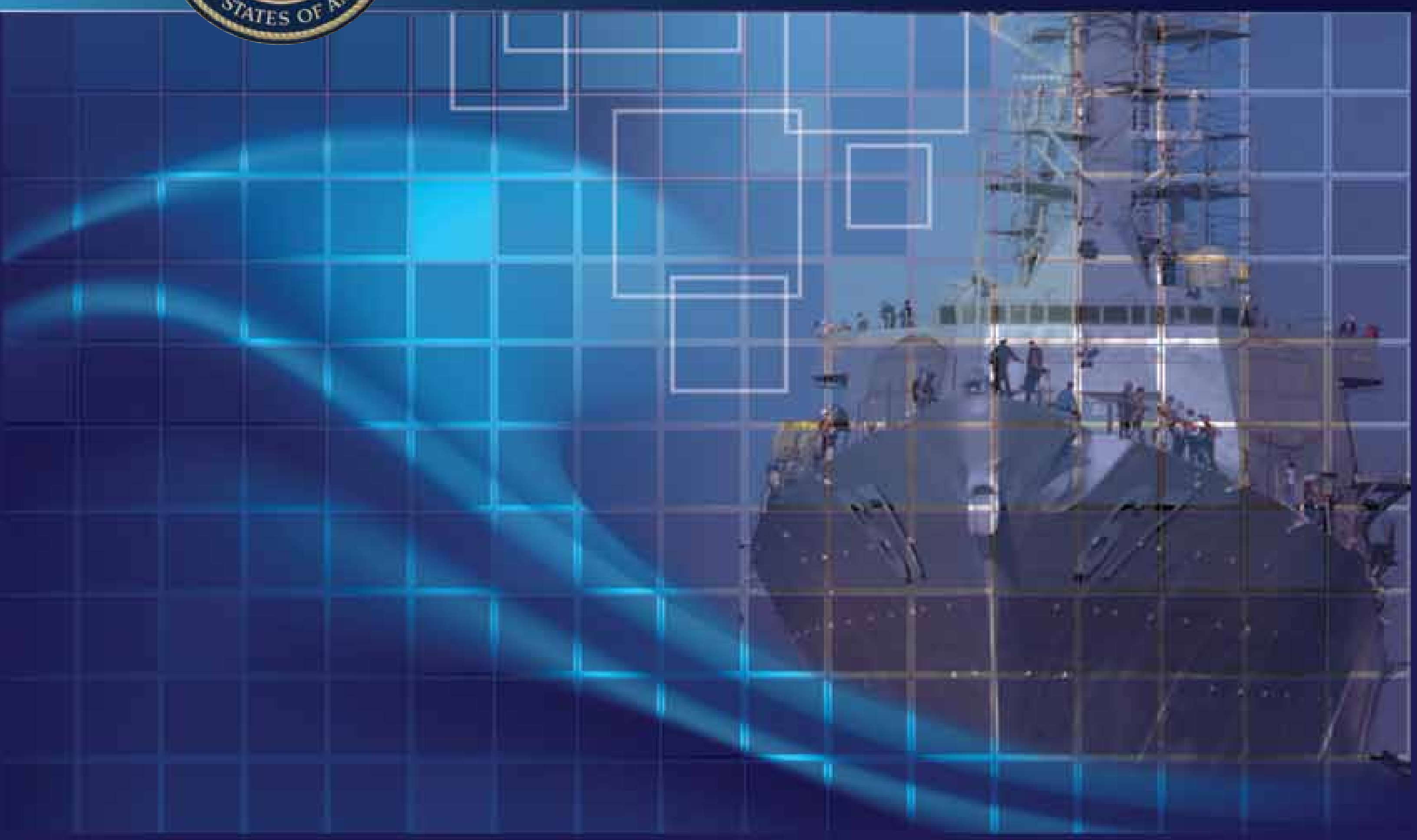
Department of the Navy Fiscal Year 2011 Annual Financial Report

Mission Ready: Managing Risk and Meeting Objectives



Report Documentation Page	*Form Approved* *OMB No. 0704-0188*

1. REPORT DATE	2. REPORT TYPE	3. DATES COVERED
2011		**00-00-2011 to 00-00-2011**

4. TITLE AND SUBTITLE	
Mission Ready: Managing Risk and Meeting Objectives. Department of the Navy Fiscal Year 2011 Annual Financial Report	5a. CONTRACT NUMBER
	5b. GRANT NUMBER
	5c. PROGRAM ELEMENT NUMBER
6. AUTHOR(S)	5d. PROJECT NUMBER
	5e. TASK NUMBER
	5f. WORK UNIT NUMBER
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) **Office of the Assistant Secretary of the Navy,(Financial Management and Comptroller),10 Navy Pentagon,Washington,DC,20350-1000**	8. PERFORMING ORGANIZATION REPORT NUMBER
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)	10. SPONSOR/MONITOR’S ACRONYM(S)
	11. SPONSOR/MONITOR’S REPORT NUMBER(S)

12. DISTRIBUTION/AVAILABILITY STATEMENT
Approved for public release; distribution unlimited

13. SUPPLEMENTARY NOTES

14. ABSTRACT

15. SUBJECT TERMS

16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT	18. NUMBER OF PAGES	19a. NAME OF RESPONSIBLE PERSON
a. REPORT	b. ABSTRACT	c. THIS PAGE			
unclassified	**unclassified**	**unclassified**	**Same as Report (SAR)**	**156**	

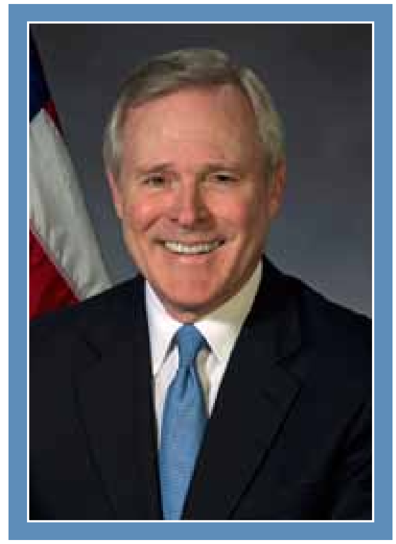
Standard Form 298 (Rev. 8-98)
Prescribed by ANSI Std Z39-18

Contents

Message from the Secretary of the Navy 2
Message from the Assistant Secretary of the Navy (Financial Management & Comptroller).......3
Management's Discussion and Analysis 5
General Fund Principal Statements 33
Working Capital Fund Principal Statements 101
Audit Opinions 139

THE SECRETARY OF THE NAVY
WASHINGTON, DC 20350-1000

November 4, 2011



Today's Navy and Marine Corps are the most flexible and formidable expeditionary fighting forces the world has ever known. This is our legacy and our ethos, and is what makes people around the globe turn to us in times of need with confidence that we will rise to the occasion.

This past year, we were able to execute very different missions using the same equipment and personnel and often with little notice or time to prepare, further demonstrating the flexibility and skill of the Navy-Marine Corps team. We deployed to defend our country, respond to natural disasters, ensure regional security, and maintain the flow of commerce.

Last Spring, the aircraft carrier USS RONALD REAGAN was headed across the Pacific to conduct combat air support missions over Afghanistan when the earthquake and tsunami struck Japan. In an instant, the carrier changed course and became a humanitarian assistance and disaster relief platform and operations center. The same day USS RONALD REAGAN was providing assistance to Japan, other Navy ships and submarines launched Tomahawk missiles against targets in Libya, while aircraft flew combat sorties enforcing the international approved no-fly zone. At the same time, more than twenty thousand Marines fighting in Afghanistan were joined by thousands of Sailors carrying out missions ranging from conducting strikes off the decks of ships in the Arabian Sea to building and reconstruction projects.

All the while, we remain committed to moving forward with our priorities for the Department of the Navy. We are taking care of our Sailors, Marines, civilians and their families at home and abroad, on ship and ashore. We are making improvements to the acquisitions process so that we can buy the equipment needed to succeed in current missions while meeting the challenges of the 21st century. We are investing in and building the ships, aircraft, submarines, unmanned vehicles and technologies we will need to respond now and in the future. When I became Secretary, the Navy's fleet was the smallest it has been since 1916. I made building our fleet a priority, and in the past two years we have gone from building fewer than six ships a year to an average of 11 ships per year.

We have also made significant progress toward energy independence. Energy security is first and foremost about making us better warfighters by making us more expeditionary and less vulnerable to foreign fuel sources. The Navy continues to grow and adapt as the needs of our country have changed. However, we are not interested in change for its own sake. By improving our systems and moving to renewable energy sources, we are becoming more self-reliant and making our people safer.

The Department of the Navy's Fiscal Year 2011 Annual Financial Report, *Mission Ready: Managing Risk and Meeting Objectives*, represents our enduring commitment to the proper stewardship of public resources, the continuous improvement of financial transparency and accountability, and the sustainment of national security and defense. We will continue managing risks facing our country and meeting our objectives for a stronger, more flexible and more efficient fighting force.

Ray Mabus

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

October 2011

Fiscal Year (FY) 2011 was a year of sustained effort for improving critical processes in external and internal operations. We worked to support our forces' key activities, both afloat and ashore, and to ensure agility and responsiveness in reacting to unexpected events. Our Sailors and Marines represented the United States of America around the globe, securing our homeland and providing humanitarian assistance where needed. That effort was made possible by the budgetary resources entrusted to the Department of the Navy (DON). We at the DON prudently managed those resources entrusted to us by the United States (U.S.) taxpayers and Congress by shoring up existing processes and priorities and initiating new areas for improvement.

We are taking steps to manage our risks by buying smarter, streamlining our organizations and operations, realigning manpower, and pursuing energy efficiencies. The responsibility for carefully overseeing and spending the DON's resources requires a continuous effort to improve transparency, accountability, and efficiency through improved financial systems and reporting. These overarching goals guided us in FY 2011.

OUR TOP PRIORITIES

Supporting the War Fighter. Supporting our war fighters in Afghanistan and around the world continued to be our most important priority during FY 2011. We ensured the proper systems, processes, and equipment were in place, so our people could carry out their critical missions. In addition, we continued to focus on quality of life improvements for our Sailors and Marines. An initiative on family housing reinforced our efforts to take care of Navy and Marine Corps families, and we remained committed to ensuring the best care for our wounded warriors.

Relief Efforts. A total of 12,750 personnel, 20 ships and 140 aircraft of the U.S. 7th fleet assisted Japan in recovering from a devastating earthquake and tsunami. The piers were completely empty in Yokosuka, Japan– marking the first time in memory that not a single U.S. ship was in port. The men and women of the U.S. 7th fleet were at sea focused on Operation Tomodachi, delivering relief to the people of northeast Honshu. We also provided humanitarian assistance and disaster relief in Pakistan and in Haiti. We supported relief efforts after Hurricane Irene impacted the East Coast of the United States. In addition, eight USS Missouri Sailors assisted with recovery efforts following a tornado that tore through Joplin, Missouri.

Moving Toward Energy Independence. We continued to implement actions that support the Secretary's stated goals of reducing energy usage risk and moving toward alternative energy sources. To develop biofuel technologies, we established partnerships with other federal agencies and state governments, such as the Departments of Agriculture and Energy and the state of Hawaii. We established similar partnerships with private entities through the Small Business Administration, venture capitalists, and investment firms to ensure that alternative fuel development also helps American industry.

The successful flight test of "The Green Hornet", an F/A-18 Super Hornet strike fighter was the first aviation program to test and evaluate the performance of a 50/50 biofuel blend in supersonic operations - a critical test point to successfully clear the F/A-18 E/F for biofuel operations through its entire flight envelope. The DON also completed successful biofuel flights for the T-45 training aircraft, the MH-60S Seahawk helicopter, and the Marine Corps' MV-22 Osprey. The Secretary of the Navy announced on 1 September 2011, that the Navy's precision aerial demonstration team, the Blue Angels, also would run on a biofuel mixture. Lastly, on 16 September 2011 an EA-6B Prowler became the first aircraft in the electronic warfare category to fly a biofuel blend. All of these aircraft were or will be powered by a biofuel blend made from the camelina plant, a hardy U.S.-grown plant that can thrive even on marginal agricultural lands and does not compete with food crops. The successful test flights and extensive fuels lab testing demonstrate that Navy and Marine Corps aircraft can safely operate on fuel produced from renewable sources.

Achieving Financial Auditability. The Marine Corps continued to make steady progress during its second audit of the Statement of Budgetary Resources. The Navy received an unqualified audit opinion on its Appropriations Received examination. We worked to create better information through Enterprise Resource Planning (ERP) development at Naval Sea Systems Command (NAVSEA) and Naval Supply Systems Command (NAVSUP). We standardized processes to ensure consistent and continuous financial reporting.

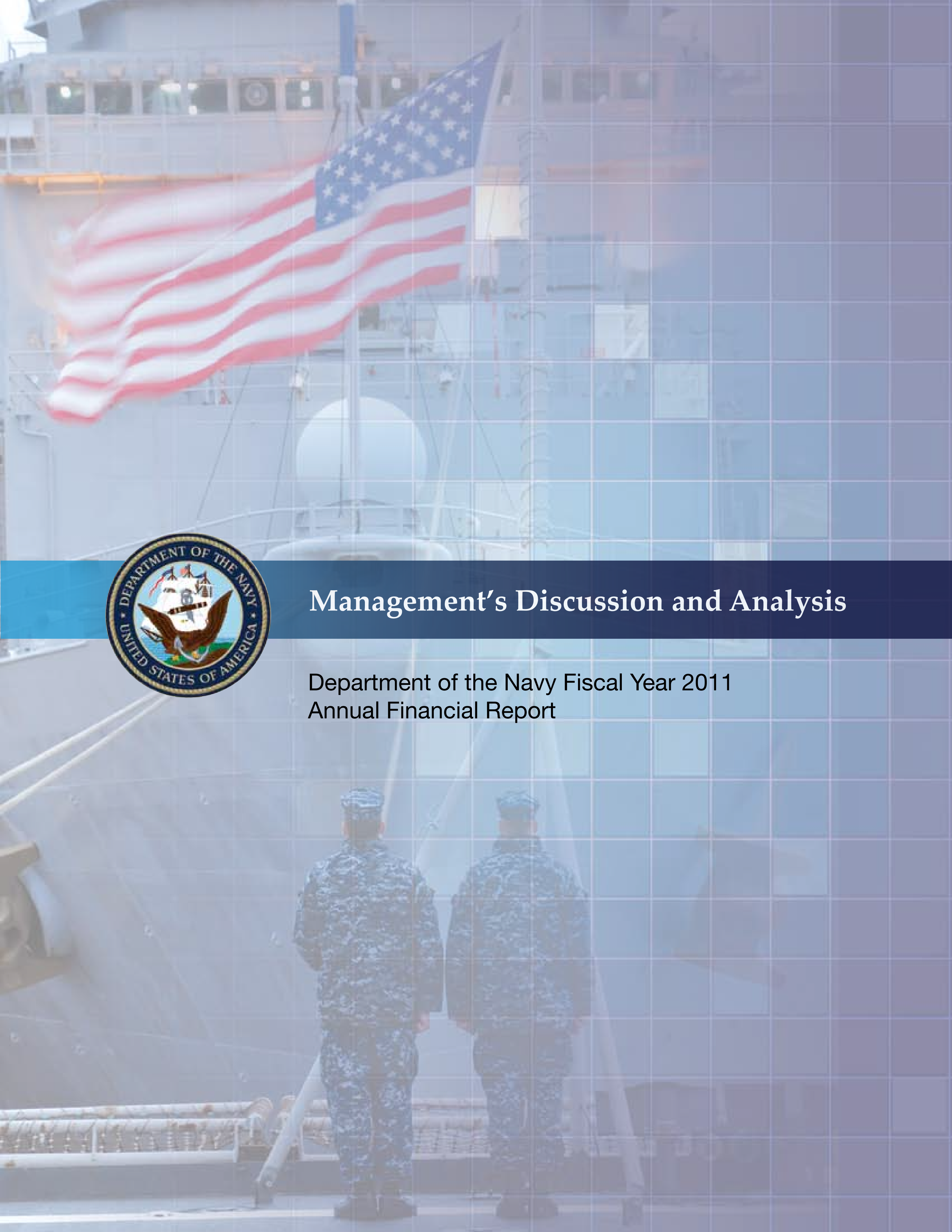
Continuing a Culture of Cost Savings and Efficiency. We raised the cost consciousness of our Department and identified more than $35 billion in cost savings across the Future Year Defense Plan (FYDP). The DON's Deputy Chief Management Officer spearheaded the DON Efficiency Working Group, comprised of members representing the Assistant Secretaries of the Navy and other Department leadership. Opportunities for savings were directed at overhead functions to include streamlining business operations without negatively impacting the war fighter. We looked for savings from the cost of doing business (workforce size and composition, number and size of staffs, and other human resource issues) and how we do business (acquisition reform, process improvements). We continued our efforts to reduce the cost to own and operate our Fleet. We significantly reduced overhead costs, and applied the savings to war fighting capability and capacity that improved the long-term sustainability of our force.

Supporting the Financial Management Workforce. We responded to the changing needs of our Financial Management (FM) workforce. We provided additional training and career development, graduated our first Executive Masters of Business Administration class, and provided resources for career broadening opportunities, as well as academic fellowships. Additionally, we initiated a new audit readiness course that will begin in FY 2012, and we sustained our successful trainee and associate programs, which bring new entry and mid-level employees into our personnel pipeline.

OUR COMMITMENT AND GOAL

Secretary Mabus and I are committed to using the taxpayers' dollars wisely. As we look ahead, we will continue to provide oversight and leadership that lead to greater efficiencies and savings. Our focus will continue to be on streamlining operations to ensure accuracy, reliability, and accessibility of financial information while meeting our operational objectives at home and abroad. As we move toward transparency in all DON financial transactions, the DON will be better at managing risks and successfully meeting our operational and financial objectives.

Gladys J. Commons



Management's Discussion and Analysis

Department of the Navy Fiscal Year 2011
Annual Financial Report

A Sailor test fires a .50 caliber machine gun aboard the aircraft carrier USS George H.W. Bush (CVN 77), which is supporting maritime security operations and theater security cooperation efforts in the U.S. 5th Fleet area of responsibility.

An officer-in-charge of the Convoy Security Element of Naval Mobile Construction Battalion (NMCB) 3, stationed in Afghanistan and part of Navy Expeditionary Combat Command, discusses a convoy movement using a terrain model.

The U.S. Navy was founded on 13 October 1775, and the DON was established on 30 April 1798. The DON 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 DON consists of two uniformed Services: the United States Navy and the United States Marine Corps.

The service and sacrifice of Sailors and Marines is a daily reminder that we are a nation at war. Today's Navy and Marine Corps team maintains its active contribution to continuing Overseas Contingency Operations, and remains committed to supporting non-traditional joint requirements in Iraq, Afghanistan, the Horn of Africa, and other locations worldwide. The Navy has over 40,000 active and reserve sailors continually deployed in support of the contingency operations overseas serving as members of carrier strike groups, expeditionary strike groups, Special Operating Forces, Seabee units, Marine forces, medical units, and as Individual Augmentees (IAs). Our Sailors and Marines are fully engaged on the ground, in the air, and at sea in support of operations in Iraq and Afghanistan. Navy Commanders are leading seven of the thirteen U.S.-led Provincial Reconstruction Teams in Afghanistan. A significant portion of the combat air missions over Afghanistan are flown by naval air forces. Our elite teams of Navy SEa, Air and Land teams (SEALs) are heavily engaged in combat operations, while Navy Explosive Ordnance Disposal platoons are defusing improvised explosive devices and landmines. Our SEABEE construction battalions are rebuilding schools and restoring critical infrastructure. Navy sealift is delivering the majority of heavy war equipment to Central Command, while Navy logisticians are ensuring materiel arrives on time. Our Navy doctors are providing medical assistance in the field and at forward operating bases.

The total naval workforce is shaped and optimized to support the National Defense Strategy. By maintaining U.S. maritime dominance, our Sailors and Marines promote security, stability, and trust around the world. Together, we provided a persistent forward presence, power projection abroad, and protection of the world's sea lanes. In fiscal year (FY) 2011, our Sailors and Marines, in cooperation with our foreign partners and allies, continued to provide training and deliver humanitarian aid, disaster relief, and other assistance throughout the globe. In times of crisis, Navy and Marine Corps units were often already on the scene or the first U.S. assets to arrive in force.

U.S. Marines assigned to Marine Medium Helicopter Squadron (HMM) 265 assist citizens of northern Japan, where a 9.0 magnitude earthquake struck the island nation on March 11.

Readily available energy is essential for deploying our Sailors and Marines around the globe in support of our nation's interests. Since our operational flexibility and sustainability are directly linked to our energy supplies, energy reliability is a strategic concern for our forces. The potential vulnerability of energy supplies could threaten our ability to perform on the battlefield and energy costs siphon resources from warfighting requirements. Therefore, the DON is working to develop greater energy independence and conservation ashore and afloat.

An alternative fuel blend powers a Riverine Command Boat (Experimental) (RCB-X) during test demonstrations in October at Naval Station Norfolk, Virginia.

Energy reform improves the capability and efficiency of ships, aircraft, and weapons systems, and ultimately makes us better warfighters, and ensures the safety of our Sailors and Marines. In Fall 2009, Secretary Mabus set five ambitious energy goals for the Navy and Marine Corps. Most overarching was that 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. Also by 2020, 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's progress on this target includes submarines that are powered using nuclear energy representing seventeen percent of total energy consumed.

The Navy and Marine Corps continued to make significant progress toward reaching the Secretary's goals in 2011. One of the most visible was a series of successful F-18 flights conducted on biofuel. That plane, called "The Green Hornet," flew 1.2 times the speed of sound on camelina and avgas blend. In addition, the Navy has tested an algae-based biofuel blend on MH-60 helicopters and a Riverine command ship. One benefit to camelina and algae is that neither impacts the food supply. The Navy has certified swift boats, and is working on guided missile destroyers and other surface combatants using biofuel blends. On ships, the Navy is looking at hybrid drives – electric drives – to increase fuel efficiency. The USS Makin Island saved almost $2 million in fuel costs on its maiden voyage around South America to its homeport in San Diego. The Navy is also working to improve the efficiency of bases by monitoring electricity usage in buildings. The Navy has signed contracts for larger uses of solar power, and is considering geothermal, hydrothermal, wave, solar, and wind. The focus is to ensure that alternate power does not impact food production but continues to decrease fossil fuel usage by the DON because more than half the ships and aircraft that will be around in 2020 are in the fleet today. The Navy continues to focus on sustainable energy by offering military contract opportunities to small businesses with sustainable energy programs, pilots, and initiatives. The Navy's efforts support a clean energy economy and 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 (DoD) mission. The pursuit of auditability will result in improved stewardship, reduced cost of business operations, and compliance with congressional direction. In FY 2011, the US Marine Corps was in its second year of the Statement of Budgetary Resources (SBR) audit. Concurrently, the DON Financial Improvement Program team is preparing the rest of the Department for SBR audit readiness with focused efforts to ready people, processes, and business systems for a financial statement audit. The DON understands that fundamental improvements to establish tighter internal controls and more standardized processes are needed within its operations. To standardize and enforce uniform business processes, especially within disparate commands, the DON is in the process of establishing a Navy Enterprise Resource Planning (ERP) system. Although processes are not yet standardized, the DON has employed control gap analysis to identify when a command's processes and/or controls differ significantly from suggested controls. Control gap analysis allows the DON to track and address significant deviations. Additionally, the DON began a concerted, multi-year effort to standardize processes and controls with the Navy ERP environment.

During FY 2011, the DON continued to demonstrate its commitment to effectively managing and mitigating risks to reflect progress with respect to mission objectives. These priority objectives are to:

- Provide a Total Naval Workforce Capable and Optimized to Support the National Defense Strategy
- Use the Navy-Marine Corps Team to Aggressively Prosecute Overseas Contingency Operations
- Build the Navy-Marine Corps Force for Tomorrow
- Safeguard the People and Resources of the Navy-Marine Corps Team
- Strengthen Ethics as a Foundation of Exemplary Conduct within the DON
- Provide First-Rate Facilities to Support Stationing, Training, and Operations of Naval Forces

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

Organization and Mission

We are structured to respond to a broad range of mission priorities that preserve our 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 the 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. SECNAV also oversees the construction, outfitting, and repair of naval ships, equipment, and facilities. 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 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, 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.

United States Navy	United States Marine Corps
Founded 13 October 1775	*Founded 10 November 1775*
Title 10 U.S. Code, Section 5062	*Title 10 U.S. Code, Section 5063*

Founded 30 April 1798

Title 10 U.S. Code, Section 5061

SECRETARY OF THE NAVY

UNDER SECRETARY OF THE NAVY

- **Assistant Secretary of the Navy** (Research, Development & Acquisition)
- **Assistant Secretary of the Navy** (Manpower & Reserve Affairs)
- **Assistant Secretary of the Navy** (Financial Management & Comptroller)
- **Assistant Secretary of the Navy** (Installations & Environment)
- **General Counsel of the Department of the Navy**

CHIEF OF NAVAL OPERATIONS

- U.S. Navy Shore Establishment
- U.S. Navy Reserves
- U.S. Navy Operating Forces

COMMANDANT OF THE MARINE CORPS

- U.S. Marine Corps Operating Forces
- U.S. Marine Corps Reserves
- U.S. Marine Corps Supporting Establishment

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

The chart above is a simplified illustration of the DON organizational structure. The full structure is shown online at www.navy.mil under "About the Navy."

The U.S. Navy and the U.S. 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 forces ready to support the U.S. joint military commands in conducting their worldwide missions.

Naval Sea Systems Command (NAVSEA)

With a force of 53,000 civilian, military, and contract support personnel, NAVSEA engineers, build, buy, and maintain the Navy's ships and submarines and their combat systems. To accomplish this, NAVSEA manages 150 acquisition programs and manages foreign military sales cases that include billions of dollars in annual military sales to partner nations. Today, the NAVSEA organization has 33 activities in 16 states. NAVSEA strives to be an efficient provider of defense resources for the nation, and it plays an important role in the Navy Enterprise. As a Provider Command, it has the responsibility of directing resource sponsors into the proper mix of manpower and resources to properly equip the fleet. NAVSEA further has the responsibility of establishing and enforcing technical authority in combat system design and operation. These technical standards use the organization's technical expertise to ensure systems are engineered effectively, and that they operate safely and reliably.

Naval Air Systems Command (NAVAIR)

NAVAIR is headquartered in Patuxent River, Maryland, with military and civilian personnel stationed at eight locations across the continental United States and one site overseas. NAVAIR's mission is to provide full life-cycle support of naval aviation aircraft, weapons, and systems operated by Sailors and Marines. This support includes research, design, development, and systems engineering; acquisition; test and evaluation; training facilities and equipment; repair and modification; and in-service engineering and logistics support. 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 (PEOs) 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 (NAE), while contributing to every Warfare enterprise in the interest of national security.

Naval Facilities Engineering Command (NAVFAC)

NAVFAC is the Systems Command that 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 manages the planning, design, construction, contingency engineering, real estate, environmental, and public works support for U.S. Navy shore facilities around the world. They provide the Navy's forces with the operating, expeditionary, support, and training bases needed. NAVFAC is a global organization with an annual volume of business in excess of $11 billion. 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.

Naval Supply Systems Command (NAVSUP)

NAVSUP's mission is to provide Navy, Marine Corps, and Joint and Allied Forces with products and services that deliver Combat Capability through Logistics. They manage supply chains that provide material for Navy aircraft, surface ships, submarines, and their associated weapons systems and provide centralized inventory management for Navy's nonnuclear ordnance stockpile. NAVSUP provides a wide range of base operating and waterfront logistics support services, coordinating material deliveries, contracting for supplies and services, and providing material management and warehousing services. NAVSUP is responsible for many of the Quality of Life programs that touch the lives of Sailors and their families every day, including: Navy Exchanges, Navy Lodges, the Navy Personal Property Program, and the Navy Postal System. They administer the Navy Food Service Program, with responsibility for the policies and procedures that govern the day-to-day operations of general messes afloat and ashore.

Space and Naval Warfare Systems Command (SPAWAR)

SPAWAR is an acquisition command. SPAWAR delivers higher-end Navy information technology products and services to the fleet and other Defense Department stakeholders. As the Navy's Information Dominance Systems Command, SPAWAR designs, develops, and deploys advanced communications and information capabilities. With more than 8,900 active duty military and civil service professionals located around the world and close to the fleet, SPAWAR is at the forefront of research, engineering, acquisition, and support services that provide vital decision superiority to our forces at the right time and for the right cost. It is SPAWAR's mission to make the Navy's Information Dominance vision a reality. SPAWAR products and services transform ships, aircraft, and vehicles from individual platforms into integrated battle forces, enhancing information dominance and awareness among Navy, Marine, joint forces, federal agencies, and international allies.

Strategic Systems Program (SSP)

SSP is a highly specialized workforce composed of military and civilian, scientific, engineering, and professional personnel who work closely with private contractors and consultants. They direct 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 US/UK Polaris Sales Agreement.

Bureau of Medicine and Surgery (BUMED)

BUMED is the headquarters command for Navy Medicine. Under the leadership of the Navy Surgeon General, Navy Medicine provides high quality health care to beneficiaries in wartime and in peacetime. 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. At the same time, Navy Medicine's military and civilian health care professionals are providing care for uniformed services' family members and retirees at military treatment facilities around the globe. Today, BUMED is the site where the policies and direction for Navy Medicine are developed to ensure the DON Patient and Family Center Care vision is carried out.

Bureau of Naval Personnel (BUPERS)

BUPERS Command strives to support the needs of the Navy by providing the fleet with the right person in the right place at the right time, using the most efficient Human Resource process. The BUPERS organization serves to provide administrative leadership, policy planning, and general oversight of the Command.

Military Sealift Command (MSC)

MSC operates approximately 110 noncombatant, civilian-crewed ships that replenish U.S. Navy ships, conduct specialized missions, strategically preposition combat cargo at sea around the world, and move military cargo and supplies used by deployed U.S. forces and coalition partners. MSC is headquartered at the Washington Navy Yard in Washington, D.C., and operates six subordinate commands worldwide. Five operational commands operate in the Atlantic, Pacific, Europe, Central, and Far East areas.

Naval Special Warfare Command (NSW)

NSW train, equip, and deploy components of NSW Squadrons to meet the exercise, contingency, and wartime requirements of the regional combatant commanders, theater special operations commands, and numbered fleets located around the world. Additionally, they receive support from permanently deployed NSW units in Guam, Bahrain, and Germany. NSW Squadrons are built around deployed SEAL Teams and include senior leadership, SEAL Delivery Vehicle Teams, Special Boat Teams, and support technicians such as mobile communications teams, tactical cryptologic support, and explosive ordnance disposal specialists. Naval Special Warfare Squadrons are among the most responsive, versatile, and effective force packages fighting the other contingency operations today. Because SEALs are experts in special reconnaissance and direct action missions — the primary skill sets needed to combat terrorism — NSW is postured to fight a globally-dispersed enemy, whether ashore or afloat, before they can act.

U.S. Pacific Fleet (PAC Fleet)

PAC Fleet, the world's largest fleet command, encompasses 100 million square miles, more than half the Earth's surface, from the West Coast of the United States into the Indian Ocean. The PAC Fleet consists of approximately 180 ships, nearly 2,000 aircraft and 25,000 Sailors, Marines and Civilians. PAC Fleet was established in February 1941 and is headquartered at Pearl Harbor, Hawaii. PAC 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, PAC Fleet enhances stability, promotes maritime security and freedom of the seas, deters aggression, and when necessary, fights to win. Commands that fall directly under the PAC Fleet include "type" commands for surface ships, submarines, and aircraft as well as Navy construction. Operational commands that report directly to the PAC Fleet include Third Fleet in the Eastern Pacific and Seventh Fleet in the Western Pacific and Indian Ocean.

Commander Navy Installations Command (CNIC)

Established on 1 October 2003, CNIC is the Echelon II command under the Chief of Naval Operations responsible for Navy-wide shore installation management. The stand up of CNIC was an effort in the continuation of fleet and regional shore installation management organizational alignment that began in 1997 with the reduction of installation management claimants from 18 to 8. The intent of CNIC is to establish a single shore installation management organization that will focus on installation effectiveness and improve the shore installation management community's ability to support the fleet. Commander, Navy Installations Command 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.

U.S. Fleet Forces Command (FFC)

FFC supports both the Chief of Naval Operations and Combatant Commanders worldwide by providing responsive, relevant, and sustainable Naval forces ready-for-tasking. The command 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.

United States Marine Corps (USMC)

USMC is a branch of the U.S. military responsible for providing power projection from the sea, utilizing the mobility of the U.S. Navy to rapidly deliver combined-arms task forces to global crises. The USMC is the nation's Expeditionary Force in Readiness. Established originally by an act of the Second Continental Congress on 10 November 1775, the Marine Corps has evolved into a balanced air-ground-logistics team that is forward deployed and forward engaged: shaping, training, deterring, and responding to all manner of crises and contingencies. Through the ongoing support of Congress and the American people, the Marine Corps is a cohesive force of 201,693 Active Duty Marines; 39,772 Selected Reserve Marines; and 23,446 Civilian Marines. At any given time, approximately 30,000 Marines are forward deployed in operations supporting our Nation's defense.

Office of Naval Research (ONR)

As the Department of the Navy's Science and Technology provider, ONR provides technology solutions for Navy and Marine Corps needs. ONR's mission defined by law is to plan, foster, and encourage scientific research in recognition of its paramount importance as related to the maintenance of future naval power, and the preservation of national security. Further, ONR manages the Navy's basic, applied, and advanced research to foster transition from science and technology to higher levels of research, development, test, and evaluation. ONR provides technical advice to the Chief of Naval Operations and the Secretary of the Navy. Led by the Chief of Naval Research, its senior leadership oversees a portfolio of investments ranging from immediate, quick-turnaround technologies to long term basic research.

Office of Naval Intelligence (ONI)

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. Established in 1882, ONI specializes in the analysis, production, and dissemination of vital, timely, and accurate, scientific, technical, geopolitical, and military intelligence information to key consumers worldwide. ONI produces meaningful maritime intelligence and moves that intelligence rapidly to key strategic, operational, and tactical decision makers. Its integrated workforce of active duty and Reserve naval and civilian professionals supports combat operations and provides vital information for planning America's defense against maritime threats at home and around the world.

Naval Reserve Force Command (NAVRESFOR)

The mission of the U.S. Navy Reserve is to provide mission-capable units and individuals to the Navy-Marine Corps Team throughout the full range of operations from peace to war. In today's environment, this mandate takes on added meaning and responsibilities as the Navy Reserve is called on to play an increasingly active role in the day-to-day planning and operational requirements of the active Navy. The Navy Reserve represents 20 percent of the Navy's total assets and is a significant force multiplier the fleet must have to meet its growing global commitments. The Navy Reserve consists of the Ready Reserve, the Standby Reserve, and the Retired Reserve numbering over 690,000 men and women.

Field Support Activity (FSA)

The mission of FSA is to establish, maintain, and provide a system of financial services as the Budget Submitting Office (BSO) and Principal Administering Office (PAO) for assigned unified commands, Navy Headquarters, and activities; to initiate action in matters pertaining to the provision of funds and manpower and to evaluate the utilization of such resources and initiate or recommend appropriate corrective action.

Department of Navy Administrative Assistant (DON/AA)

DON/AA provides leadership and oversight of all administrative matters in support of the Secretary of the Navy (SECNAV). The DON/AA organization provides administrative management and support to the Office of the SECNAV, its 6,000 member Secretariat, staff offices, field activities, and supported organizations. These administrative divisions consist of Customer Service, Directives and Records Management, Contract Management, Executive Dining, Facilities and Support Services, Financial Management, Human Resources, Information Technology, and Security.

Navy Civilians: *(Full-time Equivalents)*	**188,964**
Marine Corps Civilians: *(Full-time Equivalents)*	**23,446**
U.S. Navy Active: *(Officers, Enlisted, and Midshipmen)*	**325,123**
U.S. Marine Corps Active: *(Officers and Enlisted)*	**201,693**
U.S. Navy Reserve: *(Drilling Reserve and Full-time Support)*	**64,792**
U.S. Marine Corps Reserve: *(Drilling Reserve and Full-time Support)*	**39,772**

Personnel Data as of Fiscal Year Ended September 30, 2011

Strategic Management

We are 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 strategy that will apply maritime power to the crucial responsibility of protecting U.S. vital 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—closer together than ever before in a mission to more fully safeguard maritime interests at home and abroad.

Our six priority objectives (on the pages that follow) support the U.S. maritime strategy by focusing on key efforts that will increase our effectiveness, improve the lives of our Sailors, Marines, and their families, and result in greater security for our nation and U.S. global interests. A summary of key accomplishments by objective begins below.

In addition, as a separate and supporting element of our priority objectives, we are committed to transforming the way we do business. A summary of our key business transformation initiatives follows our discussion on priority objectives.

Objective 1: Provide a Total Naval Workforce Capable and Optimized to Support the National Defense Strategy

Our Sailors, Marines, and civilians are the critical component to the U.S. maritime strategy, and we must ensure that we provide them with adequate compensation, medical care, and career training opportunities. These are key factors in attracting and retaining highly motivated and qualified naval personnel. We remain 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.

We are committed to providing our wounded, ill, and injured service members and their families with the medical and non-medical care and support worthy of their service and sacrifice. Through the Navy Safe Harbor Program and the Marine Corps Wounded Warrior Regiment, our service members receive support and assistance throughout their recovery, rehabilitation, and return to full duty and reintegration into their communities. We also continue to provide encouragement and support for our wounded Sailors and Marines, in partnership with the Department of Veterans Affairs, long after they have left the Service.

Using advanced technologies, we have shifted training from the traditional classroom to the use of simulators, trainers, computer-based interactive curriculums, and other media-based approaches. This initiative provides our naval workforce with appropriate training in a more efficient manner and prepares them to better perform mission-critical tasks. One example is the Infantry Immersion Trainer, a training system that simulates foreign urban scenes using battlefield effects simulators, culturally appropriate role players, and interactive avatars. Another example is Bold Alligator 2011, the first large-scale amphibious training exercise between the Navy and Marine Corps in nearly 10 years. During this training event, the Navy-Marine Corps team engaged in simulated forcible entry and non-combatant evacuation operations using advanced equipment and technology, such as unmanned aerial and surface vessels.

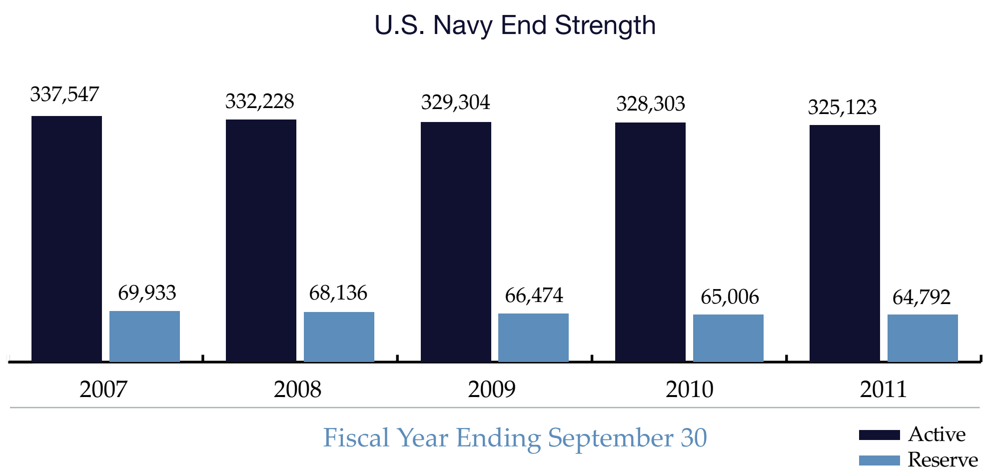
Sailors participate in a visit, board, search and seizure training exercise aboard the guided-missile cruiser USS Vicksburg (CG 69).

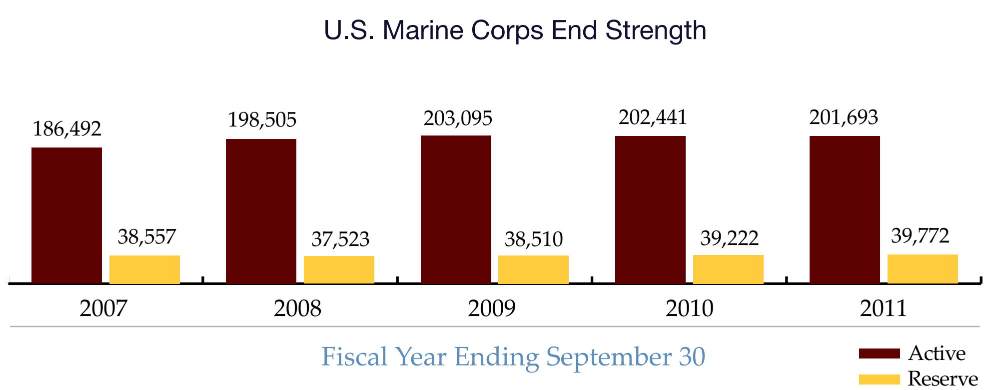
U.S. Navy

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 4% and 7%, 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. Marine Corps

The Marine Corps active duty forces end strength has been necessary to support the full spectrum of U.S. military operations and Marine units that have a continually high operational tempo, such as reconnaissance. Over the last five years, the Marine Corp has resized its active and reserve components by 8% and 3%, respectively. To remain a force capable and optimized to support the National Defense Strategy, the Marine Corps completed a comprehensive force structure review in FY 2011. The review focused on the organization, posture, and capabilities required to meet future challenges and threats. A copy of the Force Structure Review Report is available at *www.marines.mil*.

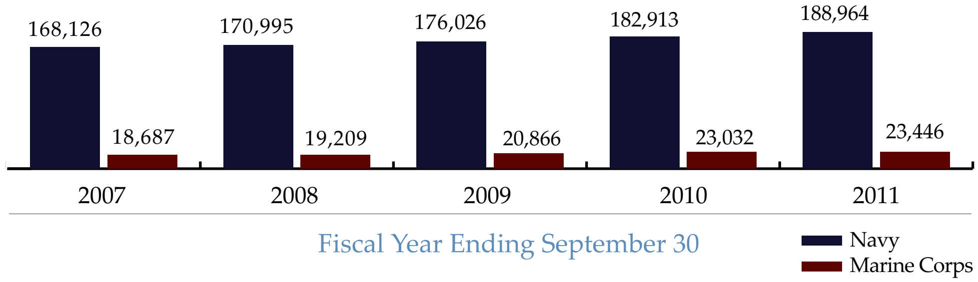




Navy and Marine Corps Civilian Personnel

The size of the civilian workforce, which has increased by 14% 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: Use the Navy-Marine Corps Team to Aggressively Prosecute Overseas Contingency Operations

Our Navy-Marine Corps team has become an integral part of continuing overseas contingency operations. With the shift in operational focus from Iraq to Afghanistan, our naval forces are providing greater support to the Afghanistan theater, both in the conduct of direct operational missions, as well as increased combat support for U. S. and coalition forces on the ground. Significant tactical air support for Afghanistan comes from our carriers and as the ground infrastructure in Afghanistan increases, more carriers will be required to bring these assets to bear on the battlefield. For example, our naval forces have integrated and synchronized close air support missions with coalition ground forces to protect key infrastructure, deter and disrupt extremist operations or hostile activities, and provide oversight for reconstruction efforts.

Fleet Response Plan

We remain focused on providing ready naval forces, from individual units to carrier and expeditionary strike groups, that are forward deployed and capable of providing a substantial surge force. The Fleet Response Plan (FRP), which supports the National Military Strategy, provides the readiness for this capability. The FRP provides adaptable, flexible, and sustainable naval forces necessary not only to fight current ongoing contingencies, but also to support the needs of the combatant commanders to maintain a global forward presence and any other evolving national defense requirements.

A Lance Corporal assigned to Marine Corps 3rd Light Armored Reconnaissance Battalion (3rd LAR) stands watch as Seabees assigned to Naval Mobile Construction Battalion (NMCB) 3 prepare a look-out post at Forward Operating Base Payne, Helmand Province, Afghanistan.

Individual Augmentees

Individual augmentees (IAs) have been instrumental in fulfilling combatant commanders' mission requirements for overseas contingency operations. They are assigned individually, rather than as part of a traditional unit, to fill shortages or provide specialized knowledge or skill sets. The Navy identifies both active and reserve service members with specific skill sets to fill IA roles, and the Marine Corps relies principally on activated reserve members to fill IA positions vacated by forward-deployed active component Marines.

Sailors participate in the four-week U.S. Navy Individual Augmentee Combat Training course at Fort Dix, New Jersey.

Marine Corps Operating Forces

Marine Expeditionary Forces (MEFs) provide highly trained, versatile expeditionary forces capable of rapid response to global contingencies. Each MEF consists of a command element, one infantry division, one aircraft wing, and one Marine logistics group. Embedded within each MEF are three Marine Expeditionary Units, which deploy regularly in the Expeditionary Strike Groups. Each MEF also has an embedded capability to source a Marine Expeditionary Brigade.

Objective 3: Build the Navy-Marine Corps Force for Tomorrow

Sustaining U.S. maritime preeminence requires our naval forces to prepare continually for future challenges as well as threats to national security and U.S. global interests. Key initiatives in this regard are energy reform, unmanned systems, and acquisition reform.

Energy Reform

Reducing our naval forces' reliance on fossil fuels is critical to our national security, environment, and naval capabilities. Our nation and naval forces rely heavily on a finite source of fuel from volatile global regions. To a certain extent, we have ceded this strategic resource to other nations, creating an obvious vulnerability to our national security. In addition, our reliance on fossil fuels affects our naval forces' operational independence, both in terms of the resources required to obtain fuel and to transport it to the ships, aircraft, and equipment, and the Sailors and Marines whose duty it is to protect the ships and convoys moving the fuel.

With these risks in mind, we have taken a bolder, more aggressive stance toward energy reform by committing to five energy goals (see chart on page 20). These goals require adoption of new fuels and development of new systems and energy efficient practices and techniques over the next 10 years.

Some examples of our progress toward energy reform during FY 2011 include:

- Test and evaluation of a Riverine Command Boat (Experimental) (RCB-X) powered by hydro-processed renewable diesel.
- Completion of a solar photovoltaic system on Naval Base Guam that will produce 411,000 kilowatt hours of clean renewable electricity.
- Delivery of Leadership in Energy and Environmental Design (LEED) Gold-certified facilities at Naval Support Facility Dahlgren, Virginia; Naval Air Station Patuxtent River, Maryland; and Naval Base Guam; and LEED Silver-certified facility at Marine Corps Base Quantico, Virginia.
- Test of the DDG 1000's Integrated Power System, which generates the ship's total electric power requirements. DDG 1000 will be the first U.S. Navy surface combatant to leverage this technology.

Chief of Naval Operations, Admiral Gary Roughead, views components of the DDG 1000 Integrated Power System land-based test site on board Naval Surface Warfare Center Carderock Division, Ship Systems Engineering Station, Philadelphia.

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": The DON will demonstrate a Green Strike Group in local operations by 2012 and sail it by 2016.

Reduce Non-Tactical Petroleum Use: By 2015, the DON will reduce petroleum use in the commercial fleet by 50%.

Increase Alternative Energy Ashore: By 2020, the DON will produce at least 50% of shore-based energy requirements from alternative sources; 50% of the 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.

Unmanned Systems

Unmanned systems expand our naval capabilities in intelligence, surveillance, and reconnaissance (ISR), and reduce the exposure of our naval forces to unnecessary threats. For example, in February 2011, an X-47B Navy Unmanned Combat Air System Demonstrator (NUCAS-D) completed its first flight at Edwards Air Force Base, California. The flight represented an essential step in Navy's effort to design, develop, and integrate an autonomous unmanned air system on board an aircraft carrier. The Navy will continue to implement the plan to transition from NUCAS-D to the Unmanned Carrier Launched Surveillance Strike (UCLASS) system to provide an unmanned carrier capability by 2018. UCLASS will provide the joint force with persistent, carrier-based ISR and strike system.

An X-47B Navy Unmanned Combat Air System Demonstrator completes its first flight at Edwards Air Force Base, California.

Acquisition Reform

The replacement costs of our aging ships, aircraft, and weapons systems continue to rise faster than our procurement budgets' top-line. This has resulted in a reduction in the number of ships and aircraft available to support the Navy's forward deployed mission. This erosion in the number of available ships and aircraft has also increased the operating tempo required of the remaining smaller fleet. This trend towards growth in individual unit acquisition costs, therefore, places at risk our future forward presence capability to support our nation's foreign policy and protect its interests.

In accordance with the Weapons System Acquisition Reform Act of 2009, and in coordination with strong DoD-wide initiatives being taken by the Secretary of Defense and his staff in this area, we are aggressively working to examine and streamline the Navy's design and construction processes. The result will be improved management of the design and schedule processes so that the impact on acquisition and total weapons systems life cycle costs can be better estimated earlier in the design and scheduling processes. This will enable the cost impact of design and scheduling changes to be better forecasted and their impact on future fleet sizes to be better understood and anticipated.

In addition, a healthy industrial base and strong performance from our industry partners improve our ability to deliver an affordable combat capability to the fleet. We have worked diligently to procure our ships, aircraft, and weapon systems at a rate intended to bring stability to the industrial base and enable efficient production. We will continue to work with our shipyards, aircraft manufacturers, and weapon systems providers to benchmark performance, to identify improvements, to provide the proper incentives for capital investments, and to reward strong performance with terms and conditions that reflect our desire for a strong government-industry partnership.

We are also rebuilding the acquisition workforce through a number of parallel efforts. These include expansion of recruitment at all levels, including interns, journeymen, and highly qualified experts, and the retention and credentialing of qualified personnel at the middle and senior career levels. We remain committed to preventing capability gaps in the acquisition workforce, with a view of ensuring the Navy and Marine Corps maintain a healthy technical authority within the Department.

Objective 4: Safeguard the People and Resources of the Navy-Marine Corps Team

We continue to promote and enhance a culture of safety excellence. Through our risk management training continuum, we provide the DON personnel with opportunities to understand and apply operational risk management (ORM) principles. As an example, four new ORM e-learning modules became available in FY 2011 via our Navy Knowledge Online site. Our Naval Safety Center website provides the DON personnel with access to a wide range of resources, such as training, best practices, alerts and recalls, guidance, and new for 2011, "e-blast," a brief bi-monthly e-mail update on Safety Center products, resources, and safety initiatives. In addition, through our Safety Excellence Award Program, we recognize the DON commands and programs that best exemplify the highest regard for the safety of our Sailors, Marines, and civilians; and the protection of our aircraft, ships, and facilities from mishaps.

A Navy Counselor 1st Class and Yeoman 2nd Class fly the Secretary of the Navy (SECNAV) Safety Excellence flag during a ceremony at Naval Weapons Station Seal Beach, California, marking the third consecutive year that the weapons station received the prestigious SECNAV award.

Objective 5: Strengthen Ethics as a Foundation of Exemplary Conduct within the Department of the Navy

We continue to reinforce ethics and exemplary conduct as an obligation of every DON employee. Through training and education, we promote understanding and application of our core values—honor, courage, and commitment—and standards of ethical conduct as a framework for making decisions at every career level. Our ethics website, The Ethics Compass, provides the DON personnel with access to annual ethics training and other resources, such as a directory of certified DON ethics counselors and an employee ethics guide.

Objective 6: Provide First-Rate Facilities to Support Stationing, Training, and Operations of Naval Forces

We remain committed to providing high-quality facilities to support evolving mission requirements and quality of life initiatives. To support the Marine Corps' end strength of 201,693 active duty forces, we have been investing in new construction projects, including permanent barracks, mess facilities, operations centers, and training ranges. Similarly, we have been investing in military construction projects that improve the quality of life for our Sailors and Marines and their families. These projects include Bachelor Enlisted Quarters, student officer quarters, fitness centers, and child care facilities. In addition, we continue to invest in military construction projects that support improvements in our global defense posture. Examples include the planned realignment of U.S. Marines and their families from Okinawa to Guam, an operations and support facility at Naval Support Activity Bahrain, and a headquarters facility and joint operations center in Djibouti.

Military and civilian personnel participate in a ribbon cutting ceremony for the opening of the new Child and Youth 24/7 Center at Naval Air Station North Island, California.

Business Transformation

As a separate and supporting element of our priority objectives, we are committed to transforming the way we do business by using our people, processes, and systems more effectively. The DON Financial Improvement Program is the integrating financial element of our business transformation strategy and a supporting initiative of the DoD Financial Improvement and Audit Readiness Plan, which organizes and prioritizes the financial improvement and audit readiness efforts of DoD Components. Audit readiness is a goal of business transformation and a key metric for measuring its success and progress. Navy Enterprise Resource Planning is the key system driver of our business transformation and a key enabler of the DoD Enterprise Transition Plan, which organizes and prioritizes efforts to modernize DoD business and financial systems. Continuous Process Improvement/Lean Six Sigma (CPI/LSS) initiatives, part of the DoD-wide CPI/LSS program, enable more effective and efficient operations across the DON enterprise.

DON Financial Improvement Program

The DON Financial Improvement Program and the Marine Corps Financial Improvement and Audit

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

Our financial improvement and audit readiness 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 Statement of Budgetary Resources (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 our daily business operations, particularly for funds control and resource utilization.

We asserted audit readiness of key business processes related to the DON General Fund SBR for Appropriations Received. An independent public audit firm reviewed the Appropriations Received assertion and assigned it an unqualified opinion. We are continuing corrective actions for Civilian Payroll and Transportation of People (initiated through the Defense Travel System), with planned assertions in FY 2012. On 13 October 2011, the Secretary of Defense issued a memorandum on improving financial information and achieving audit readiness. He directed the Under Secretary of Defense (Comptroller) to accelerate key elements of the DoD's audit readiness, and provide a plan to achieve audit readiness for the SBR by the end of 2014. The DON fully supports the efforts of the Secretary of Defense and we plan to assert audit readiness of the DON General Fund SBR in FY 2013. Additionally, the DON and our primary service provider, the Defense Finance and Accounting Service (DFAS), have forged a strong partnership and, together, have made considerable progress in moving closer to fully reconciling the DON's Fund Balance with Treasury. Jointly, with DFAS, the DON has launched initiatives to bring transparency to the DON's full transaction universe, which will allow meaningful testing and provide audit trails. These DFAS initiatives will yield considerable value to our audit readiness efforts over the next year. In addition, the Marine Corps SBR audit continues to move forward in its second year, providing significant insight and lessons that have led the DON to enhance its overall SBR Audit Readiness Plan.

We also asserted audit readiness of significant components of military equipment-ships (including submarines), aircraft, intercontinental ballistic missiles, satellites, and ordnance and are about to assert uninstalled aircraft engines and Navy boats in FY 2012. Department of Defense Inspector General (DoDIG) examination of our assertion began in FY 2011 with ships/submarines, ballistic missiles, and satellites. We expect DoDIG to continue with examinations of aircraft and ordnance in FY 2012.

Marine Corps Financial Improvement and Audit Readiness Initiative

By means of an independent study, we analyzed the value of the Marine Corps' effort to pursue financial audit readiness in terms of the bottom line impact for improving the efficiency and effectiveness of its financial processes and controls. This impact was measured in terms of the direct return for every dollar appropriated by Congress. The results of this analysis showed that for every dollar invested, nearly three dollars in value were created and that the resulting economies translated directly into the Marine Corps having the capability to purchase more mission supportive weapons for the same amount of appropriated resources. In the future, we will use this return on investment metric as a guide as we implement the substantial lessons learned from the ongoing Marine Corps audit experience to the Navy.

The Marine Corps is the first major operational war-fighting organization to achieve audit readiness for any of the four financial statements and therefore, over a broad part of its business operations. The Marine Corps selected the SBR as the first statement to assert for audit readiness because it is the most heavily used and therefore, most heavily relied upon in the day-to-day management of its resources. The Marine Corps' audit readiness efforts also provide a meaningful pilot for the DON as we continue to discover how to use the audit process to improve resource management.

Navy Enterprise Resource Planning

Navy Enterprise Resource Planning (Navy ERP) is an integrated business management system that unifies, standardizes, and streamlines Navy business operations. It is replacing multiple older, more costly information systems, leading to lower operational costs for the Navy. Navy commands who have implemented Navy ERP have realized measurable improvements in accuracy, timeliness, and accessibility of information and efficiencies in business and reporting processes. Expansion of the Navy ERP Program over the next few years will continue to drive enterprise-wide efficiencies and provide financial transparency and total asset visibility across the enterprise; it will be a major positive force contributing toward Navy's financial audit readiness.

The Navy ERP system Release 1.0 (Acquisition and Financial Management functionality) has been operational since October 2007 and is currently deployed to Naval Air Systems Command, Naval Supply Systems Command, Naval Sea Systems Command (General Fund operations), and Space and Naval Warfare Systems Command.

The Navy is in the process of deploying Release 1.1 (Single Supply Solution). Deployment of Release 1.1 will be completed during FY 2012. The new release consolidates wholesale and retail supply functions.

The Navy will continue to expand Navy ERP throughout the enterprise. Other Commands scheduled for implementation are Naval Sea Systems Command (Working Capital Fund operations, October 2011); Strategic Systems Programs (October 2012); and Office of Naval Research (October 2012). More information on Navy ERP is available at *http://www.erp.navy.mil*.

Personnel from Navy Supply Corps School and Surface Warfare Officers School attend Lean/Six Sigma green belt training at the Center for Service Support in Newport, Rhode Island.

Continuous Process Improvement

Continuous Process Improvement (CPI) is a primary enabler for managing the effectiveness and efficiency of our 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, 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, we are bringing together processes and organizations for the accomplishment of strategic and corporate business objectives.

During FY 2011, our workforce continued to demonstrate its commitment to performance improvement. For example, the Navy Medicine Support Command's Centralized Credentials and Privileging Directorate (CCPD) streamlined its pre-accession credentialing process by applying Lean/Six Sigma methodology. The pre-accession credentialing process is a key process for bringing qualified health care practitioners into the Navy and requires completion of an application. The average time for completion of the application process is 64 days. Through its process improvement efforts, CCPD reduced the average time by approximately 40 days.

In addition, many of our naval personnel have completed Lean/Six Sigma training, such as personnel onboard the USS Theodore Roosevelt (CVN 71). Theodore Roosevelt now has a CPI division that can apply Lean/Six Sigma methodology to improve customer service in the ship's medical department.

Management Assurances

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

Below is a brief discussion of our compliance with the FFMIA and FMFIA in FY 2011.

Federal Financial Management Improvement Act

The FFMIA of 1996 requires agencies to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger (USSGL) at the transaction level. FFMIA supports the same objectives as the Chief Financial Officers Act of 1990 but with a systems emphasis. Our legacy financial management systems and feeder systems are not yet substantially compliant with Federal financial management systems requirements, generally accepted accounting principles, and the USSGL at the transaction level. While FFMIA compliancy requires a solid systems element, the improvements in process documentation and internal control testing being made through our Financial Improvement Program, combined with the ongoing deployment of Navy Enterprise Resource Planning (ERP), will move us toward these goals over the next several years. Navy ERP will be compliant with the DoD Standard Financial Information Structure (SFIS), which includes support for the USSGL at the transaction level. SFIS is DoD's common business language that supports standardization of financial reporting for all DoD Components.

Federal Managers' Financial Integrity Act

The FMFIA of 1982 requires agencies to evaluate their system of internal accounting and administrative controls and to report on the effectiveness of these controls in an annual statement of assurance. The FMFIA was the model for the Sarbanes-Oxley Act of 2002, which applies to publicly traded companies. Application of the Sarbanes-Oxley Act led to the Federal Government's reevaluation of internal control policies under FMFIA, including the addition of Appendix A to Office of Management and Budget (OMB) Circular A-123 in December 2004, "Management's Responsibility for Internal Control." Appendix A of the revised circular requires agencies to provide a separate statement of assurance on the effectiveness of internal controls over financial reporting.

We assessed our systems of internal controls over non-financial operations and financial reporting, in effect as of 30 June 2011. Based on these assessments, we provided qualified assurance on the effectiveness of our internal controls over non-financial operations, and provided no assurance on the effectiveness of our internal controls over financial reporting. For more information on the results of these assessments, see our FMFIA FY 2011 Annual Statement of Assurance at *http://www.fmo.navy.mil/services/mic/soa_index.htm*.

The accompanying financial statements and related disclosures represent our enduring commitment to fiscal accountability and transparency. Through our Financial Improvement Program and related business transformation initiatives discussed earlier, we have made significant progress toward improving the quality and timeliness of our financial information. However, we are currently unable to fully implement all elements of U.S. generally accepted accounting principles and Office of Management and Budget (OMB) Circular A-136, "Financial Reporting Requirements," due to limitations of our financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the Department of Defense, Office of Inspector General, was unable to express an opinion on our FY 2011 financial statements.

For financial reporting purposes, we are organized into two reporting entities: Department of the Navy General Fund (DON GF) and Navy Working Capital Fund (NWCF), which include financial information for both the U.S. Navy and the USMC. Each reporting entity has a separate set of financial statements and related disclosures.

DON General Fund

The DON GF supports overall Departmental operations. Enacted appropriations comprise the majority of the GF account structure, which includes five major appropriation groups:

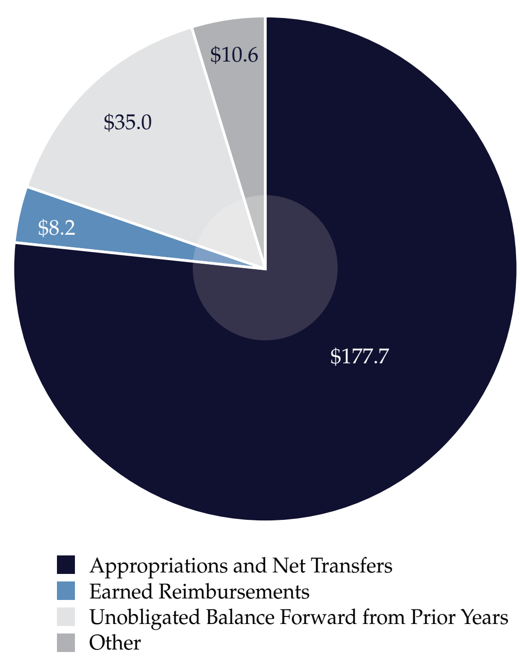
- Operations, Readiness, and Support
- Military Personnel
- Procurement
- Research, Development, Test, and Evaluation
- Family Housing and Military Construction

Enacted appropriations flow through OMB and the Office of the Secretary of Defense 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

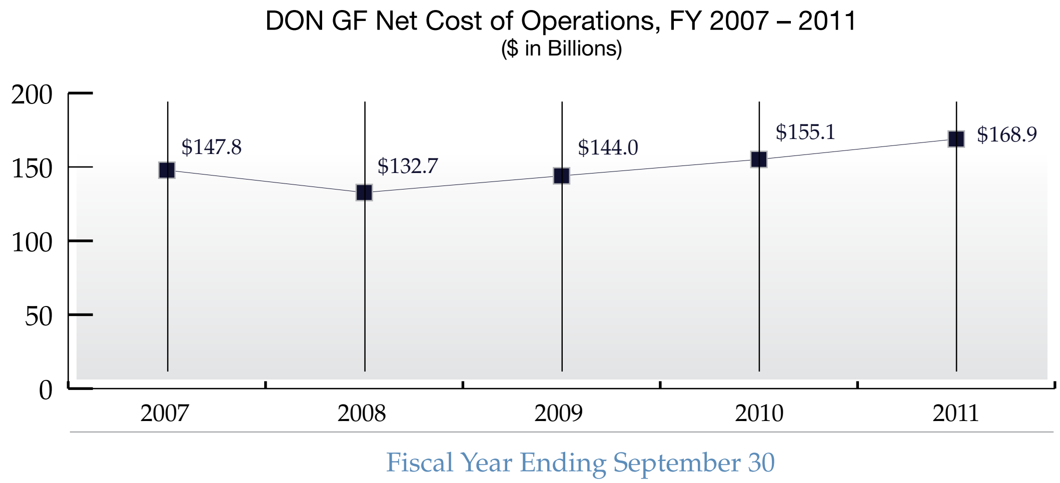
The Combined Statement of Budgetary Resources presents total budgetary resources of $231.6 billion that were available to the DON GF during FY 2011 and the status of those resources at fiscal year end. Total budgetary resources were up $6.0 billion, a 2.6% increase in FY 2011 over FY 2010. The increase was primarily due to the $35.0 billion unobligated balance brought forward from the prior year, which comprised 15% of total budgetary resources. The majority of the increase in unobligated balance brought forward was in the Procurement appropriation accounts. The enacted appropriations of $175.1 billion represent 76% of total budgetary resources and increased $1.0 billion over FY 2010. The majority of this increase was with respect to Operations, readiness, and support appropriation accounts. The DON obligated $198.3 billion of the $231.6 billion total resources in FY 2011, which is an increase of $7.8 billion or 4% over FY 2010.

DON GF Sources of Funds, FY 2011
($ in Billions)



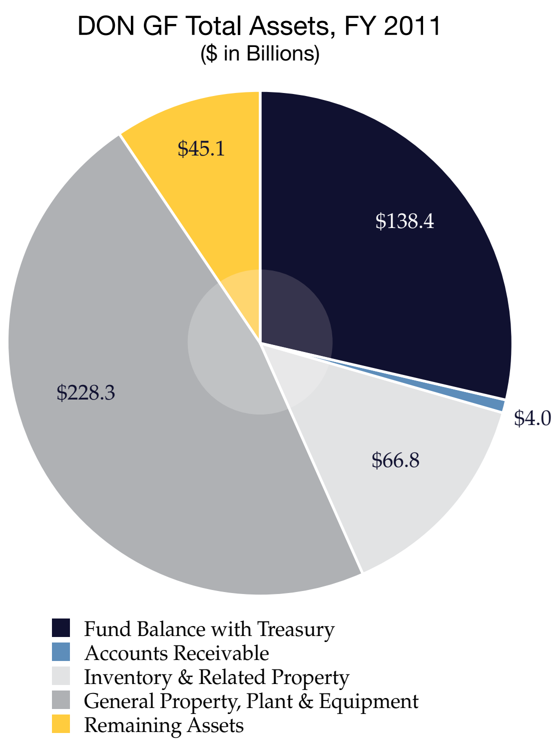
The Combined Statement of Net Cost presents net cost of operations of $168.9 billion during FY 2011.

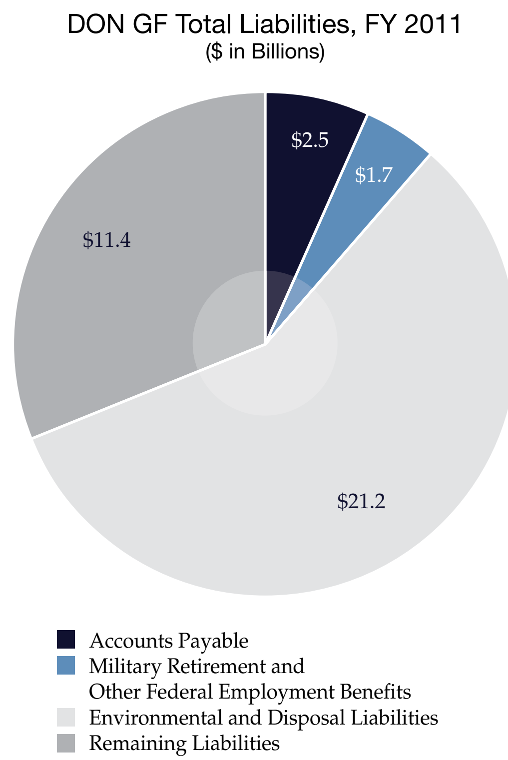
Net cost of operations represents gross costs incurred by the DON GF, less earned revenue. Net cost of operations increased $13.8 billion, which represents an 9% increase over FY 2010.



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, 2011, net position totaled $445.8 billion, which represents a 4.6% increase of $19.8 billion from FY 2010. Increase in total assets of $19.4 billion and a decrease of $0.4 billion in total liabilities contributed to the overall increase in net position.





Navy Working Capital Fund

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.

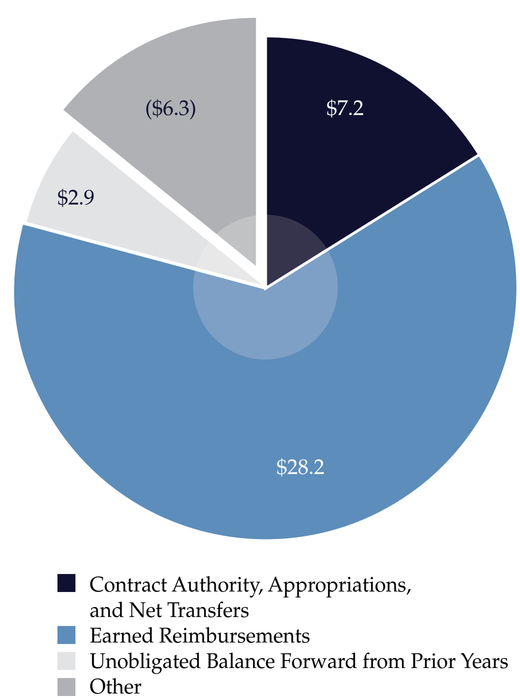
Navy Working Capital Fund Business Activities By Business Area

Supply Management	Depot Maintenance
Supply Management, Navy *(https://www.navsup.navy.mil)* Supply Management, Marine Corps *(http://www.logcom.usmc.mil)*	Depot Maintenance, Aviation *(http://www.navair.navy.mil)* Depot Maintenance, Marine Corps *(http://www.logcom.usmc.mil)*
Base Support	**Transportation**
Facilities Engineering Commands *(https://portal.navfac.navy.mil)* Naval Facilities Engineering Service Center *(https://portal.navfac.navy.mil)*	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://enterprise.spawar.navy.mil)* *Also see Office of Naval Research *(http://www.onr.navy.mil)*

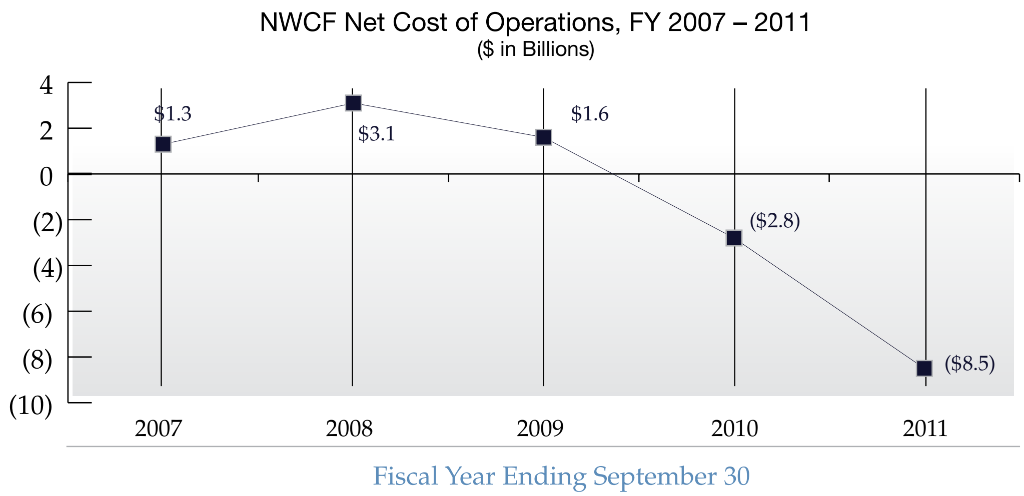
Results of Operations

The Combined Statement of Budgetary Resources presents total budgetary resources of $32.0 billion that were available to NWCF during FY 2011 and the status of those resources at fiscal year-end. Total budgetary resources increased $2.3 billion, which was a 7.9% increase over FY 2010. NWCF budget authority is comprised of contract authority and spending authority from offsetting collections of which the latter accounts for 87.0% of total budgetary resources. The majority of the increase in overall budget authority is due to $2.0 billion increase in spending authority from offsetting collections in FY 2011. NWCF business activities obligated $28.9 billion of the $32.0 billion total resources in FY 2011 which represents a 7.8% increase of $2.1 billion over FY 2010.

NWCF Sources of Funds, FY 2011
($ in Billions)

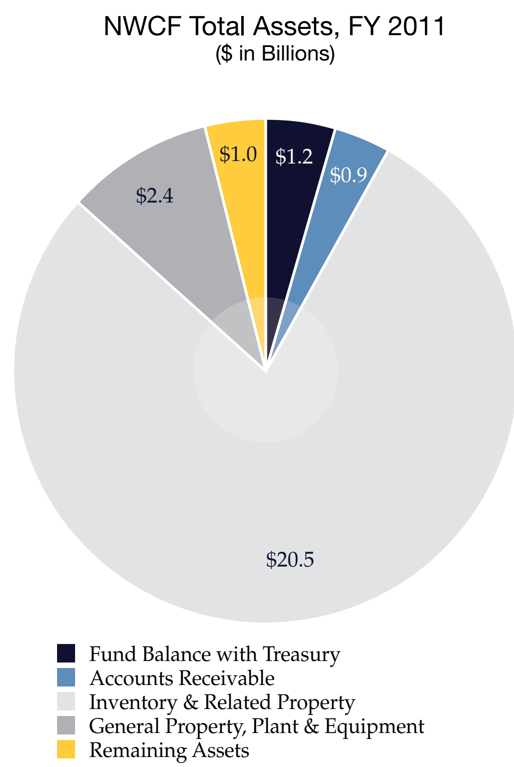


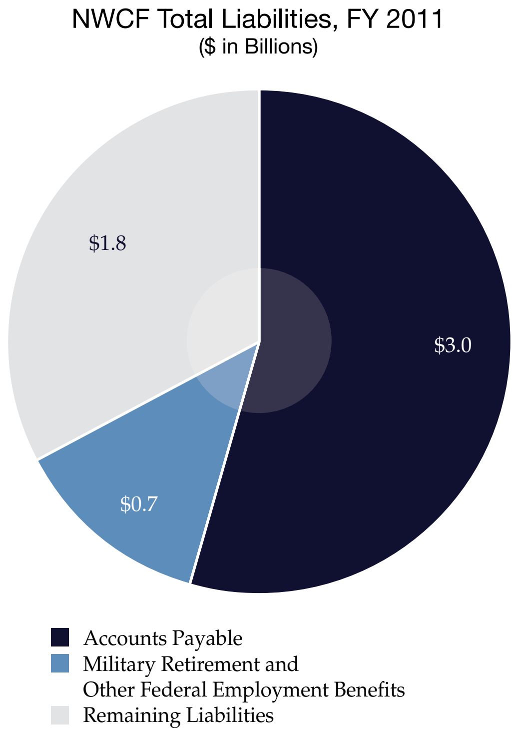
The Combined Statement of Net Cost presents net cost of operations of $(8.5) billion during FY 2011. Net cost of operations represents gross costs incurred by NWCF, less earned revenue. Sources of earned revenue include DON, Army, and Air Force General Funds; Defense Working Capital Funds; other Navy and DoD appropriations; and non-DoD fund sources. The increase in earned revenue exceeded the increase in gross costs by $5.7 billion in FY 2011 over FY 2010, which accounts for the negative net cost of operations.



Financial Position

The NWCF 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, 2011, net position totaled $20.5 billion, which represents an increase of $7.2 billion and a 54% increase from FY 2010. An increase of $6.8 billion in total assets and a decrease of $0.4 billion in total liabilities contributed to the overall increase in net position.

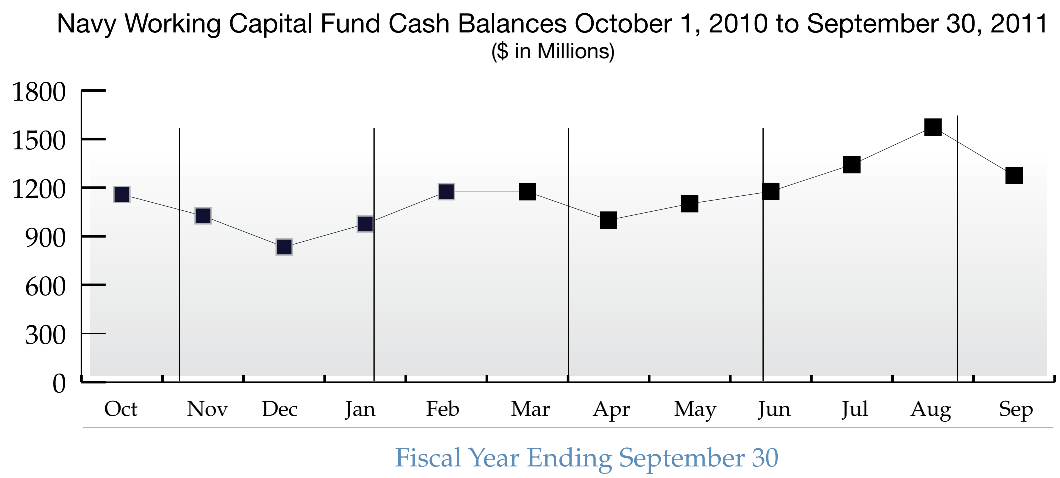




Cash Management

The DON manages working capital fund cash at the Departmental level. It must maintain cash levels at seven to ten days of operational costs, plus have sufficient cash reserves to meet six months of projected capital outlays, as required by the Department of Defense Financial Management Regulation. For FY 2011, the seven-day cash requirement was $849.0 million and the ten-day requirement was $1.2 billion.

Supply Management, Navy received a $72.8 million reimbursement for ordered items delivered to Defense Logistics Agency.



Looking Forward

Our achievements during FY 2011 established a firm foundation that will assure future success in executing our mission and building a sound business operating environment. In FY 2012, we will remain focused on priorities that increase our effectiveness and efficiency, improve the lives of our Sailors and Marines, and result in greater security for our nation and U.S. global interests. Highlighted below are a few of these priorities.

Sea Control

The ability to operate freely at sea is one of the most important elements of joint and interagency operations, and sea control requires capabilities in all aspects of the maritime domain, including space and cyberspace. We will not permit an adversary to impede the United States and its allies from freedom to maneuver on the seas and access to vital sea-lines of communication and commerce. The Department's ability to overcome challenges to access while simultaneously project and sustain power ashore is the basis of our combat credibility. Our advantages will continue to be sustained through properly sized forces, innovative technologies, understanding of adversary capabilities, adaptive joint planning processes, and the proficiency and ingenuity of our Sailors and Marines.

A visit, board, search, and seizure team (right) assigned to the guided-missile cruiser USS Anzio (CG 68) investigates a suspected pirate skiff in the Gulf of Aden.

Taking Care of Our People

Development and retention of highly qualified and dedicated people are vital to our continued success. Our vision is a naval manpower, personnel, training, and education system that targets and attracts the right talent, then trains, develops, equips, and motivates these men and women throughout their naval service. Navy total force readiness will be enhanced by focusing on sailor readiness. Our strategy for the future will be guaranteed by focusing on developing policies that bring forth the promise of our people, thereby ensuring full development of their personal and professional capabilities. Our objectives remain: to align the personal and professional goals of our workforce with the needs of the joint force while ensuring the welfare of our Sailors and their families; to deliver a high performing, competency-based and mission-focused force to meet the full spectrum of joint operations; and to provide the right person with the right skills, at the right time as the best value to the joint force.

Energy Reform

Readily available energy is essential for deploying our Sailors and Marines around the globe in support of our nation's interests. Since our operational flexibility and sustainability are directly linked to our energy supplies, energy reliability is a strategic concern for our forces. The potential vulnerability of energy supplies could threaten our ability to perform on the battlefield and energy costs siphon resources from warfighting requirements. Therefore, the DON is working to develop greater energy independence and conservation ashore and afloat. Overall, we will achieve the goal of cutting petroleum use in non-tactical vehicles by 50% by 2015 and allow for 50% of the DON total energy consumption to come from alternative sources by 2020. The planned "Green" Strike Group is on track to be operational by FY 2016.

Seawolf-class submarine USS Connecticut (SSN 22) participates in the biennial ice exercise, ICEX, designed to improve naval operations in the Arctic.

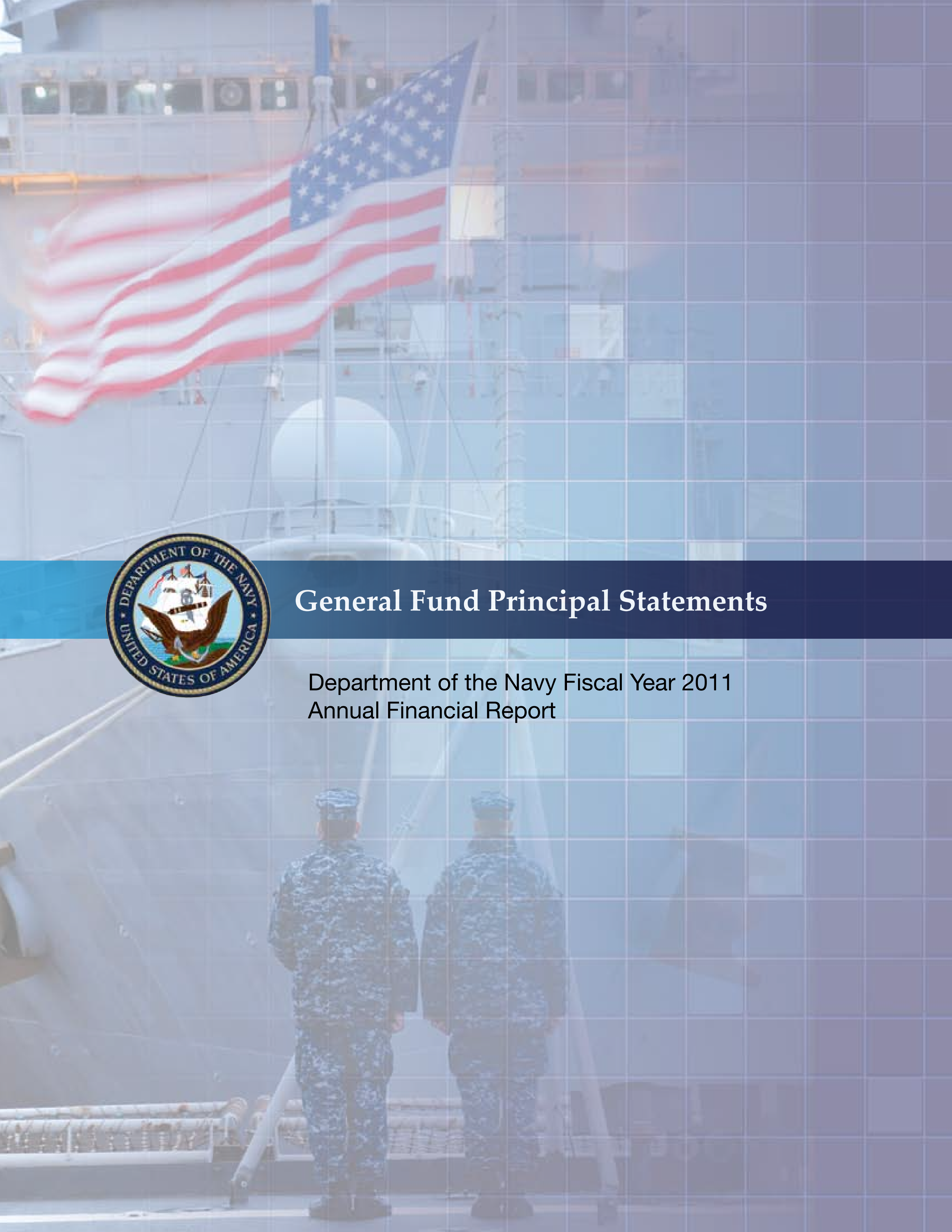
Business Transformation

The DON continues to develop its vision for Business Transformation. In these times of fiscal constraint, the DON is challenged to make necessary investments in future capabilities while sustaining current warfighting effectiveness. The DON's adopted business transformation policy is designed to employ business process change to create more effective operations at reduced costs and exploit process improvements, technology enhancements, and an effective human capital strategy to ensure continued mission superiority.

The DON business process improvement involves executing, aligning, and integrating a series of enterprise-wide initiatives which will dramatically transform our ability to execute programs and support our mission. The result will be improved efficiency, better decision-making, and an organizational culture that is performance-based. The DON Financial Improvement Program, in concert with the continuing roll-out of Navy ERP and other enterprise business initiatives, will transform the Department's business environment into a "best practices," auditable end-state. This transformed environment will be both transparent and accountable to the DON's stakeholders – the DoD, Congress, and the American taxpayer.

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 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.



General Fund Principal Statements

Department of the Navy Fiscal Year 2011
Annual Financial Report

Principal Statements

The Fiscal Year 2011 Department of the Navy 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 General Fund for the fiscal year ending September 30, 2011, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2010.

The following statements comprise the Department of the Navy General Fund principal statements:

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

CONSOLIDATED BALANCE SHEET

As of September 30, 2011 and 2010

($ in Thousands)

		2011 Consolidated		2010 Consolidated
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	138,448,267	$	133,919,522
Investments (Note 4)		9,289		9,465
Accounts Receivable (Note 5)		321,788		394,557
Other Assets (Note 6)		165,099		263,633
Total Intragovernmental Assets		138,944,443		134,587,177
Cash and Other Monetary Assets (Note 7)		106,042		107,277
Accounts Receivable, Net (Note 5)		3,679,317		3,691,483
Inventory and Related Property, Net (Note 9)		66,782,595		62,053,484
General Property, Plant, and Equipment, Net (Note 10)		228,275,598		220,504,519
Other Assets (Note 6)		44,799,298		42,276,508
TOTAL ASSETS	$	482,587,293	$	463,220,448
Stewardship Property, Plant, and Equipment (Note 10) *				
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$	1,996,758	$	1,657,333
Other Liabilities (Note 15 & Note 16)		4,869,187		4,994,706
Total Intragovernmental Liabilities		6,865,945		6,652,039
Accounts Payable (Note 12)		558,726		2,682,893
Military Retirement and Other Federal Employment Benefits (Note 17)		1,655,019		1,692,851
Environmental and Disposal Liabilities (Note 14)		21,186,694		19,333,895
Other Liabilities (Note 15 & Note 16)		6,564,768		6,873,542
TOTAL LIABILITIES		36,831,152		37,235,220
Commitments and Contingencies (Note 16) *				
NET POSITION				
Unexpended Appropriations - Other Funds		178,477,576		169,307,091
Cumulative Results of Operations - Earmarked Funds		25,545		33,682
Cumulative Results of Operations - Other Funds		267,253,020		256,644,455
TOTAL NET POSITION		445,756,141		425,985,228
TOTAL LIABILITIES AND NET POSITION	$	482,587,293	$	463,220,448

* - Disclosure but no value required per Federal Accounting Standards.

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Consolidated	2010 Consolidated
Program Costs		
Gross Costs		
Military Personnel	$ 47,198,600	$ 48,744,274
Operations, Readiness, & Support	65,501,114	58,676,332
Procurement	48,531,687	32,484,136
Research, Development, Test, & Evaluation	18,201,273	19,526,997
Family Housing & Military Construction	1,966,777	920,254
Less: Earned Revenue	(12,463,027)	(5,246,995)
Net Program Cost	168,936,424	155,104,998
Losses/(Gains) from Acturarial Assumption Changes for Military Retirement Benefits	-	-
Net Cost of Operations	$ 168,936,424	$ 155,104,998

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Earmarked Funds	2011 Other Funds
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 33,682	$ 256,644,455
Prior Period Adjustments:		
Correction of errors (+/-)	-	-
Beginning Balances, as adjusted	33,682	256,644,455
Budgetary Financing Sources:		
Appropriations used	-	165,646,982
Nonexchange revenue	249	(14)
Donations & forfeitures of cash & cash equivalents	18,292	130
Other Financing Sources:		
Donations and forfeitures of property	-	652
Transfers in/out without reimbursement (+/-)	-	225,126
Imputed financing from costs absorbed by others	-	881,374
Other (+/-)	-	12,764,061
Total Financing Sources	18,541	179,518,311
Net Cost of Operations (+/-)	26,678	168,909,746
Net Change	(8,137)	10,608,565
Cumulative Results of Operations	$ 25,545	$ 267,253,020
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ -	$ 169,307,091
Prior Period Adjustments:		
Correction of errors (+/-)	-	-
Beginning Balances, as adjusted	-	169,307,091
Budgetary Financing Sources:		
Appropriations received	-	175,092,446
Appropriations transferred-in/out (+/-)	-	2,607,610
Other adjustments (rescissions, etc) (+/-)	-	(2,882,589)
Appropriations used	-	(165,646,982)
Total Budgetary Financing Sources	-	9,170,485
Unexpended Appropriations	-	178,477,576
Net Position	$ 25,545	$ 445,730,596

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Consolidated	2010 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 256,678,137	$ 255,999,213
Prior Period Adjustments:		
Correction of errors (+/-)	-	-
Beginning Balances, as adjusted	256,678,137	255,999,213
Budgetary Financing Sources:		
Appropriations used	165,646,982	157,582,719
Nonexchange revenue	235	(512)
Donations & forfeitures of cash & cash equivalents	18,422	27,374
Other Financing Sources:		
Donations and forfeitures of property	652	5,258
Transfers in/out without reimbursement (+/-)	225,126	1,243,648
Imputed financing from costs absorbed by others	881,374	884,867
Other (+/-)	12,764,061	(3,959,432)
Total Financing Sources	179,536,852	155,783,922
Net Cost of Operations (+/-)	168,936,424	155,104,998
Net Change	10,600,428	678,924
Cumulative Results of Operations	$ 267,278,565	$ 256,678,137
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 169,307,091	$ 153,212,818
Prior Period Adjustments:		
Correction of errors (+/-)	-	(574,538)
Beginning Balances, as adjusted	169,307,091	152,638,280
Budgetary Financing Sources:		
Appropriations received	175,092,446	174,174,405
Appropriations transferred-in/out (+/-)	2,607,610	2,589,140
Other adjustments (rescissions, etc) (+/-)	(2,882,589)	(2,512,015)
Appropriations used	(165,646,982)	(157,582,719)
Total Budgetary Financing Sources	9,170,485	16,668,811
Unexpended Appropriations	178,477,576	169,307,091
Net Position	$ 445,756,141	$ 425,985,228

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Combined	2010 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 35,002,674	$ 27,048,361
Recoveries of prior year unpaid obligations	14,169,438	16,099,877
Budget Authority:		
Appropriations received	175,110,945	174,202,102
Spending authority from offsetting collections:		
Earned		
Collected	8,387,178	8,853,881
Change in receivables from Federal sources	(176,901)	(60,947)
Change in unfilled customer orders		
Advances received	(154,658)	(24,024)
Without advance from Federal sources	(468,113)	(582,631)
Subtotal	182,698,451	182,388,381
Nonexpenditure Transfers, net, anticipated and actual	2,607,610	2,589,140
Permanently not available	(2,882,590)	(2,512,014)
Total Budgetary Resources	231,595,583	225,613,745
Status of Budgetary Resources:		
Obligations incurred:		
Direct	189,108,300	179,434,110
Reimbursable	9,281,402	11,176,960
Subtotal	198,389,702	190,611,070
Unobligated balance:		
Apportioned	29,803,065	31,804,999
Subtotal	29,803,065	31,804,999
Unobligated balances not available	3,402,816	3,197,676
Total Status of Budgetary Resources	$ 231,595,583	$ 225,613,745

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Combined	2010 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 101,601,676	$ 101,403,501
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(3,154,897)	(3,798,476)
Total Unpaid Obligated Balance	98,446,779	97,605,025
Obligations incurred, net (+/-)	198,389,702	190,611,070
Less: Gross outlays	(178,343,901)	(174,313,017)
Less: Recoveries of prior year unpaid obligations, actual	(14,169,438)	(16,099,877)
Change in uncollected customer payments from Federal sources (+/-)	645,010	643,578
Obligated balance, net, end of period		
Unpaid obligations	107,478,039	101,601,677
Less: Uncollected customer payments from Federal sources	(2,509,887)	(3,154,898)
Total Unpaid Obligated Balance, net, end of period	104,968,152	98,446,779
Net Outlays:		
Gross Outlays	178,343,901	174,313,017
Less: Offsetting collections	(8,232,516)	(8,829,857)
Less: Distributed Offsetting receipts	36,444	(141,386)
Net Outlays	$ 170,147,829	$ 165,341,774

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) General Fund (GF), 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 GF 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 DON GF 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 GF financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance and Accounting Service, Cleveland (DFAS-CL) collects the financial system information and incorporates it into the financial statements for DON GF. The DON GF 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 DON GF, DFAS-CL also collects information from multiple sources, such as intragovernmental data from DON GF'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 feeder systems for the DON GF financial statements. The DDRS DCM identifies the information requirements to the source provider, provides an audit trail, and integrates data into the financial statement preparation process.

The DON GF 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 GF 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 DON GF continues to implement process and system improvements addressing these limitations.

The Department of Defense Inspector General (DoDIG) issued an audit report dated November 9, 2011 and identified several financial statement material weaknesses: Financial Management Systems; Fund Balance with Treasury; Accounts Receivable; Other Assets; Inventory and Related Property; General Property, Plant, and Equipment (GPP&E); Accounts Payable; Statement of Net Cost; Problem Disbursements; and Unobligated Balances. The DON GF (as identified in the DON fiscal year (FY) 2011 Annual Statement of Assurance dated August 26, 2011) recognizes those weaknesses as well as weaknesses associated with Collections and Disbursements, Procure to Pay Processes, General Equipment, Military Equipment, Real Property, and Operating Materiel and Supplies (OM&S) (and the associated weaknesses with Inventory).

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 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 funds (excluding deposit funds) to execute its missions and subsequently report on resource usage.

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

These general funds also include supplemental funds enacted by the American Recovery and Reinvestment Act (Recovery Act) of 2009. Details relating to Recovery Act appropriated funds are available on-line at *http://www.defenselink.mil/recovery*.

The National Defense Sealift Fund is DON GF'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 earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The DON GF is required to separately account for and report on the receipt, use, and retention of revenues and other financing sources for earmarked funds.

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

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

The DON GF receives allocation transfers for 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.

1.D. Basis of Accounting

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

The DON financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of 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. These actions include revising the accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). DON GF's financial data will be derived from budgetary transactions, data from nonfinancial feeder systems, and accruals, until DON GF's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by USGAAP.

1.E. Revenues and Other Financing Sources

The DON GF 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 GF recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full-cost pricing is DON GF's standard policy for services provided as required by OMB Circular A-25, User Charges. The DON GF recognizes revenue when earned within the constraints of its current system capabilities. In some instances, revenue is recognized when bills are issued.

The DON GF 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 21, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

DON GF adheres to the DoD policy that requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items such as payroll expenses, accounts payable, environmental liabilities, and FECA liabilities. In the case of Operating Materiel & 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 GF 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 GF cannot accurately identify intragovernmental transactions by customer because DON GF'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 DoD 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 U.S. Treasury's Federal Intragovernmental Transactions Accounting Policy Guide and Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government, provide guidance for reporting and reconciling intragovernmental balances. While DON GF is unable to fully reconcile intragovernmental transactions with all federal agencies, DON GF is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The 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, 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 GF's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of Defense Finance and Accounting Service (DFAS), the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the 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, DON GF's FBWT is adjusted to agree with the U.S. Treasury accounts.

1.J. Foreign Currency

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 GF 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 GF 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. The DON GF recognizes an allowance for estimated uncollectible amounts due from the public. In accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities, the methodology for losses due to uncollectable 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 DoD 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 Bulletin No. 2011-08.

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

The DON GF 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 DON GF's materiel management activities. The DON GF 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. The DON GF uses both the consumption method and the purchase method of accounting for OM&S. DON GF OM&S is categorized as (1) operating materiel and supplies held for use, (2) operating materiel and supplies held in reserve for future use ("held for repair") (including munitions not held for sale) and (3) excess, obsolete and unserviceable operating materiel 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, DON GF uses the purchase method. Under this method, materiel and supplies are expensed when purchased. During FY 2011 and 2010, DON GF 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.

DON GF 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. The LAC method is used because legacy logistics systems were designed for materiel 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 (P.L. 104-208) (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 recognizes excess, obsolete, and unserviceable inventory and OM&S at a Net Realizable Value of $0 pending development of an effective means of valuing such materiel.

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

The DON GF reports investments in accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities. The DON GF maintains 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 GF'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 GF invests in nonmarketable market-based U.S. Treasury securities, which are issued to federal agencies by the U.S. Treasury's Bureau of Public Debt. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

1.O. General Property, Plant, and Equipment

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

The DON GF General Property, Plant, and Equipment (PP&E) capitalization threshold is $100 thousand for General PP&E.

In accordance with SFFAS No. 6, Accounting for Property, Plant and Equipment, General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds 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 DoD depreciates all General PP&E, other than land, on a straight-line basis.

The inventory reporting systems changed for military equipment in FY 2011. Effective the 1st Quarter, FY 2011, military equipment is recorded in Defense Property Accountability System (DPAS), the Capital Asset Management System-Military Equipment (CAMS-ME) is no longer used for recording military equipment transactions.

When it is in the best interest of the government, the DON GF provides government property to contractors to complete contract work. The DON GF 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 GF'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 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 GF has not fully implemented this policy primarily due to system limitations.

1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, 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 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 GF has not implemented this policy primarily due to system limitations.

1.Q. 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 GF records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The DON GF 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 GF, 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 GF are the largest component of operating leases and are based on costs gathered from existing leases, General Services Administration (GSA) bills, and interservice support agreements. Future year projections use the Consumer Price Index.

1.R. Other Assets

In accordance with SFFAS No.1, DON GF categorizes military and civil service employee pay advances and certain contract financing payments (that are not reported elsewhere on DON GF's Balance Sheet).

Advances are cash outlays made by DON GF to its employees, contractors, or others to cover a part of 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.

The DON GF 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, DON GF 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 DON GF has not fully implemented this policy primarily due to system limitations.

Due to inconsistencies in the posting logic for Nonfederal Advances and Prepayments, Navy GF is noncompliant with the 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.

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

1.S. Contingencies and Other Liabilities

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

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The DON GF’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 DON GF’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 GF 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.T. 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.U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred. Cumulative results of operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.V. Treaties for Use of Foreign Bases

The 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 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.W. Undistributed Disbursements and Collections

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

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

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. Supported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly. Unsupported undistributed disbursements are recorded as disbursements in transit and reduce nonfederal accounts payable. Unsupported undistributed collections are recorded in nonfederal other liabilities.

1.X. Fiduciary Activities

Fiduciary cash and other assets are not assets of the DON GF 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.Y. Military Retirement and Other Federal Employment Benefits

Not applicable.

1.Z. Significant Events

Not applicable.

Note 2. Nonentity Assets

As of September 30	2011	2010
(Amounts in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	$ 386,464	$ 421,725
B. Accounts Receivable	-	-
C. Other Assets	$ -	$ -
D. Total Intragovernmental Assets	386,464	421,725
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ 106,042	$ 107,278
B. Accounts Receivable	3,503,156	3,483,615
C. Other Assets	-	-
D. Total Nonfederal Assets	$ 3,609,198	$ 3,590,893
3. Total Nonentity Assets	$ 3,995,662	$ 4,012,618
4. Total Entity Assets	$ 478,591,631	$ 459,207,830
5. Total Assets	$ 482,587,293	$ 463,220,448

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

Intragovernmental Fund Balance with Treasury

This nonentity asset category primarily represents amounts in DON's GF 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 as agents of the U.S. Treasury and are not available for DON's use in normal operations.

Nonentity Nonfederal Accounts Receivable (Public)

The primary component of nonentity accounts receivable is an advance payment made to a contractor, which remains in litigation and includes associated accrued interest. These receivable balances are being reported in nonentity nonfederal accounts receivable since the original appropriation year has been cancelled and any funds collected as a result of this litigation would be remitted to the U.S. Treasury.

Note 3. Fund Balance with Treasury

As of September 30		2011		2010
(Amounts in thousands)				
1. Fund Balances				
A. Appropriated Funds	$	136,450,135	$	131,782,542
B. Revolving Funds		1,590,127		1,689,432
C. Trust Funds		19,458		23,615
D. Special Funds		2,083		2,208
E. Other Fund Types		386,464		421,725
F. Total Fund Balances	$	138,448,267	$	133,919,522
2. Fund Balances Per Treasury Versus Agency				
A. Fund Balance per Treasury	$	139,907,357	$	135,351,248
B. Fund Balance per DON		138,448,267		133,919,522
3. Reconciling Amount	$	1,459,090	$	1,431,726

The total reconciling amount of $1.5 billion in Fund Balance with Treasury (FBWT) is due to cancelled authority, trust receipts, saving deposit program differences, and parent-child transactions. The cancelled authority balances, which comprise a majority of the reconciling amount, are still carried at Treasury, but not at the DON. 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.

Other Fund Types (Line 1.E) 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.

DON acknowledges that it has a material internal control weakness in that it does not reconcile its FBWT between accounting systems at the DON Level and Treasury records at the transaction level. To remediate the weakness the DON has partnered with its accounting service provider DFAS to reconcile its FBWT and to sustain this reconciliation in the future.

Status of Fund Balance with Treasury

As of September 30		2011		2010
(Amounts in thousands)				
1. Unobligated Balance				
A. Available	$	29,803,065	$	31,804,998
B. Unavailable		3,402,816		3,197,676
2. Obligated Balance not yet Disbursed		107,478,039		101,601,677
3. Nonbudgetary FBWT		283,449		479,502
4. NonFBWT Budgetary Accounts		(2,519,102)		(3,164,331)
5. Total	$	138,448,267	$	133,919,522

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

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

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

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

NonFBWT Budgetary Accounts reduces the Status of FBWT. NonFBWT Budgetary Accounts include Trust Fund investments in U.S. Treasury securities, unfilled customer orders without advance, and reimbursements receivable.

Unobligated balances are segregated to show available and unavailable amounts in the notes schedule. Unobligated, unavailable balances are restricted to future use and are not apportioned for current use.

Although funds have been appropriated, expired single year appropriations, such as Operation and Maintenance and Military Personnel accounts, are not generally available for obligation because the period for obligation established by law in the applicable appropriation act has lapsed. Multi-year accounts and "X" or no year accounts are restricted based on their appropriation type. Trust funds and Earmarked funds are restricted to their intended use.

Note 4. Investments and Related Interest

As of September 30	2011				
(Amounts in thousands)	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
1. Intragovernmental Securities					
A. Nonmarketable, Market-Based					
1. Military Retirement Fund	$ -		$ -	$ -	$ -
2. Medicare Eligible Retiree Health Care Fund	-		-	-	-
3. US Army Corps of Engineers	-		-	-	-
4. Other Funds	9,324		(71)	9,253	9,259
5. Total Nonmarketable, Market-Based	$ 9,324		$ (71)	$ 9,253	$ 9,259
B. Accrued Interest	36		-	36	36
C. Total Intragovernmental Securities	$ 9,360		$ (71)	$ 9,289	$ 9,295
2. Other Investments					
A. Total Other Investments	$ -		$ -	$ -	$ N/A

As of September 30	2010				
(Amounts in thousands)	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
1. Intragovernmental Securities					
A. Nonmarketable, Market-Based					
1. Military Retirement Fund	$ -		$ -	$ -	$ -
2. Medicare Eligible Retiree Health Care Fund	-		-	-	-
3. US Army Corps of Engineers	-		-	-	-
4. Other Funds	9,480		(30)	9,450	9,453
5. Total Nonmarketable, Market-Based	$ 9,480		$ (30)	$ 9,450	$ 9,453
B. Accrued Interest	15		-	15	15
C. Total Intragovernmental Securities	$ 9,495		$ (30)	$ 9,465	$ 9,468
2. Other Investments					
A. Total Other Investments	$ -		$ -	$ -	$ N/A

Intragovernmental Investments for Earmarked Funds

The U.S. Treasury securities are issued to the earmarked funds as evidence of its receipts and are an asset to the DON GF and a liability to the U.S. Treasury. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash generated from earmarked funds are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Since the 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 a liability in the U.S. Governmentwide financial statements.

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

Other Funds (Line 1.A.4) represents DON GF 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 Earmarked Funds, DON Trust Funds are reported as earmarked funds.

Note 5. Accounts Receivable

As of September 30	2011		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
1. Intragovernmental Receivables	$ 321,788	N/A	$ 321,788
2. Nonfederal Receivables (From the Public)	3,694,629	(15,312)	3,679,317
3. Total Accounts Receivable	$ 4,016,417	$ (15,312)	$ 4,001,105

As of September 30	2010		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
(Amounts in thousands)			
1. Intragovernmental Receivables	$ 394,557	N/A	$ 394,557
2. Nonfederal Receivables (From the Public)	3,711,724	(20,241)	3,691,483
3. Total Accounts Receivable	$ 4,106,281	$ (20,241)	$ 4,086,040

The DON GF is currently working on complying with 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 its service providers 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. Since the DON is at risk of not collecting on these public Accounts Receivable, the DON GF is recognizing an allowance for uncollectible amounts. The methodology used in determining the allowance amount is discussed in Note 1.K.

The DON GF Intragovernmental and Nonfederal Accounts Receivable balance is impacted by the Defense Departmental Reporting System Audited Financial Statements (DDRS-AFS) accounting system as a result of adjustments recorded for undistributed collections, trading partners, and the Navy A-12 Program required in the preparation of the GF consolidated statements.

Note 6. Other Assets

As of September 30	2011	2010
(Amounts in thousands)		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 165,099	$ 263,633
B. Other Assets	-	-
C. Total Intragovernmental Other Assets	$ 165,099	$ 263,633
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 44,497,095	$ 42,042,591
B. Advances and Prepayments	289,676	220,572
C. Other Assets (With the Public)	12,527	13,345
D. Total Nonfederal Other Assets	$ 44,799,298	$ 42,276,508
3. Total Other Assets	$ 44,964,397	$ 42,540,141

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 GF 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 GF is unable to identify these payments due to system limitations and all amounts are reported as OCFP.

The balance of OCFP includes $43.7 billion in contract financing payments and an additional $775.4 million in estimated future payments to contractors upon delivery and government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

Nonfederal Other Assets- Advances and Prepayments
Advances and prepayments include amounts reclassified from federal to nonfederal, to account for the inability of the accounting system to properly account for these transactions.

Nonfederal Other Assets - Other Assets (With the Public)
Other Assets (With the Public) includes advance pay to DON GF military personnel, travel advances to military and civilian personnel, and miscellaneous advances to contractors that are not considered OCFP.

Note 7. Cash and Other Monetary Assets

As of September 30	2011	2010
(Amounts in thousands)		
1. Cash	$ 76,772	$ 64,352
2. Foreign Currency	29,270	42,925
3. Other Monetary Assets	-	-
4. Total Cash, Foreign Currency, & Other Monetary Assets	$ 106,042	$ 107,277

Cash and Foreign Currency consist primarily of cash held by the 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. DON Disbursing Officers are agents of the U.S. Treasury.

Restriction on Cash, Foreign Currency, and Other Monetary Assets
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 $106.0 million in Cash and Foreign Currency is restricted as to its use.

Note 8. Direct Loan and Loan Guarantees

Not applicable.

Note 9. Inventory and Related Property

As of September 30		2011		2010
(Amounts in thousands)				
1. Inventory, Net	$	-	$	-
2. Operating Materiel & Supplies, Net		66,782,595		62,053,484
3. Stockpile Materiel, Net		-		-
4. Total	$	66,782,595	$	62,053,484

Inventory, Net

Not applicable.

Operating Materiel and Supplies, Net

As of September 30	2011			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
(Amounts in thousands)				
1. OM&S Categories				
A. Held for Use	$ 61,924,364	$ -	$ 61,924,364	SP, LAC, MAC
B. Held for Repair	6,093,922	(1,235,691)	4,858,231	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable	1,163,912	(1,163,912)	-	NRV
D. Total	$ 69,182,198	$ (2,399,603)	$ 66,782,595	

As of September 30	2010			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
(Amounts in thousands)				
1. OM&S Categories				
A. Held for Use	$ 57,697,650	$ -	$ 57,697,650	SP, LAC, MAC
B. Held for Repair	6,401,691	(2,045,857)	4,355,834	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable	1,328,957	(1,328,957)	-	NRV
D. Total	$ 65,428,298	$ (3,374,814)	$ 62,053,484	

Legend for Valuation Methods:

LAC = Latest Acquistion Cost
NRV = Net Realizable Value
SP = Standard Price
MAC = Moving Average Cost

General Composition of Operating Materiel and Supplies (OM&S)

The consumption method shall be applied when accounting for OM&S and valued at historical cost or any method approximating historical cost (e.g. Standard Price or Latest Acquisition Cost). 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 purchases method may be used.

OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The categories of OM&S are Ammunitions and Munitions, Principal End and Secondary Items, Sponsor Owned Materiel (SOM), Realtime Reutilization Asset Management (RRAM) Materiel, and Other OM&S. The Moving Average Cost valuation method 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.

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. They normally possess one of the following characteristics: essential for combat or training; high dollar value; difficult to procure or produce; or critical basic materiel or components. Principal End and Secondary Items are valued at Moving Average Cost.

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

Materiel maintained and valued in RRAM is considered excess to the owner or materiel manager responsible for the materiel, but may not be excess to DON. Standard price is used to value all stock-numbered items. Part-numbered items are valued by best available information. Stock-numbered items represent common items available in the supply system. Part-numbered items are older, unique items only used in specific types of OM&S.

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

Restrictions on the Use of OM&S

There are no known restrictions on the use of OM&S.

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

The DON GF assigns OM&S items to a category based upon the type and condition of the asset. OM&S Held for Use includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged materiel held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable OM&S consists of scrap materiel or items that cannot be economically repaired and are awaiting disposal. Raw Materials consist of items consumed in the production of goods for sale or in the provision of services for a fee.

Stockpile Materiel, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30	2011				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 615,579	N/A	$ 615,579
B. Buildings, Structures, and Facilities	S/L	20 or 40	40,040,721	$ (22,578,930)	17,461,791
C. Leasehold Improvements	S/L	lease term	6,530	(2,391)	4,139
D. Software	S/L	2-5 or 10	10,956	(10,439)	517
E. General Equipment	S/L	5 or 10	14,718,004	(8,816,331)	5,901,673
F. Military Equipment	S/L	various	374,404,232	(177,473,327)	196,930,905
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	6,167,963	N/A	6,167,963
J. Other			1,193,031	-	1,193,031
K. Total General PP&E			$ 437,157,016	$ (208,881,418)	$ 228,275,598

As of September 30	2010				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 614,992	N/A	$ 614,992
B. Buildings, Structures, and Facilities	S/L	20 or 40	36,123,500	$ (21,104,162)	15,019,338
C. Leasehold Improvements	S/L	lease term	6,530	(2,079)	4,451
D. Software	S/L	2-5 or 10	11,594	(10,921)	673
E. General Equipment	S/L	5 or 10	14,979,935	(6,472,441)	8,507,494
F. Military Equipment	S/L	various	353,215,833	(161,790,209)	191,425,624
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	3,717,174	N/A	3,717,174
J. Other			1,214,773	-	1,214,773
K. Total General PP&E			$ 409,884,331	$ (189,379,812)	$ 220,504,519

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

Restrictions on the Use or Convertibility of General Property, Plant, & Equipment (PP&E)

The DON GF 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.

Accounting Standards for Military Equipment

Effective FY 2011, DON GF no longer uses the CAMS-ME for valuing Military Equipment. DPAS is the current inventory reporting system for Military Equipment. The change in reporting system for reporting Military Equipment created a significant change in the asset balance from FY 2010 to the ending balance at FY 2011. This significant change was primarily a result of discrepancies of valuation methods between the two systems and recording of depreciation. It was determined that a prior period adjustment was not recorded due to the inability to obtain accurate and sufficient documentation to support the amount recorded in a prior period adjustment.

The DoD identified the universe of Military Equipment by accumulating information relating to program funding and associated Military Equipment, equipment useful life, program acquisitions, and disposals to establish a baseline. The Military Equipment baseline is updated using expenditure, acquisition, and disposals information.

With the audit readiness clean-up efforts, DON identified additional aircraft that were not previously reported as Military Equipment. These 1,106 aircraft, which are primarily trainers that are being reported for the first time, have a net book value of approximately $8.0 billion.

During FY 2011, 231 new aircraft were added to the inventory and 156 were retired.

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, such as BRAC property awaiting sale or transfer to another Federal agency.

Heritage Assets and Stewardship Land

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

DON differences for Heritage Assets reported for FY 2010 ending and FY 2011 beginning balances are a result of U.S. Marine Corps audit readiness clean-up efforts.

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.

Categories	Measure Quantity	As of September 30, 2010	Additions	Deletions	As of September 30, 2011
Buildings and Structures	Each	23,174	35	13,174	10,035
Archaeological Sites	Each	19,370	371	1,207	18,534
Museum Collection Items (Objects, Not Including Fine Art)	Each	634,799	18,604	1,777	651,626
Museum Collection Items (Objects, Fine Art)	Each	33,069	768	21	33,816

The DON's stewardship land consists mainly of mission essential land acquired by donation or devise. The DON held the following acres of land as of September 30, 2011.

(acres in Thousands)

Facility Code	Facility Title	As of September 30, 2010	Additions	Deletions	As of September 30, 2011
9110	Government Owned Land	6	-	1	5
9111	State Owned Land	-	-	-	-
9120	Withdrawn Public Land	2,030	-	-	2,030
9130	Licensed and Permitted Land	21	-	-	21
9140	Public Land	-	-	-	-
9210	Land Easement	-	-	-	-
9220	In-Leased Land	-	-	-	-
9230	Foreign Land	-	-	-	-
				Grand Total	2,056
				TOTAL - All Other Lands	26
				TOTAL - Stewardship Lands	2,030

Relationship of Heritage Assets to DON's Mission

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.

Assets under Capital Lease

Not applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2011	2010
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ -	$ -
B. Debt	-	-
C. Other	553,572	571,299
D. Total Intragovernmental Liabilities	$ 553,572	$ 571,299
2. Nonfederal Liabilities		
A. Accounts Payable	$ 88,870	$ 77,278
B. Military Retirement and Other Federal Employment Benefits	1,654,800	1,692,779
C. Environmental Liabilities	21,186,693	19,333,895
D. Other Liabilities	4,764,684	4,550,479
E. Total Nonfederal Liabilities	$ 27,695,047	$ 25,654,431
3. Total Liabilities Not Covered by Budgetary Resources	$ 28,248,619	$ 26,225,730
4. Total Liabilities Covered by Budgetary Resources	$ 8,582,533	$ 11,009,490
5. Total Liabilities	$ 36,831,152	$ 37,235,220

Liabilities Not Covered by Budgetary Resources are liabilities incurred which are not covered by available budgetary resources. 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. Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress.

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 are future actuarial liabilities. Environmental liabilities are estimates related to future events, such as cleanup of nuclear powered assets that will be budgeted for when those assets are removed from service. Finally, 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.

Military Retirement and Other Federal Employment Benefits consists of unfunded FECA actuarial liabilities not due and payable during the current fiscal year. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Intragovernmental Liabilities – Other consists primarily of funded FECA liabilities due to the Department of Labor and unemployment compensation.

Nonfederal Liabilities – Other consists primarily of liabilities for annual leave, estimated legal contingencies, and for the disposal of excess and obsolete structures.

Note 12. Accounts Payable

As of September 30	2011		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 1,996,758	$ N/A	$ 1,996,758
2. Nonfederal Payables (to the Public)	558,714	12	558,726
3. Total	$ 2,555,472	$ 12	$ 2,555,484

As of September 30	2010		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 1,657,333	$ N/A	$ 1,657,333
2. Nonfederal Payables (to the Public)	2,682,876	17	2,682,893
3. Total	$ 4,340,209	$ 17	$ 4,340,226

Accounts Payable include amounts owed to federal and nonfederal entities for goods and services received by DON GF. The DON GF'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 reclassifying amounts between federal and nonfederal cost categories, and accruing additional costs when necessary.

The DON GF Intragovernmental and Nonfederal Accounts Payable balance is impacted in the DDRS-AFS accounting system as a result of adjustments recorded for undistributed collections and trading partners which were required in the preparation of the consolidated statements.

Note 13. Debt

Not applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2011	2010
(Amounts in thousands)		
1. Environmental Liabilities–Nonfederal		
A. Accrued Environmental Restoration Liabilities		
1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 2,582,351	$ 2,464,830
2. Active Installations—Military Munitions Response Program (MMRP)	1,898,185	824,373
3. Formerly Used Defense Sites—IRP and BD/DR	-	-
4. Formerly Used Defense Sites–MMRP	-	-
B. Other Accrued Environmental Liabilities—Non-BRAC		
1. Environmental Corrective Action	$ 69,811	$ 77,011
2. Environmental Closure Requirements	359,376	553,204
3. Environmental Response at Operational Ranges	13,999	14,380
4. Asbestos	348,972	206,305
5. Non-Military Equipment	513,504	78,818
6. Other	831	810
C. Base Realignment and Closure Installations		
1. Installation Restoration Program	$ 1,413,412	$ 1,459,029
2. Military Munitions Response Program	163,564	146,931
3. Environmental Corrective Action / Closure Requirements	24,404	33,814
4. Asbestos	-	-
5. Non-Military Equipment	-	-
6. Other	-	-
D. Environmental Disposal for Military Equipment / Weapons Programs		
1. Nuclear Powered Military Equipment / Spent Nuclear Fuel	$ 13,637,332	$ 13,290,837
2. Non-Nuclear Powered Military Equipment	-	-
3. Other Weapons Systems	160,953	183,553
E. Chemical Weapons Disposal Program		
1. Chemical Demilitarization - Chemical Materials Agency (CMA)	$ -	$ -
2. Chemical Demilitarization - Assembled Chemical Weapons Alternatives (ACWA)	-	-
3. Other	-	-
2. Total Environmental Liabilities	$ 21,186,694	$ 19,333,895

The unrecognized portion of the estimated total cleanup costs associated with General PP&E was $2.5 billion for FY 2011 and $2.5 billion for FY 2010.

The “Other” type of environmental liabilities under Other Accrued Environmental Costs (Line 1.B.6) represents an environmental estimate for disposal of Polychlorinated Biphenyls (PCBs) transformers located at various Naval installations.

In addition to the liabilities reported above, the DON GF 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.

1. Applicable Laws and Regulations of Cleanup Requirements

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

- Superfund Amendments and Reauthorization Act of 1986
- The Resource Conservation and Recovery Act of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984
- The Clean Water Act of 1977, amended the Federal Water Pollution Control Act
- 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 1970 (BRAC only)

2. Methods for Assigning Total Cleanup Costs to Current Operating Periods

Active Installations - Defense Environmental Restoration Program (DERP) Funded: Accrued DERP cleanup liabilities represent the cost to correct past releases of hazardous constituents to PP&E, including acquired land and Stewardship Land, as described in DoD FMR, Volume 4, Chapter 6.

Environmental cleanup of past releases is funded by DERP and carried out under applicable regulatory laws and procedural guidance including the DoD's "Management Guidance for DERP," and "Environmental and Non-Environmental Liabilities," DoD FMR, Volume 4, Chapter 13.

Environmental restoration activities may be conducted at operating installations (IRP) and at Closed, Transferred, and Transferring Munitions Ranges (MRP). 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 validated in accordance with DoD Instruction 5000.61, "DoD Modeling and Simulation, Verification, Validation, and Accreditation," of May 2003. 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.

MRP liabilities are specific to the identification, investigation and removal and remedial actions to address environmental contamination at ranges that were closed prior to September 30, 2002. The contamination may include munitions, chemical residues from military munitions and munitions scrap at ranges on active installations that pose a threat to human health or the environment. CTC is not estimated until there is sufficient site-specific data available to estimate the total cost to complete. 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.

3. Description of the Types of Environmental Liabilities and Disposal Liabilities

Active Installation-DERP Funded Accrued Environmental Restoration Liabilities.
The DoD FMR, Volume 6B, Chapter 10 requires that "any estimate produced must be based on site specific information and use cost models validated in accordance with DoD Instruction 5000.61." The DON environmental cleanup cost estimate was based on 3,952 IRP and 330 MRP sites at 280 active installations. The Marine Corps is included in these programs. As of 4th Quarter, FY 2011, DON estimated and reported $4.5 billion for environmental restoration liabilities. This amount is comprised of $2.6 billion in Active Installations-IRP liabilities and $1.9 billion in Active Installations-MRP liabilities.

Other Accrued Environmental Costs (Non-BRAC funds).
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 PCBs transformers, underground storage tank remedial investigation and closure. As part of the DON FIP efforts, the Navy completed surveying, identifying, and estimating Non-BRAC units and began recognizing the estimated environmental liability 1st Quarter, FY 2007. For 4th Quarter, FY 2011, the total Other Accrued Environmental Liabilities is $1.3 billion. Of the total, the Navy portion is $1.0 billion while the Marine Corps portion is $278.8 million.

Base Realignment and Closure.
BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated BRAC process. For FY 2011, DON estimated and reported $1.6 billion for BRAC funded environmental liabilities. This amount includes $1.4 billion for IRP, $163.6 million for MMRP, and $24.4 million 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 Weapons Systems Programs.
Environmental Disposal for Weapons Systems are those estimates associated with the environmental disposal costs for DON Nuclear Weapons Programs that includes Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. The DON reported an environmental disposal liability for Weapons Systems Programs of $13.8 billion in FY 2011. This amount includes Nuclear Powered Military Equipment of $10.9 billion, Spent Nuclear Fuel (Other) of $2.8 billion, and Other Weapons Systems of $161.0 million.

4. 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 FY 2011, 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.

5. 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.

Overall, DON has a reasonable level of confidence in the estimates recognized on the financial statements. This reasonable level of confidence in the estimates is because the estimates for DERP/BRAC programs are based on the CTC module of the NORM System. A verification, validation, and accreditation were completed by a third party for CTC module of NORM, while the environmental program managers continue to validate the data.

For the Weapons systems, the environmental program managers base their environmental disposal estimates on actual costs for similar projects. A change in the overall methodology in Weapons systems reflects a more accurate estimate of what it will cost to dispose of the Weapons systems. Given the fact that the planned date for opening the Department of Energy's (DOE's) planned waste repository has been delayed, there is uncertainty associated with the estimate for spent nuclear fuel. As DOE's plans are solidified, DON's estimates for spent nuclear fuel will change accordingly.

The DON believes that the total current environmental liabilities for BRAC are reasonable, based upon information available at the time in calculating the estimates. However, as the FY 2005 BRAC closure activities are implemented over the next several fiscal years, the actual results may vary materially from the required reportable estimates. The variance will depend on additional information obtained from planned or ongoing studies of the extent and concentration of site environmental contamination and based on property disposal requirements to meet community needs. In addition to the possibility of the estimates changing on current identified sites, DON may incur additional environmental cleanup and restoration costs if new sites are identified as BRAC activities are implemented.

The DON believes that the current environmental liabilities for Other Accrued Environmental Liabilities (Non-DERP) for 4th Quarter, FY 2011 are reasonable, based upon the information available at the time in calculating the estimates and completing the fence to fence survey. However, as internal controls are implemented to sustain this effort, changes to some of the estimates could occur. In addition to the possibility of some of the estimates changing for the current list of identified units, DON may incur additional units and changes to estimates as the inventory of units are reviewed annually. The BRAC Program Management Office has been notified that a status change was made in the Other Environmental Liabilities (OEL) database. BRAC is developing eligibility criteria for the reporting of these OEL units.

Note 15. Other Liabilities

As of September 30	2011		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
1. Intragovernmental			
A. Advances from Others	$ 286,402	$ -	$ 286,402
B. Deposit Funds and Suspense Account Liabilities	386,464	-	386,464
C. Disbursing Officer Cash	107,433	-	107,433
D. Judgment Fund Liabilities	6,605	-	6,605
E. FECA Reimbursement to the Dept. of Labor	164,436	217,859	382,295
F. Custodial Liabilities	3,501,764	-	3,501,764
G. Employer Contribution and Payroll Taxes Payable	30,004	-	30,004
H. Other Liabilities	168,220	-	168,220
I. Total Intragovernmental Other Liabilities	$ 4,651,328	$ 217,859	$ 4,869,187
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 398,789	$ -	$ 398,789
B. Advances from Others	550,805	-	550,805
C. Deferred Credits	-	-	-
D. Deposit Funds and Suspense Accounts	(25,423)	-	(25,423)
E. Temporary Early Retirement Authority	-	-	-
F. Nonenvironmental Disposal Liabilities			
(1) Military Equipment (Nonnuclear)	12,844	207,551	220,395
(2) Excess/Obsolete Structures	3,218	535,369	538,587
(3) Conventional Munitions Disposal	-	-	-
G. Accrued Unfunded Annual Leave	2,896,018	-	2,896,018
H. Capital Lease Liability	-	-	-
I. Contract Holdbacks	71,252	-	71,252
J. Employer Contribution and Payroll Taxes Payable	19,677	-	19,677
K. Contingent Liabilities	13,395	1,871,643	1,885,038
L. Other Liabilities	9,630	-	9,630
M. Total Nonfederal Other Liabilities	$ 3,950,205	$ 2,614,563	$ 6,564,768
3. Total Other Liabilities	$ 8,601,533	$ 2,832,422	$ 11,433,955

As of September 30	2010		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
1. Intragovernmental			
A. Advances from Others	$ 302,441	$ -	$ 302,441
B. Deposit Funds and Suspense Account Liabilities	421,725	-	421,725
C. Disbursing Officer Cash	109,657	-	109,657
D. Judgment Fund Liabilities	26,687	-	26,687
E. FECA Reimbursement to the Dept. of Labor	168,025	214,077	382,102
F. Custodial Liabilities	3,481,236	-	3,481,236
G. Employer Contribution and Payroll Taxes Payable	77,587	-	77,587
H. Other Liabilities	193,271	-	193,271
I. Total Intragovernmental Other Liabilities	$ 4,780,629	$ 214,077	$ 4,994,706
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 1,091,417	$ -	$ 1,091,417
B. Advances from Others	689,422	-	689,422
C. Deferred Credits	-	-	-
D. Deposit Funds and Suspense Accounts	-	-	-
E. Temporary Early Retirement Authority	-	-	-
F. Nonenvironmental Disposal Liabilities			
(1) Military Equipment (Nonnuclear)	8,792	245,247	254,039
(2) Excess/Obsolete Structures	105,813	131,335	237,148
(3) Conventional Munitions Disposal	-	-	-
G. Accrued Unfunded Annual Leave	2,904,512	-	2,904,512
H. Capital Lease Liability	-	-	-
I. Contract Holdbacks	77,852	-	77,852
J. Employer Contribution and Payroll Taxes Payable	70,995	-	70,995
K. Contingent Liabilities	10,679	1,524,164	1,534,843
L. Other Liabilities	13,314	-	13,314
M. Total Nonfederal Other Liabilities	$ 4,972,796	$ 1,900,746	$ 6,873,542
3. Total Other Liabilities	$ 9,753,425	$ 2,114,823	$ 11,868,248

Intragovernmental Other Liabilities (Line 1.H) consists primarily of Unemployment Compensation unfunded liabilities.

Contingent Liabilities includes $775.0 million 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. These rights should not be misconstrued as rights of ownership. The DON GF is under no obligation to pay contractors for amounts greater than the amounts authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of potential future payments are estimable, the DON GF has recognized a contingent liability for estimated future payments which are conditional pending delivery and government acceptance.

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

Contingent Liabilities also include Overseas Contingency Operations (OCO), consisting of programs providing funding for unexpected disasters overseas and within the United States. The programs involved in this effort are as follows:

Japan Earthquake/Tsunami	China Earthquake	Operation Noble Eagle
Guam Relocation	Hurricane Gustav & Tropical Storm Hanna	OEF (Afghanistan)
Hurricane Katrina	Hurricane Ike	OEF (Horn of Africa)
Hurricane Rita	H1N1 Influenza Effort	OEF (Philippines)
Hurricane Wilma	Pacific Natural Disaster Relief	OEF (Other)
Pakistan Earthquake	Haiti Earthquake Relief Effort	Operation Iraqi Freedom (OIF)
Hurricane Stan (Guatemala)	Haiti Migrant Operational Support	Operation New Dawn
Sigonella Flood	Deepwater Horizon Oil Spill	ODF (Bosnia No Fly Zone)
Hurricane 2006	Tennessee Flooding	IJF (Kosovo Peacekeeping)
Lebanon Evacuation	Pakistan Flooding	HGE Georgia
Typhoon Ioke	Typhoon Megi (Philippines)	GWOT Cost Transfer From (-)
California Fires 2007	Natural Disaster Cost Transfer From (-)	Reimbursable
Northwest Flood 2007	Libyan Unrest	Capitol Police
Burma Relief	Natural Disaster Reimbursable	Bahrain Unrest

The DON GF FY 2011 Overseas Contingency Operations funding was obligated and expended as follows:

Bahrain Evacuation (BE) obligations incurred $594.0 thousand and total disbursements $576.0 thousand.

Operation Pacific (Japan) Passage obligations incurred $27.8 million and total disbursements $27.2 million.

Operation Tomodachi (Japan) obligations incurred $51.9 million and total disbursements $6.1 million. Reimbursable OHDACA obligations incurred $23.1 million and total disbursements $22.0 million.

Capital Lease Liability

Not applicable.

Note 16. 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 Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The DON GF records contingent liabilities in Note 15, Other Liabilities.

For FY 2011, DON GF materiality threshold for reporting litigation, claims, or assessments is $49.3 million. The DON OGC conducts a review of litigation and claims threatened or asserted involving DON GF to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The DON currently has 16 cases that meet the existing FY 2011 DON GF materiality threshold. DON legal counsel was unable to express an opinion concerning the likely outcome on 12 of 16 cases.

Due to the inherent uncertainties of litigation, lawyers generally refrain from expressing judgments as to outcomes except in those relatively few clear cases. In response to a Department of Defense (DOD) Inspector General Audit, "DoD Process for Reporting Contingent Legal Liabilities," DON developed a methodology to determine an estimate for contingent legal liabilities. DON recognized and disclosed an estimate for contingent legal liabilities. The methodology considers the likelihood of an unfavorable outcome or potential liability and provides an overall assessment of all cases currently pending and not on an individual case basis. The likelihood of an unfavorable or potential liability was determined by using an average of the data from the current year-to-date and the preceding two years. The total dollar amount of the cases closed was divided by the total dollar amount claimed in those closed cases for each of the last two years plus current year, which were then used to calculate the average. This average is based entirely on historical data and represents the percentage that has historically been paid on claims. The merits of each individual case have not been taken into consideration. The estimate for those cases considered reasonably possible to result in an adverse judgment against DON is $496.6 million. Until sufficient historical data can be collected for the Navy Working Capital Fund, the DON GF estimate will consider all DON funding sources together.

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 contingent liabilities.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2011			
(Amounts in thousands)	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
1. Pension and Health Actuarial Benefits				
A. Military Retirement Pensions	$ -		$ -	$ -
B. Military Retirement Health Benefits	-		-	-
C. Military Medicare-Eligible Retiree Benefits	-		-	-
D. Total Pension and Health Actuarial Benefits	$ -		$ -	$ -
2. Other Actuarial Benefits				
A. FECA	$ 1,654,801		$ -	$ 1,654,801
B. Voluntary Separation Incentive Programs	-		-	-
C. DoD Education Benefits Fund	-		-	-
D. Other	218		(218)	-
E. Total Other Actuarial Benefits	$ 1,655,019		$ (218)	$ 1,654,801
3. Other Federal Employment Benefits	$ -		$ -	$ -
4. Total Military Retirement and Other Federal Employment Benefits:	$ 1,655,019		$ (218)	$ 1,654,801

As of September 30	2010			
(Amounts in thousands)	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
1. Pension and Health Actuarial Benefits				
A. Military Retirement Pensions	$ -		$ -	$ -
B. Military Retirement Health Benefits	-		-	-
C. Military Medicare-Eligible Retiree Benefits	-		-	-
D. Total Pension and Health Actuarial Benefits	$ -		$ -	$ -
2. Other Actuarial Benefits				
A. FECA	$ 1,692,779		$ -	$ 1,692,779
B. Voluntary Separation Incentive Programs	-		-	-
C. DoD Education Benefits Fund	-		-	-
D. Other	72		(72)	-
E. Total Other Actuarial Benefits	$ 1,692,851		$ (72)	$ 1,692,779
3. Other Federal Employment Benefits	$ -		$ -	$ -
4. Total Military Retirement and Other Federal Employment Benefits:	$ 1,692,851		$ (72)	$ 1,692,779

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

Discount Rates
3.535% in Year 1
4.025% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2011 were also used to adjust the methodology's historical payments to current year constant dollars. The compensation COLAs and CPIMs used in the projections for various CBY were as follows:

CBY	COLA	CPIM
2011	N/A	N/A
2012	2.10%	3.07%
2013	2.53%	3.62%
2014	1.83%	3.66%
2015	1.93%	3.73%
2016	2.00%	3.73%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2011 to the average pattern observed during the most current three charge back years, and (4) a comparison thereafter of the estimated liability per case in the 2011 projection to the average pattern for the projections of the most recent three projections.

Note 18. Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue

As of September 30	2011	2010
(Amounts in thousands)		
1. Intragovernmental Costs	$ 50,201,170	$ 47,048,345
2. Public Costs	131,198,281	113,303,648
3. Total Costs	$ 181,399,451	$ 160,351,993
4. Intragovernmental Earned Revenue	$ (3,546,706)	$ (3,633,777)
5. Public Earned Revenue	(8,916,321)	(1,613,218)
6. Total Earned Revenue	$ (12,463,027)	$ (5,246,995)
7. Net Cost of Operations	$ 168,936,424	$ 155,104,998

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 do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The 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 GF systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by (1) reclassifying amounts between federal and nonfederal expenses or (2) accruing additional accounts payable and expenses. Intradepartmental revenues and expenses are then eliminated.

The DON GF'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 GF 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. Intradepartmental 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 GAAP. One such action is the revision of its accounting systems to record transactions based on the USSGL. 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 GAAP, DON GF'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.

General Disclosures Related to the SNC Note 18

Revenues:

Earned revenue (line 1.B) increased causing a net change of $7.2 billion. This increase is due to the recording of OM&S assets to no year appropriations within Navy ERP which were not previously recorded within the legacy system.

Other Gains increased by $6.0 billion and Unrealized Gains increased by $1.7 billion resulting from Navy ERP postings to no year appropriations.

Gross Costs:
Gross costs (line 1.A) increased causing a net change of $21.0 billion consisting primarily of Construction in Progress (CIP), Military Equipment, Personal Property and Real Property.

Note 19. 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. No-year appropriations remain available for obligation until expended. Annual appropriations remain available for upward or downward adjustment of obligations until expended.

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) accrued salaries, (c) expenses for contingent liabilities, and (d) expenses for environmental liabilities.

Appropriations Received on the Statement of Change 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 $18.5 million 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 No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.

In the SCNP, all offsetting balances (i.e. transfers-in, transfers-out, revenue and expenses) for general fund activity between earmarked and other (nonearmarked) funds are reported on the same lines. Therefore, the Eliminations column contains all appropriate elimination entries, which net to zero within each respective line, except for intra-entity imputed financing costs.

Description of Lines for Statement of Changes in Net Position
Donations and forfeitures of cash and property decreased by $13.0 million, as a result of a reduction of donations to the government by a nonfederal entity, of financial resources, such as cash or nonfinancial resources such as land or buildings. This reduction occurred in five appropriations within the DON GF.

Transfers-in/out without reimbursement decreased by a net effect of $1.0 billion, as a result of property transfers in and out of NAVFAC.

Prior Period Adjustments made in the prior fiscal year are not appropriately reflected in the comparative period. There was a prior period adjustment recorded for Marine Corps of $574.0 million in FY 2010, therefore the reduction of prior period adjustments from FY 2010 to FY 2011 represents one hundred percent of that adjustment.

Other Adjustments represent an increase of $370.0 million due to change in budget authority and rescissions in accordance with Public Law.

For Other Financing Sources-Other, DON GF sustained a valuation gain of $16.7 billion for Military Equipment, Operating Materiel & Supplies, and Real Property. This gain was a result of a change in inventory reporting system. See note 10 for additional details in the inventory reporting system.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2011	2010
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 148,297,754	$ 137,981,530
2. Available Borrowing and Contract Authority at the End of the Period	-	-

Apportionment Categories for Obligations Incurred
On the SBR: Obligations Incurred includes $189.1 billion of Direct Program Obligations and $9.3 billion of Reimbursable Program Obligations.

On the Report on Budget Execution (SF-133):

- Direct Obligations, Category A, amounts apportioned quarterly, are $109.7 billion.
- Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are $79.3 billion.
- Total Direct Obligations are therefore $189.1 billion.
- The $5.9 million difference in direct obligations between the SBR and SF-133 is due to adjustments on the SBR to recognize fringe benefits, reclassify reimbursable obligations as noted below, and recognize other adjustments not captured in the field accounting systems.
- Category A Reimbursable Obligations are $(449.2) thousand.
- Category B Reimbursable Obligations are $9.3 billion.
- Total Reimbursable Obligations are therefore $9.3 billion.

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

As noted above, in terms of obligations, differences exist between the SF-133 and the SBR for a number of reasons; including accruals recorded for fringe benefits, liabilities recorded for the Judgment Fund, and accruals recorded for trading partner advances and liabilities.

Appropriations Received on the SCNP does not agree with Appropriations Received on the SBR due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $18.5 million is due to Trust Funds and Special Receipt Accounts included in the Appropriations Received line of the SBR.

Legal limitations and restrictions affect the use of the unobligated balance of budget authority based upon program and fiscal year in the applicable appropriation language or in the alternative provisions section at the end of the appropriations act.

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 Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve

Fleet, including the acquisition, alteration or conversion of vessels. During FY 2011, there was one transfer for $1.3 million to NDSF.

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. For FY 2011, there were four transfers from ER, N for $303.8 million to the Operation and Maintenance, Navy appropriation. There were no transfers into ER, N during FY 2011.

Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30	2011	2010
(Amounts in thousands)		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	$ 198,389,702	$ 190,611,070
2. Less: Spending authority from offsetting collections and recoveries (-)	(21,756,944)	(24,286,156)
3. Obligations net of offsetting collections and recoveries	176,632,758	166,324,914
4. Less: Offsetting receipts (+/-)	36,444	(141,386)
5. Net obligations	176,669,202	166,183,528
Other Resources:		
6. Donations and forfeitures of property	652	5,258
7. Transfers in/out without reimbursement (+/-)	225,126	1,243,648
8. Imputed financing from costs absorbed by others	881,374	884,867
9. Other (+/-)	12,764,061	(3,959,432)
10. Net other resources used to finance activities	13,871,213	(1,825,659)
11. Total Resources Used to Finance Activities	**$ 190,540,415**	**$ 164,357,869**
Resources Used to Finance Items not Part of the Net Cost of Operations:		
12. Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
12a. Undelivered Orders (-)	$ (10,316,024)	$ (8,050,975)
12b. Unfilled Customer Orders	(622,769)	(606,655)
13. Resources that fund expenses recognized in prior periods (-)	(182,244)	(2,110,921)
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	(36,444)	141,386
15. Resources that finance the acquisition of assets (-)	(16,206,440)	(21,358,668)
16. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	-	-
16b. Other (+/-)	(12,989,838)	2,710,529
17. Total resources used to finance items not part of the Net Cost of Operations	$ (40,353,759)	$ (29,275,304)
18. Total resources used to finance the Net Cost of Operations	$ 150,186,656	$ 135,082,565

As of September 30		2011		2010
(Amounts in thousands)				
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
19. Increase in annual leave liability	$	30,795	$	1,702,301
20. Increase in environmental and disposal liability		1,891,194		819,497
21. Upward/Downward reestimates of credit subsidy expense		-		-
22. Increase in exchange revenue receivable from the public (-)		27,231		(189,330)
23. Other (+/-)		283,146		699,205
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	$	2,232,366	$	3,031,673
Components not Requiring or Generating Resources:				
25. Depreciation and amortization	$	19,729,331	$	12,292,840
26. Revaluation of assets or liabilities (+/-)		(6,173,204)		413,703
27. Other (+/-)				
27a. Trust Fund Exchange Revenue		-		-
27b. Cost of Goods Sold		-		-
27c. Operating Materiel and Supplies Used		5,527,002		4,349,363
27d. Other		(2,565,727)		(65,146)
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	$	16,517,402	$	16,990,760
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	18,749,768	$	20,022,433
30. Net Cost of Operations	$	168,936,424	$	155,104,998

The Reconciliation of Net Cost of Operations to Budget is designed to provide information about the total resources used by an entity, to explain how those resources were used to finance orders for goods and services not yet delivered, to acquire assets and liabilities, and to fund the entity's net cost of operations. It is designed to report the differences and facilitate the reconciliation of accrual based amounts used in the Statement of Net Cost (SNC) and obligation-based amounts used in the Statement of Budgetary Resources. The computations and presentation of items in the Reconciliation of Net Cost of Operations to Budget demonstrate that the budgetary and proprietary information in an entity's financial management system agrees.

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. This causes a difference in net cost between the SNC and the Reconciliation of Net Cost of Operations to Budget that requires an adjustment to the Reconciliation of Net Cost of Operations to Budget. For 4th Quarter, FY 2011, an adjustment of ($106.0 million) was made to Resources that Finance the Acquisition of Assets so that proprietary accounts reconcile with the budgetary accounts.

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

Description of Other Lines

Resources Used to Finance Activities - Budgetary Resources Obligated:

The balance of $12.8 billion represents the data call net gains and losses recorded in relation to the capitalization of assets such as Real Property, Operating Materiel and Supplies, and Military Equipment.

Resources Used to Finance Items not Part of the Net Cost of Operations:

The balance of ($13.0 billion) reflects net gains and losses recorded in relation to the net change of the value of assets such as Military Construction, Ammunition, Real Property, and Shipbuilding and Conversion.

Components Requiring or Generating Resources in Future Periods:

The balance of $283.1 million consists primarily of accrued expenses for Contingent Legal Liabilities and Environmental Liabilities.

Components Not Requiring or Generating Resources:

The balance of ($2.6 billion) consists primarily of crosswalk change for CIP reporting.

Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

Note 23. Earmarked Funds

BALANCE SHEET		Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
		2011				
As of September 30						
(Amounts in thousands)						
ASSETS						
Fund balance with Treasury	$	-	-	21,541	-	21,541
Investments		-	-	9,289	-	9,289
Accounts & Interest Receivable		-	-		-	-
Other Assets		-	-		-	-
Total Assets	$	-	-	30,830	-	30,830
LIABILITIES and NET POSITION						
Military Retirement Benefits and Other Federal Employment Benefits	$	-	-	-	-	-
Other Liabilities		-	-	5,285	-	5,285
Total Liabilities	$	-	-	5,285	-	5,285
Unexpended Appropriations		-	-	-	-	-
Cumulative Results of Operations		-	-	25,545	-	25,545
Total Liabilities & Net Position	$	-	-	30,830	-	30,830
STATEMENT OF NET COST						
For the period ended September 30						
Program Costs	$	-	-	26,678	-	26,678
Less Earned Revenue		-	-	-	-	-
Net Program Costs	$	-	-	26,678	-	26,678
Less Earned Revenues Not Attributable to Programs		-	-	-	-	-
Net Cost of Operations	$	-	-	26,678	-	26,678
STATEMENT OF CHANGES IN NET POSITION						
For the period ended September 30						
Net Position Beginning of the Period	$	-	-	33,682	-	33,682
Net Cost of Operations		-	-	26,678	-	26,678
Budgetary Financing Sources		-	-	18,541	-	18,541
Other Financing Sources		-	-	-	-	-
Change in Net Position	$	-	-	(8,137)	-	(8,137)
Net Position End of Period	$	-	-	25,545	-	25,545

BALANCE SHEET		2010 Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
As of September 30						
(Amounts in thousands)						
ASSETS						
Fund balance with Treasury	$	-	-	25,823	-	25,823
Investments		-	-	9,465	-	9,465
Accounts & Interest Receivable		-	-	-	-	-
Other Assets		-	-	-	-	-
Total Assets	$	-	-	35,288	-	35,288
LIABILITIES and NET POSITION						
Military Retirement Benefits and Other Federal Employment Benefits	$	-	-	-	-	-
Other Liabilities		-	-	1,606	-	1,606
Total Liabilities	$	-	-	1,606	-	1,606
Unexpended Appropriations		-	-	-	-	-
Cumulative Results of Operations		-	-	33,682	-	33,682
Total Liabilities & Net Position	$	-	-	35,288	-	35,288
STATEMENT OF NET COST						
For the period ended September 30						
Program Costs	$	-	-	20,135	-	20,135
Less Earned Revenue		-	-	-	-	-
Net Program Costs	$	-	-	20,135	-	20,135
Less Earned Revenues Not Attributable to Programs		-	-	-	-	-
Net Cost of Operations	$	-	-	20,135	-	20,135
STATEMENT OF CHANGES IN NET POSITION						
For the period ended September 30						
Net Position Beginning of the Period	$	-	-	26,171	-	26,171
Net Cost of Operations		-	-	20,135	-	20,135
Budgetary Financing Sources		-	-	27,644	-	27,644
Other Financing Sources		-	-	2	-	2
Change in Net Position	$	-	-	7,511	-	7,511
Net Position End of Period	$	-	-	33,682	-	33,682

Earmarked funds are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. The DON has seven earmarked funds. Four are categorized as Special Funds and three are categorized as Trust Funds. A list of these earmarked funds and a brief description of each follows below. There have been no changes in legislation during or subsequent to the reporting period that significantly changes the purpose of any of the seven funds or that redirects a material portion of the accumulated balances of any of the seven funds. Generally, revenues for DON's earmarked funds are inflows of resources to the Government.

Special Earmarked Funds

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 Navy and Marine Corps 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.

Kaho'olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy –
This fund, authorized by 107 Statute 1483, was established to recognize and fulfill the commitments made on behalf of the United States to the people of Hawaii and to return to the State of Hawaii the Island of Kaho'olawe. Congress has found it to be in the national interest and an essential element in the Federal Government's relationship with the State of Hawaii the conveyance, clearance, or removal of unexploded ordnance, environmental restoration, control of access to the Island and future use of the Island be undertaken in a manner consistent with the enhancement of that relationship, the Department of Defense's military mission, the federal interest, and applicable provisions of law. This fund is financed by congressional appropriations.

Rossmoor Liquidating Trust Settlement Account –
The Rossmoor Liquidating Trust account was established by Section 2208 of Public Law 104-106; the National Defense Authorization Act of 1996. Per the statute, monies awarded the United States when litigation is settled in favor of the Rossmoor Liquidating Trust is deposited into this account. The monies are made available to DON solely for the acquisition or construction of military family housing in, or in the vicinity of, San Diego, California.

Ford Island Improvement Account –
The Ford Island Improvement fund is authorized by 10 United States Code 2814 and was established to carry out improvements to property and facilities that will deliver overall benefits to DON at the Pearl Harbor Naval Complex at Ford Island, Hawaii. Ford Island is a central feature in the Pearl Harbor National Historic Landmark. The Ford Island legislation allows DON to sell or lease properties in Hawaii and use the proceeds to develop Ford Island.

Trust Earmarked Funds

DON General Gift Fund –
This trust fund is authorized by 10 United States Code 2601. Under the provisions of this statute, the Secretary of the Navy 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 trust 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 trust fund is authorized by 10 United States Code 6973. Under the provisions of this statute, the Secretary of the Navy 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 24. Fiduciary Activities

For the period ended September 30	2011	2010
(Amounts in thousands)		
1. Fiduciary net assets, beginning of year	$ 28,384	$ 26,731
2. Fiduciary revenues	-	-
3. Contributions	47,803	39,172
4. Investment earnings	2,905	2,319
5. Gain (Loss) on disposition of investments, net	-	-
6. Administrative and other expenses	-	-
7. Distributions to and on behalf of beneficiaries	(46,323)	(39,838)
8. Increase/(Decrease) in fiduciary net assets	$ 4,385	$ 1,653
9. Fiduciary net assets, end of period	$ 32,769	$ 28,384

For the period ended September 30	2011	2010
(Amounts in thousands)		
Fiduciary Assets		
1. Cash and cash equivalents	$ 32,769	$ 28,384
2. Investments	-	-
3. Other Assets	-	-
Fiduciary Liabilities		
4. Less: Liabilities	$ -	$ -
Total Fiduciary Net Assets	$ 32,769	$ 28,384

The Department of the Navy's Fiduciary Activity consists of funds in the Savings Deposit Program. Under 10, USC, §1035, and Department of Defense Financial Management Regulation, Volume 7A, Chapter 51, deployed service members of both the Navy and Marine Corps can earn 10 percent interest on up to $10 thousand deposited into the program. Funds are held in the program during the member's tour of duty and are paid out within 90 days after the member leaves the eligible region. The accounts included in the balance are 17X6025 for Navy and 17X6026 for Marine Corps.

Note 25. Other Disclosures

As of September 30	2011			
(Amounts in thousands)	Land and Buildings	Equipment	Other	Total
1. Entity as Lessee - Operating Leases				
Future Payments Due				
Fiscal Year				
2012	$ 146,970	$ -	$ 5,824	$ 152,794
2013	150,845	-	5,970	156,815
2014	154,830	-	6,119	160,949
2015	158,928	-	6,272	165,200
2016	163,143	-	6,429	169,572
After 5 Years	167,479	-	6,589	174,068
Total Future Lease Payments Due	$ 942,195	$ -	$ 37,203	$ 979,398

Note 26. Restatements

Not applicable.

Investments in Research and Development
Yearly Investment in Research and Development

For Fiscal Years 2007 through 2011

($ in Millions)

Categories	FY11	FY10	FY09	FY08	FY07
Basic Research	$ 547	$ 552	$ 523	$ 452	$ 448
Applied Research	728	752	854	748	781
Development					
Advanced Technology Development	821	859	883	752	801
Advanced Component Development and Prototypes	4,080	3,910	3,464	3,329	3,229
System Development and Demonstration	6,429	7,325	8,288	8,141	8,731
Research, Development, Test, and Evaluation Management Support	1,285	1,293	1,245	1,112	1,034
Operational Systems Development	4,285	4,505	4,249	3,943	3,810
Totals	**$ 18,175**	**$ 19,196**	**$ 19,506**	**$ 18,477**	**$ 18,834**

Investments in Research and Development

Investment values are based on Research and Development outlays (expenditures). Outlays are used because current Department of the Navy (DON) systems are unable to fully capture and summarize costs in accordance with standards promulgated by the Federal Accounting Standards Advisory Board.

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

A. Basic Research

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

The following are two representative program examples for the Basic Research category.

Training Science & Technology:

The Office of Naval Research's (ONR) game and simulation-based training research focuses on the design and development of frameworks for training and assessing complex performance in non-linear, 3D computer-based games and simulations.

Central to these unique frameworks is the incorporation of domain ontology with Bayesian networks. This combination enables the framework for both 1.) identifying what cognitive constructs need to be taught, and 2.) predicting player competencies based on observed sequences of actions within the game. Current research examines the damage control domain related to firefighting and flooding aboard naval ships. The key constructs being assessed are communication, situational awareness and decision-making.

The Navy's need for high-quality instruction and reliable assessment of complex performances necessitates the need for consistent and valid methodologies, which often include the use of games and simulations. However, assessing performance in these settings can be difficult—particularly in nonlinear simulations where more than one pathway to success or failure exists. The challenge lies not in capturing the raw data from game-play, but in interpreting what a player's actions and decisions mean in the broader context of cognitive readiness for a particular job function or task.

ONR is investigating game-based training with the support of the Center for Naval Engineering in Norfolk and San Diego. A third generation damage control game/simulation is being built to assess situational awareness, communication abilities and decision-making skills. This environment challenges the player to manage a main space fire and flood casualty from the perspective of multiple roles aboard a Flight II DDG. It assesses the player's ability to organize personnel, manage resources, follow established protocols, and coordinate containment actions across multiple events. This next-generation trainer will be used in classroom assessments as well as for practice among damage control teams aboard Navy ships.

What this research will accomplish:

- These advanced training systems will yield insights about personnel skill sets, either individually or in a team environment, that are otherwise difficult to assess through conventional means, such as observed actions.
- Its automation will reduce the demands placed on instructors and human evaluators of performance.

Undersea Medicine:

The Office of Naval Research has funded research in Undersea Medicine since the early 1950's, and in 2007, Undersea Medicine was designated as a National Naval Responsibility (NNR). Efforts have shifted from defining safety/performance windows for undersea operations to leveraging new biomedical and electrophysiological technologies to directly address and explore novel approaches to undersea disorders and performance challenges.

The Undersea Medicine Program seeks innovative biomedical approaches to reduce the medical risks of operation in the hostile undersea environment, improve undersea mission flexibility and efficiency, and decrease the medical logistic burden of undersea operations.

The program explores novel interventions against decompression sickness, hyperbaric oxygen toxicity, innovations to decrease the medical logistic burden for undersea operations, and new approaches to improve the health, safety, and performance of submarine forces and divers.

The Undersea Medicine Program is working on specific technologies to predict/prevent hyperbaric oxygen toxicity, ensure safe submarine escape and rescue, ensure safe diving in contaminated water, monitor submarine atmospheric conditions, monitor carbon dioxide levels in re-breathers, and interventions against underwater sound/blast effects.

What this research will accomplish:

- The capability to operate deeper, longer, safer, and cheaper- depends on our ability to develop novel approaches to undersea biomedical issues.
- Improve capability to operate safely in a hostile environment, increase mission flexibility/efficiency and decrease the logical burden of treating injuries while decreasing the morbidity and mortality of undersea operations.

B. Applied Research

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

The following are two representative program examples for the Applied Research category.

Solid State Fiber Laser:

The Office of Naval Research's Solid-State Fiber Laser provides Incoherent Fiber Lasers for short asymmetric threat engagement and Coherent Combined Fiber Lasers for long range aircraft self protection. This future fiber laser weapon system is being designed to be game changing and fit into aircraft pods. The capability of having speed of-light delivery for a wide range of missions and threats is a key element of a future aircraft layered defense.

A "fiber" laser is a laser in which the active gain medium is an optical fiber doped with rare earth elements such as erbium, ytterbium, neodymium, dysprosium, praseodymium and thulium. Light is kept in the "core" of the optical fiber by total internal reflection. This causes the fiber to act as a waveguide. Fibers that support many propagation paths or transverse modes are called multi-mode fibers (MMF). Fibers that support only a single mode are called single mode fibers (SMF). MMFs generally have a large diameter core, and are used for short distance communication links or for applications where high power must be transmitted. Single mode fibers are used for most communication links longer than 200 meters.

Understanding the physics for modeling and simulation is necessary for effective testing of smaller and lighter high power solid state lasers. This technology is scalable, has high optical quality, and has a highly compact modular design for high efficiency.

What this research will accomplish:

- Improved efficiency, reduction in weight, volume, prime power, etc., defines a fiber laser as the best pathway to provide Naval aviation / Navy a 100 kW laser weapon.
- The ability for aircraft self protection, time critical strike, precision engagements, graduated lethality, low collateral damage, and asymmetric threat engagement allow for significant increases in warfighter capability.

Submarine Payload Tube Actuator:

An Office of Naval Research SwampWorks program developed a complete, power-dense, electric actuator system (EAS) for submarine payload tubes, with benefits in reliability and total cost reduction over legacy hydraulic actuator systems. This program targets the maximum torque capacity and density to replace hydraulic actuators in the same ship layout space. Torque capacity, stroke and actuation speed was demonstrated in laboratory testing in December 2010. The electric actuator includes a fully submersible, high torque, scalable motor. This electric actuator enables location external to the pressure hull, simplifying and reducing hull penetrations, as well as associated maintenance costs.

Acquisition and life cycle cost reduction is a Navy priority for future submarine platforms. Current controls are hydraulic and mechanical, requiring piping and ancillary systems that contribute significantly to construction and maintenance costs. In addition to the high life cycle costs associated with the hydraulic system, the method of transmitting force and torque is costly due to the alignment-critical nature of the linkages, bearings, guide tubes, pushrods, pressure-hull penetrations, and hydraulic rams. Arrangement constraints also make it difficult to have multiple actuator configurations that might otherwise be desired.

ONR is investing in electric actuation to support low-cost technology insertions to satisfy this need for submarine control surfaces. Electrically actuated systems offer the potential for construction and in-service cost reduction through elimination of shipboard hydraulic systems and ancillary equipment. Systems will also support future condition-based maintenance with integrated sensors and prognostics.

Recent accomplishments include a full-scale, proof-of-concept linear actuator developed collaboratively with General Atomics, which achieved 90,000 lbf thrust and a 26-inch stroke in 20 seconds in laboratory testing. It is expected the next phase of this effort will include testing through relevant force profiles of the actuator using a linear dynamometer, and finally testing a pre-manufacturing prototype in submarine relevant environments.

What this research will accomplish:

- The Submarine Payload Tube Electric Actuator demonstrates technologies to meet the challenge of submarine actuator electrification. It establishes a Navy vendor base for electric actuation, reduces the number of pressure hull penetrations, and enables opportunities to reduce total ownership costs.

C. Development

Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development is comprised of five stages, as defined below.

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

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

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

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

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

The following are four representative program examples for the Development category.

Autonomous Aerial Cargo Utility System:

The Autonomous Aerial Cargo/Utility Systems (AACUS) program explores advanced autonomous capabilities for reliable resupply/retrograde and casualty evacuation by unmanned air cargo utility systems under adverse conditions. Integrated autonomous capability for unmanned vertical takeoff and landing (VTOL) aircraft would feature capability modules for approach/landing zone selection; operations to/from slopes, unprepared terrain and ships; waypoint navigation, contingency management and mission planning; obstacle detection and avoidance; threat sensing and avoidance; and ground control and interface systems.

The AACUS is an Innovative Naval Prototype program that will start in fiscal year 2012. This builds on the small business technology transfer effort, Autonomous Landing at Unprepared Sites for a Cargo Unmanned Air System. VTOL systems have significant advantages over other means of resupply and evacuation, including avoidance of improvised explosive devices, greater speed over trucks, and improved affordability and availability over manned rotorcraft. AACUS will develop advanced autonomous capabilities to enable unmanned and optionally manned VTOL air systems to be fully capable of reliable, responsive cargo delivery to distributed small units in demanding conditions. AACUS will lead the way in developing autonomous capabilities with sufficient reliability to be entrusted with evacuating human casualties from remote sites.

A number of efforts, including the Marine Corps Immediate Cargo Unmanned Air System, are underway to develop unmanned VTOL air systems capable of cargo delivery. The AACUS program will work in parallel with these complementary programs, and will provide the advanced autonomous capabilities needed for revolutionary capability enhancements for these and future platforms.

What this research will accomplish:

- This program will develop an open architecture autonomous capability for VTOL aircraft capable of launch and recovery using unprepared landing zones with little or no human supervision.
- Systems will provide reliable resupply and casualty evacuation in ship operations to sea state 4, adverse weather and degraded visual environments, GPS-denied conditions and at night.
- It will enhance survivability in the presence of threats.

Tactical Microsatellite:

TacSat-4 is a Navy-led joint mission to provide relevant capabilities and to enable Operationally Responsive Space. TacSat-4 provides ten Ultra High Frequency (UHF) channels, which can be used for any combination of communications, data ex-filtration, or Blue Force tracking. Notably, TacSat-4 provides communications-on-the-move with legacy radios and provides a wide band channel for early testing.

TacSat-4 uses relatively low-cost, small satellite and launch vehicle technologies. The spacecraft is 450kg with a 1000W solar array and a 12 foot diameter payload antenna to provide high gain, enabling most communications-on-the-move to be supported without ground antenna pointing. A "low HEO" (highly elliptical orbit) with a 4 hour period (6 orbits per day) provides long dwells over theaters. TacSat-4 payload technologies include a 12-foot UHF deployable antenna, advanced thermal control using several heat pipe technologies, and compact ten channel transponder electronics, all provided at a lower cost point for spacecraft. Development areas include spacecraft bus standards, long dwell orbits, dynamic tasking, and net-centric operations.

The Minotaur-IV launch vehicle will be used to achieve orbit. A single satellite can provide 2 hours of coverage three times a day over a given theater (2000nm diameter), as well as support multiple theaters throughout the world each day. Users will use their existing equipment or early wide-band radios, when applicable.

The Blossom Point (BP) Ground Station in Maryland provides the command and control for TacSat-4 and maintains its user tasking system. BP's flexible common ground architecture allows rapid transitions and enables net-centric operations. Payload tasking will be performed via the SIPRNET-based Virtual Mission Operations Center, with frequencies allocated by the Joint Task Force-Global Network Operations and theater managers, as appropriate.

What this research will accomplish:

- TacSat-4 will augment operational communications. Ten UHF channels will allow communication-on-the-move, data-exfiltration, and Blue Force tracking.
- The unique orbit augments geosynchronous communications by allowing near global, but not continuous, coverage including the high latitudes.

Small Unit Mobility Enhancement Technology:

The Small Unit Mobility Enhancement Technologies (SUMET) program aims to increase the platform capability and affordability of unmanned, ground vehicle-enabling technologies to include low-cost, video-based perception systems, advanced video processing techniques, cognitive reasoning architectures and novel algorithm coding methodologies.

The SUMET science and technology effort aims to introduce increased unmanned ground platform autonomous capability into the Marine Corps at an affordable cost.

Commenced in October 2009, collaborative program leverages robotic efforts taking place in every department, or code, within the ONR. The SUMET perception system and video processing effort classifies objects by examining certain material characteristics in a spatial scene at the pixel level while utilizing advanced processing techniques. The program develops a cognitive reasoning architecture emphasizing unified cognition theory and learning working memory. Finally, significant emphasis is also placed on developing advanced behavior generation and novel coding techniques such as physicomimetics and genetic programming.

Key ONR technology programs contributing technology research include Image Understanding and Robotic Perception; Unmanned Underwater Systems; Developing Autonomy for Unmanned Surface Vehicles by Using Virtual Environments; Natural-language Dialogue with Autonomous Systems, and; Intelligent Autonomy for Unmanned Autonomous Systems Mission Control Interfaces.

Additional collaboration occurs with several other organizations. Performers include the Naval Research Laboratory, University of Maryland, Southwest Research Institute, SOAR Technologies, Nevada Automotive Test Center, and Carnegie Mellon University.

What this research will accomplish:

- SUMET will decrease the Navy and Marine Corps' reliance on costly sensors
- Enable systems to maneuver with greater autonomy in complex terrain and decreases algorithm development time.
- Addresses the need for advanced unmanned systems to perform logistic functions in the distributed battle-space, removing the logistic burden from the individual Marine.

Software reprogrammable Payload:

The Software Reprogrammable Payload (SRP) is an open-architecture, government owned reference design for a flexible, in-operational reconfigurable software radio designed to meet current and future needs for USMC UAS systems supporting a wide variety of missions.

The USMC SRP effort started to satisfy urgent needs to improve battlefield communications. The app-oriented modular design allows the SRP to support a wide variety of requirements to include ISR, Electronic Warfare, and other processing and data handling functions. The initial capability of SRP to the Marine Corps Shadow includes a jam resistant IP Router for netted communications on the move and a SINCGARS Relay that are both fully compatible with the current inventory of tactical radios. In addition, the SRP provides an RF collection application for the Automatic Identification System used for vessel tracking.

During a typical mission, the operator can use a simple drag-and-drop interface to select an application while on route to a convoy surveillance support mission. Once on station, the payload could do SIGINT collection while simultaneously performing beyond-line-of-sight UHF communications relay. If interference is detected on the communications channel the operator can select an interference mitigation filter, applied similarly to a Photoshop filter, or reprogram the communications channel from a pre-selected frequency plan.

Two key elements of the SRP are its non-proprietary design and a software developer's tool kit that enables the widest community to develop applications. Non-proprietary, government defined standards, and government-owned applications reduce the cost of acquisition by "solving the problem once." Department of Defense acquisition programs benefit from efficiency of re-use when applications developed for one platform may be re-hosted on another without re-inventing common components and functions. The software development tool kit can be provided to academia, industry, and government laboratories and thereby stimulate innovation and competition to bring new and effective communications and collection applications to the Marine Corps.

The delivery of the USMC Shadow SRP is the completion of the "initial capability." Additional pre-planned product improvements (P3I) are in the pipeline with new capabilities coming online over the next two years. Several demonstrations are planned in the future, including UAS platforms as well as manned systems for both USMC and Navy requirements.

What this research will accomplish:

- Provide the USMC with robust, flexible, reconfigurable payload operation with their Shadow UAS
- Four baseline applications are part of the initial capability: automated identification system; UHF communications relay with interference mitigation; UHF IP router capability for legacy radios; SINCGARS relay; and additional applications are on a parallel development path.

NON-FEDERAL PHYSICAL PROPERTY

The DON General Fund does not fund this type of Activity.

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

For Fiscal Year Ended September 30, 2011

($ in Thousands)

Property Type	1. Plant Replacement Value		2. Required Work (Deferred Maintenance and Repair)		3. Percentage
Category 1: Enduring Facilities					
Navy	$	137,137,110	$	38,149,290	27.82%
Marine Corps	$	44,724,778	$	1,102,280	2.46%
Category 2: Excess Facilities or Planned for Replacement					
Navy	$	1,096,970	$	467,350	42.60%
Marine Corps	$	845,844	$	-	0.0%
Category 3: Heritage Assets					
Navy	$	-	$	-	0.0%
Marine Corps	$	4,442,483	$	109,285	2.46%

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

1. The method used to assess facilities condition is a combination of commercial Infrastructure Condition Assessment Program (ICAP) software and facilities inspection. The method used to assess Marine Corps facilities conditions is a facilities inspection, which categorizes buildings as Adequate, Substandard, or Inadequate and also by direct inspection using the BUILDER methodology developed by the Army. The Navy's Quality rating (Q-rating) is calculated using the below formula:

$$Q = \frac{1 - (\mathit{Requirements})}{PRV} \times 100$$

   The Navy models the "Requirements" value from the condition rating and configuration rating. Condition Index for those Marine Corp buildings with BUILDER ratings are used directly for the Q rating. For those facilities without Condition Index ratings the Adequate Substandard and Inadequate ratings are converted to Q-ratings by assessing facilities that are rated as Adequate and less than 25 years old as Q1; facilities that are over 25 years old and rated as Adequate as Q2; facilities rated as Substandard as Q3; and Inadequate facilities as Q4. Since last year Marine Corps began using Condition Index ratings from BUILDER for most buildings replacing the interim process of converting Adequate, Substandard and Inadequate ratings into Q ratings. The Marine Corps has also made an effort to identify all Heritage assets, which greatly increased that number as a percentage of total.

2. The condition rating is a measure (0 -100) of an asset's physical condition at a particular point in time. The Navy uses condition modeling software to capture condition assessment data to model system/component condition ratings. The condition assessment data is supplemented by eyes-on condition assessments that capture accurate facility components and confirm as-built condition. The condition assessment program has not been expanded to include utility systems yet. Therefore, the condition ratings are inaccurate and the deferred maintenance and repair backlog is understated for utility systems.

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. The Navy's Q-rating is represented by the bands: 100%-90% Q1; 90%-80% Q2; 80%-60% Q3; and less than 60% Q4.

5. The FY 2011 target Q-rating value representing full investment requirement for the Navy is Q1. The Department of the Navy (DON) 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 for the Navy is valued at 27.82%, 42.60% and 0% of PRV for categories 1 through 3, respectively. The deferred maintenance and repair estimates are based on the facility Q-ratings found in the Navy's real property inventory.

   The table above shows that deferred maintenance for the Marine Corps is valued at approximately 2.46% of PRV for categories 1 and 3. This represents 2.46% over the acceptable 15% level. The percentage for category 1 and 3 facilities is the same because Marine Corps cannot separate the deferred maintenance between those categories at this time. Category 2 is zero because Marine Corps do not hold deferred maintenance backlogs on facilities to be demolished.

6. The Facility Readiness Evaluation System (FRES) application was used to generate the Deferred Maintenance and Repair Report. FRES is updated with iNFADS data on a weekly basis and at the end of the fiscal year. The PRV and deferred maintenance and repair estimates for all three categories are reported for CNIC installations only, and only the Maintenance Fund Sources listed below are included. Facilities maintained by BUMED, defense agencies, and Family Housing, Navy are excluded from the estimates.

   - Operation and Maintenance, Navy
   - Operation and Maintenance, Navy Reserve
   - Research, Development, Test, and Evaluation
   - Navy Working Capital Fund

7. Category 1 excludes facilities identified in Categories 2 and 3. During FY 2010, Category 2 facilities were identified by facilities assigned an Excess Action Code in iNFADS. During FY 2011, the Excess Action Code data element was deleted from iNFADS. The Navy currently identifies Category 2 facilities as follows: facilities assigned a RPA Operational Status Code of excess or surplus and RPA Interest Type Code Fee, ONST, ONFG, or Lease. Excess is defined as "property under the control of a federal agency that the head of the agency determines is not required to meet the agency's needs or responsibilities." The source for this definition is CFT Title 40 USC 102. Category 3 includes facilities that are single-use Heritage Assets. iNFADS does not identify any Navy facilities as single-use Heritage Assets; therefore, the amounts recorded for this category are zero.

Description of Property Type categories:

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

- Category 2 – Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal, including multi-use Heritage Assets.
- Category 3 – Buildings, Structures, and Utilities that are Heritage Assets.

Military Equipment Deferred Maintenance

For Fiscal Year Ended September 30, 2011

($ in Thousands)

Major Category	OP30 Amounts	Adjustments	Totals
1. Aircraft	$326,766	$(326,766)	$-
2. Automotive Equipment	14,561	(2,266)	12,295
3. Combat Vehicles	11,871	(6,986)	4,885
4. Construction Equipment	8,160	(322)	7,838
5. Electronics and Communications Systems	1,469	(866)	603
6. Missiles	93,998	6,916	100,914
7. Ships	189,107	(175,954)	13,153
8. Ordnance Weapons and Munitions	18,331	87,386	105,717
9. All Other Items Not Identified Above	120,318	8,558	128,876
Total	**$784,581**	**$(410,300)**	**$374,281**

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 Deferred Maintenance

Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), component repair, and software maintenance. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircraft that failed Aircraft Service Period Adjustment (ASPA) inspections or reached fixed Period End Date (PED) at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance represents the difference between the validated requirements minus corresponding funding. The $326,766 adjustment in the table above represents aircraft maintenance shortfall that was reduced with additional funds.

Airframe rework and maintenance (active and reserve) is currently performed under both the Standard Depot Level Maintenance (SDLM) and Integrated Maintenance Concept (IMC) programs. Currently, the AV-8B, C-130, C-2, E-2, E-6, EA-6B, F-5, F/A-18, H-1, H-46, H-53, H-60, P-3, and S-3 aircraft programs have been incorporated under the IMC concept. 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 Deferred Maintenance

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. The adjustment of $6,986 in the table above represents the deferred maintenance shortfall reduced with supplemental funding.

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 Deferred Maintenance

Four categories are used to determine missile maintenance: missiles, tactical missiles, software maintenance, and other. Deferred maintenance is defined as the difference between the total weapon maintenance requirement as determined by requirements modeling processes and the weapon maintenance that is funded in accordance with the annual budget controls for the missile maintenance program. The maintenance requirements model projects the quantity of missiles and missile components per weapon system that are required to be maintained or reworked annually.

Ships Deferred Maintenance

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. The adjustment of $175,954 in the table above represents ship maintenance shortfall reduced with additional funds.

Ordnance Weapons and Munitions Deferred Maintenance

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. The adjustment in the table above represents the increase in deferred maintenance due to reduced supplemental funding.

Deferred Maintenance on 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. The automotive equipment adjustment of $2,266 represents the deferred maintenance shortfall reduced by supplemental funding.

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).

Heritage Assets Condition Information

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

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

For the periods ended September 30, 2011 and 2010

($ in Thousands)

BUDGETARY FINANCING ACCOUNTS	Research, Development, Test & Evaluation	Procurement	Military Personnel	Family Housing & Military Construction
BUDGETARY RESOURCES				
Unobligated balance, brought forward, October 1	$ 2,776,115	$ 27,056,805	$ 604,845	$ 2,686,689
Recoveries of prior year unpaid obligations	581,685	4,269,412	4,034,039	1,314,788
Budget authority				
Appropriation	17,841,084	47,790,304	47,168,496	3,551,612
Borrowing authority	-	-	-	-
Contract authority	-	-	-	-
Spending authority from offsetting collections				
Earned				
Collected	310,161	787,499	381,011	1,333,271
Change in receivables from Federal sources	(31,437)	38,521	2,049	(93,494)
Change in unfilled customer orders				
Advance received	(59,167)	-	73	(143,285)
Without advance from Federal sources	(90,116)	(13,780)	4,003	(313,413)
Anticipated for rest of year, without advances	-	-	-	-
Previously unavailable	-	-	-	-
Expenditure transfers from trust funds	-	-	-	-
Subtotal	17,970,525	48,602,544	47,555,632	4,334,691
Nonexpenditure transfers, net, anticipated and actual	305,365	1,215,345	384,368	2,318
Temporarily not available pursuant to Public Law	-	-	-	-
Permanently not available	(270,475)	(1,022,146)	(300,407)	(83,240)
Total Budgetary Resources	$ 21,363,215	$ 80,121,960	$ 52,278,477	$ 8,255,246
Status of Budgetary Resources:				
Obligations incurred:				
Direct	$ 18,255,992	$ 54,209,680	$ 51,337,914	$ 3,514,052
Reimbursable	224,956	822,981	386,943	2,057,442
Subtotal	18,480,948	55,032,661	51,724,857	5,571,494
Unobligated balance:				
Apportioned	2,603,771	24,294,140	103,291	2,585,458
Exempt from apportionment	-	-	-	-
Subtotal	2,603,771	24,294,140	103,291	2,585,458
Unobligated balance not available	278,495	795,160	450,329	98,293
Total status of budgetary resources	$ 21,363,214	$ 80,121,961	$ 52,278,477	$ 8,255,245
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 10,051,107	$ 59,494,873	$ 2,505,192	$ 5,491,609
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(255,489)	(220,499)	6,001	(1,055,440)
Total unpaid obligated balance	9,795,618	59,274,374	2,511,193	4,436,169
Obligations incurred net (+/-)	18,480,948	55,032,661	51,724,858	5,571,494
Less: Gross outlays	(18,446,638)	(45,254,104)	(48,513,372)	(3,971,311)
Obligated balance transferred, net				
Actual transfers, unpaid obligations (+/-)	-	-	-	-
Actual transfers, uncollected customer payments from Federal sources (+/-)	-	-	-	-
Total Unpaid obligated balance transferred, net	-	-	-	-
Less: Recoveries of prior year unpaid obligations, actual	(581,685)	(4,269,412)	(4,034,039)	(1,314,788)
Change in uncollected customer payments from Federal sources (+/-)	121,553	(24,742)	(6,053)	406,906
Obligated balance, net, end of period				
Unpaid obligations	9,503,731	65,004,018	1,682,639	5,777,004
Less: Uncollected customer payments (+/-) from Federal sources (-)	(133,936)	(245,242)	(52)	(648,533)
Total, unpaid obligated balance, net, end of period	9,369,795	64,758,776	1,682,587	5,128,471
Net Outlays:				
Gross outlays	18,446,638	45,254,104	48,513,372	3,971,311
Less: Offsetting collections	(250,994)	(787,499)	(381,084)	(1,189,984)
Less: Distributed Offsetting receipts	-	-	-	-
Net Outlays	$ 18,195,644	$ 44,466,605	$ 48,132,288	$ 2,781,327

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

For the periods ended September 30, 2011 and 2010

($ in Thousands)

BUDGETARY FINANCING ACCOUNTS	Operations, Readiness & Support	2011 Combined	2010 Combined
BUDGETARY RESOURCES			
Unobligated balance, brought forward, October 1	$ 1,878,220	$ 35,002,674	$ 27,048,361
Recoveries of prior year unpaid obligations	3,969,514	14,169,438	16,099,877
Budget authority			
Appropriation	58,759,449	175,110,945	174,202,102
Borrowing authority	-	-	-
Contract authority	-	-	-
Spending authority from offsetting collections			
Earned			
Collected	5,575,236	8,387,178	8,853,881
Change in receivables from Federal sources	(92,540)	(176,901)	(60,947)
Change in unfilled customer orders			
Advance received	47,721	(154,658)	(24,024)
Without advance from Federal sources	(54,807)	(468,113)	(582,631)
Anticipated for rest of year, without advances	-	-	-
Previously unavailable	-	-	-
Expenditure transfers from trust funds	-	-	-
Subtotal	64,235,059	182,698,451	182,388,381
Nonexpenditure transfers, net, anticipated and actual	700,214	2,607,610	2,589,140
Temporarily not available pursuant to Public Law	-	-	-
Permanently not available	(1,206,322)	(2,882,590)	(2,512,014)
Total Budgetary Resources	$ 69,576,685	$ 231,595,583	$ 225,613,745
Status of Budgetary Resources:			
Obligations incurred:			
Direct	$ 61,790,662	$ 189,108,300	$ 179,434,110
Reimbursable	5,789,080	9,281,402	11,176,960
Subtotal	67,579,742	198,389,702	190,611,070
Unobligated balance:			
Apportioned	216,405	29,803,065	31,804,999
Exempt from apportionment	-	-	-
Subtotal	216,405	29,803,065	31,804,999
Unobligated balance not available	1,780,539	3,402,816	3,197,676
Total status of budgetary resources	$ 69,576,686	$ 231,595,583	$ 225,613,745
Change in Obligated Balance:			
Obligated balance, net			
Unpaid obligations, brought forward, October 1	$ 24,058,895	$ 101,601,676	$ 101,403,501
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(1,629,470)	(3,154,897)	(3,798,476)
Total unpaid obligated balance	22,429,425	98,446,779	97,605,025
Obligations incurred net (+/-)	67,579,741	198,389,702	190,611,070
Less: Gross outlays	(62,158,476)	(178,343,901)	(174,313,017)
Obligated balance transferred, net			
Actual transfers, unpaid obligations (+/-)	-	-	-
Actual transfers, uncollected customer payments from Federal sources (+/-)	-	-	-
Total Unpaid obligated balance transferred, net	-	-	-
Less: Recoveries of prior year unpaid obligations, actual	(3,969,514)	(14,169,438)	(16,099,877)
Change in uncollected customer payments from Federal sources (+/-)	147,346	645,010	643,578
Obligated balance, net, end of period			
Unpaid obligations	25,510,647	107,478,039	101,601,677
Less: Uncollected customer payments (+/-) from Federal sources (-)	(1,482,124)	(2,509,887)	(3,154,898)
Total, unpaid obligated balance, net, end of period	24,028,523	104,968,152	98,446,779
Net Outlays:			
Gross outlays	62,158,476	178,343,901	174,313,017
Less: Offsetting collections	(5,622,955)	(8,232,516)	(8,829,857)
Less: Distributed Offsetting receipts	36,444	36,444	(141,386)
Net Outlays	$ 56,571,965	$ 170,147,829	$ 165,341,774

Entity Accounts

General Funds

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1000	Medicare-Eligible Retiree Health Fund Contribution, Navy
17 1001	Medicare-Eligible Retiree Health Fund Contribution, Marine Corps
17 1002	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy
17 1003	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps
17X1105	Military Personnel, Marine Corps
17 1105	Military Personnel, Marine Corps
17X1106	Operations and Maintenance, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps
17 1109	Procurement, Marine Corps
17 1116	Operation and Maintenance - Recovery Act, Marine Corps
17 1117	Operation and Maintenance - Recovery Act, Marine Corps Reserve
17X1205	Military Construction, Navy and Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1206	Military Construction - Recovery Act, Navy and Marine Corps
17 1235	Military Construction, Naval Reserve
17X1236	Payments to Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
17 1319	Research, Development, Test, and Evaluation, Navy
17 1320	Research, Development, Test and Evaluation - Recovery Act, Navy
17 1405	Reserve Personnel, Navy
17X1453	Military Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17X1507	Weapons Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17X1611	Shipbuilding and Conversion, Navy
17 1611	Shipbuilding and Conversion, Navy
17X1804	Operation and Maintenance, Navy
17 1804	Operation and Maintenance, Navy
17 1805	Operation and Maintenance - Recovery Act, Navy
17X1806	Operations and Maintenance, Navy Reserve
17 1806	Operation and Maintenance, Navy Reserve
17 1807	Operation and Maintenance - Recovery Act, Navy Reserve
17X1810	Other Procurement, Navy
17 1810	Other Procurement, Navy

Revolving Funds

17X4557	National Defense Sealift Fund, Navy
17 4557	National Defense Sealift Fund, Navy

Earmarked Trust Funds

17X8716	Department of the Navy General Gift Fund
17X8723	Ships Stores Profits, Navy
17X8733	United States Naval Academy General Gift Fund

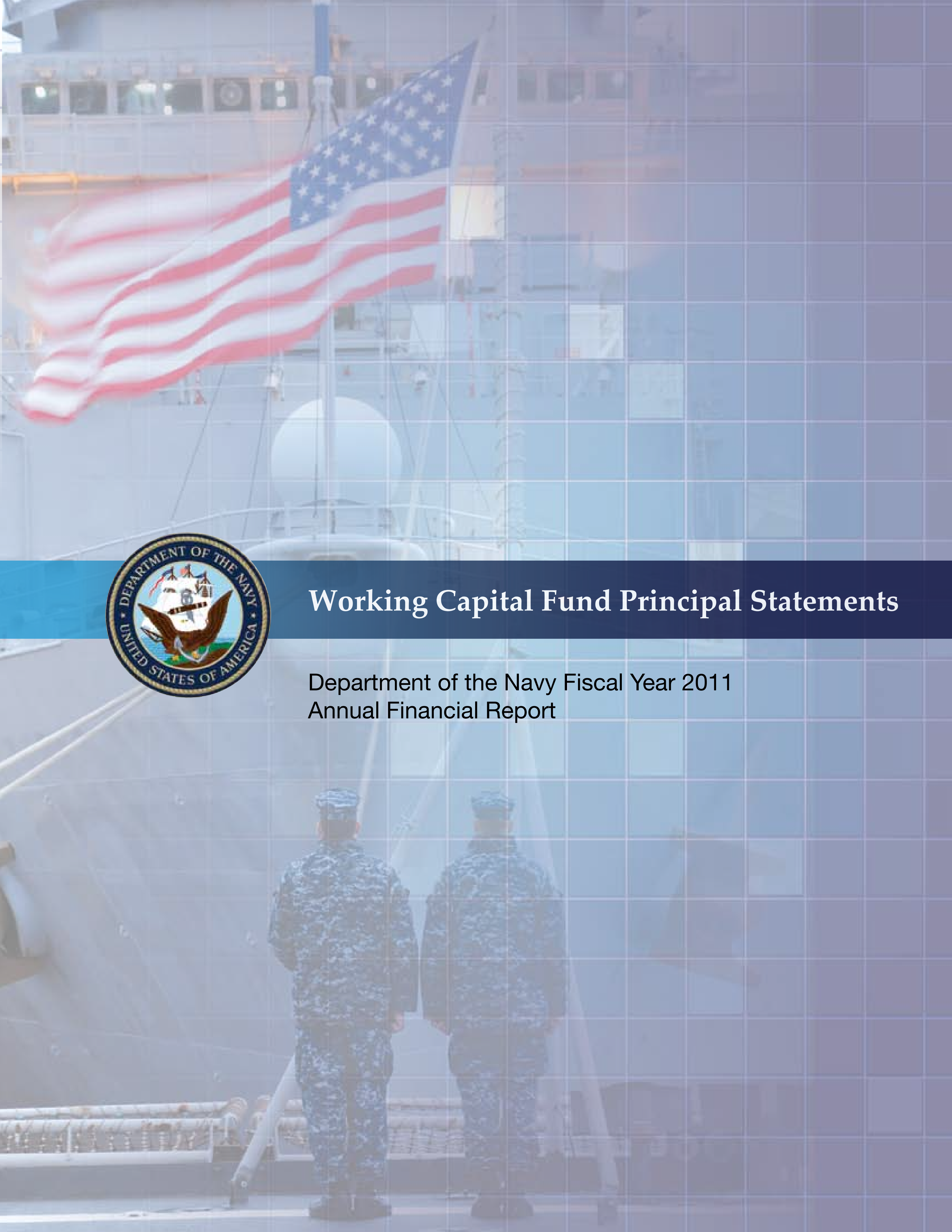
Earmarked Special Funds

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

General Fund Non- Entity Accounts

Deposit Funds

17X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)
17X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)
17X6025	Pay of the Navy, Deposit Fund (T)
17X6026	Pay of the Marine Corps, Deposit Fund (T)
17X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
17X6705	Civilian Employees Allotment Account, Navy
17X6706	Commercial Communication Service, Navy
17 6763	Gains and Deficiencies on Exchange Transactions, Navy
17X6850	Housing Rentals, Navy
17X6999	Accounts Payable, Check Issue Underdrafts, Navy



Working Capital Fund Principal Statements

Department of the Navy Fiscal Year 2011
Annual Financial Report

Principal Statements

The Fiscal Year 2011 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 Navy Working Capital Fund for the fiscal year ending September 30, 2011, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2010.

The following statements comprise the Navy Working Capital Fund 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.

CONSOLIDATED BALANCE SHEET

As of September 30, 2011 and 2010

($ in Thousands)

		2011 Consolidated		2010 Consolidated
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)	$	1,247,786	$	992,689
Accounts Receivable (Note 5)		894,434		965,699
Other Assets (Note 6)		10		227
Total Intragovernmental Assets		2,142,230		1,958,615
Cash and Other Monetary Assets (Note 7)		2,452		1,531
Accounts Receivable, Net (Note 5)		39,995		70,615
Inventory and Related Property, Net (Note 9)		20,519,479		14,264,715
General Property, Plant, and Equipment, Net (Note 10)		2,340,475		2,554,317
Other Assets (Note 6)		1,021,730		401,392
TOTAL ASSETS	$	26,066,361	$	19,251,185
Stewardship Property, Plant, and Equipment (Note 10) *				
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$	181,490	$	159,514
Other Liabilities (Note 15 & Note 16)		631,748		428,926
Total Intragovernmental Liabilities		813,238		588,440
Accounts Payable (Note 12)		2,799,892		2,828,324
Military Retirement and Other Federal Employment Benefits (Note 17)		739,256		770,309
Other Liabilities (Note 15 & Note 16)		1,174,979		1,752,328
TOTAL LIABILITIES		5,527,365		5,939,401
Commitments and Contingencies (Note 16) *				
NET POSITION				
Unexpended Appropriations - Other Funds		1,254		28,521
Cumulative Results of Operations - Other Funds		20,537,742		13,283,263
TOTAL NET POSITION		20,538,996		13,311,784
TOTAL LIABILITIES AND NET POSITION	$	26,066,361	$	19,251,185

* - Disclosure but no value required per Federal Accounting Standards.

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Consolidated	2010 Consolidated
Program Costs		
Gross Costs		
Operations, Readiness, & Support	$ 46,240,534	$ 27,458,067
(Less: Earned Revenue)	(54,714,590)	(30,276,489)
Net Cost of Operations	$ (8,474,056)	$ (2,818,422)

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Consolidated	2010 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 13,283,263	$ 10,385,207
Prior Period Adjustments:		
Correction of errors (+/-)	-	473,378
Beginning Balances, as adjusted	13,283,263	10,858,585
Budgetary Financing Sources:		
Appropriations used	27,267	205,977
Nonexchange Revenue	-	212
Other Financing Sources:		
Transfers in/out without reimbursement (+/-)	(85,696)	(62,137)
Imputed financing from costs absorbed by others	578,014	591,919
Other (+/-)	(1,739,162)	(1,129,715)
Total Financing Sources	(1,219,577)	(393,744)
Net Cost of Operations (+/-)	(8,474,056)	(2,818,422)
Net Change	7,254,479	2,424,678
Cumulative Results of Operations	$ 20,537,742	$ 13,283,263
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 28,521	$ 30,954
Prior Period Adjustments:		
Correction of errors (+/-)	-	-
Beginning Balances, as adjusted	28,521	30,954
Budgetary Financing Sources:		
Appropriations received	-	203,544
Appropriations used	(27,267)	(205,977)
Total Budgetary Financing Sources	(27,267)	(2,433)
Unexpended Appropriations	1,254	28,521
Net Position	$ 20,538,996	$ 13,311,784

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Combined	2010 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 2,900,938	$ 3,554,313
Recoveries of prior year unpaid obligations	564,486	660,572
Budget Authority:		
Appropriations received	-	203,544
Contract Authority	7,218,237	6,139,859
Spending authority from offsetting collections:		
Earned		
Collected	28,314,017	26,273,602
Change in receivables from Federal sources	(70,383)	369,979
Change in unfilled customer orders		
Advances received	241,308	(223,167)
Without advance from Federal sources	1,192,068	444,790
Subtotal	36,895,247	33,208,607
Permanently not available	(8,318,066)	(7,736,410)
Total Budgetary Resources	32,042,605	29,687,082
Status of Budgetary Resources:		
Obligations incurred:		
Direct	26,561	-
Reimbursable	28,851,960	26,786,142
Subtotal	28,878,521	26,786,142
Unobligated balance:		
Apportioned	3,145,928	-
Exempt from Apportionment	-	2,888,744
Subtotal	3,145,928	2,888,744
Unobligated balances not available	18,156	12,196
Total Status of Budgetary Resources	$ 32,042,605	$ 29,687,082

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2011 and 2010

($ in Thousands)

	2011 Combined	2010 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 12,105,212	$ 12,411,972
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(9,724,859)	(8,910,090)
Total Unpaid Obligated Balance	2,380,353	3,501,882
Obligations incurred, net (+/-)	28,878,521	26,786,142
Less: Gross outlays	(28,300,227)	(26,432,333)
Less: Recoveries of prior year unpaid obligations, actual	(564,486)	(660,572)
Change in uncollected customer payments from Federal sources (+/-)	(1,121,687)	(814,771)
Obligated balance, net, end of period		
Unpaid obligations	12,119,020	12,105,209
Less: Uncollected customer payments from Federal sources	(10,846,546)	(9,724,861)
Total Unpaid Obligated Balance, net, end of period	1,272,474	2,380,348
Net Outlays:		
Gross Outlays	28,300,227	26,432,333
Less: Offsetting collections	(28,555,323)	(26,050,433)
Net Outlays	$ (255,096)	$ 381,900

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) 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. DON is currently converting legacy systems to Navy Enterprise Resource Planning (ERP) and developing plans to ensure accurate and complete financial records.

The NWCF currently has 13 auditor identified financial statement weaknesses as stated in the Department of Defense Inspector General (DoDIG) issued audit report dated November 9, 2011: (1) DON financial management systems do not comply with USGAAP and the U.S. Government Standard General Ledger at the transaction level; (2) Defense Working Capital Fund (DWCF) activities do not reconcile cash accounts to the Department of the Treasury cash account balance on a regular basis; (3) DON does not reconcile subsidiary records to corresponding general ledger accounts on a regular basis; (4) DON does not have adequate data, processes, and methodologies to make accurate conversion of inventory balances from latest acquisition cost to historical cost; (5) DON cannot establish or support ownership and valuation of General Equipment; (6) Unmatched disbursement are transferred to accounts payable using journal vouchers; (7) DON needs to resolve unsupported, undistributed disbursement as well as analyze contract accruals to determine these amounts are properly posted to Other Liabilities; (8) the Statement of Budgetary Resources is populated from proprietary accounts at a business-area-level and guidance and training need to be provided on appropriate accounts that should be maintained; (9) Intragovernmental eliminations; (10) Unsupported accounting entries; (11) Operating Materiel and Supplies; (12) Statement of Net Cost; and (13) Reconciliation of net cost of operations to budget.

Relative to the identified financial statement weaknesses, the DON has documented in its Statement of Assurance dated August 26, 2011 the following corrective actions: (1) In FY 2011, DON has made significant progress in reconciling its Fund Balance with Treasury (FBWT) for the Working Capital Fund (WCF) through the use of the Cash Reconciliation Tool (CRT); (2) the Navy is completing conversion of Inventory records from legacy systems into Navy ERP and once fully converted, the Navy plans on sample testing to ensure Inventory records are accurate and complete; and (3) DON has developed a plan to ensure the existence of adequate documentation to support accurate and timely Real Property estimates and valuations.

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 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 DON consists of eight reporting commands to include the Naval Sea Systems Command (NAVSEA); Naval Air Systems Command (NAVAIR); Space and Naval Warfare Systems Command (SPAWAR); Naval Facilities Engineering Command (NAVFAC); Naval Research Lab (NRL); Military Sealift Command (MSC); Naval Supply Systems Command (NAVSUP); and the Marine Corp (MC). The NWCF provides goods, services, and infrastructure to DON and other DoD customers to help ensure our military forces are mobile, ready, and have the most advanced technology.

1.C. Appropriations and Funds

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

WCF received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations which result in transactions that flow through the fund. The WCF resources the goods and services sold to customers on a reimbursable basis and maintain 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 WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

1.D. Basis of Accounting

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

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

The DoD is determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the conversion DON's legacy systems to Navy ERP which will be designed to modernize and standardize Navy's business practices. Navy ERP will also be developed within the U.S. Standard General Ledger (USSGL) account structure and be in compliance with applicable financial management requirements.

1.E. Revenues and Other Financing Sources

The NWCF's mission includes Depot Maintenance, Supply Management, Research and Development, Base Support, and Transportation. Each of the NWCF programs recognizes revenues and other financing sources in the manner described below.

Depot Maintenance WCF activities recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items. Research and Development WCF activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Base Support WCF activities recognize revenue at the time service is rendered.

Transportation WCF 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 the amount reported in the Statement of Net Cost and Note 21, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost-sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items, such as payroll expenses, accounts payable, FECA liabilities, and unbilled revenue. Operating Materiel & 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 DoD 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 U.S. Treasury's Federal Intragovernmental Transactions Accounting Policy Guide and Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government, provide guidance for reporting and reconciling intragovernmental balances. While 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.

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

1.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 Services, 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. 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 FBWT account. On a monthly basis, FBWT is adjusted to agree with the U.S. Treasury accounts.

1.J. Cash and Foreign Currency

Not applicable.

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 1, Accounting for Selected Assets and Liabilities, the methodology for losses due to uncollectable 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 DoD 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 Bulletin No. 2011-08.

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventory and Related Property

The NWCF values approximately 92% of its resale inventory using the Moving Average Cost (MAC) method. The NWCF reports the remaining 8% of resale inventories at an approximation of historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. 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. 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) (FFMIA). The NWCF is continuing to transition the balance of the inventories to the moving average cost method through the implementation of Navy ERP. Most transitioned balances, however, were not baselined to auditable historical cost and remain noncompliant with SFFAS No. 3.

The NWCF manages only military or government-specific materiel under normal conditions. 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 (1) operating materiel and supplies held for use, (2) operating materiel and supplies held in reserve for future use (including munitions not held for sale) and (3) excess, obsolete and unserviceable operating materiel and supplies. The OM&S, including munitions not held for sale, are valued at standard purchase price. 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, materiel and supplies are expensed when purchased. During FY 2011 and FY 2010, 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 materiel.

The NWCF is in agreement with SFFAS No. 3, Interpretation 7, “Items Held for Remanufacture,” that inventory held for repair should be accounted for as inventory held for remanufacture. 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.N. Investments in U.S. Treasury Securities

Not applicable.

1.O. General Property, Plant and Equipment

Federal Property, Plant, and Equipment (PP&E) consists of four categories: General PP&E, Federal Mission PP&E, Heritage Assets, and Stewardship Land. Military Equipment, Heritage Assets and Stewardship Land are reported on the financial statements of the DON’s General Fund (GF). The WCF classifies all PP&E assets in the General PP&E category. The NWCF’s General PP&E capitalization threshold is $100 thousand except for real property, which is $20 thousand.

With the exception of USACE Civil Works and WCF, General PP&E assets are capitalized (in accordance with SFFAS No. 6, Accounting for Property, Plant, and Equipment) at historical acquisition cost 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 DoD 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.

1.P. 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 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 NWCF has not implemented this policy primarily due to system limitations.

1.Q. 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 and 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.R. Other Assets

Other assets include nonfederal 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.

Due to inconsistencies in the posting logic for Nonfederal Advances and Prepayments, NWCF is noncompliant with the 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.

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.S. Contingencies and Other Liabilities

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

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The 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.

1.T. 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.U. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended Appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred. Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.V. Treaties for Use of Foreign Bases

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

1.W. Undistributed Disbursements and Collections

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

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

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. Supported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly. Unsupported undistributed disbursements are recorded as disbursements in transit and reduce nonfederal accounts payable. Unsupported undistributed collections are recorded in nonfederal other liabilities.

1.X. Fiduciary Activities

Not applicable.

1.Y. Military Retirement and Other Federal Employment Benefits

The Department applies SFFAS No. 33, Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates, in selecting the discount rate and valuation date used in estimating actuarial liabilities. In addition, gains and losses from changes in long-term assumptions used to estimate the actuarial liability are presented on Note 17, Military Retirement and Other Federal Employment Benefits and Note 18, General Disclosures Related to the Statement of Net Cost, for additional information.

1.Z. Significant Events

Not applicable.

Note 2. Nonentity Assets

As of September 30	2011	2010
(Amounts in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	$ -	$ -
B. Accounts Receivable	-	-
C. Other Assets	-	-
D. Total Intragovernmental Assets	$ -	$ -
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ -	$ -
B. Accounts Receivable	6,513	6,480
C. Other Assets	-	-
D. Total Nonfederal Assets	$ 6,513	$ 6,480
3. Total Nonentity Assets	$ 6,513	$ 6,480
4. Total Entity Assets	$ 26,059,848	$ 19,244,705
5. Total Assets	$ 26,066,361	$ 19,251,185

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

The Nonentity Nonfederal Accounts Receivable amount represents interest, penalties, fines and administrative fees that will be deposited directly into a Treasury general fund receipts account upon collection.

Note 3. Fund Balance with Treasury

As of September 30	2011	2010
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ -	$ -
B. Revolving Funds	1,247,786	992,689
C. Trust Funds	-	-
D. Special Funds	-	-
E. Other Fund Types	-	-
F. Total Fund Balances	$ 1,247,786	$ 992,689
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 1,247,787	$ 992,689
B. Fund Balance per DON	1,247,786	992,689
3. Reconciling Amount	$ 1	$ 0

Status of Fund Balance with Treasury

As of September 30	2011	2010
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	$ 3,145,928	$ 2,888,745
B. Unavailable	18,156	12,194
2. Obligated Balance not yet Disbursed	12,119,020	12,105,210
3. Nonbudgetary FBWT	-	-
4. NonFBWT Budgetary Accounts	(14,035,318)	(14,013,460)
5. Total	$ 1,247,786	$ 992,689

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 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.

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

NonFBWT 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.

Note 4. Investments and Related Interest

Not applicable.

Note 5. Accounts Receivable

As of September 30	2011		
(Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 894,434	N/A	$ 894,434
2. Nonfederal Receivables (From the Public)	58,413	(18,418)	39,995
3. Total Accounts Receivable	$ 952,847	$ (18,418)	$ 934,429

As of September 30	2010		
(Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 965,699	N/A	$ 965,699
2. Nonfederal Receivables (From the Public)	70,615	-	70,615
3. Total Accounts Receivable	$ 1,036,314	$ -	$ 1,036,314

The DON is currently working on an effort to drive compliance with 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 its service providers 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. Since the DON is at risk of not collecting on these public accounts receivable, the DON is recognizing an allowance for uncollectible amounts. NWCF recognized an allowance for estimated uncollectible of $18.4M as compared to FY 2010 when the methodology was not used. The methodology used in determining the allowance amount is discussed in Note 1.K.

The NWCF Intragovernmental Accounts Receivable balance is $1,214.5 million in the accounting system prior to adjustments recorded for trading partners and undistributed collections required in the preparation of the NWCF consolidated statements.

The NWCF Nonfederal Accounts Receivable balance is $61.5 million in the accounting systems prior to adjustments recorded for trading partners, undistributed collections, or interest, penalties, and administrative fees required in the preparation of the NWCF consolidated statements.

Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules.

Note 6. Other Assets

As of September 30		2011		2010
(Amounts in thousands)				
1. Intragovernmental Other Assets				
A. Advances and Prepayments	$	10	$	227
B. Other Assets		-		-
C. Total Intragovernmental Other Assets	$	10	$	227
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	$	461,867	$	293,838
B. Advances and Prepayments		558,464		103,024
C. Other Assets (With the Public)		1,399		4,530
D. Total Nonfederal Other Assets	$	1,021,730	$	401,392
3. Total Other Assets	$	1,021,740	$	401,619

The balance of Outstanding Contract Financing Payments includes $430.6 million in contract financing payments and an additional $31.3 million in estimated future funded payments to contractors upon delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities)

Contract terms and conditions for certain types of contract financing payments convey certain rights to the NWCF 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 NWCF is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

Nonfederal Other Assets - Advances and Prepayments are cash outlays and payments made by the NWCF to contractors, grantees, or others to cover the recipients' anticipated and periodic expenses before those expenses are incurred. Advances and prepayments are reduced when goods and services are received, contract terms are met, progress is made on a contract, or prepaid expenses expire.

There are two factors driving the large increase in Nonfederal Advances and Prepayments: (1) Nonfederal Other Assets - Advances and Prepayments increased $455.4 million primarily attributable to Navy Supply Management due to a reclassification of Federal Advances and Prepayments to Nonfederal Advances and Prepayments in order to reconcile seller side trading partner data; and (2) The Navy ERP proprietary posting logic is not correctly relieving advances which caused the Federal advances account to be overstated due to the posting logic's noncompliance with USSGL. The issue has been logged in the Navy ERP Program Management Office Quality Center and NWCF will continue to work on a resolution.

Other Assets (With the Public) consists of prepayments made to vendors and travel advances.

Note 7. Cash and Other Monetary Assets

As of September 30	2011	2010
(Amounts in thousands)		
1. Cash	$ 2,452	$ 1,531
2. Foreign Currency	-	-
3. Other Monetary Assets	-	-
4. Total Cash, Foreign Currency, & Other Monetary Assets	$ 2,452	$ 1,531

NWCF Cash consists of coins, paper currency and readily negotiable instruments. There are no restrictions on cash.

Note 8. Direct Loan and Loan Guarantees

Not applicable.

Note 9. Inventory and Related Property

As of September 30	2011	2010
(Amounts in thousands)		
1. Inventory, Net	$ 20,315,654	$ 14,044,853
2. Operating Materiel & Supplies, Net	203,825	219,862
3. Stockpile Materiel, Net	-	-
4. Total	$ 20,519,479	$ 14,264,715

Inventory, Net

As of September 30	2011			
(Amounts in thousands)	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
1. Inventory Categories				
A. Available and Purchased for Resale	$ 9,870,424	$ 834,387	$ 10,704,811	LAC, MAC
B. Held for Repair	9,446,780	103,362	9,550,142	LAC, MAC
C. Excess, Obsolete, and Unserviceable	582,729	(582,729)	-	NRV
D. Raw Materiel	-	-	-	MAC, SP, LA
E. Work in Process	60,701	-	60,701	AC
F. Total	$ 19,960,634	$ 355,020	$ 20,315,654	

As of September 30	2010			
(Amounts in thousands)	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
1. Inventory Categories				
A. Available and Purchased for Resale	$ 26,013,203	$ (16,247,006)	$ 9,766,197	LAC, MAC
B. Held for Repair	7,133,683	(3,070,881)	4,062,802	LAC, MAC
C. Excess, Obsolete, and Unserviceable	1,031,765	(1,031,765)	-	NRV
D. Raw Materiel	-	-	-	MAC, SP, LA
E. Work in Process	215,854	-	215,854	AC
F. Total	$ 34,394,505	$ (20,349,652)	$ 14,044,853	

Legend for Valuation Methods:

LAC = Latest Acquistion Cost	NRV = Net Realizable Value	MAC = Moving Average Cost
SP = Standard Price	LCM = Lower of Cost or Market	
AC = Actual Cost	O = Other	

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 $59.4 thousand 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.

Inventory available and purchased for resale includes consumable spare and repair parts as well as reparable items owned and managed by the NWCF and includes all materiel available for customer purchase. Inventory held for repair consists of damaged materiel that requires repair to make it usable and all economically reparable materiel. Excess inventory includes scrap materiels 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 materiel, 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 sale.” The NWCF currently has $526.2 million reported for 4th Quarter, FY 2011 in Inventory Held for Sale, Net.

Inventory is assigned to categories based upon condition of the inventory items, or in the case of raw materiel and work-in-process based upon stage of fabrication.

Supply Management’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 by the number of total units available at that time. Legacy inventory systems were 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 the 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. The Navy ERP system values inventory at MAC in accordance with generally accepted accounting principles. At the end of FY11, 92% 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.

The conversion of wholesale inventory from legacy systems into Navy ERP contributed to the NWCF abnormal balance of $834.4 million in the Allowance for Available and Purchased for Resale. Included in the allowance account are losses that occurred as a result of converting inventory from LAC to MAC. Furthermore, we are in the process of converting retail inventory into Navy ERP which is projected to be completed by the end of FY 2012. Upon the completion of the retail conversion in FY 2012, Supply Management, Navy will develop a plan to address abnormal balances that remain in the legacy systems.

Operating Materiel and Supplies, Net

As of September 30	2011			
(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
1. OM&S Categories				
A. Held for Use	$ 203,825	$ -	$ 203,825	SP, LAC, MAC
B. Held for Repair	-	-	-	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable	-	-	-	NRV
D. Total	$ 203,825	$ -	$ 203,825	

As of September 30	2010			
(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
1. OM&S Categories				
A. Held for Use	$ 219,862	$ -	$ 219,862	SP, LAC, MAC
B. Held for Repair	-	-	-	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable	-	-	-	NRV
D. Total	$ 219,862	$ -	$ 219,862	

Legend for Valuation Methods:

LAC = Latest Acquistion Cost
NRV = Net Realizable Value
SP = Standard Price
MAC = Moving Average Cost

OM&S held for use consists of property that is consumed during normal operations and includes consumable spare and repair parts for use on customer work by various activities.

There are no restrictions with regard to the use, sale, or disposition of OM&S applicable to NWCF activities.

The NWCF determines categories to which OM&S are assigned based upon readiness for issue and use as determined by condition of the individual inventory items.

SFFAS No. 3 require disclosure of the amount of OM&S held for "future use." The NWCF reports that $0 of OM&S is held for future use and is included in the "held for use" category. These items are not readily available in the market and there is a more than remote chance that they will eventually be needed.

Stockpile Materiel, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30	2011				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 31,269	N/A	$ 31,269
B. Buildings, Structures, and Facilities	S/L	20 or 40	6,642,569	$ (5,095,377)	1,547,192
C. Leasehold Improvements	S/L	lease term	-	-	-
D. Software	S/L	2-5 or 10	402,760	(311,388)	91,372
E. General Equipment	S/L	5 or 10	2,656,854	(2,152,881)	503,973
F. Military Equipment	S/L	various	-	-	-
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	166,657	N/A	166,657
J. Other	N/A	N/A	12	-	12
K. Total General PP&E			$ 9,900,121	$ (7,559,646)	$ 2,340,475

As of September 30	2010				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 37,317	N/A	$ 37,317
B. Buildings, Structures, and Facilities	S/L	20 or 40	6,550,506	$ (4,812,815)	1,737,691
C. Leasehold Improvements	S/L	lease term	46	(14)	32
D. Software	S/L	2-5 or 10	477,773	(369,301)	108,472
E. General Equipment	S/L	5 or 10	2,585,375	(2,086,154)	499,221
F. Military Equipment	S/L	various	-	-	-
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	170,078	N/A	170,078
J. Other	N/A	N/A	1,506	-	1,506
K. Total General PP&E			$ 9,822,601	$ (7,268,284)	$ 2,554,317

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

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

The acquisition cost for General PP&E is captured and maintained in the applicable property accountability systems. There are no material amounts or types of General PP&E for which the acquisition cost is unknown.

General PP&E, Other consists of $11.5 thousand of assets awaiting disposal.

Military equipment, heritage assets and stewardship land are reported on the financial statements of the DON GF.

Assets under Capital Lease

Not applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2011	2010
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ -	$ -
B. Debt	-	-
C. Other	161,605	163,568
D. Total Intragovernmental Liabilities	$ 161,605	$ 163,568
2. Nonfederal Liabilities		
A. Accounts Payable	$ -	$ -
B. Military Retirement and Other Federal Employment Benefits	739,256	770,308
C. Environmental Liabilities	-	-
D. Other Liabilities	-	-
E. Total Nonfederal Liabilities	$ 739,256	$ 770,308
3. Total Liabilities Not Covered by Budgetary Resources	$ 900,861	$ 933,876
4. Total Liabilities Covered by Budgetary Resources	$ 4,626,504	$ 5,005,525
5. Total Liabilities	$ 5,527,365	$ 5,939,401

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

Other Intragovernmental Liabilities consist of the unfunded portion of FECA liability that will be funded by future year's budgetary resources.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities primarily consist of FECA Actuarial liability of $739.2 million. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Note 12. Accounts Payable

As of September 30	2011		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 181,490	$ N/A	$ 181,490
2. Nonfederal Payables (to the Public)	2,799,892	-	2,799,892
3. Total	$ 2,981,382	$ -	$ 2,981,382

As of September 30	2010		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 159,514	$ N/A	$ 159,514
2. Nonfederal Payables (to the Public)	2,828,324	-	2,828,324
3. Total	$ 2,987,838	$ -	$ 2,987,838

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

The NWCF Intragovernmental Accounts Payable balance is $1,216.8 million in the accounting system prior to adjustments recorded for intra-governmental eliminations and undistributed disbursements required in the preparation of the NWCF consolidated statements.

The NWCF Nonfederal Accounts Payable balance is $2,355.3 million in the accounting systems prior to adjustments recorded for undistributed disbursements required in the preparation of the NWCF consolidated statements.

Note 13. Debt

Not applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

The NWCF Environmental Liabilities are reported under the DON GF.

Note 15. Other Liabilities

As of September 30	2011		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
1. Intragovernmental			
A. Advances from Others	$ 441,336	$ -	$ 441,336
B. Deposit Funds and Suspense Account Liabilities	-	-	-
C. Disbursing Officer Cash	-	-	-
D. Judgment Fund Liabilities	-	-	-
E. FECA Reimbursement to the Dept. of Labor	69,616	91,988	161,604
F. Custodial Liabilities	6,513	-	6,513
G. Employer Contribution and Payroll Taxes Payable	22,295	-	22,295
H. Other Liabilities	-	-	-
I. Total Intragovernmental Other Liabilities	$ 539,760	$ 91,988	$ 631,748
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 910,890	-	$ 910,890
B. Advances from Others	232,077	-	232,077
C. Deferred Credits	-	-	-
D. Deposit Funds and Suspense Accounts	(2,502)	-	(2,502)
E. Temporary Early Retirement Authority	-	-	-
F. Nonenvironmental Disposal Liabilities			
(1) Military Equipment (Nonnuclear)	-	-	-
(2) Excess/Obsolete Structures	-	-	-
(3) Conventional Munitions Disposal	-	-	-
G. Accrued Unfunded Annual Leave	-	-	-
H. Capital Lease Liability	-	-	-
I. Contract Holdbacks	1,186	-	1,186
J. Employer Contribution and Payroll Taxes Payable	2,020	-	2,020
K. Contingent Liabilities	-	31,308	31,308
L. Other Liabilities	-	-	-
M. Total Nonfederal Other Liabilities	$ 1,143,671	$ 31,308	$ 1,174,979
3. Total Other Liabilities	$ 1,683,431	$ 123,296	$ 1,806,727

As of September 30	2010					
(Amounts in thousands)		Current Liability		Noncurrent Liability		Total
1. Intragovernmental						
A. Advances from Others	$	204,262	$	-	$	204,262
B. Deposit Funds and Suspense Account Liabilities		-		-		-
C. Disbursing Officer Cash		-		-		-
D. Judgment Fund Liabilities		-		-		-
E. FECA Reimbursement to the Dept. of Labor		71,969		91,600		163,569
F. Custodial Liabilities		6,480		-		6,480
G. Employer Contribution and Payroll Taxes Payable		54,615		-		54,615
H. Other Liabilities		-		-		-
I. Total Intragovernmental Other Liabilities	$	337,326	$	91,600	$	428,926
2. Nonfederal						
A. Accrued Funded Payroll and Benefits	$	1,002,417	$	-	$	1,002,417
B. Advances from Others		235,076		-		235,076
C. Deferred Credits		-		-		-
D. Deposit Funds and Suspense Accounts		25		-		25
E. Temporary Early Retirement Authority		-		-		-
F. Nonenvironmental Disposal Liabilities						
(1) Military Equipment (Nonnuclear)		-		-		-
(2) Excess/Obsolete Structures		-		-		-
(3) Conventional Munitions Disposal		-		-		-
G. Accrued Unfunded Annual Leave		-		-		-
H. Capital Lease Liability		-		-		-
I. Contract Holdbacks		850		-		850
J. Employer Contribution and Payroll Taxes Payable		1,292		-		1,292
K. Contingent Liabilities		485,395		27,273		512,668
L. Other Liabilities		-		-		-
M. Total Nonfederal Other Liabilities	$	1,725,055	$	27,273	$	1,752,328
3. Total Other Liabilities	$	2,062,381	$	118,873	$	2,181,254

Contingent Liabilities includes $31.3 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 vest with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The NWCF is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and government acceptance. Due to the probability the contractor will complete their efforts and deliver satisfactory products, and because the amount of potential future payments are estimable, the NWCF has recognized a contingent liability for estimated future payments which are conditional pending delivery and government acceptance.

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

Capital Lease Liability

Not applicable.

Note 16. Commitments and Contingencies

A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. A loss contingency is a liability when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. In addition to loss contingencies, the DON also discloses (1) an estimate of obligations related to cancelled appropriations for which the reporting entity has a contractual commitment for payment, and (2) amounts for contractual arrangements that may require future financial obligations. Examples of claims or other contingencies include: (1) indemnity agreements –reimbursements due to licensees or contractors for losses incurred in support of federal activities; (2) claims against the federal government that are in process of judicial proceedings; (3) the unfunded portion of total liabilities to international organizations; and (4) litigation addressing claims for equity relief or non-monetary judgments whereby claimants are seeking specific actions by the DON.

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.

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 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 DON records Contingent liabilities in Note 15, Other Liabilities.

For FY 2011, the NWCF materiality threshold for reporting litigation, claims, or assessments is $2.6 million. The DON WCF currently has 4 cases that meet the existing FY 2011 DON WCF threshold. The DON OGC was unable to express an opinion concerning the likely outcome of 3 of the 4 cases.

Due to the inherent uncertainties of litigation, lawyers generally refrain from expressing judgments as to outcomes except in those relatively few clear cases. In response to a DoDIG, “DoD Process for Reporting Contingent Legal Liabilities,” DON developed a methodology to determine an estimate for contingent legal liabilities. Beginning with 1st Quarter, FY 2007 DON recognized and disclosed an estimate for contingent legal liabilities. The methodology considers the likelihood of an unfavorable outcome or potential liability and is provided as an overall assessment of all cases currently pending and not on an individual case basis. The likelihood of an unfavorable or potential liability was determined by using an average of the data from the current year-to-date and the preceding four years. The total dollar amount of the cases closed was divided by the total dollar amount claimed in those closed cases for each of the last four years plus current year, which were then used to calculate the average. This average is based entirely on historical data and represents the percentage that has historically been paid on claims for all DON cases. The merits for each individual case have not been taken into consideration. As a result, estimates cannot be allocated between NWCF and DON GF. Until sufficient historical data can be collected for the NWCF, the DON GF will disclose the entire amount of the estimate.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2011						
(Amounts in thousands)	Liabilities		Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)		Unfunded Liabilities	
1. Pension and Health Actuarial Benefits							
A. Military Retirement Pensions	$	-		$	-	$	-
B. Military Retirement Health Benefits		-			-		-
C. Military Medicare-Eligible Retiree Benefits		-			-		-
D. Total Pension and Health Actuarial Benefits	$	-		$	-	$	-
2. Other Actuarial Benefits							
A. FECA	$	739,256		$	-	$	739,256
B. Voluntary Separation Incentive Programs		-			-		-
C. DoD Education Benefits Fund		-			-		-
D. Total Other Actuarial Benefits	$	739,256		$	-	$	739,256
3. Other Federal Employment Benefits	$	-		$	-	$	-
4. Total Military Retirement and Other Federal Employment Benefits:	$	739,256		$	-	$	739,256

As of September 30	2010						
(Amounts in thousands)	Liabilities		Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)		Unfunded Liabilities	
1. Pension and Health Actuarial Benefits							
A. Military Retirement Pensions	$	-		$	-	$	-
B. Military Retirement Health Benefits		-			-		-
C. Military Medicare-Eligible Retiree Benefits		-			-		-
D. Total Pension and Health Actuarial Benefits	$	-		$	-	$	-
2. Other Actuarial Benefits							
A. FECA	$	770,309		$	-	$	770,309
B. Voluntary Separation Incentive Programs		-			-		-
C. DoD Education Benefits Fund		-			-		-
D. Total Other Actuarial Benefits	$	770,309		$	-	$	770,309
3. Other Federal Employment Benefits	$	-		$	-	$	-
4. Total Military Retirement and Other Federal Employment Benefits:	$	770,309		$	-	$	770,309

Actuarial Cost Method Used and Assumptions:
The DON actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON at the end of each fiscal year. The liability is distributed between the NWCF and DON GF based upon the number of civilian employees funded in each entity as reported in the Navy Budget Tracking System. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. The estimated actuarial liability is updated only at the end of each fiscal year.

The assumptions relate to FECA. Consistent with past practice, the projected annual benefit payments are discounted to the present value using Office of Management and Budget's economic assumptions for ten year U.S. Treasury notes and bonds.

The interest rate assumptions utilized when discounting were as follows:

Discount Rates
3.535% in Year 1
4.025% in Year 2 and thereafter

To provide more specificity concerning the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2011 were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2011	N/A	N/A
2012	2.10%	3.07%
2013	2.53%	3.62%
2014	1.83%	3.66%
2015	1.93%	3.73%
2016	2.00%	3.73%

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2011 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the Discount Rates projection to the average pattern for the projections of the most recent three years.

Note 18. Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue

As of September 30	2011	2010
(Amounts in thousands)		
1. Intragovernmental Costs	$ 6,219,209	$ 4,739,000
2. Public Costs	40,021,325	22,719,067
3. Total Costs	$ 46,240,534	$ 27,458,067
4. Intragovernmental Earned Revenue	$ (25,540,258)	$ (23,961,250)
5. Public Earned Revenue	(29,174,332)	(6,315,239)
6. Total Earned Revenue	$ (54,714,590)	$ (30,276,489)
7. Net Cost of Operations	$ (8,474,056)	$ (2,818,422)

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government that are supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The 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 are related to transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between the reporting entity and a nonfederal entity. Large balances in the Public costs and revenue lines are a result of the current process in Navy Enterprise Resource Planning. 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 in-transit 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. Intradepartmental revenues and expenses are then eliminated.

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

The Statement of Changes in Net Position (SCNP) 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 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2011	2010
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period"	$ 8,931,466	$ 8,331,652
2. Available Borrowing and Contract Authority at the End of the Period	-	-

Obligations Incurred – Direct	Category A	$0.0 billion
Obligations Incurred – Reimbursable	Category B	$28.9 billion
Obligations Incurred – Reimbursable	Exempt from Apportionment	$0.0 billion

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

Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30	2011	2010
(Amounts in thousands)		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	$ 28,878,521	$ 26,786,142
2. Less: Spending authority from offsetting collections and recoveries (-)	(30,241,496)	(27,525,776)
3. Obligations net of offsetting collections and recoveries	(1,362,975)	(739,634)
4. Less: Offsetting receipts (-)	-	-
5. Net obligations	(1,362,975)	(739,634)
Other Resources:		
6. Donations and forfeitures of property	-	-
7. Transfers in/out without reimbursement (+/-)	(85,696)	(62,137)
8. Imputed financing from costs absorbed by others	578,014	591,919
9. Other (+/-)	(1,739,162)	(1,129,715)
10. Net other resources used to finance activities	(1,246,844)	(599,933)
11. Total Resources Used to Finance Activities	$ (2,609,819)	$ (1,339,567)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
12. Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
12a. Undelivered Orders (-)	$ (599,813)	$ (125,109)
12b. Unfilled Customer Orders	1,433,376	221,623
13. Resources that fund expenses recognized in prior periods (-)	(33,015)	(207,938)
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	-	-
15. Resources that finance the acquisition of assets (-)	(9,030,214)	(4,826,279)
16. Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	-	-
16b. Other (+/-)	1,824,857	1,191,852
17. Total resources used to finance items not part of the Net Cost of Operations	$ (6,404,809)	$ (3,745,851)
18. Total resources used to finance the Net Cost of Operations	$ (9,014,628)	$ (5,085,418)

As of September 30		2011		2010
(Amounts in thousands)				
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
19. Increase in annual leave liability	$	-	$	-
20. Increase in environmental and disposal liability		-		-
21. Upward/Downward reestimates of credit subsidy expense		-		-
22. Increase in exchange revenue receivable from the public (-)		-		-
23. Other (+/-)		-		3,912
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	$	-	$	3,912
Components not Requiring or Generating Resources:				
25. Depreciation and amortization	$	367,940	$	263,064
26. Revaluation of assets or liabilities (+/-)		723,819		277,334
27. Other (+/-)				
27a. Trust Fund Exchange Revenue		-		-
27b. Cost of Goods Sold		8,307,478		10,377,119
27c. Operating Material and Supplies Used		-		-
27d. Other		(8,858,665)		(8,654,433)
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	$	540,572	$	2,263,084
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	540,572	$	2,266,996
30. Net Cost of Operations	$	(8,474,056)	$	(2,818,422)

The Reconciliation of Net Cost of Operations to Budget is designed to provide information about the total resources used by an entity, to explain how those resources were used to finance orders for goods and services not yet delivered, to acquire assets and liabilities, and to fund the entity's net cost of operations. It is designed to report the differences and facilitate the reconciliation of accrual based amounts used in the SNC and obligation-based amounts used in the Statement of Budgetary Resources. The computations and presentation of items in the Reconciliation of Net Cost of Operations to Budget demonstrate that the budgetary and proprietary information in an entity's financial management system agrees.

Due to NWCF financial system limitations, budgetary data do 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 was adjusted downward by $10.2 billion (absolute amount) at the end of 4th Quarter, FY 2011 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 intra-agency budgetary transactions not being eliminated:

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

Other Resources Used to Finance Activities consists of gains and losses associated with: 1) transfers of assets out of NWCF; and 2) the inventory stratification process.

Other Resources Used to Finance Items not Part of the Net Cost of Operations consists of gains and losses associated with: 1) transfers of assets out of NWCF; and 2) the inventory stratification process.

Other Components not Requiring or Generating Resources consists of overhead costs distributed to work in process, as well as costs originally recorded into another expense account that are transferred to one of three accounts: inventory work in process, internal use software in development, or completed assets.

Note 22. Disclosures Related to Incidental Custodial Collections

NWCF collected $10.7 million of incidental custodial revenues generated primarily from 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.

Note 23. Earmarked Funds

Not applicable.

Note 24. Fiduciary Activities

Not applicable.

Note 25. Other Disclosures

Not applicable.

Note 26. Restatements

Not applicable.

Navy Working Capital Fund
General Property, Plant, and Equipment
Real Property Deferred Maintenance and Repair

For Fiscal Year Ended September 30, 2011

The Navy Working Capital Fund real property deferred maintenance and repair information for fiscal year ended September 30, 2011 is reported with the Department of the Navy General Fund deferred maintenance and repair. See Department of the Navy General Fund Required Supplementary Information.

Reporting Entity

Navy Working Capital Fund (NWCF)

Fund/Account Treasury Symbol and Title

97X4930.002

Navy Working Capital Fund Activity Group Treasury Symbol and Title

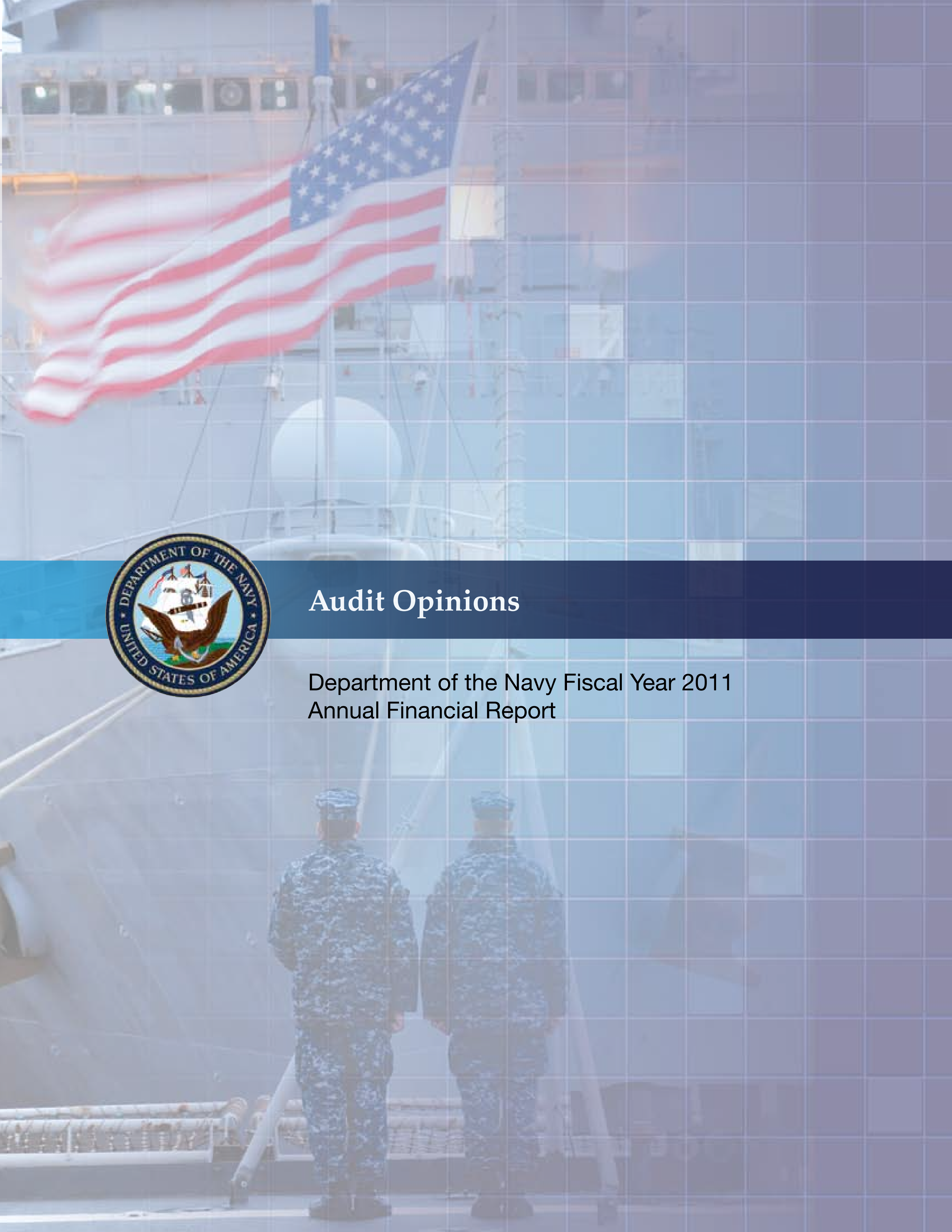
97X4930.NA1*	Depot Maintenance – Shipyards[a]
97X4930.NA2*	Depot Maintenance – Aviation
97X4930.NA4*	Depot Maintenance – Other, Marine Corps
97X4930.NA3*	Ordnance[b]
97X4930.ND*	Transportation
97X4930.NE*	Base Support
97X4930.NH*	Research and Development
97X4930.NC*	Supply Management
97X4930.NC2A*	Supply 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 General Fund 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 General Fund in FY 2000. The Ordnance information included in this report represents residual NWCF accounting for this group.



Audit Opinions

Department of the Navy Fiscal Year 2011
Annual Financial Report

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

November 9, 2011

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 2011 and FY 2010 Basic Financial Statements (Report No. DODIG-2012-014)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy General Fund Consolidated Balance Sheet as of September 30, 2011 and 2010, and the Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Department of the Navy General Fund FY 2011 and FY 2010 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance With Laws and Regulations (Report). The Report is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy General Fund FY 2011 and FY 2010 Basic Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and that the Department of the Navy financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2011. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government Accountability Office, "Government Auditing Standards," and Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," as amended[1] to determine whether material amounts on the financial statements were presented fairly.

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

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

Summary of Internal Control

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

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

- Financial Management Systems
- Fund Balance with Treasury
- Accounts Receivable
- Other Assets
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Statement of Net Cost
- Problem Disbursements
- Unobligated Balances

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

Internal control work that we conducted as part of our prior audits would not necessarily disclose all significant deficiencies. The Attachment offers additional details on significant deficiencies, all of which we consider to be material internal control weaknesses.

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged the 10 material weaknesses identified above in the FY 2011 engagement letter. The Department of the Navy stated these weaknesses were included within one or all of the segment weaknesses reported in the FY 2011 Statement of Assurance; however, we did not verify this statement. We will continue to monitor and report these material weaknesses until the Department of the Navy provides evidence that each respective item has been corrected.

Summary of Compliance With Laws and Regulations

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

Management's Responsibilities

Management is responsible for:

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

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management and Comptroller), who provided technical comments that we have incorporated as appropriate. The Department of the Navy officials expressed their continuing commitment to addressing the problems this report outlines.

Amy J. Frontz

Amy J. Frontz, CPA
Principal Assistant Inspector General
for Auditing

Attachment: As stated
Attachment

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

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

Previously Identified Material Weaknesses

Management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

Financial Management Systems

Department of the Navy legacy financial management systems and feeder systems do not comply with Federal financial management system requirements, U.S. GAAP, and U.S. Government Standard General Ledger.

Fund Balance With Treasury

Deficiencies associated with Fund Balance with Treasury include unmatched disbursements, collections, and abnormal balances and the inability to reconcile Department of the Navy General Fund records with the Department of the Treasury records and the Statement of Budgetary Resources.

Accounts Receivable

There are two deficiencies associated with the Accounts Receivable line: the audit trails are inadequate and the accounts receivable sub-ledgers do not reconcile with the general ledger.

Other Assets

The Department of the Navy acknowledged deficiencies with the procure to pay and disbursements process segments.

Inventory and Related Property, Net

Legacy systems do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property." In addition, completeness issues exist because the legacy systems were not designed to provide the value of Operating Materials and Supplies using the moving average cost method and to ensure that all of the items are included in the values reported on the Balance Sheet. Some Department of the Navy commands have not used the consumption method for expensing Operating Materials and Supplies.

General Property, Plant, and Equipment

Completeness issues may exist with recognizing internal use software and leasehold improvements. The Department of the Navy is currently working with the Under Secretary of Defense (Acquisition, Technology, and Logistics) and the Navy major commands to fully implement Statement of Federal Financial Accounting Standards No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment." In addition, the Department of the Navy is working with the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, to ensure that documentation for real property is available, beginning with FY 1999; an imputed cost policy is properly implemented; and Form DD 1354, "Transfer and Acceptance of Military Property," is properly used throughout the Department of the Navy.

Accounts Payable

The Department of the Navy intragovernmental accounts payable transactions, such as military standard requisitioning and issue procedures, fuel payables, and non-PowerTrack transportation, are not being recorded promptly, completely, or accurately. In addition, some existing Department of the Navy procedures create abnormal balances.

Statement of Net Cost

The Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," requires agencies to provide reliable and timely information on the full cost of Federal programs, activities, and outputs. Currently, the Department of the Navy derives from budgetary accounts, and not on an accrual basis, the Intragovernmental Gross Costs and the Gross Costs with the Public, as well as Intragovernmental Earned Revenue and Earned Revenue From the Public.

Problem Disbursements

Inaccurate or missing accounting data have resulted in unmatched disbursements and collections and an inability to reconcile the Department of the Navy General Fund records with the Department of the Treasury records.

Unobligated Balances

Deficiencies exist in recorded unobligated amounts because financial systems are not fully integrated, and not all commands sufficiently review unliquidated obligations. Additionally, reimbursable transactions are not properly documented or reported on the Disbursing Officer Statement of Accountability. These financial management deficiencies may cause inaccurate management information. As a result, the Department of the Navy management decisions based in whole or in part on this information may be adversely affected. Financial information reported by DoD may also contain misstatements resulting from these deficiencies.

Compliance With Laws and Regulations

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

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2011, the Department of the Navy did not fully comply with FFMIA. The Department of the Navy acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2011.

Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341[1990]) limits the Department of the Navy and its agents to making or authorizing only expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Department of 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. The Department of the Navy management representations disclosed three violations of the Antideficiency Act. The Department of the Navy did not comply with 31 U.S.C. § 1341 (1990).

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on April 21, 2011, that the Department of the 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 continued to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: the Government Performance and Results Act, the Antideficiency Act, the Prompt Payment Act, the Improper Payments Information Act, the Federal Credit Reform Act of 1990, the Pay and Allowance System for Civilian Employees, and the Provisions Governing Claims of the United States Government.

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

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

November 9, 2011

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 2011 and FY 2010 Basic Financial Statements (Report No. DODIG-2012-015)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy Working Capital Fund Consolidated Balance Sheet as of September 30, 2011 and 2010, and the Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Department of the Navy Working Capital Fund FY 2011 and FY 2010 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance With Laws and Regulations (Report). The Report is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy Working Capital Fund FY 2011 and FY 2010 Basic Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and that the Department of the Navy financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2011. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government Accountability Office, "Government Auditing Standards," and Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," as amended[1] to determine whether material amounts on the financial statements were presented fairly.

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

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

Summary of Internal Control

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

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

- Financial Management Systems
- Fund Balance with Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Other Liabilities
- Statement of Budgetary Resources
- Intragovernmental Eliminations
- Unsupported Accounting Entries
- Operating Materials and Supplies
- Statement of Net Cost
- Reconciliation of Net Cost of Operations to Budget

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. Internal control work that we conducted as part of our prior audits would not necessarily disclose all significant deficiencies.

The Attachment offers additional details on significant deficiencies, all of which we consider to be material internal control weaknesses.

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged the 13 material weaknesses identified above in the FY 2011 engagement letter. The Department of the Navy stated these weaknesses were included within one or all of the segment weaknesses reported in the FY 2011 Statement of Assurance; however, we did not verify this statement. We will continue to monitor and report these material weaknesses until the Department of the Navy provides evidence that each respective item has been corrected.

Summary of Compliance With Laws and Regulations

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

Management's Responsibilities

Management is responsible for:

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

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management and Comptroller), who provided technical comments that we have incorporated as appropriate. The Department of the Navy officials expressed their continuing commitment to addressing the problems this report outlines.

Amy J Frontz

Amy J. Frontz, CPA
Principal Assistant Inspector General
for Auditing

Attachment: As stated
Attachment

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

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

Previously Identified Material Weaknesses

Management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

Financial Management Systems

Department of the Navy financial management systems do not substantially comply with Federal financial management system requirements. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with U.S. GAAP. These deficiencies in financial management and feeder systems, as well as inadequate business processes, prevent the Department of the Navy from collecting and reporting financial and performance information that is accurate, reliable, and timely.

Fund Balance With Treasury

The Department of the Navy Working Capital Fund system interfaces do not exist between the financial reporting systems, which results in unmatched disbursements and collections.

Accounts Receivable

The Department of the Navy does not reconcile subsidiary records to corresponding general ledger accounts on a regular basis, resulting in control weaknesses and no audit trail. The Department of the Navy also posts unmatched collections to accounts receivable using journal vouchers, leaving no audit trail.

Inventory and Related Property, Net

The Department of the Navy Working Capital Fund supply management activities record inventory at the latest acquisition cost because the Department of the Navy does not have adequate data, processes, and methodologies to make accurate conversions. To comply with U.S. GAAP, the latest acquisition cost must be converted to an approximation of historical cost.

General Property, Plant, and Equipment

The Department of the Navy Working Capital Fund cannot establish or support ownership and valuation of General Equipment because of the lack of supporting documentation, improper interpretation of guidance, underutilization of the accounting system of record, and system limitations. In addition, the Department of the Navy cannot substantiate that the asset records represent all General Equipment assets, including all ancillary costs to the asset, or assign a correct useful life. Further, the Department of the Navy cannot reconcile its property accountability system with its financial systems, causing its presentation and disclosure of assets to be inaccurate.

Accounts Payable
The Accounts Payable line item is adversely affected by insufficient or inconsistent reconciliations and supporting documentation; undistributed disbursements; the inability to capture trading partner information; and the lack of direct system interfaces, which causes matching difficulties. Unmatched disbursements are transferred to accounts payable using journal vouchers, leaving no audit trail and often causing abnormal balances.

Other Liabilities
The Department of the Navy needs to resolve unsupported, undistributed disbursements.

Statement of Budgetary Resources
Multiple deficiencies exist within the Statement of Budgetary Resources. Defense Finance and Accounting Service Cleveland staff posts adjustments to this statement based on proprietary data. The Department of the Navy needs to ensure that beginning balances are verified, reconciliation processes are established, and performance reviews are completed. The Department of the Navy needs to identify and correct all disconnects between budgetary and proprietary data.

Intragovernmental Eliminations
The Department of the Navy systems do not track intragovernmental transactions by customer or provider. Therefore, the Department of the Navy is unable to fully reconcile intragovernmental transactions with all Federal partners.

Unsupported Accounting Entries
The Department of the Navy financial feeder systems and accounting systems do not provide sufficient detail to identify Federal and non-Federal or supported and unsupported transactions.

Operating Materials and Supplies
The Department of the Navy generally does not include Government Furnished Material in the Operating Materials and Supplies amounts reported.

Statement of Net Cost
The current Department of the Navy processes and systems do not capture and report accumulated costs for major programs based upon performance measures as required by the Government Performance and Results Act. The Department of the Navy is in the process of reviewing the available data and developing a cost reporting methodology.

Reconciliation of Net Cost of Operations of Budget
Department of the Navy budgetary data are not in agreement with proprietary expenses and assets capitalized because of the Department of the Navy financial system limitations. The difference between budgetary and proprietary data has been previously identified as a system deficiency.

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

Compliance With Laws and Regulations

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

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2011, the Department of the Navy did not fully comply with FFMIA. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2011.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on April 21, 2011, that the Department of the 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 continued to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: the Government Performance and Results Act, the Antideficiency Act, the Prompt Payment Act, the Improper Payments Information Act, the Federal Credit Reform Act of 1990, the Pay and Allowance System for Civilian Employees, and the Provisions Governing Claims of the United States Government.

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

Cover Credits

A Surveying aircraft movement from the flight deck camera position aboard the aircraft carrier USS Harry S. Truman (CVN 75). (U.S. Navy photo by Mass Communication Specialist 2nd Class Kilho Park/Released)

B Explosive ordnance technicians assigned to Explosive Ordnance Disposal Mobile Unit (EODMU) 11 perform a static line water drop from a C-2A Greyhound. (U.S. Navy photo by Mass Communication Specialist 2nd Class David A. Brandenburg/Released)

C The Arleigh Burke-class destroyer USS Cole (DDG 67) is back in the water. Cole was relaunched at Northrop Grumman Ship Systems Ingalls Operations in Pascagoula, Miss., after repairs on her hull were completed. U.S. Navy Photo (Released)

Page 1 Credit

Students assigned to Basic Underwater Demolition/SEAL (BUD/S) class 286 participate in a surf passage training exercise at Naval Amphibious Base Coronado. (U.S. Navy photo by Mass Communication Specialist 2nd Class Kyle D. Gahlau/Released)

Section Dividers Credit

Sailors prepare to lower the national ensign during evening colors aboard the amphibious transport dock ship USS Ponce (LPD 15). (U.S. Navy photo by Mass Communication Specialist 1st Class Nathanael Miller/Released)

Preparation of this report/study cost the Department of Defense a total of approximately $625,000 in Fiscal Years 2010 - 2011.

Generated on 2011Nov08 0929 RefID: 5-1D26D6D

For More Information

Assistant Secretary of the Navy Financial Management and Comptroller
http://www.finance.hq.navy.mil/FMC

Navy
http://www.navy.mil

Marine Corps
http://www.marines.mil

Contact Us

An electronic copy of this report is available at http://www.fmo.navy.mil

Comments or requests for printed copies of this report may be sent to DON_Financial_Report@navy.mil