Department of Defense
Department of the Navy
CONSOLIDATED BALANCE SHEET
As of December 31, 2005 and 2004

		2006 Consolidated		2005 Consolidated
1. ASSETS (Note 2)				
A. Intragovernmental:				
1. Fund Balance with Treasury (Note 3)				
a. Entity	$	94,584,525,041.84	$	171,564,467,004.95
b. Non-Entity Seized Iraqi Cash		0.00		0.00
c. Non-Entity-Other		259,216,468.09		(78,439,444.19)
2. Investments (Note 4)		9,484,013.50		9,433,191.69
3. Accounts Receivable (Note 5)		152,031,529.08		118,424,202.75
4. Other Assets (Note 6)		531,043,052.72		291,410,881.96
5. Total Intragovernmental Assets	$	95,536,300,105.23	$	171,905,295,837.16
B. Cash and Other Monetary Assets (Note 7)	$	262,715,377.03	$	267,275,552.03
C. Accounts Receivable (Note 5)		3,570,566,836.74		2,720,996,630.53
D. Loans Receivable (Note 8)		0.00		0.00
E. Inventory and Related Property (Note 9)		58,832,249,976.77		54,191,676,746.72
F. General Property, Plant and Equipment (Note 10)		159,869,625,708.62		152,969,573,955.45
G. Investments (Note 4)		0.00		0.00
H. Other Assets (Note 6)		7,347,586,379.63		8,157,160,181.60
2. TOTAL ASSETS	$	325,419,044,384.02	$	390,211,978,903.49
3. LIABILITIES (Note 11)				
A. Intragovernmental:				
1. Accounts Payable (Note 12)	$	988,086,805.74	$	905,567,278.05
2. Debt (Note 13)		0.00		0.00
3. Other Liabilities (Note 15 & 16)		4,285,046,589.45		3,765,224,935.87
4. Total Intragovernmental Liabilities	$	5,273,133,395.19	$	4,670,792,213.92
B. Accounts Payable (Note 12)	$	1,211,637,345.42	$	1,102,518,474.59
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)		1,532,819,451.36		1,575,815,538.46
D. Environmental and Disposal Liabilities (Note 14)		18,258,544,637.25		17,007,808,086.25
E. Loan Guarantee Liability (Note 8)		0.00		0.00
F. Other Liabilities (Note 15 & Note 16)		4,731,233,266.43		3,821,042,194.68
4. TOTAL LIABILITIES	$	31,007,368,095.65	$	28,177,976,507.90
5. NET POSITION				
A. Unexpended Appropriations - Earmarked Funds (Note 23)	$	2,218,618.41	$	0.00
B. Unexpended Appropriations - Other Funds		98,389,261,028.35		169,351,609,320.46
C. Cumulative Results of Operations - Earmarked Funds		20,833,231.08		0.00
D. Cumulative Results of Operations - Other Funds		195,999,363,410.53		192,682,393,075.13
6. TOTAL NET POSITION	$	294,411,676,288.37	$	362,034,002,395.59
7. TOTAL LIABILITIES AND NET POSITION	$	325,419,044,384.02	$	390,211,978,903.49

Department of Defense

Department of the Navy

CONSOLIDATED STATEMENT OF NET COST

For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
1. Program Costs		
A. Gross Costs	$ 31,741,011,510.64	$ 26,981,091,739.67
B. (Less: Earned Revenue)	(1,048,332,881.94)	(1,388,443,247.63)
C. Net Program Costs	$ 30,692,678,628.70	$ 25,592,648,492.04
2. Cost Not Assigned to Programs	0.00	0.00
3. (Less: Earned Revenue Not Attributable to Programs)	0.00	0.00
4. Net Cost of Operations	$ 30,692,678,628.70	$ 25,592,648,492.04

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
1. Beginning Balances	$ 192,520,090,780.13	$ 188,170,325,142.74
2. Prior Period Adjustments:		
2.A. Changes in accounting principles (+/-)	0.00	0.00
2.B. Corrections of errors (+/-)	0.00	0.00
3. Beginning balances, as adjusted	192,520,090,780.13	188,170,325,142.74
4. Budgetary Financing Sources:		
4.A. Appropriations received		
4.A.1 Earmarked funds	0.00	0.00
4.A.2 All other funds	0.00	0.00
4.B. Appropriations transferred-in/out (+/-)	0.00	0.00
4.C. Other adjustments (rescissions, etc.) (+/-)	0.00	0.00
4.D. Appropriations used		
4.D.1 Earmarked Funds	192,532.96	0.00
4.D.2 All other Funds	34,030,659,503.25	29,966,829,193.09
4.E. Nonexchange revenue		
4.E.1 Earmarked funds	81,871.22	0.00
4.E.2 All other funds	0.00	0.00
4.F. Donations and forfeitures of cash and cash equivalents		
4.F.1 Earmarked funds	4,313,809.74	0.00
4.F.2 All other funds	0.00	0.00
4.G. Transfers-in/out without reimbursement (+/-)	0.00	0.00
4.H. Other budgetary financing sources (+/-)		
4.H.1 Earmarked funds	0.00	0.00
4.H.2 All other funds	0.00	0.00
5. Other Financing Sources:		
5.A. Donations and forfeitures of property		
5.A.1 Earmarked funds	0.00	0.00
5.A.2 All other funds	0.00	0.00
5.B. Transfers-in/out without reimbursement (+/-)	17,381,706.15	0.00
5.C. Imputed financing from costs absorbed by others	140,155,066.86	137,887,231.34
5.D. Other (+/-)	0.00	0.00
6. Total Financing Sources		
6.A. Earmarked funds	4,588,213.92	0.00
6.B. All other funds	34,188,196,276.26	30,104,716,424.43
7. Net Cost of Operations (+/-)		
7.A. Earmarked funds	7,312,768.05	0.00
7.B. All other funds	30,685,365,860.65	25,592,648,492.04
8. Net Change		
8.A. Earmarked funds	(2,724,554.13)	0.00
8.B. All other funds	3,502,830,415.61	4,512,067,932.39
9. Ending Balances		
9.A. Earmarked funds	20,833,231.08	0.00
9.B. All other funds	195,999,363,410.53	192,682,393,075.13

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
10. Total all funds	$ 196,020,196,641.61	$ 192,682,393,075.13

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CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
UNEXPENDED APPROPRIATIONS		
1. Beginning Balances	$ 89,739,875,682.97	$ 79,161,773,513.55
2. Prior Period Adjustments:		
2.A. Changes in accounting principles (+/-)	0.00	0.00
2.B. Corrections of errors (+/-)	0.00	0.00
3. Beginning balances, as adjusted	89,739,875,682.97	79,161,773,513.55
4. Budgetary Financing Sources:		
4.A. Appropriations received		
4.A.1 Earmarked funds	100,000.00	0.00
4.A.2 All other funds	42,236,061,000.00	120,682,229,000.00
4.B. Appropriations transferred-in/out (+/-)	512,892,000.00	225,582,000.00
4.C. Other adjustments (rescissions, etc) (+/-)	(66,597,000.00)	(751,146,000.00)
4.D. Appropriations used		
4.D.1 Earmarked Funds	(192,532.96)	0.00
4.D.2 All other Funds	(34,030,659,503.25)	(29,966,829,193.09)
4.E. Nonexchange revenue		
4.E.1 Earmarked funds	0.00	0.00
4.E.2 All other funds	0.00	0.00
4.F. Donations and forfeitures of cash and cash equivalents		
4.F.1 Earmarked funds	0.00	0.00
4.F.2 All other funds	0.00	0.00
4.G. Transfers-in/out without reimbursement (+/-)	0.00	0.00
4.H. Other budgetary financing sources (+/-)		
4.H.1 Earmarked funds	0.00	0.00
4.H.2 All other funds	0.00	0.00
5. Other Financing Sources:		
5.A. Donations and forfeitures of property		
5.A.1 Earmarked funds	0.00	0.00
5.A.2 All other funds	0.00	0.00
5.B. Transfers-in/out without reimbursement (+/-)	0.00	0.00
5.C. Imputed financing from costs absorbed by others	0.00	0.00
5.D. Other (+/-)	0.00	0.00
6. Total Financing Sources		
6.A. Earmarked funds	(92,532.96)	0.00
6.B. All other funds	8,651,696,496.75	90,189,835,806.91
7. Net Cost of Operations (+/-)		
7.A. Earmarked funds	0.00	0.00
7.B. All other funds		
8. Net Change		
8.A. Earmarked funds	(92,532.96)	0.00
8.B. All other funds	8,651,696,496.75	90,189,835,806.91
9. Ending Balances		
9.A. Earmarked funds	2,218,618.41	0.00
9.B. All other funds	98,389,261,028.35	169,351,609,320.46

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
10. Total all funds	$ 98,391,479,646.76	$ 169,351,609,320.46

Department of Defense
Department of the Navy
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended December 31, 2005 and 2004

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES:		
1. Unobligated balance, brought forward, October 1	$ 17,128,478,891.28	$ 18,027,995,386.41
2. Recoveries of prior year unpaid obligations	1,462,423,588.43	4,233,463,591.94
3. Budget authority		
3.A. Appropriation	125,396,895,718.12	120,688,984,061.05
3.B. Borrowing authority	0.00	0.00
3.C. Contract authority	0.00	0.00
3.D. Spending authority from offsetting collections		
3.D.1 Earned		
3.D.1.a. Collected	1,861,851,686.82	1,709,085,355.19
3.D.1.b. Change in receivables from Federal sources	(771,952,193.87)	423,716,147.65
3.D.2 Change in unfilled customer orders		
3.D.2.a. Advance received	98,379,661.86	27,541,894.92
3.D.2.b. Without advance from Federal sources	2,040,367,291.35	1,743,027,845.43
3.D.3. Anticipated for rest of year, without advances	228,700,000.00	181,022,119.00
3.D.4. Previously unavailable	0.00	0.00
3.D.5. Expenditure transfers from trust funds	0.00	0.00
3.E. Subtotal	128,854,242,164.28	124,773,377,423.24
4. Nonexpenditure transfers, net, anticipated and actual	512,892,000.00	225,755,528.00
5. Temporarily not available pursuant to Public Law	(83,156,159,000.00)	0.00
6. Permanently not available	(66,597,000.00)	(751,146,000.00)
7. Total Budgetary Resources	$ 64,735,280,643.99	$ 146,509,445,929.59

Department of Defense
Department of the Navy
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended December 31, 2005 and 2004

		2006 Combined		2005 Combined
Status of Budgetary Resources:				
8. Obligations incurred:				
8.A. Direct	$	30,600,436,066.95	$	44,083,739,158.55
8.B. Reimbursable		3,351,387,959.28		6,058,001,926.23
8.C. Subtotal		33,951,824,026.23		50,141,741,084.78
9. Unobligated balance:				
9.A. Apportioned		28,670,819,537.75		94,403,336,093.97
9.B. Exempt from apportionment		74,024.00		0.00
9.C. Subtotal		28,670,893,561.75		94,403,336,093.97
10. Unobligated balance not available		2,112,563,056.01		1,964,368,750.84
11. Total status of budgetary resources	$	64,735,280,643.99	$	146,509,445,929.59
Change in Obligated Balance:				
12. Obligated balance, net				
12.A. Unpaid obligations, brought forward, October 1		72,093,186,783.26		67,196,764,316.08
12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$	(3,400,813,853.87)	$	(3,340,540,664.99)
12.C. Total unpaid obligated balance		68,692,372,929.39		63,856,223,651.09
13. Obligations incurred net (+/-)	$	33,951,824,026.23	$	50,141,741,084.78
14. Less: Gross outlays		(35,849,439,215.42)		(32,207,979,899.17)
15. Obligated balance transferred, net				
15.A. Actual transfers, unpaid obligations (+/-)		0.00		0.00
15.B. Actual transfers, uncollected customer payments from Federal sources (+/-)		0.00		0.00
15.C. Total Unpaid obligated balance transferred, net		0.00		0.00
16. Less: Recoveries of prior year unpaid obligations, actual		(1,462,423,588.43)		(4,233,463,591.94)
17. Change in uncollected customer payments from Federal sources (+/-)		(1,268,415,097.48)		(2,166,743,993.08)
18. Obligated balance, net, end of period				
18.A. Unpaid obligations		68,733,148,005.64		80,897,061,909.75
18.B. Less: Uncollected customer payments (+/-) from Federal sources (-)		(4,669,228,951.35)		(5,507,284,658.07)
18.C. Total, unpaid obligated balance, net, end of period		64,063,919,054.29		75,389,777,251.68
Net Outlays				
19. Net Outlays:				
19.A. Gross outlays		35,849,439,215.42		32,207,979,899.17
19.B. Less: Offsetting collections		(1,960,231,348.68)		(1,736,627,250.11)
19.C. Less: Distributed Offsetting receipts		(32,785,645.33)		(20,528,462.70)
19.D. Net Outlays	$	33,856,422,221.41	$	30,450,824,186.36

Department of Defense
Department of the Navy
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended December 31, 2005 and 2004

	2006 Combined	2005 Combined
NONBUDGETARY FINANCING ACCOUNTS		
BUDGETARY RESOURCES		
1. Unobligated balance, brought forward, October 1	$ 0.00	$ 0.00
2. Recoveries of prior year unpaid obligations	0.00	0.00
3. Budget authority		
3.A. Appropriation	0.00	0.00
3.B. Borrowing authority	0.00	0.00
3.C. Contract authority	0.00	0.00
3.D. Spending authority from offsetting collections		
3.D.1 Earned		
3.D.1.a. Collected	0.00	0.00
3.D.1.b. Change in receivables from Federal sources	0.00	0.00
3.D.2 Change in unfilled customer orders		
3.D.2.a. Advance received	0.00	0.00
3.D.2.b. Without advance from Federal sources	0.00	0.00
3.D.3 Anticipated for rest of year, without advances	0.00	0.00
3.D.4 Previously unavailable	0.00	0.00
3.D.5 Expenditure transfers from trust funds	0.00	0.00
3.E. Subtotal	0.00	0.00
4. Nonexpenditure transfers, net, anticipated and actual	0.00	0.00
5. Temporarily not available pursuant to Public Law	0.00	0.00
6. Permanently not available	0.00	0.00
7. Total Budgetary Resources	$ 0.00	$ 0.00

Department of Defense

Department of the Navy

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended December 31, 2005 and 2004

	2006 Combined	2005 Combined
Status of Budgetary Resources:		
8. Obligations incurred:		
8.A. Direct	$ 0.00	$ 0.00
8.B. Reimbursable	0.00	0.00
8.C. Subtotal	0.00	0.00
9. Unobligated balance:		
9.A. Apportioned	0.00	0.00
9.B. Exempt from apportionment	0.00	0.00
9.C. Subtotal	0.00	0.00
10. Unobligated balance not available	0.00	0.00
11. Total Status of Budgetary Resources	$ 0.00	$ 0.00
Change in Obligated Balance:		
12. Obligated balance, net		
12.A. Unpaid obligations, brought forward, October 1	0.00	0.00
12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ 0.00	$ 0.00
12.C. Total unpaid obligated balance	0.00	0.00
13. Obligations incurred net (+/-)	$ 0.00	$ 0.00
14. Less: Gross outlays	0.00	0.00
15. Obligated balance transferred, net		
15.A. Actual transfers, unpaid obligations (+/-)	0.00	0.00
15.B. Actual transfers, uncollected customer payments from Federal sources (+/-)	0.00	0.00
15.C. Total Unpaid obligated balance transferred, net	0.00	0.00
16. Less: Recoveries of prior year unpaid obligations, actual	0.00	0.00
17. Change in uncollected customer payments from Federal sources (+/-)	0.00	0.00
18. Obligated balance, net, end of period		
18.A. Unpaid obligations	0.00	0.00
18.B. Less: Uncollected customer payments (+/-) from Federal sources (-)	0.00	0.00
18.C. Total, unpaid obligated balance, net, end of period	0.00	0.00
Net Outlays		
19. Net Outlays:		
19.A. Gross outlays	0.00	0.00
19.B. Less: Offsetting collections	0.00	0.00
19.C. Less: Distributed Offsetting receipts	0.00	0.00
19.D. Net Outlays	$ 0.00	$ 0.00

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF FINANCING
For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 33,951,824,026.23	$ 50,141,741,084.78
2. Less: Spending authority from offsetting collections and recoveries (-)	(4,691,070,034.59)	(8,136,834,835.13)
3. Obligations net of offsetting collections and recoveries	29,260,753,991.64	42,004,906,249.65
4. Less: Offsetting receipts (-)	(32,785,645.33)	(20,528,462.70)
5. Net obligations	29,227,968,346.31	41,984,377,786.95
Other Resources		
6. Donations and forfeitures of property	0.00	0.00
7. Transfers in/out without reimbursement (+/-)	17,381,706.15	0.00
8. Imputed financing from costs absorbed by others	140,155,066.86	137,887,231.34
9. Other (+/-)	0.00	0.00
10. Net other resources used to finance activities	157,536,773.01	137,887,231.34
11. Total resources used to finance activities	$ 29,385,505,119.32	$ 42,122,265,018.29
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 (-)	2,850,754,229.84	(17,976,449,191.05)
12b. Unfilled Customer Orders	2,138,746,953.21	1,770,569,740.35
13. Resources that fund expenses recognized in prior periods	(205,807,714.23)	(208,028,854.91)
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	0.00	0.00
15. Resources that finance the acquisition of assets	(6,273,364,471.46)	(1,372,094,879.34)
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 (-)	0.00	0.00
16b. Other (+/-)	(17,381,706.15)	0.00
17. Total resources used to finance items not part of the net cost of operations	$ (1,507,052,708.79)	$ (17,786,003,184.95)
18. Total resources used to finance the net cost of operations	$ 27,878,452,410.53	$ 24,336,261,833.34

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF FINANCING
For the periods ended December 31, 2005 and 2004

	2006 Consolidated	2005 Consolidated
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	258,830,468.94	1,842,137.88
20. Increase in environmental and disposal liability	1,208,094,019.00	973,164,943.00
21. Upward/Downward reestimates of credit subsidy expense (+/-)	0.00	0.00
22. Increase in exchange revenue receivable from the public (-)	0.00	0.00
23. Other (+/-)	37,390,425.22	3,884,002.23
24. Total components of Net Cost of Operations that will require or generate resources in future periods	1,504,314,913.16	978,891,083.11
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	3,939,158,748.89	1,872,227,183.07
26. Revaluation of assets or liabilities (+/-)	627,372,535.38	(722,304,271.54)
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0.00	(6,704,539.35)
27b. Cost of Goods Sold	0.00	0.00
27c. Operating Material & Supplies Used	(3,247,413,283.29)	(851,009,459.86)
27d. Other	(9,206,695.97)	(14,713,336.73)
28. Total components of Net Cost of Operations that will not require or generate resources	1,309,911,305.01	277,495,575.59
29. Total components of net cost of operations that will not require or generate resources in the current period	$ 2,814,226,218.17	$ 1,256,386,658.70
30. Net Cost of Operations	$ 30,692,678,628.70	$ 25,592,648,492.04

Note 1.	Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON), as required by the "Chief Financial Officers (CFO) Act of 1990," expanded by the "Government Management Reform Act (GMRA) of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the DON in accordance with the "Department of Defense Financial Management Regulation" (DoD FMR), the Office of Management and Budget (OMB) Circular A-136, "Financial Reporting Requirements", and to the extent possible, generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the DON is responsible. 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 no longer classified.

The DON is unable to fully implement all elements of GAAP and the OMB Circular A-136 due to limitations of its financial management processes and systems and non-financial systems and processes that feed into the financial statements. Reported values and information for the DON's major asset and liability categories are derived largely from feeder systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with GAAP. The DON continues to implement process and system improvements addressing these limitations. The Department of Defense currently has eleven auditor identified financial statement weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and Material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing. The DON generally shares in the overall DoD auditor identified weaknesses.

Fiscal Year (FY) 2006 represents the eleventh year that the DON has prepared audited financial statements as required by the CFO Act and the GMRA.

1.B. Mission of the Reporting Entity

The Department of the Navy was created on April 30 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The overall mission of the DON is to control and maintain freedom of the seas, project power beyond the seas, and influence events and advance U.S. interests across the full spectrum of military operations.

1.C. Appropriations and Funds

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

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

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

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 funds accounts are used to process government receipts reserved for a specific purpose.

Deposit funds are used to record amounts help temporarily until transferred to the owning entity. The DON acts as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

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. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish it from general revenues. The DON has both Trust Funds and Special Fund accounts that are considered Earmarked Funds.

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

Entity Accounts:

General Accounts

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1105	Military Personnel, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps

17 1109	Procurement, Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1235	Military Construction, Naval Reserve
17 1236	Payments to Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17 1319	Research and Development, Test and Evaluation, Navy
17 1405	Reserve Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17 1611	Shipbuilding Conversion
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement

Revolving Funds

17 4557	National Defense Sealift Fund, Navy

Earmarked Trust Funds

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

Earmarked Special Funds

17X5095	Wildlife Conversion, 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

Non Entity Accounts

17 3XXX	Receipt Accounts
17X6XXX	Deposit Funds
17 47X0535	Embassy Security, Construction and Maintenance, State
17 11 1081	International Military Education and Training Funds, appropriated to the President (fiscal year)
17 11X1081	International Military Education and Training Funds, appropriated to the President
17 11 1082	Foreign Military Financing Program, Funds appropriated to the President (fiscal year)
17 12X1105B	State and Private Forestry, Forest Service

1.D. Basis of Accounting

For FY 2006, the DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the DON's legacy systems were designed to record information on a budgetary basis.

The 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 Federal GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until such time as all of the DON's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the DON's financial data will be 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.

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

1.E. <u>Revenues and Other Financing Sources</u>

Financing sources for general funds are provided primarily through congressional appropriations that are received on both an annual and a multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The DON recognizes revenue as a result of costs incurred or services provided to other Federal agencies and the public. Full cost pricing is the DON's standard policy for services provided as required by OMB Circular A-25. Revenue is recognized when earned within the constraints of current system capabilities. In other instances, revenue is recognized when bills are issued.

The DON does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Statement of Financing. The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

1.F. <u>Recognition of Expenses</u>

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because the DON's financial and non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. Expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased, but reduced when the OM&S is capitalized. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. <u>Accounting for Intragovernmental Activities</u>

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the DON, within the DoD, or between two or more federal agencies. However, the DON cannot consistently and accurately identify all of its intragovernmental transactions by customer because the accounting systems do not track all buyer and seller data needed to match related transactions. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of the DON. Seller entities within the DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra-DoD intragovernmental balances are eliminated when the DoD financial statements are prepared. The DoD is developing long-term system improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the DoD and other federal agencies. The Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental Transaction Accounting Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. While the DON is unable to fully reconcile all intragovernmental transactions with all federal partners, the DON 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 (DoL), and benefit program transactions with the Office of Personnel Management (OPM).

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

Financing for the construction of DON 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 Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

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

1.J. Foreign Currency

Cash is the total of cash resources under the control of the 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.

The majority of cash and all foreign currency is classified as nonentity and, therefore, 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. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the restoration of Iraq.

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

1.K. Accounts Receivable

Accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. The DON bases the estimate for the allowance for doubtful accounts due from the public upon an historic analysis of collection experience by type of receivable. The DON does not recognize an allowance for estimated doubtful amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4CFR 101).

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

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

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

Related property includes OM&S and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DON uses the consumption method of accounting for OM&S, for the most part, expensing material when it is issued to the end user. Where current systems cannot fully support the consumption method, the DON uses the purchase method - that is, expensed when purchased. For FY 2006, the DON expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deems that the item is in the hands of the end user.

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

The DoD recognizes condemned material as “Excess, Obsolete, and Unserviceable.” The net value of condemned material is zero, because the costs of disposal are greater than the potential scrap value. Material that can be potentially redistributed, presented in previous years as “Excess, Obsolete, and Unserviceable,” is included in the “Held for Use” or “Held for Repair” categories according to its condition.

In addition, past audit results identified uncertainties about the completeness of reported values of inventory and OM&S.

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

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

The DON invests in non-marketable securities. The two types of non-marketable securities are par value and market based intragovernmental securities. The Department of Treasury’s Bureau of Public Debt issues non-marketable par value intragovernmental Securities. Non-marketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

1.O. General Property, Plant and Equipment

The SFFAS No. 23, “Eliminating the Category National Defense Property, Plant, and Equipment”, established generally accepted accounting principles for valuing and reporting military equipment (e.g. ships, aircraft, combat vehicles, weapons) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. The DoD uses data from the Department of Commerce’s Bureau of Economic Analysis to calculate the value for military equipment.

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

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below $100,000 were written off DON General Fund statements.

When it is in the best interest of the government, the DON provides government property to contractors when deemed necessary to complete contracted work. Such property is either owned or leased by the DON, or purchased directly by the contractor for the government based on contract terms. When the value of contractor procured General PP&E exceeds the DoD capitalization threshold, such PP&E is required to be included in the value of General PP&E reported on the DON's Balance Sheet.

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

1.P. Advances and Prepayments

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

1.Q. Leases

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

Office space and leases entered into by the DON in support of contingency operations are the largest component of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms which are not expected to be renewed upon expiration. Other operating leases are generally one year leases. The DON expects to continue to reduce the level of owned assets while increasing the number of leased assets. The DON will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

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

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

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. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable and the amount of loss can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The DON’s loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

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

1.T. Accrued Leave

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

1.U. Net Position

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

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

Cumulative results of operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). The cumulative results also include donations and transfers in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

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

1.W. Comparative Data

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2006. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater 10 percent between FY 2006 and FY 2005 are explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. In-transit payments are those payments that have been made to other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

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

1.Z. <u>Data Collection Approach</u>

The DON financial statements include information from both financial systems and feeder systems. The Defense Finance Accounting Service, Cleveland (DFAS-CL) and Kansas City (DFAS-KC) collect the financial system information and incorporate it into the financial statements. The DON collects financial information from feeder systems through a data call process and submits it to DFAS-CL & KC for incorporation into the financial statements. For FY 2006, the DON is utilizing a web-based data collection instrument (DCI) that captures all required financial information from feeder systems for the General Fund (GF) statements. This is the seventh year DON has used the DCI to collect information from feeder systems. The DON DCI identifies the information requirements to the source provider, provides an audit trail, and integrates into the financial statement preparation process.

Note 2. Nonentity Assets

As of December 31		2006		2005
1. Intragovernmental Assets				
A. Fund Balance with Treasury	$	259,216,468.09	$	(78,439,444.19)
B. Investments		0.00		0.00
C. Accounts Receivable		0.00		0.00
D. Other Assets		0.00		0.00
E. Total Intragovernmental Assets	$	259,216,468.09	$	(78,439,444.19)
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	$	262,715,377.03	$	267,275,552.03
B. Accounts Receivable		3,061,625,669.60		2,552,766,175.58
C. Loans Receivable		0.00		0.00
D. Inventory & Related Property		0.00		0.00
E. General PP&E		0.00		0.00
F. Investments		0.00		0.00
G. Other Assets		0.00		0.00
H. Total Nonfederal Assets	$	3,324,341,046.63	$	2,820,041,727.61
3. Total Nonentity Assets	$	3,583,557,514.72	$	2,741,602,283.42
4. Total Entity Assets	$	321,835,486,869.30	$	387,470,376,620.07
5. Total Assets	$	325,419,044,384.02	$	390,211,978,903.49

Fluctuation and/or Abnormalities

Intragovernmental Assets.

Fund Balance with Treasury (Line 1.A): DON reported an increase of $337,656 thousand, 430 percent, in 1st Quarter FY 2006. Nonentity Fund Balance with Treasury was affected by a reclassification of the majority of 3000 series Treasury Suspense accounts from Nonentity to Entity in 2nd Quarter FY 2005. This reclassification was done to bring DON's categorization of the Suspense accounts into alignment with DoD's treatment. The Treasury Suspense accounts generally carry a credit balance; the removal of these credit balances caused a swing of $288,817 thousand. Remaining in Nonentity are the 6000 series Deposit accounts which hold items such as withheld state and local taxes and payroll savings allotments and several of the 3000 series. An increase of $46,358 thousand in the Pay of the Marine Corps Deposit Fund (symbol 6026) constituted the bulk of the remaining fluctuation. See Note 1C for a complete listing of the entity and nonentity account symbols.

Nonfederal Assets.

The overall decrease of $4,560 thousand, 2 percent, in Cash and Other Monetary Assets (Line 2A) is reflective of an increase of $53,859 thousand in Foreign Currency related to the Marine Corps Expeditionary Forces, Camp Lejeune, depositing money into a Limited Depositary Account in 2nd Quarter FY 2005. This Limited Depositary Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds. The increase in Foreign Currency was offset by a decrease of $58,419 thousand, 22 percent, in Cash as the Marine Corps converted cash into Foreign Currency.

Non-Entity Non-federal Accounts Receivable (Line 2.B): DON reported an increase of $508,859 thousand, 20 percent. A receivable of $342,329 thousand that was classified in FY 2005 as "currently not collectible", and thus was not reported as a non-entity receivable, is being reported as an active receivable in FY 2006. Additionally, a misclassification in the 1st Quarter FY 2005 Treasury Report on Receivables has since been corrected. This correction added $121,118 thousand to reported balances.

Information Related to Nonentity Assets

Definitions

Assets are categorized as:

Entity accounts.

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

Nonentity accounts.

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

Other Disclosures

Nonentity Assets.

As of 1st Quarter FY 2006, DON holds $3,583,558 thousand nonentity assets. These assets are not available for use by the DON in its day-to-day operations but the DON maintains stewardship accountability and reporting responsibility. There are three categories of significant nonentity assets held by the DON: (1) the Intragovernmental Fund Balance with Treasury, (2) the Nonfederal Cash and Other Monetary Assets, and (3) the Nonfederal Accounts Receivable.

Nonentity Nonfederal Accounts Receivable (Public).

As of 1st Quarter FY 2006, nonentity nonfederal accounts receivable contains principal of $1,333,494 thousand, representing advance payments made to contractors, that remains in litigation and $1,203,075 thousand in associated accrued interest. These balances are being reported in nonentity accounts receivable since the original appropriation year has been cancelled, and any funds collected as a result of this litigation would go to the Department of the Treasury and not be available for the DON's use in normal operations. See Note 5 for additional information.

Note 3. Fund Balance with Treasury

As of December 31	2006	2005
1. Fund Balances		
A. Appropriated Funds	$ 91,997,660,017.18	$ 168,455,984,774.78
B. Revolving Funds	2,572,053,994.39	3,086,601,054.27
C. Trust Funds	12,110,633.52	17,526,983.91
D. Special Funds	2,700,396.75	0.00
E. Other Fund Types	259,216,468.09	(74,085,252.20)
F. Total Fund Balances	$ 94,843,741,509.93	$ 171,486,027,560.76
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 58,106,707,222.87	$ 171,514,996,536.59
B. Fund Balance per DON	94,843,741,509.93	171,486,027,560.76
3. Reconciling Amount	$ (36,737,034,287.06)	$ 28,968,975.83

Explanation of Reconciliation Amount:

Receipt Accts in Treasury unavailable to DON	$ 44,584,752
Invalid Program Years	5,082
Reconciling Difference with Treasury	3,982,877
Continuing Resolution Authority	(36,785,607,000)
Total Reconciling Amount	($36,737,034,287)

Fund Balance Per Treasury Calculation

Undisbursed Appropriation Account Trial Balance (FMS 6654)	$58,076,946,916
Receipt Account Trial Balance (FMS 6655 – IAS 613)	34,262,000
Less: 6655 Trust Funds Balances included in 6654	(4,420,718)
Less: 6655 Special Funds Balances included in 6654	(80,976)
Fund Balance Per Treasury	$ 58,106,707,222

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

4. Other Information

Fluctuation and/or Abnormalities

Appropriated funds (Line 1.A) decreased by $76,458,325 thousand, 45 percent. The DoD operated under Continuing Resolution Authority (CRA) in 1st QTR FY 2006. Under a CRA, funds are not made available in the expected full amount until such time as the DoD Appropriation Act is signed into law.

The only DON Revolving Fund (Line 1.B) is the National Defense Sealift Fund, Navy. The decrease of $514,547 thousand, 17 percent also reflects the reality of operating under a CRA.

The Trust Fund balance (Line 1.C) decreased $5,416 thousand, 31 percent, primarily due to a timing issue in the Ships Stores Profit account.

Special Funds (Line 1.D) increased $2,700 thousand, 100 percent. This line includes the 5000 series of Treasury accounts. Amounts were reclassified from Other Fund Types (Line 1.E).

Other Fund types (Line 1.E) increased by $333,302 thousand, 450 percent. Included in this line are the Treasury Suspense and Clearing accounts. There were substantial efforts to clear negative balances, including $193,027 thousand in Disbursing Officer suspense account 3875, $33,664 thousand in Interfund/IPAC suspense account 3885. These clearing efforts were coupled with increases of $28,748 thousand in Military Thrift Saving Plan account 3882 and $46,368 thousand in the Pay of the Marine Corps Deposit Fund 6026.

Information Related to Fund Balance with Treasury

Other Disclosures

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

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

<u>Intragovernmental Payments and Collections.</u>
The Intragovernmental Payment and Collections (IPAC) Statements of Difference result when the amount reported by the Disbursing Office on its monthly Statement of Accountability report to the Department of the Treasury does not equal the amount of the details reported through the Treasury's IPAC system, which is one of the major components of the Government On-Line

Accounting Link System II (GOALS II). The IPAC application's primary purpose is to provide a standardized interagency fund transfer mechanism for Federal Program Agencies (FPAs). IPAC facilitates the intragovernmental transfer of funds, with descriptive data from one FPA to another.

Status of Fund Balance with Treasury

As of December 31		2006		2005
1. Unobligated Balance				
A. Available	$	28,442,119,537.75	$	94,221,966,918.97
B. Unavailable		2,112,563,056.01		1,964,368,750.84
2. Obligated Balance not yet Disbursed	$	68,733,148,005.64	$	75,380,397,078.08
3. Nonbudgetary FBWT	$	234,528,319.07	$	0.00
4. NonFBWT Budgetary Accounts	$	(4,678,617,408.54)	$	0.00
5. Total	$	94,843,741,509.93	$	171,566,732,747.89

Other Information Related to Status of Fund Balance with Treasury

Fluctuation and/or Abnormalities

Unobligated, Available represents budget authority that is currently available for new obligations. Unobligated, Available (Line 1.A) decreased $65,779,847 thousand, 70 percent, in 1st Quarter FY 2006 due to the CRA. Unobligated, Unavailable (Line 1.B) increased $148,194 thousand or 8 percent. Unobligated, Unavailable represents budget authority that is expired and not generally available for new obligations. Lines 3 and 4 were not distinctly reported in 1st Quarter FY 2005. Line 5, Total Fund Balance with Treasury, decreased $76,722,967 thousand, 45 percent, also as a result of the CRA.

Other Disclosures

Unobligated, Available includes annual funds that are subject to the quarterly apportionment rule. They will become available for obligation in subsequent periods as they are apportioned.

Disclosures Related to Suspense/Budget Clearing Accounts

As of December 31	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
Account				
F3875	$ (346,842,497.49)	$ (212,416,423.84)	$ (19,391,294.58)	$ 193,025,129.26
F3880	(8,484,093.38)	4,767,243.34	3,864,156.35	(903,086.99)
F3882	(38,120,889.59)	3,886,272.17	32,634,181.10	28,747,908.93
F3885	(402,906,970.54)	(52,421,916.02)	(9,161,010.79)	43,260,905.23
F3886	(11,134.50)	9,482.50	7,297.98	(2,184.52)
Total	$ (796,365,585.50)	$ (256,175,341.85)	$ 7,953,330.06	$ 264,128,671.91

Other Disclosures

Other Information Related to Suspense/Budget Clearing Account.

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

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

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of December 31		2004		2005		2006		(Decrease)/ Increase from FY 2005 to 2006
1. Total Problem Disbursements, Absolute Value								
A. Unmatched Disbursements (UMDs)	$	314,350,000.00	$	330,180,000.00	$	1,140,742,960.91	$	810,562,960.91
B. Negative Unliquidated Obligations (NULO)		94,460,000.00		47,520,000.00		54,799,090.25		7,279,090.25
2. Total In-transit Disbursements, Net	$	87,714,000.00	$	(58,904.00)	$	(141,582,388.23)	$	(141,523,484.23)

Fluctuation and/or Abnormalities

In 2nd Quarter FY 2005, DFAS-Cleveland expanded the scope of the definition of a UMD. Formerly, transactions that had not yet reached an accounting station were defined as undistributed. Now these transactions are being defined as an UMD. This change in practice is the primary driver behind the $810,563 thousand increase reported in UMDs.

Definitions

Unmatched Disbursements.

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

Negative Unliquidated Obligations.

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

In-Transit Disbursements, Net.

In-Transit Disbursements, Net represents the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity but not yet posted in an accounting system. Of the $(141,582) thousand reported for DON General Fund, only $180 thousand, or less than 1 percent, is over 30 days old.

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

Other Disclosures

UMDs, NULOs, and In-transit Disbursements, Net represent disbursements of DON funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. For the most part, these payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The elimination of both Problem Disbursements and In-transits is one of the highest financial management priorities of the OUSD(C). Problem Disbursements and In-transits represent a significant financial management concern since: (1) accuracy of accounting reports is affected; (2) availability of funds is more difficult to determine, and (3) the required research and resolution process becomes much more labor intensive as the age of the problem disbursements increase. As a result, the DON has efforts underway to improve the systems and to resolve all previous problem disbursements and process all in-transit disbursements.

Note 4. Investments and Related Interest

As of December 31	2006				
	Par Value / Cost	Amortization Method	Unamortized (Premium) / Discount	Investments, Net	Market Value Disclosure
1. Intragovernmental Securities					
A. Nonmarketable, Market-Based	$ 9,421,000.00		$ (3,049.88)	$ 9,417,950.12	$ 9,417,950.12
B. Accrued Interest	66,063.38			66,063.38	66,063.38
C. Total Intragovernmental Securities	$ 9,487,063.38		$ (3,049.88)	$ 9,484,013.50	$ 9,484,013.50
2. Other Investments					
A. Total Investments	$ 0.00		$ 0.00	$ 0.00	N/A

As of December 31	2005				
	Par Value / Cost	Amortization Method	Unamortized (Premium) / Discount	Investments, Net	Market Value Disclosure
3. Intragovernmental Securities					
A. Nonmarketable, Market-Based	$ 9,370,100.00		$ 10,073.60	$ 9,380,173.60	$ 9,380,173.60
B. Accrued Interest	53,018.09			53,018.09	53,018.09
C. Total Intragovernmental Securities	$ 9,423,118.09		$ 10,073.60	$ 9,433,191.69	$ 9,433,191.69
4. Other Investments					
A. Total Investments	$ 0.00		$ 0.00	$ 0.00	N/A

Fluctuation and/or Abnormalities

The DON reported an increase of $13 thousand, 25 percent, in Accrued Interest. This increase is reflective of the increase in interest rates over the past twelve months.

Other Disclosures

The two DON Trust Funds holding interest-bearing securities are the Naval Academy General Gift Fund and the Navy General Gift Fund, which have a total Investment net value of $9,484 thousand (including $66 thousand of accrued interest). These investments are Non-Marketable Market-Based securities reported at cost, net of amortized premiums and discounts. In accordance with the Statement of Federal Financial Accounting Standards No. 27, “Identifying and Reporting Earmarked Funds”, the DON Trust Funds are now classified and reported as earmarked funds.

Intragovernmental Investments in Treasury Securities.

The Federal government does not set aside assets to pay future benefits or other expenditures associated with the DON's earmarked Trust Funds. Treasury securities are an asset to the DON and a liability to the U.S. Treasury. Because the DON and the U.S. Treasury are both parts of the United States Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements. When the DON requires redemption of its Treasury securities held in the DON earmarked trust funds to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Note 5. Accounts Receivable

As of December 31	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 152,031,529.08	N/A	$ 152,031,529.08	$ 118,424,202.75
2. Nonfederal Receivables (From the Public)	$ 3,577,417,357.99	$ (6,850,521.25)	$ 3,570,566,836.74	$ 2,720,996,630.53
3. Total Accounts Receivable	$ 3,729,448,887.07	$ (6,850,521.25)	$ 3,722,598,365.82	$ 2,839,420,833.28

Information Related to Accounts Receivable

Fluctuation and/or Abnormalities

Intragovernmental Receivables.

The DON reported an increase of $33,607 thousand, 28 percent, in Intragovernmental Receivables in 1st Quarter 2006. The majority of the increase was related to an additional $28,086 thousand owed by the Army General Fund (Level Two). The total Level One Intragovernmental accounts receivable amount recorded in 1st Quarter FY 2006 was $13,525 thousand.

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

Nonfederal Receivables.

Nonfederal receivables increased $849,570 thousand, 31 percent. A receivable of $342,329 thousand that was classified in FY 2005 as "currently not collectible", and thus was not reported as a non-entity receivable, is being reported as an active receivable in FY 2006. Additionally, a misclassification in the 1st Quarter FY 2005 Treasury Report on Receivables has since been corrected. This correction added $121,118 thousand to reported balances. Finally, an increase of $300,070 thousand in the Other Procurement account related to Foreign Military Sales contributed to the overall increase.

Allowance Method

Based upon an extensive analysis of historic public receivables, the allowance for 1st Quarter FY 2006 was determined to be $6,850 thousand.

Intragovernmental Accounts Receivable Adjustments

Allocation of Undistributed Collections.

Undistributed collections are allocated between federal and nonfederal categories based on the percentage of federal and nonfederal Accounts Receivable as submitted in the field level general ledgers. This allocation was suggested as appropriate in a DFAS Arlington memorandum dated October 4, 2000, which required disclosure to the audit community of the applicable methodology used to allocate undistributed. For 1st Quarter 2006, $638,271 thousand in undistributed collections was allocated to accounts receivable.

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

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

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

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

(Amounts in thousands)	As of December 31, 2005
Contract Litigation Principal and Interest	$2,536,568
Defense Debt Management System (DDMS)	28,314
CDS/MOCAS System Debts	400,311
In-service Debt and Other Debt	96,433
Gross Nonentity Nonfederal A/R	3,061,626
Less Allowance	(5,179)
Nonentity Nonfederal Receivables, Net	3,056,447
Entity Nonfederal Receivables, Net	514,120
Nonfederal Receivables (From the Public), Net	$3,570,567

The contract litigation includes principal of $1,333,494 thousand, and accrued interest receivable of $1,203,074 thousand, which represents an increase in accrued interest of $58,963 thousand from 1st Quarter FY 2005.

AGED ACCOUNTS RECEIVABLE GROUPS					
CATEGORY	Intragovernmental	Intragovernmental	Intragovernmental	Nonfederal	Total
	Outside DoD	Within DoD	Total		
Nondelinquent					
Current	8,247,089.70	155,098,509.06	163,345,598.76	517,754,893.99	681,100,492.75
Noncurrent	438,405.00	21,369,045.00	21,807,450.00	7,460,462.00	29,267,912.00
Delinquent					
1 to 30 days	1,073,218.00	3,372,253.00	4,445,471.00	5,302,673.00	9,748,144.00
31 to 60 days	2,367,361.00	7,291,786.00	9,659,147.00	4,414,954.00	14,074,101.00
61 to 90 days	81,855.00	5,389,778.00	5,471,633.00	12,116,478.00	17,588,111.00
91 to 180 days	507,943.00	3,375,023.00	3,882,966.00	15,314,590.00	19,197,566.00
181 days to 1 year	233,057.00	2,635,573.00	2,868,630.00	33,821,662.00	36,690,292.00
Greater than 1 year and less than or equal to 2 years	119,860.00	3,264,394.00	3,384,254.00	23,682,579.00	27,066,833.00
Greater than 2 years and less than or equal to 6 years	0.00	50,009.00	50,009.00	52,345,754.00	52,395,763.00
Greater than 6 years and less than 10 years	0.00	0.00	0.00	358,468,705.00	358,468,705.00
Greater than 10 years	0.00	0.00	0.00	2,546,734,607.00	2,546,734,607.00
Eliminations	0.00	(62,883,629.68)	(62,883,629.68)	0.00	(62,883,629.68)
Total	13,068,788.70	138,962,740.38	152,031,529.08	3,577,417,357.99	3,729,448,897.07

Table 10-1. Aged Accounts Receivable

Definitions of debt system acronyms:
CDS is the Contractor Debt System and MOCAS is the Mechanization of Contract Administration System. These systems are used to manage debts owed by contractors.

Entity accounts.

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

Nonentity accounts.

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

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

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

Note 6. Other Assets

As of December 31	2006	2005
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 531,043,052.72	$ 291,410,881.96
B. Total Intragovernmental Other Assets	$ 531,043,052.72	$ 291,410,881.96
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 6,825,306,702.84	$ 7,820,791,557.53
B. Other Assets (With the Public)	522,279,676.79	336,368,624.07
C. Total Nonfederal Other Assets	$ 7,347,586,379.63	$ 8,157,160,181.60
3. Total Other Assets	$ 7,878,629,432.35	$ 8,448,571,063.56

Fluctuation and/or Abnormalities

Intragovernmental Other Assets.

The DON reported an increase of $239,632 thousand, 82 percent, in Advances and Prepayments, (Line 1.A), in 1st Quarter FY 2006. The majority of the increase was due to a $211,415 thousand increase with the Department of Commerce (Trading Partner Level One). The balances reported are determined by the Intragovernmental elimination process as submitted by DON's trading partners. In processing the elimination data, increases to Advances and Prepayments are recorded to compensate for the unresolved differences when needed. Furthermore, using historical data as a baseline, DON recorded an overall Level One estimate for advances in the amount of $294,169 thousand.

Nonfederal Other Assets.

Outstanding Contract Financing Payments.

DON reported a decrease of $995,485 thousand, 13 percent, in Outstanding Contract Financing Payments (Line 2.A) in 1st Quarter FY 2006. The majority of the decrease was due to a $1,528,234 thousand decrease in Aircraft Procurement Program as the Navy took delivery of aircraft and prior advances were liquidated. However, the decrease in the Aircraft program was offset by a $372,995 thousand increase in Marine Corps Procurement due to a reclassification from Other Assets (With the Public) per an audit recommendation.

Other Assets (With the Public).

DON reported an increase of $185,911 thousand, 55 percent, in Other Assets (With the Public) (Line 2.B.) in 1st Quarter FY 2006. The Navy Military Personnel accounts show a $356,234 thousand increase in Advance Pay. Offsetting this increase, on a comparative basis, $178,469 thousand in Marine Corps Procurement advances to contractors was reclassified to Outstanding Contract Financing Payments as noted above per an audit finding.

Information Related to Other Assets

Other Disclosures

Intragovernmental Other Assets - Advances and Prepayment.

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

Nonfederal Other Assets - Outstanding Contract Financing Payments.

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

The following table displays the Outstanding Contract Financing Payments attributed by program.

(Amounts in thousands)	As of December 31, 2005
Aircraft Procurement	$ 4,077,435
Shipbuilding and Conversion	304,357
Weapons Procurement	1,037,345
Marine Corps Procurement	372,995
Marine Corps, Other	2,302
Other Procurement	863,918
Navy Other (O&M, RDT&E)	166,955
Total	$ 6,825,307

Note 7. Cash and Other Monetary Assets

As of December 31	2006	2005
1. Cash	$ 201,927,472.86	$ 260,346,726.24
2. Foreign Currency (Nonpurchased)	60,787,904.17	6,928,825.79
3. Total Cash, Foreign Currency, & Other Monetary Assets	$ 262,715,377.03	$ 267,275,552.03

Fluctuation and/or Abnormalities
The overall decrease of $4,560 thousand, 2 percent, in Total Cash (Line 3) is reflective of an increase of $53,859 thousand in Foreign Currency (Line 2) related to the Marine Corps Expeditionary Forces, Camp Lejeune, depositing money into a Limited Depositary Account in 2nd Quarter FY 2005. This Limited Depositary Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds. The increase in Foreign Currency was offset by a decrease of $58,419 thousand, 22 percent, in Cash held by various Disbursing Officers.

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

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

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

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

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

Note 8.	Direct Loan and/or Loan Guarantee Programs

As of December 31

Direct Loan and/or Loan Guarantee Programs The entity operates the following direct loan and/or Loan guarantee program(s)

Military Housing Privatization Initiative

Armament Retooling & Manufacturing Support Initiative

Not Applicable

Direct Loans Obligated After FY 1991

As of December 31	2006	2005
Loan Programs		
1. Military Housing Privatization Initiative		
A. Loans Receivable Gross	$ 0.00	$ 0.00
B. Interest Receivable	0.00	0.00
C. Foreclosed Property	0.00	0.00
D. Allowance for Subsidy Cost (Present Value)	0.00	0.00
E. Value of Assets Related to Direct Loans	$ 0.00	$ 0.00
2. Total Loans Receivable	$ 0.00	$ 0.00

Total Amount of Direct Loans Disbursed

As of December 31	2006	2005
Direct Loan Programs		
1. Military Housing Privatization Initiative	$ 0.00	$ 0.00
2. Total	$ 0.00	$ 0.00

Subsidy Expense for Post FY 1991 Direct Loan

As of December 31

2006	Interest Differential	Defaults	Fees	Other	Total
1. New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2005	Interest Differential	Defaults	Fees	Other	Total
2. New Direct Loans Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2006	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Direct Loan Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

	2006	2005
5. Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	$ 0.00	$ 0.00

Subsidy Rate for Direct Loans

As of December 31	Interest Differential	Defaults	Fees and other Collections	Other	Total
Direct Loan Programs					
1. Military Housing Privatization Initiative	0.00%	0.00%	0.00%	0.00%	0.00%

Schedule for Reconciling Subsidy Cost Allowance Balances for Post 1991 Direct Loans

As of December 31	2006	2005
1. Beginning Balance of the Subsidy Cost Allowance	$ 0.00	$ 0.00
2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component		
A. Interest Rate Differential Costs	$ 0.00	$ 0.00
B. Default Costs (Net of Recoveries)	0.00	0.00
C. Fees and Other Collections	0.00	0.00
D. Other Subsidy Costs	0.00	0.00
E. Total of the above Subsidy Expense Components	$ 0.00	$ 0.00
3. Adjustments		
A. Loan Modifications	$ 0.00	$ 0.00
B. Fees Received	0.00	0.00
C. Foreclosed Property Acquired	0.00	0.00
D. Loans Written Off	0.00	0.00
E. Subsidy Allowance Amortization	0.00	0.00
F. Other	0.00	0.00
G. Total of the above Adjustment Components	$ 0.00	$ 0.00
4. Ending Balance of the Subsidy Cost Allowance before Re-estimates	$ 0.00	$ 0.00
5. Add or Subtract Subsidy Re-estimates by Component		
A. Interest Rate Re-estimate	$ 0.00	$ 0.00
B. Technical/Default Reestimate	0.00	0.00
C. Total of the above Reestimate Components	$ 0.00	$ 0.00
6. Ending Balance of the Subsidy Cost Allowance	$ 0.00	$ 0.00

Defaulted Guaranteed Loans from Post FY 1991 Guarantees

As of December 31	2006	2005
Loan Guarantee Program(s)		
1. Military Housing Privatization Initiative		
A. Defaulted Guaranteed Loans Receivable, Gross	$ 0.00	$ 0.00
B. Interest Receivable	0.00	0.00
C. Foreclosed Property	0.00	0.00
D. Allowance for Subsidy Cost (Present Value)	0.00	0.00
E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	$ 0.00	$ 0.00
2. Armament Retooling & Manufacturing Support Initiative		
A. Defaulted Guaranteed Loans Receivable, Gross	$ 0.00	$ 0.00
B. Interest Receivable	0.00	0.00
C. Foreclosed Property	0.00	0.00
D. Allowance for Subsidy Cost (Present Value)	0.00	0.00
E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net	$ 0.00	$ 0.00
3. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable	$ 0.00	$ 0.00

Guaranteed Loans Outstanding

As of December 31	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding		
1. Military Housing Privatization Initiative	$ 0.00	$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	$ 0.00	$ 0.00
3. Total	$ 0.00	$ 0.00
2006		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	$ 0.00	$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	$ 0.00	$ 0.00
3. Total	$ 0.00	$ 0.00
2005		
New Guaranteed Loans Disbursed		
1. Military Housing Privatization Initiative	$ 0.00	$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	$ 0.00	$ 0.00
3. Total	$ 0.00	$ 0.00

Liabilities for Post FY 1991 Loan Guarantees, Present Value

As of December 31	2006	2005
Loan Guarantee Program(s)		
1. Military Housing Privatization Initiative	$ 0.00	$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	0.00	0.00
3. Total	$ 0.00	$ 0.00

Subsidy Expense for Post FY 1991 Loan Guarantees

As of December 31

2006	Interest Differential	Defaults	Fees	Other	Total
1. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2005	Interest Differential	Defaults	Fees	Other	Total
2. New Loan Guarantees Disbursed:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0.00	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2006	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
3. Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
4. Modifications and Reestimates:					
Military Housing Privatization Initiative	$ 0.00	$ 0.00	$ 0.00	$ 0	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0	0.00
Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

	2006	2005
5. Total Loan Guarantee:		
Military Housing Privatization Initiative	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00
Total	$ 0.00	$ 0.00

Subsidy Rates for Loan Guarantees

As of December 31	Interest Supplements	Defaults	Fees and other Collections	Other	Total
Loan Guarantee Programs:					
1. Military Housing Privatization Initiative	0.00%	0.00%	0.00%	0.00%	0.00%
2. Armament Retooling & Manufacturing Support Initiative	0.00%	0.00%	0.00%	0.00%	0.00%

Schedule for Reconciling Loan Guarantee Liability Balances for Post FY 1991 Loan Guarantees

As of December 31	2006	2005
1. Beginning Balance of the Loan Guarantee Liability	$ 0.00	$ 0.00
2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
A. Interest Supplement Costs	$ 0.00	$ 0.00
B. Default Costs (Net of Recoveries)	0.00	0.00
C. Fees and Other Collections	0.00	0.00
D. Other Subsidy Costs	0.00	0.00
E. Total of the above Subsidy Expense Components	$ 0.00	$ 0.00
3. Adjustments		
A. Loan Guarantee Modifications	$ 0.00	$ 0.00
B. Fees Received	0.00	0.00
C. Interest Supplements Paid	0.00	0.00
D. Foreclosed Property and Loans Acquired	0.00	0.00
E. Claim Payments to Lenders	0.00	0.00
F. Interest Accumulation on the Liability Balance	0.00	0.00
G. Other	0.00	0.00
H. Total of the above Adjustments	$ 0.00	$ 0.00
4. Ending Balance of the Loan Guarantee Liability before Reestimates	$ 0.00	$ 0.00
5. Add or Subtract Subsidy Reestimates by Component		
A. Interest Rate Reestimate	0.00	0.00
B. Technical/default Reestimate	0.00	0.00
C. Total of the above Reestimate Components	$ 0.00	$ 0.00
6. Ending Balance of the Loan Guarantee Liability	$ 0.00	$ 0.00

Administrative Expenses

As of December 31	2006	2005
1. Direct Loans		
Military Housing Privatization Initiative	$ 0.00	$ 0.00
Total	$ 0.00	$ 0.00
2. Loan Guarantees		
Military Housing Privatization Initiative	$ 0.00	$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00
Total	$ 0.00	$ 0.00

Note 9. Inventory and Related Property

As of December 31	2006	2005
1. Inventory, Net	$ 0.00	$ 0.00
2. Operating Materials & Supplies, Net	58,832,249,976.77	54,191,676,746.72
3. Stockpile Materials, Net	0.00	0.00
4. Total	$ 58,832,249,976.77	$ 54,191,676,746.72

Inventory, Net

As of December 31	2006			2005	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
1. Inventory Categories					
A. Available and Purchased for Resale	$ 0.00	$ 0.00	0.00	$ 0.00	LAC,MAC
B. Held for Repair	0.00	0.00	0.00	0.00	LAC,MAC
C. Excess, Obsolete, and Unserviceable	0.00	0.00	0.00	0.00	NRV
D. Raw Materials	0.00	0.00	0.00	0.00	MAC,SP,LAC
E. Work in Process	0.00	0.00	0.00	0.00	AC
F. Total	$ 0.00	$ 0.00	0.00	$ 0.00	

Legend for Valuation Methods:

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

Operating Materials and Supplies, Net

As of December 31	2006			2005	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
1. OM&S Categories					
A. Held for Use	$ 53,630,981,817.55	$ 0.00	$ 53,630,981,817.55	$ 49,788,541,972.13	SP, LAC
B. Held for Repair	6,686,017,055.81	(1,484,748,896.59)	5,201,268,159.22	4,403,134,774.59	SP, LAC
C. Excess, Obsolete, and Unserviceable	475,017,511.54	(475,017,511.54)	0.00	0.00	NRV
D. Total	$ 60,792,016,384.90	$ (1,959,766,408.13)	$ 58,832,249,976.77	$ 54,191,676,746.72	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
SP = Standard Price
AC = Actual Cost
NRV = Net Realizable Value
O = Other

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

3. Other Information Related to Operating Materials and Supplies

Fluctuation and/or Abnormalities

The DON reported an increase of $798,133 thousand, 18 percent, for OM&S, Held for Repair (Line 1.B) in 1st Quarter FY 2006. The majority of the increase is due to:

- Increase of $872,758 thousand in Sponsor Owned Material (SOM) Held for Repair
- Price adjustments in the revaluation allowance for OM&S Held for Repair
- The increase was offset by a decrease of $144,758 thousand in Principal End Items Held for Repair.

Information Related to Operating Material and Supplies, Net

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

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

(Amounts in thousands)	As of December 31, 2005
Ammunition and Munitions	$34,923,358
Appropriation Purchase Account (APA)	
Principal End Item	8,916,611
Sponsor Owned Material	11,348,566
APA Secondary Inventory	1,148,854
Real-time Reutilization Asset Management (RRAM)	2,129,210
Other	365,651
Total	$58,832,250

The Statement of Federal Financial Accounting Standards (SFFAS) No. 3 "Accounting for Inventory and Related Property" requires disclosure of the amount of OM&S held for "Future Use." This information is not captured by current OM&S systems which were designed for material management rather than accounting purposes.

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

Government Furnished Material (GFM) and Contractor Acquired Material (CAM).
When it is in the best interest of the government, the DON provides government property to contractors when deemed necessary to complete contracted work. Such property is either owned or leased by the DON, or purchased directly by the contractor for the government based on contract terms. When the value of contractor procured General PP&E exceeds the DoD capitalization threshold, such PP&E is required to be included in the value of General PP&E reported on the DON's Balance Sheet.

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

Other Disclosures

Ammunition and Munitions.

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

APA Principal End Items.

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

Sponsor Owned Material (SOM).

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

Real-time Reutilization Asset Management (RRAM).

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

Other Operating Materials & Supplies.

Other OM&S totaled $365,651 thousand as of 1st Quarter FY 2006. Other OM&S consists primarily of $315,505 thousand in Fleet Hospitals and $44,263 thousand in materials for War Reserves in possession of the U.S. Coast Guard. During 4th Quarter FY 2005, $53,014 thousand of Civil Engineering Support Equipment was issued from the Fleet Hospital and War Reserve program, which accounts for the decrease in the overall value of the Other OM&S on hand.

Stockpile Materials, Net

As of December 31	2006			2005	
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method
1. Stockpile Materials Categories					
A. Held for Sale	$ 0.00	$ 0.00	$ 0.00	$ 0.00	AC, LCM
B. Held in Reserve for Future Sale	0.00	0.00	0.00	0.00	AC, LCM
C. Total	$ 0.00	$ 0.00	$ 0.00	$ 0.00	

Legend for Valuation Methods:

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

Note 10. General PP&E, Net

As of December 31	2006					2005
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
1. Major Asset Classes						
A. Land	N/A	N/A	$ 612,047,424.00	N/A	$ 612,047,424.00	$ 596,061,890.00
B. Buildings, Structures, and Facilities	S/L	20 Or 40	34,702,371,497.00	$ (20,963,359,065.36)	13,739,012,431.64	13,437,170,566.96
C. Leasehold Improvements	S/L	lease term	7,514,035.00	(475,937.19)	7,038,097.81	210,440.00
D. Software	S/L	2-5 Or 10	3,070,660.44	(2,964,894.34)	105,766.10	464,348.81
E. General Equipment	S/L	5 or 10	2,622,263,112.70	(2,144,858,274.19)	477,404,838.51	498,757,844.05
F. Military Equipment	S/L	Various	453,960,000,000.00	(311,840,000,000.00)	142,120,000,000.00	134,760,000,000.00
G. Assets Under Capital Lease	S/L	lease term	114,695.76	(1,911.60)	112,784.16	59,232.74
H. Construction-in-Progress	N/A	N/A	2,913,904,366.40	N/A	2,913,904,366.40	3,676,849,632.89
I. Other			0.00	0.00	0.00	0.00
J. Total General PP&E			$ 494,821,285,791.30	$ (334,951,660,082.68)	$ 159,869,625,708.62	$ 152,969,573,955.45

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

Fluctuation and/or Abnormalities

Total General Property, Plant, and Equipment, Net increased by $6,900,051 thousand or 5 percent from 1st Quarter FY 2005.

<u>Leasehold Improvements.</u>
The DON reported an increase of $6,828 thousand, 3,244 percent, in Leasehold Improvements in 1st Quarter FY 2006. The increase is due to the Office of Naval Research relocating during 4th Quarter FY 2005 to a newly leased space, where major improvements were made to the site to accommodate their operations.

<u>Software.</u>
The DON reported a decrease of $359 thousand, 77 percent, in Software in 1st Quarter FY 2006. The decrease is due to accumulated depreciation and current depreciation.

<u>Assets Under Capital Lease.</u>
The DON reported an increase of $54 thousand, 90 percent, in Capital Leases, net in 1st Quarter FY 2006. While three leases expired in 4th Quarter FY 2005, one new lease was reported in 1st Quarter FY 2006.

Construction-in-Progress (CIP).
The DON reported a decrease of $762,945 thousand, 21 percent, in CIP, net in 1st Quarter FY 2006. This decrease is a result of the completion of a large number of projects over the past twelve months. Some of the projects include an Aircraft Maintenance Hangar and Waterfront Electrical Upgrades in Norfolk, VA and the replacement of the Bachelors Enlisted Quarters in Yorktown, VA.

Information Related to General PP&E, Net

Buildings, Structures and Facilities.
While positive weather conditions facilitated military projects being completed earlier than scheduled, Hurricanes Katrina and Rita caused damage to real property at several DON installations during FY 2005. Department of the Navy Damage Assessment Teams consisting of structural and mechanical engineers, architects, roofing specialists and construction contract specialists were deployed to the Gulf Coast area of the United States to assess damage caused by Hurricanes Katrina and Rita.

The DON Damage Assessment Teams are providing support to local facilities management teams. Among the installations that the DON Damage Assessment Teams are providing engineering damage assessment are Naval Air Station/Joint Reserve Base New Orleans; Naval Support Activity New Orleans; Naval Station Gulfport, Mississippi; Naval Station Pascagoula, Mississippi; and Stennis Space Center, Mississippi. The DON Damage Assessment Teams are dealing with three broad categories of buildings, structures, and utilities: (1) facilities that only have cosmetic/minor damage and therefore repair costs; (2) facilities that have major damage that it makes more economic sense to build new rather than repair and therefore new military construction; and (3) structures that have significant damage, but it makes more economic sense to repair them than to build new and therefore capitalized improvements. As of the end of 1st Quarter FY 2006, the assessments are not yet completed; however once completed, decisions will be made to either replace or repair buildings, and over time the values of the buildings, structures, and utilities on the financial statements will either increase due to new construction and capital improvements or the values will be adjusted downward because they were demolished by the Hurricanes and/or require demolition.

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

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

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

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

For the DON, the BEA analysis provided for an Acquisition value of $453,960,000 thousand for military equipment, less an Accumulated Depreciation value of $311,840,000 thousand giving a Net Book Value of $142,120,000 thousand for military equipment as of 1st Quarter FY 2006.

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

Heritage Assets and Stewardship Land.

Relationship of Heritage Assets to Department of the Navy's (DON's) Mission.
The overall mission of the 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 the DON has become a large-scale owner of historic buildings, structures, districts, archeological sites and artifacts, ships, aircraft, and other cultural resources. Protection of these components of the nation's heritage is an essential part of DON's mission; the DON is committed to responsible cultural resources stewardship.

Stewardship Policies for Heritage Assets.
The overall policy for the DON's stewardship policies for heritage assets is contained in the Secretary of the Navy Instruction 4000.35A, "DON Cultural Resources Program."

- Heritage Assets are items that are unique for one of more of the following reasons: (1) historical or natural significance; (2) cultural, educational or artistic importance; or (3) significant architectural characteristics. The process used to define items as having heritage significance varies between categories and type of assets being evaluated. Subject matter experts, including historians and curators, play a significant role in the definition process. In all cases, a myriad of federal statutes, regulations, and other guidelines mandate heritage significance or provide guidance in its determination.
- Preservation considerations are incorporated into routine DON management of historic buildings, structures, districts, sites, ships, aircraft and other cultural resources. Compliance with cultural resources protection requirements is incorporated as appropriate into other DON planning processes, including but not limited to master planning, environmental planning,

budgeting/programming, and facilities management. When functionally appropriate and economically prudent, DON gives preference to the rehabilitation or adaptive use of historic properties over new construction or leasing.

- The appropriate consultation is initiated with State Historic Preservation Officers, Tribal Historic Preservation Officers, Advisory Council on Historic Preservation, Native Americans, Native Hawaiians, and other interested agencies and publics whenever the DON conducts or supports undertakings that may affect any National Register resource.
- DON designated staff maintain an awareness of specific legal obligations regarding its management of cultural resources such as establishing a program to locate and inventory all cultural resources under DON control and to evaluate them against National Register eligibility criteria for possible nomination to the National Register.
- Cultural resources management, including consultation, takes place at the lowest appropriate level in the chain of command.
- Archeological sites under the control of the DON are excavated only to the extent required for evaluation and identification, unless scientific or programmatic considerations, or concerns about the integrity or security of a site, make more extensive excavation necessary or advisable.

<u>Description of Each Major Category of Heritage Assets.</u>

- Archaeological Sites are locations that contain the remains of past human activity of various sorts that are listed or eligible for listing on the National Register of Historic Places.
- Buildings and Structures are listed as or determined eligible for listing on the National Register of Historic Places, including Multi-Use Heritage Assets.
- Cemeteries are government owned burial grounds on which gravesites of prominent historical figures may be located in addition to other gravesites.
- Major Collections include archeological artifacts that are maintained and inventoried by cubic feet, archival items that are maintained and inventoried by linear feet, and artwork and historical artifacts that are maintained and inventoried by individual items.
- Monuments and Memorials are those items that are built or placed to commemorate a person or event, preserve the memory of a historical event, or is shown or maintained for its historical interest.

<u>Relationship of Stewardship Land to Department of the Navy's (DON's) Mission.</u>
The overall mission of the 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 the DON has accumulated several hundred installations throughout the United States. These installations provide the capability to organize, train, and equip the DON to perform its mission.

<u>Stewardship Land Policy.</u>
The DON Stewardship Land policy is the same as that which DON maintains over all land and installations. The DON strives to be a responsible steward of the land and to maintain it in a way that both protects human health and the environment and allows training and support of fleet readiness. The DON works to develop and improve partnerships with the communities in which its installations are located, the federal regulatory agencies such as U.S. Environmental Protection Agency, state regulatory agencies, and within the military services by sharing lessons learned and transfer of technologies.

Stewardship Land is defined as the type of land not acquired of or in connection with land on which General Plant and Equipment is located. For the DON, Stewardship Land includes land acquired through public domain, land set aside, and donated land. Some of this land is used as a buffer around the perimeter of DON installations and may include but is not limited to grazing lands and forestry maintenance areas.

Other Disclosures

Real Property.

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

Leasehold Improvements.

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

Software.

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

Construction-in-Progress (CIP).

CIP balances were obtained from the Facilities Information System (FIS). Data on construction that is performed for the benefit of non-DON customers, such as Air Force and several of the Defense Agencies, is provided to Air Force, the Defense Agencies, and the Defense Finance and Accounting Service; such work for others is not included in DON CIP balances.

Preponderant Use.

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

- The asset embodies a probable future benefit;
- The DoD Component that reports the asset obtains the benefit and controls access to the benefit inherent in the asset;
- The transaction or event giving the Component the right to, and control over, the benefit has already occurred; and
- The predominantly used assets, taken as a whole, are material to the Component's financial statements.

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

Assets Under Capital Lease

As of December 31	2006	2005
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	$ 0.00	$ 0.00
B. Equipment	114,695.76	224,245.00
C. Other	0.00	0.00
D. Accumulated Amortization	(1,911.60)	(165,012.26)
E. Total Capital Leases	$ 112,784.16	$ 59,232.74

2. Description of Lease Arrangements

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

3. Other Information Related to Assets Under Capital Lease

Fluctuation and/or Abnormalities

The DON reported an increase of $54 thousand, 90 percent, in Capital Leases, net in 1st Quarter FY 2006. While three leases expired in 4th Quarter FY 2005, one new lease was reported in 1st Quarter FY 2006.

Note 11. Liabilities Not Covered by Budgetary Resources

As of December 31	2006	2005
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0.00	$ 0.00
B. Debt	0.00	0.00
C. Other	3,493,267,676.41	2,993,166,214.85
D. Total Intragovernmental Liabilities	$ 3,493,267,676.41	$ 2,993,166,214.85
2. Nonfederal Liabilities		
A. Accounts Payable	$ 28,048,894.52	$ 89,472,623.49
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,532,819,451.36	1,575,815,538.46
C. Environmental Liabilities	17,534,734,637.25	17,007,808,086.25
D. Loan Guarantee Liability	0.00	0.00
E. Other Liabilities	3,833,473,686.51	3,475,195,128.33
F. Total Nonfederal Liabilities	$ 22,929,076,669.64	$ 22,148,291,376.53
3. Total Liabilities Not Covered by Budgetary Resources	$ 26,422,344,346.05	$ 25,141,457,591.38
4. Total Liabilities Covered by Budgetary Resources	$ 4,585,023,749.60	$ 3,036,518,916.52
5. Total Liabilities	$ 31,007,368,095.65	$ 28,177,976,507.90

6. Other Information Related to Liabilities Not Covered by Budgetary Resources

Fluctuation and/or Abnormalities

Intragovernmental Liabilities.

Intragovernmental Other Liabilities (Line 1.C) The DON reported an increase of $500,101 thousand, 17 percent, in 1st Quarter FY 2006. A receivable of $342,329 thousand that was classified in FY 2005 as “currently not collectible”, and thus was not reported as a non-entity receivable, is being reported as an active receivable in FY 2006. Additionally, a misclassification in the 1st Quarter FY 2005 Treasury Report on Receivables has since been corrected. This correction added $121,118 thousand to reported balances.

Nonfederal Liabilities.

Accounts Payable (Line 2.A) The DON reported a decrease of $61,423 thousand, 69 percent, in Accounts Payable, in 1st Quarter FY 2005. This line item represents cancelled year payables that were reported on the September 30, 2005 SF-133 Report on Budget Execution.

Other Liabilities

Other Liabilities (Line 2.E) increased by $358,279 thousand, 10 percent, in 1st Quarter 2006. The majority of the increase consists of a $642,350 thousand increase in non-environmental disposal liabilities, which was partially offset by a decrease of $290,088 thousand in annual leave. See Note 15 for a detailed explanation of Other Liabilities.

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

Definitions

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

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

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

Other Disclosures

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

	As of December 31, 2005
Federal Employees Compensation Act (FECA)	$ 358,952
Unemployment	72,690
Liabilities to Treasury	3,061,626
Total	$ 3,493,268

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

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

	As of December 31, 2005
(Amounts in thousands)	
Annual Leave	$ 2,179,200
Military Equipment – Non-nuclear Non-Environmental Disposal Liabilities	1,429,989
Disposal Liabilities for Excess/Obsolete Structures	182,114
Contract Incentives	42,171
Total	$ 3,833,474

Reference
For additional line item discussion, see:
Note 8, Direct Loans and/or Loan Guarantee Programs
Note 12, Accounts Payable
Note 13, Debt
Note 14, Environmental Liabilities and Disposal Liabilities
Note 15, Other Liabilities
Note 16, Commitments and Contingencies
Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities

Note 12. Accounts Payable

As of December 31	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
1. Intragovernmental Payables	$ 988,086,805.74	$ N/A	$ 988,086,805.74	$ 905,567,278.05
2. Nonfederal Payables (to the Public)	1,211,637,345.42	0.00	1,211,637,345.42	1,102,518,474.59
3. Total	$ 2,199,724,151.16	$ 0.00	$ 2,199,724,151.16	$ 2,008,085,752.64

4. Other Information Related to Accounts Payable

Fluctuation and/or Abnormalities

Intragovernmental Payables.

The DON reported an increase of $82,520 thousand, 9 percent, in Intragovernmental payables in 1st Quarter FY 2006. These balances are largely driven by the trading partner process. Upon receipt of accounts receivable data reported by our trading partners, DON records compensating accounts payable. For agencies that do not provide account receivable data, DON records accounts payable estimates based upon historical data. The total Level One Intragovernmental accounts payable amount recorded in 1st Quarter FY 2006 was $367,959 thousand.

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

Intragovernmental Entities	Level	Amounts (in thousands)
Navy Working Capital Fund	Two	$ 412,853
Army General Fund	Two	18,085

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

Intragovernmental Entities	Level	Amounts (in thousands)
Other Defense Organizations WCF	Two	$ 199,368
Other Defense Organizations GF	Two	96,030
General Services Administration	One	55,557

Nonfederal Payables.

DON reported an increase of $109,119 thousand, 10 percent, in Nonfederal Accounts Payable in 1st Quarter FY 2006. Payables, more than any other liability, are subject to the vagaries of the business cycle, the timing of the receipt of invoices for goods and services, and the subsequent liquidation of those invoices; thus variances from the previous reporting period are expected.

Definitions

Intragovernmental Accounts Payable.

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

Nonfederal Payables (to the Public).

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

Undistributed Disbursements.

Undistributed Disbursements are the difference between disbursements recorded at the detailed level to a specific obligation or payable in the activity field records versus those reported by the Department of the Treasury. This should agree with the undistributed disbursements reported on monthly accounting reports. Generally, timing issues between systems cause undistributed disbursements. In-transit disbursements are payments that have been made by other agencies, entities, or systems that have not yet been recorded in the DON's accounting records. For 1st Quarter FY 2006, total supported undistributed disbursements were $1,771,061 thousand.

Intragovernmental Elimination.

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

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

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

Other Disclosures

Abnormal Account Balances.

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

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

Judgment Fund Liabilities.

The DON must reimburse the Department of the Treasury for payments made from the Judgment Fund on its behalf. These payments are a result of claims being resolved under the Contracts Dispute Act. In addition, the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR) was implemented on Oct 1, 2003. This law requires all agencies to reimburse the Judgment Fund for cases covered by the No FEAR Act. For FY 2005, the DON reported $250 thousand for No FEAR Act liabilities.

Note 13. Debt

As of December 31	2006			2005	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
1. Agency Debt (Intragovernmental)					
A. Debt to the Treasury	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
B. Debt to the Federal Financing Bank	0.00	0.00	0.00	0.00	0.00
C. Total Agency Debt	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
2. Total Debt	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

Note 14.	Environmental Liabilities and Disposal Liabilities

As of December 31	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
1. Environmental Liabilities--Nonfederal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations--Environmental Restoration (ER)	$ 478,930,000.00	$ 2,139,722,000.00	$ 2,618,652,000.00	$ 2,734,034,000.00
2. Active Installations--ER for Closed Ranges	54,580,000.00	505,071,000.00	559,651,000.00	544,563,000.00
3. Formerly Used Defense Sites (FUDS)--ER	0.00	0.00	0.00	0.00
4. FUDS--ER for Transferred Ranges	0.00	0.00	0.00	0.00
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	0.00	29,861,342.00	29,861,342.00	0.00
2. Active Installations--Environmental Closure Requirements	0.00	195,176,594.00	195,176,594.00	0.00
3. Active Installations--Environ. Response at Active Ranges	0.00	0.00	0.00	0.00
4. Other	0.00	0.00	0.00	0.00
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	0.00	1,079,256,000.00	1,079,256,000.00	1,068,659,000.00
2. BRAC Installations--ER for Transferring Ranges	0.00	65,236,000.00	65,236,000.00	55,216,000.00
3. BRAC Installations--Environmental Corrective Action	0.00	0.00	0.00	0.00
4. Other	0.00	0.00	0.00	0.00
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0.00	6,742,200,000.00	6,742,200,000.00	6,426,100,000.00
2. Nuclear Powered Submarines	91,700,000.00	6,103,800,000.00	6,195,500,000.00	5,694,200,000.00
3. Other Nuclear Powered Ships	96,300,000.00	236,000,000.00	332,300,000.00	223,900,000.00
4. Other National Defense Weapons Systems	2,300,000.00	438,411,701.25	440,711,701.25	261,136,086.25
5. Chemical Weapons Disposal Program	0.00	0.00	0.00	0.00
6. Other	0.00	0.00	0.00	0.00
2. Total Environmental Liabilities	$ 723,810,000.00	$ 17,534,734,637.25	$ 18,258,544,637.25	$ 17,007,808,086.25

Fluctuation and/or Abnormalities

Other Accrued Environmental Costs (Non-DERP funds).

DON reported an increase of $29,861 thousand, 100 percent for Other Accrued Environmental Costs (Non-DERP funds) Active Installations-Environmental Corrective Action (line 1.B.1) and $195,177 thousand, 100 percent, for Active Installations---Environmental Closure Requirements (line 1.B.2) in 1st Quarter FY 2006. This increase is attributed to the Marine Corps completing their survey at the end of FY 2005 and estimations of Marine Corps environmental liabilities of closure requirements for on-going operations. Under the DON Financial Improvement Plan (FIP), the Navy currently is surveying installations to identify the inventory of units and estimates for environmental liabilities associated with closure requirements of on-going operations.

Base Realignment and Closure (BRAC).
DON reported a net increase of $10,020 thousand, 18 percent, for BRAC Installations Environmental Restoration for Transferring Ranges (Line 1.C.2) in 1st Quarter FY 2006. The net increase is attributed to an increase in the projects' cost to complete (CTC) estimates for the current operating period.

Environmental Disposal for Weapon Systems.
The DON reported an overall increase of $108,400 thousand, 48 percent, for Other Nuclear Powered Ships (Line 1.D.3) in 1st Quarter FY 2006. Two factors attributed to the increase in the liability estimate. (1) An increase in the labor rates and cost of materials used in the disposal process. The source for labor rates and cost of materials is the annual escalation guidance. (2) The discovery that the environmental liability was decreased when obligations were made for the disposal project rather than when the actual disposal project was completed. The accounting process was corrected during 1st Quarter FY 2006.

For Other National Defense Weapons Disposal Program (Line 1.D.4) the DON reported an overall increase of $179,576 thousand, 69 percent, in 1st Quarter FY 2006. The majority of the increase is attributable to recognizing the environmental liability for active conventional ships during 1st Quarter FY 2006.

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

Accrued Environmental Restoration (DERP Funded) Cost Liabilities.
The DON Environmental Restoration (Department of Defense Environmental Restoration Program) includes those sites that have been identified as legacy cleanup sites. For 1st Quarter FY 2006, the DON estimated and reported $3,178,303 thousand for environmental restoration liabilities. This amount is comprised of $2,618,652 thousand in Active Installations - Environmental Restoration (ER) liabilities and $559,651 thousand in Active Installations – ER for Closed Ranges, liabilities, which represents Unexploded Ordnance (UXO). The DoD FMR, Volume 6B, Chapter 10 requires that "any estimate produced must be based on site specific information and use cost models validated in accordance with DoD Instruction 5000.61." The DON is supporting this requirement by continuing to validate its range inventory as well as by pursuing the process of obtaining valid cost estimates for each range.

Other Accrued Environmental Costs (Non-DERP funds).
The DON defines Non-DERP environmental sites as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retrofill, and/or disposal of PCB transformers, underground storage tank remedial investigation and closure. A component of the DON FIP is to survey, identify, estimate, and provide an inventory of Non-DERP sites throughout the DON. The milestone for this action is to be completed by 4th Quarter FY 2006. The Marine Corps has completed its survey of on-going operations and their total liability for Non-DERP environmental liabilities is $225,038 thousand.

Base Realignment and Closure (BRAC).
BRAC environmental sites are environmental sites at DON installations that are or will be closed under the Base Realignment and Commission process. For 1st Quarter FY 2006, the DON estimated and reported $1,144,492 thousand for BRAC funded environmental restoration liabilities. This amount includes $1,079,256 thousand for environmental restoration (ER) and $65,236 thousand for ER transferring ranges, which includes military munitions, chemical residues from military munitions, and munitions scrap at locations on or associated with a military range on a BRAC installation.

Environmental Disposal for Weapons Systems Programs.
Environmental Disposal for Weapon Systems are those estimates associated with the environmental disposal costs for the DON nuclear weapons programs that includes Nuclear Powered Aircraft Carriers, Nuclear Powered Submarines and Other Nuclear Powered Ships and conventional ships. The DON reported an environmental disposal liability for Weapons Systems Programs of $13,710,712 thousand in 1st Quarter FY 2006. This amount includes nuclear powered aircraft carriers of $6,742,200 thousand, nuclear powered submarines of $6,195,500 thousand, other nuclear powered ships of $332,300 thousand and other national defense weapons systems of $440,711 thousand.

Methodology Used to Estimate Environmental Liabilities
Accrued Environmental Restoration (DERP Funded) Costs.
Active Installations – Environmental Restoration (ER): Accrued restoration (cleanup) liabilities represent the cost to correct past environmental areas that are funded under the Defense Environmental Restoration Program in accordance with "Management Guidance for the DERP," and "Environmental and Non-Environmental Liabilities", Chapter 13 of Volume 4 of the DoD FMR. These liabilities relate to PP&E, including acquired land and Stewardship Land, as those major asset categories are described in Chapter 6 of Volume 4 of the DoD FMR. Environmental restoration activities may be conducted at operating installations, at FUDS, at Closed, Transferred, and Transferring Ranges. Environmental restoration measurements involve the use of cost estimates that consider, on a current cost basis, the anticipated costs of the level of effort required to affect the restoration, as well as applicable legal and/or regulatory requirements. Program management and support costs are included in the estimates. The estimates are based on the DON's cost-to-complete (CTC) module of the DON Normalization of Data System (NORM). Certification of the CTC module was completed in FY 2002. Such cost estimates are based on the current technology available. Site inventory and estimated cost data prepared for the DERP report to the Congress was used by the DON as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services). The Accrued Environmental Restoration (Cleanup) Costs do not include the costs of environmental compliance; pollution prevention, conservation activities, contamination or spills associated with current operations, or treaty obligations, all of which are accounted for as part of ongoing operations. The DON Environmental Restoration (ER, N) Program includes 3,692 clean-up sites while those installations covered by Base Realignment and Closure (BRAC) funding includes 1,057 clean-up sites.

Active Installations – Environmental Restoration For Closed Ranges: This represents the environmental liabilities associated with the identification, investigation and removal and remedial actions to address environmental contamination at ranges that were closed prior to September 30, 2002. The contamination may include munitions, chemical residues from military munitions and munitions scrap at ranges on active installations that pose a threat to human health or the environment. The amount reported is the portion of the liability that can be estimated based on site level investigations and characterizations. The estimate produced is based on site-specific information and use of cost models validated in accordance with DoD Instruction 5000.61, "DoD Modeling and Simulation (M&S) Verification, Validation, and Accreditation (VV&A)" of May 2003. Total liabilities (cost-to-complete) are not estimated until there is sufficient site-specific data available to estimate the total liability. Beginning in FY 2001, the Department began an inventory of closed ranges and transferring ranges under the Military Munitions Response Program (MMRP) or UXO program. The inventory was completed September 2002 and contains 208 closed ranges at active installations and 19 transferring ranges at BRAC sites.

Additional Disclosures.

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

The DON defines environmental cleanup associated with general property, plant, and equipment as Non-DERP. As part of the action of the DON FIP, the Department contracted with several environmental vendors to survey, estimate, and establish a database of DON sites associated with cleanup associated with general property, plant, and equipment.

Therefore, the DON does not have any amount to report for the estimated and the unrecognized portion of the total estimated cleanup costs associated with general property, plant, and equipment for the current period and prior periods. The DON expects to have the estimates completed 4th Quarter, FY 2006.

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

For the DERP/BRAC programs a survey data of the Department of the Navy Environmental Restoration Program cost estimate changes for sites that had over 10 percent change indicated diverse reasons for change in estimates. The reasons for changes include estimation changes (26 percent), regulatory changes (60 percent), and technical changes (15 percent). Reasons for changes in estimation are as follows: cost-to-complete (CTC) overlooked or previously unknown, better site characterization with sampling, cost avoidance rerun CTC, re-estimation based on different assumptions and/or escalation, and re-estimation of costs based on lessons learned. Reasons for changes in the regulatory area include: addition of range rule/munitions requirements, additional or extended long-term monitoring requirements or 5 year reviews, no further action agreement with regulator, and risk based corrective action. Reasons for changes in the technical area include: additional contamination level reduction with sampling, additional or extended remedial action operation, additional sites and incomplete site data, and changes in technical solutions.

References and Significant Laws

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

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

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

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

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

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

Note 15. Other Liabilities

As of December 31	2006 Current Liability	2006 Noncurrent Liability	2006 Total	2005 Total
1. Intragovernmental				
A. Advances from Others	$ 31,305,082.00	$ 0.00	$ 31,305,082.00	$ 31,447,000.00
B. Deposit Funds and Suspense Account Liabilities	226,574,988.60	0.00	226,574,988.60	177,735,897.66
C. Disbursing Officer Cash	262,715,377.03	0.00	262,715,377.03	267,275,552.03
D. Judgment Fund Liabilities	0.00	0.00	0.00	0.00
E. FECA Reimbursement to the Department of Labor	266,121,381.71	337,976,134.90	604,097,516.61	590,874,575.67
F. Other Liabilities	3,160,353,625.21	0.00	3,160,353,625.21	2,697,891,910.51
G. Total Intragovernmental Other Liabilities	$ 3,947,070,454.55	$ 337,976,134.90	$ 4,285,046,589.45	$ 3,765,224,935.87
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 481,968,098.50	$ 0.00	$ 481,968,098.50	$ 227,165,887.24
B. Advances from Others	218,289,158.09	0.00	218,289,158.09	0.00
C. Deferred Credits	0.00	0.00	0.00	0.00
D. Deposit Funds and Suspense Accounts	0.00	0.00	0.00	0.00
E. Temporary Early Retirement Authority	0.00	0.00	0.00	698,631.00
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	17,752,488.34	1,429,988,753.81	1,447,741,242.15	563,131,599.81
(2) Excess/Obsolete Structures	53,783,000.00	182,114,000.00	235,897,000.00	343,324,000.00
(3) Conventional Munitions Disposal	0.00	0.00	0.00	0.00
(4) Other	0.00	0.00	0.00	0.00
G. Accrued Unfunded Annual Leave	2,179,200,169.93	0.00	2,179,200,169.93	2,469,288,105.36
H. Capital Lease Liability	112,784.16	0.00	112,784.16	59,232.74
I. Other Liabilities	140,294,050.83	27,730,762.77	168,024,813.60	217,374,738.53
J. Total Nonfederal Other Liabilities	$ 3,091,399,749.85	$ 1,639,833,516.58	$ 4,731,233,266.43	$ 3,821,042,194.68
3. Total Other Liabilities	$ 7,038,470,204.40	$ 1,977,809,651.48	$ 9,016,279,855.88	$ 7,586,267,130.55

Fluctuation and/or Abnormalities

Intragovernmental Other Liabilities.

Deposit Funds and Suspense Account Liabilities (Line 1.B): The DON reported an increase of $48,839 thousand, 27 percent, in 1st Quarter FY 2005. An increase of $46,358 thousand in the Pay of the Marine Corps Deposit Fund (Treasury symbol 6026) constituted the bulk of the fluctuation.

Disbursing Officer Cash (Line 1.C): The overall decrease of $4,560 thousand, 2 percent, is reflective of an increase of $53,859 thousand in Foreign Currency related to the Marine Corps Expeditionary Forces, Camp Lejeune, depositing money into a Limited Depositary Account in 2nd Quarter FY 2005. This Limited Depositary Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds. The increase in Foreign Currency was offset by a decrease of $58,419 thousand, 22 percent, in Cash held by various Disbursing Officers.

Other Liabilities (Line 1.F): The variance of $462,462 thousand or 17 percent, on this line can be attributed to non-entity receivables for which the DON, as these receivables cannot be used in normal operations, is liable to Treasury. A receivable of $342,329 thousand that was classified in FY 2005 as "currently not collectible", and thus was not reported as a non-entity receivable, is being reported as an active receivable in FY 2006. Additionally, a misclassification in the 1st Quarter FY 2005 Treasury Report on Receivables has since been corrected. This correction added $121,118 thousand to reported balances.

Nonfederal Other Liabilities.
Accrued Funded Payroll and Benefits (Line 2.A): Accrued Funded Payroll and Benefits increased $254,802 thousand, 112 percent, in 1st Quarter FY 2006. The Marine Corps began to recognize Accrued Payroll in Other Liabilities in 4th Quarter FY 2005.

Advances from Others (Line 2.B): Advances from Others increased $218,289 thousand, 100 percent, in 1st Quarter FY 2006 due to a process change whereby DON began recognizing unearned revenue on the balance sheet.

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

Military Equipment (Non-nuclear) (Line 2.F.1): this line increased $884,610 thousand, 157 percent, in 1st Quarter FY 2006. The increase is attributable to recognizing a non-environmental liability for active conventional, i.e., non- nuclear ships.

Excess/ Obsolete Structures (Line 2.F.2): the liability for Excess/ Obsolete Structures decreased $107,427 thousand, 31 percent, in 1st Quarter FY 2006 which is reflective of revised estimates for demolition costs in future years.

Capital Leases Liability (Line 2.H): Capital Leases Liability increased $54 thousand, 90 percent, in 1st Quarter FY 2006. While three leases expired in 4th Quarter FY 2005, one new lease was reported in 1st Quarter FY 2006.

Intragovernmental Other Liabilities:

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

	As of December 31, 2005
Liability to Treasury & Others	$3,062,220
Unemployment	72,690
Employment Benefit	25,444
Total Intragovernmental Other Liabilities	$3,160,354

With respect to the major fiduciary balances, the DON must reconcile with the Department of Labor and the Office of Personnel Management. In 1st Quarter FY 2006, the DON reported the following Intragovernmental Fiduciary liabilities: $604,098 thousand in FECA, $72,690 thousand in Unemployment, $25,444 thousand in Employment Benefit.

Nonfederal Other Liabilities:

Other Liabilities - Other (Line 2.I.) includes $125,854 thousand Contract Holdbacks and $42,171 thousand Contract Incentives.

Capital Lease Liability

As of December 31	2006				2005
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due					
A. 2006	$ 0.00	$ 112,784.16	$ 0.00	$ 112,784.16	$ 59,232.74
B. 2007	0.00	0.00	0.00	0.00	0.00
C. 2008	0.00	0.00	0.00	0.00	0.00
D. 2009	0.00	0.00	0.00	0.00	0.00
E. 2010	0.00	0.00	0.00	0.00	0.00
F. After 5 Years	0.00	0.00	0.00	0.00	0.00
G. Total Future Lease Payments Due	$ 0.00	$ 112,784.16	$ 0.00	$ 112,784.16	$ 59,232.74
H. Less: Imputed Interest Executory Costs	0.00	0.00	0.00	0.00	0.00
I. Net Capital Lease Liability	$ 0.00	$ 112,784.16	$ 0.00	$ 112,784.16	$ 59,232.74
2. Capital Lease Liabilities Covered by Budgetary Resources				$ 112,784.16	$ 0.00
3. Capital Lease Liabilities Not Covered by Budgetary Resources				$ 0.00	$ 59,232.74

4. Other Information Related to Capital Lease Liability

Fluctuation and/or Abnormalities

The DON reported an increase of $54 thousand, 90 percent, in Capital Lease liability in 1st Quarter FY 2006. While three leases expired in 4th Quarter FY 2005, one new lease was reported in 1st Quarter FY 2006.

Other Disclosures

The liabilities associated with capital leases are captured in legacy systems and are not consistently recorded in the accounting system. The DON has recognized a liability equal to the net value of the assets (i.e. gross value less accumulated amortization). The resulting liability was recorded as a payment due in FY 2006. The proper breakout of future payments to appropriate years will be done when a process for capturing lease liabilities is implemented.

Note 16. Commitments and Contingencies

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

For fiscal year 2005, the DON General Fund materiality threshold for reporting litigation, claims, or assessments was $53.2 million. The materiality threshold for FY 2006 has not yet been set. Legal actions affecting the DON include those for civil and environmental litigation, claims, and assessments. Based on information contained in the Legal Representation Letters, management does not have sufficient reason to believe that it is likely that the Government will be liable for the maximum amounts claimed.

The DON currently has 20 cases that meet the existing FY 2005 materiality threshold. However, DON legal counsel was unable to express an opinion concerning the likely outcome of these cases. The Legal Representation Letters will be updated in the 4th Quarter FY 2006.

Other Commitments and Contingencies
No further disclosures required.

Note 17. Military Retirement Benefits and Other Employment Related Actuarial Liabilities

As of December 31	2006							2005	
	Actuarial Present Value of Projected Plan Benefits		Assume Interest Rate (%)	(Less: Assets Available to Pay Benefits)		Unfunded Actuarial Liability		Unfunded Actuarial Liability	
1. Pension and Health Benefits									
A. Military Retirement Pensions	$	0.00		$	0.00	$	0.00	$	0.00
B. Military Retirement Health Benefits		0.00			0.00		0.00		0.00
C. Military Medicare-Eligible Retiree Benefits		0.00			0.00		0.00		0.00
D. Total Pension and Health Benefits	$	0.00		$	0.00	$	0.00	$	0.00
2. Other									
A. FECA	$	1,532,819,451.36		$	0.00	$	1,532,819,451.36	$	1,575,815,538.46
B. Voluntary Separation Incentive Programs		0.00			0.00		0.00		0.00
C. Military Medicare-Eligible Retiree Benefits		0.00			0.00		0.00		0.00
D. Total Other	$	1,532,819,451.36		$	0.00	$	1,532,819,451.36	$	1,575,815,538.46
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$	1,532,819,451.36		$	0.00	$	1,532,819,451.36	$	1,575,815,538.46

Actuarial Cost Method Used:
Assumptions:
Market Value of Investments in Market-based and Marketable Securities:

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

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

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

<u>Federal Employees Compensation Act (FECA).</u>
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 at the end of each fiscal year. The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment

patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

FY 2006
4.528 percent in Year 1
5.020 percent in Year 2 and thereafter

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

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPIM
2006	3.33%	4.09%
2007	2.93%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.01%
2010+	2.40%	4.01%

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

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

	Personnel	Allocation %
DON General Fund	105,930	56%
DON Working Capital Fund	82,020	44%
Total	187,950	100%

Voluntary Separation Incentive (VSI) Program.

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

DoD Education Benefits Fund.

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

Note 18. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue As of December 31		2006		2005
1. Intragovernmental Costs	$	11,514,401,927.25	$	7,600,417,235.84
2. Public Costs		20,226,609,583.39		19,380,674,503.83
3. Total Costs	$	31,741,011,510.64	$	26,981,091,739.67
4. Intragovernmental Earned Revenue	$	(620,331,355.39)	$	(457,585,417.31)
5. Public Earned Revenue		(428,001,526.55)		(930,857,830.32)
6. Total Earned Revenue	$	(1,048,332,881.94)	$	(1,388,443,247.63)
7. Net Cost of Operations	$	30,692,678,628.70	$	25,592,648,492.04

Net Costs of Operations

The DON reported an increase of $5,100,030 thousand, 20 percent, in the Net Cost of Operations in 1st Quarter FY 2006. Intragovernmental Earned Revenue increased $162,746 thousand or 36 percent. Public Earned Revenue decreased $502,856 thousand or 54 percent. Intragovernmental Costs increased $3,913,985 thousand or 52 percent while Public Costs increased $845,935 thousand or 4 percent.

Intergovernmental Costs

Intragovernmental Costs increased $3,913,985 thousand, 52 percent, in 1st Quarter FY 2006. These costs are driven by DON's trading partners' seller side revenue. Since DON accounting systems cannot necessarily identify expenses as Intragovernmental or Public, a process was developed to match reported expenses to the revenue of DON's seller trading partners. Expenses are initially identified as Public. When DON's intergovernmental expenses are recognized in the trading partner elimination process expenses are reclassified to match to DON's trading partners.

Intergovernmental expense included $3,438,847 thousand for new Military Personnel appropriations attributable to the Medicare Eligible Retiree Health Care Fund. The appropriated amounts were expended in 1st Quarter FY 2006.

Public Costs

Public Costs increased $845,935 thousand, 4 percent, in 1st Quarter FY 2006.

Intergovernmental Earned Revenue

Intragovernmental Earned Revenue increased $162,746 thousand, 36 percent, in 1st Quarter FY 2006. The following table summarizes the increases/ (decreases) in activity with DON's trading partners

Army General Fund	$122,086
Other Defense Organizations, General Fund	51,162
Navy Working Capital Fund	43,241
Other Defense Organizations, Working Capital	(62,838)
Multiple Federal Agencies (combined)	9,094
Total	$162,746

Public Earned Revenue

Public Earned Revenue decreased $502,856 thousand, 54 percent, in 1st Quarter FY 2006. This was a result of MILCON real property asset capitalization which decreased $550,985 thousand.

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

As of December 31	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	$ 0.00	$ 0.00	$ 0.00	$ 0.00
B. Errors and Omissions in Prior Year Accounting Reports	0.00	0.00	0.00	0.00
C. Total Prior Period Adjustments	$ 0.00	$ 0.00	$ 0.00	$ 0.00
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 51,972,672.66	$ 0.00	$ 54,349,009.05	$ 0.00
B. Civilian Health	81,407,326.00	0.00	78,872,987.50	0.00
C. Civilian Life Insurance	243,561.69	0.00	234,736.39	0.00
D. Judgment Fund	6,531,506.51	0.00	4,430,498.40	0.00
E. IntraEntity	0.00	0.00	0.00	0.00
F. Total Imputed Financing	$ 140,155,066.86	$ 0.00	$ 137,887,231.34	$ 0.00

Disclosures

Imputed Financing.
The amounts the Department of Defense remits to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System (CSRS), the Federal Employees' Retirement System (FERS), the Federal Employees' Health Benefits (FEHB) program, and the Federal Employees' Group Life Insurance (FEGLI) program do not fully cover the government's cost to provide these benefits. An imputed cost is recognized as the difference between the government's cost of providing these benefits to employees and the Agency’s contributions for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for the computation of imputed financing costs. These costs are provided by DFAS to the Office of the Under Secretary of Defense (Personnel and Readiness) for validation and approval. The approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Judgment Fund.
Treasury provided information related to amounts paid for Judgment Fund liabilities under the Contracts Dispute Act and the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR Act) on behalf of the DON, which the DON is required to repay. Judgment Fund payments

made out of the following Treasury appropriations does not require reimbursement and therefore represent imputed financing to the DON: 20X1740 and 20X1742. Only those payments made from Treasury appropriation 20X1743 and that portion of 20X1741 that is related to the No FEAR Act are required to be repaid by DON.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of December 31	2006	2005
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 73,541,307,229.79	$ 81,033,592,641.54
2. Available Borrowing and Contract Authority at the End of the Period	0.00	0.00

3. Other Information Related to the Statement of Budgetary Resources

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

The difference of $4,502 thousand between the SBR Appropriations Received and the Statement of Change of Net Position (SOCNP) Appropriations Received is due to the Trust Funds and Special Receipt Accounts, USSGL 4114, not being included in the Appropriations Received line of the SOCNP.

Other Disclosures

On the SBR: Obligations Incurred includes $30,600,436 thousand of Direct Program Obligations and $3,351,388 thousand of Reimbursable Program Obligations.

On the SF-133 Report on Budget Execution:
Direct Obligations, Category A, amounts apportioned quarterly, are $15,756,926 thousand.
Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are $15,992,078 thousand.
Total Direct Obligations are therefore $31,749,005 thousand.
Category B Reimbursable Obligations, exempt from apportionment, are $1,872,267 thousand.

SF-133 Total Direct Obligations are $1,148,568 greater than those reported on the SBR.
SF-133 Total Reimbursable Obligations are $1,479,121 less than those reported on the SBR.
The SF-133 obligation grand total therefore is $330,553 thousand less than the SBR obligation grand total.

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

DON has two permanent, indefinite appropriations.

National Defense Sealift Fund.

The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet (NDRF) including the acquisition, alteration or conversion of vessels built in U.S. shipyards for the NDRF. Thus far in FY 2006, no transfers from the NDSF have occurred.

Environmental Restoration, Navy.

Environmental Restoration, Navy (ER, N) is a transfer account that funds environmental restoration, reduction and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds are to remain available until transferred, and remain available for the same purpose and same time period as the appropriations to which transferred. Thus far in FY 2006, no transfers from ER, N have occurred.

Note 21. Disclosures Related to the Statement of Financing

Fluctuation and/or Abnormalities

Budgetary data is not in agreement with proprietary expenses and assets capitalized. This fact causes a difference in net cost between the Statement of Net Cost and the Statement of Financing. Adjustments are posted to the Statement of Financing for these differences. Thus far in FY 2006, an adjustment of ($513,310) thousand was made to line 15 of the Statement of Financing so that proprietary accounts reconcile with the budgetary accounts. This alignment was made per the Office of the Under Secretary of Defense (Comptroller) guidance.

Other Disclosures

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

The Statement of Financing is presented as combined or combining statements rather than consolidated statements due to intragovernmental transactions not being eliminated. Adjustments in funds which are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the “Adjustments” line on the Statement of Budgetary Resources), are not included in “Spending Authority From Offsetting Collections and Adjustments” line on the Statement of Budgetary Resources or on the Statement of Financing. The Statement of Financing was expanded to further articulate and detail the relationship between new obligations from budgetary accounting and net cost of operations from proprietary accounting.

Note 22.	Disclosures Related to the Statement of Custodial Activity

Not Applicable

Note 23.	Earmarked Funds

BALANCE SHEET As of December 31		MRF		MERHCF		Other Earmarked Funds		Total Earmarked Funds
ASSETS								
Fund balance with Treasury	$	0.00	$	0.00	$	14,811,030.27	$	14,811,030.27
Investments		0.00		0.00		9,467,413.77		9,467,413.77
Accounts and Interest Receivable		0.00		0.00		0.00		0.00
Other Assets		0.00		0.00		0.00		0.00
Total Assets	$	0.00	$	0.00	$	24,278,444.04	$	24,278,444.04
LIABILITIES and NET POSITION								
Military Retirement Benefits and Other Employment Related Actuarial Liabilities	$	0.00	$	0.00	$	0.00	$	0.00
Other Liabilities		0.00		0.00		486,050.84		486,050.84
Unexpended Appropriations		0.00		0.00		2,218,618.41		2,218,618.41
Cumulative Results of Operations		0.00		0.00		20,833,231.08		20,833,231.08
Total Liabilities and Net Position	$	0.00	$	0.00	$	23,537,900.33	$	23,537,900.33
STATEMENT OF NET COST As of December 31								
Program Costs	$	0.00	$	0.00	$	7,312,768.05	$	7,312,768.05
Less Earned Revenue		0.00		0.00		0.00		0.00
Net Program Costs	$	0.00	$	0.00	$	7,312,768.05	$	7,312,768.05
Less Earned Revenues Not Attributable to Programs		0.00		0.00		0.00		0.00
Net Cost of Operations	$	0.00	$	0.00	$	7,312,768.05	$	7,312,768.05
STATEMENT OF CHANGES IN NET POSITION As of December 31								
Net Position Beginning of the Period	$	0.00	$	0.00	$	25,868,936.58	$	25,868,936.58
Net Cost of Operations		0.00		0.00		7,312,768.05		7,312,768.05
Other Nonexchange Revenue		0.00		0.00		4,495,680.96		4,495,680.96
Change in Net Position	$	0.00	$	0.00	$	(2,817,087.09)	$	(2,817,087.09)
Net Position End of Period	$	0.00	$	0.00	$	23,051,849.49	$	23,051,849.49

Fluctuation and/or Abnormalities

Earmarked funds are required to be reported and disclosed separately from other funds beginning 1st Quarter FY 2006. For the DON General Fund, a reclassification to the new earmarked funds reporting attribute was performed, beginning balances were transferred from the previous attributes, and the status of the earmarked funds is displayed in this Note to the financial statements.

General Disclosures

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 that are categorized as Special Funds and three that as categorized as Trust Funds. A list of these earmarked funds and a brief description of each follows below.

<u>Special Earmarked Funds</u>

Wildlife Conservation, Military Reservations, Navy
This fund 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 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.

Roosmoor Liquidating Trust Settlement Account
The Roosmoor 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 Roosmoor Liquidating Trust are deposited into this account. The monies are made available to the 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 the 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.

<u>Trust Earmarked Funds</u>

Department of the Navy 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 they 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 the Department of the Navy.

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

US 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 they used for the benefit, or in connection with the United States Naval Academy, or the Naval Academy Museum, its collections, or its services.

Note 24. Other Disclosures

As of December 31	2006 Asset Category			
	Land and Buildings	Equipment	Other	Total
1. ENTITY AS LESSEE- Operating Leases				
Future Payments Due				
Fiscal Year				
2006	$ 17,788,273.00	$ 1,500.00	$ 0.00	$ 17,789,773.00
2007	18,456,670.00	0.00	0.00	18,456,670.00
2008	19,150,224.00	0.00	0.00	19,150,224.00
2009	19,273,039.00	0.00	0.00	19,273,039.00
2010	19,992,719.00	0.00	0.00	19,992,719.00
After 5 Years	0.00	0.00	0.00	0.00
Total Future Lease Payments Due	$ 94,660,925.00	$ 1,500.00	$ 0.00	$ 94,662,425.00

Fluctuations and/or Abnormalities

Although a comparative column is not displayed, the DON reported a decrease of $9,461 thousand, 9 percent, in Operating Leases Future Payment in 1st Quarter FY 2006. The decrease is due to the ongoing effort to validate operating leases throughout the Navy shore establishment.

Definitions

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

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

Other Disclosure

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