Department of Defense
Department of the Navy
CONSOLIDATED BALANCE SHEET
As of June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated Restated
1. ASSETS (Note 2)		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	$ 131,123,946,672.93	$ 120,383,759,450.59
b. Non-Entity Seized Iraqi Cash	0.00	0.00
c. Non-Entity-Other	409,391,194.46	303,434,085.81
2. Investments (Note 4)	9,753,140.08	9,498,371.45
3. Accounts Receivable (Note 5)	225,486,464.94	293,985,590.94
4. Other Assets (Note 6)	438,743,936.20	765,852,983.15
5. Total Intragovernmental Assets	$ 132,207,321,408.61	$ 121,756,530,481.94
B. Cash and Other Monetary Assets (Note 7)	$ 200,050,887.44	$ 325,341,481.13
C. Accounts Receivable,Net (Note 5)	3,712,414,863.93	3,196,733,785.80
D. Loans Receivable (Note 8)	0.00	0.00
E. Inventory and Related Property,Net (Note 9)	57,697,348,630.00	56,324,101,571.90
F. General Property, Plant and Equipment,Net (Note 10)	180,474,528,834.35	175,352,190,495.62
G. Investments (Note 4)	0.00	0.00
H. Other Assets (Note 6)	7,350,320,603.62	7,517,848,007.65
2. TOTAL ASSETS	$ 381,641,985,227.95	$ 364,472,745,824.04
3. LIABILITIES (Note 11)		
A. Intragovernmental:		
1. Accounts Payable (Note 12)	$ 912,685,044.48	$ 1,575,510,680.11
2. Debt (Note 13)	0.00	0.00
3. Other Liabilities (Note 15 & 16)	4,309,672,454.23	3,947,092,332.22
4. Total Intragovernmental Liabilities	$ 5,222,357,498.71	$ 5,522,603,012.33
B. Accounts Payable (Note 12)	$ 1,848,382,712.67	$ 1,404,401,966.01
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)	17,441,819,053.05	17,127,094,316.25
E. Loan Guarantee Liability (Note 8)	0.00	0.00
F. Other Liabilities (Note 15 & Note 16)	3,664,091,547.25	4,634,262,713.24
4. TOTAL LIABILITIES	$ 29,709,470,263.04	$ 30,264,177,546.29
5. NET POSITION		
A. Unexpended Appropriations - Earmarked Funds (Note 23)	$ 1,701,333.14	$ 0.00
B. Unexpended Appropriations - Other Funds	134,549,881,710.54	118,225,814,035.75
C. Cumulative Results of Operations - Earmarked Funds	16,134,727.09	0.00
D. Cumulative Results of Operations - Other Funds	217,364,797,194.14	215,982,754,242.00
6. TOTAL NET POSITION	$ 351,932,514,964.91	$ 334,208,568,277.75
7. TOTAL LIABILITIES AND NET POSITION	$ 381,641,985,227.95	$ 364,472,745,824.04

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF NET COST
For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
1. Program Costs		
A. Gross Costs	$ 96,261,457,173.05	$ 86,458,576,927.32
B. (Less: Earned Revenue)	(2,576,743,681.58)	(4,645,083,956.07)
C. Net Program Costs	$ 93,684,713,491.47	$ 81,813,492,971.25
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	$ 93,684,713,491.47	$ 81,813,492,971.25

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated Restated
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 (+/-)	18,480,000,000.00	17,974,000,000.00
3. Beginning balances, as adjusted	211,000,090,780.13	206,144,325,142.74
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	709,818.23	0.00
4.D.2 All other Funds	99,483,845,299.06	91,184,229,578.80
4.E. Nonexchange revenue		
4.E.1 Earmarked funds	402,201.93	0.00
4.E.2 All other funds	0.00	148,797.64
4.F. Donations and forfeitures of cash and cash equivalents		
4.F.1 Earmarked funds	11,939,007.35	0.00
4.F.2 All other funds	0.00	18,762,231.45
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 (+/-)	143,833,072.34	16,819,360.27
5.C. Imputed financing from costs absorbed by others	424,825,233.66	431,962,102.35
5.D. Other (+/-)	0.00	0.00
6. Total Financing Sources		
6.A. Earmarked funds	13,051,027.51	0.00
6.B. All other funds	100,052,503,605.06	91,651,922,070.51
7. Net Cost of Operations (+/-)		
7.A. Earmarked funds	20,474,085.63	0.00
7.B. All other funds	93,664,239,405.84	81,813,492,971.25
8. Net Change		
8.A. Earmarked funds	(7,423,058.12)	0.00
8.B. All other funds	6,388,264,199.22	9,838,429,099.26
9. Ending Balances		
9.A. Earmarked funds	16,134,727.09	0.00
9.B. All other funds	217,364,797,194.14	215,982,754,242.00

Department of Defense

Department of the Navy

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
10. Total all funds	$ 217,380,931,921.23	$ 215,982,754,242.00

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended June 30, 2006 and 2005

	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	145,478,219,000.00	130,972,538,000.00
4.B. Appropriations transferred-in/out (+/-)	1,028,977,000.00	26,878,101.00
4.C. Other adjustments (rescissions, etc) (+/-)	(2,211,033,522.00)	(751,146,000.00)
4.D. Appropriations used		
4.D.1 Earmarked Funds	(709,818.23)	0.00
4.D.2 All other Funds	(99,483,845,299.06)	(91,184,229,578.80)
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	(609,818.23)	0.00
6.B. All other funds	44,812,317,178.94	39,064,040,522.20
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	(609,818.23)	0.00
8.B. All other funds	44,812,317,178.94	39,064,040,522.20
9. Ending Balances		
9.A. Earmarked funds	1,701,333.14	0.00
9.B. All other funds	134,549,881,710.54	118,225,814,035.75

Department of Defense

Department of the Navy

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
10. Total all funds	$ 134,551,583,043.68	$ 118,225,814,035.75

Department of Defense
Department of the Navy
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended June 30, 2006 and 2005

	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	3,749,810,369.42	8,210,518,970.63
3. Budget authority		
3.A. Appropriation	145,490,670,523.08	130,991,667,354.34
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	5,499,511,583.18	6,816,917,741.41
3.D.1.b. Change in receivables from Federal sources	(384,998,169.94)	293,198,767.49
3.D.2 Change in unfilled customer orders		
3.D.2.a. Advance received	76,285,265.52	68,515,821.90
3.D.2.b. Without advance from Federal sources	1,914,887,632.25	1,905,946,803.34
3.D.3. Anticipated for rest of year, without advances	21,592,330.81	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	152,617,949,164.90	140,076,246,488.48
4. Nonexpenditure transfers, net, anticipated and actual	1,028,977,000.00	26,878,101.00
5. Temporarily not available pursuant to Public Law	0.00	0.00
6. Permanently not available	(2,211,033,522.00)	(751,146,000.00)
7. Total Budgetary Resources	$ 172,314,181,903.60	$ 165,590,492,946.52

Department of Defense

Department of the Navy

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the periods ended June 30, 2006 and 2005

	2006 Combined	2005 Combined
Status of Budgetary Resources:		
8. Obligations incurred:		
8.A. Direct	$ 114,846,609,068.73	$ 110,112,400,517.52
8.B. Reimbursable	3,528,943,000.59	9,726,538,914.97
8.C. Subtotal	118,375,552,069.32	119,838,939,432.49
9. Unobligated balance:		
9.A. Apportioned	51,475,801,459.65	43,230,552,086.71
9.B. Exempt from apportionment	51,886.19	0.00
9.C. Subtotal	51,475,853,345.84	43,230,552,086.71
10. Unobligated balance not available	2,462,776,488.44	2,521,001,427.32
11. Total status of budgetary resources	$ 172,314,181,903.60	$ 165,590,492,946.52
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 (+/-)	$ 118,375,552,069.32	$ 119,838,939,432.49
14. Less: Gross outlays	(104,558,499,356.14)	(98,442,265,541.06)
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	(3,749,810,369.42)	(8,210,518,970.63)
17. Change in uncollected customer payments from Federal sources (+/-)	(1,529,889,462.31)	(2,199,145,570.83)
18. Obligated balance, net, end of period		
18.A. Unpaid obligations	82,160,429,127.02	80,382,919,236.88
18.B. Less: Uncollected customer payments (+/-) from Federal sources (-)	(4,930,703,316.18)	(5,539,686,235.82)
18.C. Total, unpaid obligated balance, net, end of period	77,229,725,810.84	74,843,233,001.06
Net Outlays		
19. Net Outlays:		
19.A. Gross outlays	104,558,499,356.14	98,442,265,541.06
19.B. Less: Offsetting collections	(5,575,796,848.70)	(6,885,433,563.31)
19.C. Less: Distributed Offsetting receipts	(60,054,232.80)	(75,660,614.77)
19.D. Net Outlays	$ 98,922,648,274.64	$ 91,481,171,362.98

Department of Defense
Department of the Navy
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended June 30, 2006 and 2005

	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 June 30, 2006 and 2005

	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 June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ 118,375,552,069.32	$ 119,838,939,432.49
2. Less: Spending authority from offsetting collections and recoveries (-)	(10,855,496,680.43)	(17,295,098,104.77)
3. Obligations net of offsetting collections and recoveries	107,520,055,388.89	102,543,841,327.72
4. Less: Offsetting receipts (-)	(60,054,232.80)	(75,660,614.77)
5. Net obligations	107,460,001,156.09	102,468,180,712.95
Other Resources		
6. Donations and forfeitures of property	0.00	0.00
7. Transfers in/out without reimbursement (+/-)	143,833,072.34	16,819,360.27
8. Imputed financing from costs absorbed by others	424,825,233.66	431,962,102.35
9. Other (+/-)	0.00	0.00
10. Net other resources used to finance activities	568,658,306.00	448,781,462.62
11. Total resources used to finance activities	$ 108,028,659,462.09	$ 102,916,962,175.57
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 (-)	(9,900,952,814.09)	(21,407,002,277.72)
12b. Unfilled Customer Orders	1,991,172,897.77	1,974,462,625.24
13. Resources that fund expenses recognized in prior periods	(950,704,842.98)	(146,670,300.68)
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	171,637,079.02	0.00
15. Resources that finance the acquisition of assets	(12,450,937,283.76)	(8,682,134,511.74)
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 (+/-)	(143,833,072.34)	(16,819,360.27)
17. Total resources used to finance items not part of the net cost of operations	$ (21,283,618,036.38)	$ (28,278,163,825.17)
18. Total resources used to finance the net cost of operations	$ 86,745,041,425.71	$ 74,638,798,350.40

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF FINANCING
For the periods ended June 30, 2006 and 2005

	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	54,620,236.71	160,847,700.93
20. Increase in environmental and disposal liability	225,037,936.00	988,553,913.00
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 (+/-)	75,705,240.16	85,304,521.93
24. Total components of Net Cost of Operations that will require or generate resources in future periods	355,363,412.87	1,234,706,135.86
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	7,150,849,614.47	10,456,854,620.03
26. Revaluation of assets or liabilities (+/-)	1,554,176,698.90	(1,518,723,157.64)
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0.00	(242.63)
27b. Cost of Goods Sold	0.00	0.00
27c. Operating Material & Supplies Used	(2,112,458,725.16)	(2,983,434,285.04)
27d. Other	(8,258,935.32)	(14,708,449.73)
28. Total components of Net Cost of Operations that will not require or generate resources	6,584,308,652.89	5,939,988,484.99
29. Total components of net cost of operations that will not require or generate resources in the current period	$ 6,939,672,065.76	$ 7,174,694,620.85
30. Net Cost of Operations	$ 93,684,713,491.47	$ 81,813,492,971.25

Note 1.	Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON) General Fund (GF), as required by the "Chief Financial Officers (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 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 DON GF is responsible. Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernable.

The DON is unable to fully implement all elements of GAAP and OMB Circular A-136 due to limitations of its financial management processes and systems, and nonfinancial systems and processes that feed into the financial statements. The DON derives its reported values and information for major asset and liability categories, largely from nonfinancial 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 DON currently has four auditor identified financial statement material weaknesses: (1) accuracy and complete reporting of accounts payable, (2) identifying and reporting environmental disposal liabilities, (3) military equipment reporting, and (4) valuation of inventory and operating materials and supplies.

Fiscal year (FY) 2006 represents the eleventh year that DON has prepared audited financial statements as required by CFO Act and 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 Department of the Navy (DON) is to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression and maintaining freedom of the seas.

1.C. Appropriations and Funds

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

General funds are used for financial transactions funded by congressional appropriations, including personnel, operations 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 DON General Fund'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 fund accounts are used to process government receipts reserved for a specific purpose.

Deposit funds are used to record amounts held temporarily until ownership is determined. The DON is acting as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

Certain special and trust funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. 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 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.

OMB Circular A-136 provides guidance for reporting Parent-Child (Allocation) Transfer accounts. As the recipient of allocations from parent accounts, DON has determined that the allocation transfers are not material to its financial statements.

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 1000	Medicare Eligible Retiree Health Care Fund, Military Personnel Navy
17 1001	Medicare Eligible Retiree Health Care Fund, Military Personnel Marine Corps

17 1002	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Navy
17 1003	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Marine Corps
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, Navy Reserve
17 1236	Payments to Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17 1319	Research, 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 and Conversion, Navy
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement, Navy

Revolving Funds

17 4557	National Defense Sealift Fund, Navy

Earmarked Trust Funds

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

Earmarked Special Funds

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

General Fund Receipt, Deposit, Suspense, and Clearing Accounts

17 1XXX	Receipt Accounts
17 3XXX	Receipt Accounts
17X6XXX	Deposit Funds

Parent-Child (Allocation) Transfer Accounts

17 47X0535	Embassy Security, Defense Relocation Program, State Department
17 11 1081	International Military Education and Training Funds, appropriated to the President
17 11X1081	International Military Education and Training Funds, appropriated to the President
17 11 1082	Foreign Military Financing Program Funds appropriated to the President
17 12X1105B	State and Private Forestry, Forest Service
17 69X8083	Federal-Aid Highways (Liquidation of Contract Authorization), Federal Highway Administration

1.D. Basis of Accounting

For FY 2006, DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of 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 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 GAAP. One such action is the revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until all of DON's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DON's financial data will be largely based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, 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. Revenues and Other Financing Sources

The DON receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The DON recognizes revenue as a result of costs incurred or services provided to other Federal agencies and the public. Full cost pricing is DON's standard policy for services provided as required by OMB Circular A-25, “Transmittal Memorandum #1, User Charges.” The DON recognizes revenue 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 counties 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 DON’s financial and nonfinancial 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. The DON’s 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. 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 DON, within DoD, or between two or more federal agencies. However, DON cannot consistently and accurately identify all of its intragovernmental transactions by customer because DON’s accounting systems do not track all buyer and seller data needed to match related transactions. For the DON GF, the Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions and balances between components or activities of DON. Seller entities within DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra-DoD intragovernmental balances are eliminated when DoD financial statements are prepared. The DON properly eliminates the revenue resulting from intra-DoD sales of capitalized assets. 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 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 DON is unable to fully reconcile all intragovernmental transactions with all federal partners, 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. The federal government does not apportion debt and its related costs 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, DON sells defense articles and services to foreign governments and international organizations under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the 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 disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U. S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the 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 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 records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between DON's recorded balance in 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 DON, 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.

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 adjustments to the original obligation amount at the time of payment. The DON does not separately identify foreign currency fluctuations.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for doubtful accounts due form the public are based upon analysis of collection experience by fund type. 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 4 CFR 101).

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.

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

Most of DON's Inventory and Related Property are currently reported at an approximation of historical cost using latest acquisition cost (LAC) adjusted for holding gains and losses. The DON uses LAC and other methods as its inventory systems were designed for material management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain the historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, DON has transitioned, and is continuing to transition the inventory to the Moving Average Cost (MAC) method. At this point, DON is unable to determine the value of OM&S that is being reported using MAC methodology. Further, since the on-hand balances which transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS No. 3 and GAAP.

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 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, DON does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future use" based on SFFAS No. 3 definitions.

Related property includes operating materials and supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DON uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. Where current systems cannot fully support the consumption method, DON uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2006, DON expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user.

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

The DON recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore the net value of condemned material is zero. Potentially redistributed material, 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.

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

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

The DON invests in nonmarketable securities. The two types of nonmarketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues nonmarketable par value intragovernmental securities. Nonmarketable, 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," establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The Standard provided for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost information is not practical. The DON used Bureau of Economic Analysis (BEA) to calculate the value of the military equipment for reporting periods from October 1, 2002 through March 31, 2006.

Effective for reporting periods beginning after March 31, 2006, DON is replacing the BEA estimation methodology with an estimation methodology based on DON internal records. The DON initially identified the universe of military equipment by meeting with program managers to gather information relating to program funding and associated military equipment, equipment useful life, and program acquisitions and disposals. The military equipment baseline is updated using expenditure information, information from acquisition and logistics personnel to identify acquisitions and disposals.

The DoD is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property, Plant and Equipment (PP&E) to one that is specific for each individual category.

The capitalization threshold was revised from $100,000 to $20,000 for real property. The DON has not implemented the $20,000 real property capitalization threshold yet pending an evaluation of real property systems, processes, and procedures that will have to be revised in order to implement the lowered threshold. The current $100,000 capitalization threshold remains unchanged for the remaining General PP&E categories.

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

Prior to fiscal year 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 financial statements in fiscal year 1998.

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

The DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, DON reports only government property in the possession of contractors that is maintained in DON's property systems. The DoD has issued new property accountability and reporting requirements that requires DON to maintain, in its 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

The DON records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. The DON recognizes advances and prepayments as expenses when it receives the related goods and services.

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) 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 market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The DON deems the use of estimates for these costs as adequate and appropriate due to the low dollar value of capital leases. The DON as the lessee receives the use and possession of the leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all of the benefits or risks of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space and leases entered into by DON are the largest components 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 where feasible.

1.R. Other Assets

The DON conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DON provides financing payments. 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 on the Balance Sheet and in the related note.

The Federal Acquisition Regulation (FAR) allows DON to make financing payments under fixed price contracts. The DON reports these financing payments as advances or prepayments as "Other Assets" because 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, DON is not obligated to reimburse the contractor for its costs and the contractor is liable to repay 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. The DON recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The DON's loss contingencies arise 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 DON's assets. This type of liability has two components - nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of the asset based upon DoD's policy, which is consistent with SFFAS No.5 "Accounting for Liabilities of Federal Government." The DON recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed in service. Such amounts are developed in conjunction with, and not easily identifiable separately from, environmental disposal costs.

1.T. Accrued Leave

The DON reports as liabilities civilian annual leave and military leave that has been accrued and not used as of the Balance Sheet date. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

Net Position consists of Unexpended Appropriations and Cumulative Results of Operations.

Unexpended Appropriations represent the amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not 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). Beginning with FY 1998, 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 overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The DON purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow DON continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any nonretrievable capital assets. This takes place after negotiations between U.S. and the host country have determined 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 two percent of total assets on the Balance Sheet or greater than ten percent from the prior period presented 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 by other agencies or entities that have not been recorded in the DON's accounting records. These payments are applied to the DON's 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 DON's accounts receivable balance.

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

1.Z. Data Collection Approach

The DON financial statements include information from both financial systems and nonfinancial 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 nonfinancial feeder systems through a data call process and submits it to DFAS-CL and DFAS-KC for incorporation into the financial statements. For FY 2006, DON is utilizing a web-based data collection instrument (DCI) that captures certain 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. The DON is transitioning the data collection process to the Defense Departmental Reporting System (DDRS) Data Collection Module (DCM). When the transition to DCM is complete, the stand-alone DCI legacy application will be terminated.

Note 2. Nonentity Assets

As of June 30	2006	2005
1. Intragovernmental Assets		
A. Fund Balance with Treasury	$ 409,391,194.46	$ 303,434,085.81
B. Accounts Receivable	0.00	0.00
C. Total Intragovernmental Assets	$ 409,391,194.46	$ 303,434,085.81
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ 200,050,887.44	$ 325,341,481.13
B. Accounts Receivable	3,109,066,281.82	2,675,734,311.36
C. Other Assets	0.00	0.00
D. Total Nonfederal Assets	$ 3,309,117,169.26	$ 3,001,075,792.49
3. Total Nonentity Assets	$ 3,718,508,363.72	$ 3,304,509,878.30
4. Total Entity Assets	$ 377,923,476,864.23	$ 361,168,235,945.74
5. Total Assets	$ 381,641,985,227.95	$ 364,472,745,824.04

Fluctuation and/or Abnormalities
The DON reported in increase in Total Nonentity Assets (Line 3) of $414.0 million, 13%, in 3rd Quarter, FY 2006 which is primarily attributed to accounts receivable as described below.

Nonfederal Assets.
Nonentity Nonfederal Accounts Receivable (Line 2.B): The DON reported an increase of $433.3 million, 16%. A receivable of $345.6 million that was classified in FY 2005 as "currently not collectible" was not reported as a nonentity receivable. The DON began reporting this as an active nonentity receivable in the 1st Quarter, FY 2006 due to a change in the litigation status.

Information Related to Nonentity Assets

Definitions
Entity accounts.
Assets that 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 3rd Quarter, FY 2006, DON holds $3.7 billion nonentity assets. These assets are not available for use by DON in its day-to-day operations but DON maintains stewardship

accountability and reporting responsibility. There are three categories of significant nonentity assets held by 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 3rd Quarter, FY 2006, the primary component of nonentity nonfederal accounts receivable is a principal amount of $1.3 billion, representing advance payments made to contractors, which remains in litigation and $1.2 billion 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 DON's use in normal operations. See Note 5 for additional information.

Note 3. Fund Balance with Treasury

As of June 30		2006		2005
1. Fund Balances				
A. Appropriated Funds	$	128,420,844,338.51	$	117,808,856,413.22
B. Revolving Funds		2,693,147,682.98		2,762,029,466.50
C. Trust Funds		7,636,671.30		12,370,891.21
D. Special Funds		2,317,980.14		0.00
E. Other Fund Types		409,391,194.46		103,936,765.47
F. Total Fund Balances	$	131,533,337,867.39	$	120,687,193,536.40
2. Fund Balances Per Treasury Versus Agency				
A. Fund Balance per Treasury	$	131,514,402,977.68	$	120,803,086,528.88
B. Fund Balance per DON		131,533,337,867.39		120,687,193,536.40
3. Reconciling Amount	$	(18,934,889.71)	$	115,892,992.48

Explanation of Reconciliation Amount:

(Amounts in thousands)	
Parent/ Child Allocation Accounts	$ 39,470
Invalid Program Years	5
Reconciling Difference with Treasury	(58,410)
Total Reconciling Amount	$(18,935)

Fund Balance per Treasury Calculation

(Amounts in thousands)	
Undisbursed Appropriation Account Trial Balance (FMS 6654)	$131,448,825
Receipt Account Trial Balance (FMS 6655 – IAS 613)	77,878
Less: 6655 Trust Funds Balances included in 6654	(12,151)
Less: 6655 Special Funds Balances included in 6654	(149)
Fund Balance Per Treasury	$ 131,514,403

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.

The Reconciling Difference with Treasury amount of $(58.4) million primarily represents differences in both expenditures and collections between the SF-133 Report on Budget Execution and its associated budgetary trial balances, and the Treasury ledgers.

Parent/child Allocation accounts includes Treasury symbol 1081, International Military Education and Training with $38.8 million, Treasury symbol 1082 Foreign Military Financing with $556.0 thousand, and Treasury symbol 1105B State and Private Forestry with $114.0 thousand. The DON, as the “child” is the recipient of these allocation transfers from other Federal agencies and has determined that the allocations are not material to the DON financial statements. The providing agency, as the “parent” is responsible for reporting the FBWT for these allocations.

Fluctuation and/or Abnormalities

Total Fund Balances (Line 1.F) increased by $10.8 billion, 9%. This increase is a direct reflection of increased appropriations of $14.5 billion received in FY 2006. Multi-year appropriations take longer to expend and these accounts showed increases. Fund balances increased in conjunction with appropriations received with Procurement showing a $6.7 billion increase and RDT&E showing a $1.9 billion increase in fund balances.

4. Other Information Related to Fund Balance with Treasury

Other Disclosures

Deposit Differences.

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

Intragovernmental Payments and Collections.

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

Status of Fund Balance with Treasury

As of June 30		2006		2005
1. Unobligated Balance				
A. Available	$	51,454,209,128.84	$	43,230,351,998.71
B. Unavailable		2,462,776,488.44		2,521,001,427.32
2. Obligated Balance not yet Disbursed	$	82,160,429,127.02	$	74,833,791,252.75
3. Nonbudgetary FBWT	$	396,217,413.49	$	0.00
4. NonFBWT Budgetary Accounts	$	(4,940,294,290.40)	$	0.00
5. Total	$	131,533,337,867.39	$	120,585,144,678.78

Other Information Related to Status of Fund Balance with Treasury

Fluctuation and/or Abnormalities

Unobligated, Available (Line 1.A) which represents budget authority that is currently available for new obligations increased $8.2 billion, 19%, in 3rd Quarter, FY 2006 due to increased appropriations received, primarily in multi-year appropriations. Unobligated, Unavailable (Line 1.B) represents budget authority that is expired and not generally available for new obligations. Line 2, Obligated Balance not yet Disbursed, increased $7.3 billion, 10%, in line with the increase in appropriations received. Expenditures represent the final phase of the budget execution cycle, and it is logical that increased multi-year budget authority translates into delayed expenditures. Lines 3 and 4 were not distinctly reported until 4th Quarter, FY 2005. Line 3 does not have budgetary representation and thus was not included in unexpended balances. Accounts included in Line 4 were previously mapped to Obligated Balance not yet Disbursed. Line 5, Total Fund Balance with Treasury, increased $10.9 billion, 9%.

Definitions

The Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the Status includes various accounts that affect either budgetary reporting or Fund Balance with Treasury, but not both.

Unobligated Balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated Balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Non-Budgetary Fund Balance with Treasury (FBWT) includes entity and nonentity Fund Balance with Treasury accounts that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect Fund Balance with Treasury, such as contract authority, borrowing authority and investment accounts. This category reduces the Status of Fund Balance with Treasury.

Other Disclosures
Unobligated, Unavailable balances are restricted to future use and are not apportioned for current use.

Disclosures Related to Suspense/Budget Clearing Accounts

As of June 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
Account				
F3845 – Personal Property Proceeds	$ 0.00	$ 0.00	$ 0.00	$ 0.00
F3875 – Disbursing Officer Suspense	(369,813,706.72)	(167,316,596.06)	7,711,619.93	175,028,215.99
F3880 – Lost or Cancelled Treasury Checks	(2,774,911.12)	4,836,041.89	3,632,473.15	(1,203,568.74)
F3882 – Uniformed Services Thrift Savings Plan Suspense	(15,172,193.33)	40,129,041.92	46,659,229.62	6,530,187.70
F3885 – Interfund/IPAC Suspense	(390,131,239.47)	(39,015,361.95)	(24,517,874.05)	14,497,487.90
F3886 – Thrift Savings Plan Suspense	2,737.44	(1,123,972.50)	1,292,636.05	2,416,608.55
Total	$ (777,889,313.20)	$ (162,490,846.70)	$ 34,778,084.70	$ 197,268,931.40

Fluctuation and/or Abnormalities

The total amount in Suspense/Budget Clearing Accounts increased $197.3 million, 121%, from the prior period credit balance, in 3rd Quarter, FY 2006. Account F3875 – Disbursing Officer Suspense increased $175.0 million from the prior period credit balance as a result of efforts to clear aged suspended transactions throughout FY 2006. This effort is part of the DON Financial Improvement Plan and includes an analysis of the types of inflows into the suspense accounts. Additionally, DON is establishing policies and procedures to ensure accurate and consistent use of these accounts.

Disclosures Related to Suspense/Budget Clearing Accounts

The F3882 suspense clearing account represents the primary source of the overall positive balance. Account F3882 reported a positive balance of $46.7 million. Account F3882 was established for the Uniformed Services Thrift Savings Plan in FY 2002. The balance in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these amounts in the military accounting systems in the following month.

The F3875 suspense account reported a positive balance of $7.7 million that represents the Disbursing Officer's (DO) suspense. Account F3885, that includes the Interfund/IPAC suspense, reported a negative balance of $24.5 million. Account F3886 has a positive balance of $1.3 million and represents the civilian Thrift Savings Plan suspense. These three suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

The F3880 suspense account reported a positive balance of $3.6 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

Other Disclosures

Other Information Related to Suspense/Budget Clearing Account.

In general, suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation. 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.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of June 30		2004		2005		2006		(Decrease)/ Increase from FY 2005 to 2006
1. Total Problem Disbursements, Absolute Value								
A. Unmatched Disbursements (UMDs)	$	1,279,000,000.00	$	2,184,564,605.19	$	1,664,145,704.52	$	(520,418,900.67)
B. Negative Unliquidated Obligations (NULO)		57,500,000.00		36,614,394.81		38,849,757.01		2,235,362.20
2. Total In-transit Disbursements, Net	$	72,168,000.00	$	732,845,091.95	$	422,551,704.04	$	(310,293,387.91)

Fluctuation and/or Abnormalities

Since 3rd Quarter, FY 2005 Unmatched Disbursements (UMDs) have decreased by $520.4 million or 24%. The DON and DFAS have partnered to reduce UMD balances and the 24% reduction is reflective of those efforts. In 2nd Quarter, FY 2005, DFAS-Cleveland expanded the scope of the definition of an 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 was the primary driver behind the increase from FY 2004 to FY 2005.

In-Transit Disbursements, Net decreased $310.3 million, 42%, since 3rd Quarter, FY 2005. This decrease reflects a concerted effort by DON and DFAS to identify systemic errors and implement corrective actions through synchronization of edit tables to validate data between systems.

In March 2006, DON submitted a plan of action and milestones to the Under Secretary of Defense (Comptroller) that describes how the DON will work in conjunction with DFAS to resolve aged problem disbursements.

Definitions

Unmatched Disbursements.

An Unmatched Disbursements (UMD) occurs when payments do not match to a corresponding obligation in the accounting system.

Negative Unliquidated Obligations.

A Negative Unliquidated Obligations (NULO) occurs 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 $422.6 million reported for DON General Fund, only $77.7 million, 18%, 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 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, 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 June 30	2006								
		Par Value / Cost	Amortization Method		Unamortized (Premium) / Discount		Investments, Net		Market Value Disclosure
1. Intragovernmental Securities									
A. Nonmarketable, Market-Based	$	9,624,000.00		$	51,120.25	$	9,675,120.25	$	9,675,120.25
B. Accrued Interest		78,019.83					78,019.83		78,019.83
C. Total Intragovernmental Securities	$	9,702,019.83		$	51,120.25	$	9,753,140.08	$	9,753,140.08
2. Other Investments									
A. Total Investments	$	0.00		$	0.00	$	0.00		N/A

As of June 30	2005								
		Par Value / Cost	Amortization Method		Unamortized (Premium) / Discount		Investments, Net		Market Value Disclosure
3. Intragovernmental Securities									
A. Nonmarketable, Market-Based	$	9,439,100.00		$	2,648.31	$	9,441,748.31	$	9,441,748.31
B. Accrued Interest		56,623.14					56,623.14		56,623.14
C. Total Intragovernmental Securities	$	9,495,723.14		$	2,648.31	$	9,498,371.45	$	9,498,371.45
4. Other Investments									
A. Total Investments	$	0.00		$	0.00	$	0.00		N/A

Fluctuation and/or Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

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 $9.8 million (including $78.0 thousand of accrued interest). These investments are Nonmarketable Market-Based U.S. Treasury 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,” DON Trust Funds are now classified and reported as earmarked funds.

Intragovernmental Investments in U.S. Treasury Securities.

The Federal government does not set aside assets to pay future benefits or other expenditures associated with DON's earmarked Trust Funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to DON as evidence of its receipts. Treasury securities are an asset to DON and a liability to the U.S. Treasury. Because 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 DON requires redemption of its Treasury securities held in 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 June 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 225,486,464.94	N/A	$ 225,486,464.94	$ 293,985,590.94
2. Nonfederal Receivables (From the Public)	$ 3,720,574,711.61	$ (8,159,847.68)	$ 3,712,414,863.93	$ 3,196,733,785.80
3. Total Accounts Receivable	$ 3,946,061,176.55	$ (8,159,847.68)	$ 3,937,901,328.87	$ 3,490,719,376.74

Information Related to Accounts Receivable

Fluctuation and/or Abnormalities

Intragovernmental Receivables.
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.

The DON reported a decrease of $68.5 million, 23%, in Intragovernmental Receivables in 3rd Quarter, FY 2006. A decrease of $84.7 million reported with Other Defense Organizations General Fund (Level Two), primarily with the Defense Health Program, was offset by increases of $15.1 million reported with the Department of Homeland Security (DHS) (Level One) and $11.6 million reported for the Navy Working Capital Fund (Level Two). The increase with DHS is related to work performed for Hurricane Katrina support.

Nonfederal Receivables.
Nonfederal receivables increased $515.7 million, 16%. A receivable of $345.6 million that was classified in FY 2005 as "currently not collectible," and thus was not reported as a nonentity receivable, is being reported as an active receivable beginning in 1st Quarter, FY 2006 due to a change in the status of litigation. Additionally, an increase of $65.0 million in accrued interest related to a case in litigation added to reported nonfederal receivable balances.

Allowance Method
Based upon an extensive analysis of historic public receivables, the allowance for 3rd Quarter, FY 2006 was determined to be $8.2 million.

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 collections. For 3rd Quarter, FY 2006, $697.1 million in undistributed collections was allocated to accounts receivable.

Elimination Adjustments.

The DON's accounting systems do not consistently capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, DON was unable to reconcile intragovernmental accounts receivable balances with its trading partners. Through the ongoing Business Transformation Agency effort, the Department intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations.

Intrafund transactions are eliminated based upon trading partner information obtained from the Naval Personnel Command, the Naval Air Systems Command Enterprise Resource Planning system, 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 June 30, 2006
Contract Litigation Principal and Interest	$2,571,096
Defense Debt Management System (DDMS)	110,026
CDS/MOCAS System Debts	426,477
In-service Debt and Other Debt	5,822
Gross Nonentity Nonfederal A/R	$3,113,421
Less Nonentity Allowance	(4,355)
Nonentity Nonfederal Receivables, Net	$3,109,066
Entity Nonfederal Receivables, Net	603,349
Nonfederal Receivables (From the Public), Net	$3,712,415

Aged Accounts Receivable

As of June 30	2006		2005	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
CATEGORY				
Nondelinquent				
Current	$ 630,466,520.74	$ 870,681,463.05	$ 508,614,134.47	$ 373,770,493.30
Noncurrent	34,685,776.00	98,638,561.00	38,222,848.00	102,957,347.00
Delinquent				
1 to 30 days	$ 1,538,310.69	$ 13,132,155.02	$ 0.00	$ 0.00
31 to 60 days	6,829,677.82	8,473,329.94	0.00	0.00
61 to 90 days	6,467,127.86	18,086,241.66	29,696,439.35	23,667,446.66
91 to 180 days	10,147,610.20	(3,092,175.03)	(16,576,506.81)	16,054,567.72
181 days to 1 year	8,845,967.60	33,385,906.80	28,089,302.62	16,746,170.70
Greater than 1 year and less than or equal to 2 years	3,687,557.21	40,525,439.68	93,224,890.27	104,299,559.65
Greater than 2 years and less than or equal to 6 years	32,149,025.05	61,530,462.96	41,361,034.22	31,058,123.90
Greater than 6 years and less than or equal to 10 years	259,431.00	363,164,000.08	248,009.00	355,166,884.54
Greater than 10 years	0.00	2,581,556,461.08	0.00	2,513,259,715.70
Subtotal	$ 735,077,004.17	$ 4,086,081,846.24	$ 722,880,151.12	$ 3,536,980,309.17
Less Supported Undistributed Collections	(332,354,128.58)	(365,507,134.63)	(384,219,011.92)	(303,782,984.06)
Less Eliminations	(177,236,410.65)	0.00	(12,378,994.41)	0.00
Less Other	0.00	0.00	(32,296,553.85)	(25,588,909.78)
Total	$ 225,486,464.94	$ 3,720,574,711.61	$ 293,985,590.94	$ 3,207,608,415.33

Nondelinquent Accounts Receivables are receivables outstanding for 30 days or less or those not yet due under the contract or billing document pertaining to the receivable. Current nondelinquent accounts receivable are those that are due in the next twelve months. Noncurrent nondelinquent accounts receivable are those amounts that are due beyond the next twelve months, and are valued at $133.3 million for 3rd Quarter, FY 2006. These accounts are not considered delinquent since the associated repayment schedules allow for repayment after a 30-day period. The DON is actively pursuing collection action on all accounts receivable in accordance with guidance in the DoD Financial Management Regulation, Volume 4, Chapter 3 and OMB Circular A-129 “Policies for Federal Credit Programs and Non-Tax Receivables”. It must be recognized that, in certain instances, the status of litigation impacts the ability of the DON to actively pursue collection action.

As displayed in the table above, the amounts reported for 3rd Quarter, FY 2005 are not directly comparable to those reported for 3rd Quarter, FY 2006. Primary reasons for this include:

The methodology used to calculate delinquent receivables has changed: in 3rd Quarter, FY 2005, when a receivable reached the age of 31 days, it was considered 31 days delinquent. In 3rd Quarter, FY 2006 a receivable reaching the age of 31 days is considered 1 day delinquent.

Aging categories have changes: in 3rd Quarter, FY 2005, a 1-90 day delinquent category was used. In 3rd Quarter, FY 2006 this category was broken out to display the 1-30, 31-60, and 61-90 day categories.

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 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.

Note 6. Other Assets

As of June 30		2006		2005
1. Intragovernmental Other Assets				
A. Advances and Prepayments	$	438,743,936.20	$	765,852,983.15
B. Total Intragovernmental Other Assets	$	438,743,936.20	$	765,852,983.15
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	$	6,887,491,255.65	$	7,096,785,955.27
B. Other Assets (With the Public)		462,829,347.97		421,062,052.38
C. Total Nonfederal Other Assets	$	7,350,320,603.62	$	7,517,848,007.65
3. Total Other Assets	$	7,789,064,539.82	$	8,283,700,990.80

Fluctuation and/or Abnormalities

Intragovernmental Other Assets.

The DON reported a decrease of $327.1 million, 43%, in Advances and Prepayments, (Line 1.A), in 3rd Quarter, FY 2006. The majority of the decrease was due to a $266.0 million decrease with the Navy Working Capital Fund (NWCF) (Trading Partner Level Two). To alleviate a cash shortage in FY 2005, NWCF Shipyards were granted authority to advance bill and through 3rd Quarter, FY 2005, DON advanced NWCF Shipyards $301.4 million for ship repairs. As the cash shortage was addressed, in FY 2006 NWCF Shipyards were only granted $92.5 million in advance billing authority and the level of advances provided by DON for ship repairs has declined to $35.4 million.

Nonfederal Other Assets

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

Information Related to Other Assets

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).

In general, the balances reported for advances are determined by the Intragovernmental elimination process as submitted by DON's trading partners. In processing the elimination data on a quarterly basis, increases to Advances and Prepayments are recorded to compensate for the unresolved differences when needed. For those trading partners who do not submit quarterly elimination data, DON records an estimate for advances. In 3rd Quarter, FY 2006, DON recorded an overall Level One estimate for advances in the amount of $256.0 million using historical data as a baseline.

Nonfederal Other Assets Other Assets (With the Public)- includes advance pay to DON military personnel, travel advances, and miscellaneous advances to contractors.

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, 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, DON is not obligated to reimburse the contractor for its costs and the contractor is liable to repay DON for the full amount of the outstanding contract financing payments.

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

(Amounts in thousands)	As of June 30, 2006
Aircraft Procurement	$3,907,714
Shipbuilding and Conversion	259,863
Weapons Procurement	1,073,298
Procurement, Marine Corps	519,808
O&M Marine Corps	2,793
Other Procurement	954,299
Other (O&M, RDT&E)	169,716
Total	$6,887,491

Note 7. Cash and Other Monetary Assets

As of June 30	2006	2005
1. Cash	$ 194,931,115.79	$ 239,593,502.87
2. Foreign Currency	5,119,771.65	85,747,978.26
3. Total Cash, Foreign Currency, & Other Monetary Assets	$ 200,050,887.44	$ 325,341,481.13

Fluctuation and/or Abnormalities

Total Cash, Foreign Currency and Other Monetary Assets (Line 3) decreased $125.3 million or 39%. This is reflective of a decrease of $80.6 million, 94%, in Foreign Currency. When the Marine Corps Expeditionary Forces, Camp Lejeune returned from an overseas deployment in 2nd Quarter, FY 2006, their Disbursing Officer dissolved the Limited Depositary Account that had been held in the National Bank of Kuwait. This Limited Depositary Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds. In addition, Cash held by DON Disbursing Officers decreased by $44.7 million, 19%. The amount of Disbursing Officer cash varies depending on the level of business activity they encounter. In general, through the use of debit cards and other cashless programs, DON is endeavoring to reduce the level of cash held by Disbursing Officers. The Navy CASH program, in which debit cards held by sailors are loaded with a cash value and can be used for purchases aboard ships, has demonstrated a reduction in cash held of up to 90%. Over the past year, over thirty Navy ships have transitioned to the Navy CASH program.

Definitions

Cash - the total of cash resources under the control of 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 nonpurchased 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, including foreign currency, are classified as nonentity, which means that the assets are not available for DON's use in normal operations. Therefore, all cash and other monetary assets, including foreign currency is restricted.

Other Disclosures

Cash and Foreign Currency 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 DoD Disbursing Officers, Statement of Accountability (Standard Form 1219).

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 June 30

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 June 30	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 June 30	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 June 30

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 June 30	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 June 30	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 June 30	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 June 30	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 June 30	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 June 30

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 June 30	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 June 30	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

Note 9. Inventory and Related Property

As of June 30	2006	2005
1. Inventory, Net	$ 0.00	$ 0.00
2. Operating Materials & Supplies, Net	57,697,348,630.00	56,324,101,571.90
3. Stockpile Materials, Net	0.00	0.00
4. Total	$ 57,697,348,630.00	$ 56,324,101,571.90

Inventory, Net

As of June 30	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 June 30	2006						2005		
	OM&S Gross Value		Revaluation Allowance		OM&S, Net		OM&S, Net		Valuation Method
1. OM&S Categories									
A. Held for Use	$	53,245,761,413.64	$	0.00	$	53,245,761,413.64	$	51,540,503,213.30	SP, LAC
B. Held for Repair		6,527,214,812.51		(2,075,627,596.15)		4,451,587,216.36		4,783,598,358.60	SP, LAC
C. Excess, Obsolete, and Unserviceable		547,321,360.95		(547,321,360.95)		0.00		0.00	NRV
D. Total	$	60,320,297,587.10	$	(2,622,948,957.10)	$	57,697,348,630.00	$	56,324,101,571.90	

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

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

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 June 30, 2006
Ammunition and Munitions	$ 35,162,109
Appropriation Purchase Account (APA) Principal End Item	8,347,337
Sponsor Owned Material	10,605,816
APA Secondary Inventory	1,059,152
Real-time Reutilization Asset Management (RRAM)	2,138,778
Other	384,157
Total	$ 57,697,349

Balances.

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

Decision Criteria For Identifying The Category To Which Operating Materials And Supplies Are Assigned.
In order to standardize reporting of the categories Held for Use; Held for Repair; and Excess, Obsolete and Unserviceable, DON implemented the Under Secretary of Defense (Comptroller) (USD(C)) condition code crosswalk as defined in the memorandum “Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies” dated August 12, 2002. In addition, the condition code crosswalk was amended to include code “V” in the Excess, Obsolete, Unserviceable category in September 2002. OM&S is reported as follows:

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

Valuation Method for OM&S.
On July 6, 2001, USD(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 a DoD Business Transformation Agency effort 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 material management systems are renovated or replaced. Until then, DON continues to value OM&S using different valuation methodologies such as standard purchase price or actual cost. These valuation methodologies vary by system.

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’s mission requirements for production, life cycle maintenance, and installation of systems and equipment consistent with the mission charter. The SOM material 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 consist primarily of Fleet Hospitals and War Reserve material in possession of the U.S. Coast Guard.

Stockpile Materials, Net

As of June 30	2006 Stockpile Materials Amount	2006 Allowance for Gains (Losses)	2006 Stockpile Materials, Net	2005 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 June 30	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	$ 606,521,677.00	N/A	$ 606,521,677.00	$ 623,230,664.00
B. Buildings, Structures, and Facilities	S/L	20 Or 40	33,852,166,585.00	$ (20,345,575,363.38)	13,506,591,221.62	14,276,993,099.79
C. Leasehold Improvements	S/L	lease term	7,514,035.00	(658,008.07)	6,856,026.93	210,440.00
D. Software	S/L	2-5 Or 10	3,817,887.44	(3,712,121.34)	105,766.10	273,565.79
E. General Equipment	S/L	5 or 10	2,725,486,332.40	(2,246,397,809.09)	479,088,523.31	486,054,266.05
F. Military Equipment	S/L	Various	302,230,000,000.00	(139,220,000,000.00)	163,010,000,000.00	156,414,000,000.00
G. Assets Under Capital Lease	S/L	lease term	114,695.76	(7,646.38)	107,049.38	0.00
H. Construction-in-Progress	N/A	N/A	2,865,258,570.01	N/A	2,865,258,570.01	3,551,428,459.99
I. Other			0.00	0.00	0.00	0.00
J. Total General PP&E			$ 342,290,879,782.61	$ (161,816,350,948.26)	$ 180,474,528,834.35	$ 175,352,190,495.62

[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

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

Other Information Related to General PP&E, Net

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

<u>Military Equipment.</u>

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 DON initially used data provided by the Bureau of Economic Analysis (BEA), Department of Commerce to disclose a value for military equipment. Effective for reporting periods beginning after March 31, 2006, the DON replaced the BEA estimation methodology with an estimation methodology based on internal records. The military equipment baseline is updated using internal records such as expenditure information and inputs from acquisition and logistic support personnel to identify acquisitions and disposals. The value of military equipment for the 3rd Quarter, FY 2005 was restated from $138.4 billion to $156.4 billion for comparative purposes using the new valuation method. See Note 19 for further disclosures. Military Equipment is valued at $163.0 billion based on internal records. Under the previously used BEA valuation methodology, this equipment would have been valued at $143.2 billion.

Property in the Possession of Contractors.
The value of 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 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 an approved strategy with Office of Management Budget (OMB), Government Accountability Office (GAO) and DoD Inspector General, DoD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with Federal General Accepted Accounting Principles (GAAP).

Heritage Assets and Stewardship Land.

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

Stewardship Policies for Heritage Assets and Description of Each Major Category of Heritage Assets.
The overall policy for 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 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 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.
- 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 DON is to control and maintain freedom of the seas; project power beyond the sea; and influence events and advance U.S. interests across the full spectrum of military operations. As this mission has been executed DON has 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 for or in connection with land, on which General Plant and Equipment is located. For 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
<u>Real Property.</u>
The Internet Naval Facility Asset Database Store (iNFADS) provides real property values for financial statement reporting purposes.

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

<u>Software.</u>

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

Construction-in-Progress (CIP).
The CIP balances were obtained from the Facilities Information System (FIS). Data on construction that is performed for the benefit of 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. The balances of 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. A milestone of the DON Financial Improvement Plan (FIP) is to reconcile with DoD activities and to ensure that the DON real property database recognizes the preponderant user. As these efforts are completed and reconciliations are documented, DON General Fund will make the adjustments to the General Property, Plant and Equipment line.

Assets Under Capital Lease

As of June 30	2006	2005
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	$ 0.00	$ 0.00
B. Equipment	114,695.76	106,944.00
C. Accumulated Amortization	(7,646.38)	(106,944.00)
D. Total Capital Leases	$ 107,049.38	$ 0.00

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

Note 11. Liabilities Not Covered by Budgetary Resources

As of June 30	2006		2005	
1. Intragovernmental Liabilities				
A. Accounts Payable	$	0.00	$	0.00
B. Debt		0.00		0.00
C. Other		3,678,637,735.13		3,258,037,783.68
D. Total Intragovernmental Liabilities	$	3,678,637,735.13	$	3,258,037,783.68
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		16,973,809,053.05		17,127,094,316.25
D. Other Liabilities		2,628,907,822.00		3,572,905,063.47
E. Total Nonfederal Liabilities	$	21,163,585,220.93	$	22,365,287,541.67
3. Total Liabilities Not Covered by Budgetary Resources	$	24,842,222,956.06	$	25,623,325,325.35
4. Total Liabilities Covered by Budgetary Resources	$	4,867,247,306.98	$	4,640,852,220.94
5. Total Liabilities	$	29,709,470,263.04	$	30,264,177,546.29

Fluctuation and/or Abnormalities

Intragovernmental Liabilities.
There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

Nonfederal Liabilities.
There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

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 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:

(Amounts in thousands)	As of June 30, 2006
Federal Employees' Compensation Act (FECA)	$491,392
Unemployment	78,180
Liabilities to Treasury	3,109,066
Total	$3,678,638

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.D.) includes the following:

(Amounts in thousands)	As of June 30, 2006
Annual Leave	$2,261,989
Military Equipment – Nonnuclear Non Environmental Disposal Liabilities	117,248
Disposal Liabilities for Excess/Obsolete Structures	182,114
Contract Incentives	67,557
Total	$2,628,908

Note 12. Accounts Payable

As of June 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
1. Intragovernmental Payables	$ 912,685,044.48	$ N/A	$ 912,685,044.48	$ 1,575,510,680.11
2. Nonfederal Payables (to the Public)	1,848,382,712.67	0.00	1,848,382,712.67	1,404,401,966.01
3. Total	$ 2,761,067,757.15	$ 0.00	$ 2,761,067,757.15	$ 2,979,912,646.12

4. Other Information Related to Accounts Payable

Fluctuation and/or Abnormalities

Intragovernmental Payables.
The DON reported a decrease of $662.8 million, 42%, in Intragovernmental payables in 3rd Quarter, FY 2006. The trading partner process largely drives the balances in Intragovernmental payables. 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 3rd Quarter, FY 2006 was $441.1 million. The Level One estimate is updated quarterly.

The majority of the decrease was with the following trading partners:

Intragovernmental Entities	Level	Amounts (in millions)
Office of Personnel Management	One	$431.2
General Services Administration	One	$109.4

The Level One estimate with the Office of Personnel Management (OPM) was overstated in 3rd Quarter, FY 2005 due to a compilation error which caused a material difference for the DON in that quarter. Subsequent correction of the overstated estimate using actual data from OPM is reflected in the variance of $431.2 million listed above. The decrease of $109.4 million with the General Services Administration, based on data submitted through the trading partner process, will be validated within the constraints of current system limitations.

Nonfederal Payables.
DON reported an increase of $444.0 million, 32%, in Nonfederal Accounts Payable in 3rd Quarter, FY 2006. The Marine Corps accounts show an increase of $520.9 million, 128%. This increase is a direct reflection of execution of funding received in May 2005 to support the Global War on Terror (GWOT). 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 not uncommon.

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 DON's accounting records. For 3rd Quarter, FY 2006, total supported undistributed disbursements were $1.4 billion.

Intragovernmental Elimination.

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

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

The 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

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 October 1, 2003. This law requires all agencies to reimburse the Judgment Fund for cases covered by the No FEAR Act. For 3rd Quarter, FY 2006, DON reported $375.5 thousand for No FEAR Act liabilities.

Note 13. Debt

As of June 30	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

Not applicable.

Note 14.	Environmental Liabilities and Disposal Liabilities

As of June 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
1. Environmental Liabilities-- Nonfederal				
A. Accrued Environmental Restoration Liabilities				
1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 385,659,000.00	$ 2,010,734,000.00	$ 2,396,393,000.00	$ 2,732,281,000.00
2. Active Installations—Military Munitions Response Program (MMRP)	82,351,000.00	639,368,000.00	721,719,000.00	556,538,000.00
3. Formerly Used Defense Sites—IRP and BD/DR	0.00	0.00	0.00	0.00
4. Formerly Used Defense Sites--MMRP	0.00	0.00	0.00	0.00
B. Other Accrued Environmental Liabilities—Active Installations				
1. Environmental Corrective Action	0.00	29,861,342.00	29,861,342.00	0.00
2. Environmental Closure Requirements	0.00	195,176,594.00	195,176,594.00	0.00
3. Environmental Response at Operational 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. Installation Restoration Program	0.00	1,197,128,825.00	1,197,128,825.00	1,096,052,000.00
2. Military Munitions Response Program	0.00	101,704,000.00	101,704,000.00	65,769,000.00
3. Environmental Corrective Action / Closure Requirements	0.00	66,552,352.00	66,552,352.00	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	5,604,268,445.64	5,604,268,445.64	6,426,100,000.00
2. Nuclear Powered Submarines	0.00	3,376,302,131.70	3,376,302,131.70	5,819,300,000.00
3. Other Nuclear Powered Ships	0.00	277,607,852.00	277,607,852.00	223,900,000.00
4. Other National Defense Weapons Systems	0.00	237,699,405.71	237,699,405.71	207,154,316.25
5. Chemical Weapons Disposal Program	0.00	0.00	0.00	0.00
6. Other	0.00	3,237,406,105.00	3,237,406,105.00	0.00
2. Total Environmental Liabilities	$ 468,010,000.00	$ 16,973,809,053.05	$ 17,441,819,053.05	$ 17,127,094,316.25

Fluctuation and/or Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

Other Category Disclosure

The only "Other" type of environmental liabilities that the Department of the Navy (DON) is currently reporting is Spent Nuclear Fuel (Line1.D.6). Per a Government Accountability Office audit recommendation, DON has begun to recognize the estimated environmental disposal liability associated with Spent Nuclear Fuel. Spent Nuclear Fuel is the used fuel that is removed from the nuclear reactors of nuclear powered ships and submarines. Beginning with 3rd Quarter, FY 2006, DON recognized the environmental liability associated with shipping, processing, and storing the spent nuclear fuel. The total liability for spent nuclear fuel is $3.2 billion. DON did not recognize a liability for spent nuclear fuel in FY 2005.

<u>Other Information Related to Environmental Liabilities</u>

1. Applicable Laws and Regulations of Cleanup Requirements

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

The National Environmental Policy Act (NEPA) of 1970 requires DON 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 (HSWA) of 1984, 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 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 Superfund Amendments and Reauthorization Act (SARA) of 1986. This amendment established procedures to ensure that actual or threatened hazardous substance releases have proper responses. The procedures address reporting, investigation, remedy selection, and responsive provisions. Another amendment to CERCLA was the Community Environmental Response Facilitation Act (CERF) of 1992. The DON 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 DON is still responsible for any remediation or corrective action or any response action found to be necessary after the transfer.

The Clean Water Act (CWA) of 1977, Section 405 Disposal of Sewage Sludge, amended the Federal Water Pollution Control Act. The purpose of CWA is to restore and maintain the integrity of the nation's waters. The CWA implementing regulations established closure and post closure requirements for sewage sludge disposal. To help protect the nation's drinking water supply, including underground injections through a permitting scheme, is the purpose of the Safe Drinking Water Act of 1974 (Well Head Protection Areas). The Clean Air Act (CAA) of 1990 established standards/limitations to prevent and control air pollutant discharges that could harm human health and natural resources. Requirements ensure that units can no longer operate when they are shutdown. Finally, the Toxic Substances Control Act (TSCA) of 1976 was implemented to understand the health risks of chemical substances by developing production and health risk data from the manufacturers. Based on the data, the Environmental Protection Agency has promulgated regulations for specific chemicals. The control of polychlorinated biphenyls (PCBs) is a good example. The control addresses spill cleanup and removal and disposal of units containing PCBs.

For the nuclear powered aircraft carriers and submarines, other nuclear powered ships, and spent nuclear fuel, the following significant laws affect DON'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, DON 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.

2. Methods for Assigning Total Cleanup Costs to Current Operating Periods
Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) Funded)) Liabilities. 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 DERP," and "Environmental and Non-Environmental Liabilities," Chapter 13 of Volume 4 of Department of Defense Financial Management Regulation (DoD FMR). These liabilities relate to Plant, Property and Equipment, including acquired land and Stewardship Land, as those major asset categories are described in Chapter 6 of Volume 4 of DoD FMR. Environmental restoration activities may be conducted at operating installations, at Formerly Used Defense Sites (FUDS), and 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 DON's cost-to-complete (CTC) module of DON Normalization of Data System (NORM). Verification, validation, and accreditation (VV&A) of CTC module was completed in FY 2002. Such cost estimates are based on the current technology available. The DON, as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services), used the site inventory and estimated cost data prepared for DERP report to the Congress. 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 3,927 clean-up sites while those installations covered by Base Realignment and Closure (BRAC) funding include 1,734 clean-up sites. The Marine Corps is included in DON Environmental Restoration and BRAC programs.

Active Installations – Military Munitions Response Program: This area 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, DON began an inventory of closed ranges and transferring ranges under the Military Munitions Response Program (MMRP) or Unexploded Ordnance (UXO) program. The inventory was completed September 2002 and currently contains 213 closed ranges at active installations and 19 transferring ranges at BRAC sites.

Environmental Disposal for Weapons Systems Programs: This area represents environmental liabilities associated with the Nuclear Powered Aircraft Carriers and Submarines, Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. During FY 2006, under DON Financial Improvement Program, DON completed a review of the estimating methodology for determining the cost for disposal of ships and submarines. This review resulted in an estimate, both environmental and nonenvironmental, that more accurately reflects the true costs of disposal. The estimating methodology is based on average cost per class of ship rather than an average applied to all ships regardless of class. This change in estimating methodology resulted in an overall decrease in the estimated environmental liability for nuclear powered ships and submarines and conventional ships in 3rd Quarter, FY 2006. However this decrease was offset by recognizing for the first time spent nuclear fuel during this reporting period.

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

Accrued Environmental Restoration (DERP Funded) Cost Liabilities.
The DON Environmental Restoration includes those sites that have been identified as legacy cleanup sites. For 3rd Quarter, FY 2006, DON estimated and reported $3.1 billion for environmental restoration liabilities. This amount is comprised of $2.4 billion in Active Installations - Environmental Restoration (ER) liabilities and $721.7 million in Active Installations – ER for Closed Ranges, liabilities, which represents 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 polychlorinated biphenyls (PCBs) transformers, underground storage tank remedial investigation and closure. A component of DON Financial Improvement Program is to survey, identify, estimate, and provide an inventory of Non-DERP sites throughout 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 is $225.0 million.

Base Realignment and Closure (BRAC).
BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated Base Realignment and Closure process. For 3rd Quarter, FY 2006, DON estimated and reported $1.4 billion for BRAC funded environmental restoration liabilities. This amount includes $1.2 billion for environmental restoration (ER) program, $66.6 million for environmental corrective action and closure requirements, and $101.7 million for the military munitions response program which includes military munitions, chemical residues from military munitions, and munitions scrap at locations on or associated 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 DON nuclear weapons programs that includes Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. The DON reported an environmental disposal liability for Weapons Systems Programs of $12.7 billion in 3rd Quarter, FY 2006. This amount includes nuclear powered aircraft carriers of $5.6 billion, nuclear powered submarines of $3.4 billion, other nuclear powered ships of $277.6 million, other national defense weapons systems of $237.7 million, and spent nuclear fuel (Other) of $3.2 billion.

4. Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to Inflation, Deflation, Technology, or Applicable Laws and Regulations
For both current and prior periods, the changes due to price growth (inflation) and increases in labor rates and materials have been offset by a change in the estimating methodology for weapons systems. This change in estimating methodology resulted in an overall decrease in the estimated environmental disposal liability. Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of 3rd Quarter, FY 2006, there are no changes to the environmental liability estimates due to changes in laws, regulations, and in agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

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

The environmental liabilities for DON are based on accounting estimates that require certain judgments and assumptions that DON believes are reasonable based upon information available to us at the time of calculating the estimates. The actual results may vary materially from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. The liabilities can be further impacted if further investigation of the environmental sites discloses contamination different than known at the time of the estimates.

Overall, DON 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 NORM System. A verification, validation, and accreditation was completed by a third party for CTC module of NORM, while the environmental program managers continue to validate the data. For the Weapons systems, the environmental program managers base their environmental disposal estimates on actual costs for similar projects. A change in the overall methodology in weapons systems reflects a more accurate estimate of what it will cost to dispose of the weapons systems. Given the fact that the planned date for opening the Department of Energy's (DOE) planned waste repository has been delayed, there is uncertainty associated with the estimate for spent nuclear fuel. As DOE's plans are solidified, DON's estimates for spent nuclear fuel may change accordingly.

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

Environmental Disclosures

As of June 30	2006	2005
A. Amount of operating and capital expenditures used to remediate legacy waste. Legacy wastes are the remediation efforts covered by IRP, MMRP, and BD/DR regardless of funding source.	301,341,000.00	265,955,000.00
B. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment.	1,365,782,860.00	0.00
C. The estimated cleanup costs associated with general property, plant, and equipment placed into service during each fiscal year.	0.00	0.00
D. Changes in total cleanup costs due to changes in laws, regulations, and/or technology.	0.00	0.00
E. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.	0.00	0.00

Explanations

Line A. The prior year only includes the Accrued Environmental Restoration Liabilities. There was no BRAC funding for FY 2005. For FY 2006, $4.9 million of the total $301.3 million is related to BRAC.

Line B. The unrecognized portion of the estimated total cleanup costs is associated with Nuclear Powered Carriers and Submarines, and Conventional Ships. Of the total, $36.0 million is associated with conventional ships while the remainder, $1.3 billion is associated with Nuclear Powered Carriers and Submarines. For FY 2005, DON was not accruing the liability as required by DoD FMR, Volume 4, and Chapter 13 and therefore did not have any unrecognized portion for Weapons Systems Programs environmental liability to report. For Other Environmental Liabilities (OEL) DON has not completed the survey and related estimates for those liabilities and therefore does not have an unrecognized portion to report for either FY 2006 or FY 2005. The survey is expected to be completed by 4th Quarter, FY 2006. For the Marine Corps, though they reported an estimate for OEL, they are in the process of determining what portion of OEL relates to units put into service after October 1, 1997 and therefore cannot provide the data at this time.

Line C. For FY 2005, DON recognized the entire environmental liability for Weapons Systems Programs. For FY 2006, DON did not place into service any new assets that have an environmental liability associated with the asset. For OEL, DON is still completing the survey and estimates for those liabilities and therefore does not have an amount to report for environmental liabilities associated with asset placed into service during FY 2006.

Lines D. and E. Through our quarterly data call process, DON determined that there are no changes to the environmental liability estimates due to changes in laws, regulations, in agreements with regulatory agencies, and advances in technology for both FY 2005 and FY 2006.

Note 15. Other Liabilities

As of June 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
1. Intragovernmental				
A. Advances from Others	$ 0.00	$ 0.00	$ 0.00	$ 31,447,000.00
B. Deposit Funds and Suspense Account Liabilities	409,391,194.46	0.00	409,391,194.46	264,429,016.39
C. Disbursing Officer Cash	200,050,887.44	0.00	200,050,887.44	325,341,481.13
D. Judgment Fund Liabilities	0.00	0.00	0.00	0.00
E. FECA Reimbursement to the Department of Labor	20,976,240.31	470,415,224.00	491,391,464.31	500,634,323.66
F. Other Liabilities	3,207,069,607.02	1,769,301.00	3,208,838,908.02	2,825,240,511.04
G. Total Intragovernmental Other Liabilities	$ 3,837,487,929.23	$ 472,184,525.00	$ 4,309,672,454.23	$ 3,947,092,332.22
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 491,238,582.15	$ 0.00	$ 491,238,582.15	$ 939,537,338.50
B. Advances from Others	227,499,843.75	0.00	227,499,843.75	810,942.39
C. Deferred Credits	0.00	0.00	0.00	0.00
D. Deposit Funds and Suspense Accounts	95,580,376.16	0.00	95,580,376.16	0.00
E. Temporary Early Retirement Authority	0.00	0.00	0.00	0.00
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	7,378,645.67	117,248,000.56	124,626,646.23	513,259,589.81
(2) Excess/Obsolete Structures	53,783,000.00	182,114,000.00	235,897,000.00	289,478,000.00
(3) Conventional Munitions Disposal	0.00	0.00	0.00	0.00
G. Accrued Unfunded Annual Leave	2,261,988,997.31	0.00	2,261,988,997.31	2,708,591,466.18
H. Capital Lease Liability	107,049.38	0.00	107,049.38	0.00
I. Other Liabilities	176,384,228.14	50,768,824.13	227,153,052.27	182,585,376.36
J. Total Nonfederal Other Liabilities	$ 3,313,960,722.56	$ 350,130,824.69	$ 3,664,091,547.25	$ 4,634,262,713.24
3. Total Other Liabilities	$ 7,151,448,651.79	$ 822,315,349.69	$ 7,973,764,001.48	$ 8,581,355,045.46

Fluctuation and/or Abnormalities

Intragovernmental Other Liabilities.

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

Nonfederal Other Liabilities.
The DON reported a decrease of $970.2 million, 21%, in Nonfederal Other Liabilities in 3rd Quarter, FY 2006. This decrease is attributed to the following factors:

Accrued Funded Payroll and Benefits (Line 2.A): the liability decreased $448.3 million, 48%, in 3rd Quarter, FY 2006. Based upon a trend analysis of the data, in 3rd Quarter, FY 2005, Accrued Payroll was overstated by approximately $420.0 million due to problems in the reconciliation of proprietary accounts payable and manual reporting processes. The overstatement in the previous reporting period is almost entirely responsible for the current variance of $448.3 million. The overstatement was corrected in 4th Quarter, FY 2005.

Military Equipment (Nonnuclear) (Line 2.F.1): the decreased liability of $388.6 million, 76%, reflects revised 3rd Quarter, FY 2006 estimates for nonenvironmental liabilities for the disposal of Navy ships. The Department of the Navy Financial Improvement Plan has an initiative underway at the Naval Sea Systems Command, who is responsible for the disposition of Navy ships, to review and update the methodologies used to estimate both environmental and non-environmental disposal costs of military equipment. The new methodology, rather than using a standard rate per (ship) ton, is based on cost factors and rates for each class of ship awaiting disposal.

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

(Amounts in thousands)	*As of June 30, 2006*
Liability to Treasury & Others	$3,110,689
Unemployment	79,949
Employment Benefit	18,201
Total Intragovernmental Other Liabilities	$3,208,839

Nonfederal Other Liabilities:

Other Liabilities - Other (Line 2.I.) includes $159.6 million Contract Holdbacks and $67.6 million Contract Incentives.

Capital Lease Liability

As of June 30	2006				2005
	Asset Category				
	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due					
A. 2006	$ 0.00	$ 107,049.38	$ 0.00	$ 107,049.38	$ 0.00
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. 2011	0.00	0.00	0.00	0.00	0.00
G. After 5 Years	0.00	0.00	0.00	0.00	0.00
H. Total Future Lease Payments Due	$ 0.00	$ 107,049.38	$ 0.00	$ 107,049.38	$ 0.00
I. Less: Imputed Interest Executory Costs	0.00	0.00	0.00	0.00	0.00
J. Net Capital Lease Liability	$ 0.00	$ 107,049.38	$ 0.00	$ 107,049.38	$ 0.00
2. Capital Lease Liabilities Covered by Budgetary Resources				$ 107,049.38	$ 0.00
3. Capital Lease Liabilities Not Covered by Budgetary Resources				$ 0.00	$ 0.00

4. Other Information Related to Capital Lease Liability

Fluctuation and/or Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

Other Disclosures

The liabilities associated with capital leases are captured in legacy systems and are not consistently recorded in the accounting systems. 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 (DON) is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON will accrue contingent liabilities for legal actions in those instances where the DON's Office of the General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from DON's resources, either directly or by reimbursement to the Judgment Fund. The DON records Judgment Fund liabilities in Accounts Payable, which are detailed in Note 12.

For fiscal year (FY) 2005, DON General Fund materiality threshold for reporting litigation, claims, or assessments was $53.2 million. The materiality threshold for FY 2006 has been set at $56.1 million. Based on information contained in the FY 2005 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 in individual or aggregated cases.

The DON currently has 20 cases that meet the existing FY 2005 materiality threshold. 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 using the new materiality threshold of $56.1 million.

Other Commitments and Contingencies

The DON has recorded a contingent liability in the amount of $28.0 million for obligations related to cancelled appropriations.

The DON has recorded a contingent liability in the amount of $67.6 million for Contract Incentives.

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

As of June 30	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. DoD Education Benefits Fund	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:

Fluctuation and/or Abnormalities
There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for 3rd Quarter, FY 2006.

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

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

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

Federal Employees' Compensation Act (FECA).
Actuarial Cost Method Used and Assumptions:

The DON's actuarial liability for workers' compensation benefits is developed by 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 % in Year 1
5.020 % 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%
Navy Working Capital Fund	82,020	44%
Total	187,950	100%

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

Intragovernmental Costs and Exchange Revenue As of June 30		2006		2005
1. Intragovernmental Costs	$	29,635,603,327.40	$	30,596,282,048.32
2. Public Costs		66,625,853,845.65		55,862,294,879.00
3. Total Costs	$	96,261,457,173.05	$	86,458,576,927.32
4. Intragovernmental Earned Revenue	$	(1,902,015,751.39)	$	(1,815,273,452.23)
5. Public Earned Revenue		(674,727,930.19)		(2,829,810,503.84)
6. Total Earned Revenue	$	(2,576,743,681.58)	$	(4,645,083,956.07)
7. Net Cost of Operations	$	93,684,713,491.47	$	81,813,492,971.25

Fluctuation and/or Abnormalities

Net Costs of Operations

The DON reported an increase in the Net Cost of Operations of $11.9 billion, 15% in 3rd Quarter, FY 2006. The pertinent changes are described below in the disclosure for Total Costs and Earned Revenue.

Total Costs

Total Costs increased $9.8 billion, 11% in 3rd Quarter, FY 2006. Public Costs increased $10.8 billion which represents the majority of the increase in Total Costs. The factors that caused the increase in Public Costs were:

- The DON accounting systems do not identify costs as Federal or Public. As a result, costs are classified as Public in the financial reporting process. As intragovernmental costs are identified in a seller side exchange of DoD and Federal Agency trading partner data, these costs are reclassified from Public to Intragovernmental. DON reclassified $4.5 billion less costs from Public to Intragovernmental resulting in an increase in Public costs in 3rd Quarter, FY 2006. From a buyer side perspective, DON did $1.8 billion less business with other Federal Agency trading partners through 3rd Quarter, FY 2006, including $1.6 billion less with General Service Administration and $178.9 million less with Department of Transportation. As DON accounting systems do not identify trading partners, the seller side data provided by other Federal Agencies is used to record DON's buyer side data, including cost data. In addition DON did less intra appropriation trading between appropriations (e.g., Navy to Navy and Marine Corps to Marine Corps – Level 6 trading partner) of $1.6 billion.
- Research, Development, Test and Evaluation (RDT&E) program expenditures increased $2.1 billion. Increases in RDT&E programs included Systems Development & Demonstration,

$922.7 million, Operational Systems Development, $225.1 million, Advanced Component Development, $44.3 million and RDT&E Management Support, $31.9 million.

- Costs associated with Procurement Programs increased $3.1 billion. Aircraft and Weapons Procurement programs include advance payments on contracts that were liquidated when aircraft and weapons systems were delivered.
- Losses associated with Real Property increased $1.6 billion due to revaluations and corrections in asset values in DON's real property data base.
- Operating Material and Supplies (OM&S), other than Ammunition and Munitions, used/consumed in operations increased $1.8 billion due to issuances and disposals of materials. The use of OM&S increases costs.
- Ammunition and Munitions restocking of $1.0 billion, reflecting a gradual return to normal inventory levels, caused a decrease in Public Costs.

<u>Total Earned Revenue</u>

Total Earned Revenue decreased $2.1 billion or 45%. The majority of the total decrease is in Public Earned Revenue which decreased $2.2 billion, 76%, in 3rd Quarter, FY 2006. The two major drivers behind the decrease in Public Earned Revenue were:

- Marine Corps real property additions decreased $589.0 million due to completion of construction projects and increased additions during FY 2005 that were not reflected in FY 2006.
- Navy Military construction real property asset capitalization decreased $959.0 million due to completion of construction projects and increased additions during FY 2005 that were not reflected in FY 2006.

Other Disclosures Related to the Statement of Net Cost

The FY 2005 total costs have not been restated for the FY 2005 portion of the net cost adjustment related to the prior period adjustment for military equipment. This adjustment will be incorporated into the 4th Quarter FY 2006 financial statements. Refer to Notes 10 and 19 for further disclosures.

Intragovernmental costs above are understated and public costs overstated by $71.7 million due to errors in the reporting of intragovernmental costs with the U.S. Postal Service. The errors will be corrected in 4th Quarter FY 2006.

Intragovernmental costs and revenues are related to transactions made between two reporting entities within the Federal Government.

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

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

The DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Generally Accepted Accounting Principles (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 DON's legacy systems were designed to record information on a budgetary basis. Considering these systems limitations, the DON is unable to compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental trading partners.

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 GAAP. One such action is the revision of its accounting systems to record transactions based on the US 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, DON's financial data will be largely based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

Heritage Asset Disclosure

The DON's accounting systems do not capture information relative to Heritage Assets separately and distinctly from normal operations. The DON has not had any transfers of heritage assets or any donations of heritage assets.

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

As of June 30	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	18,480,000,000.00	0.00	17,974,000,000.00	0.00
C. Total Prior Period Adjustments	$ 18,480,000,000.00	$ 0.00	$ 17,974,000,000.00	$ 0.00
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 162,018,983.75	$ 0.00	$ 171,154,385.15	$ 0.00
B. Civilian Health	244,220,832.00	0.00	235,478,733.00	0.00
C. Civilian Life Insurance	777,244.89	0.00	755,703.14	0.00
D. Judgment Fund	17,808,173.02	0.00	24,573,281.06	0.00
E. IntraEntity	0.00	0.00	0.00	0.00
F. Total Imputed Financing	$ 424,825,233.66	$ 0.00	$ 431,962,102.35	$ 0.00

Disclosures

The DON recorded $18.5 billion and $18.0 billion for the 3rd Quarter of FY 2006 and FY 2005, respectively, in a prior period adjustment for the reporting of military equipment. The DON, in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, reported military equipment using data available from the Bureau of Economic Analysis (BEA) on an interim basis. Effective for the reporting period beginning after March 31, 2006, the DON is replacing the BEA estimation methodology with a valuation based on internal DON records. The DON initially identified the universe of military equipment by meeting with program managers to gather information relating to program funding and associated military equipment, equipment useful life, and program acquisitions and disposals. The military equipment baseline is updated using expenditure information, and information from acquisition and logistics personnel to identify acquisitions and disposals. The DON considers this a correction of a material error as it was determined that the BEA estimates failed to consider disposals, thresholds, and construction in process, and thus was not compliant with generally accepted accounting principles (GAAP).

Appropriations Received on the Statement of Changes in Net Position (SOCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $12.5 million between the Statement of Changes in Net Position (SOCNP) Appropriations Received and the Statement of Budgetary Resources Appropriations Received is primarily due to the values for Trust Funds and Special Receipt Accounts in Appropriated Trust or Special Fund Receipts (USSGL 4114) not being included in the Appropriations Received line of SOCNP.

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 DoD reporting entities 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 DON, which 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 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 June 30	2006	2005
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 86,291,680,066.61	$ 84,466,731,849.33
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

Apportionment Categories for Obligations Incurred
On the Statement of Budgetary Resources: Obligations Incurred includes $114.8 billion of Direct Program Obligations and $3.5 billion of Reimbursable Program Obligations.

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

- Direct Obligations, Category A, amounts apportioned quarterly, are $61.5 billion.
- Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are $51.2 billion.
- Total Direct Obligations are therefore $112.7 billion.
- Category B Reimbursable Obligations, exempt from apportionment, are $5.5 billion.

Intraentity Transactions
Intraentity transactions have not been eliminated because the statements are presented as combined and combining.

Permanent, Indefinite Appropriations.
DON has two permanent, indefinite appropriations.

<u>National Defense Sealift Fund.</u>
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 NDRF. As of June 30, 2006, one transfer for $1.0 million from the Defense Working Capital Fund to the NDSF was recorded; no transfers from 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. As of June 30, 2006, $296.4 million has been transferred to Operations and Maintenance, Navy from ER, N.

Differences between the SBR and the Budget of the United States Government
Legitimate reasons can exist for differences between SBR and DON's programs in the Budget of the United States Government, such as expired unobligated balances being reported on SBR but not in the Budget.

Differences between the SBR and the SF-133 Report on Budget Execution
Differences exist between the SF-133 and the SBR for a number of reasons; including accruals recorded for fringe benefits, liabilities recorded for the Judgment Fund, and accruals recorded for trading partner advances and liabilities.

Other Disclosures
Information about legal limitations and restrictions affecting the use of unobligated balances of budget authority is specifically stated by program and fiscal year in the applicable appropriation language or in the alternative provisions section at the end of the appropriations act.

As noted above, the National Defense Sealift Fund, a revolving fund, received a transfer of $1.0 million in June, 2006 from the Defense Working Capital Fund per Public Law 109-148.

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 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. As of 3rd Quarter, FY 2006, a reduction of $223.9 million was made to Resources that Finance the Acquisition of Assets (Line 15) of the Statement of Financing so that proprietary accounts reconcile with the budgetary accounts. The alignment was made per Office of the Under Secretary of Defense (Comptroller) guidance.

Other Disclosures
The increase in 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 a consolidated statement. However, the following Statement of Financing lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

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

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.

Statement of Financing Line 16B - Other resources or adjustments to net obligated resources that do not affect the net cost of operations: the balance of $143.8 million consists primarily of transfers of Construction in Progress from other agencies.

Statement of Financing Line 23 - Other: the balance of $75.7 million consists primarily of unfunded liabilities for employment related programs.

Statement of Financing Line 27D - Other: the balance of ($8.2) million consists primarily of bad debt expense related to the allowance for doubtful accounts. .

Note 22.	Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 23. Earmarked Funds

BALANCE SHEET As of June 30	MRF	MERHCF	Other Earmarked Funds	Total Earmarked Funds
ASSETS				
Fund balance with Treasury	$ 0.00	$ 0.00	$ 9,954,651.44	$ 9,954,651.44
Investments	0.00	0.00	9,753,140.08	9,753,140.08
Accounts and Interest Receivable	0.00	0.00	0.00	0.00
Other Assets	0.00	0.00	17,985.85	17,985.85
Total Assets	$ 0.00	$ 0.00	$ 19,725,777.37	$ 19,725,777.37
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	1,889,717.14	1,889,717.14
Unexpended Appropriations	0.00	0.00	1,701,333.14	1,701,333.14
Cumulative Results of Operations	0.00	0.00	16,134,727.09	16,134,727.09
Total Liabilities and Net Position	$ 0.00	$ 0.00	$ 19,725,777.37	$ 19,725,777.37
STATEMENT OF NET COST As of June 30				
Program Costs	$ 0.00	$ 0.00	$ 20,474,085.63	$ 20,474,085.63
Less Earned Revenue	0.00	0.00	0.00	0.00
Net Program Costs	$ 0.00	$ 0.00	$ 20,474,085.63	$ 20,474,085.63
Less Earned Revenues Not Attributable to Programs	0.00	0.00	0.00	0.00
Net Cost of Operations	$ 0.00	$ 0.00	$ 20,474,085.63	$ 20,474,085.63
STATEMENT OF CHANGES IN NET POSITION As of June 30				
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	20,474,085.63	20,474,085.63
Other Nonexchange Revenue	0.00	0.00	12,441,209.28	12,441,209.28
Change in Net Position	$ 0.00	$ 0.00	$ (8,032,876.35)	$ (8,032,876.35)
Net Position End of Period	$ 0.00	$ 0.00	$ 17,836,060.23	$ 17,836,060.23

Fluctuation and/or Abnormalities

Earmarked funds were required to be reported and disclosed separately from other funds beginning 1st Quarter, FY 2006. For 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. However, prior year amounts were not remapped to the new earmarked funds reporting attributes.

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 are categorized as Special Funds and three are categorized as Trust Funds. A list of these earmarked funds and a brief description of each follows below. There have been no changes in legislation that significantly changes the purpose of any of the seven funds or that redirects a material portion of the accumulated balances of any of the seven funds.

The DON does not eliminate transactions between earmarked funds and other funds within the reporting entity.

<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 is deposited into this account. The monies are made available to DON solely for the acquisition or construction of military family housing in, or in the vicinity of San Diego, California.

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

Trust Earmarked Funds

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.

U.S. Naval Academy General Gift Fund

This trust fund is authorized by 10 United States Code 6973. Under the provisions of this statute, the Secretary of the Navy may accept, hold, administer, and spend any gift, devise, or bequest of personal property, made on the condition that it 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 June 30	2006 Asset Category			
	Land and Buildings	Equipment	Other	Total
1. ENTITY AS LESSEE- Operating Leases				
Future Payments Due				
Fiscal Year				
2006	$ 16,396,660.00	$ 0.00	$ 464,000.00	$ 16,860,660.00
2007	16,693,485.00	0.00	475,600.00	17,169,085.00
2008	17,065,553.37	0.00	487,490.00	17,553,043.37
2009	16,865,306.85	0.00	499,678.00	17,364,984.85
2010	17,261,561.49	0.00	512,170.00	17,773,731.49
2011	0.00	0.00	0.00	0.00
After 5 Years	0.00	0.00	0.00	0.00
Total Future Lease Payments Due	$ 84,282,566.71	$ 0.00	$ 2,438,938.00	$ 86,721,504.71

Fluctuations and/or Abnormalities

Although a comparative column is not displayed, the DON reported a decrease of $19.4 million, 18%, in Operating Leases Future Payments Due in 3rd Quarter, FY 2006. The decrease is due to the ongoing effort to validate operating leases throughout the Navy shore establishment.

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.