Today's Achievements
Assure Tomorrow's Success


Department of the Navy
Annual Financial Report
Fiscal Year 2008

*Today’s Achievements Assure Tomorrow’s Success*

Department of the Navy

FISCAL YEAR 2008

# ANNUAL FINANCIAL REPORT

**The Honorable Donald C. Winter**
*Secretary of the Navy*

THE SECRETARY OF THE NAVY
WASHINGTON, D.C. 20350-1000

October 2008

Our Navy-Marine Corps Team is the bedrock of U.S. maritime power, deployed around the world 24/7, deterring potential adversaries, forging cooperative partnerships to maintain security at sea, and defending our Nation. This has been true since the Navy came of age 100 years ago when President Theodore Roosevelt deployed the Great White Fleet. This historic deployment sent a clear message: America is a respected world power, with a strong Navy leading the way. That message is as relevant today as it was a century ago.

The continued strength of our naval forces depends in part on our ability to maintain a portfolio of capabilities to meet future unknown challenges. Our next generation ships will sustain a forward presence longer and respond quickly to emerging contingencies. Enhancements to Navy and Marine Corps special operations and the integration of intelligence, observation, and navigation systems will enable the U.S. to identify threats within the Maritime Domain early and reliably. Investments in protective gear and equipment, such as the Mine Resistant Ambush Protected vehicles, will enhance combat effectiveness in hostile environments. Additionally, investments in our information technology infrastructure will enhance the reliability and security of network-centric capabilities. In the 21st century battlespace and workplace, information is power.

To ensure the affordability and timely delivery of these capabilities, we have launched an acquisition improvement initiative that fosters senior leadership engagement, enhanced transparency, and greater discipline throughout the acquisition lifecycle. We are re-investing in our government acquisition workforce to enhance contractor oversight. We are also addressing issues related to the special challenges faced when contracting for goods and services overseas in support of the Global War on Terrorism.

Underlying our ability to support the warfighter is a renewed enterprise focus on our business processes. Continuous process improvement has become part of our organizational culture. Lean Six Sigma, the Navy Enterprise Resource Planning program, and the Department of the Navy (DON) Financial Improvement Program continue to shape business transformation. Consistent with Congressional direction and DoD guidance, we have recently established position of Chief Management Officer that will facilitate the planning, integration, and execution of overall DON business transformation.

Taking care of our people remains foremost among our priorities. We have invested in many initiatives to improve the quality of care of our Sailors, Marines, and their families. Examples include our Comprehensive Casualty Care initiative; improvements to preventive and post deployment care for post traumatic stress disorder; and expansion of Traumatic Brain Injury research and availability of services.

Our achievements over the past year assure our future success in executing our mission and building a sound business operating environment. The Department of the Navy's Fiscal Year 2008 Annual Financial Report, *Today's Achievements Assure Tomorrow's Success*, represents our enduring commitment to the proper stewardship of public resources that are critical for the defense of our Nation and the protection of our war-fighters.

Donald C. Winter

**The Honorable Douglas A. Brook**
*The Assistant Secretary of the Navy*
*(Financial Management and Comptroller)*

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

October 2008

2008 has truly been a year of progress and accomplishment for the Department of the Navy financial management community. By focusing on a set of key priorities, we have established a foundation that will serve the Department well as we transition to a new leadership team. Common themes throughout are the importance of an enterprise perspective and the quality of the financial information we use to advise senior leadership; while also ensuring we are providing the proper stewardship of the resources that are entrusted to us by the taxpayer.

Our priorities this year focused on:
**Improving our long term planning**: In translating our role in the national security strategy into a long term program and ultimately a proposed budget for the President, we re-crafted the current program and budget process to add flexibility while incorporating senior leadership input up-front and periodically through the process. The results were improved quality, less rework and timely submission of our program to OSD.

**Strengthening cost analysis capability**: Complementing the Secretary of the Navy's emphasis on improved acquisition practices, we have increased our internal capability to provide meaningful and credible independent cost estimates for major program elements. As our senior leadership makes decisions on future weapon systems, it's imperative they have the very best possible cost information.

**Pursuing financial auditability through business transformation**: We are committed to demonstrating an improved level of standardization and control in our business processes that will, over time, support our ability to achieve financial auditability. This objective goes well beyond the financial management community. As the acting Chief Management Officer, I am establishing an enterprise focus on business transformation and other strategic business goals. We have asserted audit readiness for the Marine Corps budgetary statements and qualified audit readiness for the Naval Research Laboratory.

**Investing in our human capital:** The progress we achieved would not be possible without a first rate financial management workforce. Our focus here has been to ensure our managers—both military and civilian—have the competencies and knowledge required to advance competitively using a career roadmap that considers both organizational and individual needs. We have surveyed our workforce and translated the survey results into an action plan that will better support our future needs.

In summary, during FY2008, we made significant and potentially far-reaching improvements in our financial management capabilities. We have re-tooled our planning and budgeting process to make it more accessible to our leaders; we have built up sustainable momentum toward financial auditability; and we constructed a framework to foster business transformation within DoN. Reliable financial information can go a long way toward improving public confidence in the management of government resources. Additionally, we continue to cultivate a more capable career workforce to aid in our progression towards improving the business of the Department. The Department of the Navy's 2008 Annual Financial Report, *Today's Achievements Assure Tomorrow's Success*, reflects our enduring commitment to the proper stewardship of public resources and continuous improvement in fiscal transparency and accountability.

Douglas A. Brook

# Management's Discussion and Analysis

# OCTOBER and NOVEMBER 2007

An Aviation Warfare Systems Specialist 3rd Class, attached to Helicopter Sea Combat Squadron (HSC) 85, searches for a burning target to dump 420 gallons of water. U.S. Navy photo by Mass Communication Specialist 3rd Class Dustin Kelling.

A Corporal attached to 2D Marine Logistics Group shakes hands with a little girl while on a security patrol. U.S. Marine Corps photo by Lance Cpl. Robert S. Morgan.


Sailors and Marines board a CH-46E Sea Knight, assigned to Marine Medium Helicopter Squadron (HMM) 265, after the amphibious assault ship USS Essex (LHD 2) arrived off the coast of Sihanoukville, Kingdom of Cambodia. U.S. Navy photo by Mass Communication Specialist 2nd Class Drae Parker.

Secretary of the Navy Donald C. Winter (left) arrives on board Naval Support Activity Bahrain. U.S. Navy photo by Mass Communication Specialist 1st Class Jennifer Stride.

# DECEMBER 2007 and JANUARY 2008

The Theodore Roosevelt Honor Guard parades the colors at the Great White Fleet Gala aboard USS Theodore Roosevelt (CVN 71). U.S. Navy photo by Mass Communications Specialist 2nd Class Nathan Laird.

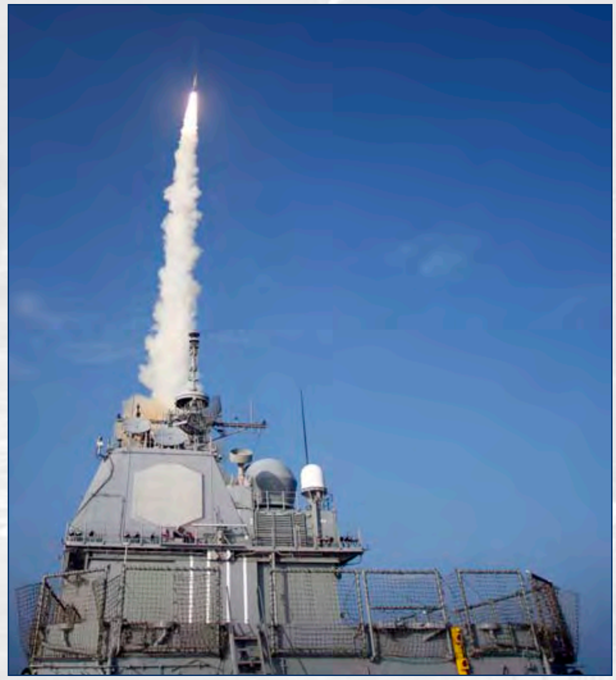
Sailors aboard the amphibious assault ship USS Kearsarge (LHD 3) look out at the amphibious assault ship USS Tarawa (LHA 1) as the two ships pass each other. U.S. Navy photo by Lt. James R. Hoeft.

This photograph was taken from a high-speed video camera during a record-setting firing of an electromagnetic railgun (EMRG) at Naval Surface Warfare Center, Dahlgren, Virginia. U.S. Navy Photograph.

Africa Partnership Station (APS) pulled into Lome, Togo aboard High Speed Vessel (HSV) 2 Swift, as the first U.S. Navy ship to visit Togo in 15 years. U.S. Navy photo by Mass Communication Specialist 2nd Class Elizabeth Merriam.

# FEBRUARY and MARCH 2008

The amphibious assault ship USS Nassau (LHA 4) leads a formation of ships during an Atlantic Ocean crossing of the Nassau Expeditionary Strike Group. U.S. Navy photo by Mass Communication Specialist 2nd Class Andrew King.



A single modified tactical Standard Missile-3 (SM-3) launches from the U.S. Navy AEGIS cruiser USS Lake Erie (CG 70). U.S. Navy photo.

A Corpsman 3rd Class maintains security with 3rd Battalion, 5th Marines, Regimental Combat Team 1 while on a patrol in the Al Sina district of Fallujah. U.S. Marine Corps photo by Lance Cpl. Grant T. Walker.


Members of the Navy Band perform during the christening ceremony of Pre-Commissioning Unit New York (LPD 21). New York is the fifth of nine San Antonio Class amphibious transport dock ships, but the first to be named in remembrance of the victims of the September 11, 2001 terrorist attacks. U.S. Navy photo by Mass Communication Specialist 1st Class Tiffini M. Jones.

# APRIL and MAY 2008

The Mine Resistant Ambush Protected (MRAP) vehicle will provide deployed Marine units with protection from improvised explosive devices. U.S. Navy photo by Mass Communication Specialist 2nd Class Michael B. Lavender.

A U.S. Navy Ceremonial Guardsman pours waters from the Seven Seas and Great Lakes into the U.S. Navy Memorial fountain in Washington, DC during the 17th annual Blessing of the Fleets celebration. U.S. Navy photo by Mass Communication Specialist 2nd Class Erin Kerby.

Newly commissioned officers from the U.S. Naval Academy Class of 2008 celebrate the conclusion of their graduation and commissioning ceremony with the traditional hat toss. U.S. Navy photo by Mass Communication Specialist 3rd Class Matthew Ebarb.

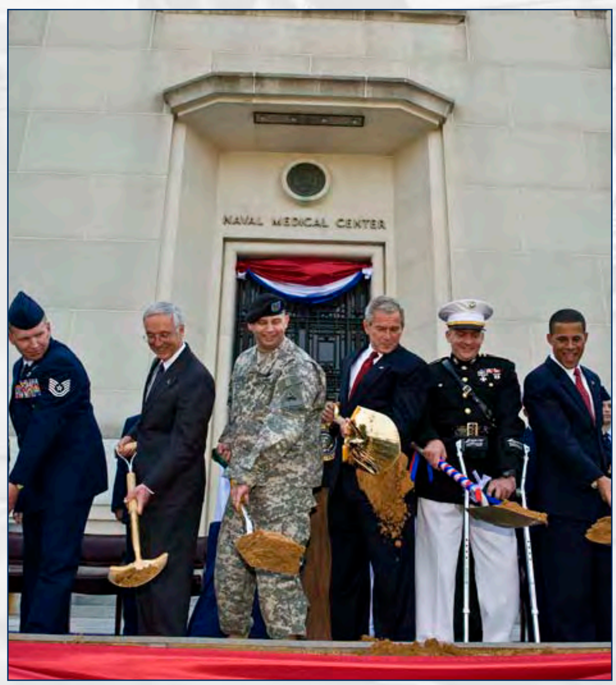
The mother of Navy SEAL Lt. Michael Murphy cuts the ribbon during a dedication ceremony for her son on May 7, 2008. U.S. Navy photo by Mass Communication Specialist 2nd Class Kevin S. O'Brien.

# JUNE and JULY 2008


Pre-Commissioning Unit (PCU) New Hampshire (SSN 778) sits moored to the pier in Groton, Connecticut after its christening ceremony. It is scheduled to be commissioned in October 2008. U.S. Navy photo by John Narewski.

An SH-60B assigned to Helicopter Anti-Submarine Squadron Light (HSL) 42 prepares to depart the guided-missile cruiser USS Vella Gulf (CG 72) during the Iwo Jima Expeditionary Strike Group (ESG) composite unit training exercise (COMPTUEX). U.S. Navy photo by Mass Communication Specialist Seaman Chad R. Erdmann.

Sailors assigned to Riverine Squadron (RIVRON) 3 and Marines assigned to the civil affairs group of 2nd Battalion, 11th Marine Regiment are patrolling Lake Quadsiyah near Haditha, Iraq. U.S. Marine Corps photo by Cpl. Seth Maggard.

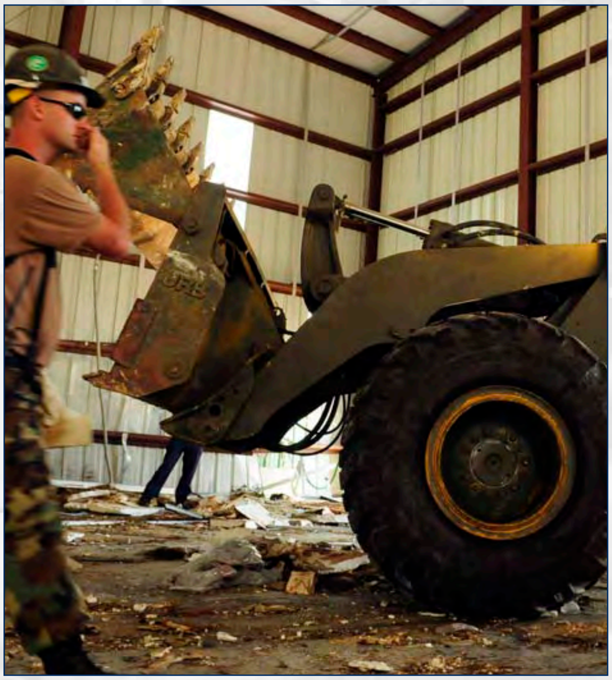



President George W. Bush and other Department of Defense officials break ground for the new Walter Reed National Military Medical Center during a ceremony at Bethesda Naval Hospital in Maryland on July 3, 2008. U.S. Air Force photo by Tech. Sgt. Jerry Morrison.

## AUGUST and SEPTEMBER 2008

Civilians watch as the littoral combat ship USS Freedom (LCS 1) goes to sea to begin acceptance trials. The littoral combat ship was designed to provide the U.S. Navy with greater flexibility and capability in operating in the littoral or "green water" coastal areas. U.S. Navy photo by Mass Communication Specialist 3rd Class Jhi L. Scott.

The amphibious transport dock ship USS San Antonio (LPD 17) transits the Atlantic Ocean. U.S. Navy photo by Mass Communication Specialist 2nd Class Jason R. Zalasky.



Sailors assigned to Amphibious Construction Battalion (ACB) 2, embarked aboard the amphibious assault ship USS Nassau (LHA 4), clean debris left behind from Hurricane Ike at Cloverfield Airport in Galveston, Texas. U.S. Navy photo by Mass Communication Specialist 3rd Class Kenneth R. Hendrix.

Medical personnel from the amphibious assault ship USS Kearsarge (LHD 3) carry medical supplies to a nearby church in Marose, Haiti. U.S. Navy photo by Mass Communication Specialist Seaman Apprentice Joshua Adam Nuzzo.

# Introduction

The Department of the Navy (DON) has made significant strides in its transformation efforts. We are evolving our portfolio of Naval capabilities to defend our Nation against current and future challenges in support of our maritime strategy, *A Cooperative Strategy for 21st Century Seapower*. Construction of next generation ships, the consolidation and recapitalization of our naval aircraft, and enhancement of Navy and Marine Corps special operations represent our commitment to ensuring capabilities evolve to remain ahead of emerging threats. We have embraced continuous process improvement as the means to increase efficiency, effectiveness, and to ensure the responsible use of resources. These and other achievements will help us to sustain U.S. maritime superiority and assure our future success in building a sound business operating environment.

The Fiscal Year (FY) 2008 Management's Discussion and Analysis (MD&A) provides perspective on the breadth and depth of the DON's mission and the resources appropriated to it. The FY 2008 MD&A is organized as follows:

- Organization and Mission
- Strategic Management
- Management Assurances
- Financial Condition and Results of Operations
- Looking Forward

# Organization and Mission

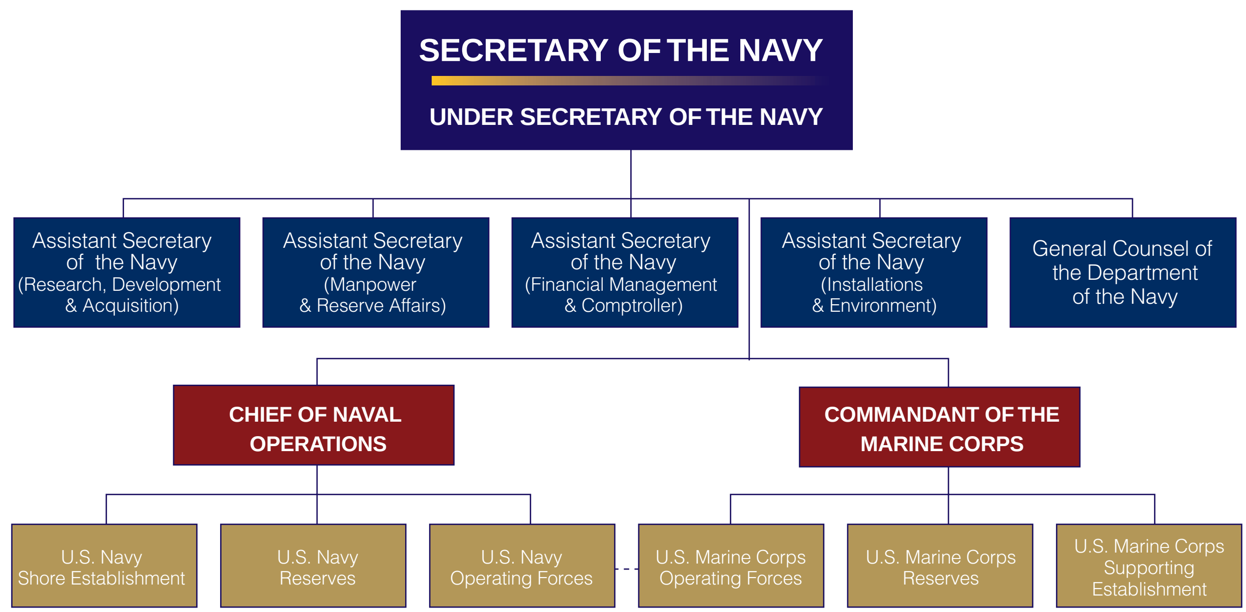
The DON is a large and complex organization with over 630,000 U.S. Navy and U.S. Marine Corps personnel and over 190,000 Navy and Marine Corps civilians located worldwide. Headquartered at the Pentagon, DON is organized under the Secretary of the Navy, a civilian appointed by the President, who conducts all Department affairs under the authority, direction, and control of the Secretary of Defense. Under the purview of the Secretary of the Navy are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, the General Counsel, and two key military leaders—the Chief of Naval Operations, a four-star Admiral, responsible for the command and operating efficiency of the U.S. Navy and the Commandant of the Marine Corps, a four-star General, responsible for the performance of the U.S. Marine Corps.

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

- Department of the Navy Mission

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

***Founded April 30, 1798***
*Title 10 U.S. Code, Section 5061*




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

The chart above is a simplified illustration of the DON organizational structure. The full structure is shown online at [www.navy.mil](http://www.navy.mil) under "About the Navy."

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

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


U.S. Navy photo by Robert Cole (Released)

*Personnel Data as of Fiscal Year Ended September 30, 2008*

**Navy Civilians: 170,995**
(Full-time Equivalents)

**U.S. Navy Active: 332,228**
(Officers, Enlisted, & Midshipmen)

**U.S. Navy Reserve: 68,136**
(Drilling Reserve & Full-time Support)

**Marine Corps Civilians: 19,209**
(Full-time Equivalents)

**U.S. Marine Corps Active: 198,505**
(Officers & Enlisted)

**U.S. Marine Corps Reserve: 37,523**
(Drilling Reserve & Full-time Support)

# Strategic Management

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

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

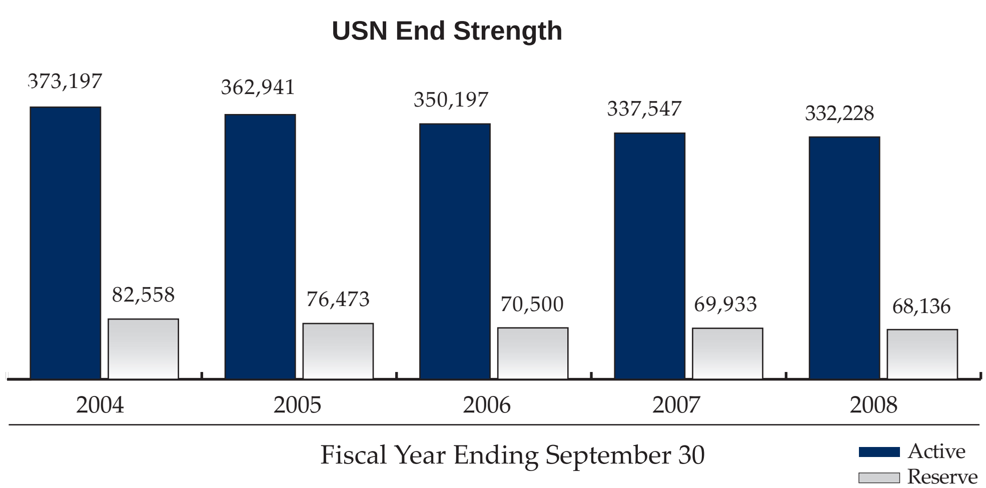
The *Department of the Navy Objectives for FY 2008 and Beyond* (listed below) support our maritime strategy by focusing on key efforts that will increase our effectiveness, improve the lives of our Sailors and Marines, and result in greater security for the U.S. A summary of key accomplishments by objective is provided below.

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

The DON continued to focus on sizing, shaping, and stabilizing the total force, applying the right skill sets to projected requirements in the most cost efficient manner. The DON also continued to ensure that our wounded Sailors and Marines and their families receive the highest priority care, respect, and treatment for their sacrifices. Representative examples of DON initiatives for improving care for our people include Comprehensive Casualty Care; Wounded Warrior and Safe Harbor; and family support programs.

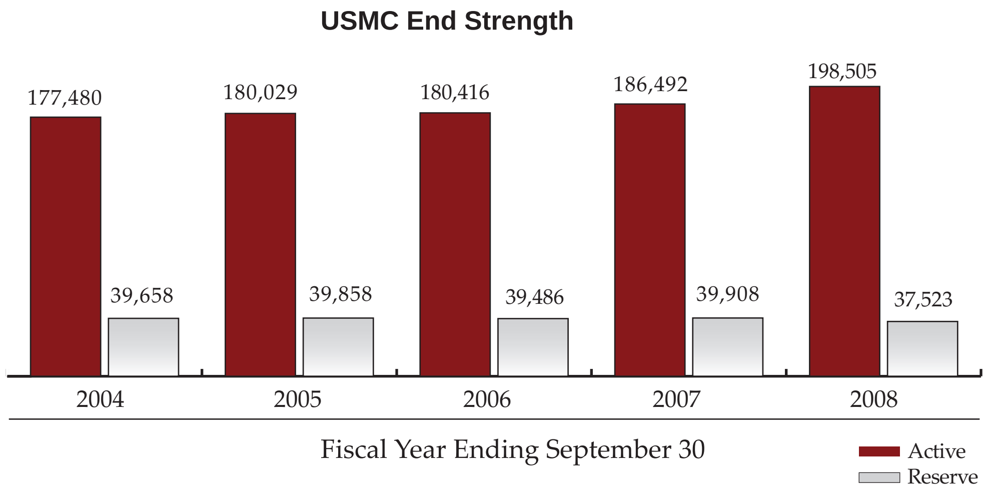
### U.S. Navy

The Navy continued to reshape its forces to enhance its ability to meet the deployment requirements of the Global War on Terrorism, Homeland Defense, and stability operations. From FY 2004 to FY 2008, the Navy reduced the size of its active and reserve components by 11% and 18%, respectively. All assigned missions were accomplished at this level as a result of force structure changes, efficiencies gained through technology, altering the workforce mix, and new manning practices.



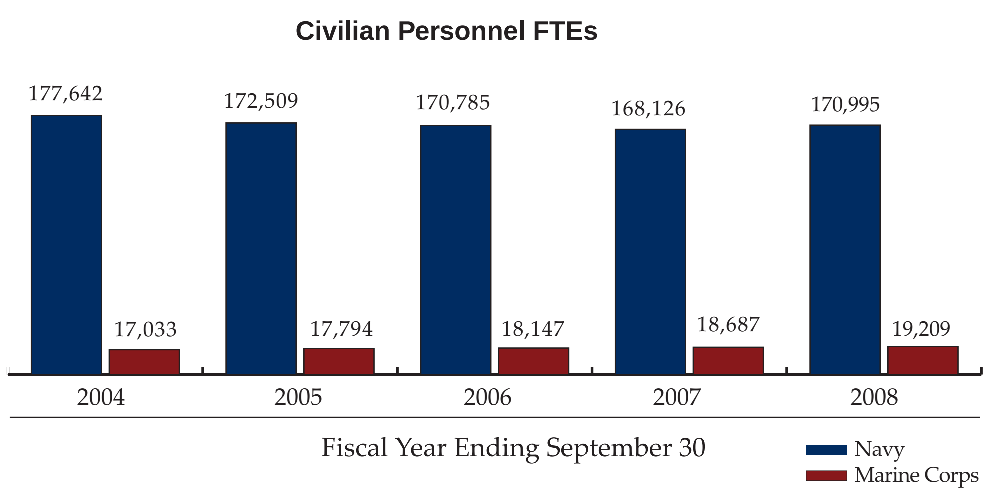
## U.S. Marine Corps

The Marine Corps continued to grow the force to meet the increasing demands of the Global War on Terrorism and to provide trained forces in support of other contingencies. From FY 2004 to FY 2008, the Marine Corps increased the size of its active component by 11.8%. The Marine Corps is on track to meet the goal of 202,000 active component Marines by FY 2009.




## Navy and Marine Corps Civilian Personnel

The size of the civilian workforce remains stable. In FY 2008, 30,315 civilian employees were converted to the National Security Personnel System pay for performance system. See section, "National Security Personnel System," for more information.

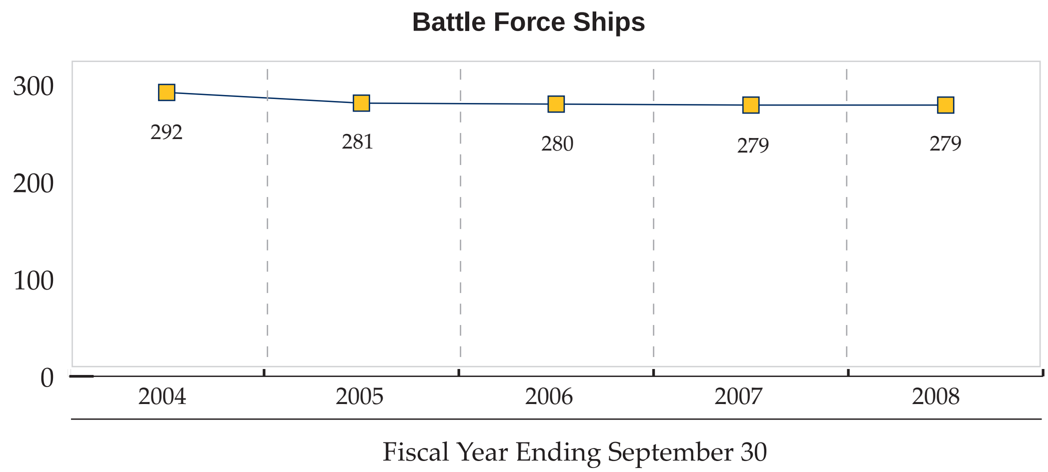



## *Objective 2: Use the Navy-Marine Corps Team to Aggressively Prosecute the Global War on Terrorism*

The Navy and Marine Corps team continued to answer our Nation's call, both in the Global War on Terrorism and in the establishment of stability and security in the world's trouble spots. From combat operations in Iraq and Afghanistan to humanitarian assistance and disaster relief throughout the world, the DON has proven ready to meet any task and answer any challenge.

## Fleet Response Plan

The Navy's focus continued to be providing ready naval forces, from individual units to strike groups, that are forward deployed and capable of providing a substantial surge force. The readiness for this capability is enabled by the Fleet Response Plan (FRP), which supports the National Military Strategy. The FRP provides adaptable, flexible and sustainable naval forces necessary not only to fight the Global War on Terror, but also to support the needs of the Combatant Commanders to maintain a global forward presence or provide for any other evolving national defense requirements. Battle force ships are integral to the FRP, which is structured to provide six ready carriers in less than 30 days with an additional surge in 90 days. The DON's goal is to sustain a fleet of 313 ships.




## Marine Corps Operating Forces

During 2008, Marines operated from Iraq to Afghanistan to the Horn of Africa displaying the flexibility and responsiveness of the Marine Air-Ground Task Force as well as maintaining forward presence and security cooperation deterrence in the Western Pacific and the Central Command Area of Responsibility. These forces, along with the deployment of numerous Fleet Anti-terrorism Security Teams, continued to display the versatility and dependability of Marine Forces.

To support the operational tempo of the Global War on Terrorism, the Marine Corps has embarked on a program of growing the force to 202,000 Marines. This growth in end strength is specifically targeted to ensure Marines are able to prepare for current and future contingencies and improve the quality of life of the individual Marine. Part of this Grow the Force program has been the addition of an active duty Infantry Battalion to bring the total to 27 Active Infantry Battalions in 2008. These battalions joined with the three active Air Wings and three Logistics Groups to comprise the three Marine Expeditionary Forces (MEFs). Each MEF provides a highly trained, versatile expeditionary force capable of rapid response to global contingencies. The inherent flexibility of the MEF organization, combined with Maritime Prepositioning Force assets, allows for the rapid deployment of appropriately sized and equipped forces.

| Marine Corps Land Forces | 2007 | 2008 |
|---|---|---|
| Marine Expeditionary Forces | 3 | 3 |
| Active Infantry Battalions | 26 | 27 |
| Reserve Infantry Battalions | 9 | 9 |

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

The DON is committed to finding solutions that allow the Navy and Marine Corps to balance our current requirements and operational realities with the likely needs of the future. We strive to maintain an agile and flexible force that not only contributes to winning our Nation's wars but also deters future conflict to the maximum extent possible—whether through persuading by strength or support for humanitarian relief.

To build our future Navy-Marine Corps Force today, DON continued to invest in a new generation of warfighting capabilities. A brief discussion of ship construction, aircraft procurement, and acquisition governance and execution follows.

## Ship Construction

The future fleet of ships, as represented in our 30-year shipbuilding plan, will sustain operations in forward areas longer, be able to respond more quickly to emerging contingencies, and generate more sorties and simultaneous attacks against greater numbers of multiple targets and with greater effect than our current fleet. Examples of ship construction programs include:

- Dry cargo and ammunition ship (T-AKE)
- Guided missile destroyers (DDG)
- *Ford* Class (CVN 21), next generation of aircraft carrier
- Nuclear-powered attack submarine (SSN)
- Amphibious platform dock ship (LPD 17)
- Littoral combat ship (LCS)

## Aircraft Procurement

The DON is in the midst of an extensive, long-term consolidation and recapitalization of all naval aircraft in order to develop the optimum balance between requirements and usage. To sustain global air superiority, the DON has invested in naval aviation acquisition programs. Examples of aircraft procured are listed below.

Navy Aircraft:

- F/A-18 E/F Super Hornet – long-range, multi-mission, all-weather strike fighter
- EA-18G Growler – next-generation electronic attack aircraft
- MH-60S Knighthawk, MH-60R Seahawk – multi-mission support/combat helicopters
- MQ-8B Fire Scout – vertical take-off and landing tactical unmanned aerial vehicle

Marine Corps Aircraft:

- MV-22B Osprey – vertical/short take-off and landing, multi-purpose tactical transport
- AH-1Z / UH-1Y – utility and attack helicopters
- KC-130J – multi-mission, tactical aerial refueler/transport aircraft

## Acquisition Governance and Execution

The DON continued to address challenges in the governance and oversight of major weapons systems acquisition. Improvements made in the Virginia-class submarine acquisition and shipbuilding process are contributing to early deliveries and reduced costs. Improvements were also made that increased rate of production and delivery of Mine Resistant Ambush Protected (MRAP) and Counter-Improvised Explosive Devices (C-IED) capabilities. Additionally, the Gate Review process implemented in FY 2008 has provided guidance and discipline for acquisition programs through the review and enforcement of program health criteria.

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

Fundamental to taking care of Sailors, Marines, and DON civilian employees is establishing a culture and environment where safety is an intrinsic component of all decision-making, both on- and off-duty. Safety and risk management are integrated into on- and off-duty evolutions to maximize mission readiness and to establish DON as a world-class safety organization where no mishap is accepted as the cost of doing business.

In FY 2008, in coordination with the Motorcycle Safety Foundation and Commandant of the Marine Corps (Safety Division), the Naval Safety Center developed the Military Sport Bike Rider Course (MSRC). This course is providing Sailors and Marines with the knowledge and skills needed to operate motorcycles safely, and is being adopted by the other Services.

The Naval Safety Center also established a working group to promote a more open environment within the afloat community in the reporting of hazards, near mishaps, and lessons learned. Major Command representatives and several ship Safety Officers participate in monthly round-table discussions at the Naval Safety Center. The identification and dissemination of hazard information directly supports the maintenance of the Navy's warfighting readiness by contributing to mishap reduction.

A volunteer motorcycle safety instructor gives feedback to an Aviation Boatswain's Mate (Handling) 2nd Class during the first Military Sport Bike Course in Norfolk, Virginia.

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

The DON continues to strengthen ethics as a foundation of exemplary conduct by teaching and enforcing ethics, DON Core Values, and standards of exemplary conduct, starting at the earliest career stages. During FY 2008, the Office of the Naval Inspector General briefed 1,019 individuals to reinforce ethics as the foundation of conduct within the DON. The recipients included 124 Flag/SES and 427 Commanding Officers. The briefing provided relative examples and reference material to reinforce ethical standards.

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

The DON continues to invest in military construction projects to keep pace with evolving mission requirements. The DON established the Joint Guam Program Office (JGPO) under the auspices of the Defense Policy Review Initiative with Japan. The mission of the JGPO is to facilitate, manage, and execute requirements associated with rebasing Marine Corps assets from Okinawa to Guam and to establish a Joint Base on Guam. The Marine Corps is working with JGPO, the Secretary of the Navy, and Commander, U.S. Pacific Command to ensure plans meet operational requirements.

Additionally, the DON continues to invest in its infrastructure to support the Grow the Force and quality of life initiatives. New construction and replacement of existing facilities on Marine Corps installations within the United States will support the Marine Corps growth in end strength. Replacement of inadequate family and bachelor housing will continue through public-private ventures the DON has used to leverage capital investment and private sector expertise. Construction of wounded warrior barracks at Camp Lejeune and Camp Pendleton will ensure quality and accessible living quarters for our wounded Marines.

## *Business Transformation*

As a separate and supporting element of our strategic objectives, DON is committed to transforming the way we do business by using our people, processes, and systems more effectively. The DON Financial Improvement Program is the integrating financial element of the DON's business transformation strategy, and a supporting initiative of the Department of Defense (DoD) Financial Improvement and Audit Readiness plan. Lean Six Sigma, Navy Enterprise Resource Planning, and National Security Personnel System are supporting components of the DON's business transformation strategy.

### DON Financial Improvement Program

The DON Financial Improvement Program (FIP) and the Marine Corps Financial Improvement Initiative (FII) are multi-year Department-wide efforts to modernize Navy-Marine Corps financial processes and systems to better serve worldwide operations. The goal of the FIP and FII is to produce financial management information with greater accuracy, reliability, and accessibility. With improved information, DON managers can allocate the Department's resources in a more precise way. Also, with improved financial information, the DON will move closer to audit readiness.

The DON has conducted and completed significant discovery and documentation efforts across select key business processes that affect financial management. The documentation, and subsequent evaluation of internal controls, serves as a basis for assertion of audit readiness. To date, the DoD Inspector General has examined the FY 2007 Cash and Other Monetary Assets line item and the weapons systems portion of the Environmental Liabilities line item. The weapons systems portion was based on Naval Sea Systems Command's disposal estimation process for active and inactive DON ships.

Additionally, the FIP and FII are using an internal control methodology to confirm effectiveness of internal controls over financial reporting. The DON is on track to correct all known material weaknesses over financial reporting by FY 2014.

Additional accomplishments for FY 2008 are identified below:

- Asserted qualified audit readiness for the Naval Research Laboratory (NRL), a component of the Navy Working Capital Fund Research and Development business area. Additionally, NRL developed and implemented a sustainable methodology to assess internal control effectiveness and the validity of financial statement balances, including the use of an information management tool to capture internal control testing results.

- Completed documentation and an internal control evaluation of DON processes for recognizing, estimating, and reporting Environmental Liabilities. DON plans to assert audit readiness of Environmental Liabilities in FY 2009.

- Completed documentation and an internal control evaluation of Collection and Disbursement processes, in association with Defense Finance and Accounting Service, Cleveland. Collection and Disbursement processes comprise major business event drivers that impact the DON Fund Balance with Treasury.

- Tested key internal controls for the civilian pay process at the Commander, Naval Installations Command (CNIC) and Office of Naval Intelligence (ONI). The testing methodology used at CNIC and ONI sets the stage for all DON commands that will begin testing their civilian pay processes in FY 2009.

- Asserted audit readiness of the General Fund Contingent Liabilities for existing or pending litigation.

- Completed validation activities for the Military Sealift Command's (MSC) business processes as a step towards completing audit readiness activities. MSC is a component of the Navy Working Capital Fund Transportation business area.

- Maintained internal controls testing for the DON's previously asserted Weapons Systems component of Environmental Liabilities, General Fund Investments, and General Fund Cash and Other Monetary Assets.

- Developed a methodology to test internal controls over financial reporting and a strategy to support more comprehensive internal controls testing in FY 2009.

- Executed the initial implementation of the financially compliant Navy Enterprise Resource Planning Program, an integrated business application supporting a large percentage of the Naval Aviation Enterprise.

### Marine Corps Financial Improvement Initiative

The Marine Corps, a subsidiary reporting entity within the DON, has strengthened business processes to improve the accuracy, timeliness, and reliability of financial information. This year, the Marine Corps asserted audit readiness for financial statement compilation, Fund Balance with Treasury, and the General Fund Statement of Budgetary Resources. The Marine Corps anticipates an audit of its

Statement of Budgetary Resources to occur in FY 2009.

The Marine Corps is the first major operational war fighting organization to achieve audit readiness over a broad part of its business operations. During this process, the Marine Corps has quantified the direct resource contribution that audit readiness has made and the proportion of each appropriated dollar that buys war fighting capability.

The newly formed DON Audit Committee, created to monitor the audit's execution and value, will continue to monitor and measure the value of the audit process to the war fighter. Together with the Marine Corps, the DON Audit Committee will jointly seek ways to use the audit process to add value to the Marine Corps war fighting capabilities. They will also work with the Office of the Secretary of Defense Audit Committee to streamline and improve the audit process to the benefit of the entire Department of Defense.

### Navy Enterprise Resource Planning

The Navy Enterprise Resource Planning (ERP) is the key automated system driver of DON business transformation. On October 1, 2007, the Naval Air Systems Command became the first of the DON major commands to implement Navy ERP. Navy ERP will integrate and improve Navy processes for logistics, acquisition, and financial operations. It will be a major component of the Navy's Global Combat Support System (GCSS) family of systems and provide a critical link between operating forces and the Navy's support echelons. The Navy ERP program will reduce overall Navy costs by applying proven industry best practices and processes and replacing legacy information technology systems; facilitating an end-to-end solution for receiving requests for resources and processing them to fulfillment; replacing stove-piped systems used for financial management and inventory management with an integrated system that provides a financial "backbone" for business operations.

The Navy is expanding the Navy ERP program throughout the Navy Enterprise. Some of the DON major commands scheduled for ERP implementation are the Naval Supply Systems Command (FY 2009); Space and Naval Warfare Systems Command (FY 2010); and the Naval Sea Systems Command (FY 2011-2012).

### National Security Personnel System

The National Security Personnel System (NSPS) is the key people driver of DON business transformation. Authorized by Congress, NSPS provides Department of Defense leaders the right tools to manage the civilian workforce, facilitate competition for high quality talent, offer compensation competitive with the private sector, and reward outstanding service. The NSPS supports the enterprise-wide objective to provide a total Naval workforce capable and optimized to support the National Defense Strategy (see "Strategic Management," Objective 1).

The DON continued transition of its workforce to NSPS during FY 2008. Strategic Systems Program and the Naval Historical Center (under Field Support Activity) successfully completed NSPS conversion during FY 2008. Among the commands that continued NSPS conversion efforts in FY 2008 were: Bureau of Medicine and Surgery; Bureau of Naval Personnel; Commander, Naval Installations Command; Fleet Forces Command; Naval Sea Systems Command; Naval Supply Systems Command; Pacific Fleet; Space and Naval Warfare Systems Command; Naval Special Warfare Command; and U.S. Marine Corps.

### Continuous Process Improvement

The DON is committed to Continuous Process Improvement (CPI) as the means toward increasing readiness and utilizing our resources more efficiently and effectively. The DON continues to champion use of Lean Six Sigma (LSS) as the primary toolset of CPI. The LSS supports the enterprise-wide objective to provide a total Naval workforce capable and optimized to support the National Defense Strategy (see "Strategic Management," Objective 1).

The Secretary of the Navy challenged departmental leadership to complete LSS Green Belt training, undertake projects, and accelerate training in their organizations. As a result, DON has trained over 4,800 Senior Leaders; 9,300 Green Belts; 1,200 Black Belts; and 60 Master Black Belts. The DON has completed over 6,700 projects and is currently engaged in over 2,200 projects. For example, the Bureau of Medicine and Surgery completed 20 projects, including a web-based tracking system to provide real-time medical readiness data. In addition, DON has begun implementing a family of CPI software that will allow for transparency of reporting projects and savings benefits across DON.

# Management Assurances

Commanders and managers throughout the DON must ensure the integrity of their programs and operations. Part of this responsibility entails compliance with Federal requirements for financial reporting, financial management systems, and internal controls. These requirements promote the production of more timely, reliable, and accessible financial information, supported by the development and implementation of more effective internal controls. More useful financial information and effective controls enhance public confidence in DON's stewardship of public resources, which are critical for the protection and sustainment of our Nation and vital U.S. interests.

Below is a brief discussion of DON compliance with Federal requirements in FY 2008.

## *Financial Statement Certification*

Effective in FY 2008, the Office of the Under Secretary of Defense (Comptroller) established a requirement that the senior leaders of Department of Defense (DoD) components attest to the accuracy, reliability, and completeness of their quarterly financial statements and related note disclosures. For the fiscal year ended September 30, 2008, we provided limited assurance over the DON financial statements taken as a whole. The Secretary of the Navy's Certification follows the MD&A.

## *Federal Financial Management Improvement Act*

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires agencies to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger (SGL) at the transaction level. The DON legacy financial management systems and feeder systems are not substantially compliant with Federal financial management systems requirements, generally accepted accounting principles, and the USSGL at the transaction level. While FFMIA compliancy requires a solid systems element, the improvements in process documentation and internal control testing being made through the DON FIP, combined with the ongoing deployment of the Navy ERP, will move DON toward this goal over the next five to seven years. The Navy ERP will be compliant with the DoD Standard Financial Information Structure (SFIS), which includes support for the USSGL at the transaction level. The SFIS is DoD's common business language that supports standardization of financial reporting across DoD Components.

## *Federal Managers' Financial Integrity Act*

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

### FMFIA Over Non-Financial Operations

The DON's system of administrative and operational internal controls overall, in effect as of June 30, 2008, provided qualified assurance, with the exception of eight material weaknesses, that controls are in place, operating effectively, and being used. The DON has planned aggressive corrective action to strengthen internal controls, including targeting six of the material weaknesses for closure during FY 2009. The DON will continue to emphasize internal controls in its operational and business processes to improve operating efficiency, promote good stewardship, enhance decision-making capability, and comply with Office of the Secretary of Defense policy. The increased self-reporting activity and resulting transparency of the reporting process have served to ensure DON controls are reasonably sound and relevant to the overall DON mission.

### Internal Controls Over Financial Reporting

The DON remains committed to improving the quality of its financial information and ultimately achieving audit readiness. Beginning in FY 2006, in response to the addition of Appendix A to OMB Circular A-123, the DON increased its emphasis on the documentation and testing of internal controls over financial reporting. As of June 30, 2008, not all significant internal controls over financial reporting for the DON General Fund and Navy Working Capital Fund have been tested and as a result, the DON was unable to comprehensively determine their operating effectiveness. Also, the DON identified several weaknesses requiring corrective action. The DON has planned aggressive corrective action to strengthen its controls over financial reporting to include expansion of coverage by a reporting network that monitors controls over financial reporting.

Through recently concluded internal control assessments, the Marine Corps is able to highlight financial and business practice reliability for much of the Marine Corps General Fund Balance Sheet and Statement of Budgetary Resources. The scope of testing and the degree of confidence achieved also demonstrate steady progress toward asserting audit readiness in FY 2009. Therefore, internal controls over financial reporting for the Marine Corps General Fund, in effect as of June 30, 2008, provided qualified assurance, with the exception of three material weaknesses, that controls are in place, operating effectively, and being used. The Marine Corps has planned aggressive corrective action to strengthen its controls.

The FY 2008 FMFIA Annual Statement of Assurance is available at http://www.fmo.navy.mil /mic/soa_index.htm.

## *Improper Payments Information Act*

The Improper Payments Information Act (IPIA) of 2002 seeks to reduce improper payments throughout the Federal Government by requiring agencies to report on programs and activities that are susceptible to improper payments. Improper payments are those that should not have been made or that were disbursed in incorrect amounts. Pursuant to the IPIA, several DON major commands must report non-Defense Travel System travel payments on a quarterly basis and other vendor payments and civilian payroll payments made by DON entities other than the Defense Finance and Accounting Service (DFAS) on an annual basis. The DON has chartered an IPIA working group to standardize, validate, and improve the current overall DON IPIA reporting process. Note, however, that DFAS performs the vast majority of DON's entitlement computation and disbursement functions.

For FY 2008, DON identified $767 thousand of potentially improper payments. While no amount of improper payments is ever acceptable to management, this amount falls below the 2.5% error rate threshold established by the Office of Management and Budget (OMB). DON is examining root causes and instituting more internal controls, where applicable, to reduce improper payments.

# Financial Condition and Results of Operations

The accompanying financial statements and related disclosures represent DON's enduring commitment to fiscal accountability and transparency. Through the DON FIP and related business transformation initiatives discussed earlier, the DON has made significant progress toward improving the quality and timeliness of its financial information. However, the DON is currently unable to fully implement all elements of Generally Accepted Accounting Principles and OMB Circular A-136, *Financial Reporting Requirements*, due to limitations of its financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the Department of Defense, Office of Inspector General was unable to express an opinion on the FY 2008 DON financial statements.

It should be noted that these limitations exist primarily in our proprietary accounting processes, and less so in the budgetary accounting performed to manage and report on the application of budget authority to the purposes and programs approved in appropriations acts. Despite documented material weaknesses and because of compensating measures and close oversight, the DON believes the budgetary information used for decision-making is accurate and reliable.

For financial reporting purposes, the DON is organized into two reporting entities: DON General Fund (GF) and Navy Working Capital Fund (NWCF), which include financial information for both the U.S. Navy and the U.S. Marine Corps (USMC). Each reporting entity has its own set of financial statements and related notes. The USMC also has a separate set of subsidiary financial statements and related notes, which are included in this annual financial report.

## *DON General Fund*

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

- Operation and Maintenance
- Military Personnel

- Procurement
- Research, Development, Test, and Evaluation
- Military Construction

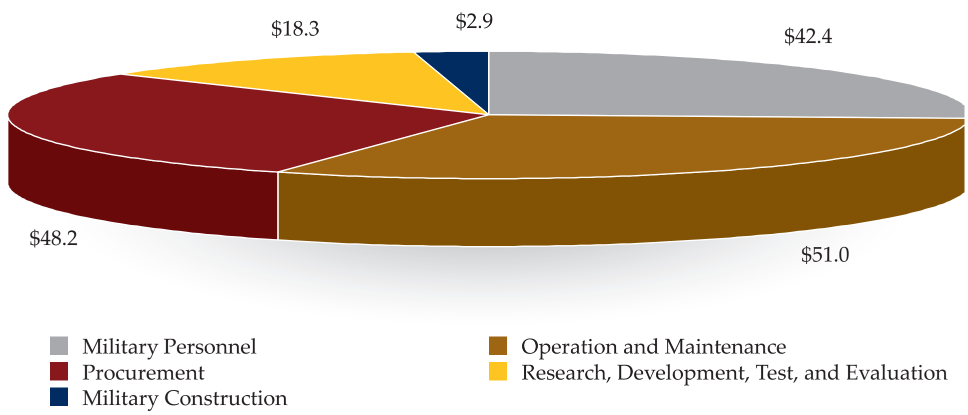
Enacted appropriations flow through OMB and the Office of the Secretary of Defense to the Office of the Secretary of the Navy where they are allocated to administering offices and major commands. The administering offices and major commands, which in turn obligate the appropriations to fund operational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

## Major Sources and Uses of Funds

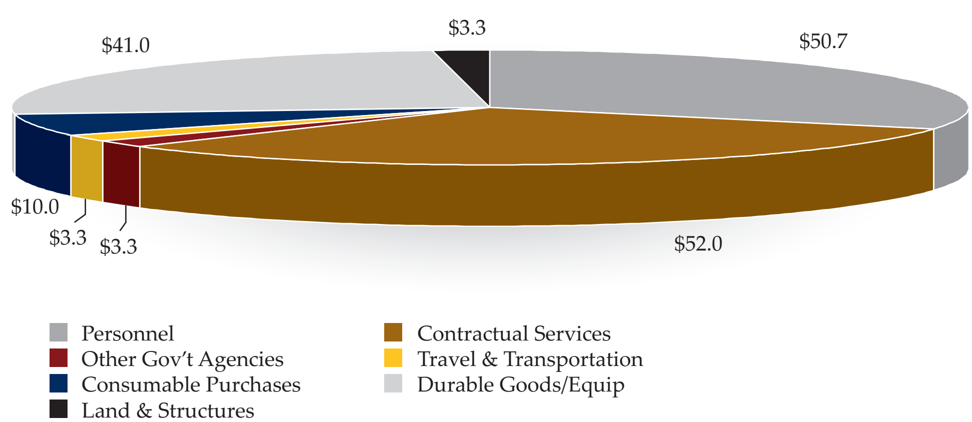
Enacted appropriations increased by $11.9 billion, or 7%, for a total of $162.7 billion, when compared with FY 2007. The majority of the $11.9 billion increase was in the Operation and Maintenance, and Procurement accounts. Though general categories of funds use remained relatively stable, Contractual Services and Personnel remain the largest groups, followed by procurement of Durable Goods and Equipment.

More information on DON GF budgetary resources is available in the Combined Statement of Budgetary Resources and Note 20.

**DON General Fund Major Sources of Funding in FY 2008 ($ in Billions)**




**DON General Fund Major Uses of Funding in FY 2008 ($ in Billions)**



## Financial Position

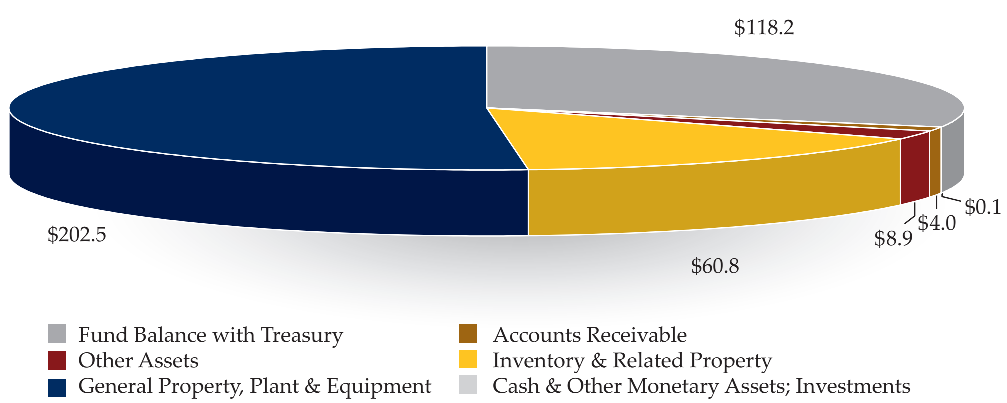
The DON GF continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets (what we own) and total liabilities (what we owe). As of September 30, 2008, net position totaled $357.3 billion, which represents an increase of $26.2 billion, or 8%, from fiscal year ended 2007. Increases of $27.3 billion in total assets and $1.1 billion in total liabilities resulted in the overall increase in net position.

Primary contributors of the increase in total assets were General Property, Plant, Equipment (GPP&E) and Fund Balance with Treasury (FBWT). The addition of new aircraft and ships during FY 2008 resulted in an increase of $12.9 billion in Military Equipment, a component of GPP&E. Supplemental appropriations related to the Global War on Terrorism drove an increase of $10.9 billion in FBWT. The supplemental appropriations included $7.8 billion in multi-year funds for procurement of aircraft, weapons, and ammunition, much of which remained unexpended at fiscal year-end; the DON received the supplemental funding in 4th Quarter, FY 2008.

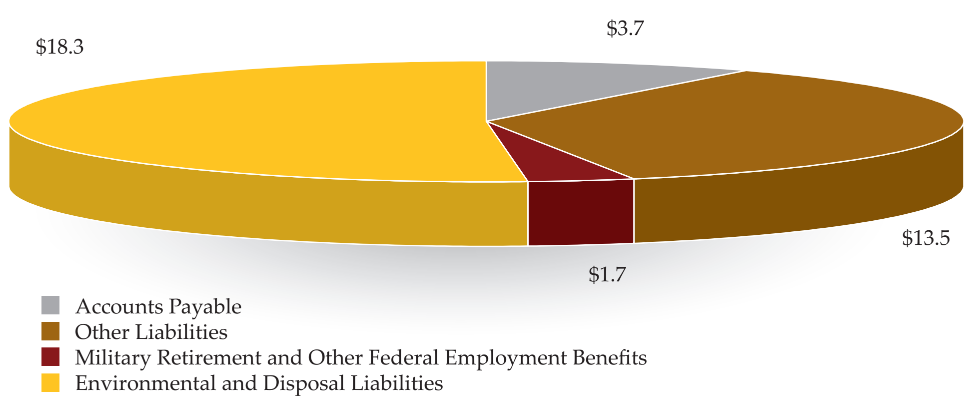
A primary contributor of the increase in total liabilities was Other Liabilities (Nonfederal). Contingent liabilities, a component of Other Liabilities (Nonfederal) increased $1.8 billion due to the implementation of a more accurate process to estimate probable legal liabilities.

More information on DON GF financial position is available in the Consolidated Balance Sheet and related notes.

**FY 2008 Total Assets, DON General Fund ($ in Billions)**




**FY 2008 Total Liabilities, DON General Fund ($ in Billions)**



## *Navy Working Capital Fund*

The NWCF is a revolving fund established to meet the diverse requirements of the Navy and Marine Corps operating forces. Under the revolving fund concept, an appropriation or a transfer of funds finances initial NWCF operations. General or appropriated fund payments from customers for goods delivered or services performed subsequently replenish this initial working capital investment and sustain a continuous cycle of operations, minimizing the need for additional annual appropriations by Congress.

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

**Navy Working Capital Fund Business Activities By Business Area**

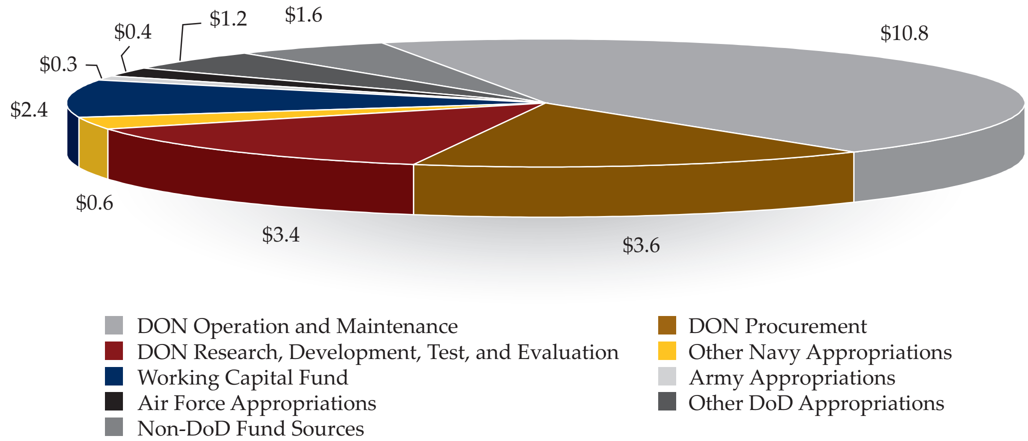
| Supply Management | Depot Maintenance |
|---|---|
| Supply Management, Navy<br>(*https://www.navsup.navy.mil*)<br><br>Supply Management, Marine Corps<br>(*http://www.logcom.usmc.mil*) | Depot Maintenance, Aviation<br>(*http://www.navair.navy.mil*)<br><br>Depot Maintenance, Marine Corps<br>(*http://www.logcom.usmc.mil*) |
| **Base Support** | **Transportation** |
| Facilities Engineering Commands<br>(*https://portal.navfac.navy.mil*)<br><br>Naval Facilities Engineering Service Center<br>(*https://portal.navfac.navy.mil*) | Military Sealift Command<br>(*http://www.msc.navy.mil*) |
| **Research and Development** | |
| Naval Research Laboratory*<br>(*http://www.nrl.navy.mil*)<br><br>Naval Surface Warfare Center<br>(*http://www.navsea.navy.mil*)<br><br>Naval Undersea Warfare Center<br>(*http://www.navsea.navy.mil*) | Naval Air Warfare Center<br>(*http://www.navair.navy.mil*)<br><br>Space and Naval Warfare Systems Centers<br>(*http://enterprise.spawar.navy.mil*)<br><br>*Also see Office of Naval Research<br>(*http://www.onr.navy.mil*) |

### Major Sources and Uses of Funds

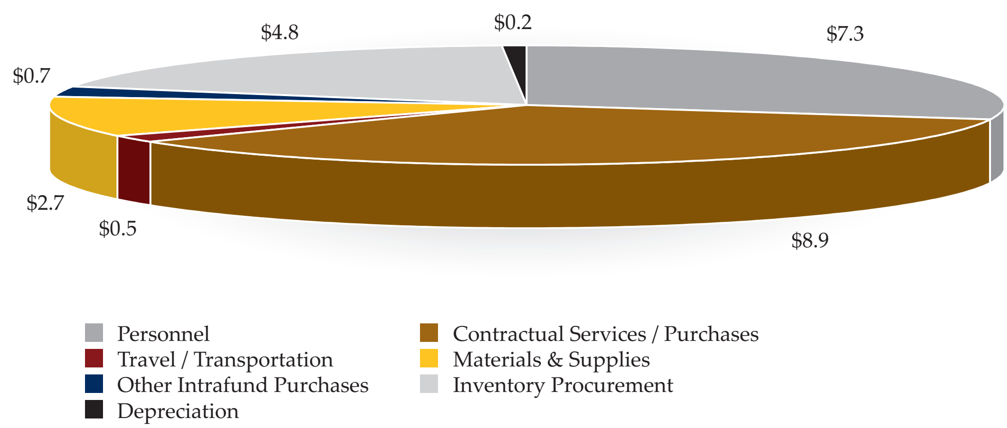
Revenue increased $0.4 billion, or 1.8%, and total costs increased $0.5 billion, or 2.1%, between FY 2007 and FY 2008. Major sources and uses of funding in FY 2008 are displayed below.

More information on NWCF revenue and costs is available in the Consolidated Statement of Net Cost and Note 18.

**Navy Working Capital Fund Major Sources of Funding in FY 2008 ($ in Billions)**




**Navy Working Capital Fund Major Uses of Funding in FY 2008 ($ in Billions)**




## Financial Position

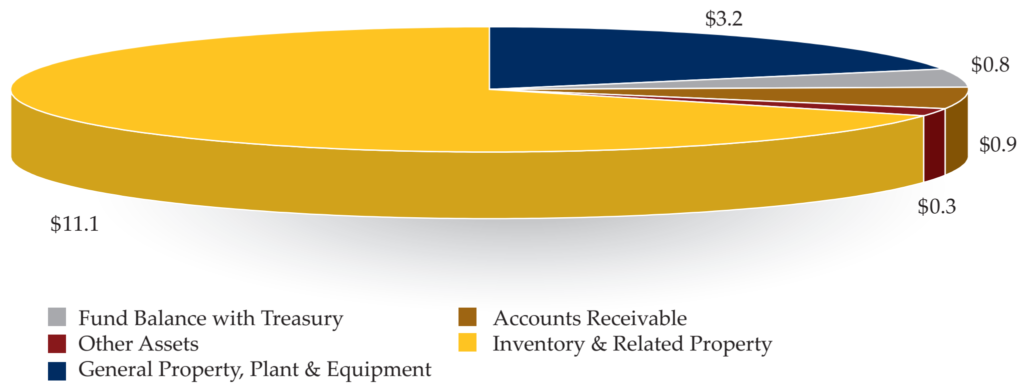
The NWCF continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets (what we own) and total liabilities (what we owe). As of September 30, 2008, net position totaled $10.0 billion, which represents a decrease of $2.0 billion, or 17%, from fiscal year ended 2007. Decreases of $2.0 billion in total assets and $0.07 billion in total liabilities resulted in the overall decrease in net position.

Primary contributors of the decrease in total assets were Inventory and Related Property and Fund Balance with Treasury (FBWT). Inventory clean-up initiatives to improve the categorization and reporting of inventory resulted in lower inventory values due to a revaluation of inventory held for sale. These reclassification and revaluation efforts contributed to a $1.6 billion decrease in Inventory and Related Property. Authorized transfers of funds from NWCF to DON GF drove a decrease of $0.4 billion in FBWT. Included in this authorized transfer was a reprogramming action of $0.1 billion in support of the accelerated Maritime Domain Awareness Initiative, which is a key enabler of the Global War on Terrorism and Homeland Defense Operations.

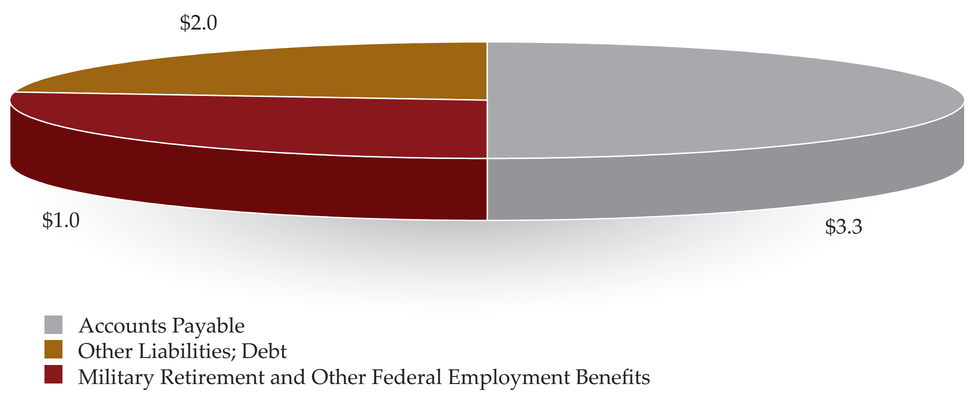
The decrease in total liabilities is primarily attributed to DON financial improvement efforts in liquidating $43.8 million of unsupported accruals at the Naval Sea Systems Command.

More information on NWCF financial position is available in the Consolidated Balance Sheet and related notes.

**FY 2008 Total Assets, Navy Working Capital Fund ($ in Billions)**



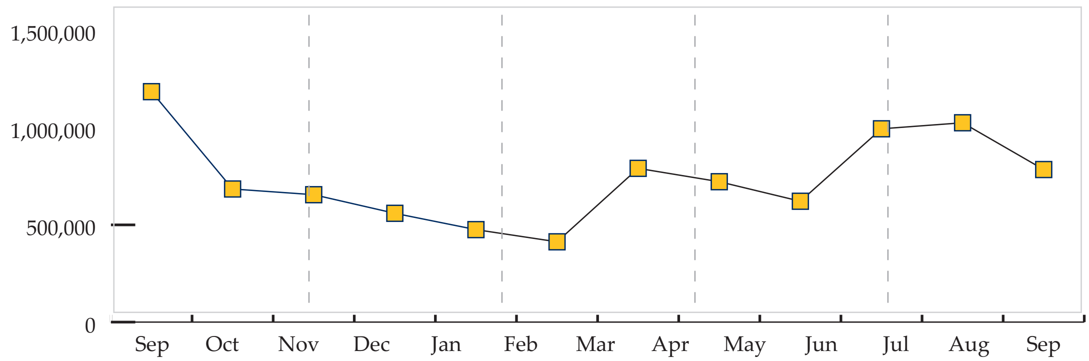

**FY 2008 Total Liabilities, Navy Working Capital Fund ($ in Billions)**




## Cash Management

The DON manages working capital fund cash at the Departmental level. It must maintain cash levels at seven to ten days of operational costs, plus have sufficient cash reserves to meet six months of projected capital outlays, as required by the Department of Defense Financial Management Regulation. For FY 2008, the seven-day cash requirement was $749.0 million and the ten-day requirement was $1.024 billion. The NWCF finished FY 2008 with an ending cash balance of $784.6 million.

**Navy Working Capital Fund Cash Balances, October 1, 2007 to September 30, 2008**
**($ in Thousands)**




*Note: Cash balances above represent the combined total of monthly cash balances for five business areas and the corporate account.*

In FY 2008, the NWCF received fuel supplemental funding of $250.7 million; transferred cash of $102.8 million for the Maritime Domain Awareness reprogramming; and completed three net zero internal NWCF cash realignments to establish and maintain accurate cash balances at the business activity level.

During the transition to the Navy Enterprise Resource Planning (ERP) system, the Naval Air Warfare Center estimated monthly cash collections. By the end of the fiscal year, system deficiencies had been corrected and normal billing processes were in place.

**Cash Management Initiative**

As part of the DON Financial Management Strategic Plan business transformation effort, the NWCF Cash Management Team deployed the Cash Management Tool and a new Cash Management System. The Cash Management Tool increases the capability of NWCF activities to model cash trends. It also automatically populates the Cash Management System to produce the Cash and Revenue/Expense phasing plans in the proper budget submission format. In addition, the Cash Management System produces monthly cash variance reports for each of the NWCF activity groups. Use of the tool and system has resulted in more transparency, improved reporting, and enhanced the development of rates charged to customers.

# Looking Forward

The DON's achievements during FY 2008 established a firm foundation that will assure future success in executing its mission and building a sound business operating environment. In FY 2009 and beyond, DON will remain focused on areas that increase its effectiveness, improve the lives of Sailors and Marines, and result in greater security for the U.S. Below is a brief discussion of a few key areas of emphasis.

## *Maritime Strategy*

The DON, in collaboration with the U.S. Coast Guard, will continue to reinforce and expand core capabilities that prevent war and build partnerships—forward presence, deterrence, sea control, power projection, maritime security, and humanitarian assistance and disaster response. More information on our maritime strategy is available at *http://www.navy.mil/maritime*.

## *Infrastructure Investment*

Support for the DON's 21st century mission is dependent on a reliable, capable, and secure information technology infrastructure. The Navy and Marine Corps have planned several programs to deliver agile and interoperable network-centric capabilities. These programs include the Next Generation Enterprise Network, which will replace the Navy Marine Corps Intranet (NMCI), and the Marine Corps' Command and Control Harmonization Strategy. These emerging capabilities will ensure our forces have accurate situational awareness to enable decision superiority within a secure information environment.

## *Environmental Stewardship*

The DON will build upon its gains in alternative fuel implementation. The DON's new Petroleum Reduction and Alternative Fuel Vehicle Strategy will challenge the Navy and Marine Corps to meet and exceed the established federal goals contained in Executive Order 13423 and the Energy Independence and Security Act of 2007. In FY 2009, the DON will lay the groundwork for a testing and certification program for alternative fuel use.

The DON will continue to afford significant protection to marine mammals while preserving its ability to train using mid-frequency active (MFA) sonar. The tactical use of MFA sonar is the best means of detecting potentially hostile, quiet, diesel-electric submarines. The Navy, working with the National Marine Fisheries Service, is engaged in a three-year controlled exposure study of sound on whales. This study, along with other research, development, test, and evaluation efforts, will provide further information to effectively mitigate the effects of MFA on marine mammals.

## *Business Transformation*

Through more effective management of Business Transformation initiatives, DON will continue to improve the support its business operations provide warfighters. The DON has begun rapidly developing its model for promoting these initiatives and integrating them within DON; an enterprise perspective is necessary for projects that have enterprise-wide implications. The motivation for the Business Transformation movement resulted from the need to improve both vertical alignment with Department of Defense-wide transformation initiatives and horizontal integration of DON enterprise initiatives across functional stove-pipes. This effort also complies with current congressional guidance. Moreover, Business Transformation management is advancing because investment in and expansion of these initiatives will result in improved use of these resources. During FY 2008, the Under Secretary of the Navy was designated the DON Chief Management Officer (CMO), and the DON Business Transformation Council met several times to ratify operating guidelines for the CMO. In FY 2009, DON will form a Business Transformation Office reporting to the CMO. This office will draft plans identifying transformation objectives and identifying the future enterprise business system environment required to support these objectives.

U.S. Navy photo by Mass Communication Specialist 2nd Class Kevin S. O'Brien (Released)

## Department of the Navy Certification of Financial Statements

Pursuant to Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) policy, effective Second Quarter Fiscal Year 2008, the Secretary of the Navy has attested to the accuracy, reliability, and completeness of the Fiscal Year 2008 Department of the Navy General Fund and Navy Working Capital Fund financial statements in a signed certification statement (see next page). The purpose of the OUSD(C) policy is to increase accountability and to more closely align Department of Defense requirements for internal controls over financial reporting with tenets of the Sarbanes-Oxley Act of 2002 (Public Law No. 107-204, Section 302). Sarbanes-Oxley has been the impetus for improved policies relating to internal controls over financial reporting, as reflected in OMB Circular A-123.

THE SECRETARY OF THE NAVY
WASHINGTON, D.C. 20350-1000

October 30, 2008

MEMORANDUM FOR DEPUTY SECRETARY OF DEFENSE

SUBJECT: Department of the Navy (DON) Certification Statement Regarding the Financial Statements for the Period Ended September 30, 2008

Responsibility for the integrity and objectivity of information presented in the financial statements rests with the DON management. This fiscal year's financial statements were prepared to report the financial position and results of operations of the DON for the period ending September 30, 2008. However, the DON is unable to fully implement all elements of Generally Accepted Accounting Principles and the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements,* due to limitations of its financial and non-financial management processes and systems feeding into the financial statements.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting. We have a program in place and are in the process of conducting an assessment of the effectiveness of our internal controls over financial reporting consistent with the criteria in 31 U.S.C. 3512 (c), (d) (commonly referred to as the Federal Managers' Financial Integrity Act) and in Appendix A of OMB Circular No. A-123, *Management's Responsibility for Internal Control.* However, as of September 30, 2008, not all significant internal controls over financial reporting have been tested and, as a result, we are unable to determine their operating effectiveness. Consequently, this assessment provides limited assurance that controls as of September 30, 2008 are established and operating effectively.

With few exceptions, however, documented material weaknesses in controls over financial reporting, to include associated financial systems described in the DON annual statement of assurance, and in the most recent preliminary management representation letter provided to the Department of Defense Office of Inspector General, continue to impair our ability to produce auditable financial statements.

We are addressing the impact of current deficiencies through the Department's Financial Improvement Program components of the Department of Defense Financial Improvement and Audit Readiness Plan (FIAR). We are currently on track to correct all known material weaknesses over financial reporting by FY 2014.

During FY 2008, we:

- Asserted audit readiness of United States Marine Corps (USMC) General Fund Statement of Budgetary Resources and Fund Balance with Treasury;
- Asserted audit readiness of the General Fund Contingent Legal Liabilities;

- Asserted qualified audit readiness for the Naval Research Laboratory, a component of the Navy Working Capital Fund Research and Development business area.
- Completed validation activities for the Military Sealift Command's business processes as a step towards completing audit readiness activities;
- Maintained internal controls testing for the Department's previously asserted Weapons Systems component of Environmental Liabilities, General Fund Investments, and General Fund Cash and Other Monetary Assets;
- Developed a methodology to test internal controls over financial reporting and a strategy to support more comprehensive internal controls testing in FY 2009; and
- Executed the initial implementation of the financially compliant Navy Enterprise Resource Planning (N-ERP) Program, (an integrated business application supporting a large percentage of the Naval Aviation Enterprise).

Based on the information above, I hereby provide limited assurance over the financial statements taken as a whole. Specifically, we also disclose the following:

(a) Our accompanying financial statements are in compliance with laws and regulations governing the use of budget authority. Despite documented material weaknesses we believe our budgetary information used for decision making is accurate and reliable.

(b) We have not comprehensively documented all our processes and controls in a manner that would satisfy an independent auditor conducting a financial statement audit. However, as indicated by the accomplishments above, we are making progress toward this objective. During this fiscal year we've completed control testing of: (1) civilian pay processes at two commands, (2) all environmental liabilities except BRAC, (3) collections and disbursements processed by DFAS, and (4) all USMC business processes.

(c) We cannot provide assurance of controls over financial reporting across all aspects of the departmental financial statements. Noteworthy examples of positive assurance include the budgetary aspects of the USMC General Fund and selected elements of the DON General Fund such as the weapons component of environmental liabilities.

My point of contact is Mr. Mark Easton, DASN for Financial Operations. He can be contacted at 202-685-6701 or email mark.easton@navy.mil.

Donald C. Winter

ATTACHMENTS:
As stated

# General Fund Principal Statements

## Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with Generally Accepted Accounting Principles for Federal entities and the formats prescribed by Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

## Principal Statements

The Fiscal Year 2008 Department of the Navy General Fund principal statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the General Fund for the fiscal year ending September 30, 2008, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2007.

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

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

The principal statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the principal statements.

**Department of Defense**
**Department of the Navy General Fund**

# CONSOLIDATED BALANCE SHEET

**As of September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **ASSETS (Note 2)** | | |
| Intragovernmental: | | |
| Fund Balance with Treasury (Note 3) | $ 118,168,348 | $ 107,344,399 |
| Investments (Note 4) | 10,356 | 9,756 |
| Accounts Receivable (Note 5) | 393,989 | 206,091 |
| Other Assets (Note 6) | 302,751 | 400,261 |
| Total Intragovernmental Assets | 118,875,444 | 107,960,507 |
| Cash and Other Monetary Assets (Note 7) | 137,277 | 142,971 |
| Accounts Receivable, Net (Note 5) | 3,648,029 | 3,613,512 |
| Inventory and Related Property, Net (Note 9) | 60,804,137 | 58,249,650 |
| General Property, Plant and Equipment, Net (Note 10) | 202,484,326 | 189,054,744 |
| Other Assets (Note 6) | 8,560,975 | 8,175,144 |
| Stewardship Property, Plant and Equipment (Note 10) * | | |
| **TOTAL ASSETS** | 394,510,188 | 367,196,528 |
| **LIABILITIES (Note 11)** | | |
| Intragovernmental: | | |
| Accounts Payable (Note 12) | 1,434,076 | 1,495,517 |
| Other Liabilities (Note 15 & Note 16) | 4,430,067 | 4,642,819 |
| Total Intragovernmental Liabilities | 5,864,143 | 6,138,336 |
| Accounts Payable (Note 12) | 2,270,814 | 2,948,867 |
| Military Retirement and Other Federal Employment Benefits (Note 17) | 1,650,038 | 1,648,124 |
| Environmental and Disposal Liabilities (Note 14) | 18,291,417 | 18,789,725 |
| Other Liabilities (Note 15 & Note 16) | 9,131,795 | 6,594,994 |
| Commitments and Contingencies (Note 16) * | | |
| **TOTAL LIABILITIES** | 37,208,207 | 36,120,046 |
| **NET POSITION** | | |
| Unexpended Appropriations - Other Funds | 121,305,364 | 109,221,612 |
| Cumulative Results of Operations - Earmarked Funds | 24,230 | 24,258 |
| Cumulative Results of Operations - Other Funds | 235,972,387 | 221,830,612 |
| **TOTAL NET POSITION** | 357,301,981 | 331,076,482 |
| **TOTAL LIABILITIES AND NET POSITION** | $ 394,510,188 | $ 367,196,528 |

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

*The accompanying notes are an integral part of these statements.*

**Department of Defense**

**Department of the Navy General Fund**

# CONSOLIDATED STATEMENT OF NET COST

**For the Years Ended September 30, 2008 and 2007**

**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **Program Costs** | | |
| Gross Costs | $ 144,511,881 | $ 152,141,735 |
| Less: Earned Revenue | (4,606,524) | (4,375,830) |
| Net Program Costs | 139,905,357 | 147,765,905 |
| **Net Cost of Operations** | $ 139,905,357 | $ 147,765,905 |

*The accompanying notes are an integral part of these statements.*

Department of Defense

Department of the Navy General Fund

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2008 and 2007

($ in Thousands)

| | 2008 Earmarked Funds | 2008 Other Funds |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS** | | |
| **Beginning Balances** | $ 24,258 | $ 221,830,612 |
| **Prior Period Adjustments** | | |
| **Beginning Balances, as adjusted** | 24,258 | 221,830,612 |
| **Budgetary Financing Sources:** | | |
| Appropriations used | 0 | 150,491,563 |
| Nonexchange revenue | 620 | 0 |
| Donations and forfeitures of cash and cash equivalents | 24,216 | 0 |
| Transfers in/out without reimbursement (+/-) | 0 | 102,833 |
| **Other Financing Sources:** | | |
| Transfers in/out without reimbursement (+/-) | 0 | 348,312 |
| Imputed financing from costs absorbed by others | 0 | 678,845 |
| Other (+/-) | (2) | 2,400,717 |
| **Total Financing Sources** | 24,834 | 154,022,270 |
| **Net Cost of Operations (+/-)** | 24,863 | 139,880,494 |
| **Net Change** | (29) | 14,141,776 |
| **Cumulative Results of Operations** | $ 24,229 | $ 235,972,388 |
| | | |
| **UNEXPENDED APPROPRIATIONS** | | |
| **Beginning Balances** | $ 0 | $ 109,221,611 |
| **Prior Period Adjustments (+/-)** | | |
| **Beginning Balances, as adjusted** | 0 | 109,221,611 |
| **Budgetary Financing Sources:** | | |
| Appropriations received | 0 | 162,715,443 |
| Appropriations transferred-in/out (+/-) | 0 | 2,403,645 |
| Other adjustments (rescissions, etc) (+/-) | 0 | (2,543,772) |
| Appropriations used | 0 | (150,491,563) |
| **Total Budgetary Financing Sources** | 0 | 12,083,753 |
| **Unexpended Appropriations** | 0 | 121,305,364 |
| **Net Position** | $ 24,229 | $ 357,277,752 |

*The accompanying notes are an integral part of these statements.*

Department of Defense

Department of the Navy General Fund

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2008 and 2007

($ in Thousands)

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS** | | |
| **Beginning Balances** | $ 221,854,870 | $ 223,851,891 |
| **Prior Period Adjustments** | | |
| **Beginning Balances, as adjusted** | 221,854,870 | 223,851,891 |
| **Budgetary Financing Sources:** | | |
| Appropriations used | 150,491,563 | 139,861,973 |
| Nonexchange revenue | 620 | 461 |
| Donations and forfeitures of cash and cash equivalents | 24,216 | 22,172 |
| Transfers in/out without reimbursement (+/-) | 102,833 | 166,189 |
| **Other Financing Sources:** | | |
| Transfers in/out without reimbursement (+/-) | 348,312 | 91,282 |
| Imputed financing from costs absorbed by others | 678,845 | 730,190 |
| Other (+/-) | 2,400,715 | 4,896,617 |
| **Total Financing Sources** | 154,047,104 | 145,768,884 |
| **Net Cost of Operations (+/-)** | 139,905,357 | 147,765,905 |
| **Net Change** | 14,141,747 | (1,997,021) |
| **Cumulative Results of Operations** | $ 235,996,617 | $ 221,854,870 |
| **UNEXPENDED APPROPRIATIONS** | | |
| **Beginning Balances** | $ 109,221,611 | $ 99,699,301 |
| **Prior Period Adjustments (+/-)** | | |
| **Beginning Balances, as adjusted** | 109,221,611 | 99,699,301 |
| **Budgetary Financing Sources:** | | |
| Appropriations received | 162,715,443 | 150,734,232 |
| Appropriations transferred-in/out (+/-) | 2,403,645 | (21,826) |
| Other adjustments (rescissions, etc) (+/-) | (2,543,772) | (1,328,122) |
| Appropriations used | (150,491,563) | (139,861,973) |
| **Total Budgetary Financing Sources** | 12,083,753 | 9,522,311 |
| **Unexpended Appropriations** | 121,305,364 | 109,221,612 |
| **Net Position** | $ 357,301,981 | $ 331,076,482 |

*The accompanying notes are an integral part of these statements.*

**Department of Defense**

**Department of the Navy General Fund**

# COMBINED STATEMENT OF BUDGETARY RESOURCES

**For the Years Ended September 30, 2008 and 2007**

**($ in Thousands)**

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **BUDGETARY FINANCING ACCOUNTS** | | |
| **Budgetary Resources:** | | |
| Unobligated balance, brought forward, October 1 | $ 23,934,546 | $ 20,835,975 |
| Recoveries of prior year unpaid obligations | 20,966,590 | 16,508,300 |
| Budget Authority: | | |
| Appropriations received | 162,740,229 | 150,757,067 |
| Spending authority from offsetting collections: | | |
| Earned | | |
| Collected | 7,252,127 | 7,690,260 |
| Change in receivables from Federal sources | 262,649 | 317,620 |
| Change in unfilled customer orders | | |
| Advances received | 435,937 | 50,491 |
| Without advance from Federal sources | 305,473 | 7,319 |
| Subtotal | 170,996,415 | 158,822,757 |
| Nonexpenditure Transfers, net, anticipated and actual | 2,506,478 | 144,174 |
| Permanently not available | (2,543,773) | (1,328,122) |
| **Total Budgetary Resources** | 215,860,256 | 194,983,084 |
| | | |
| **Status of Budgetary Resources:** | | |
| Obligations incurred: | | |
| Direct | 179,361,449 | 163,297,807 |
| Reimbursable | 8,470,011 | 7,750,730 |
| Subtotal | 187,831,460 | 171,048,537 |
| Unobligated balance: | | |
| Apportioned | 25,329,935 | 21,765,826 |
| Exempt from apportionment | | |
| Subtotal | 25,329,935 | 21,765,826 |
| Unobligated balances not available | 2,698,861 | 2,168,721 |
| **Total Status of Budgetary Resources** | $ 215,860,256 | $ 194,983,084 |

*The accompanying notes are an integral part of these statements.*

**Department of Defense**

**Department of the Navy General Fund**

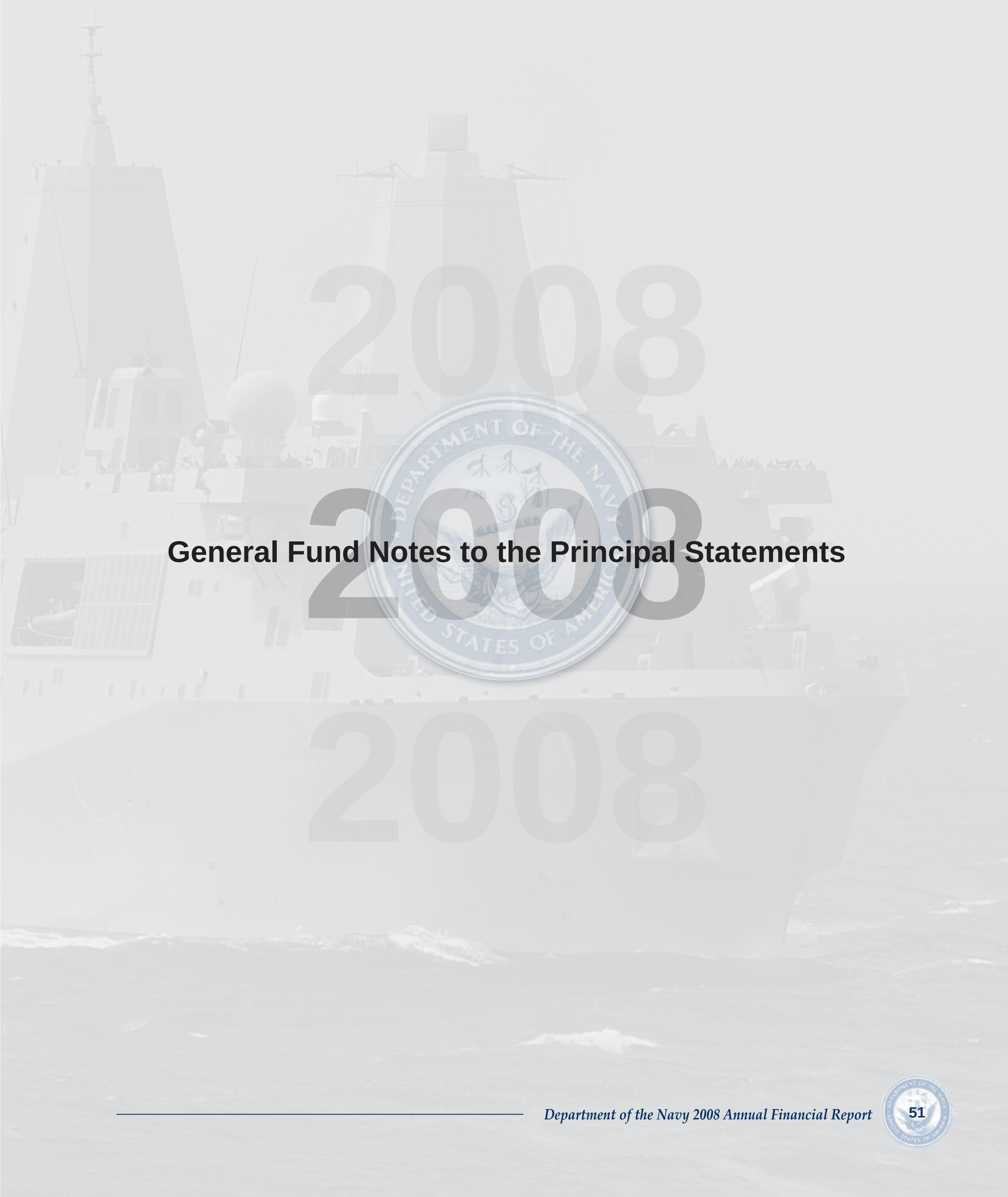
# COMBINED STATEMENT OF BUDGETARY RESOURCES

**For the Years Ended September 30, 2008 and 2007**

**($ in Thousands)**

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **RELATIONSHIP OF OBLIGATIONS TO OUTLAYS** | | |
| **Change in Obligated Balance:** | | |
| Obligated balance, net | | |
| Unpaid obligations, brought forward, October 1 | $ 86,191,077 | $ 78,088,020 |
| Less: Uncollected customer payments from Federal sources, brought forward, October 1 | (3,296,095) | (2,971,157) |
| **Total Unpaid Obligated Balance** | 82,894,982 | 75,116,863 |
| Obligations incurred, net (+/-) | 187,831,460 | 171,048,537 |
| Less: Gross outlays | (159,279,403) | (146,437,179) |
| Less: Recoveries of prior year unpaid obligations, actual | (20,966,590) | (16,508,300) |
| Change in uncollected customer payments from Federal sources (+/-) | (568,123) | (324,938) |
| Obligated balance, net, end of period | | |
| Unpaid obligations | 93,776,544 | 86,191,077 |
| Less: Uncollected customer payments from Federal sources | (3,864,218) | (3,296,095) |
| **Total Unpaid Obligated Balance, net, end of period** | 89,912,326 | 82,894,982 |
| | | |
| **Net Outlays:** | | |
| Gross Outlays | 159,279,403 | 146,437,179 |
| Less: Offsetting collections | (7,688,063) | (7,740,753) |
| Less: Distributed Offsetting receipts | 98,060 | (270,572) |
| **Net Outlays** | $ 151,689,400 | $ 138,425,854 |

*The accompanying notes are an integral part of these statements.*




# General Fund Notes to the Principal Statements

# Note 1. Significant Accounting Policies

## *1.A. Basis of Presentation*

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON) 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 GF in accordance with the Department of Defense (DoD), Financial Management Regulation (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 unless otherwise noted.

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

The DON GF is unable to fully implement all elements of GAAP and the OMB Circular A-136, due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The DON GF derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The DON GF continues to implement process and system improvements addressing these limitations.

The DoDIG has identified several financial statement material weaknesses (i.e., Financial Management Systems; Intragovernmental Eliminations; Unsupported Accounting Entries; Accounts Payable; Accounts Receivable; Fund Balance with Treasury; and the Statement of Net Cost). The DON GF (as identified in the DON FY 2008 Annual Statement of Assurance dated August 28, 2008) recognizes those weaknesses as well as weaknesses associated with Collections and Disbursements and Procure to Pay Processes; Environmental Liabilities; General Equipment; Military Equipment; and Real Property as related to the General Property, Plant and Equipment (GPP&E) line on the Balance Sheet; and Operating Materials and Supplies (OM&S) (and the associated weaknesses with Inventory).

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

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

## *1.C. Appropriations and Funds*

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

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

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

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. Certain trust and special funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits, or purposes, and remain available over time. 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 them from general revenues.

Special fund accounts are used to record government receipts reserved for a specific purpose.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. The DON GF is acting as an agent or a custodian for funds awaiting distribution.

The DON GF is a party to allocation transfers with other federal agencies as a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one agency of its authority to obligate budget authority and outlay funds for another agency. Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity. Exceptions to this general rule apply to specific funds for which OMB has directed that all activity be reported in the financial statements of the child entity. Exceptions include all U.S. Treasury-Managed Trust Funds, Executive Office of the President (EOP), and all other funds specifically designated by OMB.

The DON GF is a party to allocation transfers as the child for the following agencies: the EOP for the Foreign Military Financing Program, as well as for the International Military Education and Training program. These funds meet the OMB exception; however, activities for these funds are reported separately from the DoD financial statements. The DON GF also receives allocation transfers, as the child, from the U.S. Forest Service and the Federal Highway Administration and reports financial activity for those funds to the parent.

## *1.D. Basis of Accounting*

For FY 2008, DON GF's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of 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 (financial and nonfinancial) legacy systems were designed to record information on a budgetary basis.

The DoD 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 current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Until all of

DON GF's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DON GF's financial data will be derived from budgetary transactions (obligations, disbursements and collections), transactions from nonfinancial feeder systems, and accruals made of major items such as payroll expenses, accounts payable, and environmental liabilities.

## 1.E. Revenues and Other Financing Sources

The DON GF 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 GF recognizes revenue as a result of costs incurred for goods or services provided to other federal agencies and the public. Full cost pricing is the DON GF's standard policy for services provided as required by OMB Circular A-25, Transmittal Memorandum #1, User Charges. The DON GF recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The DON GF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 21, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

## 1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because DON GF's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. In the case of OM&S, operating expenses are generally recognized when the items are purchased. Subsequent adjustments to operating expenses are recognized when OM&S is inventoried. Efforts are underway to transition towards the consumption method for recognizing OM&S expenses.

## 1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, DON GF cannot accurately eliminate intragovernmental transactions by customer because DON GF's systems do not track at the transaction level. Generally, seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra-DoD intragovernmental balances are then eliminated. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements to ensure accurate intragovernmental information and to include sufficient up-front edits and controls eliminating the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD and other federal agencies. The U.S. Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government," and the U.S. Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide," provide guidance for reporting and reconciling intragovernmental balances. While DON GF is unable to fully reconcile intragovernmental transactions with all federal partners, DON GF is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

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

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

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

The DON GF's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of 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 DON's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and the USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. The DON GF's recorded balance in FBWT accounts and U.S. Treasury's FBWT accounts must balance monthly.

## 1.J. Foreign Currency

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

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

The DON GF conducts a significant portion of 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 GF does not separately identify foreign currency fluctuation transactions.

## *1.K. Accounts Receivable*

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the U.S. Treasury Financial Manual.

## *1.L. Direct Loans and Loan Guarantees*

Not applicable.

## *1.M. Inventories and Related Property*

Related property is comprised of Operating Materiel and Supplies (OM&S) and stockpile materials. The DON GF 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. When current systems cannot fully support the consumption method, the DON GF uses the purchase method. Under this method, materiel and supplies are expensed when purchased. During FY 2008, DON GF expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for using the consumption method of accounting.

The DON GF manages only military or government specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes all items (including ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment, but excluding real property, installations, and utilities) necessary to equip, operate, maintain, and support military activities without distinction as to its application for administrative or combat purposes. Items commonly used in and available from the commercial sector are not managed in DON GF's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The DON GF holds materiel based on military need and support for contingencies.

The DON GF values OM&S assets using several cost valuation methods. Most OM&S is valued at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy logistics systems were designed for materiel management rather than accounting purposes. Although these systems provide visibility and accountability over inventory and related property items, they do not maintain historical cost data necessary to comply with Statement of

Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." Additionally, these legacy inventory systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, DON is continuing to transition OM&S to the moving average cost method. However, since the on-hand balances, which were 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 determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and required a separate reporting category. Many high dollar items, such as aircraft engines, are categorized as OM&S rather than military equipment.

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

The DON GF reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investment using the effective interest rate method or another method obtaining similar results. The DON GF's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The DON GF invests in nonmarketable market-based U.S. Treasury securities. These are U.S. Treasury securities issued by the Bureau of Public Debt to federal agencies. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

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

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

The DON GF's General Property, Plant, & Equipment (PP&E) capitalization threshold is $100 thousand except for real property, which is $20 thousand. The DON GF has not implemented the threshold for real property. The DON GF is currently using the capitalization threshold of $100 thousand for all General PP&E.

General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the DoD capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the DoD capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

General PP&E previously capitalized at amounts below $100 thousand was written off DON GF financial statements in FY 1998.

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

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

When advances are permitted by law, legislative action, or presidential authorization, the DoD's policy is to record advances or prepayments in accordance with GAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The DON GF has not implemented this policy, primarily due to system limitations.

## *1.Q. Leases*

Lease payments for the rental of 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 GF records the applicable asset and liability if the value equals or exceeds the current capitalization threshold. The DON GF records the amount 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 GF, as the lessee, receives the use and possession of leased property, for example real estate, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits or risk 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 GF in support of contingency operations are the largest component of operating leases. These costs were gathered from existing leases, General Services Administration (GSA) bills, and Interservice 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.

## *1.R. Other Assets*

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments that are not reported elsewhere on DON GF's Balance Sheet.

The DON GF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DON GF may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction in Progress. It is DoD policy to record certain contract financing payments as Other Assets.

## *1.S. Contingencies and Other Liabilities*

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

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

Other liabilities arise as a result of anticipated disposal costs for DON's assets. This type of liability has two components: environmental and nonenvironmental. 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 policy, which is consistent with SFFAS No. 5, "Accounting for Liabilities of the Federal Government." The DoD recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed into service. Such amounts are developed in conjunction with, and not easily identifiable from, environmental disposal costs.

## *1.T. Accrued Leave*

The DON GF reports as liabilities, military leave and civilian earned leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. 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 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 that were not reimbursed.

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

The DoD has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The DON purchases capital assets overseas with appropriated funds; however, the host country retains title to 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. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

## 1.W. Comparative Data

The DON GF's financial statements and notes are presented on a comparative basis.

## 1.X. Unexpended Obligations

The DON GF obligates funds to provide goods and services for outstanding orders not yet delivered. Unless the title has passed, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations includes both obligations for which goods and services have been delivered (title passed) and a liability recognized, and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources, and is referred to as "Total, Unpaid Obligated Balance, net, end of period."

## 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 monthly accounting reports. In-transit payments are those payments that have been made but not recorded in the fund holder's accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

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

## 1.Z. *Significant Events*

During FY 2008, DON began conversion to Navy Enterprise Resource Planning (ERP). In 1st Quarter, FY 2008, the Naval Air Systems Command was the first command to convert to the new system. Though the reporting process improved by year end, the limited data feed from ERP had an effect on the financial statements throughout the year. The standardization of systems and processes in financial functions and acquisition programs is the backbone of Navy ERP and will provide the foundation for subsequent releases. The system will provide financial transparency and total asset visibility, key ingredients for improved enterprise management. Additional commands will convert to ERP in FY 2009 and thereafter.

## 1.AA. *Data Collection Approach*

The DON GF financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance and Accounting Service, Cleveland (DFAS-CL) collects the financial system information and incorporates it into the financial statements for both the Navy and United States Marine Corps. The DON GF collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL for incorporation into the financial statements. On behalf of DON GF, DFAS also collects information from multiple sources, such as intragovernmental data from DON GF's trading partners, which is incorporated into the financial statements. Beginning in FY 2007, DON GF completed migration from the DON Data Collection Instrument to the Defense Departmental Reporting System (DDRS) Data Collection Module (DCM). The DDRS DCM captures certain required financial information from feeder systems for the DON GF financial statements. The DDRS DCM identifies the information requirements to the source provider, provides an audit trail, and integrates data into the financial statement preparation process.

# Note 2. Nonentity Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Assets** | | |
| A. Fund Balance with Treasury | $ 417,049 | $ 516,593 |
| B. Accounts Receivable | 0 | 0 |
| **C. Total Intragovernmental Assets** | $ 417,049 | $ 516,593 |
| **2. Nonfederal Assets** | | |
| A. Cash and Other Monetary Assets | $ 137,277 | $ 142,971 |
| B. Accounts Receivable | 3,339,850 | 3,303,128 |
| C. Other Assets | 0 | 0 |
| **D. Total Nonfederal Assets** | $ 3,477,127 | $ 3,446,099 |
| **3. Total Nonentity Assets** | $ 3,894,176 | $ 3,962,692 |
| **4. Total Entity Assets** | $ 390,616,012 | $ 363,233,836 |
| **5. Total Assets** | $ 394,510,188 | $ 367,196,528 |

Nonentity assets are assets for which the Department of the Navy (DON) maintains stewardship accountability and responsibility to report, but are not available for DON's normal operations.

**Intragovernmental Fund Balance with Treasury.**
This nonentity asset category represents amounts in DON's deposit fund accounts, such as the savings plans that were established by Congress to benefit deployed sailors and Marines, and receipts fund accounts such as the General Fund Proprietary Receipts account that is used to temporarily hold amounts until they are remitted to the U.S. Treasury. Amounts in deposit and receipt accounts are not available for DON's use in normal operations.

**Cash and Other Monetary Assets.**
This nonentity asset category represents disbursing officers' cash, foreign currency, and undeposited collections as reported on the Disbursing Officer's Statement of Accountability. These assets are held by DON disbursing officers as agents of the U.S. Treasury and are not available for DON's use in normal operations.

**Nonentity Nonfederal Accounts Receivable (Public).**
The primary component of nonentity accounts receivable is an advance payment made to a contractor, and associated accrued interest, which remains in litigation. These receivable 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 be remitted to the U.S. Treasury.

## Note 3. Fund Balance with Treasury

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Fund Balances** | | |
| A. Appropriated Funds | $ 116,157,423 | $ 105,133,424 |
| B. Revolving Funds | 1,574,364 | 1,678,815 |
| C. Trust Funds | 17,171 | 13,182 |
| D. Special Funds | 2,341 | 2,385 |
| E. Other Fund Types | 417,049 | 516,593 |
| **F. Total Fund Balances** | $ 118,168,348 | $ 107,344,399 |
| **2. Fund Balances Per Treasury Versus Agency** | | |
| A. Fund Balance per Treasury | $ 119,501,677 | $ 108,480,114 |
| B. Fund Balance per DON | 118,168,348 | 107,344,399 |
| **3. Reconciling Amount** | $ 1,333,329 | $ 1,135,715 |

The total reconciling amount of $1.3 billion in Fund Balance with Treasury (FBWT) is primarily due to cancelled appropriations. Cancelled appropriations are not available as of the end of the reporting period; therefore, they are excluded from the Department of the Navy's (DON) FBWT but remained in fund balance reported by U.S. Treasury.

Other Fund Types (Line 1.E) consists primarily of amounts in the following deposit and receipt accounts: General Fund Proprietary Receipts, Pay of the Navy Deposit Fund, and Pay of the Marine Corps Deposit Fund.

## Status of Fund Balance with Treasury

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Unobligated Balance** | | | | |
| A. Available | $ | 25,329,935 | $ | 21,765,826 |
| B. Unavailable | | 2,698,861 | | 2,168,721 |
| **2. Obligated Balance not yet Disbursed** | $ | 93,776,544 | $ | 86,191,076 |
| **3. Nonbudgetary FBWT** | $ | 237,359 | $ | 524,455 |
| **4. NonFBWT Budgetary Accounts** | $ | (3,874,351) | $ | (3,305,679) |
| **5. Total** | $ | 118,168,348 | $ | 107,344,399 |

The Status of FBWT reflects the budgetary resources to support the FBWT.

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, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts that represent adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts. For DON General Fund (GF), Nonbudgetary FBWT consists of balances in receipt accounts and clearing accounts.

NonFBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT. For DON GF, Non FBWT Budgetary Accounts include Trust Fund investments in U.S. Treasury securities, unfilled customer orders without advance, and reimbursements receivable. This category reduces the Status of FBWT.

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

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

# Note 4. Investments and Related Interest

| As of September 30 | 2008 | | | | |
|---|---|---|---|---|---|
| | Cost | Amortization Method | Amortized (Premium) / Discount | Investments, Net | Market Value Disclosure |
| (Amounts in thousands) | | | | | |
| **1. Intragovernmental Securities** | | | | | |
| A. Nonmarketable, Market-Based | | | | | |
| 1. Military Retirement Fund | $ 0 | | $ 0 | $ 0 | $ 0 |
| 2. Medicare Eligible Retiree Health Care Fund | 0 | | 0 | 0 | 0 |
| 3. US Army Corps of Engineers | 0 | | 0 | 0 | 0 |
| 4. Other Funds | 10,301 | | (51) | 10,250 | 10,279 |
| 5. Total Nonmarketable, Market-Based | 10,301 | | (51) | 10,250 | 10,279 |
| B. Accrued Interest | 106 | | | 106 | 106 |
| **C. Total Intragovernmental Securities** | $ 10,407 | | $ (51) | $ 10,356 | $ 10,385 |
| **2. Other Investments** | | | | | |
| **A. Total Other Investments** | $ 0 | | $ 0 | $ 0 | N/A |

| As of September 30 | 2007 | | | | |
|---|---|---|---|---|---|
| | Cost | Amortization Method | Amortized (Premium) / Discount | Investments, Net | Market Value Disclosure |
| (Amounts in thousands) | | | | | |
| **3. Intragovernmental Securities** | | | | | |
| A. Nonmarketable, Market-Based | | | | | |
| 1. Military Retirement Fund | $ 0 | | $ 0 | $ 0 | $ 0 |
| 2. Medicare Eligible Retiree Health Care Fund | 0 | | 0 | 0 | 0 |
| 3. US Army Corps of Engineers | 0 | | 0 | 0 | 0 |
| 4. Other Funds | 9,630 | | (14) | 9,616 | 9,657 |
| 5. Total Nonmarketable, Market-Based | 9,630 | | (14) | 9,616 | 9,657 |
| B. Accrued Interest | 140 | | | 140 | 140 |
| **C. Total Intragovernmental Securities** | $ 9,770 | | $ (14) | $ 9,756 | $ 9,797 |
| **4. Other Investments** | | | | | |
| **A. Total Other Investments** | $ 0 | | $ 0 | $ 0 | N/A |

**Intragovernmental Investments for Earmarked Funds.**

The Federal Government does not set aside assets to pay future benefits and expenditures associated with earmarked funds. The cash generated from earmarked funds is deposited in the U.S. Treasury, which uses the cash for general Government purposes. U.S. Treasury securities are issued as evidence of earmarked fund receipts. The U.S. Treasury securities are an asset to the Department of the Navy (DON) and a liability to the U.S. Treasury. Because DON and the U.S. Treasury are both parts of the 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. Governmentwide financial statements. The U.S. Treasury securities provide DON with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When DON requires redemption of these securities, the Government finances the securities out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public, by repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Other Funds (Line 1.A.4) represents DON Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the Navy General Gift Fund. These investments are Nonmarketable Market-Based U.S. Treasury securities reported at cost, net of amortized premiums and discounts. In accordance with the Statement of Federal Financial Accounting Standards No. 27, "Identifying and Reporting Earmarked Funds," DON Trust Funds are reported as earmarked funds.

## Note 5. Accounts Receivable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net | Accounts Receivable, Net |
| (Amounts in thousands) | | | | |
| **1. Intragovernmental Receivables** | $ 393,989 | N/A | $ 393,989 | $ 206,091 |
| **2. Nonfederal Receivables (From the Public)** | $ 3,677,354 | $ (29,325) | $ 3,648,029 | $ 3,613,512 |
| **3. Total Accounts Receivable** | $ 4,071,343 | $ (29,325) | $ 4,042,018 | $ 3,819,603 |

## Note 6. Other Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Other Assets** | | |
| A. Advances and Prepayments | $ 302,751 | $ 400,261 |
| B. Other Assets | 0 | 0 |
| **C. Total Intragovernmental Other Assets** | $ 302,751 | $ 400,261 |
| **2. Nonfederal Other Assets** | | |
| A. Outstanding Contract Financing Payments | $ 7,807,128 | $ 7,757,776 |
| B. Advances and Prepayments | 743,840 | 407,362 |
| C. Other Assets (With the Public) | 10,007 | 10,006 |
| **D. Total Nonfederal Other Assets** | $ 8,560,975 | $ 8,175,144 |
| **3. Total Other Assets** | $ 8,863,726 | $ 8,575,405 |

**Nonfederal Other Assets - Outstanding Contract Financing Payments.**
Contract terms and conditions for certain types of contract financing payments convey certain rights to the Department of the Navy (DON) that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and DON is not obligated to make payments to the contractor until delivery and acceptance.

The Outstanding Contract Financing Payment balance of $7.8 billion is comprised of $7.5 billion in contract financing payments and an additional $289.3 million in estimated future payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

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

# Note 7. Cash and Other Monetary Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Cash** | $ 106,883 | $ 107,615 |
| **2. Foreign Currency** | 30,394 | 35,356 |
| **3. Other Monetary Assets** | 0 | 0 |
| **4. Total Cash, Foreign Currency, & Other Monetary Assets** | $ 137,277 | $ 142,971 |

Cash and Foreign Currency consists primarily of cash held by Department of the Navy (DON) Disbursing Officers to carry out their payment, collection, and foreign currency accommodation exchange mission. Foreign currency is also held in overseas banks in support of contingency operations. The primary source of the amounts reported is the Disbursing Officers Statements of Accountability. DON Disbursing Officers are agents of the U.S. Treasury.

**Restriction on Cash, Foreign Currency, and Other Monetary Assets.**
Total Cash, Foreign Currency, and Other Monetary Assets reported are nonentity assets that are not available for DON's use in normal operations. Therefore, the $137.3 million in Cash and Foreign Currency is restricted as to its use.

# Note 8. Direct Loan and Loan Guarantees

Not applicable.

# Note 9. Inventory and Related Property

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Inventory, Net** | $ 0 | $ 0 |
| **2. Operating Materiel & Supplies, Net** | 60,804,137 | 58,249,650 |
| **3. Stockpile Materiel, Net** | 0 | 0 |
| **4. Total** | $ 60,804,137 | $ 58,249,650 |

## Inventory, Net

Not applicable.

## Operating Materiel and Supplies, Net

| As of September 30 | 2008 | | | 2007 | |
|---|---|---|---|---|---|
| | OM&S Gross Value | Revaluation Allowance | OM&S, Net | OM&S, Net | Valuation Method |
| (Amounts in thousands) | | | | | |
| **1. OM&S Categories** | | | | | |
| A. Held for Use | $ 54,867,199 | $ 0 | $ 54,867,199 | $ 52,673,072 | SP, LAC, MAC |
| B. Held for Repair | 7,296,002 | (1,359,064) | 5,936,938 | 5,576,578 | SP, LAC, MAC |
| C. Excess, Obsolete, and Unserviceable | 597,471 | (597,471) | 0 | 0 | NRV |
| **D. Total** | $ 62,760,672 | $ (1,956,535) | $ 60,804,137 | $ 58,249,650 | |

**Legend for Valuation Methods:**

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

**Restrictions on the Use of Operating Materiel and Supplies (OM&S).**
There are no known restrictions on the use of OM&S.

**General Composition of 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 Ammunitions and Munitions, Principal End and Secondary Items, Sponsor Owned Materiel (SOM), Realtime Reutilization Asset Management (RRAM) Materiel and Other OM&S.

Ammunition and Munitions are maintained in the Department of the Navy (DON) Ordnance Information System and valued at latest acquisition cost.

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

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

Materiel maintained and valued in RRAM is considered excess to the owner, or materiel manager responsible for the materiel, but may not be excess to DON. Standard price is used to value all stock-numbered items. Part-numbered items are valued by best available information.

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

**Decision Criteria for Identifying the Category to Which Operating Materiel and Supplies Are Assigned.** The DON GF assigns Inventory items to a category based upon the type and condition of the asset. Inventory Available and Purchased for Resale includes spare and repair parts, clothing and textiles, and petroleum products. Inventory Held for Repair consists of damaged materiel held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable Inventory consists of scrap materiel or items that cannot be economically repaired and are awaiting disposal. Raw Materials consists of items consumed in the production of goods for sale or in the provision of services for a fee.

## Stockpile Materiel, Net

Not applicable.

# Note 10. General PP&E, Net

| As of September 30 | 2008 | | | | | 2007 |
|---|---|---|---|---|---|---|
| | Depreciation/ Amortization Method | Service Life | Acquisition Value | (Accumulated Depreciation/ Amortization) | Net Book Value | Prior FY Net Book Value |
| (Amounts in thousands) | | | | | | |
| **1. Major Asset Classes** | | | | | | |
| A. Land | N/A | N/A | $ 601,649 | N/A | $ 601,649 | $ 603,841 |
| B. Buildings, Structures, and Facilities | S/L | 20 or 40 | 33,163,260 | $ (20,582,861) | 12,580,399 | 12,497,355 |
| C. Leasehold Improvements | S/L | lease term | 7,283 | (1,457) | 5,826 | 6,191 |
| D. Software | S/L | 2-5 or 10 | 11,171 | (9,571) | 1,600 | 1,998 |
| E. General Equipment | S/L | 5 or 10 | 11,048,453 | (6,018,065) | 5,030,388 | 4,776,227 |
| F. Military Equipment | S/L | Various | 326,702,773 | (145,367,183) | 181,335,590 | 168,419,982 |
| G. Assets Under Capital Lease | S/L | lease term | 0 | 0 | 0 | 0 |
| H. Construction-in-Progress | N/A | N/A | 2,928,874 | N/A | 2,928,874 | 2,749,150 |
| I. Other | | | 0 | 0 | 0 | 0 |
| **J. Total General PP&E** | | | $ 374,463,463 | $ (171,979,137) | $ 202,484,326 | $ 189,054,744 |

Note 15 for additional information on Capital Leases

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

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

**Adjustments Resulting from Changes in the Accounting Standards for Military Equipment.**
DON estimates values for Capitalized Military Equipment using department internal records. In 4th Quarter, FY 2007, DON GF implemented the revised DoD definition of military equipment, which excludes training devices and simulators. Implementing the new definition resulted in a reduction of $4.2 billion in the net book value of Military Equipment with an offsetting increase to General Equipment.

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

**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 of historical,

natural, cultural, educational, or artistic significance; or items with significant architectural characteristics. Heritage Assets are expected to be preserved indefinitely. Monetary values are not required for Heritage Asset reporting; only physical units of measure are reported.

- Heritage Assets are items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. The process used to define items as having heritage significance varies between categories and type of assets being evaluated.

- Consultation, as appropriate, is initiated with State Historic Preservation Officers, Tribal Historic Preservation Officers, Advisory Council on Historic Preservation, Native Americans, Native Hawaiians, and other interested agencies whenever DON conducts or supports undertakings that may affect any National Register resource. Preservation considerations are incorporated into routine DON management of historic buildings, structures, districts, sites, ships, aircraft, and other cultural resources.

- 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. These sites are excavated only to the extent required for evaluation and identification. DON currently has 17,699 Archaeological sites.

- Buildings and Structures are listed as or determined eligible for listing on the National Register of Historic Places, including Multi-Use Heritage Assets. DON currently has 4,956 Buildings and Structures.

- Cemeteries are government owned burial grounds on which gravesites of prominent historical figures may be located in addition to other gravesites. DON currently has 62 Cemeteries.

- 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. Refer to DON's Required Supplementary Information for a detailed breakout of Major Collections.

- 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 are shown or maintained for its historical interest. DON currently has 537 Monuments and Memorials.

**Stewardship Land Policy.**
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. 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.

The DON's heritage asset system does not identify the method by which heritage assets were obtained nor does it maintain costs, therefore we are unable to determine the number and value of heritage assets, other than land, that may have been obtained through donation or devise. Examples of heritage assets that are obtained on a regular basis include artwork and historical artifacts, such as papers and mementos that have been donated by former sailors, Marines, and their families.

## Assets Under Capital Lease

Not applicable.

## Note 11. Liabilities Not Covered by Budgetary Resources

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Intragovernmental Liabilities** | | | | |
| A. Accounts Payable | $ | 0 | $ | 0 |
| B. Debt | | 0 | | 0 |
| C. Other | | 3,899,279 | | 3,938,842 |
| **D. Total Intragovernmental Liabilities** | $ | 3,899,279 | $ | 3,938,842 |
| **2. Nonfederal Liabilities** | | | | |
| A. Accounts Payable | $ | 60,712 | $ | 10,568 |
| B. Military Retirement and Other Federal Employment Benefits | | 1,650,038 | | 1,646,486 |
| C. Environmental Liabilities | | 18,291,417 | | 18,305,233 |
| D. Other Liabilities | | 7,114,125 | | 5,052,597 |
| **E. Total Nonfederal Liabilities** | $ | 27,116,292 | $ | 25,014,884 |
| **3. Total Liabilities Not Covered by Budgetary Resources** | $ | 31,015,571 | $ | 28,953,726 |
| **4. Total Liabilities Covered by Budgetary Resources** | $ | 6,192,636 | $ | 7,166,320 |
| **5. Total Liabilities** | $ | 37,208,207 | $ | 36,120,046 |

Liabilities Not Covered by Budgetary Resources are those liabilities that 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 Department of 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.

Conversely, 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.

Accounts payable not covered by budgetary resources is related to cancelled year accounts payable that are not budgeted. Military retirement and other federal employment benefits are future actuarial liabilities. Environmental liabilities are estimates related to future events, such as cleanup of nuclear powered assets that will be budgeted for when those assets are removed from service. Finally, other liabilities for annual leave, estimated legal contingent liabilities, and the disposal of excess structures are not currently budgeted for but will become funded as future events occur.

Intragovernmental Liabilities – Other (Not Covered by Budgetary Resources) (Line 1.C) consists primarily of liabilities to U.S. Treasury related to nonentity assets, and Federal Employees' Compensation Act (FECA) liabilities due to the Department of Labor.

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources are comprised of FECA actuarial liabilities not due and payable during the current fiscal year. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Nonfederal Liabilities – Other (Not Covered by Budgetary Resources) (Line 2.D) consists primarily of liabilities for annual leave and estimated legal contingencies.

## Note 12. Accounts Payable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Accounts Payable | Interest, Penalties, and Administrative Fees | Total | Total |
| (Amounts in thousands) | | | | |
| 1. Intragovernmental Payables | $ 1,434,076 | $ N/A | $ 1,434,076 | $ 1,495,517 |
| 2. Nonfederal Payables (to the Public) | 2,270,741 | 73 | 2,270,814 | 2,948,867 |
| **3. Total** | $ 3,704,817 | $ 73 | $ 3,704,890 | $ 4,444,384 |

Department of the Navy (DON) General Fund (GF) accounting systems do not track intragovernmental transactions by customer at the transaction level, which is required to facilitate reconciliation of intragovernmental accounts payable to the related intragovernmental accounts receivable on other agencies' records that generated the DON GF payable. Therefore, DON GF buyer-side accounts payable and expense balances were adjusted to match seller-side accounts receivable and revenue balances. This is accomplished by reclassifying amounts between federal and nonfederal cost categories, and accruing additional costs when necessary.

In FY 2007, the Department recognized accounts payable balances of the Mechanization of Contract Administration Services system at gross value without reductions for partial, progress payments, and non-accounts payable records overstating accounts payable and expenses. The overstated balances for FY 2007 were undeterminable due to system limitations; therefore, no corrections have been made. Balances at FY 2008 are properly reported net of non-accounts payable records, partial and progress payments of $154.3 billion.

## Note 13. Debt

Not applicable.

# Note 14. Environmental Liabilities and Disposal Liabilities

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Current Liability | Noncurrent Liability | Total | Total |
| (Amounts in thousands) | | | | |
| **1. Environmental Liabilities--Nonfederal** | | | | |
| A. Accrued Environmental Restoration Liabilities | | | | |
| 1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR) | $ 250,056 | $ 2,122,876 | $ 2,372,932 | $ 2,251,651 |
| 2. Active Installations—Military Munitions Response Program (MMRP) | 49,079 | 850,870 | 899,949 | 779,757 |
| 3. Formerly Used Defense Sites—IRP and BD/DR | 0 | 0 | 0 | 0 |
| 4. Formerly Used Defense Sites--MMRP | 0 | 0 | 0 | 0 |
| B. Other Accrued Environmental Liabilities—Non-BRAC | | | | |
| 1. Environmental Corrective Action | 4,373 | 121,543 | 125,916 | 45,976 |
| 2. Environmental Closure Requirements | 1,102 | 623,856 | 624,958 | 728,896 |
| 3. Environmental Response at Operational Ranges | 0 | 19,767 | 19,767 | 25,565 |
| 4. Asbestos | 0 | 0 | 0 | 0 |
| 5. Non-Military Equipment | 0 | 60,024 | 60,024 | 0 |
| 6. Other | 0 | 990 | 990 | 971 |
| C. Base Realignment and Closure Installations | | | | |
| 1. Installation Restoration Program | 321,822 | 1,241,811 | 1,563,633 | 1,679,695 |
| 2. Military Munitions Response Program | 20,563 | 110,874 | 131,437 | 148,760 |
| 3. Environmental Corrective Action / Closure Requirements | 19,422 | 19,250 | 38,672 | 40,291 |
| 4. Asbestos | 0 | 0 | 0 | 0 |
| 5. Non-Military Equipment | 0 | 0 | 0 | 0 |
| 6. Other | 0 | 0 | 0 | 0 |
| D. Environmental Disposal for Military Equipment / Weapons Programs | | | | |
| 1. Nuclear Powered Military Equipment / Spent Nuclear Fuel | 164,248 | 12,091,494 | 12,255,742 | 12,883,022 |
| 2. Non-Nuclear Powered Military Equipment | 0 | 0 | 0 | 0 |
| 3. Other National Defense Weapons Systems | 1,490 | 195,907 | 197,397 | 205,141 |
| 4. Other | 0 | 0 | 0 | 0 |
| E. Chemical Weapons Disposal Program | | | | |
| 1. Chemical Agents and Munitions Destruction (CAMD) | 0 | 0 | 0 | 0 |
| 2. CAMD Assembled Chemical Weapons Assessment (ACWA) | 0 | 0 | 0 | 0 |
| 3. Other | 0 | 0 | 0 | 0 |
| **2. Total Environmental Liabilities** | $ 832,155 | $ 17,459,262 | $ 18,291,417 | $ 18,789,725 |

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

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

**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 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 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 which was the Superfund Amendments and Reauthorization Act of 1986. It established procedures to ensure that actual or threatened hazardous substance releases have proper responses. Another amendment to CERCLA was the Community Environmental Response Facilitation Act 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 and the 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, the Safe Drinking Water Act of 1974 (Well Head Protection Areas) was created. The Clean Air Act 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 shut down. Finally, the Toxic Substances Control Act of 1976 was implemented to understand the health risks of chemical substances by developing production and health risk data from the manufacturers. The control of PCBs is a good example.

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 (DOE). 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: 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, 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 the Normalization of Data System (NORM). Verification, validation, and accreditation 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 Program includes 3,725 clean-up sites at active installations while those installations covered by Base Realignment and Closure (BRAC) funding include 1,129 IRP sites and 32 MMRP sites. The Marine Corps is included in these programs. In addition, the DON Environmental Corrective Action Program at BRAC installations includes 608 sites.

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, Verification, Validation, and Accreditation" of May 2003. Total liabilities (CTC) are not estimated until there is sufficient site-specific data available to estimate the total liability. However, DON uses the cost of the study as the estimate until the study is completed. 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 and completed it in September 2002. Currently there are 251 closed range sites at active installations and 32 sites MMRP sites at BRAC installations.

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 (FIP), DON completed a review of the estimating methodology for determining the cost for disposal of ships and submarines. This review resulted in an environmental and nonenvironmental liability estimate that more accurately reflects the true costs of disposal. The estimating methodology is based on average cost per class of ship rather than an average applied to all ships regardless of class.

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

Accrued Environmental Restoration (DERP Funded) Liabilities.

The DON Environmental Restoration includes those sites that have been identified as legacy cleanup sites. For FY 2008, DON estimated and reported \$3.3 billion for environmental restoration liabilities. This amount is comprised of \$2.4 billion in Active Installations – Installation Restoration Program (IRP) liabilities and \$899.9 million in Active Installations – MMRP, 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-BRAC funds).
The DON defines Non-BRAC environmental units as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retro fill, and/or disposal of PCBs transformers, underground storage tank remedial investigation and closure. As part of the DON FIP efforts, the Navy completed surveying, identifying, and estimating, Non-BRAC units and began recognizing the estimated environmental liability 1st Quarter, FY 2007. For FY 2008, the total Other Accrued Environmental Liabilities is $831.6 million. Of the total, the Navy portion is $569.2 million while the Marine Corps portion is $262.4 million.

Base Realignment and Closure.
BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated BRAC process. For FY 2008, DON estimated and reported $1.7 billion for BRAC funded environmental liabilities. This amount includes $1.6 billion for IRP, $131.4 million for MMRP, and $38.7 million for environmental corrective action and closure requirements. MMRP includes military munitions, chemical residues from military munitions, and munitions scrap at locations on a BRAC installation.

Environmental Disposal for Weapons Systems Programs.
Environmental Disposal for Weapons Systems are those estimates associated with the environmental disposal costs for DON Nuclear Weapons Programs that includes Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. The DON reported an environmental disposal liability for Weapons Systems Programs of $12.5 billion in FY 2008. This amount includes Nuclear Powered Ships of $9.3 billion, Non-Nuclear Powered Ships of $228.7 million, Other Weapons Systems of $197.4 million, and Spent Nuclear Fuel of $2.7 billion.

**4. Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to Inflation, Deflation, Technology, or Applicable Laws and Regulations**
Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of FY 2008, there are no changes to the environmental liability estimates due to changes in laws, regulations, and agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

**5. Description of the Level of Uncertainty Regarding the Accounting Estimates used to calculate the Reported Environmental Liabilities**
The environmental liabilities for DON are based on accounting estimates 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 because the estimates for DERP/BRAC programs are based on the CTC module of the NORM System. A verification, validation, and accreditation were completed by a third party for CTC module of NORM, while the environmental program managers continue to validate the data.

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

The DON believes that the current environmental liabilities for BRAC are reasonable, based upon information available at the time in calculating the estimates. However, as the FY 2005 BRAC closure activities are implemented over the next several fiscal years, the actual results may vary materially from the required accounting 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.

The DON believes that the environmental liabilities for Other Accrued Environmental Liabilities (Non-DERP) for FY 2008 are reasonable, based upon the information available at the time in calculating the estimates and completing the fence to fence survey. However, as internal controls are implemented to sustain this effort, changes to some of the estimates could occur. In addition to the possibility of some of the estimates changing for the current list of identified units, DON may incur additional units and changes to estimates as the inventory of units are reviewed annually.

## Environmental Disclosures

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| A. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment. | 1,590,838 | 1,521,867 |
| B. Changes in total cleanup costs due to changes in laws, regulations, and/or technology. | 0 | 0 |
| C. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods. | 0 | 0 |

Line A. The unrecognized portion of the estimated total cleanup costs is associated with Nuclear Powered Carriers and Submarines, Conventional Ships, Spent Nuclear Fuel, and Non-BRAC. Of the total $1.6 billion, $1.4 billion is associated with Nuclear Powered Carriers and Submarines and Spent Nuclear Fuel, $43.7 million is associated with conventional ships while the remainder of $97.2 million is associated with Non-BRAC.

# Note 15. Other Liabilities

| As of September 30 | 2008 Current Liability | 2008 Noncurrent Liability | 2008 Total | 2007 Total |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Intragovernmental** | | | | |
| A. Advances from Others | $ 57,611 | $ 0 | $ 57,611 | $ 0 |
| B. Deposit Funds and Suspense Account Liabilities | 417,049 | 0 | 417,049 | 516,593 |
| C. Disbursing Officer Cash | 139,608 | 0 | 139,608 | 142,971 |
| D. Judgment Fund Liabilities | 0 | 0 | 0 | 0 |
| E. FECA Reimbursement to the Department of Labor | 152,091 | 198,470 | 350,561 | 559,940 |
| F. Custodial Liabilities | 3,337,519 | 0 | 3,337,519 | 3,303,128 |
| G. Employer Contribution and Payroll Taxes Payable | 54,414 | 0 | 54,414 | 42,452 |
| H. Other Liabilities | 73,305 | 0 | 73,305 | 77,735 |
| **I. Total Intragovernmental Other Liabilities** | $ 4,231,597 | $ 198,470 | $ 4,430,067 | $ 4,642,819 |
| **2. Nonfederal** | | | | |
| A. Accrued Funded Payroll and Benefits | $ 981,664 | $ 0 | $ 981,664 | $ 818,017 |
| B. Advances from Others | 634,361 | 0 | 634,361 | 256,035 |
| C. Deferred Credits | 0 | 0 | 0 | 0 |
| D. Deposit Funds and Suspense Accounts | (9,152) | 0 | (9,152) | 4,173 |
| E. Temporary Early Retirement Authority | 0 | 0 | 0 | 0 |
| F. Nonenvironmental Disposal Liabilities | | | | |
| (1) Military Equipment (Nonnuclear) | 7,748 | 244,509 | 252,257 | 271,142 |
| (2) Excess/Obsolete Structures | 116,171 | 616,611 | 732,782 | 662,973 |
| (3) Conventional Munitions Disposal | 0 | 0 | 0 | 0 |
| G. Accrued Unfunded Annual Leave | 2,550,357 | 0 | 2,550,357 | 2,386,889 |
| H. Capital Lease Liability | 0 | 0 | 0 | 0 |
| I. Contract Holdbacks | 104,823 | 11,077 | 115,900 | 171,814 |
| J. Employer Contribution and Payroll Taxes Payable | 5,576 | 0 | 5,576 | 4,331 |
| K. Contingent Liabilities | 10,539 | 3,857,511 | 3,868,050 | 2,019,620 |
| L. Other Liabilities | 0 | 0 | 0 | 0 |
| **M. Total Nonfederal Other Liabilities** | $ 4,402,087 | $ 4,729,708 | $ 9,131,795 | $ 6,594,994 |
| **3. Total Other Liabilities** | $ 8,633,684 | $ 4,928,178 | $ 13,561,862 | $ 11,237,813 |

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

Contingent Liabilities includes $289.3 million in estimated future contract financing payments that will be paid to the contractors upon delivery and Government acceptance. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payments is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Department of the Navy (DON) General Fund (GF) is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to DON and the amount of potential future payments is estimable, DON GF has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

## Capital Lease Liability

Not applicable.

# Note 16. Commitments and 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 which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON will accrue contingent liabilities for legal actions in those instances where DON's Office of 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 Note 12, "Accounts Payable." See Note 12 for details.

For FY 2008, DON General Fund (GF) materiality threshold for reporting litigation, claims, or assessments is $64.8 million. The DON Office of General Counsel conducts a review of litigation and claims threatened or asserted involving DON General Fund to which Office of General Counsel attorneys devoted substantial attention in the form of legal consultation or representation.

The DON currently has 12 cases that meet the existing FY 2008 DON GF materiality threshold of $64.8 million. DON legal counsel was unable to express an opinion concerning the likely outcome of 10 of 12 cases. Based on information contained in the FY 2008 preliminary and final Legal Representation Letters, management does not have sufficient reason to believe that it is likely that the Government will be liable for the amounts claimed in individual or aggregated cases.

**Methodology used for Estimated Legal Contingent Liabilities**

Due to the inherent uncertainties of litigation, lawyers generally refrain from expressing judgments as to outcomes except in those relatively few clear cases. In response to a Department of Defense (DoD), Inspector General Audit, "DoD Process for Reporting Contingent Legal Liabilities," DON developed a methodology to determine an estimate for contingent legal liabilities. Beginning with 1$^{st}$ Quarter, FY 2007 DON recognized and disclosed an estimate for contingent legal liabilities. The methodology considers the likelihood of an unfavorable outcome or potential liability is provided as an overall assessment of all cases currently pending and not on an individual case basis. The likelihood of an unfavorable or potential liability was determined by using an average of the data from the current year-to-date and the preceding four years.

The total dollar amount of the cases closed was divided by the total dollar amount claimed in those closed cases for each of the last four years plus current year which were then used to calculate the average. This average is based entirely on historical data and represents the percentage that has historically been paid on claims. The merits of each individual case have not been taken into consideration. The estimate for those cases considered reasonably possible to result in an adverse judgment against DON is $17.7 billion. Until sufficient historical data can be collected for the Navy Working Capital Fund, the DON GF estimate will consider all DON funding sources together. The estimate for those cases considered probable to result in an adverse judgment against DON is $3.5 billion. This amount has been recorded in Note 15 as a contingent liability.

The DON is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, DON does not have a systemic process by which it captures or assesses these potential contingent liabilities; therefore, the amounts reported may not fairly present DON contingent liabilities.

The DON GF has recorded in Note 12 a contingent liability in the amount of $60.7 million for obligations related to cancelled appropriations.

The DON GF has recorded in Note 15 a contingent liability in the amount of $94.3 million for Contract Incentives.

## Note 17. Military Retirement and Other Federal Employment Benefits

| As of September 30 | 2008 | | | | 2007 |
|---|---|---|---|---|---|
| | Liabilities | Assumed Interest Rate (%) | (Less: Assets Available to Pay Benefits) | Unfunded Liabilities | Liabilities |
| (Amounts in thousands) | | | | | |
| **1. Pension and Health Actuarial Benefits** | | | | | |
| A. Military Retirement Pensions | $ 0 | | $ 0 | $ 0 | $ 0 |
| B. Military Retirement Health Benefits | 0 | | 0 | 0 | 0 |
| C. Military Medicare-Eligible Retiree Benefits | 0 | | 0 | 0 | 0 |
| D. Total Pension and Health Actuarial Benefits | $ 0 | | $ 0 | $ 0 | $ 0 |
| **2. Other Actuarial Benefits** | | | | | |
| A. FECA | $ 1,650,038 | | $ 0 | $ 1,650,038 | $ 1,646,486 |
| B. Voluntary Separation Incentive Programs | 0 | | 0 | 0 | 0 |
| C. DoD Education Benefits Fund | 0 | | 0 | 0 | 0 |
| D. Total Other Actuarial Benefits | $ 1,650,038 | | $ 0 | $ 1,650,038 | $ 1,646,486 |
| **3. Other Federal Employment Benefits** | $ 0 | | $ 0 | $ 0 | $ 1,638 |
| **4. Total Military Retirement and Other Federal Employment Benefits:** | $ 1,650,038 | | $ 0 | $ 1,650,038 | $ 1,648,124 |

**Federal Employees' Compensation Act.**

Actuarial Cost Method Used and Assumptions:

The DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON only at the end of each fiscal year. The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. 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 U.S. Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Discount Rates
4.368% in Year 1
4.770% 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) 2008 were also used to adjust the methodology's historical payments to current year constant dollars. The compensation COLAs and CPIMs used in the projections for various CBYs were as follows:

| CBY | COLA | CPIM |
|---|---|---|
| 2008 | 3.03% | 4.71% |
| 2009 | 3.87% | 4.01% |
| 2010 | 2.73% | 3.86% |
| 2011 | 2.20% | 3.87% |
| 2012 | 2.23% | 3.93% |
| 2013+ | 2.30% | 3.93% |

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitive analysis of the model to economic assumptions; (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments; (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2008 to the average pattern observed during the most current three CBYs; and (4) a comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections of the most recent three years.

**Other Federal Employment Benefits**

Other federal employment benefits (Line 3) consist primarily of voluntary separation incentive pay for former employees.

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

| Intragovernmental Costs and Exchange Revenue<br>As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| 1. Intragovernmental Costs | $ 42,702,854 | $ 40,664,719 |
| 2. Public Costs | 101,809,027 | 111,477,016 |
| **3. Total Costs** | $ 144,511,881 | $ 152,141,735 |
| 4. Intragovernmental Earned Revenue | $ (3,526,762) | $ (3,466,409) |
| 5. Public Earned Revenue | (1,079,762) | (909,421) |
| **6. Total Earned Revenue** | $ (4,606,524) | $ (4,375,830) |
| **7. Net Cost of Operations** | $ 139,905,357 | $ 147,765,905 |

Intragovernmental costs and revenues are related to transactions made between the Department of the Navy General Fund (DON GF) and another federal entity within the Federal Government.

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

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

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

The DON's accounting systems do not capture information relative to Heritage Assets separately and distinctly from normal operations.

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

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $24.8 million is due to Trust Funds and Special Receipt Accounts included in the Appropriations Received line of the SBR. Refer to Note 20 for additional details.

In the SCNP, all offsetting balances (i.e. transfers-in and transfers-out, revenues, and expenses) for intradepartment activity between earmarked and other (nonearmarked) funds are reported on the same lines. This results in an eliminations column, which appears to contain no balances. In reality, the column contains all appropriate elimination entries, but all net to zero within each respective line except for intraentity imputed financing costs.

**Description of Other Lines on the SCNP**

Other Financing Sources – Other (Line 5.D) represents net gains and losses recorded in relation to the capitalization of assets, such as Real Property, Construction in Progress, Operating Materiel and Supplies, and Military Equipment.

Other Adjustments (Line 13.C) represents reductions to budget authority and rescissions in accordance with Public Law.

## Note 20. Disclosures Related to the Statement of Budgetary Resources

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | $ 97,204,927 | $ 88,903,894 |
| 2. Available Borrowing and Contract Authority at the End of the Period | 0 | 0 |

**Apportionment Categories for Obligations Incurred.**

On the Statement of Budgetary Resources (SBR): Obligations Incurred includes $179.4 billion of Direct Program Obligations and $8.4 billion of Reimbursable Program Obligations.

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

- Direct Obligations, Category A, amounts apportioned quarterly, are $99.7 billion.
- Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are $79.0 billion.

- Total Direct Obligations are therefore $178.7 billion.
- The $693.5 million difference in direct obligations between the SBR and SF-133 is due to adjustments on the SBR to recognize fringe benefits, reclassify reimbursable obligations as noted below, and recognize other adjustments not captured in the field accounting systems.
- Category B Reimbursable Obligations are $8.5 billion.
- The $51.1 million difference in reimbursable obligations between the SBR and SF-133 results from a reclassification adjustment to record trading partner data.

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

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

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the SBR due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $24.8 million is due to the values for Trust Funds and Special Receipt Accounts not being included in the Appropriations Received line of the SCNP.

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

**Permanent, Indefinite Appropriations.**
The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet, including the acquisition, alteration or conversion of vessels. For FY 2008, no transfers to or from NDSF occurred.

The Environmental Restoration, Navy (ER, N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. For FY 2008, four transfers from ER, N for $312.6 million to the Operations and Maintenance, Navy appropriation was recorded; no transfers to ER, N occurred.

# Note 21. Reconciliation of Net Cost of Operations to Budget

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **Resources Used to Finance Activities:** | | |
| Budgetary Resources Obligated: | | |
| 1. Obligations incurred | $ 187,831,460 | $ 171,048,537 |
| 2. Less: Spending authority from offsetting collections and recoveries (-) | (29,222,776) | (24,573,990) |
| 3. Obligations net of offsetting collections and recoveries | $ 158,608,684 | $ 146,474,547 |
| 4. Less: Offsetting receipts (-) | 98,060 | (270,572) |
| 5. Net obligations | $ 158,706,744 | $ 146,203,975 |
| Other Resources: | | |
| 6. Donations and forfeitures of property | 0 | 0 |
| 7. Transfers in/out without reimbursement (+/-) | 348,312 | 91,282 |
| 8. Imputed financing from costs absorbed by others | 678,845 | 730,190 |
| 9. Other (+/-) | 2,400,715 | 4,896,617 |
| 10. Net other resources used to finance activities | $ 3,427,872 | $ 5,718,089 |
| **11. Total resources used to finance activities** | $ 162,134,616 | $ 151,922,064 |
| **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 (-) | $ (8,299,836) | $ (5,855,322) |
| 12b. Unfilled Customer Orders | 741,410 | 57,810 |
| 13. Resources that fund expenses recognized in prior Periods (-) | (750,198) | (4,161,568) |
| 14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations | (98,060) | 270,572 |
| 15. Resources that finance the acquisition of assets (-) | (27,771,911) | (9,847,856) |
| 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 | 0 |
| 16b. Other (+/-) | (2,749,027) | (4,987,899) |
| **17. Total resources used to finance items not part of the Net Cost of Operations** | $ (38,927,622) | $ (24,524,263) |
| **18. Total resources used to finance the Net Cost of Operations** | $ 123,206,994 | $ 127,397,801 |

| As of September 30<br>(Amounts in thousands) | 2008 | 2007 |
|---|---|---|
| **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 | $ 163,468 | $ 1,808,214 |
| 20. Increase in environmental and disposal liability | 37,808 | 1,522,737 |
| 21. Upward/Downward reestimates of credit subsidy expense (+/-) | 0 | 0 |
| 22. Increase in exchange revenue receivable from the public (-) | 0 | 0 |
| 23. Other (+/-) | 1,952,276 | 3,727,419 |
| 24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods | $ 2,153,552 | $ 7,058,370 |
| Components not Requiring or Generating Resources: | | |
| 25. Depreciation and amortization | $ 11,958,197 | $ 8,560,724 |
| 26. Revaluation of assets or liabilities (+/-) | (519,521) | 36,616 |
| 27. Other (+/-) | | |
| 27a. Trust Fund Exchange Revenue | 0 | 0 |
| 27b. Cost of Goods Sold | 0 | 0 |
| 27c. Operating Material and Supplies Used | 3,098,196 | 4,665,050 |
| 27d. Other | 7,939 | 47,344 |
| 28. Total Components of Net Cost of Operations that will not Require or Generate Resources | $ 14,544,811 | $ 13,309,734 |
| **29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period** | $ 16,698,363 | $ 20,368,104 |
| **30. Net Cost of Operations** | $ 139,905,357 | $ 147,765,905 |

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

Due to DON financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. Differences between budgetary and proprietary data are a previously identified deficiency. This causes a difference in net cost between the SNC and the Reconciliation of Net Cost of Operations to Budget that requires an adjustment to the Reconciliation of Net Cost of Operations to Budget. For 4th Quarter, FY 2008, an adjustment of $1.3 thousand was made to Resources that Finance the Acquisition of Assets so that proprietary accounts reconcile with the budgetary accounts.

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

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

**Description of Other Lines.**
Resources Used to Finance Activities – Budgetary Resources Obligated –
The balance of $2.4 billion represents net gains and losses recorded in relation to the capitalization of assets such as Real Property, Construction in Progress, Operating Materiel and Supplies, and Military Equipment.

Resources Used to Finance Items not Part of the Net Cost of Operations –
The balance of $2.8 billion reflects net gains and losses recorded in relation to the net change of the value of assets such as Military Construction, Ammunition, Real Property, and Shipbuilding and Conversion.

Components Requiring or Generating Resources in Future Periods –
The balance of $2.0 billion consists primarily of accrued expenses for contingent legal liabilities.

Components not Requiring or Generating Resources –
The balance of $7.9 million consists primarily of bad debt expense and expenses not requiring budgetary resources.

## Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

# Note 23. Earmarked Funds

| BALANCE SHEET<br>As of September 30<br>(Amounts in thousands) | 2008<br>Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Fund balance with Treasury | $ 0 | $ 0 | $ 19,512 | $ 0 | $ 19,512 |
| Investments | 0 | 0 | 10,356 | 0 | 10,356 |
| Accounts and Interest Receivable | 0 | 0 | 0 | 0 | 0 |
| Other Assets | 0 | 0 | 23 | 0 | 23 |
| **Total Assets** | $ 0 | $ 0 | $ 29,891 | $ 0 | $ 29,891 |
| **LIABILITIES and NET POSITION** | | | | | |
| Military Retirement Benefits and Other Federal Employment Benefits | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Other Liabilities | 0 | 0 | 5,661 | 0 | 5,661 |
| Total Liabilities | $ 0 | $ 0 | $ 5,661 | $ 0 | $ 5,661 |
| Unexpended Appropriations | 0 | 0 | 0 | 0 | 0 |
| Cumulative Results of Operations | 0 | 0 | 24,230 | 0 | 24,230 |
| **Total Liabilities and Net Position** | $ 0 | $ 0 | $ 29,891 | $ 0 | $ 29,891 |
| **STATEMENT OF NET COST**<br>For the year ended September 30 | | | | | |
| Program Costs | $ 0 | $ 0 | $ 24,863 | $ 0 | $ 24,863 |
| Less Earned Revenue | 0 | 0 | 0 | 0 | 0 |
| Net Program Costs | $ 0 | $ 0 | $ 24,863 | $ 0 | $ 24,863 |
| Less Earned Revenues Not Attributable to Programs | 0 | 0 | 0 | 0 | 0 |
| **Net Cost of Operations** | $ 0 | $ 0 | $ 24,863 | $ 0 | $ 24,863 |

| STATEMENT OF CHANGES IN NET POSITION<br>For the year ended September 30 | 2008<br>Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
|---|---|---|---|---|---|
| Net Position Beginning of the Period | $ 0 | $ 0 | $ 24,258 | $ 0 | $ 24,258 |
| Net Cost of Operations | 0 | 0 | 24,863 | 0 | 24,863 |
| Budgetary Financing Sources | 0 | 0 | 24,837 | 0 | 24,837 |
| Other Financing Sources | 0 | 0 | (2) | 0 | (2) |
| Change in Net Position | $ 0 | $ 0 | $ (28) | $ 0 | $ (28) |
| **Net Position End of Period** | $ 0 | $ 0 | $ 24,230 | $ 0 | $ 24,230 |

| **BALANCE SHEET**<br>As of September 30<br>(Amounts in thousands) | 2007 | | | | |
|---|---|---|---|---|---|
| | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
| **ASSETS** | | | | | |
| Fund balance with Treasury | $ 0 | $ 0 | $ 15,568 | $ 0 | $ 15,568 |
| Investments | 0 | 0 | 9,756 | 0 | 9,756 |
| Accounts and Interest Receivable | 0 | 0 | 0 | 0 | 0 |
| Other Assets | 0 | 0 | 22 | 0 | 22 |
| **Total Assets** | $ 0 | $ 0 | $ 25,346 | $ 0 | $ 25,346 |
| **LIABILITIES and NET POSITION** | | | | | |
| Military Retirement Benefits and Other Federal Employment Benefits | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Other Liabilities | 0 | 0 | 1,088 | 0 | 1,088 |
| Total Liabilities | $ 0 | $ 0 | $ 1,088 | $ 0 | $ 1,088 |
| Unexpended Appropriations | 0 | 0 | 0 | 0 | 0 |
| Cumulative Results of Operations | 0 | 0 | 24,258 | 0 | 24,258 |
| **Total Liabilities and Net Position** | $ 0 | $ 0 | $ 25,346 | $ 0 | $ 25,346 |

| **STATEMENT OF NET COST**<br>For the year ended September 30 | | | | | |
|---|---|---|---|---|---|
| Program Costs | $ 0 | $ 0 | $ 18,958 | $ 0 | $ 18,958 |
| Less Earned Revenue | 0 | 0 | 0 | 0 | 0 |
| Net Program Costs | $ 0 | $ 0 | $ 18,958 | $ 0 | $ 18,958 |
| Less Earned Revenues Not Attributable to Programs | 0 | 0 | 0 | 0 | 0 |
| **Net Cost of Operations** | $ 0 | $ 0 | $ 18,958 | $ 0 | $ 18,958 |

| **STATEMENT OF CHANGES IN NET POSITION**<br>For the year ended September 30 | 2007 | | | | |
|---|---|---|---|---|---|
| | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
| Net Position Beginning of the Period | $ 0 | $ 0 | $ 20,393 | $ 0 | $ 20,393 |
| Net Cost of Operations | 0 | 0 | 18,958 | 0 | 18,958 |
| Budgetary Financing Sources | 0 | 0 | 22,823 | 0 | 22,823 |
| Other Financing Sources | 0 | 0 | 0 | 0 | 0 |
| Change in Net Position | $ 0 | $ 0 | $ 3,865 | $ 0 | $ 3,865 |
| **Net Position End of Period** | $ 0 | $ 0 | $ 24,258 | $ 0 | $ 24,258 |

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

**Special Earmarked Funds.**

Wildlife Conservation, Military Reservations, Navy –

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

Kaho'olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy –

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

Rossmoor Liquidating Trust Settlement Account –

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

Ford Island Improvement Account –

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

**Trust Earmarked Funds.**

DON General Gift Fund –

This trust fund is authorized by 10 United States Code 2601. Under the provisions of this statute, the Secretary of the Navy may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that 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 DON.

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

U.S. Naval Academy General Gift Fund –
This trust fund is authorized by 10 United States Code 6973. Under the provisions of this statute, the Secretary of the Navy may accept, hold, administer, and spend any gift, devise, or bequest of personal property, made on the condition that it be used for the benefit, 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 September 30 | 2008 Asset Category | | | |
|---|---|---|---|---|
| | Land and Buildings | Equipment | Other | Total |
| (Amounts in thousands) | | | | |
| **1. ENTITY AS LESSEE-Operating Leases** | | | | |
| Future Payments Due | | | | |
| Fiscal Year | | | | |
| 2009 | 46,189 | 0 | 941 | 47,130 |
| 2010 | 46,750 | 0 | 89 | 46,839 |
| 2011 | 47,811 | 0 | 91 | 47,902 |
| 2012 | 48,897 | 0 | 94 | 48,991 |
| 2013 | 50,008 | 0 | 96 | 50,104 |
| After 5 Years | 51,144 | 0 | 98 | 51,242 |
| **Total Future Lease Payments Due** | $ 290,799 | $ 0 | $ 1,409 | $ 292,208 |

# Note 25. Restatements

For FY 2008, the Department of the Navy General Fund does not have any restatements.

# General Fund Required Supplementary Stewardship Information

**Investments in Research and Development**
**Yearly Investment in Research and Development**
For Fiscal Years 2004 through 2008
*($ in Millions)*

| Categories | FY 08 | FY 07 | FY 06 | FY 05 | FY 04 |
|---|---|---|---|---|---|
| Basic Research | $ 452 | $ 448 | $ 449 | $ 437 | $ 431 |
| Applied Research | 748 | 781 | 739 | 692 | 686 |
| Development | | | | | |
| Advanced Technology Development | 752 | 801 | 912 | 951 | 967 |
| Advanced Component Development and Prototypes | 3,329 | 3,229 | 3,223 | 3,030 | 2,361 |
| System Development and Demonstration | 8,141 | 8,731 | 7,819 | 7,094 | 6,115 |
| Research, Development, Test, and Evaluation Management Support | 1,112 | 1,034 | 1,022 | 955 | 906 |
| Operational Systems Development | 3,943 | 3,810 | 3,399 | 3,775 | 1,820 |
| **Totals** | **$ 18,477** | **$ 18,834** | **$ 17,563** | **$ 16,934** | **$ 13,286** |

## *Narrative Statement:*

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

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

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

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

**2008 Chief of Naval Research Challenge Draws the Best and Brightest in Science and Technology**
The annual Chief of Naval Research (CNR) Challenge offers a monetary reward to participants who submit the best science and technology ideas that could significantly contribute to future military force capabilities. The 2008 CNR Challenge required participants to demonstrate potential and relevance to one of six themes: Fighting at Hypervelocity and Light Speed; Next Generation Hull, Propulsion and Power; Dominating the Electromagnetic Spectrum; Dominating the Battle in Littorals; Out-Thinking and Out-Adapting the Enemy; and Adaptable Autonomous Systems. The Office of Naval Research (ONR) selected 12 finalists out of more than 200 participants who submitted white papers. The large quantity and high caliber of ideas received for the 2008 CNR Challenge emphasize how ONR is perceived as a leader in science and technology.

**Naval Research Laboratory to Design Telescope for Peering into Dark Ages**

A team of scientists and engineers led by the Naval Research Laboratory (NRL) will study how to design a telescope based on the far side of the Moon for peering into the first 100 million years of the Universe's existence. This telescope concept, known as the Dark Ages Lunar Interferometer (DALI), is part of a series of studies sponsored by the National Aeronautics and Space Administration that focus on next-generation space missions for astronomy. The Dark Ages refer to a time in the Universe's history in which no stars existed.

This telescope concept involves using signals from hydrogen atoms, which are imperceptible to the human eye. Hydrogen is the most abundant element in the Universe and the raw material from which stars, planets, and people are formed. If these first signals from hydrogen atoms in the Dark Ages can be detected, astronomers can essentially probe how the first stars, the first galaxies, and ultimately the modern Universe evolved.

With no atmosphere and the Earth as a shield, the far side of the Moon presents a nearly ideal environment for a sensitive Dark Ages telescope. In NRL's DALI concept, scientists and engineers will investigate novel antenna constructions, methods to deploy the antennas, electronics that can survive the harsh lunar environment, and related technology in preparation for developing a roadmap for research and development of a lunar telescope over the next decade.

**B. Applied Research**

Applied Research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is the practical application of such knowledge or understanding for the purpose of meeting the recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs are scientific studies, investigations, and research papers, hardware components, software codes, and limited construction of, or part of, a weapon system to include nonsystem specific development efforts.

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

**Transformable Craft to be Developed**

The U.S. Navy plans to have a Transformable Craft (T-Craft) developed that will be capable of ferrying heavy tanks from ships at sea, through the surf, and onto beachheads around the world. The T-Craft is part of the Sea Base Connector Transformable-Craft program. This program is an integral part of the military's "sea basing" concept, in which floating bases fill in where land bases are unfeasible. This allows U.S. forces to reduce reliance on foreign ports.

ONR has developed design requirements for the T-Craft. It must travel at 40 knots, carry at least six tanks, and be able to survive 57-knot winds and 60-foot waves. It must mitigate wave motion to allow for the transfer of vehicles from one ship to the other. It must also allow for the rapid transfer of military equipment ashore.

**Infrared Free Electron Laser to be Developed**

ONR has long been interested in the potential of directed energy weapons for shipboard defense at the speed of light. ONR has funded development of a laser that can operate in a maritime environment and be consistent with the Navy's planned all-electric ship. One promising technology, the high average power infrared free electron laser (FEL), provides intense beams of laser light that can be tuned to atmosphere-penetrating wavelengths.

ONR has sponsored FEL research at several national laboratories and universities. A laser housed at a national laboratory delivered 10 kilowatts of infrared laser light, making it the most powerful tunable laser in the world. This beam power continues to increase as further development work is done. The use of a superconducting radio frequency accelerator and an energy-recovering electron recirculator provide significant savings in energy consumption and operating costs.

ONR will sponsor further studies on topics, including laser materials damage and atmospheric propagation to assess the potential of new laser-based shipboard defense strategies. Free electron lasers show promise for a wide array of applications in defense and manufacturing, and they support advanced studies of chemistry, physics, biology, and medical science.

The U.S. Navy is also interested in the ultraviolet and terahertz light that the FEL can produce at world-record powers. The Navy plans to leverage its laboratory partnerships and support of the FEL, scaling to the megawatt power level needed for speed-of-light shipboard defense.

**C. Development**

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

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

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

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

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

5. Operational Systems Development is concerned with development projects in support of

programs or upgrades that are still in engineering and manufacturing development. These projects have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

The following are two representative program examples each for the DON and United States Marine Corps for the Development category.

**RATTLRS Technology Creates New Standard for Time-Critical Strike Weaponry**

Meeting the needs of the future joint warfighter demands collaborative efforts. The Revolutionary Approach to Time-critical Long Range Strike (RATTLRS) technology demonstration program, led by the Office of Naval Research and supported by the U.S. Air Force, National Aeronautics and Space Administration, and the Defense Advanced Research Projects Agency, will create a new standard for time-critical strike weaponry.

RATTLRS, using the unique capability of turbine power systems, can be launched from Navy and Air Force platforms, including surface ships, submarines, and aircraft, at subsonic speeds, without a booster, and accelerate on its own accord to cruise speeds in excess of Mach 3. RATTLRS will also combine the latest technological advances in accuracy and targeting with high performance non-afterburning turbine technology found in the YJ102R. This turbine offers supersonic speed, extended range, high fuel efficiency, and the ability to trade speed for increased range.

With its speed, accuracy, range, and responsiveness, RATTLRS will be able to address a wide variety of target types, including mobile, time-critical, hard, or buried targets. RATTLRS will give tomorrow's warfighters a leap ahead in capability and greater flexibility without increased logistical burden.

**Electromagnetic Rail Gun Will Provide High-Volume, Precise, Time-Critical Fires**

The Electromagnetic Rail Gun (EMRG) will provide high-volume, precise, and time-critical fires in all-weather conditions. The goal of the Office of Naval Research EMRG project is to develop and smoothly transition a prototype system that can deliver fires with high accuracy and lethality at distances greater than 200 nautical miles. The rounds will contain little or no high explosive material. Instead, they will inflict damage through high-velocity impact. With no explosives or propellants, the logistics of supporting the weapon will be simplified and crew and safety will be enhanced.

The EMRG barrel contains a pair of metal conducting rails embedded in a structure made of composite materials. Very strong opposing magnetic fields are generated within the launcher by a high current pulse that flows through the rails and a bridging armature positioned behind the projectile when the rail gun is fired. These fields create a propulsive force that accelerates the armature and projectile out of the barrel. The Global Positioning System (GPS)-guided projectile will exit the launcher at approximately 2500 meters per second. On the way to its target, the projectile will leave the Earth's atmosphere, making it less susceptible to jamming or interception, and minimizing interference with friendly aircraft upon re-entry into airspace.

Key tasks of the EMRG project are the development of a launcher, rail gun modeling and simulation toolset, GPS-guided projectile, pulse power system, and integration into a yet-to-be-determined ship class. A 100-shot bore demonstration is planned for 2011 and a long-range integrated system demonstration is planned for 2015. A fully functioning weapon system aboard a deployable ship is planned in the 2020-2025 timeframe.

**Marine Corps Will Field Next Generation of Assault Vehicles**

The Expeditionary Fighting Vehicle (EFV) Program will field a successor to the Marine Corps' current amphibious vehicle, the Assault Amphibious Vehicle Model 7A1. The EFV will provide the principal means of tactical surface mobility for the Marine Air Group Task Force during both ship-to-objective maneuvers and sustained combat operations ashore.

The EFV program is an Acquisition Category-1D program managed by the Marine Corps. The EFV is the next generation of Marine Corps Assault Vehicles being developed to satisfy the requirements of the 21st Century Marine War Fighters. Along with the Landing Craft Air Cushion and the MV-22 Osprey, the EFV will provide the Marine Corps with the tactical mobility assets required within the Expeditionary Maneuver Warfare capstone. Acquisition of the EFV is critical to the Marine Corps.

During FY 2008, the EFV program continued engineering and logistics efforts to support design development, manufacturing planning, and design enhancements of both the EFV Command and Personnel variants. The program continued developmental and reliability test support as well as the design, integration and testing of vehicle modifications that will support the Milestone C Operational Assessment. Developmental Testing and Reliability/Availability/Maintainability (RAM) testing were conducted during FY 2008 that included a water gunnery demo, direction stability demo, amphibious launch and recovery operations with USS New Orleans (PLD-18), and system level shock testing. The Design for Reliability effort continued during this period and followed the established systems engineering processes. Test spares were procured and the System Development Demonstration (SDD) prototypes began to be manufactured.

The SDD-2 contract was awarded during FY 2008. This follow-on SDD Phase will include continued design, development, and reliability upgrades; increased RAM testing; modification of existing SDD prototypes; and manufacture and testing of up to seven additional SDD prototype vehicles.

**Joint Light Tactical Vehicle Will Be Developed and Tested for the Army and Marine Corps**

The Joint Light Tactical Vehicle (JLTV) capabilities represent a shift to adapt from a threat-based, Cold War garrison force focused on containment to a capabilities-based expeditionary force focused on flexibility, survivability, force protection, responsiveness, and agility. The JLTV Family of Vehicles must be capable of operating across a broad spectrum of terrain and weather conditions. The Military Services and the U.S. Special Operations Command require enhanced capabilities, greater than those provided by the existing High Mobility Multipurpose Wheeled Vehicle (HMMWV) to support the Joint Functional Concepts of Battlespace Awareness Force Application, and Focused Logistics. To that end, the approved JLTV Initial Capabilities Document, and the JLTV Capability Development Document identifies required capabilities for the next generation of JLTVs needed to support Joint Forces across the full Range of Military Operations and provide a vital force enabler, multiplier and extender. The initial production of JLTVs will provide the Marine Air Group Task Force commander a family of tactical wheeled vehicles capable of providing combat forces protected, sustained, and netted mobility in irregular warfare operations and enhancing its contribution to the integrated Joint Task Force.

**NON-FEDERAL PHYSICAL PROPERTY**

The DON does not fund this type of Activity.

# General Fund Required Supplementary Information

**Department of the Navy**
**General Property, Plant, and Equipment**
**Real Property Deferred Maintenance**
For Fiscal Year Ended September 30, 2008
*($ in Thousands)*

| Property Type | 1. Plant Replacement Value | 2. Required Work (Deferred Maintenance) | 3. Percentage |
|---|---|---|---|
| Category 1: Enduring Facilities | | | |
| Navy | $ 104,392,918 | $ 23,507,822 | 22.5% |
| Marine Corps | $38,040,907 | $ 1,070,560 | 2.8% |
| Category 2: Excess Facilities or Planned for Replacement | | | |
| Navy | $ 1,679,847 | $ 549,494 | 32.7% |
| Marine Corps | $1,050,183 | $0 | 0.0% |
| Category 3: Heritage Assets | | | |
| Navy | $ 23,958,467 | $ 5,237,923 | 21.9% |
| Marine Corps | $3,133,442 | $88,182 | 2.8% |

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

## *Narrative Statement:*

1. The method used to assess facilities conditions is a facilities inspection, which categorizes buildings as Adequate, Substandard or Inadequate. Those ratings are converted to Quality ratings (Q-ratings) of 100%-90% Q1; 90%-80% Q2; 80%-60% Q3; and less than 60% Q4 by assessing facilities that are rated as Adequate and less than 25 years old as Q1; facilities that are over 25 years old and rated as Adequate as Q2; facilities rated as Substandard as Q3; and Inadequate facilities as Q4.

2. During Fiscal Years (FY) 2005 through 2008, the Navy transitioned to the Facility Condition Assessment Program. The Navy derived its FY 2008 Q-ratings from a combination of facilities inspections and building condition modeling software. Prior to FY 2008, the Navy derived its Q-ratings from inspections of maintenance and repair backlog. The FY 2008 target Q-rating value representing acceptable operating condition for the Navy is Q1.

3. The Department of the Navy (DON) follows the Office of the Secretary of Defense installation strategic plan goal of having facilities at a Q2 level on average as an acceptable rating. This represents an average level of 15% of Plant Replacement Value (PRV) as an acceptable level of deferred maintenance. The table above shows that deferred maintenance for the Navy is valued at 22.5%, 32.7%, and 21.9% of PRV for categories 1 through 3, respectively. The deferred maintenance estimates are based on the facility Q-ratings found in the Navy's real property inventory. The PRV and deferred maintenance estimates are reported for the following Maintenance Fund Sources:

   - Operation and Maintenance, Navy
   - Operation and Maintenance, Navy Reserve
   - Research, Development, Test, and Evaluation

- Other Department of Defense
- Defense Logistics Agency
- Navy Working Capital Fund
- Nonappropriated Fund

The table above also shows that deferred maintenance for the Marine Corps is valued at 2.81% of PRV for categories 1 and 3. The percentage for category 1 and 3 facilities is the same because we cannot separate deferred maintenance between those categories at this time. Category 2 is zero because we do not hold deferred maintenance backlogs on facilities to be demolished.

### *Description of Property Type categories:*

- Category 1 – Buildings, Structures, and Utilities that are enduring and required to support an ongoing mission, including multi-use Heritage Assets.
- Category 2 – Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal, including multi-use Heritage Assets.
- Category 3 – Buildings, Structures, and Utilities that are Heritage Assets.

**Military Equipment Deferred Maintenance**
For Fiscal Year Ended September 30, 2008
*($ in Thousands)*

| Major Category | Amount |
|---|---|
| 1. Aircraft | $ 77,787 |
| 2. Automotive Equipment | 987 |
| 3. Combat Vehicles | 12,973 |
| 4. Construction Equipment | 1,981 |
| 5. Electronics and Communications Systems | 204 |
| 6. Missiles | 48,582 |
| 7. Ships | 29,878 |
| 8. Ordnance Weapons and Munitions | 19,545 |
| 9. General Purpose Equipment | - |
| 10. All Other Items Not Identified Above | 48,557 |
| **Total** | **$ 240,494** |

## *Narrative Statement:*

**Aircraft Deferred Maintenance**
Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), component repair, and software maintenance. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircraft that failed Aircraft Service Period Adjustment (ASPA) inspections or reached fixed Period End Date (PED) at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements

minus actual funded units. Component repair deferred maintenance represents the difference between the validated requirements minus corresponding funding.

Airframe rework and maintenance (active and reserve) is currently performed under both the Standard Depot Level Maintenance (SDLM) and Integrated Maintenance Concept (IMC) programs. Currently, the AV-8B, C-130, C-2, E-2, E-6, EA-6B, F-5, F/A-18, H-1, H-46, H-53, H-60, P-3, and S-3 aircraft programs have been incorporated under the IMC concept. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, but with smaller work packages, thereby reducing out-of-service time. The goal of this program is to improve readiness while reducing operating and support costs. The Naval Air Systems Command's (NAVAIR) Industrial Strategy is to maintain the minimum level of organic capacity, consistent with force levels, that is necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR works in partnership with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance.

**Combat Vehicles Deferred Maintenance**

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

**Missiles Deferred Maintenance**

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

**Ships Deferred Maintenance**

Fleet Type Commanders provide deferred ship maintenance data. Data is collected from the Current Ships' Maintenance Plan (CSMP) database, which captures maintenance actions at all levels (organizational, intermediate, depot) for active and reserve ships. Only depot level deferred maintenance is provided in the calculation of ship deferred maintenance. This includes maintenance actions deferred from actual depot maintenance work-packages as well as maintenance deferred before inclusion in a work package due to fiscal, operational, or capacity constraints. Although there are some deferred maintenance actions, no ships fall into the category of "unacceptable operating condition." Any ship that would be at risk of being in unacceptable operating condition would receive priority for maintenance funding to maintain acceptable operating condition.

**Ordnance Weapons and Munitions Deferred Maintenance**

Ordnance weapons and munitions are part of a broader category, Other Weapons Systems. This category is comprised of ordnance, end item maintenance for support equipment, camera equipment, landing aids, calibration equipment, air traffic control equipment, target systems, expeditionary airfield equipment, special weapons, target maintenance, and repair of repairable components. Three categories define ordnance maintenance: ordnance maintenance, software maintenance, and other. Although the various programs vary in the methodology in defining requirements, all programs define deferred maintenance as the difference between validated requirements and funding.

**Deferred Maintenance on All Other Items Not Identified Above**
This category comprises deferred maintenance for software, radar equipment, arrest gear, lighting and surfacing equipment, and EFTM (external fuel transfer module). The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Software maintenance includes the operational and system test software that runs in the airborne avionics systems (e.g., mission computer, display computer, radar) and the software that runs the ground-based support labs used to perform software sustainment (e.g., compilers, editors, simulation, configuration management).

**Heritage Assets**
For Fiscal Year Ended September 30, 2008

| (a) | (b) | (c) | (d) | (e) | (f) | (g) |
|---|---|---|---|---|---|---|
| Categories | Measurement Quantity | As of 10/01/07 | Adjustments (+/-) | Additions | Deletions | As of 9/30/08 |
| Buildings and Structures [a] | Each | 3,771 | 34 | 1,797 | 21 | 5,581 |
| Archeological Sites | Each | 18,296 | 0 | 441 | 1,068 | 17,669 |
| Museum Collection Items (Fine Art) | Each | 38,728 | (7,647) | 152 | 102 | 31,131 |
| Museum Collection Items (Objects) | See table, "Museum Collection Items (Objects)" | | | | | |

[a] *See table, "Buildings & Structures."*

## *Narrative Statement:*

The DON is required to report Heritage Assets in accordance with the following public laws and regulations:

- Antiquities Act of 1906
- Historic Sites Act of 1935
- USC 470 National Historic Preservation Act of 1966
- National Environmental Policy Act of 1969
- American Indian Religious Freedom Act of 1978
- Archeological Resources Protection Act of 1979
- Native American Graves Protection & Repatriation Act of 1990
- Presidential Memorandum for Heads of Executive Departments and Agencies: Government to Government Relations with Native American Tribal Governments Act of 1994
- 36 CFR 79 – Curation of Federally Owned and Administered Archeological Collections
- 36 CFR 60.4 – National Register of Historic Places

- Federal Accounting Standards Advisory Board (FASAB) Standard No. 29, "Heritage Assets and Stewardship Land"
- Executive Order 13287 – Preserve America – of 2003
- Executive Order 13327 – Federal Real Property Asset Management – of 2004
- SECNAVINST 5755.1A – Navy Museums – of 1992

Heritage Assets are items of historical, natural, cultural, educational, or artistic significance; or items with significant architectural characteristics. Heritage Assets are expected to be preserved indefinitely. Monetary values are not required for Heritage Asset reporting; only physical units of measure are reported.

### *Process Used to Define Assets as Heritage Assets*

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

### *Multi-Use Heritage Assets*

Per DoD FMR Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," Multi-Use Heritage Assets are reported as Heritage Assets in the Required Supplementary Information and on the Balance Sheet as General Property, Plant and Equipment.

### *Information Pertaining to the Condition of DON Heritage Assets*

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

**Buildings & Structures**
For Fiscal Year Ended September 30, 2008

| (a) | (b) | (c) | (d) | (e) | (f) | (g) |
|---|---|---|---|---|---|---|
| **Categories** | **Measurement Quantity** | **As of 10/01/07** | **Adjustments (+/-)** | **Additions** | **Deletions** | **As of 9/30/08** |
| Buildings and Structures | Each | 3,164 | 0 | 1,792 | 0 | 4,956 |
| Cemeteries | Sites | 62 | 0 | 0 | 0 | 62 |
| Monuments & Memorials | Each | 519 | 34 | 5 | 21 | 537 |
| Museums | Each | 26 | 0 | 0 | 0 | 26 |
| | **Total** | **3,771** | **34** | **1,797** | **21** | **5,581** |

**Museum Collection Items (Objects)**
For Fiscal Year Ended September 30, 2008

| (a) | (b) | (c) | (d) | (e) | (f) | (g) |
|---|---|---|---|---|---|---|
| Categories | Measurement Quantity | As of 10/01/07 | Adjustments (+/-) | Additions | Deletions | As of 9/30/08 |
| Archeological Artifacts | Cubic Ft | 35,184 | (12,500) | 1,015 | 0 | 23,699 |
| Archival | Linear Ft | 98,312 | 73,572 | 485 | 12 | 172,357 |
| Historic Artifacts | Item | 1,142,544 | (3,074) | 1,973 | 168 | 1,141,275 |

## *Description of Heritage Assets Categories:*

- Buildings and Structures – Includes buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-use Heritage Assets.
- Archeological Sites – Sites that have been identified, evaluated, and determined to be eligible for listing on, or are listed on, the National Register of Historic Places.
- Museum Collection Items – Items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics. Museum collection items are divided into two subcategories: Objects and Fine Art. Objects are current use, excess, obsolete, or condemned material; war trophies; personal property, such as uniforms, medals, or diaries; and military equipment. Fine art includes paintings, sculptures, and other three-dimensional art.

**Stewardship Land**
For Fiscal Year Ended September 30, 2008
*(Acres in Thousands)*

| (a) | (b) | (c) | (d) | (e) | (f) |
|---|---|---|---|---|---|
| Facility Code | Facility Title | As of 10/01/07 | Additions | Deletions | As of 9/30/08 |
| 9110 | Government Owned Land | 2,093 | 1 | 82 | 2,012 |
| 9111 | State Owned Land | - | - | - | - |
| 9120 | Withdrawn Public Land | - | - | - | - |
| 9130 | Licensed and Permitted Land | - | - | - | - |
| 9140 | Public Land | - | - | - | - |
| 9210 | Land Easement | - | - | - | - |
| 9220 | In-Leased Land | - | - | - | - |
| 9230 | Foreign Land | - | - | - | - |
| | **Totals** | **2,093** | **1** | **82** | **2,012** |

## *Narrative Statement:*

Stewardship Land comprises land and land rights owned by the Federal Government but not acquired for, or in connection with, items of General Property, Plant, and Equipment (PP&E).

The DON categorizes Stewardship Land pursuant to DoD Instruction 4165.14, Real Property Inventory and Forecasting.

Department of Defense
Department of the Navy
**DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES**
For the Years Ended September 30, 2008 and 2007
($ in Thousands)

| | Other | Research, Development, Test & Evaluation | Operation and Maintenance | Procurement |
|---|---|---|---|---|
| **BUDGETARY FINANCING ACCOUNTS** | | | | |
| **BUDGETARY RESOURCES** | | | | |
| Unobligated balance, brought forward, October 1 | $ 10,121 | $ 2,533,037 | $ 1,493,085 | $ 18,122,631 |
| Recoveries of prior year unpaid obligations | 2,366 | 1,527,360 | 4,581,342 | 7,890,220 |
| Budget authority | | | | |
| Appropriation | 325,244 | 18,284,632 | 50,643,329 | 48,169,412 |
| Borrowing authority | 0 | 0 | 0 | 0 |
| Contract authority | 0 | 0 | 0 | 0 |
| Spending authority from offsetting collections | | | | |
| Earned | | | | |
| Collected | (45,318) | 287,381 | 4,973,184 | 983,442 |
| Change in receivables from Federal sources | 1,186 | 93,076 | 55,703 | 47,640 |
| Change in unfilled customer orders | | | | |
| Advance received | 57,611 | 22,187 | 282,146 | 0 |
| Without advance from Federal sources | 0 | (43,126) | (87,348) | 41,225 |
| Anticipated for rest of year, without advances | 0 | 0 | 0 | 0 |
| Previously unavailable | 0 | 0 | 0 | 0 |
| Expenditure transfers from trust funds | 0 | 0 | 0 | 0 |
| Subtotal | 338,723 | 18,644,150 | 55,867,014 | 49,241,719 |
| Nonexpenditure transfers, net, anticipated and actual | (312,578) | 629,487 | 497,688 | 1,357,328 |
| Temporarily not available pursuant to Public Law | 0 | 0 | 0 | 0 |
| Permanently not available | (1,492) | (273,627) | (1,014,001) | (1,158,550) |
| **Total Budgetary Resources** | $ 37,140 | $ 23,060,407 | $ 61,425,128 | $ 75,453,348 |
| **Status of Budgetary Resources:** | | | | |
| Obligations incurred: | | | | |
| Direct | $ 23,855 | $ 20,096,735 | $ 54,125,840 | $ 52,867,759 |
| Reimbursable | 0 | 395,065 | 5,653,380 | 1,050,664 |
| Subtotal | 23,855 | 20,491,800 | 59,779,220 | 53,918,423 |
| Unobligated balance: | | | | |
| Apportioned | 13,285 | 2,244,832 | 120,621 | 21,136,530 |
| Exempt from apportionment | 0 | 0 | 0 | 0 |
| Subtotal | 13,285 | 2,244,832 | 120,621 | 21,136,530 |
| Unobligated balance not available | 0 | 323,775 | 1,525,287 | 398,396 |
| **Total status of budgetary resources** | $ 37,140 | $ 23,060,407 | $ 61,425,128 | $ 75,453,349 |
| **Change in Obligated Balance:** | | | | |
| Obligated balance, net | | | | |
| Unpaid obligations, brought forward, October 1 | 71,882 | 9,332,998 | 21,041,317 | 51,054,445 |
| Less: Uncollected customer payments from Federal sources, brought forward, October 1 | $ 1,186 | $ (340,556) | $ (1,656,654) | $ (181,964) |
| Total unpaid obligated balance | 73,068 | 8,992,442 | 19,384,663 | 50,872,481 |
| Obligations incurred net (+/-) | $ 23,855 | $ 20,491,800 | $ 59,779,220 | $ 53,918,422 |
| Less: Gross outlays | (19,783) | (18,872,226) | (54,666,632) | (40,152,888) |
| Obligated balance transferred, net | | | | |
| Actual transfers, unpaid obligations (+/-) | 0 | 0 | 0 | 0 |
| Actual transfers, uncollected customer payments from Federal sources (+/-) | 0 | 0 | 0 | 0 |
| Total Unpaid obligated balance transferred, net | 0 | 0 | 0 | 0 |
| Less: Recoveries of prior year unpaid obligations, actual | (2,366) | (1,527,360) | (4,581,342) | (7,890,220) |
| Change in uncollected customer payments from Federal sources (+/-) | (1,186) | (49,950) | 31,646 | (88,865) |
| Obligated balance, net, end of period | | | | |
| Unpaid obligations | 73,588 | 9,425,212 | 21,572,563 | 56,929,760 |
| Less: Uncollected customer payments (+/-) from Federal sources (-) | 0 | (390,505) | (1,625,008) | (270,829) |
| Total, unpaid obligated balance, net, end of period | 73,588 | 9,034,707 | 19,947,555 | 56,658,931 |
| **Net Outlays** | | | | |
| **Net Outlays:** | | | | |
| Gross outlays | 19,783 | 18,872,226 | 54,666,632 | 40,152,888 |
| Less: Offsetting collections | (12,293) | (309,569) | (5,255,330) | (983,442) |
| Less: Distributed Offsetting receipts | 98,060 | 0 | 0 | 0 |
| **Net Outlays** | $ 105,550 | $ 18,562,657 | $ 49,411,302 | $ 39,169,446 |

Department of Defense
Department of the Navy
**DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES**
For the Years Ended September 30, 2008 and 2007
($ in Thousands)

| | Military Personnel | Military Construction/ Family Housing | 2008 Combined | 2007 Combined |
|---|---|---|---|---|
| **BUDGETARY FINANCING ACCOUNTS** | | | | |
| **BUDGETARY RESOURCES** | | | | |
| Unobligated balance, brought forward, October 1 | $ 274,873 | $ 1,500,799 | $ 23,934,546 | $ 20,835,975 |
| Recoveries of prior year unpaid obligations | 6,933,843 | 31,459 | 20,966,590 | 16,508,300 |
| Budget authority | | | | |
| Appropriation | 42,393,986 | 2,923,626 | 162,740,229 | 150,757,067 |
| Borrowing authority | 0 | 0 | 0 | 0 |
| Contract authority | 0 | 0 | 0 | 0 |
| Spending authority from offsetting collections | | | | |
| Earned | | | | |
| Collected | 395,400 | 658,036 | 7,252,127 | 7,690,260 |
| Change in receivables from Federal sources | 2,553 | 62,492 | 262,649 | 317,620 |
| Change in unfilled customer orders | | | | |
| Advance received | 5 | 73,988 | 435,937 | 50,491 |
| Without advance from Federal sources | (18,308) | 413,030 | 305,473 | 7,319 |
| Anticipated for rest of year, without advances | 0 | 0 | 0 | 0 |
| Previously unavailable | 0 | 0 | 0 | 0 |
| Expenditure transfers from trust funds | 0 | 0 | 0 | 0 |
| Subtotal | 42,773,636 | 4,131,172 | 170,996,415 | 158,822,757 |
| Nonexpenditure transfers, net, anticipated and actual | 355,345 | (20,792) | 2,506,478 | 144,174 |
| Temporarily not available pursuant to Public Law | 0 | 0 | 0 | 0 |
| Permanently not available | (83,740) | (12,362) | (2,543,773) | (1,328,122) |
| **Total Budgetary Resources** | $ 50,253,957 | $ 5,630,276 | $ 215,860,256 | $ 194,983,084 |
| **Status of Budgetary Resources:** | | | | |
| Obligations incurred: | | | | |
| Direct | $ 49,536,618 | $ 2,710,643 | $ 179,361,449 | $ 163,297,807 |
| Reimbursable | 379,201 | 991,701 | 8,470,011 | 7,750,730 |
| Subtotal | 49,915,819 | 3,702,344 | 187,831,460 | 171,048,537 |
| Unobligated balance: | | | | |
| Apportioned | 34,703 | 1,779,963 | 25,329,935 | 21,765,826 |
| Exempt from apportionment | 0 | 0 | 0 | 0 |
| Subtotal | 34,703 | 1,779,963 | 25,329,935 | 21,765,826 |
| Unobligated balance not available | 303,435 | 147,968 | 2,698,861 | 2,168,721 |
| **Total status of budgetary resources** | $ 50,253,957 | $ 5,630,275 | $ 215,860,256 | $ 194,983,084 |
| **Change in Obligated Balance:** | | | | |
| Obligated balance, net | | | | |
| Unpaid obligations, brought forward, October 1 | 1,968,411 | 2,722,024 | 86,191,077 | 78,088,020 |
| Less: Uncollected customer payments from Federal sources, brought forward, October 1 | $ (41,814) | $ (1,076,294) | $ (3,296,095) | $ (2,971,157) |
| Total unpaid obligated balance | 1,926,597 | 1,645,730 | 82,894,982 | 75,116,863 |
| Obligations incurred net (+/-) | $ 49,915,818 | $ 3,702,344 | $ 187,831,460 | $ 171,048,537 |
| Less: Gross outlays | (43,332,342) | (2,235,533) | (159,279,403) | (146,437,179) |
| Obligated balance transferred, net | | | | |
| Actual transfers, unpaid obligations (+/-) | 0 | 0 | 0 | 0 |
| Actual transfers, uncollected customer payments from Federal sources (+/-) | 0 | 0 | 0 | 0 |
| Total Unpaid obligated balance transferred, net | 0 | 0 | 0 | 0 |
| Less: Recoveries of prior year unpaid obligations, actual | (6,933,843) | (31,459) | (20,966,590) | (16,508,300) |
| Change in uncollected customer payments from Federal sources (+/-) | 15,755 | (475,522) | (568,123) | (324,938) |
| Obligated balance, net, end of period | | | | |
| Unpaid obligations | 1,618,044 | 4,157,377 | 93,776,544 | 86,191,077 |
| Less: Uncollected customer payments (+/-) from Federal sources (-) | (26,059) | (1,551,816) | (3,864,218) | (3,296,095) |
| Total, unpaid obligated balance, net, end of period | 1,591,985 | 2,605,561 | 89,912,326 | 82,894,982 |
| **Net Outlays** | | | | |
| **Net Outlays:** | | | | |
| Gross outlays | 43,332,342 | 2,235,533 | 159,279,403 | 146,437,179 |
| Less: Offsetting collections | (395,405) | (732,024) | (7,688,063) | (7,740,753) |
| Less: Distributed Offsetting receipts | 0 | 0 | 98,060 | (270,572) |
| **Net Outlays** | $ 42,936,937 | $ 1,503,509 | $ 151,689,400 | $ 138,425,854 |

# General Fund Other Accompanying Information

# Appropriations, Funds, and Accounts Included in the Principal Statements

## *Entity Accounts*

**General Funds**

| | |
|---|---|
| 17X0380 | Coastal Defense Augmentation, Navy |
| 17 0703 | Family Housing, Navy and Marine Corps |
| 17 0730 | Family Housing Construction, Navy and Marine Corps |
| 17 0735 | Family Housing Operation and Maintenance, Navy and Marine Corps |
| 17X0810 | Environmental Restoration, Navy |
| 17 1000 | Medicare Eligible Retiree Health 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, Naval 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 |
| 17 1804 | Operation and Maintenance, Navy |
| 17 1806 | Operation and Maintenance, Navy Reserve |
| 17 1810 | Other Procurement, Navy |

**Revolving Funds**

| | |
|---|---|
| 17X4557 | 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 | Rossmoor Liquidating Trust Settlement Account |
| 17X5562 | Ford Island Improvement Account |

## *General Fund Non- Entity Accounts*

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

**Parent-Child (Allocation) Transfer Accounts**

| | |
|---|---|
| 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 |

# Navy Working Capital Fund Principal Statements

## Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with Generally Accepted Accounting Principles for Federal entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

# Principal Statements

The Fiscal Year 2008 Navy Working Capital Fund principal statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the Navy Working Capital Fund for the fiscal year ending September 30, 2008, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2007.

The following statements comprise the Navy Working Capital Fund principal statements:

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

The principal statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the principal statements.

**Department of Defense**
**Navy Working Capital Fund**

# CONSOLIDATED BALANCE SHEET

**As of September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **ASSETS (Note 2)** | | |
| Intragovernmental: | | |
| Fund Balance with Treasury (Note 3) | $ 784,593 | $ 1,156,401 |
| Accounts Receivable (Note 5) | 854,151 | 698,039 |
| Other Assets (Note 6) | 2,303 | 3,886 |
| Total Intragovernmental Assets | 1,641,047 | 1,858,326 |
| Cash and Other Monetary Assets (Note 7) | (3,353) | 0 |
| Accounts Receivable, Net (Note 5) | 11,635 | 86,078 |
| Inventory and Related Property, Net (Note 9) | 11,064,646 | 12,671,057 |
| General Property, Plant and Equipment, Net (Note 10) | 3,210,420 | 3,404,310 |
| Other Assets (Note 6) | 293,597 | 294,072 |
| Stewardship Property, Plant and Equipment (Note 10) * | | |
| **TOTAL ASSETS** | 16,217,992 | 18,313,843 |
| **LIABILITIES (Note 11)** | | |
| Intragovernmental: | | |
| Accounts Payable (Note 12) | 168,350 | 207,232 |
| Debt (Note 13) | 16,881 | 70,697 |
| Other Liabilities (Note 15 & Note 16) | 420,131 | 179,553 |
| Total Intragovernmental Liabilities | 605,362 | 457,482 |
| Accounts Payable (Note 12) | 3,070,115 | 3,381,559 |
| Military Retirement and Other Federal Employment Benefits (Note 17) | 1,035,874 | 1,047,589 |
| Other Liabilities (Note 15 & Note 16) | 1,551,549 | 1,445,842 |
| Commitments and Contingencies (Note 16) * | | |
| **TOTAL LIABILITIES** | 6,262,900 | 6,332,472 |
| **NET POSITION** | | |
| Unexpended Appropriations - Other Funds | 60,156 | 33,595 |
| Cumulative Results of Operations - Other Funds | 9,894,936 | 11,947,776 |
| **TOTAL NET POSITION** | 9,955,092 | 11,981,371 |
| **TOTAL LIABILITIES AND NET POSITION** | $ 16,217,992 | $ 18,313,843 |

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

*The accompanying notes are an integral part of these statements.*

**Department of Defense**

**Navy Working Capital Fund**

# CONSOLIDATED STATEMENT OF NET COST

**For the Years Ended September 30, 2008 and 2007**

**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **Program Costs** | | |
| Gross Costs | $ 24,912,489 | $ 23,582,179 |
| Less: Earned Revenue | (21,840,461) | (22,257,566) |
| Net Program Costs | 3,072,028 | 1,324,613 |
| **Net Cost of Operations** | $ 3,072,028 | $ 1,324,613 |

*The accompanying notes are an integral part of these statements.*

Department of Defense
Navy Working Capital Fund

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

**For the Years Ended September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS** | | |
| **Beginning Balances** | $ 11,947,778 | $ 12,928,685 |
| **Prior Period Adjustments** | | |
| **Beginning Balances, as adjusted** | 11,947,778 | 12,928,685 |
| **Budgetary Financing Sources:** | | |
| Appropriations used | 158,111 | 85,166 |
| Nonexchange revenue | 50,323 | 0 |
| Transfers in/out without reimbursement (+/-) | (102,832) | 112,504 |
| **Other Financing Sources:** | | |
| Transfers in/out without reimbursement (+/-) | (66,968) | 17,242 |
| Imputed financing from costs absorbed by others | 429,565 | 475,066 |
| Other (+/-) | 550,987 | (346,274) |
| **Total Financing Sources** | 1,019,186 | 343,704 |
| **Net Cost of Operations (+/-)** | 3,072,028 | 1,324,613 |
| **Net Change** | (2,052,842) | (980,909) |
| **Cumulative Results of Operations** | $ 9,894,936 | $ 11,947,776 |

*The accompanying notes are an integral part of these statements.*

**Department of Defense**

**Navy Working Capital Fund**

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

**For the Years Ended September 30, 2008 and 2007**

**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **UNEXPENDED APPROPRIATIONS** | | |
| **Beginning Balances** | $ 33,595 | $ 2,896 |
| **Prior Period Adjustments (+/-)** | | |
| **Beginning Balances, as adjusted** | 33,595 | 2,896 |
| **Budgetary Financing Sources:** | | |
| Appropriations received | 286,072 | 116,192 |
| Appropriations transferred-in/out | (80,000) | |
| Other adjustments (rescissions, etc) (+/-) | (21,400) | (327) |
| Appropriations used | (158,111) | (85,166) |
| **Total Budgetary Financing Sources** | 26,561 | 30,699 |
| **Unexpended Appropriations** | 60,156 | 33,595 |
| **Net Position** | $ 9,955,092 | $ 11,981,371 |

*The accompanying notes are an integral part of these statements.*

**Department of Defense**
**Navy Working Capital Fund**

# COMBINED STATEMENT OF BUDGETARY RESOURCES

**For the Years Ended September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **BUDGETARY FINANCING ACCOUNTS** | | |
| **Budgetary Resources:** | | |
| Unobligated balance, brought forward, October 1 | $ 1,525,166 | $ 2,547,953 |
| Recoveries of prior year unpaid obligations | 85,626 | 31,229 |
| Budget Authority: | | |
| Appropriations received | 286,074 | 116,192 |
| Contract authority | 6,014,993 | 5,673,309 |
| Spending authority from offsetting collections: | | |
| Earned | | |
| Collected | 24,398,770 | 23,784,389 |
| Change in receivables from Federal sources | 274,593 | 263,324 |
| Change in unfilled customer orders | | |
| Advances received | 20,881 | (4,720) |
| Without advance from Federal sources | 703,403 | (357,667) |
| Anticipated for rest of year, without advances | | 0 |
| Subtotal | 31,698,714 | 29,474,827 |
| Nonexpenditure Transfers, net, anticipated and actual | (182,833) | 112,504 |
| Permanently not available | (5,701,987) | (6,597,645) |
| **Total Budgetary Resources** | 27,424,686 | 25,568,868 |
| | | |
| **Status of Budgetary Resources:** | | |
| Obligations incurred: | | |
| Direct | 144,111 | 599 |
| Reimbursable | 24,457,687 | 24,043,103 |
| Subtotal | 24,601,798 | 24,043,702 |
| Unobligated balance: | | |
| Apportioned | 2,773,872 | 1,525,168 |
| Exempt from apportionment | 44,445 | (60,183) |
| Subtotal | 2,818,317 | 1,464,985 |
| Unobligated balances not available | 4,571 | 60,181 |
| **Total Status of Budgetary Resources** | $ 27,424,686 | $ 25,568,868 |

*The accompanying notes are an integral part of these statements.*

Department of Defense
Navy Working Capital Fund

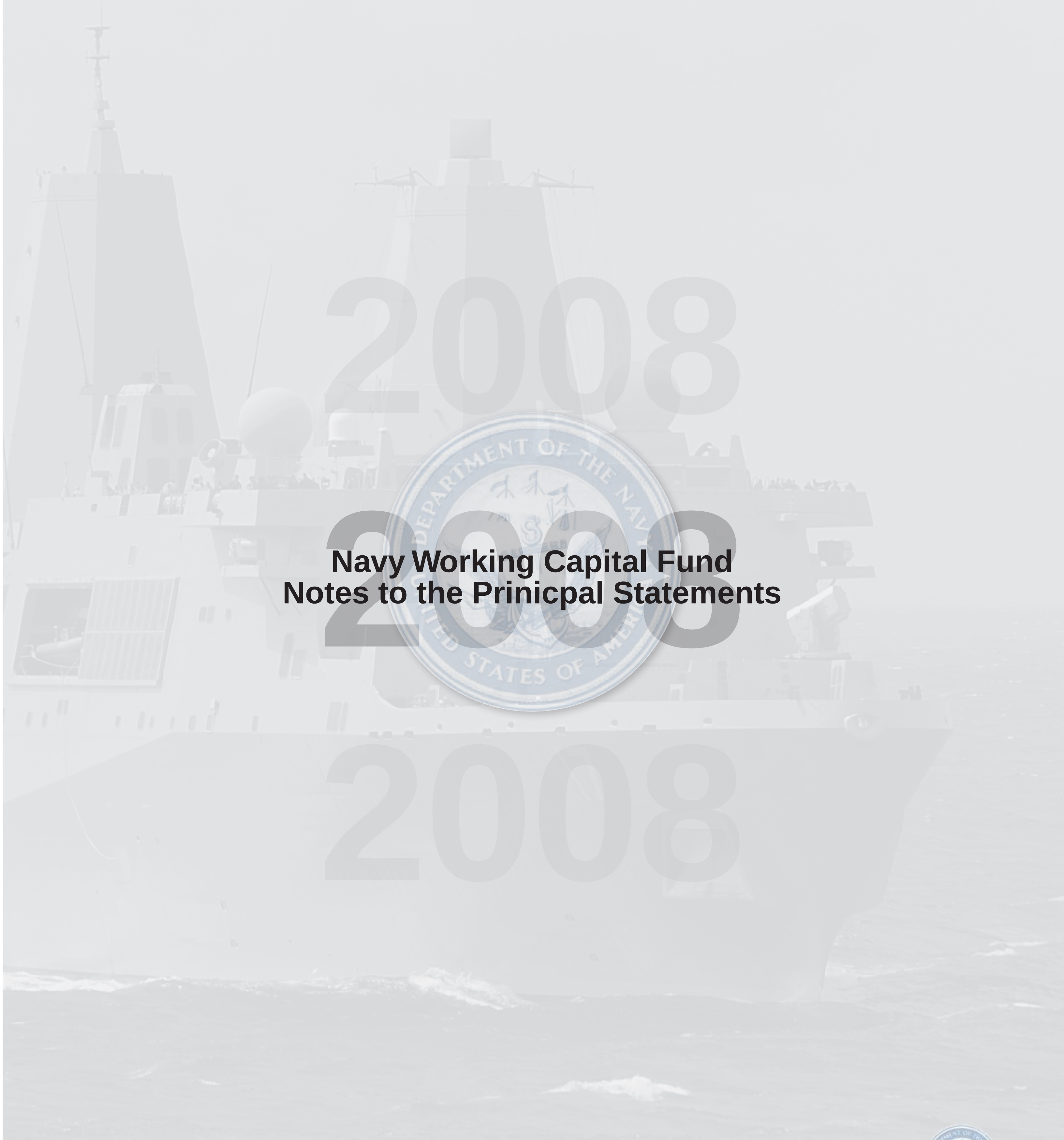
# COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2008 and 2007

($ in Thousands)

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **RELATIONSHIP OF OBLIGATIONS TO OUTLAYS** | | |
| **Change in Obligated Balance:** | | |
| Obligated balance, net | | |
| Unpaid obligations, brought forward, October 1 | $ 12,129,800 | $ 12,112,506 |
| Less: Uncollected customer payments from | | |
| Federal sources, brought forward, October 1 | (7,281,919) | (7,376,260) |
| **Total Unpaid Obligated Balance** | 4,847,881 | 4,736,246 |
| Obligations incurred, net (+/-) | 24,601,798 | 24,043,702 |
| Less: Gross outlays | (24,820,298) | (23,995,180) |
| Less: Recoveries of prior year unpaid obligations, actual | (85,627) | (31,229) |
| Change in uncollected customer | | |
| payments from Federal sources (+/-) | (978,001) | 94,343 |
| Obligated balance, net, end of period | | |
| Unpaid obligations | 11,825,673 | 12,129,800 |
| Less: Uncollected customer payments from | | |
| Federal sources | (8,259,920) | (7,281,919) |
| **Total Unpaid Obligated Balance, net, end of period** | 3,565,753 | 4,847,881 |
| | | |
| **Net Outlays:** | | |
| Gross Outlays | 24,820,298 | 23,995,180 |
| Less: Offsetting collections | (24,419,646) | (23,779,670) |
| **Net Outlays** | $ 400,652 | $ 215,510 |

*The accompanying notes are an integral part of these statements.*



# Navy Working Capital Fund Notes to the Prinicpal Statements

# Note 1. Significant Accounting Policies

## 1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Navy Working Capital Fund (NWCF), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the NWCF in accordance with the Department of Defense (DoD), Financial Management Regulation (FMR), Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible, generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the NWCF is responsible unless otherwise noted.

The NWCF is unable to fully implement all elements of GAAP and OMB Circular A-136, due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The NWCF derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The NWCF continues to implement process and system improvements addressing these limitations.

The NWCF currently has 7 auditor identified financial statement material weaknesses: (1) Financial Management Systems, (2) Fund Balance with Treasury, (3) Accounts Receivable, (4) Inventory and Related Property, (5) General Equipment, (6) Accounts Payable, and (7) Other Liabilities.

## 1.B. Mission of the Reporting Entity

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

## 1.C. Appropriations and Funds

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

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

## 1.D. Basis of Accounting

For FY 2008, the NWCF's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the NWCF's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of the NWCF's (financial and nonfinancial) legacy systems were designed to record information on a proprietary basis.

The DoD 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 current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Until all of the NWCF's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the NWCF's financial data will be derived from proprietary transactions, transactions from nonfinancial feeder systems, and accruals made of major items, such as payroll expenses and accounts payable.

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

Depot Maintenance WCF activities recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items. Research and Development activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Revenue is recognized at the time service is rendered for Base Support WCF activities. The Transportation WCF activity, Military Sealift Command, recognizes revenue on either a reimbursable or per diem basis. The preponderance of per diem projects are billed and collected in the month services are rendered. In the case of remaining per diem projects, revenue is accrued in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered. MSC does not generate bills until actual invoiced costs on the project are recorded.

The NWCF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 21, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost-sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

## *1.F. Recognition of Expenses*

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because the NWCF's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items, such as payroll expenses, accounts payable, and unbilled revenue. In the case of Operating Materiel and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to transition towards the consumption method for recognizing OM&S expenses.

## *1.G. Accounting for Intragovernmental Activities*

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, the NWCF cannot accurately eliminate intragovernmental transactions by customer because the NWCF's systems do not track at the transaction level. Generally, seller entities within the DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. IntraDoD intragovernmental balances are then eliminated. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements to ensure accurate intragovernmental information, to include sufficient up-front edits and controls eliminating the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service 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 U.S. Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. While the NWCF is unable to fully reconcile intragovernmental transactions with all federal partners, the NWCF is able to reconcile balances pertaining to borrowings from the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

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

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

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

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

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. The NWCF's recorded balance in FBWT accounts and U.S. Treasury's FBWT accounts must balance monthly.

## *1.J. Foreign Currency*

Not applicable.

## 1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual.

## 1.L. Direct Loans and Loan Guarantees

Not applicable.

## 1.M. Inventories and Related Property

The NWCF values 100% of its inventories at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the Statement of Federal Financial Accounting Standards (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). At the current time, NWCF does not report any inventory using the moving average cost method. However, by utilizing new system development processes, the NWCF will be transitioning to the moving average cost method with the implementation of the Navy Enterprise Resource Planning (ERP).

The NWCF manages only military or government specific materiel under normal conditions. Materiel is a unique term that relates to military force management and includes all items (including ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment, but excluding real property, installations, and utilities) necessary to equip, operate, maintain, and support military activities without distinction as to its application for administrative or combat purposes. Items commonly used in and available from the commercial sector are not managed in the NWCF materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The NWCF holds materiel based on military need and support for contingencies. The DoD does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future sale" based on SFFAS No. 3 definitions, unless otherwise noted.

Related property includes OM&S and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The NWCF uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the NWCF uses the purchase method. Under this method, materiel and supplies are expensed when purchased. During FY 2008, the NWCF expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

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

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

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

Not applicable.

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

The NWCF's General Property Plant & Equipment (PP&E) capitalization threshold is $100 thousand except for real property which is $20 thousand. The NWCF has not implemented the threshold for real property. The NWCF is currently using the capitalization threshold of $100 thousand for all General PP&E.

General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the DoD capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed DoD capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

The WCF capitalizes all General PP&E used in the performance of their mission. These capitalized assets are categorized as General PP&E, whether or not it meets the definition of any other General PP&E categories.

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

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

When advances are permitted by law, legislative action, or presidential authorization, the DoD's policy is to record advances and prepayments in accordance with GAAP. As such, payments made in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The NWCF has not implemented this policy primarily due to system limitations.

## 1.Q. Leases

Lease payments for the rental of 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), NWCF records the applicable asset and liability if the value equals or exceeds the current capitalization threshold. The NWCF records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The NWCF as the lessee receives the use and possession of leased property, for example real estate, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space and leases entered into by NWCF in support of contingency operations are the largest component of operating leases. These costs were gathered from existing leases, General Services Administration (GSA) bills, and Interservice 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.

## 1.R. Other Assets

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

The NWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, NWCF may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as Construction in Progress. It is DoD policy to record certain contract financing payments as other assets.

## 1.S. Contingencies and Other Liabilities

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

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

## 1.T. Accrued Leave

The NWCF reports as liabilities military leave and civilian earned leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. 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 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 that were not reimbursed.

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

The DoD has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The NWCF purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow the NWCF 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. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

## 1.W. Comparative Data

The NWCF financial statements and notes are presented on a comparative basis.

## 1.X. Unexpended Obligations

The NWCF obligates funds to provide goods and services for outstanding orders not yet delivered. Unless the title has passed, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations includes both obligations for which goods and services have been delivered (title passed) and a liability recognized, and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources, and is referred to as "Total, unpaid obligated balances, net, end of period."

## 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 monthly accounting reports. In-transit payments are those payments that have been made but have not been recorded in the fund holder's accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are applied to the entities' accounts receivable balance.

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

## 1.Z. Significant Events

During FY 2008, DON began conversion to Navy ERP. In 1st Quarter, FY 2008, the Naval Air Systems Command was the first command to convert to the new system. The DON anticipated some issues associated with implementing ERP but the future benefits (greater asset visibility, business process standardization, improved funds management and improved planning efficiencies) of ERP far outweigh these issues. The implementation of ERP materially affected many accounts (e.g. collections, disbursements, accounts receivable, accounts payable, and other liabilities) causing them to be misstated during FY 2008. The DON is currently working these issues and should see improvement in the near future. Additional commands will convert to ERP in FY 2009 and thereafter.

# Note 2. Nonentity Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Assets** | | |
| A. Fund Balance with Treasury | $ 0 | $ 0 |
| B. Accounts Receivable | 0 | 0 |
| **C. Total Intragovernmental Assets** | $ 0 | $ 0 |
| **2. Nonfederal Assets** | | |
| A. Cash and Other Monetary Assets | $ 0 | $ 0 |
| B. Accounts Receivable | 3,369 | 3,031 |
| C. Other Assets | 0 | 0 |
| **D. Total Nonfederal Assets** | $ 3,369 | $ 3,031 |
| **3. Total Nonentity Assets** | $ 3,369 | $ 3,031 |
| **4. Total Entity Assets** | $ 16,214,623 | $ 18,310,812 |
| **5. Total Assets** | $ 16,217,992 | $ 18,313,843 |

Nonentity assets are assets for which the Navy Working Capital Fund (NWCF) maintains stewardship accountability and responsibility to report, but are not available for NWCF operations.

The Nonentity Accounts Receivable amount represents interest, penalties, fines and administrative fees. These fees do not belong to NWCF and will be distributed directly to the U.S. Treasury.

# Note 3. Fund Balance with Treasury

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Fund Balances** | | |
| A. Appropriated Funds | $ 0 | $ 0 |
| B. Revolving Funds | 784,593 | 1,156,401 |
| C. Trust Funds | 0 | 0 |
| D. Special Funds | 0 | 0 |
| E. Other Fund Types | 0 | 0 |
| **F. Total Fund Balances** | $ 784,593 | $ 1,156,401 |
| **2. Fund Balances Per Treasury Versus Agency** | | |
| A. Fund Balance per Treasury | $ 784,593 | $ 1,156,401 |
| B. Fund Balance per NWCF | 784,593 | 1,156,401 |
| **3. Reconciling Amount** | $ 0 | $ 0 |

## Status of Fund Balance with Treasury

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Unobligated Balance** | | | | |
| A. Available | $ | 2,818,318 | $ | 1,464,986 |
| B. Unavailable | | 4,571 | | 60,181 |
| **2. Obligated Balance not yet Disbursed** | $ | 11,825,672 | $ | 12,129,800 |
| **3. Nonbudgetary FBWT** | $ | 0 | $ | 0 |
| **4. NonFBWT Budgetary Accounts** | $ | (13,863,968) | $ | (12,498,566) |
| **5. Total** | $ | 784,593 | $ | 1,156,401 |

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support FBWT.

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 yet been received, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represent adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

NonFBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT. This amount is comprised of contract authority, accounts receivable, and unfilled orders without advance from customers for the Navy Working Capital Fund (NWCF). This category reduces the Status of FBWT.

All unobligated unavailable balances are restricted to future use and are not apportioned for current use. The unavailable balance consists of contract and budgetary authority from closed NWCF activities as a result of the financial closure process.

# Note 4. Investments and Related Interest

Not applicable.

# Note 5. Accounts Receivable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net | Accounts Receivable, Net |
| (Amounts in thousands) | | | | |
| **1. Intragovernmental Receivables** | $ 854,151 | N/A | $ 854,151 | $ 698,039 |
| **2. Nonfederal Receivables (From the Public)** | $ 11,664 | $ (29) | $ 11,635 | $ 86,078 |
| **3. Total Accounts Receivable** | $ 865,815 | $ (29) | $ 865,786 | $ 784,117 |

# Note 6. Other Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Other Assets** | | |
| A. Advances and Prepayments | $ 2,303 | $ 3,886 |
| B. Other Assets | 0 | 0 |
| **C. Total Intragovernmental Other Assets** | $ 2,303 | $ 3,886 |
| **2. Nonfederal Other Assets** | | |
| A. Outstanding Contract Financing Payments | $ 21,583 | $ 27,116 |
| B. Advances and Prepayments | 241,231 | 150,244 |
| C. Other Assets (With the Public) | 30,783 | 116,712 |
| **D. Total Nonfederal Other Assets** | $ 293,597 | $ 294,072 |
| **3. Total Other Assets** | $ 295,900 | $ 297,958 |

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

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Navy Working Capital Fund (NWCF) that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and NWCF is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

The Contract Financing Payment balance of $21.6 million is entirely comprised of estimated future funded payments that will be paid to the contractor upon future delivery and Federal Government acceptance of a satisfactory product. See additional discussion in Note 15, Other Liabilities.

The outstanding debt principal amount in Other Assets (With the Public) is reported in order to reconcile with the amount incorrectly reported by the Federal Financing Bank (FFB). As required by the Office of Under Secretary of Defense (Comptroller) memorandum of January 22, 1999, Transportation, Military Sealift Command is correctly recording payments to FFB as operating expense. The misclassification by FFB has generated this long-standing reporting problem. See additional discussion in Note 13, Debt.

## Note 7. Cash and Other Monetary Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Cash** | $ (3,353) | $ 0 |
| **2. Foreign Currency** | 0 | 0 |
| **3. Other Monetary Assets** | 0 | 0 |
| **4. Total Cash, Foreign Currency, & Other Monetary Assets** | $ (3,353) | $ 0 |

Cash has an abnormal balance of $3.4 million due to a posting issue within a feeder system used by the Naval Facilities Engineering Command (NAVFAC). The Department of Navy (DON) is currently researching the issue and will resolve in 2nd Quarter, FY 2009.

## Note 8. Direct Loan and Loan Guarantees

Not applicable.

## Note 9. Inventory and Related Property

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| 1. Inventory, Net | $ 10,802,686 | $ 12,313,482 |
| 2. Operating Materiel & Supplies, Net | 261,960 | 357,575 |
| 3. Stockpile Materiel, Net | 0 | 0 |
| **4. Total** | $ 11,064,646 | $ 12,671,057 |

# Inventory, Net

| As of September 30 | 2008 | | | 2007 | |
|---|---|---|---|---|---|
| | Inventory, Gross Value | Revaluation Allowance | Inventory, Net | Inventory, Net | Valuation Method |
| (Amounts in thousands) | | | | | |
| **1. Inventory Categories** | | | | | |
| A. Available and Purchased for Resale | $ 31,796,212 | $ (22,927,668) | 8,868,544 | $ 3,472,486 | LAC,MAC |
| B. Held for Repair | 5,656,646 | (4,017,038) | 1,639,608 | 8,533,061 | LAC,MAC |
| C. Excess, Obsolete, and Unserviceable | 930,548 | (930,548) | 0 | 0 | NRV |
| D. Raw Materiel | 0 | 0 | 0 | 0 | MAC,SP,LAC |
| E. Work in Process | 294,534 | 0 | 294,534 | 307,935 | AC |
| **F. Total** | $ 38,677,940 | $ (27,875,254) | 10,802,686 | $ 12,313,482 | |

**Legend for Valuation Methods:**

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

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

1) Distributions without reimbursement are made when authorized by Department of Defense (DoD) directives;

2) War reserve materiel in the amount of $84.3 million includes repair items that are considered restricted; and

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

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

Inventory available and purchased for resale includes consumable spare and repair parts as well as repairable items owned and managed by the Navy Working Capital Fund (NWCF) and includes all materiel available for customer purchase. Inventory held for repair consists of damaged materiel that requires repair to make it usable and all economically repairable materiel. Excess inventory includes scrap materiels or items that are uneconomical to repair and are awaiting disposal. Work in process includes costs related to the production or servicing of items, including direct materiel, direct labor, applied overhead, and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer.

Federal Accounting Standards require disclosure of the amount of inventory held for "future sale." The NWCF currently has no inventory held for future sale reported for 4th Quarter, FY 2008 in Inventory Held for Sale, Net. All inventory is currently planned for sale next fiscal year.

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

The Supply Management, Navy's inventory is reported using the approximation of historical cost method as discussed in the Financial Management Regulation (FMR) Volume 11B, Chapter 55. The approximation of historical cost is calculated by using the latest acquisition cost less the allowance for holding gains and losses. Legacy inventory systems were designed to capture materiel management information rather than accounting data. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." Since the implementation of the Office of Under Secretary of Defense, Comptroller (OUSD (C)) Cost of Goods Sold Model, prior year values in equity, inventory, and inventory allowance accounts have been impacted and remain noncompliant with SFFAS No. 3 and generally accepted accounting principles. The Navy Enterprise Resource Planning System will value inventory at moving average cost and will be compliant with necessary guidance.

## Operating Materiel and Supplies, Net

| As of September 30 | 2008 | | | 2007 | |
|---|---|---|---|---|---|
| | OM&S Gross Value | Revaluation Allowance | OM&S, Net | OM&S, Net | Valuation Method |
| (Amounts in thousands) | | | | | |
| **1. OM&S Categories** | | | | | |
| A. Held for Use | $ 261,960 | $ 0 | $ 261,960 | $ 357,575 | SP, LAC, MAC |
| B. Held for Repair | 0 | 0 | 0 | 0 | SP, LAC, MAC |
| C. Excess, Obsolete, and Unserviceable | 0 | 0 | 0 | 0 | NRV |
| **D. Total** | $ 261,960 | $ 0 | $ 261,960 | $ 357,575 | |

**Legend for Valuation Methods:**

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

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

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

Federal Accounting Standards require disclosure of the amount of OM&S held for "future use." The NWCF reports that $4.3 million of OM&S is held for future use and is included in the "held for use" category. These items are not readily available in the market and there is a more than remote chance that they will eventually be needed.

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

# Stockpile Materiel, Net

Not applicable.

# Note 10. General PP&E, Net

| As of September 30 | 2008 | | | | | 2007 |
|---|---|---|---|---|---|---|
| | Depreciation/ Amortization Method | Service Life | Acquisition Value | (Accumulated Depreciation/ Amortization) | Net Book Value | Prior FY Net Book Value |
| (Amounts in thousands) | | | | | | |
| **1. Major Asset Classes** | | | | | | |
| A. Land | N/A | N/A | $ 39,335 | N/A | $ 39,335 | $ 41,681 |
| B. Buildings, Structures, and Facilities | S/L | 20 or 40 | 6,338,727 | $ (4,391,877) | 1,946,850 | 1,956,094 |
| C. Leasehold Improvements | S/L | lease term | 348 | (289) | 59 | 50 |
| D. Software | S/L | 2-5 or 10 | 489,163 | (347,044) | 142,119 | 157,300 |
| E. General Equipment | S/L | 5 or 10 | 2,596,306 | (2,104,726) | 491,580 | 610,504 |
| F. Military Equipment | S/L | Various | 0 | 0 | 0 | 0 |
| G. Assets Under Capital Lease | S/L | lease term | 0 | 0 | 0 | 0 |
| H. Construction-in- Progress | N/A | N/A | 588,192 | N/A | 588,192 | 635,879 |
| I. Other | | | 2,285 | 0 | 2,285 | 2,802 |
| **J. Total General PP&E** | | | $ 10,054,356 | $ (6,843,936) | $ 3,210,420 | $ 3,404,310 |

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

There are no known restrictions on the use or convertibility of General Property, Plant and Equipment (PP&E) nor are there any adjustments resulting from changes in the accounting standards.

Military equipment is reported on the financial statements of the Department of the Navy General Fund (DON GF).

Heritage assets and stewardship land are reported on the financial statements of the DON GF.

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

# Assets Under Capital Lease

Not applicable.

## Note 11. Liabilities Not Covered by Budgetary Resources

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Liabilities** | | |
| A. Accounts Payable | $ 0 | $ 0 |
| B. Debt | 0 | 0 |
| C. Other | 214,104 | 3,031 |
| **D. Total Intragovernmental Liabilities** | $ 214,104 | $ 3,031 |
| **2. Nonfederal Liabilities** | | |
| A. Accounts Payable | $ 0 | $ 0 |
| B. Military Retirement and Other Federal Employment Benefits | 1,035,873 | 1,047,588 |
| C. Environmental Liabilities | 0 | 0 |
| D. Other Liabilities | 0 | 0 |
| **E. Total Nonfederal Liabilities** | $ 1,035,873 | $ 1,047,588 |
| **3. Total Liabilities Not Covered by Budgetary Resources** | $ 1,249,977 | $ 1,050,619 |
| **4. Total Liabilities Covered by Budgetary Resources** | $ 5,012,923 | $ 5,281,853 |
| **5. Total Liabilities** | $ 6,262,900 | $ 6,332,472 |

Liabilities not covered by budgetary resources are liabilities for which congressional action is needed before budgetary resources can be provided.

Other Intragovernmental Liabilities consist of custodial liabilities for interest, penalties, fines and administrative fees receivable held on behalf of the U.S Treasury. These fees will be distributed directly to the U.S. Treasury when collected, and the corresponding liabilities reduced.

Military Retirement and Other Federal Employment Benefits not covered by budgetary resources are comprised of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities are primarily comprised of Federal Employees' Compensation Act Actuarial liability of $1.0 billion. See Note 17, Military Retirement and Other Federal Employment Benefits, for additional disclosures.

# Note 12. Accounts Payable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Accounts Payable | Interest, Penalties, and Administrative Fees | Total | Total |
| (Amounts in thousands) | | | | |
| 1. Intragovernmental Payables | $ 168,350 | $ N/A | $ 168,350 | $ 207,232 |
| 2. Nonfederal Payables (to the Public) | 3,070,115 | 0 | 3,070,115 | 3,381,559 |
| **3. Total** | $ 3,238,465 | $ 0 | $ 3,238,465 | $ 3,588,791 |

The Navy Working Capital Fund's (NWCF) systems do not track Intragovernmental transactions by customer at the transaction level. Therefore, internal Department of Defense buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable and unearned revenue. Accounts payable were adjusted by reclassifying amounts between federal and nonfederal accounts payable.

# Note 13. Debt

| As of September 30 | 2008 | | | 2007 | |
|---|---|---|---|---|---|
| | Beginning Balance | Net Borrowing | Ending Balance | Net Borrowing | Ending Balance |
| (Amounts in thousands) | | | | | |
| **1. Agency Debt (Intragovernmental)** | | | | | |
| A. Debt to the Treasury | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| B. Debt to the Federal Financing Bank | 70,697 | (53,816) | 16,881 | (102,527) | 70,697 |
| **C. Total Agency Debt** | $ 70,697 | $ (53,816) | $ 16,881 | $ (102,527) | $ 70,697 |
| **2. Total Debt** | $ 70,697 | $ (53,816) | $ 16,881 | $ (102,527) | $ 70,697 |

The Afloat Prepositioning Force program, with congressional approval, provides ships for time charter to meet requirements not available in the marketplace. These ships are built or converted by private interim vessel owners using private, nongovernment financing obtained from various banking institutions. There were no payments made by the government during the building/conversion phase. Afloat Prepositioning Force program time charters are for five years with four option renewal periods of five years each, for a total of 25 years. At the end of the contract, each ship returns to the vessel's owner.

The Federal Financing Bank (FFB) is one of the institutions that provided loans to the vessel owners. The FFB reports that Transportation, Military Sealift Command (MSC) has a debt in the amount of $16.9 million, which represents an outstanding principal balance of $16.6 million and accrued interest payable of $257.7 thousand. MSC does not owe this debt to FFB. This debt is a public debt owed by the private vessel owners. In order to simplify the payments to FFB and to meet its requirements, FFB cross disburses the semi-annual principal and interest payments directly from the Navy Working Capital Fund (NWCF). This is done instead of having MSC make capital hire payments to the vessel owners, who would in turn make loan obligation payments to FFB. It is not uncommon for the Federal Government to make payments directly to the bank (FFB) and mirrors other time charters where payment is assigned directly to a bank. However, when establishing the loan, FFB coded the loan as a government debt instead of a public debt. This coding shall remain until the loan has been liquidated.

As required by the Office of the Under Secretary of Defense (Comptroller) memorandum of January 22, 1999, MSC is correctly recording these payments as an operating expense. The outstanding debt principal amount is reported on NWCF Balance Sheet as an other asset in order to reconcile with the amount incorrectly reported by FFB. The misclassification by FFB has generated this long-standing reporting problem. See Note 6 for additional disclosures.

As required by the Department of Defense Appropriations Act passed in December 1985, ten percent of the fifth year termination value of the vessels must be obligated from Operation and Maintenance, Navy funds. This was completed as each vessel was delivered.

## Note 14. Environmental Liabilities and Disposal Liabilities

Not applicable.

## Environmental Disclosures

The Navy Working Capital Fund Environmental Liabilities are reported under the Department of the Navy General Fund.

# Note 15. Other Liabilities

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Current Liability | Noncurrent Liability | Total | Total |
| (Amounts in thousands) | | | | |
| **1. Intragovernmental** | | | | |
| A. Advances from Others | $ 164,922 | $ 0 | $ 164,922 | $ 145,647 |
| B. Deposit Funds and Suspense Account Liabilities | 0 | 0 | 0 | 0 |
| C. Disbursing Officer Cash | 0 | 0 | 0 | 0 |
| D. Judgment Fund Liabilities | 0 | 0 | 0 | 0 |
| E. FECA Reimbursement to the Department of Labor | 91,672 | 119,064 | 210,736 | 0 |
| F. Custodial Liabilities | 3,369 | 0 | 3,369 | 3,031 |
| G. Employer Contribution and Payroll Taxes Payable | 41,104 | 0 | 41,104 | 30,875 |
| H. Other Liabilities | 0 | 0 | 0 | 0 |
| **I. Total Intragovernmental Other Liabilities** | $ 301,067 | $ 119,064 | $ 420,131 | $ 179,553 |
| **2. Nonfederal** | | | | |
| A. Accrued Funded Payroll and Benefits | $ 816,488 | $ 0 | $ 816,488 | $ 703,169 |
| B. Advances from Others | 248,959 | 0 | 248,959 | 247,232 |
| C. Deferred Credits | 0 | 0 | 0 | 0 |
| D. Deposit Funds and Suspense Accounts | (11,756) | 0 | (11,756) | (9,881) |
| E. Temporary Early Retirement Authority | 0 | 0 | 0 | 0 |
| F. Nonenvironmental Disposal Liabilities | | | | |
| (1) Military Equipment (Nonnuclear) | 0 | 0 | 0 | 0 |
| (2) Excess/Obsolete Structures | 0 | 0 | 0 | 0 |
| (3) Conventional Munitions Disposal | 0 | 0 | 0 | 0 |
| G. Accrued Unfunded Annual Leave | 0 | 0 | 0 | 0 |
| H. Capital Lease Liability | 0 | 0 | 0 | 0 |
| I. Contract Holdbacks | 0 | 0 | 0 | (215) |
| J. Employer Contribution and Payroll Taxes Payable | 0 | 0 | 0 | 0 |
| K. Contingent Liabilities | 474,675 | 21,583 | 496,258 | 505,537 |
| L. Other Liabilities | 1,600 | 0 | 1,600 | 0 |
| **M. Total Nonfederal Other Liabilities** | $ 1,529,966 | $ 21,583 | $ 1,551,549 | $ 1,445,842 |
| **3. Total Other Liabilities** | $ 1,831,033 | $ 140,647 | $ 1,971,680 | $ 1,625,395 |

Deposit funds and suspense accounts consist of an abnormal unsupported undistributed collections balance of $12.0 million for this reporting period. During FY 2008, the Navy Working Capital Fund (NWCF) and the Defense Finance and Accounting Service (DFAS) reconciled unsupported undistributed collections and disbursements, and per Office of Under Secretary of Defense (Comptroller) policy, 26 NWCF activities cleared stabilized unsupported undistributed collections and disbursements. The Military Sealift Command (MSC) has completed reconciliation of their abnormal balance in unsupported undistributed collections; however, their unsupported undistributed collection must be stable for a four-month period before they can submit a write-off package.  The MSC expects write-off to occur in 4th Quarter, FY 2009.

Nonfederal Other Liabilities consist of liabilities for depot level repairable carcass returns and liability for future contract financing payments.

Contingent Liabilities includes $21.6 million in estimated future contract financing payments that will be paid to the contractors upon delivery and Federal Government acceptance. In accordance with contract terms, specific rights to the contractor's work vest with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The NWCF is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Federal Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to NWCF and the amount of potential future payments is estimable, NWCF has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Federal Government acceptance.

## Note 16. Commitments and 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 which may ultimately result in settlements or decisions adverse to the Federal Government.  These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON will accrue contingent liabilities for legal actions in those instances where DON's Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable.  In the event of an adverse judgment against the Government, some of the liabilities may be payable from the 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 Note 12, "Accounts Payable."  See Note 12 for details.

The Navy Working Capital Fund (NWCF) currently has 3 cases that meet the existing FY 2008 NWCF materiality threshold of $4.1 million.  The DON OGC was unable to express an opinion concerning the likely outcome of 2 of the 3 cases.  Based on information contained in the FY 2008 preliminary and final Legal Representation Letters, management does not have sufficient reason to believe that it is likely the Government will be liable for the amounts claimed in individual or aggregated cases.

Due to the inherent uncertainties of litigation, lawyers generally refrain from expressing judgments as to outcomes except in those relatively few clear cases.  In response to a Department of Defense (DoD), Inspector General Audit, "DoD Process for Reporting Contingent Legal Liabilities," DON developed a methodology to determine an estimate for contingent legal liabilities.  Beginning with 1st Quarter, FY 2007 DON recognized and disclosed an estimate for contingent legal liabilities.  The methodology considers the likelihood of an unfavorable outcome or potential liability and is provided as an overall assessment of all cases currently pending and not on an individual case basis.  The likelihood of an unfavorable or potential liability was determined by using an average of the data from the current year-to-date and the preceding four years.  The total dollar amount of the cases closed was divided by the total dollar amount claimed in those closed cases for each of the last four years plus current year, which were then used to calculate the average.  This average is based entirely on historical data and represents the percentage that has historically been paid on claims for all DON cases. The merits for each individual case have not been taken into consideration. As a result, estimates cannot be allocated between NWCF and DON General Fund (GF), thus the entire $3.5 billion probable liability is recognized in Note 15 of the DON GF.

## Note 17. Military Retirement and Other Federal Employment Benefits

| As of September 30 | 2008 | | | | 2007 |
|---|---|---|---|---|---|
| | Liabilities | Assumed Interest Rate (%) | (Less: Assets Available to Pay Benefits) | Unfunded Liabilities | Liabilities |
| (Amounts in thousands) | | | | | |
| **1. Pension and Health Actuarial Benefits** | | | | | |
| A. Military Retirement Pensions | $ 0 | | $ 0 | $ 0 | $ 0 |
| B. Military Retirement Health Benefits | 0 | | 0 | 0 | 0 |
| C. Military Medicare-Eligible Retiree Benefits | 0 | | 0 | 0 | 0 |
| **D. Total Pension and Health Actuarial Benefits** | $ 0 | | $ 0 | $ 0 | $ 0 |
| **2. Other Actuarial Benefits** | | | | | |
| A. FECA | $ 1,035,874 | | $ 0 | $ 1,035,874 | $ 1,047,589 |
| B. Voluntary Separation Incentive Programs | 0 | | 0 | 0 | 0 |
| C. DoD Education Benefits Fund | 0 | | 0 | 0 | 0 |
| **D. Total Other Actuarial Benefits** | $ 1,035,874 | | $ 0 | $ 1,035,874 | $ 1,047,589 |
| **3. Other Federal Employment Benefits** | $ 0 | | $ 0 | $ 0 | $ 0 |
| **4. Total Military Retirement and Other Federal Employment Benefits:** | $ 1,035,874 | | $ 0 | $ 1,035,874 | $ 1,047,589 |

The Department of the Navy (DON) actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON at the end of each fiscal year. The liability is distributed between the Navy Working Capital Fund and DON General Fund based upon the number of civilian employees funded in each entity as reported in the Navy Budget Tracking System. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments.

The assumptions relate to Federal Employees' Compensation Act (FECA). The projected annual benefit payments are discounted to the present value using Office of Management and Budget's economic assumptions for ten year U.S. Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also taken into consideration when calculating projected future benefits.

The interest rate assumptions utilized when discounting were as follows:

2008
4.3680% in Year 1
4.770% in Year 2 and thereafter

To provide more specificity concerning the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) or 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) 2008 were also used to adjust the methodology's historical payments to current year constant dollars.

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

| CBY | COLA | CPIM |
|---|---|---|
| 2008 | 3.03% | 4.71% |
| 2009 | 3.87% | 4.01% |
| 2010 | 2.73% | 3.86% |
| 2011 | 2.20% | 3.87% |
| 2012 | 2.23% | 3.93% |
| 2013+ | 2.30% | 3.93% |

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2008 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections of the most recent three years.

*There have been no changes in the calculation of actuarial liability since last reporting period.*

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

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| 1. Intragovernmental Costs | $ | 5,091,758 | $ | 4,803,661 |
| 2. Public Costs | | 19,820,731 | | 18,778,518 |
| **3. Total Costs** | $ | 24,912,489 | $ | 23,582,179 |
| 4. Intragovernmental Earned Revenue | $ | (20,784,013) | $ | (20,966,636) |
| 5. Public Earned Revenue | | (1,056,448) | | (1,290,930) |
| **6. Total Earned Revenue** | $ | (21,840,461) | $ | (22,257,566) |
| **7. Net Cost of Operations** | $ | 3,072,028 | $ | 1,324,613 |

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 the reporting entity and a nonfederal entity.

The Navy Working Capital Fund's (NWCF) financial management systems do not track intragovernmental transactions by customer at the transactional level. Therefore, internal Department of Defense buyer-side balances are adjusted to agree with internal seller-side balances for revenue or by other means. Expenses were adjusted by reclassifying amounts between federal and nonfederal expenses.

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

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

The Cumulative Results of Operations, Other Financing Sources, Other consists of gains and losses associated with the financial closure of Navy Working Capital Fund activities.

The Cumulative Results of Operations, Budgetary Financing Sources, Other adjustments (rescissions, etc) consists of a rescission of an appropriation.

# Note 20. Disclosures Related to the Statement of Budgetary Resources

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | $ 7,794,257 | $ 7,875,259 |
| 2. Available Borrowing and Contract Authority at the End of the Period | 0 | 0 |

The Navy Working Capital Fund (NWCF) received contributed capital of $250.7 million in supplemental funding for fuel costs and $14.0 million for inventory augmentation.

The NWCF reports all amounts for obligations incurred under apportionment category B. Category B apportionments typically distribute budgetary resources by activities, projects, objects or a combination of these categories. The NWCF direct and reimbursable obligations incurred totaled $144.1 million and $24.5 billion, respectively.

The Statement of Budgetary Resources (SBR) includes intraentity transactions, which have not been eliminated because the statements are presented as combined.

# Note 21. Reconciliation of Net Cost of Operations to Budget

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **Resources Used to Finance Activities:** | | | | |
| Budgetary Resources Obligated: | | | | |
| 1. Obligations incurred | $ | 24,601,798 | $ | 24,043,702 |
| 2. Less: Spending authority from offsetting collections and recoveries (-) | | (25,483,273) | | (23,716,555) |
| 3. Obligations net of offsetting collections and recoveries | $ | (881,475) | $ | 327,147 |
| 4. Less: Offsetting receipts (-) | | 0 | | 0 |
| 5. Net obligations | $ | (881,475) | $ | 327,147 |
| Other Resources: | | | | |
| 6. Donations and forfeitures of property | | 0 | | 0 |
| 7. Transfers in/out without reimbursement (+/-) | | (66,968) | | 17,242 |
| 8. Imputed financing from costs absorbed by others | | 429,565 | | 475,066 |
| 9. Other (+/-) | | 550,987 | | (346,274) |
| 10. Net other resources used to finance activities | $ | 913,584 | $ | 146,034 |
| **11. Total resources used to finance activities** | $ | 32,109 | $ | 473,181 |
| **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 (-) | $ | 81,002 | $ | (176,039) |
| 12b. Unfilled Customer Orders | | 724,284 | | (362,387) |
| 13. Resources that fund expenses recognized in prior Periods (-) | | (11,715) | | (137,451) |
| 14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations | | 0 | | 0 |
| 15. Resources that finance the acquisition of assets (-) | | (4,402,419) | | (4,263,853) |
| 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 | | 0 |
| 16b. Other (+/-) | | (484,020) | | 329,032 |
| **17. Total resources used to finance items not part of the Net Cost of Operations** | $ | (4,092,868) | $ | (4,610,698) |
| **18. Total resources used to finance the Net Cost of Operations** | $ | (4,060,759) | $ | (4,137,517) |

| As of September 30 (Amounts in thousands) | 2008 | 2007 |
|---|---|---|
| **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 | $ 0 | $ 0 |
| 20. Increase in environmental and disposal liability | 0 | 0 |
| 21. Upward/Downward reestimates of credit subsidy expense (+/-) | 0 | 0 |
| 22. Increase in exchange revenue receivable from the public (-) | 0 | 0 |
| 23. Other (+/-) | 210,736 | 0 |
| 24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods | $ 210,736 | $ 0 |
| Components not Requiring or Generating Resources: | | |
| 25. Depreciation and amortization | $ 252,751 | $ 228,829 |
| 26. Revaluation of assets or liabilities (+/-) | 1,219,549 | 1,930,023 |
| 27. Other (+/-) | | |
| 27a. Trust Fund Exchange Revenue | 0 | 0 |
| 27b. Cost of Goods Sold | 14,105,206 | 11,566,742 |
| 27c. Operating Material and Supplies Used | 0 | 0 |
| 27d. Other | (8,655,455) | (8,263,464) |
| 28. Total Components of Net Cost of Operations that will not Require or Generate Resources | $ 6,922,051 | $ 5,462,130 |
| **29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period** | $ 7,132,787 | $ 5,462,130 |
| **30. Net Cost of Operations** | $ 3,072,028 | $ 1,324,613 |

Due to Navy Working Capital Fund (NWCF) financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data is a previously identified deficiency. As a result of these system limitations, resources that finance the acquisition of assets on the reconciliation of Net Cost of Operations to Budget was adjusted upward by $3.4 billion (absolute amount) at the end of FY 2008 to bring it into balance with the Statement of Net Cost.

The following Reconciliation of Net Cost of Operations to Budget lines are represented 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

Line 9 - Other Resources Used to Finance Activities consists of gains and losses associated with the financial closure of NWCF activities.

Line 16b - Other Resources Used to Finance Items not Part of the Net Cost of Operations consists of transfers of assets out of NWCF.

Line 23- Other Components Requiring or Generating Resources in Future Period consists of the Department of the Navy's Federal Employees' Compensation Act actuarial liability.

Line 27d - Other Components not Requiring or Generating Resources consists of overhead costs distributed to work in process, as well as costs originally recorded into another expense account that are transferred to one of three accounts: inventory work in process, internal use software in development, or completed assets.

## Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

## Note 23. Earmarked Funds

Not applicable.

## Note 24. Other Disclosures

Not applicable.

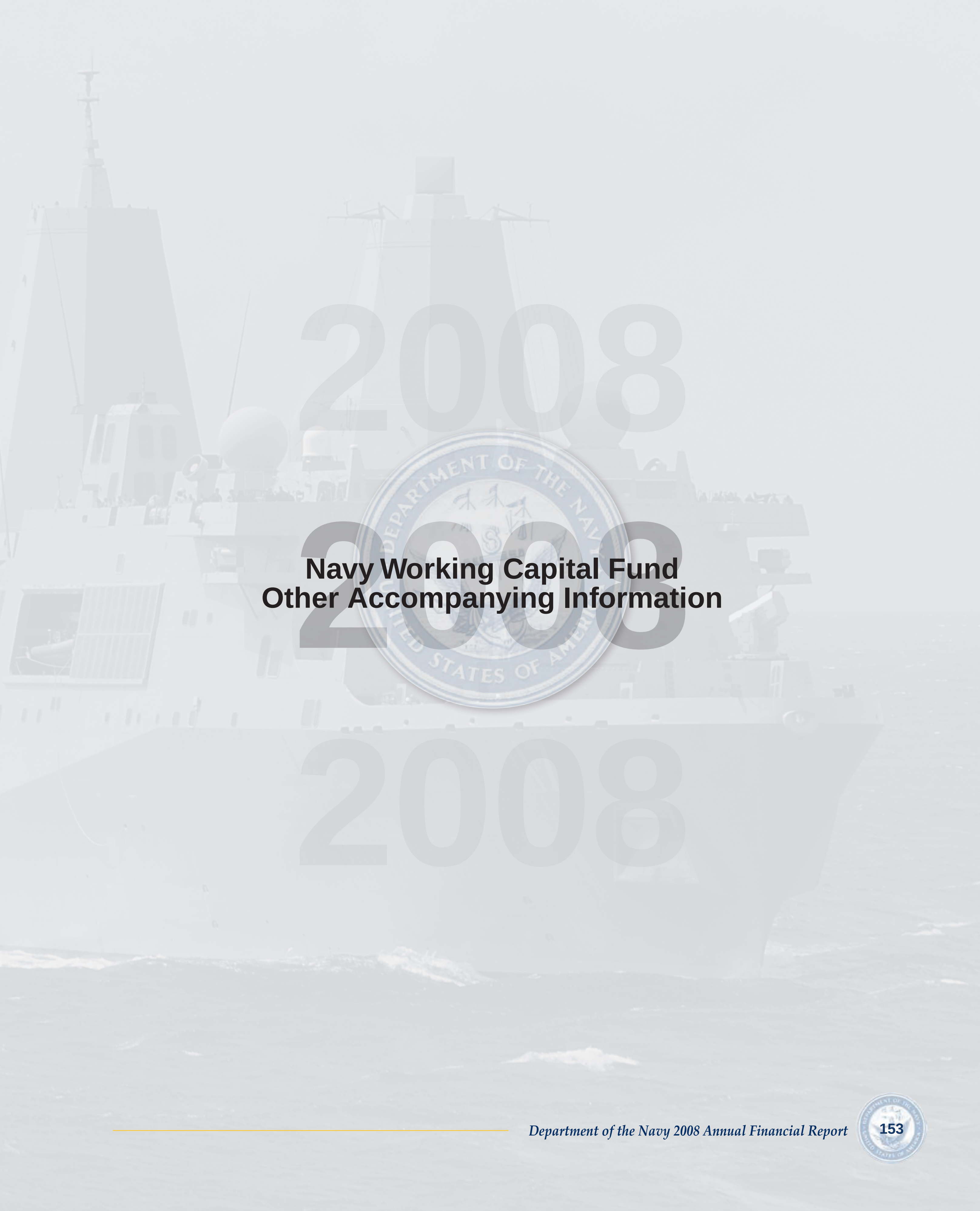
## Note 25. Restatements

For Fiscal Year 2008, the Navy Working Capital Fund does not have any restatements.

# Navy Working Capital Fund
# Required Supplementary Information

**Navy Working Capital Fund**
**General Property, Plant, and Equipment**
**Real Property Deferred Maintenance**
For Fiscal Year Ended September 30, 2008

The Navy Working Capital Fund real property deferred maintenance for fiscal year ended September 30, 2008 is reported with the Department of the Navy General Fund real property deferred maintenance. See Department of the Navy General Fund Required Supplementary Information.



# Navy Working Capital Fund Other Accompanying Information

# Appropriations, Funds, and Accounts Included in the Principal Statements

## *Reporting Entity*

**Navy Working Capital Fund (NWCF)**

**Fund/Account Treasury Symbol and Title**
97X4930.002

**Navy Working Capital Fund Activity Group Treasury Symbol and Title**

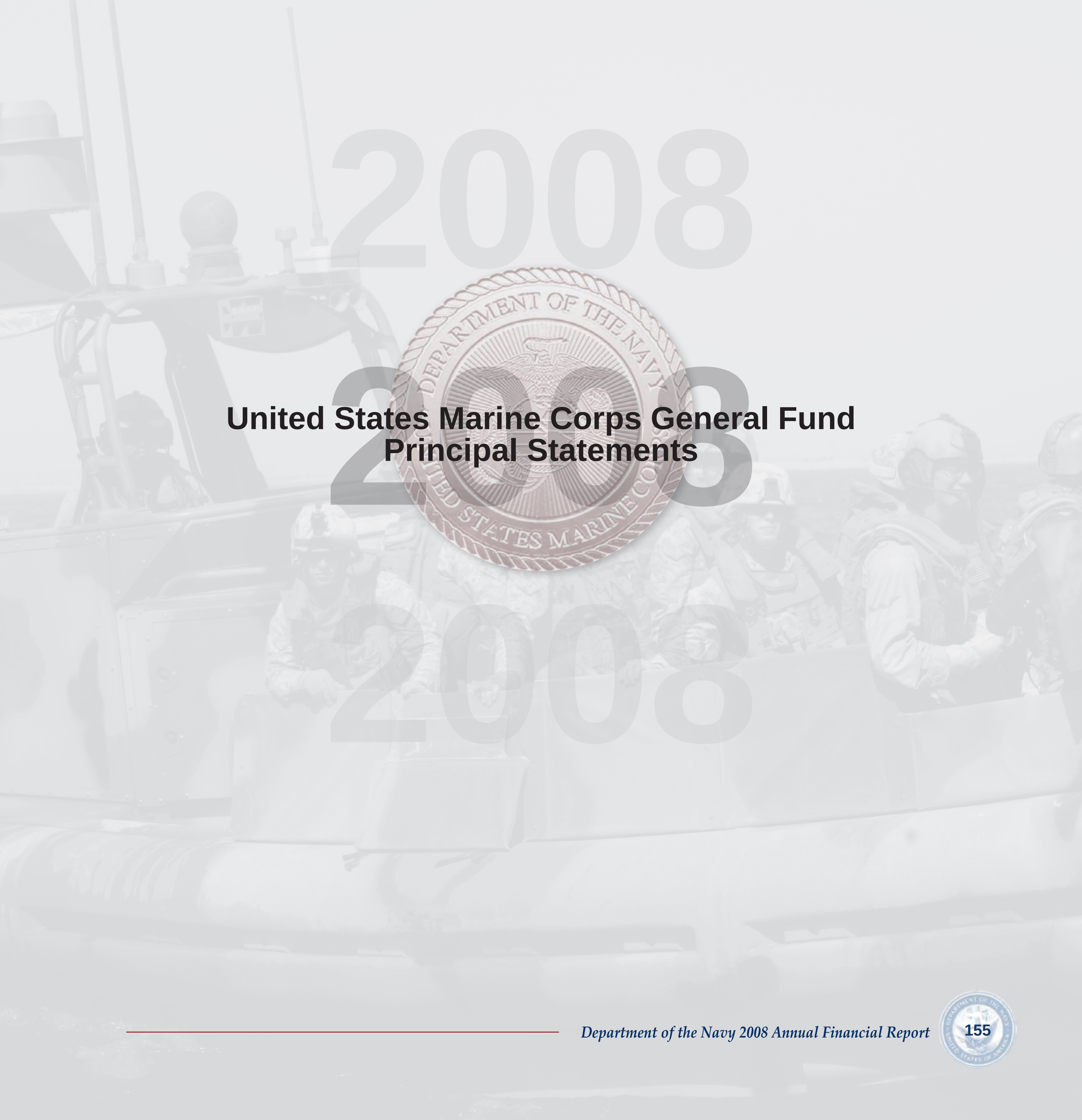
| | |
|---|---|
| 97X4930.NA1* | Depot Maintenance-Shipyards[a] |
| 97X4930.NA2* | Depot Maintenance-Aviation |
| 97X4930.NA4A* | Depot Maintenance- Other, Marine Corps |
| 97X4930.NA3* | Ordnance[b] |
| 97X4930.ND* | Transportation |
| 97X4930.NE* | Base Support |
| 97X4930.NH* | Research and Development |
| 97X4930.NC* | Supply Management |
| 97X4930.NC2A* | Supply Management, Marine Corps |

**Notes**

* The "*" represents alpha or numeric characters which identify an activity or reporting segment of the activity group.

a Depot Maintenance, Shipyards became a part of the DON General Fund in FY 2007. The Depot Maintenance, Shipyards information included in this report represents residual NWCF accounting.

b The Ordnance activity group became a part of the DON General Fund in FY 2000. The Ordnance information included in this report represents residual NWCF accounting for this group.



# United States Marine Corps General Fund Principal Statements

## Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with Generally Accepted Accounting Principles for Federal entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

In Fiscal Year (FY) 2006, the Office of the Under Secretary of Defense (Comptroller), with support from the Department of the Navy, designated the U.S. Marine Corps a financial reporting entity. This designation allowed the Marine Corps to prepare comprehensive subsidiary financial statements and related notes beginning in FY 2006.

The Marine Corps shares appropriations with the U.S. Navy and in addition maintains accountability for its own appropriations. The Marine Corps has specific funds and budget execution unto itself that are managed by Marine Corps program sponsors. Given this fiduciary responsibility, the Marine Corps is able to fully comply with Statement of Federal Financial Accounting Concepts Number 2, *Entity and Display*.

## Principal Statements

The FY 2008 U.S. Marine Corps General Fund principal statements and related notes are subsidiary financial statements and related notes of the Department of the Navy General Fund, and are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the U.S. Marine Corps General Fund for the fiscal year ending September 30, 2008, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2007.

The following statements comprise the U.S. Marine Corps General Fund principal statements:

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

The principal statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the principal statements.

**Department of Defense**
**United States Marine Corps General Fund**

# CONSOLIDATED BALANCE SHEET

**As of September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **ASSETS (Note 2)** | | |
| Intragovernmental: | | |
| Fund Balance with Treasury (Note 3) | 17,809,687 | 17,271,821 |
| Accounts Receivable (Note 5) | 56,370 | 57,516 |
| Other Assets (Note 6) | 872 | 3,083 |
| Total Intragovernmental Assets | 17,866,929 | 17,332,420 |
| Cash and Other Monetary Assets (Note 7) | 52,645 | 37,783 |
| Accounts Receivable, Net (Note 5) | 7,549 | 32,735 |
| Inventory and Related Property, Net (Note 9) | 6,439,109 | 5,694,867 |
| General Property, Plant and Equipment, Net (Note 10) | 12,028,288 | 9,209,256 |
| Other Assets (Note 6) | 663,947 | 760,944 |
| Stewardship Property, Plant and Equipment (Note 10) * | | |
| **TOTAL ASSETS** | 37,058,467 | 33,068,005 |
| **LIABILITIES (Note 11)** | | |
| Intragovernmental: | | |
| Accounts Payable (Note 12) | 197,807 | 282,256 |
| Other Liabilities (Note 15 & Note 16) | 99,600 | 307,231 |
| Total Intragovernmental Liabilities | 297,407 | 589,487 |
| Accounts Payable (Note 12) | 853,096 | 1,302,211 |
| Military Retirement and Other Federal Employment Benefits (Note 17) | 219,057 | 216,869 |
| Environmental and Disposal Liabilities (Note 14) | 262,455 | 224,645 |
| Other Liabilities (Note 15 & Note 16) | 1,292,138 | 1,224,741 |
| Commitments and Contingencies (Note 16) * | | |
| **TOTAL LIABILITIES** | 2,924,153 | 3,557,953 |
| **NET POSITION** | | |
| Unexpended Appropriations - Other Funds | 16,929,956 | 15,749,077 |
| Cumulative Results of Operations - Earmarked Funds | 576 | 475 |
| Cumulative Results of Operations - Other Funds | 17,203,782 | 13,760,500 |
| **TOTAL NET POSITION** | 34,134,314 | 29,510,052 |
| **TOTAL LIABILITIES AND NET POSITION** | $ 37,058,467 | $ 33,068,005 |

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

*The accompanying notes are an integral part of these statements.*

Department of Defense
United States Marine Corps General Fund

# CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2008 and 2007

($ in Thousands)

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **Program Costs** | | |
| Gross Costs | $ 26,840,010 | $ 24,859,117 |
| Less: Earned Revenue | (799,394) | (647,068) |
| Net Program Costs | 26,040,616 | 24,212,049 |
| **Net Cost of Operations** | $ 26,040,616 | $ 24,212,049 |

*The accompanying notes are an integral part of these statements.*

**Department of Defense**
**United States Marine Corps General Fund**

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

**For the Years Ended September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Earmarked Funds | 2008 All Other Funds |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS** | | |
| **Beginning Balances** | $ 474 | $ 13,760,501 |
| **Prior Period Adjustments** | | |
| **Beginning Balances, as adjusted** | 474 | 13,760,501 |
| **Budgetary Financing Sources:** | | |
| Appropriations used | 0 | 29,240,578 |
| Transfers in/out without reimbursement (+/-) | 153 | 0 |
| **Other Financing Sources:** | | |
| Transfers in/out without reimbursement (+/-) | 0 | 1 |
| Imputed financing from costs absorbed by others | 0 | 66,595 |
| Other (+/-) | 1 | 176,671 |
| **Total Financing Sources** | 154 | 29,483,845 |
| **Net Cost of Operations (+/-)** | 51 | 26,040,565 |
| **Net Change** | 103 | 3,443,280 |
| **Cumulative Results of Operations** | $ 577 | $ 17,203,781 |
| **UNEXPENDED APPROPRIATIONS** | | |
| **Beginning Balances** | $ 0 | $ 15,749,077 |
| **Prior Period Adjustments (+/-)** | | |
| **Beginning Balances, as adjusted** | 0 | 15,749,077 |
| **Budgetary Financing Sources:** | | |
| Appropriations received | 0 | 29,317,905 |
| Appropriations transferred-in/out (+/-) | 0 | 1,503,458 |
| Other adjustments (rescissions, etc) (+/-) | 0 | (399,906) |
| Appropriations used | 0 | (29,240,578) |
| **Total Budgetary Financing Sources** | 0 | 1,180,879 |
| **Unexpended Appropriations** | 0 | 16,929,956 |
| **Net Position** | $ 577 | $ 34,133,737 |

*The accompanying notes are an integral part of these statements.*

Department of Defense

United States Marine Corps General Fund

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2008 and 2007

($ in Thousands)

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS** | | |
| **Beginning Balances** | $ 13,760,975 | $ 12,457,189 |
| **Prior Period Adjustments** | | |
| **Beginning Balances, as adjusted** | 13,760,975 | 12,457,189 |
| **Budgetary Financing Sources:** | | |
| Appropriations used | 29,240,578 | 25,400,443 |
| Transfers in/out without reimbursement (+/-) | 153 | 134 |
| **Other Financing Sources:** | | |
| Transfers in/out without reimbursement (+/-) | 1 | 3,535 |
| Imputed financing from costs absorbed by others | 66,595 | 71,325 |
| Other (+/-) | 176,672 | 40,398 |
| **Total Financing Sources** | 29,483,999 | 25,515,835 |
| **Net Cost of Operations (+/-)** | 26,040,616 | 24,212,049 |
| **Net Change** | 3,443,383 | 1,303,786 |
| **Cumulative Results of Operations** | $ 17,204,358 | $ 13,760,975 |
| | | |
| **UNEXPENDED APPROPRIATIONS** | | |
| **Beginning Balances** | $ 15,749,077 | $ 12,443,304 |
| **Prior Period Adjustments (+/-)** | | |
| **Beginning Balances, as adjusted** | 15,749,077 | 12,443,304 |
| **Budgetary Financing Sources:** | | |
| Appropriations received | 29,317,905 | 28,863,583 |
| Appropriations transferred-in/out (+/-) | 1,503,458 | (86,118) |
| Other adjustments (rescissions, etc) (+/-) | (399,906) | (71,249) |
| Appropriations used | (29,240,578) | (25,400,443) |
| **Total Budgetary Financing Sources** | 1,180,879 | 3,305,773 |
| **Unexpended Appropriations** | 16,929,956 | 15,749,077 |
| **Net Position** | $ 34,134,314 | $ 29,510,052 |

*The accompanying notes are an integral part of these statements.*

**Department of Defense**
**United States Marine Corps General Fund**

# COMBINED STATEMENT OF BUDGETARY RESOURCES

**For the Years Ended September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **BUDGETARY FINANCING ACCOUNTS** | | |
| **Budgetary Resources:** | | |
| Unobligated balance, brought forward, October 1 | $ 3,400,875 | $ 2,582,128 |
| Recoveries of prior year unpaid obligations | 1,809,015 | 1,796,992 |
| Budget Authority: | | |
| Appropriations received | 29,318,058 | 28,863,717 |
| Contract authority | | 0 |
| Spending authority from offsetting collections: | | |
| Earned | | |
| Collected | 558,199 | 617,575 |
| Change in receivables from Federal sources | (15,858) | 18,097 |
| Change in unfilled customer orders | | |
| Advances received | 2,384 | 0 |
| Without advance from Federal sources | 52,551 | (71,500) |
| Subtotal | 29,915,334 | 29,427,889 |
| Nonexpenditure Transfers, net, anticipated and actual | 1,503,458 | (86,118) |
| Temporarily not available pursuant to Public Law | 0 | 0 |
| Permanently not available | (399,906) | (71,249) |
| **Total Budgetary Resources** | 36,228,776 | 33,649,642 |
| | | |
| **Status of Budgetary Resources:** | | |
| Obligations incurred: | | |
| Direct | 30,413,211 | 29,635,288 |
| Reimbursable | 645,916 | 613,479 |
| Subtotal | 31,059,127 | 30,248,767 |
| Unobligated balance: | | |
| Apportioned | 4,657,091 | 2,953,053 |
| Exempt from apportionment | | 0 |
| Subtotal | 4,657,091 | 2,953,053 |
| Unobligated balances not available | 512,558 | 447,822 |
| **Total Status of Budgetary Resources** | $ 36,228,776 | $ 33,649,642 |

*The accompanying notes are an integral part of these statements.*

Department of Defense
United States Marine Corps General Fund

## COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2008 and 2007
($ in Thousands)

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **RELATIONSHIP OF OBLIGATIONS TO OUTLAYS** | | |
| **Change in Obligated Balance:** | | |
| Obligated balance, net | | |
| Unpaid obligations, brought forward, October 1 | $ 13,841,236 | $ 10,418,539 |
| Less: Uncollected customer payments from Federal sources, brought forward, October 1 | (154,247) | (207,650) |
| **Total Unpaid Obligated Balance** | 13,686,989 | 10,210,889 |
| Obligations incurred, net (+/-) | 31,059,127 | 30,248,767 |
| Less: Gross outlays | (30,222,749) | (25,029,079) |
| Less: Recoveries of prior year unpaid obligations, actual | (1,809,015) | (1,796,992) |
| Change in uncollected customer payments from Federal sources (+/-) | (36,693) | 53,403 |
| Obligated balance, net, end of period | | |
| Unpaid obligations | 12,868,599 | 13,841,236 |
| Less: Uncollected customer payments from Federal sources | (190,940) | (154,247) |
| **Total Unpaid Obligated Balance, net, end of period** | 12,677,659 | 13,686,989 |
| **Net Outlays:** | | |
| Gross Outlays | 30,222,749 | 25,029,079 |
| Less: Offsetting collections | (560,583) | (617,574) |
| Less: Distributed Offsetting receipts | 167,559 | 20,195 |
| **Net Outlays** | $ 29,829,725 | $ 24,431,700 |

*The accompanying notes are an integral part of these statements.*

# United States Marine Corps General Fund Notes to the Principal Statements

# Note 1. Significant Accounting Policies

## 1.A. Basis of Presentation

The United States Marine Corps (USMC), a component of the Department of the Navy (DON) has prepared these financial statements to report the financial position and results of operations, as required by the "Chief Financial Officers (CFO) Act of 1990," Public Law 101-590, expanded by the "Government Management Reform Act of 1994," Public Law 103-356, and other appropriate legislation. Though USMC produces General Fund (GF) financial statements as a stand-alone entity, USMC remains a subsidiary of the DON financial statements and reporting process. The financial statements have been prepared from the books and records of USMC GF in accordance with the Department of Defense (DoD), Financial Management Regulation (FMR), the Office of Management and Budget (OMB) Circular No. 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 USMC GF is responsible unless otherwise noted.

Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernable. In addition to the financial statements, and pursuant to OMB directives, USMC GF also prepares financial reports that are used to monitor and control the use of budgetary resources.

The USMC GF is unable to fully implement all elements of GAAP and OMB Circular A-136, due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The USMC GF 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 USMC GF continues to implement process and system improvements addressing these limitations.

The DoD currently has several auditor identified financial material weaknesses. In designing the improved financial management and financial reporting structure, USMC GF management recognized the existence of several auditor identified financial statement material weaknesses at DoD. The USMC GF management has enabled a combined system of Standard Accounting, Budgeting, and Reporting System (SABRS) core financial system controls; standard process controls and internal audit monitoring process; extensive data quality reviews to mitigate risks. The USMC Financial Improvement Initiative (FII) program completed in-depth assessment that identified the existence of the following financial statement material weaknesses: (1) Financial Management Systems, (2) General Property, Plant, and Equipment (PP&E), (3) Accounts Payable, and (4) Environmental Liabilities. The USMC FII has designed efforts to improve and refine financial accounting and financial reporting processes to remediate and mitigate several remaining financial management issues including those identified as potential financial statement material weaknesses.

## 1.B. Mission of the Reporting Entity

The USMC was created on November 10, 1775 by an act of the 2nd Continental Congress. The overall mission of USMC is to provide trained and equipped forces to Combatant Commanders in support of the President's National Security Strategy. As set forth in the "National Security Act of 1947," USMC missions are: to seize and defend advanced naval bases and to conduct such land operations as may be essential to the prosecution of a naval campaign; to provide detachments and organizations for service in armed vessels of the Navy or for protection of naval property on naval stations and bases; to develop, with the other Armed

Forces, the tactics, techniques, and equipment employed by landing forces in amphibious operations; to train and equip, as required, Marine forces for airborne operations; to develop, with the other Armed Forces, doctrine, procedures, and equipment of interest to USMC for airborne operations which are not provided for by the Army; and to be able to expand from a peacetime posture to meet the needs of war in accordance with mobilization plans.

## 1.C. Appropriations and Funds

The USMC GF receives its appropriations and funds as general, special, and deposit funds. These appropriations and funds may be either provided solely to USMC GF or shared with other DON activities. The USMC GF uses these appropriations and funds to execute its mission and subsequently report on resource usage.

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

Special funds accounts are used to record government receipts reserved for a specific purpose. Certain special funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. 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 them from general revenues.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. The USMC GF is acting as an agent or a custodian for funds awaiting distribution.

## 1.D. Basis of Accounting

For fiscal year (FY) 2008, USMC GF's financial management systems are unable to meet all requirements for full accrual accounting. Many of USMC GF'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 USMC GF's (financial and nonfinancial) legacy systems were designed to record information on a budgetary basis.

The DoD has undertaken efforts to determine the actions required to bring financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). The USMC GF accounting system, SABRS, is GAAP, USSGL, and Standard Financial Information Structure (SFIS) compliant. The SABRS is a transaction driven general ledger accounting system that utilizes standardized transactions for processing. The USMC GF management recognizes the existence of USMC GF dependencies related to DoD financial and nonfinancial systems. The SABRS is interfaced with DoD approved business enterprise systems, such as the Defense Travel System, Standard Procurement System, Defense Civilian Personnel System, Defense Property Accountability System, and Wide Area Work Flow. These interfaces improve financial reporting and eliminate manual recording by capturing data from the source systems. Until all financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, USMC GF's financial data will be derived from budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities.

## 1.E. Revenues and Other Financing Sources

The USMC GF receives congressional appropriations as financing sources for general funds on either an annual or a multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The USMC GF recognizes revenue as a result of costs incurred or services provided to other federal agencies and the public. Full cost pricing is USMC GF's standard policy for services provided as required by OMB Circular A-25, "Transmittal Memorandum #1, User Charges." The USMC GF recognizes revenue when earned within the constraints of current system capabilities. In some instances, revenue is recognized when bills are issued.

The USMC GF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in the Statement of Net Cost and the Note 21, "Reconciliation of Net Cost of Operations to Budget." The U.S. has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in port.

## 1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because USMC GF's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. In the case of Operating Materiel and Supplies (OM&S), operating expenses are generally recognized when the items are purchased; however, the USMC GF has implemented the consumption method for recognizing OM&S expenses for certain items. Operating expenses are adjusted as a result of the elimination of trading partner balances between DoD components.

## 1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. The USMC GF accounts for all intragovernmental transactions at the transaction level. In an effort to more efficiently identify intragovernmental transactions by customer, USMC GF has implemented the DoD's trading partner requirements in its accounting system to capture trading partner data. Generally, seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. IntraDoD intragovernmental balances are then eliminated. The DoD system limitations and the volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements that will include sufficient up-front edits and controls eliminating the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service 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 U.S. Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. While USMC GF is unable to fully reconcile intragovernmental transactions with all federal partners, USMC GF is able to reconcile balances pertaining to "Federal Employees' Compensation Act" transactions with the Department of Labor, and benefit program transactions with Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

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

Each year, USMC GF 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 in U.S. dollars is required in advance.

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

The USMC GF monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of 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 USMC GF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. The USMC GF's recorded balance in FBWT accounts and U.S. Treasury's FBWT accounts must balance monthly.

## *1.J. Foreign Currency*

Cash is the total of cash resources under the control of DoD, which includes coin, paper currency, negotiable instruments, and amounts held for deposits 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 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 USMC GF conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations: operations and maintenance, military personnel, military construction, family housing operations and maintenance, and family housing construction. The gains and losses are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustment to the original obligation amount at the time of payment. The USMC GF does not separately identify currency fluctuation transactions.

## *1.K. Accounts Receivable*

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection history by fund type. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual.

## *1.L. Direct Loans and Loan Guarantees*

Not applicable.

## *1.M. Inventories and Related Property*

The USMC GF reports its inventory of repair parts, munitions, and ammunition in related property as OM&S. The USMC GF manages only military or government specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes all items (including ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment, but excluding real property, installations, and utilities) necessary to equip, operate, maintain and support military activities without distinction as to its application for administrative or combat purposes. Items commonly used in and available from the commercial sector are not managed in USMC GF OM&S management activities. The USMC GF holds materiel based on military need and support for contingencies.

The OM&S nonammunition inventories are valued at cost using the latest acquisition cost method and are comprised of high volume, high turnover, lower unit price supplies. The latest acquisition cost unit prices represent end of period contract prices. The USMC GF management has performed analysis to support that period end OM&S nonammunition account value is comparable to values of such inventories computed at the Lower of Cost or Market pricing method.

Most of USMC GF's OM&S ammunition inventories are currently reported using latest acquisition cost adjusted for holding gains and losses. The USMC GF uses the latest acquisition cost method because legacy OM&S inventory systems were designed for materiel management rather than accounting. Older OM&S munitions are reported at standard price. Although the legacy systems provide visibility and accountability over items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the "Federal Financial Management Improvement Act of 1996" (P.L. 104-208).

The USMC GF uses both the consumption method and the purchase method. Items that are centrally managed and stored inventories such as ammunition, tactical missiles, spare parts, and engines are expensed based on the consumption method. Noncentrally managed inventories are accounted for on a purchase method which expenses materiel and supplies as purchased. The GCSS system will serve to provide unit accountability to account for all items on the consumption method of accounting. For FY 2008, OM&S inventories are presented in accordance with GAAP.

The USMC GF 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 are categorized as OM&S rather than military equipment.

The USMC GF recognizes condemned materiel as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned materiel is zero. Potentially redistributed materiel, 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 Securties*

The USMC GF investments in U.S. Treasury securities are reported in the DON General Fund Financial Statements.

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

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

The USMC GF's General Property Plant & Equipment (General PP&E) capitalization threshold is $100 thousand except for real property which is $20 thousand. The USMC GF has not implemented the threshold for real property. The USMC GF is currently using the capitalization threshold of $100 thousand for all General PP&E.

General PP&E assets, exclusive of military equipment, are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the DoD capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed DoD capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

General PP&E previously capitalized at amounts below $100 thousand were written off GF financial statements in FY 1998.

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

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

When advances are permitted by law, legislative action, or presidential authorization, the DoD's policy is to record advances and prepayments in accordance with GAAP. As such, payments in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The USMC GF has implemented this policy.

## *1.Q. Leases*

Lease payments for the rental of 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), USMC GF records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The USMC GF 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 USMC GF as the lessee receives the use and possession of leased property, for example real estate, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all benefits and risk 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 USMC GF in support of contingency operations are the largest component operating leases. These costs were gathered from existing leases, General Services Administration (GSA) bills, and Interservice Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites.

## *1.R. Other Assets*

Other assets includes those assets, such as military and civil service employee pay advances, travel advances, and certain contracting financing payments that are not reported elsewhere on USMC GF's Balance Sheet.

The USMC GF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, USMC GF may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Federal Government. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulations Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. It is DoD policy to record contract financing payments as Other Assets.

## 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 USMC GF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The USMC GF's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as vehicle accidents, property or environmental damages, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for USMC GF'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."

## 1.T. Accrued Leave

The USMC GF reports as liabilities military leave and civilian earned leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. 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 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 that were not reimbursed.

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

The DoD has the use of the land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The USMC GF purchases capital assets overseas with appropriated funds; however, the host country retains the title to land and improvements. Generally, treaty terms allow USMC GF 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. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

## 1.W. Comparative Data

The USMC GF financial statements and notes are presented on a comparative basis.

## 1.X. Unexpended Obligations

The USMC GF obligates funds to provide goods and services for outstanding orders not yet delivered. Unless the title has passed, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations included both obligations for which goods and services have been delivered (title passed) and a liability recognized, obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources, and in referred to as "Total, unpaid obligated balances, net, end of period."

## 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 undistributed amounts reported on the monthly accounting reports. In-transit payments are those payments that have been made, but have not been recorded in the fund holder's accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

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

## 1.Z. Significant Events

Not applicable.

# Note 2. Nonentity Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Assets** | | |
| A. Fund Balance with Treasury | $ 129,938 | $ 204,152 |
| B. Accounts Receivable | 0 | 0 |
| **C. Total Intragovernmental Assets** | $ 129,938 | $ 204,152 |
| **2. Nonfederal Assets** | | |
| A. Cash and Other Monetary Assets | $ 52,645 | $ 37,783 |
| B. Accounts Receivable | 407 | 278 |
| C. Other Assets | 0 | 0 |
| **D. Total Nonfederal Assets** | $ 53,052 | $ 38,061 |
| **3. Total Nonentity Assets** | $ 182,990 | $ 242,213 |
| **4. Total Entity Assets** | $ 36,875,477 | $ 32,825,792 |
| **5. Total Assets** | $ 37,058,467 | $ 33,068,005 |

Nonentity assets are assets for which USMC GF maintains stewardship accountability and responsibility to report, but are not available for USMC's operations.

The nonentity fund balance with Treasury represents amounts in USMC GF deposit fund accounts. The deposit fund accounts contain various withholdings from Marines' pay such as taxes, allotments, and garnishments held until the appropriate disbursement date. The USMC GF maintains stewardship accountability and reporting responsibility for these assets, but the assets are not available for use in operations.

Nonentity cash and other monetary assets represent disbursing officers' cash and foreign currency as reported on the Statement of Accountability. These assets are held by USMC disbursing officers, as agents of the U.S. Treasury, and are not available for use in USMC's operations.

The nonentity nonfederal accounts receivable represents interest, fines, and penalties receivable on aged delinquent debt. Once collected, nonentity receivables are deposited to the U.S. Treasury as miscellaneous receipts.

# Note 3. Fund Balance with Treasury

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Fund Balances** | | | | |
| A. Appropriated Funds | $ | 17,679,140 | $ | 17,067,169 |
| B. Revolving Funds | | 0 | | 0 |
| C. Trust Funds | | 0 | | 0 |
| D. Special Funds | | 610 | | 500 |
| E. Other Fund Types | | 129,937 | | 204,152 |
| **F. Total Fund Balances** | $ | 17,809,687 | $ | 17,271,821 |
| **2. Fund Balances Per Treasury Versus Agency** | | | | |
| A. Fund Balance per Treasury | $ | 15,793,969 | $ | 15,543,476 |
| B. Fund Balance per USMC General Fund | | 17,809,687 | | 17,271,821 |
| **3. Reconciling Amount** | $ | (2,015,718) | $ | (1,728,345) |

**Explanation of Reconciliation Amount**

| (In thousands) | |
|---|---|
| Shared Appropriations per USMC GF* | $2,346,193 |
| Suspense and Deposit Accounts per USMC GF** | (166,231) |
| Cancelling Year Appropriations *** | (164,244) |
| Total Reconciling Amount | $2,015,718 |

*This amount is the fund balance with Treasury for USMC GF portion of appropriations shared with the Department of the Navy (DON): Research and Development, Test and Evaluation, Navy; Procurement of Ammunition, Navy and Marine Corps; Wildlife Conservation, Military Reservations, Navy; and Family Housing Operation and Maintenance, Navy and Marine Corps. The U.S. Treasury maintains and reports fund balances at the Treasury Index appropriation level. As a result, the U.S. Treasury does not separately identify USMC GF portion of fund balance with Treasury for the shared appropriations.

**This amount is the fund balance with Treasury for suspense and deposit accounts shared with DON: Disbursing Officer Suspense Account; Lost or Cancelled Treasury Checks Suspense Account; Interfund/Intragovernmental Payment and Collection (IPAC) Suspense Account; and Small Escrow Amounts Deposit Account. The U.S. Treasury does not separately identify USMC GF portion of fund balance with Treasury for the shared suspense and deposit accounts.

***This amount is the total of fund balance with Treasury of the appropriations that are cancelling in FY 2008. This amount is not included in the final reports per applicable guidance.

Other fund types represent USMC GF deposit fund accounts. The deposit fund accounts contain various withholdings from Marines' pay such as taxes, allotments, and garnishments held until the appropriate disbursement date. The USMC GF maintains stewardship accountability and reporting responsibility for these assets, but the assets are not available for use in USMC GF operations.

## Status of Fund Balance with Treasury

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Unobligated Balance** | | | | |
| A. Available | $ | 4,657,091 | $ | 2,953,053 |
| B. Unavailable | | 512,559 | | 447,822 |
| **2. Obligated Balance not yet Disbursed** | $ | 12,868,599 | $ | 13,841,236 |
| **3. Nonbudgetary FBWT** | $ | (37,622) | $ | 183,957 |
| **4. NonFBWT Budgetary Accounts** | $ | (190,940) | $ | (154,247) |
| **5. Total** | $ | 17,809,687 | $ | 17,271,821 |

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support the FBWT.

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, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represent adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts. Nonbudgetary FBWT is comprised of the fund balance with Treasury for the Disbursing Officer Suspense Account, Lost or Cancelled Treasury Checks Suspense Account, Interfund/IPAC Suspense Account, Small Escrow Accounts Deposit Account, and the Pay of the Marine Corps Deposit Account.

NonFBWT budgetary accounts represent adjustments to budgetary accounts that do not affect FBWT. NonFBWT budgetary accounts are comprised of unfilled customer orders without advance and reimbursements and other income earned-receivable. This category reduces the Status of FBWT.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. Certain unobligated balances may be restricted to future use and are not apportioned for current use. The USMC GF has no restrictions on unavailable/unobligated balances.

## Note 4. Investments and Related Interest

The USMC GF investments and related interest are reported under the Department of the Navy General Fund.

# Note 5. Accounts Receivable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net | Accounts Receivable, Net |
| (Amounts in thousands) | | | | |
| **1. Intragovernmental Receivables** | $ 56,370 | N/A | $ 56,370 | $ 57,516 |
| **2. Nonfederal Receivables (From the Public)** | $ 20,059 | $ (12,510) | $ 7,549 | $ 32,735 |
| **3. Total Accounts Receivable** | $ 76,429 | $ (12,510) | $ 63,919 | $ 90,251 |

# Note 6. Other Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Other Assets** | | |
| A. Advances and Prepayments | $ 872 | $ 3,083 |
| B. Other Assets | 0 | 0 |
| C. Total Intragovernmental Other Assets | $ 872 | $ 3,083 |
| **2. Nonfederal Other Assets** | | |
| A. Outstanding Contract Financing Payments | $ 635,080 | $ 740,207 |
| B. Advances and Prepayments | 28,867 | 20,737 |
| C. Other Assets (With the Public) | 0 | 0 |
| D. Total Nonfederal Other Assets | $ 663,947 | $ 760,944 |
| **3. Total Other Assets** | $ 664,819 | $ 764,027 |

Other assets (with the public) is comprised of travel advances made to Marines and civilian personnel.

Contract terms and conditions for certain types of contract financing payments convey certain rights to USMC GF that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and USMC GF is not obligated to make payment to the contractor until delivery and acceptance.

The Contract Financing Payment balance of $635.1 million is comprised of $588.6 million in contract financing payments and an additional $46.4 million in estimated future payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

# Note 7. Cash and Other Monetary Assets

| As of September 30 | 2008 | | 2007 | |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Cash** | $ | 52,645 | $ | 37,768 |
| **2. Foreign Currency** | | 0 | | 15 |
| **3. Other Monetary Assets** | | 0 | | 0 |
| **4. Total Cash, Foreign Currency, & Other Monetary Assets** | $ | 52,645 | $ | 37,783 |

Cash and foreign currency are nonentity assets and, as such, are considered restricted assets that are held by USMC GF but not available to use in its operations. Cash of $52.6 million is restricted. Cash is held by USMC disbursing officers as agents of the U.S. Treasury.

The amounts reported as cash consist of cash held by disbursing officers to carry out their payment, collection, and foreign currency accommodation exchange mission. The source of the amounts reported is the Statement of Accountability, a DoD disbursing officer's report.

# Note 8. Direct Loan and Loan Guarantees

Not applicable.

# Note 9. Inventory and Related Property

| As of September 30 | 2008 | | 2007 | |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| 1. Inventory, Net | $ | 0 | $ | 0 |
| 2. Operating Materiel & Supplies, Net | | 6,439,109 | | 5,694,867 |
| 3. Stockpile Materiel, Net | | 0 | | 0 |
| **4. Total** | $ | 6,439,109 | $ | 5,694,867 |

## Inventory, Net

Not applicable.

# Operating Materiel and Supplies, Net

| As of September 30 | 2008 | | | 2007 | |
|---|---|---|---|---|---|
| | OM&S Gross Value | Revaluation Allowance | OM&S, Net | OM&S, Net | Valuation Method |
| (Amounts in thousands) | | | | | |
| **1. OM&S Categories** | | | | | |
| A. Held for Use | $ 5,928,868 | $ 0 | $ 5,928,868 | $ 5,179,630 | SP, LAC |
| B. Held for Repair | 510,241 | 0 | 510,241 | 515,237 | SP, LAC |
| C. Excess, Obsolete, and Unserviceable | 88,964 | (88,964) | 0 | 0 | NRV |
| **D. Total** | $ 6,528,073 | $ (88,964) | $ 6,439,109 | $ 5,694,867 | |

**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

### General Composition of Operating Materiel and Supplies

Operating materiel and supplies include (1) ammunition and munitions that consists of spare and repair parts and conventional missiles, and (2) Appropriation Purchase Account (APA) Secondary Inventory that consists of spare and repair parts, clothing and textiles, medical and dental supplies, and fuel.

### Restrictions on Operating Materiel and Supplies

There are no restrictions on the use of operating materiel and supplies.

### Decision Criteria for Identifying the Category to which Operating Materiel and Supplies are Assigned

The USMC GF determines reporting categories for operating materiel and supplies based on condition codes assigned to individual inventory items.

Of the $6.4 billion operating materiel and supplies, $4.9 billion is valued using latest acquisition cost adjusted for gains and losses, the remaining $1.5 billion is valued at standard price.

# Stockpile Materiel, Net

Not applicable.

# Note 10. General PP&E, Net

| As of September 30 | 2008 | | | | | 2007 |
|---|---|---|---|---|---|---|
| | Depreciation/ Amortization Method | Service Life | Acquisition Value | (Accumulated Depreciation/ Amortization) | Net Book Value | Prior FY Net Book Value |
| (Amounts in thousands) | | | | | | |
| **1. Major Asset Classes** | | | | | | |
| A. Land | N/A | N/A | $ 166,286 | N/A | $ 166,286 | $ 164,118 |
| B. Buildings, Structures, and Facilities | S/L | 20 or 40 | 7,975,979 | $ (4,264,255) | 3,711,724 | 3,567,481 |
| C. Leasehold Improvements | S/L | lease term | 0 | 0 | 0 | 0 |
| D. Software | S/L | 2-5 or 10 | 0 | 0 | 0 | 0 |
| E. General Equipment | S/L | 5 or 10 | 507,536 | (173,235) | 334,301 | 42,754 |
| F. Military Equipment | S/L | Various | 10,119,025 | (2,303,048) | 7,815,977 | 5,434,903 |
| G. Assets Under Capital Lease | S/L | lease term | 0 | 0 | 0 | 0 |
| H. Construction-in-Progress | N/A | N/A | 0 | N/A | 0 | 0 |
| I. Other | | | 0 | 0 | 0 | 0 |
| J. Total General PP&E | | | $ 18,768,826 | $ (6,740,538) | $ 12,028,288 | $ 9,209,256 |

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

**Restrictions on the use or convertibility of General Property, Plant, and Equipment (PP&E), Net**

Other than Global War on Terror (GWOT), USMC GF property is only at Japan. There is no restriction on the use or convertibility. There is no information available regarding GWOT. For General PP&E within the U.S., there are no known restrictions.

**Heritage Assets**

The processes used to define items as having heritage significance vary between categories and type of assets being evaluated. Subject matter experts, including historians and curators, play a significant role in the definition process. In all cases, a myriad of federal statutes, Department of Defense (DoD) Financial Management Regulations, and other guidelines mandate heritage significance or provide guidance in its determination. Heritage assets are reported in the following categories.

Buildings and Structures: This includes buildings and structures listed on, or eligible for listing on, the National Register of Historic Places, which includes multi-use heritage assets. This also includes National Historic Landmarks; buildings or structures that are contributing elements to districts listed on or eligible for the National Register of Historic Places or a National Historic Landmark District; and buildings and structures designated eligible in the National Register of Historic Places for purposes of program alternatives.

Archeological Sites: These are sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Register of Historic Places.

Museum Collection Items: This includes items which are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic importance; or significant technical or architectural characteristics. Museum collection items are divided into two subcategories: fine art and objects. Fine art includes paintings, sculptures and other three dimensional art. Objects are current use, excess, obsolete, or condemned material; war trophies; personal property such as uniforms, medals or diaries, and military equipment.

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

**Stewardship Land**

The USMC GF follows DoD Financial Management Regulation definition of stewardship land to include public domain, land set aside, and donated land. Within the definition of stewardship land, land can be further categorized as improved, semi-improved or in the other category of land. Some of this land is used as a buffer around perimeter of Marine Corps installations but is not limited to, grazing land and forestry maintenance areas. The USMC GF strives to be a responsible steward of the land and maintain it in a way that protect human health and the environment and allows for training and support of force readiness.

Any additional information regarding heritage assets, multi-use heritage assets, and stewardship land is reported in Required Supplementary Information.

## Assets Under Capital Lease

Not applicable.

## Note 11. Liabilities Not Covered by Budgetary Resources

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Liabilities** | | |
| A. Accounts Payable | $ 1,693 | $ 606 |
| B. Debt | 0 | 0 |
| C. Other | 129,868 | 79,885 |
| **D. Total Intragovernmental Liabilities** | $ 131,561 | $ 80,491 |
| **2. Nonfederal Liabilities** | | |
| A. Accounts Payable | $ 19,097 | $ 3,230 |
| B. Military Retirement and Other Federal Employment Benefits | 219,057 | 215,229 |
| C. Environmental Liabilities | 262,455 | 224,645 |
| D. Other Liabilities | 716,421 | 627,458 |
| **E. Total Nonfederal Liabilities** | $ 1,217,030 | $ 1,070,562 |
| **3. Total Liabilities Not Covered by Budgetary Resources** | $ 1,348,591 | $ 1,151,053 |
| **4. Total Liabilities Covered by Budgetary Resources** | $ 1,575,562 | $ 2,406,900 |
| **5. Total Liabilities** | $ 2,924,153 | $ 3,557,953 |

Liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided.

**Material Amounts Not Covered by Budgetary Resources.**
Unfunded military and civilian leave liability, $672.1 million is not covered by budgetary resources because it is funded as leave is taken. Environmental Liabilities, $262.5 million, are estimates related to future events that will be budgeted for when those assets are removed from service and cleaned up in future years. The military retirement and other federal employment benefits, $219.1 million are future actuarial liabilities. These liabilities are not 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.

Intragovernmental liabilities – other (not covered by budgetary resources) includes liability for nonentity assets (disbursing officer's cash), $53.1 million, Federal Employees' Compensation Act (FECA), $51.6 million, and unemployment compensation, $25.2 million.

Nonfederal liabilities - other liabilities (not covered by budgetary resources) includes civilian and military unfunded leave liability, $672.1 million and nonenvironmental disposal excess/obsolete structures liability, $39.4 million.

Military retirement and other federal employment benefits not covered by budgetary resources is comprised of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities are primarily comprised of FECA actuarial, $219.1 million. Refer to Note 17, "Military Retirement and Other Federal Employment Benefits," for additional details and disclosures.

## Note 12. Accounts Payable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Accounts Payable | Interest, Penalties, and Administrative Fees | Total | Total |
| (Amounts in thousands) | | | | |
| 1. Intragovernmental Payables | $ 197,807 | $ N/A | $ 197,807 | $ 282,256 |
| 2. Nonfederal Payables (to the Public) | 853,096 | 0 | 853,096 | 1,302,211 |
| **3. Total** | $ 1,050,903 | $ 0 | $ 1,050,903 | $ 1,584,467 |

The USMC GF's systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts payable were adjusted by reclassifying amounts between federal and nonfederal accounts payable.

In FY 2007, the Department recognized accounts payable balances of the Mechanization of Contract

Service (MOCAS) system at gross value without reduction for partial, progress payments and nonaccounts payable records overstating accounting payable and expenses. These overstated balances for FY 2007 were undeterminable due to system limitations; therefore no corrections have been made. Balances at FY 2008 are properly reported net of nonaccounts payable records, partial and progress payments of $33.6 million.

## Note 13. Debt

Not applicable.

## Note 14. Environmental Liabilities and Disposal Liabilities

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Current Liability | Noncurrent Liability | Total | Total |
| (Amounts in thousands) | | | | |
| **1. Environmental Liabilities--Nonfederal** | | | | |
| **A. Accrued Environmental Restoration Liabilities** | | | | |
| 1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR) | $ 0 | $ 0 | $ 0 | $ 0 |
| 2. Active Installations—Military Munitions Response Program (MMRP) | 0 | 0 | 0 | 0 |
| 3. Formerly Used Defense Sites—IRP and BD/DR | 0 | 0 | 0 | 0 |
| 4. Formerly Used Defense Sites--MMRP | 0 | 0 | 0 | 0 |
| **B. Other Accrued Environmental Liabilities—Non-BRAC** | | | | |
| 1. Environmental Corrective Action | 2,948 | 95,979 | 98,927 | 30,956 |
| 2. Environmental Closure Requirements | 400 | 126,307 | 126,707 | 193,689 |
| 3. Environmental Response at Operational Ranges | 0 | 22 | 22 | 0 |
| 4. Asbestos | 0 | 0 | 0 | 0 |
| 5. Non-Military Equipment | 0 | 36,742 | 36,742 | 0 |
| 6. Other | 0 | 57 | 57 | 0 |
| **C. Base Realignment and Closure Installations** | | | | |
| 1. Installation Restoration Program | 0 | 0 | 0 | 0 |
| 2. Military Munitions Response Program | 0 | 0 | 0 | 0 |
| 3. Environmental Corrective Action / Closure Requirements | 0 | 0 | 0 | 0 |
| 4. Asbestos | 0 | 0 | 0 | 0 |
| 5. Non-Military Equipment | 0 | 0 | 0 | 0 |
| 6. Other | 0 | 0 | 0 | 0 |
| **D. Environmental Disposal for Military Equipment / Weapons Programs** | | | | |
| 1. Nuclear Powered Military Equipment / Spent Nuclear Fuel | 0 | 0 | 0 | 0 |
| 2. Non-Nuclear Powered Military Equipment | 0 | 0 | 0 | 0 |
| 3. Other National Defense Weapons Systems | 0 | 0 | 0 | 0 |
| 4. Other | 0 | 0 | 0 | 0 |
| **E. Chemical Weapons Disposal Program** | | | | |
| 1. Chemical Agents and Munitions Destruction (CAMD) | 0 | 0 | 0 | 0 |
| 2. CAMD Assembled Chemical Weapons Assessment (ACWA) | 0 | 0 | 0 | 0 |
| 3. Other | 0 | 0 | 0 | 0 |
| **2. Total Environmental Liabilities** | $ 3,348 | $ 259,107 | $ 262,455 | $ 224,645 |

<u>Environmental Liabilities Nonfederal</u>

<u>Other Accrued Environmental Liabilities – Active Installations</u>

In the 4th Quarter, FY 2008, USMC GF reported $98.9 million in environmental corrective action and $126.7 million in environmental closure requirements. The USMC GF is continuing efforts to complete their survey and estimations of USMC GF environmental liabilities of closure/decommissioning requirements for ongoing operations.

Environmental Liabilities Nonfederal
Other Accrued Environmental Liabilities – Other
The USMC GF reported $57.4 thousand in other accrued environmental liabilities, other which is comprised solely of noncurrent liability for transformers containing Polychlorinated Biphenyls (PCB). This is USMC GF first time reporting this liability.

**Applicable Laws and Regulations for Cleanup Requirements**
The following is a summary of significant laws that affect USMC GF's conduct of environmental policy and regulations for cleanup requirements:

The Resource Conservation and Recovery Act (RCRA) of 1976 as amended by the Hazardous and Solid Waste Amendments 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. The RCRA addresses and requires permits for solid waste and hazardous waste closure and corrective action, including solid waste landfill and hazardous waste permitted storage facility closures. Permits are required for treatment, storage or disposal. Requirements for underground storage tanks are also contained in RCRA.

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), commonly referred to as the Superfund legislation, provided for Federal agencies authority to respond to the release or the substantial threat of release of hazardous substances into the environment. The CERCLA was amended several times; one of the amendments was the Superfund Amendment and Reauthorization Act of 1986. This amendment established procedures to ensure that actual or threatened hazardous substance releases have proper responses. The procedures address reporting, investigating, remedy selection, and responsive provisions.

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. Facilities may dispose of sewage sludge on site from the operation of a treatment works. 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 implemented by the states is the purpose of the Safe Drinking Water Act (SDWA) of 1974, amended in 1986 to include Wellhead Protection Areas. The SDWA regulates the underground disposal of wastes in deep wells and establishes a program to protect public water supply wells. One requirement to protect public water supply wells addresses closure of Class I injection wells used for industrial hazardous, industrial nonhazardous and municipal (nonhazardous) waste.

**Method for Assigning Estimated Total Cleanup Costs to Current Operating Periods.**
The USMC GF uses engineering estimates and independently validated models to estimate environmental costs. The models are contained within the Remedial Action Cost Engineering Requirements and the Normalization of Data System. The Department validates the models in accordance with DoD Instruction 5000.61 and primarily uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The USMC GF primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

Once the environmental cost estimates are complete, USMC GF complies with accounting standards to assign costs to current operating periods. The USMC GF has already expensed the costs for cleanup associated with General PP&E placed into service prior to October 1, 1997, unless the costs are intended to be recovered through user charges. If the costs are recovered through user charges, then USMC GF expensed that portion of the asset that has passed since General PP&E was placed into service and is systematically recognizing the remaining cost over the life of the assets.

For General PP&E placed into service after September 30, 1997, the USMC GF expenses the associated environmental costs systematically over the life of the asset. The USMC GF expenses the full cost to clean up contamination for Stewardship PP&E at the time the asset is placed into service.

The USMC GF uses two methods for systematic recognition: physical capacity for operating landfills and life expectancy in years for all other assets.

**Method for Estimating NonDefense Environmental Restoration Program (NonDERP) Environmental Liabilities**

The NonDERP environmental liability estimates are based on the following:

- Execution/payment amounts,
- Historical references (e.g., prior projects, investigations, monitoring),
- Current projects of comparable scope (similar sites),
- Estimates from vendors/contractors,
- Estimates from Military Construction Data Project form,
- Program Objectives Memorandum Guidebook, and
- Professional experience.

**Description of the Types of Environmental Liabilities and Disposal Liabilities**

<u>Other Accrued Environmental Costs (NonDERP funds), Cost, Base Realignment and Closure (BRAC), and Environmental Disposal for Weapons Systems Programs</u>

The USMC GF defines NonDERP environmental sites/units as those sites/units associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retro fill, and/or disposal of the PCB transformers, underground storage tank remedial investigation and closure. The USMC GF has reported NonDERP environmental liabilities for USMC GF installations totaled 225 projects and covered approximately 3,290 sites. The projects span the following nonDERP reporting categories: (1) closure for units or sites put into service prior to September 30, 1997, (2) closure for units or sites put into service after September 30, 1997, and (3) corrective actions. There are no projects that are categorized as NonDERP environmental liability for "response at active ranges" and other reporting categories. For units or sites put into service after September 30, 1997, the number of years of service was used to allocate the liability for the current fiscal year and the accumulated liability to date.

**Accrued Environmental Restoration Defense Environmental Restoration Program (DERP) Funded**

The U.S. Navy centrally manages and executes DERP and BRAC portions at Department of the Navy level.

Therefore, USMC GF does not report DERP and BRAC environmental liabilities.

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

NonDERP environmental liabilities can change in the future because of changes in laws/regulations and regulatory agencies agreements, and technology advances.

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

The environmental liabilities for USMC GF are based on accounting estimates that require certain judgments and assumptions that we believe 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 laws/regulations change requiring a different closure method, or 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.

## Environmental Disclosures

Not applicable.

# Note 15. Other Liabilities

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Current Liability | Noncurrent Liability | Total | Total |
| (Amounts in thousands) | | | | |
| **1. Intragovernmental** | | | | |
| A. Advances from Others | $ 0 | $ 0 | $ 0 | $ 0 |
| B. Deposit Funds and Suspense Account Liabilities | (37,622) | 0 | (37,622) | 183,957 |
| C. Disbursing Officer Cash | 52,651 | 0 | 52,651 | 37,783 |
| D. Judgment Fund Liabilities | 0 | 0 | 0 | 0 |
| E. FECA Reimbursement to the Department of Labor | 22,036 | 29,555 | 51,591 | 50,958 |
| F. Custodial Liabilities | 401 | 0 | 401 | 280 |
| G. Employer Contribution and Payroll Taxes Payable | 7,291 | 0 | 7,291 | 5,489 |
| H. Other Liabilities | 25,288 | 0 | 25,288 | 28,764 |
| I. Total Intragovernmental Other Liabilities | $ 70,045 | $ 29,555 | $ 99,600 | $ 307,231 |
| **2. Nonfederal** | | | | |
| A. Accrued Funded Payroll and Benefits | $ 510,118 | $ 0 | $ 510,118 | $ 539,303 |
| B. Advances from Others | 2,384 | 0 | 2,384 | 0 |
| C. Deferred Credits | 0 | 0 | 0 | 0 |
| D. Deposit Funds and Suspense Accounts | 0 | 0 | 0 | 0 |
| E. Temporary Early Retirement Authority | 0 | 0 | 0 | 0 |
| F. Nonenvironmental Disposal Liabilities | | | | |
| (1) Military Equipment (Nonnuclear) | 0 | 0 | 0 | 0 |
| (2) Excess/Obsolete Structures | 5,282 | 34,110 | 39,392 | 39,392 |
| (3) Conventional Munitions Disposal | 0 | 0 | 0 | 0 |
| G. Accrued Unfunded Annual Leave | 672,100 | 0 | 672,100 | 586,677 |
| H. Capital Lease Liability | 0 | 0 | 0 | 0 |
| I. Contract Holdbacks | 0 | 11,171 | 11,171 | 1,940 |
| J. Employer Contribution and Payroll Taxes Payable | 5,598 | 0 | 5,598 | 4,348 |
| K. Contingent Liabilities | 0 | 51,375 | 51,375 | 53,080 |
| L. Other Liabilities | 0 | 0 | 0 | 1 |
| M. Total Nonfederal Other Liabilities | $ 1,195,482 | $ 96,656 | $ 1,292,138 | $ 1,224,741 |
| **3. Total Other Liabilities** | $ 1,265,527 | $ 126,211 | $ 1,391,738 | $ 1,531,972 |

Intragovernmental other liabilities includes unemployment compensation and accrued education benefits for separated Marines.

Contingent liabilities balance includes $46.4 million in estimated future contract financing payments that will be paid to the contractor upon delivery and Government acceptance. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payments is made. This action protects taxpayer funds in the event of the contract nonperformance. These rights should not be misconstrued as the right of ownership. The USMC GF is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to USMC GF and the amount of potential future payments are estimable; USMC GF has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

Contingent liabilities balance, also, includes $4.9 million in estimated legal liabilities. The FY 2007, Department of Navy/USMC GF began recognizing and disclosing an estimate for contingent legal liabilities. The methodology to determine an estimate for contingent legal liabilities considers the likelihood of an unfavorable outcome or potential liability is provided as an overall assessment of all cases currently pending and not on an individual case basis. For more details, see Note 16, Commitments and Contingencies.

## Capital Lease Liability

Not applicable.

## Note 16. Commitments and Contingencies

**Legal Contingencies**

The USMC GF, a sub-entity of the Department of the Navy (DON) General Fund, is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown.

The USMC GF has accrued contingent liabilities for legal actions where the Office of Navy General Counsel considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from DON resources, either directly or by reimbursement to the Judgment Fund. The USMC GF records Judgment Fund liabilities in Note 12, "Accounts Payable" or Note 15, "Other Liabilities."

The Office of Navy General Counsel completed a review of litigation and claims threatened or asserted involving the USMC GF to which attorneys devote substantial attention in the form of legal consultation or representation. This review reflects a threshold of materiality of $3.9 million which applies to individual and aggregate claims, litigation, assessments, or contingencies arising out of a single event or series of events, and includes matters that existed on September 30, 2008.

The USMC GF has 3 cases that individually meet the existing FY 2008 USMC GF materiality threshold of $3.9 million. The DON legal counsel was unable to express an opinion concerning the likely outcome of these cases. Based on information contained in the FY 2008 Legal Representation Letters, management does not have sufficient reason to believe that it is likely that the Government will be liable for the amounts claimed in individual or aggregated cases.

The DON developed a methodology to determine an estimate for contingent legal liabilities for aggregated cases not individually meeting the $3.9 million threshold. This average approximates the percentage that has historically been paid on claims. It is based entirely on historical data. The merits of each individual case have not been taken into consideration. Until sufficient historical data can be collected for the Navy Working Capital Fund—Marine Corps, this estimate will consider all USMC funding sources together. This estimate for contingencies that are considered both measurable and probable has been recognized and included in other liabilities in Note 15.

The estimate for those aggregate of cases considered reasonably possible to result in an adverse judgment against USMC is $16.5 billion.

The USMC GF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, USMC GF does not have a systemic process by which it captures or assesses these potential contingent liabilities; therefore, the amounts reported may not fairly present USMC GF's contingent liabilities.

The USMC GF recognizes contingent liabilities for obligations related to undelivered orders for open contracts citing canceled appropriations which remain unfilled or unreconciled in Note 15, Other Liabilities.

# Note 17. Military Retirement and Other Federal Employment Benefits

| As of September 30 | 2008 | | | | 2007 |
|---|---|---|---|---|---|
| | Liabilities | Assumed Interest Rate (%) | (Less: Assets Available to Pay Benefits) | Unfunded Liabilities | Liabilities |
| (Amounts in thousands) | | | | | |
| **1. Pension and Health Actuarial Benefits** | | | | | |
| A. Military Retirement Pensions | $ 0 | | $ 0 | $ 0 | $ 0 |
| B. Military Retirement Health Benefits | 0 | | 0 | 0 | 0 |
| C. Military Medicare-Eligible Retiree Benefits | 0 | | 0 | 0 | 0 |
| D. Total Pension and Health Actuarial Benefits | $ 0 | | $ 0 | $ 0 | $ 0 |
| **2. Other Actuarial Benefits** | | | | | |
| A. FECA | $ 219,057 | | $ 0 | $ 219,057 | $ 215,229 |
| B. Voluntary Separation Incentive Programs | 0 | | 0 | 0 | 0 |
| C. DoD Education Benefits Fund | 0 | | 0 | 0 | 0 |
| D. Total Other Actuarial Benefits | $ 219,057 | | $ 0 | $ 219,057 | $ 215,229 |
| **3. Other Federal Employment Benefits** | $ 0 | | $ 0 | $ 0 | $ 1,640 |
| **4. Total Military Retirement and Other Federal Employment Benefits:** | $ 219,057 | | $ 0 | $ 219,057 | $ 216,869 |

### Military Retirement Pensions

The portion of the military retirement benefits actuarial liability applicable to USMC GF is reported on the financial statements of the Military Retirement Fund.

**Military Retirement Health Benefits**
Health benefits are funded centrally at the Department of Defense (DoD) level. As such, the portion of the health benefits actuarial liability that is applicable to USMC GF is reported only on the DoD Agency-wide Financial Statements and the Medicare-Eligible Retiree Health Care Fund Financial Statements.

**Federal Employees Compensation Act (FECA)**
The USMC GF actuarial liability for workers' compensation benefits is developed by Department of Labor and provided to USMC GF at the end of each fiscal year. The future workers' compensation benefits include 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 U.S. Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Fiscal Year 2008
4.368% in Year 1
4.770% 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) 2008 were also used to adjust the methodology's historical payments to current year constant dollars.

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

| CBY | COLA | CPIM |
|---|---|---|
| 2008 | 3.03% | 4.71% |
| 2009 | 3.87% | 4.01% |
| 2010 | 2.73% | 3.86% |
| 2011 | 2.20% | 3.87% |
| 2012 | 2.23% | 3.93% |
| 2013 + | 2.30% | 3.93% |

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2008 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections of the most recent three years. The estimated actuarial liability is updated only at the end of each fiscal year. The change in actuarial liability for fiscal year 2008 is an increase of $3.4 million.

The estimate was allocated between USMC GF General Fund and Navy Working Capital Fund-Marine Corps based on the number of civilian employees taken from the Navy Budget Tracking System.

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

| Intragovernmental Costs and Exchange Revenue | | |
|---|---|---|
| As of September 30 | 2008 | 2007 |
| (Amounts in thousands) | | |
| 1. Intragovernmental Costs | $ 6,616,796 | $ 6,192,075 |
| 2. Public Costs | 20,223,214 | 18,667,042 |
| **3. Total Costs** | $ 26,840,010 | $ 24,859,117 |
| 4. Intragovernmental Earned Revenue | $ (381,558) | $ (457,705) |
| 5. Public Earned Revenue | (417,836) | (189,363) |
| **6. Total Earned Revenue** | $ (799,394) | $ (647,068) |
| **7. Net Cost of Operations** | $ 26,040,616 | $ 24,212,049 |

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 USMC GF and a nonfederal entity.

Although the USMC GF accounting system tracks intragovernmental transactions by customer at the transaction level, many other Department systems do not. Therefore, internal DoD buyer-side balances are adjusted to agree with internal seller-side balances for revenue. Expenses were adjusted by reclassifying amounts between federal and nonfederal expenses.

The USMC GF accounting system captures information relative to heritage assets separately and distinctly from normal operations. The USMC GF does not report any amounts for the costs of acquiring, constructing, improving, reconstructing, or renovating heritage assets (other than multi-use heritage assets); nor costs for acquiring stewardship land and preparing stewardship for its intended use.

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

Other financing sources, other is comprised of the adjustments of $158.8 million to record year-to-date change in land, building and accumulated depreciation and $17.8 million to record year-to-date changes in operating material and supplies and ammunition.

Budgetary financing source, other adjustments (rescissions, etc.) is comprised of $(399.9) million due to canceling year adjustments.

Appropriations received on the Statement of Change of Net Position (SCNP) does not agree with appropriation received on the Statement of Budgetary Resources (SBR). The difference of $153.2 thousand between appropriations received on the SCNP and appropriations received on the SBR is the amount of special receipts from USMC GF portion of the Wildlife Conservation on Military Reservations appropriation. This amount is included as appropriations received on the SBR, but not on the SCNP. Refer to Note 20 for additional details.

## Note 20. Disclosures Related to the Statement of Budgetary Resources

| As of September 30 | 2008 | 2007 |
| --- | --- | --- |
| (Amounts in thousands) | | |
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | $ 11,921,573 | $ 12,430,461 |
| 2. Available Borrowing and Contract Authority at the End of the Period | 0 | 0 |

The USMC GF Report on Budget Execution accurately reflects $23.4 billion direct obligations in category A, amounts apportioned quarterly; $7.0 billion direct obligations in category B, amounts apportioned on a basis other than quarterly; and $645.9 million reimbursable obligations in category B.

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

Appropriations Received on SBR does not agree with Appropriations Received on the Statement of Changes in Net Position (SCNP) because of differences between proprietary and budgetary accounting concepts and reporting concepts. The difference of $153.2 thousand is the amount of special receipts from USMC GF portion of the Wildlife Conservation on Military Reservations appropriation. This amount is included on the SBR, but not on SCNP.

# Note 21. Reconciliation of Net Cost of Operations to Budget

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **Resources Used to Finance Activities:** | | |
| Budgetary Resources Obligated: | | |
| 1. Obligations incurred | $ 31,059,127 | $ 30,248,767 |
| 2. Less: Spending authority from offsetting collections and recoveries (-) | (2,406,291) | (2,361,164) |
| 3. Obligations net of offsetting collections and recoveries | $ 28,652,836 | $ 27,887,603 |
| 4. Less: Offsetting receipts (-) | 167,559 | 20,195 |
| 5. Net obligations | $ 28,820,395 | $ 27,907,798 |
| Other Resources: | | |
| 6. Donations and forfeitures of property | 0 | 0 |
| 7. Transfers in/out without reimbursement (+/-) | 1 | 3,535 |
| 8. Imputed financing from costs absorbed by others | 66,595 | 71,325 |
| 9. Other (+/-) | 176,672 | 40,398 |
| 10. Net other resources used to finance activities | $ 243,268 | $ 115,258 |
| **11. Total resources used to finance activities** | $ 29,063,663 | $ 28,023,056 |
| **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 (-) | $ 508,888 | $ (2,415,619) |
| 12b. Unfilled Customer Orders | 54,935 | (71,500) |
| 13. Resources that fund expenses recognized in prior Periods (-) | (3,032) | (33,592) |
| 14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations | (167,559) | (20,194) |
| 15. Resources that finance the acquisition of assets (-) | (4,152,785) | (2,068,268) |
| 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 | 0 |
| 16b. Other (+/-) | (176,673) | (43,934) |
| **17. Total resources used to finance items not part of the Net Cost of Operations** | $ (3,936,226) | $ (4,653,107) |
| **18. Total resources used to finance the Net Cost of Operations** | $ 25,127,437 | $ 23,369,949 |

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:** | | |
| Components Requiring or Generating Resources in Future Period: | | |
| 19. Increase in annual leave liability | $ 85,423 | $ 8,003 |
| 20. Increase in environmental and disposal liability | 37,809 | 0 |
| 21. Upward/Downward reestimates of credit subsidy expense (+/-) | 0 | 0 |
| 22. Increase in exchange revenue receivable from the public (-) | 0 | 0 |
| 23. Other (+/-) | 24,564 | 2,345 |
| 24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods | $ 147,796 | $ 10,348 |
| Components not Requiring or Generating Resources: | | |
| 25. Depreciation and amortization | $ 878,531 | $ 770,514 |
| 26. Revaluation of assets or liabilities (+/-) | (112,348) | 26,298 |
| 27. Other (+/-) | | |
| 27a. Trust Fund Exchange Revenue | 0 | 0 |
| 27b. Cost of Goods Sold | 0 | 0 |
| 27c. Operating Material and Supplies Used | 0 | 28,429 |
| 27d. Other | (800) | 6,511 |
| 28. Total Components of Net Cost of Operations that will not Require or Generate Resources | $ 765,383 | $ 831,752 |
| **29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period** | $ 913,179 | $ 842,100 |
| **30. Net Cost of Operations** | $ 26,040,616 | $ 24,212,049 |

The following note schedule lines are presented as combined instead of consolidated due to intraagency budgetary transactions not being eliminated:

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

The note schedule line, "Budgetary Resources Obligated, Other" is primarily comprised of the year-to-date changes in real property and ammunition.

The note schedule line, “Other, Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations, Other” is comprised of the year-to-date changes in real property and ammunition.

The note schedule line, “Components Requiring or Generating Resources Future Period, Other” is comprised of future funded expenses from closing canceled year receivables and payables, the year-to-date change in Federal Employees’ Compensation Act (FECA) actuarial liability, and contingent legal liability.

The note schedule line, “Components Not Requiring or Generating Resources, Other, Other” is primarily comprised of adjustments made to refunds receivable and the bad debt expense for public accounts receivable.

## Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

# Note 23. Earmarked Funds

| BALANCE SHEET<br>As of September 30<br>(Amounts in thousands) | 2008 | | | | |
|---|---|---|---|---|---|
| | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
| **ASSETS** | | | | | |
| Fund balance with Treasury | $ 0 | $ 0 | $ 610 | $ 0 | $ 610 |
| Investments | 0 | 0 | 0 | 0 | 0 |
| Accounts and Interest Receivable | 0 | 0 | 0 | 0 | 0 |
| Other Assets | 0 | 0 | 0 | 0 | 0 |
| Total Assets | $ 0 | $ 0 | $ 610 | $ 0 | $ 610 |
| **LIABILITIES and NET POSITION** | | | | | |
| Military Retirement Benefits and Other Federal Employment Benefits | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Other Liabilities | 0 | 0 | 34 | 0 | 34 |
| Total Liabilities | $ 0 | $ 0 | $ 34 | $ 0 | $ 34 |
| Unexpended Appropriations | 0 | 0 | 0 | 0 | 0 |
| Cumulative Results of Operations | 0 | 0 | 576 | 0 | 576 |
| Total Liabilities and Net Position | $ 0 | $ 0 | $ 610 | $ 0 | $ 610 |

| STATEMENT OF NET COST<br>For the year ended September 30 | | | | | |
|---|---|---|---|---|---|
| Program Costs | $ 0 | $ 0 | $ 51 | $ 0 | $ 51 |
| Less Earned Revenue | 0 | 0 | 0 | 0 | 0 |
| Net Program Costs | $ 0 | $ 0 | $ 51 | $ 0 | $ 51 |
| Less Earned Revenues Not Attributable to Programs | 0 | 0 | 0 | 0 | 0 |
| Net Cost of Operations | $ 0 | $ 0 | $ 51 | $ 0 | $ 51 |

| STATEMENT OF CHANGES IN NET POSITION<br>For the year ended September 30 | 2008 | | | | |
|---|---|---|---|---|---|
| | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
| Net Position Beginning of the Period | $ 0 | $ 0 | $ 474 | $ 0 | $ 474 |
| Net Cost of Operations | 0 | 0 | 51 | 0 | 51 |
| Budgetary Financing Sources | 0 | 0 | 153 | 0 | 153 |
| Other Financing Sources | 0 | 0 | 0 | 0 | 0 |
| Change in Net Position | $ 0 | $ 0 | $ 102 | $ 0 | $ 102 |
| Net Position End of Period | $ 0 | $ 0 | $ 576 | $ 0 | $ 576 |

| BALANCE SHEET<br>As of September 30<br>(Amounts in thousands) | 2007 | | | | |
|---|---|---|---|---|---|
| | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
| **ASSETS** | | | | | |
| Fund balance with Treasury | $ 0 | $ 0 | $ 500 | $ 0 | $ 500 |
| Investments | 0 | 0 | 0 | 0 | 0 |
| Accounts and Interest Receivable | 0 | 0 | 0 | 0 | 0 |
| Other Assets | 0 | 0 | 0 | 0 | 0 |
| Total Assets | $ 0 | $ 0 | $ 500 | $ 0 | $ 500 |
| **LIABILITIES and NET POSITION** | | | | | |
| Military Retirement Benefits and Other Federal Employment Benefits | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Other Liabilities | 0 | 0 | 26 | 0 | 26 |
| Total Liabilities | $ 0 | $ 0 | $ 26 | $ 0 | $ 26 |
| Unexpended Appropriations | 0 | 0 | 0 | 0 | 0 |
| Cumulative Results of Operations | 0 | 0 | 474 | 0 | 474 |
| Total Liabilities and Net Position | $ 0 | $ 0 | $ 500 | $ 0 | $ 500 |

| STATEMENT OF NET COST<br>For the year ended September 30 | | | | | |
|---|---|---|---|---|---|
| Program Costs | $ 0 | $ 0 | $ 42 | $ 0 | $ 42 |
| Less Earned Revenue | 0 | 0 | 0 | 0 | 0 |
| Net Program Costs | $ 0 | $ 0 | $ 42 | $ 0 | $ 42 |
| Less Earned Revenues Not Attributable to Programs | 0 | 0 | 0 | 0 | 0 |
| Net Cost of Operations | $ 0 | $ 0 | $ 42 | $ 0 | $ 42 |

| STATEMENT OF CHANGES IN NET POSITION<br>For the year ended September 30 | 2007 | | | | |
|---|---|---|---|---|---|
| | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
| Net Position Beginning of the Period | $ 0 | $ 0 | $ 383 | $ 0 | $ 383 |
| Net Cost of Operations | 0 | 0 | 42 | 0 | 42 |
| Budgetary Financing Sources | 0 | 0 | 134 | 0 | 134 |
| Other Financing Sources | 0 | 0 | 0 | 0 | 0 |
| Change in Net Position | $ 0 | $ 0 | $ 92 | $ 0 | $ 92 |
| Net Position End of Period | $ 0 | $ 0 | $ 475 | $ 0 | $ 475 |

**Wildlife Conservation, Military Reservations, 16 USC 670**

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. During this reporting period, legislation regarding the purpose and use of the Wildlife Conservation, Military Reservation has not changed.

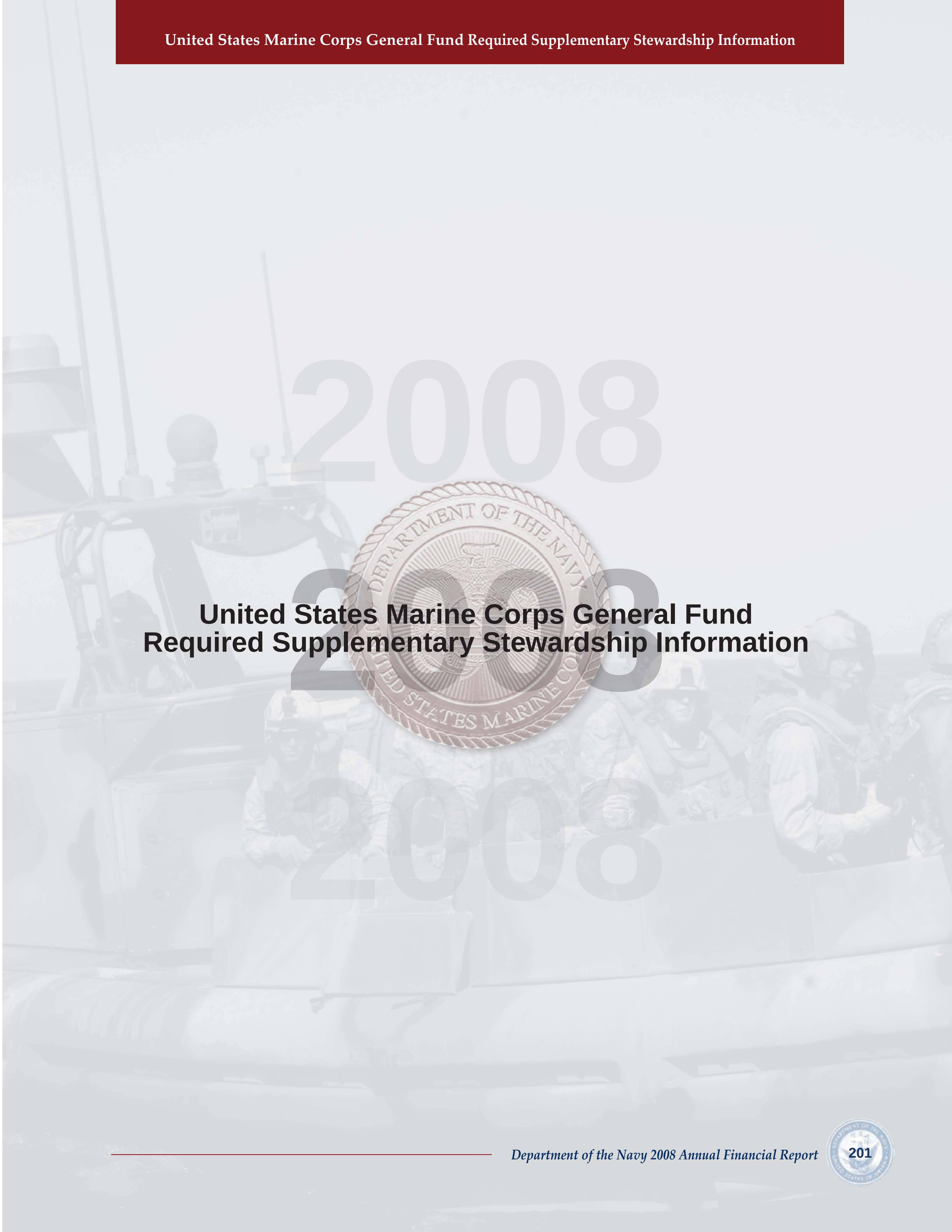
The nonexchange revenue in the amount of $153.2 thousand for 4th Quarter, FY 2008 is from the proceeds of the sale of fishing and hunting permits.

## Note 24. Other Disclosures

Currently, USMC GF does not record or report operating leases; however, under its Financial Improvement Initiative program, USMC GF has begun to implement a strategy to identify operating leases and to develop a process to report operating leases in the USMC GF financial statements. The development of the process is in its early stages, therefore, at this time, a completion date has not been established.

## Note 25. Restatements

The USMC GF does not have any restatements.




# United States Marine Corps General Fund Required Supplementary Stewardship Information

**Investments in Research and Development**
**Yearly Investment in Research and Development**
For Fiscal Years 2006 through 2008
*($ in Millions)*

| Categories | FY08 | FY07 | FY06 |
|---|---|---|---|
| Development | | | |
| Advanced Technology Development | $ 3 | $ 5 | $ 36 |
| Advanced Component Development and Prototypes | 361 | 64 | 302 |
| System Development and Demonstration | 22 | 18 | 13 |
| Research, Development, Test, and Evaluation Management Support | 44 | 48 | 48 |
| Operational Systems Development | 508 | 359 | 284 |
| **Totals** | **$ 938** | **$ 494** | **$ 683** |

## *Narrative Statement:*

**Investments in Research and Development**

Fiscal Year (FY) 2008 is the third year that the United States Marine Corps (USMC) General Fund (GF) is reporting as a separate entity and therefore is reporting three comparative years for the Investment in Research and Development schedule. The USMC GF Research, Development, Test, and Evaluation investments are all in Development; there are no basic and applied research investments. The values included in the table above are based on Development outlays (expenditures). Outlays are used because current USMC GF systems are unable to fully capture and summarize costs in accordance with standards promulgated by the Federal Accounting Standards Advisory Board.

**Development**

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

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

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

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

4. Research, Development, Test, and Evaluation Management Support is support for installations

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

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

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

**Marine Corps Will Field Next Generation of Assault Vehicles**

The Expeditionary Fighting Vehicle (EFV) Program will field a successor to the Marine Corps' current amphibious vehicle, the Assault Amphibious Vehicle Model 7A1. The EFV will provide the principal means of tactical surface mobility for the Marine Air Group Task Force during both ship-to-objective maneuvers and sustained combat operations ashore.

The EFV program is an Acquisition Category-1D program managed by the Marine Corps. The EFV is the next generation of Marine Corps Assault Vehicles being developed to satisfy the requirements of the 21st Century Marine War Fighters. Along with the Landing Craft Air Cushion and the MV-22 Osprey, the EFV will provide the Marine Corps with the tactical mobility assets required within the Expeditionary Maneuver Warfare capstone. Acquisition of the EFV is critical to the Marine Corps.

During FY 2008, the EFV program continued engineering and logistics efforts to support design development, manufacturing planning, and design enhancements of both the EFV Command and Personnel variants. The program continued developmental and reliability test support as well as the design, integration and testing of vehicle modifications that will support the Milestone C Operational Assessment. Developmental Testing and Reliability/Availability/Maintainability (RAM) testing were conducted during FY 2008 that included a water gunnery demo, direction stability demo, amphibious launch and recovery operations with USS New Orleans (PLD-18), and system level shock testing. The Design for Reliability effort continued during this period and followed the established systems engineering processes. Test spares were procured and the System Development Demonstration (SDD) prototypes began to be manufactured.

The SDD-2 contract was awarded during FY 2008. This follow-on SDD Phase will include continued design, development, and reliability upgrades; increased RAM testing; modification of existing SDD prototypes; and manufacture and testing of up to seven additional SDD prototype vehicles.

**Joint Light Tactical Vehicle Will Be Developed and Tested for the Army and Marine Corps**

The Joint Light Tactical Vehicle (JLTV) capabilities represent a shift to adapt from a threat-based, Cold War garrison force focused on containment to a capabilities-based expeditionary force focused on flexibility, survivability, force protection, responsiveness, and agility. The JLTV Family of Vehicles must be capable of operating across a broad spectrum of terrain and weather conditions. The Military Services and the U.S. Special Operations Command require enhanced capabilities, greater than those provided by the existing High Mobility Multipurpose Wheeled Vehicle (HMMWV) to support the Joint Functional Concepts of

Battlespace Awareness Force Application, and Focused Logistics. To that end, the approved JLTV Initial Capabilities Document, and the JLTV Capability Development Document identifies required capabilities for the next generation of JLTVs needed to support Joint Forces across the full Range of Military Operations and provide a vital force enabler, multiplier and extender. The initial production of JLTVs will provide the Marine Air Group Task Force commander a family of tactical wheeled vehicles capable of providing combat forces protected, sustained, and netted mobility in irregular warfare operations and enhancing its contribution to the integrated Joint Task Force.

**NON-FEDERAL PHYSICAL PROPERTY**

The USMC GF does not fund this type of Activity.

# United States Marine Corps General Fund Required Supplementary Information

**United States Marine Corps**
**General Property, Plant, and Equipment**
**Real Property Deferred Maintenance**
For Fiscal Year Ended September 30, 2008
*($ in Thousands)*

| Property Type | 1. Plant Replacement Value | 2. Required Work (Deferred Maintenance) | 3. Percentage |
|---|---|---|---|
| Category 1: Enduring Facilities | $38,040,907 | $1,070,560 | 2.8% |
| Category 2: Excess Facilities or Planned for Replacement | $1,050,183 | $0 | 0.0% |
| Category 3: Heritage Assets | $3,133,442 | $88,182 | 2.8% |

*NOTE: The table above presents real property deferred maintenance data for both U.S. Marine Corps (USMC) General Fund and Navy Working Capital Fund-Marine Corps..*

## *Narrative Statement:*

1. The method used to assess facilities conditions is a facilities inspection, which categorizes buildings as Adequate, Substandard or Inadequate. Those ratings are converted to Quality ratings (Q-ratings) of 100%-90% Q1; 90%-80% Q2; 80%-60% Q3; and less than 60% Q4 by assessing facilities that are rated as Adequate and less than 25 years old as Q1; facilities that are over 25 years old and rated as Adequate as Q2; facilities rated as Substandard as Q3; and Inadequate facilities as Q4.

2. There is no change since last year.

3. The USMC follows the Office of the Secretary of Defense installation strategic plan goal of having facilities at a Q2 level on average as an acceptable rating. This represents an average level of 15% of Plant Replacement Value (PRV) as an acceptable level of deferred maintenance. The table above shows that deferred maintenance is valued at approximately 2.81% of PRV for categories 1 and 3. The percentage for category 1 and 3 facilities is the same because we cannot separate the deferred maintenance between those categories at this time. Category 2 is zero because we do not hold deferred maintenance backlogs on facilities to be demolished.

### *Description of Property Type categories:*

- Category 1 – Buildings, Structures, and Utilities that are enduring and required to support an ongoing mission, including multi-use Heritage Assets.
- Category 2 – Buildings, Structures, and Utilities that are excess to requirements or planned for replacement or disposal, including multi-use Heritage Assets.
- Category 3 – Buildings, Structures, and Utilities that are Heritage Assets.

**Military Equipment Deferred Maintenance**
For Fiscal Year Ended September 30, 2008
*($ in Thousands)*

| Major Category | Amount |
|---|---|
| 1. Aircraft | $ - |
| 2. Automotive Equipment | 987 |
| 3. Combat Vehicles | 12,973 |
| 4. Construction Equipment | 1,981 |
| 5. Electronics and Communications Systems | 204 |
| 6. Missiles | 320 |
| 7. Ships | - |
| 8. Ordnance Weapons and Munitions | 972 |
| 9. General Purpose Equipment | - |
| 10. All Other Items Not Identified Above | - |
| **Total** | **$ 17,437** |

## *Narrative Statement:*

### Combat Vehicles Deferred Maintenance

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

### Missiles Deferred Maintenance

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

### Ordnance Weapons and Munitions Deferred Maintenance

Ordnance weapons and munitions are part of a broader category, Other Weapons Systems. This category is comprised of ordnance, end item maintenance for support equipment, camera equipment, landing aids, calibration equipment, air traffic control equipment, target systems, expeditionary airfield equipment, special weapons, target maintenance, and repair of repairable components. Three categories define ordnance maintenance: ordnance maintenance, software maintenance, and other. Although the various programs vary in the methodology in defining requirements, all programs define deferred maintenance as the difference between validated requirements and funding.

**Heritage Assets**
For Fiscal Year Ended September 30, 2008

| (a) | (b) | (c) | (d) | (e) | (f) | (g) |
|---|---|---|---|---|---|---|
| Categories | Measurement Quantity | As of 10/01/07 | Adjustments (+/-) | Additions | Deletions | As of 9/30/08 |
| Buildings and Structures | Each | 5 | 0 | 0 | 0 | 5 |
| Archeological Sites | Each | 0 | 0 | | | 0 |
| Museum Collection Items (Fine Art) | Each | 9,104 | (8,023) | 95 | 102 | 1,074 |
| Museum Collection Items (Objects) | See table, "Museum Collection Items (Objects)" | | | | | |

## *Narrative Statement:*

The USMC GF is required to report Heritage Assets in accordance with the following public laws and regulations:

- Antiquities Act of 1906
- Historic Sites Act of 1935
- USC 470 National Historic Preservation Act of 1966
- National Environmental Policy Act of 1969
- American Indian Religious Freedom Act of 1978
- Archeological Resources Protection Act of 1979
- Native American Graves Protection & Repatriation Act of 1990
- Presidential Memorandum for Heads of Executive Departments and Agencies: Government to Government Relations with Native American Tribal Governments Act of 1994
- 36 CFR 79 – Curation of Federally Owned and Administered Archeological Collections
- 36 CFR 60.4 – National Register of Historic Places
- Federal Accounting Standards Advisory Board (FASAB) Standard No. 29, "Heritage Assets and Stewardship Land"
- Executive Order 13287 – Preserve America – of 2003
- Executive Order 13327 – Federal Real Property Asset Management – of 2004

Heritage Assets are items of historical, natural, cultural, educational, or artistic significance; or items with significant architectural characteristics. Heritage Assets are expected to be preserved indefinitely. Monetary values are not required for Heritage Asset reporting; only physical units of measure are reported.

### *Explanation for Adjustment*

The Marine Corps made a downward adjustment of 8,023 items to the balance of its Museum Collection Items (Fine Art) pursuant to a Naval Audit Service recommendation.

### *Process Used to Define Assets as Heritage Assets*

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

### Multi-Use Heritage Assets

Per Department of Defense (DoD) Financial Management Regulation Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," Multi-Use Heritage Assets are reported as Heritage Assets in the Required Supplementary Information and on the Balance Sheet as General Property, Plant and Equipment.

### Information Pertaining to the Condition of USMC Heritage Assets

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

**Museum Collection Items (Objects)**
For Fiscal Year Ended September 30, 2008

| (a) | (b) | (c) | (d) | (e) | (f) | (g) |
|---|---|---|---|---|---|---|
| Categories | Measurement Quantity | As of 10/01/07 | Adjustments (+/-) | Additions | Deletions | As of 9/30/08 |
| Archeological Artifacts | Cubic Ft | 938 | 16 | 2 | 0 | 956 |
| Archival | Linear Ft | 25,891 | 0 | 396 | 12 | 26,275 |
| Historic Artifacts | Item | 54,190 | (19,650) | 819 | 161 | 35,198 |

### Description of Heritage Assets Categories:

- Buildings and Structures – Includes buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-use Heritage Assets.
- Archeological Sites – Sites that have been identified, evaluated, and determined to be eligible for listing on, or are listed on, the National Register of Historic Places.
- Museum Collection Items – Items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics. Museum collection items are divided into two subcategories: Objects and Fine Art. Objects are current use, excess, obsolete, or condemned material; war trophies; personal property, such as uniforms, medals, or diaries; and military equipment. Fine art includes paintings, sculptures, and other three-dimensional art.

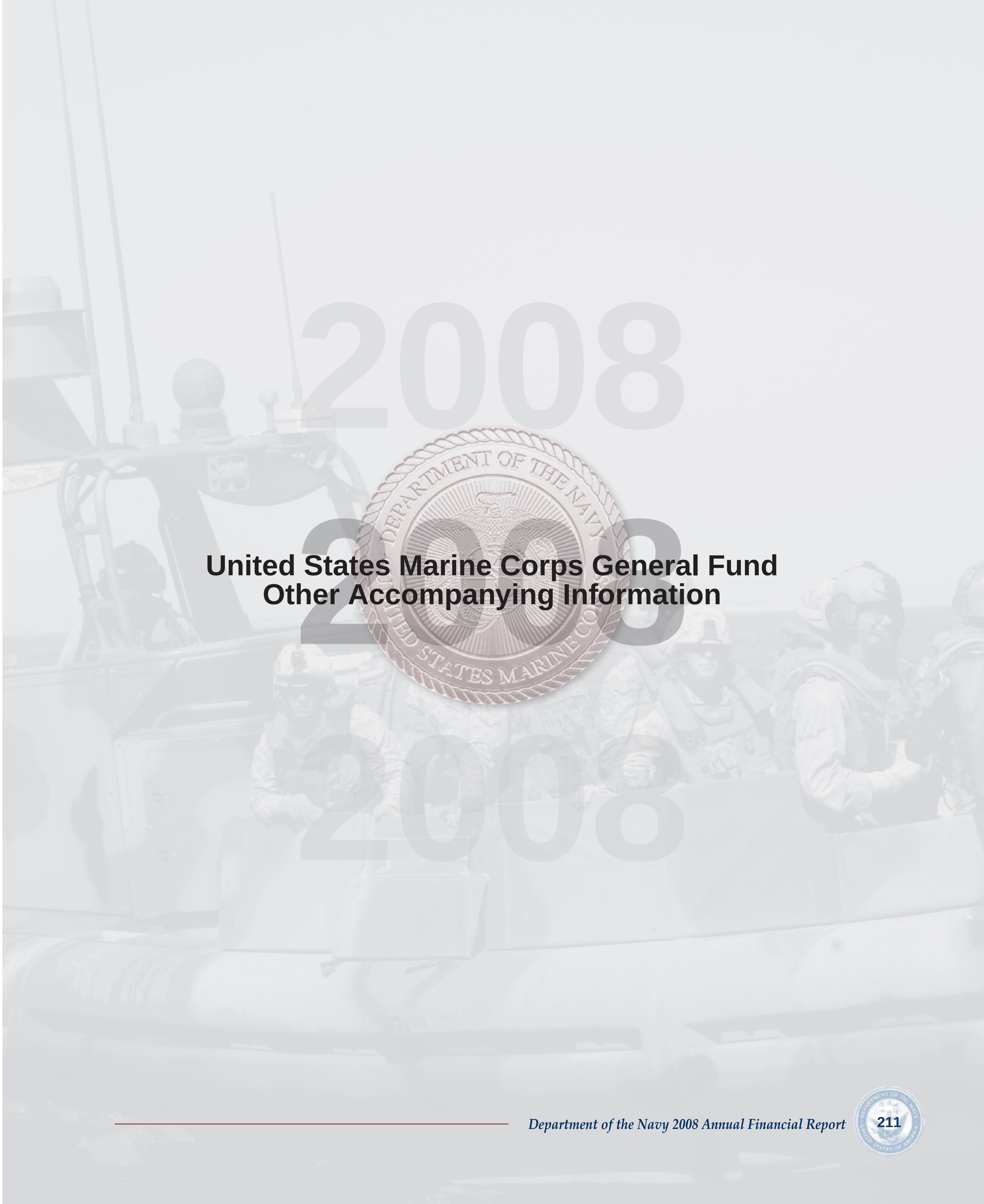
**Stewardship Land**
For Fiscal Year Ended September 30, 2008
*(Acres in Thousands)*

| (a) | (b) | (c) | (d) | (e) | (f) |
|---|---|---|---|---|---|
| **Facility Code** | **Facility Title** | **As of 10/01/07** | **Additions** | **Deletions** | **As of 9/30/08** |
| 9110 | Government Owned Land | 680 | 0 | 0 | 680 |
| 9111 | State Owned Land | - | - | - | - |
| 9120 | Withdrawn Public Land | - | - | - | - |
| 9130 | Licensed and Permitted Land | - | - | - | - |
| 9140 | Public Land | - | - | - | - |
| 9210 | Land Easement | - | - | - | - |
| 9220 | In-Leased Land | - | - | - | - |
| 9230 | Foreign Land | - | - | - | - |
| | **Totals** | **680** | **0** | **0** | **680** |

## *Narrative Statement:*

Stewardship Land comprises land and land rights owned by the Federal Government but not acquired for, or in connection with, items of General Property, Plant and Equipment.

The USMC categorizes Stewardship Land pursuant to DoD Instruction 4165.14, Real Property Inventory and Forecasting.




# United States Marine Corps General Fund Other Accompanying Information

# Appropriations, Funds, and Accounts Included in the Principal Statements

## *Entity Accounts*

**General Accounts**

| | |
|---|---|
| 17 1001 | Medicare Eligible Retiree Health Care Fund, Military Personnel Marine Corps |
| 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 |

**Shared Appropriations (Appropriations from which U.S. Marine Corps receives allocations)**

| | |
|---|---|
| 17 0703 | Family Housing, Navy and Marine Corps |
| 17 1319 | Research and Development, Test and Evaluation, Navy |
| 17 1508 | Procurement of Ammunition, Navy and Marine Corps |

**Shared Earmarked Funds**

| | |
|---|---|
| 17X5095 | Wildlife Conservation |

## *Non-Entity Accounts*

| | |
|---|---|
| 17X6026 | Pay of the Marine Corps, Deposit Fund Receipts |

**Shared Non-Entity Accounts**

| | |
|---|---|
| 17 3XXX | Receipt Accounts |
| 17X6XXX | Deposit Funds |

# Navy Working Capital Fund – Marine Corps Principal Statements

## Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with Generally Accepted Accounting Principles for Federal entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

In Fiscal Year (FY) 2006, the Office of the Under Secretary of Defense (Comptroller), with support from the Department of the Navy, designated the U.S. Marine Corps a financial reporting entity. This designation allowed the Marine Corps to prepare comprehensive subsidiary financial statements and related notes beginning in FY 2006.

The Marine Corps shares appropriations with the U.S. Navy and in addition maintains accountability for its own appropriations. The Marine Corps has specific funds and budget execution unto itself that are managed by Marine Corps program sponsors, maintained in a single core integrated Working Capital Fund accounting and budgeting reporting system, and supported by Marine Corps managerial accountants and the Defense Finance and Accounting Service-Kansas City. Given this fiduciary responsibility, the Marine Corps is able to fully comply with Statement of Federal Financial Accounting Concepts Number 2, *Entity and Display*.

## Principal Statements

The FY 2008 Navy Working Capital Fund-Marine Corps principal statements and related notes are subsidiary financial statements and related notes of the Navy Working Capital Fund, and are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual activity groups and activities within the Navy Working Capital Fund-Marine Corps for the fiscal year ending September 30, 2008, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2007.

The following statements comprise the Navy Working Capital Fund-Marine Corps principal statements:

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

The principal statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the principal statements.

**Department of Defense**
**Navy Working Capital Fund - Marine Corps**

# CONSOLIDATED BALANCE SHEET

**As of September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **ASSETS (Note 2)** | | |
| Intragovernmental: | | |
| Fund Balance with Treasury (Note 3) | $ 70,746 | $ 67,119 |
| Accounts Receivable (Note 5) | 5,826 | 24,848 |
| Other Assets (Note 6) | 295 | 684 |
| Total Intragovernmental Assets | 76,867 | 92,651 |
| Accounts Receivable, Net (Note 5) | 81 | 74 |
| Inventory and Related Property, Net (Note 9) | 350,603 | 475,126 |
| General Property, Plant and Equipment, Net (Note 10) | 45,972 | 45,925 |
| Other Assets (Note 6) | 509 | 127 |
| Stewardship Property, Plant and Equipment (Note 10) * | | |
| **TOTAL ASSETS** | 474,032 | 613,903 |
| **LIABILITIES (Note 11)** | | |
| Intragovernmental: | | |
| Accounts Payable (Note 12) | 52,258 | 5,768 |
| Other Liabilities (Note 15 & Note 16) | 1,130 | 858 |
| Total Intragovernmental Liabilities | 53,388 | 6,626 |
| Accounts Payable (Note 12) | 24,291 | 79,541 |
| Military Retirement and Other Federal Employment Benefits (Note 17) | 27,219 | 27,624 |
| Other Liabilities (Note 15 & Note 16) | 11,296 | 9,141 |
| Commitments and Contingencies (Note 16) * | | |
| **TOTAL LIABILITIES** | 116,194 | 122,932 |
| **NET POSITION** | | |
| Unexpended Appropriations - Other Funds | 32,400 | 32,400 |
| Cumulative Results of Operations - Other Funds | 325,438 | 458,571 |
| **TOTAL NET POSITION** | 357,838 | 490,971 |
| **TOTAL LIABILITIES AND NET POSITION** | $ 474,032 | $ 613,903 |

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

*The accompanying notes are an integral part of these statements.*

**Department of Defense**

**Navy Working Capital Fund - Marine Corps**

# CONSOLIDATED STATEMENT OF NET COST

**For the Years Ended September 30, 2008 and 2007**

**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **Program Costs** | | |
| Gross Costs | $ 801,781 | $ 665,405 |
| Less: Earned Revenue | (656,654) | (608,572) |
| Net Program Costs | 145,127 | 56,833 |
| **Net Cost of Operations** | $ 145,127 | $ 56,833 |

*The accompanying notes are an integral part of these statements.*

**Department of Defense**
**Navy Working Capital Fund - Marine Corps**

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

**For the Years Ended September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS** | | |
| **Beginning Balances** | $ 458,571 | $ 535,875 |
| **Prior Period Adjustments** | | |
| **Beginning Balances, as adjusted** | 458,571 | 535,875 |
| **Budgetary Financing Sources:** | | |
| Appropriations used | 798 | |
| Transfers in/out without reimbursement (+/-) | 0 | 63,393 |
| **Other Financing Sources:** | | |
| Imputed financing from costs absorbed by others | 11,197 | 12,325 |
| Other (+/-) | (1) | (96,189) |
| **Total Financing Sources** | 11,994 | (20,471) |
| **Net Cost of Operations (+/-)** | 145,127 | 56,833 |
| **Net Change** | (133,133) | (77,304) |
| **Cumulative Results of Operations** | $ 325,438 | $ 458,571 |

*The accompanying notes are an integral part of these statements.*

Department of Defense

Navy Working Capital Fund - Marine Corps

# CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2008 and 2007

($ in Thousands)

| | 2008 Consolidated | 2007 Consolidated |
|---|---|---|
| **UNEXPENDED APPROPRIATIONS** | | |
| **Beginning Balances** | $ 32,400 | $ 0 |
| **Prior Period Adjustments (+/-)** | | |
| **Beginning Balances, as adjusted** | 32,400 | 0 |
| **Budgetary Financing Sources:** | | |
| Appropriations received | 866 | 32,400 |
| Other adjustments (rescissions, etc.) | (68) | |
| Appropriations Used | (798) | |
| **Total Budgetary Financing Sources** | 0 | 32,400 |
| **Unexpended Appropriations** | 32,400 | 32,400 |
| **Net Position** | $ 357,838 | $ 490,971 |

The accompanying notes are an integral part of these statements.

**Department of Defense**
**Navy Working Capital Fund - Marine Corps**

# COMBINED STATEMENT OF BUDGETARY RESOURCES

**For the Years Ended September 30, 2008 and 2007**
**($ in Thousands)**

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **BUDGETARY FINANCING ACCOUNTS** | | |
| **Budgetary Resources:** | | |
| Unobligated balance, brought forward, October 1 | $ 179,815 | $ 177,371 |
| Budget Authority: | | |
| Appropriations received | 866 | 32,400 |
| Contract authority | 34,040 | (49,945) |
| Spending authority from offsetting collections: | | |
| Earned | | |
| Collected | 676,609 | 626,041 |
| Change in receivables from Federal sources | (7,292) | (21,618) |
| Change in unfilled customer orders | | |
| Advances received | (186) | 520 |
| Without advance from Federal sources | 51,241 | (20,741) |
| Subtotal | 755,278 | 566,657 |
| Nonexpenditure Transfers, net, anticipated and actual | 0 | 63,393 |
| Permanently not available | 27,500 | (32,400) |
| **Total Budgetary Resources** | 962,593 | 775,021 |
| | | |
| **Status of Budgetary Resources:** | | |
| Obligations incurred: | | |
| Direct | 798 | |
| Reimbursable | 671,492 | 595,206 |
| Subtotal | 672,290 | 595,206 |
| Unobligated balance: | | |
| Apportioned | 194,510 | 116,422 |
| Exempt from apportionment | 95,793 | 63,393 |
| Subtotal | 290,303 | 179,815 |
| **Total Status of Budgetary Resources** | $ 962,593 | $ 775,021 |

*The accompanying notes are an integral part of these statements.*

Department of Defense
Navy Working Capital Fund - Marine Corps

# COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2008 and 2007

($ in Thousands)

| | 2008 Combined | 2007 Combined |
|---|---|---|
| **RELATIONSHIP OF OBLIGATIONS TO OUTLAYS** | | |
| **Change in Obligated Balance:** | | |
| Obligated balance, net | | |
| Unpaid obligations, brought forward, October 1 | $ 243,475 | $ 333,699 |
| Less: Uncollected customer payments from Federal sources, brought forward, October 1 | (297,712) | (340,071) |
| **Total Unpaid Obligated Balance** | (54,237) | (6,372) |
| Obligations incurred, net (+/-) | 672,290 | 595,206 |
| Less: Gross outlays | (673,593) | (685,430) |
| Change in uncollected customer payments from Federal sources (+/-) | (43,949) | 42,360 |
| Obligated balance, net, end of period | | |
| Unpaid obligations | 242,172 | 243,475 |
| Less: Uncollected customer payments from Federal sources | (341,661) | (297,712) |
| **Total Unpaid Obligated Balance, net, end of period** | (99,489) | (54,237) |
| **Net Outlays:** | | |
| Gross Outlays | 673,593 | 685,430 |
| Less: Offsetting collections | (676,423) | (626,562) |
| **Net Outlays** | $ (2,830) | $ 58,868 |

*The accompanying notes are an integral part of these statements.*

# Navy Working Capital Fund – Marine Corps Notes to the Principal Statements

# Note 1. Significant Accounting Policies

## 1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Navy Working Capital Fund-Marine Corps (NWCF-MC), as required by the Chief Financial Officers Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of NWCF-MC in accordance with the Department of Defense (DoD), Financial Management Regulation (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 NWCF-MC is responsible unless otherwise noted.

The NWCF-MC is unable to fully implement all elements of GAAP and OMB Circular A-136, due to limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The NWCF-MC derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with GAAP. The NWCF-MC continues to implement process and system improvements addressing these limitations.

The DoD currently has several auditor identified financial statement material weaknesses. Of these, NWCF-MC has the following material weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Unsupported Accounting Entries, (4) Fund Balance with Treasury, (5) General Property, Plant, and Equipment, (6) Inventory, (7) Operating Materiel and Supplies, (8) Statement of Net Cost, (9) Reconciliation of Net Cost of Operations to Budget, (10) Accounts Payable, and (11) Accounts Receivable.

## 1.B. Mission of the Reporting Entity

The United States Marine Corps (USMC) was created on November 10, 1775 as an act of the 2nd Continental Congress. The overall mission of USMC is to defend advanced naval bases and to conduct such land operations as may be essential to the prosecution of a naval campaign. The NWCF-MC provides goods and quality products, responsive maintenance support services required to support mobilization, surge and reconstitution requirements to the Department of the Navy (DON) and other DoD customers to ensure the operating forces are equipped for war in accordance with mobilization plans. In addition, NWCF-MC supports other governmental and nongovernmental customers.

## 1.C. Appropriations and Funds

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

Working capital funds (WCF) received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations and transactions that flow through the fund. The WCF resources the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

## 1.D. Basis of Accounting

For Fiscal Year (FY) 2008, NWCF-MC's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of NWCF-MC'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. The NWCF-MC and the Defense Finance and Accounting Service (DFAS) continue with the implementation of new accounting systems designed to produce both proprietary and budgetary reports and use the United States Standard General Ledger (USSGL). Until the implementation is completed, the amounts recorded are primarily based upon proprietary data.

The DoD 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 current revision of its accounting systems to record transactions based on USSGL. Until all of NWCF-MC's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, NWCF-MC's financial data will be derived from transactions from nonfinancial feeder systems and accruals made of major items such as payroll expenses and accounts payable.

## 1.E. Revenues and Other Financing Sources

Depot Maintenance WCF activities recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items.

## 1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because NWCF-MC's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accruals are made for major items such as payroll expenses, accounts payable, and unbilled revenue. In the case of Operating Materiel and Supplies (OM&S), operating expenses are generally recognized when the items are issued for workload consumption which is the "consumption method of accounting." In certain cases, OM&S may be reported as an operating expense at the time of purchase which is the "purchase method of accounting." Some examples of OM&S that would be expensed based on the purchase method are (1) when the customer's statement of work requires the purchase method to be utilized, (2) for unique nonrecurring workload as required, and (3) for fast moving products that have minimal repair cycle times and require direct delivery to the production shops.

## 1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DoD or between two or more federal agencies. However, NWCF-MC cannot accurately eliminate intragovernmental transactions by customer because NWCF-MC's systems do not track at the transaction level. Generally, seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances.

IntraDoD intragovernmental balances are then eliminated. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources. The DoD is developing long-term system improvements to ensure accurate intragovernmental information, to include sufficient up-front edits and controls eliminating the need for after-the-fact reconciliations.

The U.S. Treasury Financial Management Service is responsible for eliminating transactions between DoD and other federal agencies. The U.S. Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government," and U.S. Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. While NWCF-MC is unable to fully reconcile intragovernmental transactions with all federal partners, NWCF-MC is able to reconcile balances pertaining to Federal Employees' Compensation Act transactions with the Department of Labor and benefit program transactions with the Office of Personnel Management.

The DoD's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

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

Each year, NWCF-MC 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 U.S. Government. Payment in U.S. dollars is required in advance.

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

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

In addition, DFAS sites and USACE Finance Center submit reports to U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. The NWCF-MC's recorded balance in FBWT accounts and U.S. Treasury's FBWT accounts must balance monthly.

## *1.J. Foreign Currency*

Not applicable.

## *1.K. Accounts Receivable*

As presented in the Balance Sheet, accounts receivable includes three categories: accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon an estimate of uncollectible accounts receivable. This estimate is a percentage of the billed amount after the total project cost has been adjusted to reflect the advance deposit. The NWCF-MC requires an advance deposit from all public entities prior to the commencement of work. Therefore, an assumption is made that the amount of uncollectible accounts should be negligible. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the U.S. Treasury Financial Manual.

### *1.L. Direct Loans and Loan Guarantees*

Not applicable.

### *1.M. Inventories and Related Property*

The NWCF-MC values and reports its resale inventories at an approximation of historical cost using latest acquisition cost (LAC) adjusted for holding gains and losses. The LAC method is used because legacy inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). A manual valuation process to comply has been designed and is in the testing phase; it is expected to be completely evaluated by the end of March 2009.

The NWCF-MC manages only military or government specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes all items (such as tanks, self-propelled weapons, etc., and related spares, repair parts, and support equipment, but excluding real property, installations, and utilities) necessary to equip, operate, maintain, and support military activities without distinction as to its application for administrative or combat purposes. Items commonly used in and available from the commercial sector are not managed in NWCF-MC materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The NWCF-MC holds materiel based on military need and support for contingencies. Materiel held in reserve for future sale is included in inventories and related property line item on the financial statements with a separate disclosure in the footnotes based on SFFAS No. 3 definitions.

Related property includes OM&S and stockpile materiels. The OM&S, including munitions not held for sale, are valued at standard purchase price. The NWCF-MC 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 as OM&S. The NWCF-MC uses the purchase method only when special circumstances exist as identified under "recognition of expenses."

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

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

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

Not applicable.

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

The NWCF-MC's General Property, Plant, & Equipment (PP&E) capitalization threshold is $100 thousand except for real property which is $20 thousand. The NWCF-MC has not implemented the threshold for real property. The NWCF-MC is currently using the capitalization threshold of $100 thousand for all General PP&E.

The WCF capitalizes all General PP&E used in the performance of their mission. These capitalized assets are categorized as General PP&E, whether or not it meets the definition of any other General PP&E categories.

## 1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy is to record advances or prepayments in accordance with GAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The NWCF-MC has not implemented this policy primarily due to system limitations.

## 1.Q. Leases

Not applicable.

## 1.R. Other Assets

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

The NWCF-MC conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, NWCF-MC may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisition Regulation Supplement authorizes only for construction of real property. Progress payments for real property are reported as Construction in Progress. It is DoD policy to record certain contract financing payments as Other Assets.

## *1.S. Contingencies and Other Liabilities*

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

The NWCF-MC is unable to identify specific legal contingencies primarily due to uncertainties of litigation and difficulty identifying data and method of computation. These difficulties include, but are not limited to unsupported comprehensive documentation that specifically identifies NWCF-MC as the liable source of contingency. During 1st Quarter, FY 2007, DON worked with the Office of General Counsel and the Office of the Under Secretary of Defense (Comptroller) to develop and implement a methodology to produce an estimate for Contingent Legal Liabilities. This methodology was able to recognize contingent legal liabilities at DON and corporate Marine Corps levels only, but not at NWCF-MC level.

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 collectability of receivables, pending, or threatened litigation, and possible claims and assessments. The NWCF-MC's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as vehicle accidents; property damages; and contract disputes.

## *1.T. Accrued Leave*

The NWCF-MC reports as liabilities military leave and civilian earned leave, except sick leave, that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. 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 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 that were not reimbursed.

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

Not applicable.

## 1.W. Comparative Data

The NWCF-MC's financial statements and notes are presented on a comparative basis.

## 1.X. Unexpended Obligations

The NWCF-MC obligates funds to provide goods and services for outstanding orders not yet delivered. Unless the title has passed, the financial statements do not reflect a liability for payment for goods and services not yet delivered. Unexpended obligations includes both obligations for which goods and services have been delivered (title passed) and a liability recognized, and obligations for which no delivery has occurred and no liability recognized. The balance of unexpended obligations appears immediately before net outlays in the Statement of Budgetary Resources, and is referred to as "Total, Unpaid Obligated Balance, net, end of period."

## 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 U.S. Treasury. These amounts should agree with the undistributed amounts reported on the monthly accounting reports. In-transit payments are those payments that have been made, but have not been recorded in the fund holder's accounting records. These payments are applied to the entities' outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the entities' accounts receivable balance.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The NWCF-MC does not follow DoD policy because financial feeder systems and accounting systems do not provide sufficient detail to identify federal and nonfederal, or supported/unsupported transactions. Further systems enhancements include providing the appropriate breakouts.

The NWCF-MC identifies undistributed disbursements and collections to specific federal and nonfederal partners based on detailed transactions and apply them to accounts payable and accounts receivable appropriately. Disbursements and collections which remain unidentified are treated as unsupported. Unsupported undistributed disbursements are recorded in federal accounts payable since the majority of NWCF-MC business is with federal entities. Unsupported undistributed collections are zero.

## 1.Z. Significant Events

Not applicable.

## Note 2. Nonentity Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Assets** | | |
| A. Fund Balance with Treasury | $ 0 | $ 0 |
| B. Accounts Receivable | 0 | 0 |
| **C. Total Intragovernmental Assets** | $ 0 | $ 0 |
| **2. Nonfederal Assets** | | |
| A. Cash and Other Monetary Assets | $ 0 | $ 0 |
| B. Accounts Receivable | 1 | 0 |
| C. Other Assets | 0 | 0 |
| **D. Total Nonfederal Assets** | $ 1 | $ 0 |
| **3. Total Nonentity Assets** | $ 1 | $ 0 |
| **4. Total Entity Assets** | $ 474,031 | $ 613,903 |
| **5. Total Assets** | $ 474,032 | $ 613,903 |

Nonentity assets are assets for which the Navy Working Capital Fund-Marine Corps (NWCF-MC) maintains stewardship accountability and responsibility to report, but are not available for NWCF-MC operations.

The amount reported in the NWCF-MC's Nonentity Assets is accounts receivable for penalties and interest related to a public receivable which has been submitted to the Debt Management Office for collection.

## Note 3. Fund Balance with Treasury

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Fund Balances** | | |
| A. Appropriated Funds | $ 0 | $ 0 |
| B. Revolving Funds | 70,746 | 67,119 |
| C. Trust Funds | 0 | 0 |
| D. Special Funds | 0 | 0 |
| E. Other Fund Types | 0 | 0 |
| **F. Total Fund Balances** | $ 70,746 | $ 67,119 |
| **2. Fund Balances Per Treasury Versus Agency** | | |
| A. Fund Balance per Treasury | $ 70,746 | $ 67,119 |
| B. Fund Balance per United States Marine Corps | 70,746 | 67,119 |
| **3. Reconciling Amount** | $ 0 | $ 0 |

The Navy Working Capital Fund-Marine Corps (NWCF-MC) has no reconciling amount to report this period.

## Status of Fund Balance with Treasury

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **1. Unobligated Balance** | | | | |
| A. Available | $ | 290,303 | $ | 179,815 |
| B. Unavailable | | 0 | | 0 |
| **2. Obligated Balance not yet Disbursed** | $ | 242,172 | $ | 243,475 |
| **3. Nonbudgetary FBWT** | $ | 0 | $ | 0 |
| **4. NonFBWT Budgetary Accounts** | $ | (461,729) | $ | (356,171) |
| **5. Total** | $ | 70,746 | $ | 67,119 |

The Status of Fund Balance with Treasury (FBWT) reflects the budgetary resources to support FBWT.

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, services that have not been performed, and goods and services that have been delivered/received but not yet paid.

Nonbudgetary FBWT includes entity and nonentity FBWT accounts which represent adjustments that do not have budgetary authority, such as unavailable receipt accounts or clearing accounts. There is no Nonbudgetary FBWT reported this period.

NonFBWT Budgetary Accounts represent adjustments to budgetary accounts that do not affect FBWT. For NWCF-MC, NonFBWT Budgetary accounts are comprised of contract authority for capital assets in depot maintenance and operating expenses in supply management, accounts receivable, and unfilled orders from customers. This category reduces the Status of FBWT.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. For this reporting period, there are no unobligated unavailable balances for NWCF-MC. Unobligated available balances are not restricted to future use and are not apportioned for current use.

## Note 4. Investments and Related Interest

The Navy Working Capital Fund-Marine Corps does not have Investments and Related Interest.

## Note 5. Accounts Receivable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net | Accounts Receivable, Net |
| (Amounts in thousands) | | | | |
| **1. Intragovernmental Receivables** | $ 5,826 | N/A | $ 5,826 | $ 24,848 |
| **2. Nonfederal Receivables (From the Public)** | $ 81 | $ 0 | $ 81 | $ 74 |
| **3. Total Accounts Receivable** | $ 5,907 | $ 0 | $ 5,907 | $ 24,922 |

## Note 6. Other Assets

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Other Assets** | | |
| A. Advances and Prepayments | $ 295 | $ 684 |
| B. Other Assets | 0 | 0 |
| **C. Total Intragovernmental Other Assets** | $ 295 | $ 684 |
| **2. Nonfederal Other Assets** | | |
| A. Outstanding Contract Financing Payments | $ 60 | $ 81 |
| B. Advances and Prepayments | 449 | 46 |
| C. Other Assets (With the Public) | 0 | 0 |
| **D. Total Nonfederal Other Assets** | $ 509 | $ 127 |
| **3. Total Other Assets** | $ 804 | $ 811 |

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Navy Working Capital Fund-Marine Corps (NWCF-MC) that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and NWCF-MC is not obligated to make payment to the contractor until delivery and acceptance.

The Contract Financing Payment balance of $59.7 thousand is the estimated future payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. See additional discussion in Note 15, "Other Liabilities."

## Note 7. Cash and Other Monetary Assets

The Navy Working Capital Fund-Marine Corps does not have Cash and Other Monetary Assets.

# Note 8. Direct Loan and Loan Guarantees

Not applicable.

# Note 9. Inventory and Related Property

| As of September 30 | 2008 | | 2007 | |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| 1. Inventory, Net | $ | 235,620 | $ | 318,682 |
| 2. Operating Materiel & Supplies, Net | | 114,983 | | 156,444 |
| 3. Stockpile Materiel, Net | | 0 | | 0 |
| **4. Total** | $ | 350,603 | $ | 475,126 |

# Inventory, Net

| As of September 30 | 2008 Inventory, Gross Value | 2008 Revaluation Allowance | 2008 Inventory, Net | 2007 Inventory, Net | Valuation Method |
|---|---|---|---|---|---|
| (Amounts in thousands) | | | | | |
| **1. Inventory Categories** | | | | | |
| A. Available and Purchased for Resale | $ 432,793 | $ (434,318) | (1,525) | $ 83,766 | LAC,MAC |
| B. Held for Repair | 237,273 | 0 | 237,273 | 234,792 | LAC,MAC |
| C. Excess, Obsolete, and Unserviceable | 0 | 0 | 0 | 0 | NRV |
| D. Raw Materiel | 0 | 0 | 0 | 0 | MAC,SP,LAC |
| E. Work in Process | (128) | 0 | (128) | 124 | AC |
| **F. Total** | $ 669,938 | $ (434,318) | 235,620 | $ 318,682 | |

**Legend for Valuation Methods:**

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

**Abnormal Balances in Available and Purchased for Resale**

The $1.5 million abnormal balance in Inventory and Purchased for Resale is the result of duplicate inventory adjustment errors, made in the calculation methodologies for 4th Quarter, FY 2008, in the inventory allowance account. This account is an offset to the inventory accounts, completed monthly, to revalue inventory from the Supply Management Activity Group (SMAG) accounts from standard to actual cost.

During March 2008, Marine Corps (MC) Logistics managers conducted a physical evaluation of on hand inventories. As a result of conducting this evaluation, several consumable, spare and replenishment items were determined to be either excess, obsolete and/or damaged beyond economic repair. Primarily during the 4th Quarter, FY 2008, these items, totaling $78.8 million were transferred to Defense Reutilization Marketing Office (DRMO) for disposal with associative inventory reduction transactions processing in the inventory financial management system. Examples of items transferred include the Homing All the Way Killer missile, M60 Tank and other weapon systems that are no longer being utilized by MC SMAG customers.

Simultaneously, the monthly journal voucher to account for inventory allowance revaluation erroneously duplicated the value of the inventory transferred to DRMO, thus reducing the gross value of inventory. The MC will work with the Defense Finance and Accounting Service to correct this error, and process for calculation of the inventory allowance account, by the end of 1st Quarter, FY 2009.

Generally, there are no restrictions with regard to the use, sale, or disposition of inventory to applicable Department of Defense (DoD) activities and personnel. Other than specified safety and war reserve levels, established as a result of DoD and MC regulatory operations, inventory may be sold to foreign countries, state and local governments, private parties and contractors in accordance with DoD and MC policies and guidance or at the direction of the President.

**Inventory Categories**

Inventory represents property that is held (a) for sale to customers, (b) in the process of supporting production for eventual sale to customers, and (c) to be consumed in the production of goods for sale or in the provision of providing services for a fee.

Inventory Available and Purchased for Resale includes consumable spare and repair parts and repairable items owned and managed by Navy Working Capital Fund-Marine Corps (NWCF-MC) as well as consumable and repairable items that are managed by other Military Services, such as the Defense Logistics Agency or the General Services Administration, where MC has permission to stock, store, and sell. Materiel available and purchased for resale includes material to support military or national contingencies, held based on various managerial decisions.

Included in Inventory Available and Purchased for Resale, is an amount of $84.3 million for War Reserve Material for Supply Management Activity Group, MC.

Federal Accounting Standards require disclosure of the amount of Inventory Held for "Future Sale." The NWCF-MC currently has no inventory included in this reporting period, which is being held for future sale. All inventory, included in Inventory, Net through 4th Quarter, FY 2008 is currently planned for sale to customers or retained for military or national contingencies. There is no management or valuation difference between the two categories.

Inventory Held for Repair is inventory that is in less than "ready for issue/sale" condition and requires repair to make suitable for sale. Some of the inventory items are more economical to repair than to procure. Since many weapon systems and machinery for warfighting readiness are no longer in commercial production, there are relatively no ready and economical sources of replenishment available via new purchase. The MC supports its customers' requests for purchase of certain items by repairing or rebuilding these items vice new acquisitions. The repair/rebuild process is an essential part of the Marine Corps' commitment as a "Force in Readiness" as well as supporting our other DoD customers in maintaining a ready, mobile, and armed military forces.

Work in Process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in Process also includes the value of finished products or completed services pending billing to the customer. Work in Process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other Government plants for accrued costs of end items of material ordered but not delivered.

## Operating Materiel and Supplies, Net

| As of September 30 | 2008 | | | 2007 | |
|---|---|---|---|---|---|
| | OM&S Gross Value | Revaluation Allowance | OM&S, Net | OM&S, Net | Valuation Method |
| (Amounts in thousands) | | | | | |
| **1. OM&S Categories** | | | | | |
| A. Held for Use | $ 114,983 | $ 0 | $ 114,983 | $ 156,444 | SP, LAC, MAC |
| B. Held for Repair | 0 | 0 | 0 | 0 | SP, LAC, MAC |
| C. Excess, Obsolete, and Unserviceable | 0 | 0 | 0 | 0 | NRV |
| **D. Total** | $ 114,983 | $ 0 | $ 114,983 | $ 156,444 | |

**Legend for Valuation Methods:**

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

Generally, there are no restrictions with regard to the use, sale, or disposition of Operating Materiel and Supplies (OM&S) applicable to DoD activities.

OM&S Held for Use represents property that is consumed during normal operations and includes consumable spare and repair parts for use on customer work by various activities. The items are recorded using different methodologies including actual, weighted-average, and historical cost.

Federal Accounting Standards require disclosure of the amount of OM&S Held for "Future Use." The NWCF-MC reports that $115.0 million of OM&S is categorized as Held for Future Use. All OM&S categories shown in the table above apply to the Depot Maintenance Activity Group, MC only.

Generally, the values of NWCF-MC's Government Furnished Material are not included in OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in other existing logistics systems in accordance with Volume 6B, Chapter 10 of DoD Financial Management Regulation.

## Stockpile Materiel, Net

Not applicable.

# Note 10. General PP&E, Net

| As of September 30 | 2008 | | | | | 2007 |
|---|---|---|---|---|---|---|
| | Depreciation/ Amortization Method | Service Life | Acquisition Value | (Accumulated Depreciation/ Amortization) | Net Book Value | Prior FY Net Book Value |
| (Amounts in thousands) | | | | | | |
| **1. Major Asset Classes** | | | | | | |
| A. Land | N/A | N/A | $ 0 | N/A | $ 0 | $ 0 |
| B. Buildings, Structures, and Facilities | S/L | 20 or 40 | 73,328 | $ (44,226) | 29,102 | 30,073 |
| C. Leasehold Improvements | S/L | lease term | 0 | 0 | 0 | 0 |
| D. Software | S/L | 2-5 or 10 | 0 | 0 | 0 | 0 |
| E. General Equipment | S/L | 5 or 10 | 70,053 | (59,613) | 10,440 | 11,693 |
| F. Military Equipment | S/L | Various | 0 | 0 | 0 | 0 |
| G. Assets Under Capital Lease | S/L | lease term | 0 | 0 | 0 | 0 |
| H. Construction-in- Progress | N/A | N/A | 6,430 | N/A | 6,430 | 4,159 |
| I. Other | | | 0 | 0 | 0 | 0 |
| **J. Total General PP&E** | | | $ 149,811 | $ (103,839) | $ 45,972 | $ 45,925 |

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

Generally, for Navy Working Capital Fund-Marine Corps (NWCF-MC), there are no restrictions on General Property, Plant, and Equipment.

Heritage Assets and Stewardship Land are reported on the financial statements of U.S. Marine Corps General Fund.

# Assets Under Capital Lease

Not applicable.

# Note 11. Liabilities Not Covered by Budgetary Resources

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **1. Intragovernmental Liabilities** | | |
| A. Accounts Payable | $ 0 | $ 0 |
| B. Debt | 0 | 0 |
| C. Other | 1 | 0 |
| **D. Total Intragovernmental Liabilities** | $ 1 | $ 0 |
| **2. Nonfederal Liabilities** | | |
| A. Accounts Payable | $ 0 | $ 0 |
| B. Military Retirement and Other Federal Employment Benefits | 27,219 | 27,624 |
| C. Environmental Liabilities | 0 | 0 |
| D. Other Liabilities | 0 | 0 |
| **E. Total Nonfederal Liabilities** | $ 27,219 | $ 27,624 |
| **3. Total Liabilities Not Covered by Budgetary Resources** | $ 27,220 | $ 27,624 |
| **4. Total Liabilities Covered by Budgetary Resources** | $ 88,974 | $ 95,308 |
| **5. Total Liabilities** | $ 116,194 | $ 122,932 |

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

Intragovernmental Other Liabilities is made up of interest, and penalties owed to U.S. Treasury for services of the Debt Management Office to handle and recover delinquent accounts receivable from public customers. Refer to Note 2, "Nonentity Assets," for additional details and disclosures.

The $27.2 million includes Military Retirement Benefits and Other Federal Employment Benefits that are related to the Department of Labor's Office of Inspector General estimated liability for future Navy Working Capital Fund-Marine Corps workers' compensation benefits. This liability is recorded as actuarial since it is based on guidelines issued by the Office of Management and Budget and represents estimated values which may or may not materialize.

These actuarial benefits will be funded in future years. Refer to Note 17, "Military Retirement and Other Federal Employment Benefits," for additional details and disclosures.

## Note 12. Accounts Payable

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Accounts Payable | Interest, Penalties, and Administrative Fees | Total | Total |
| (Amounts in thousands) | | | | |
| 1. Intragovernmental Payables | $ 52,258 | $ N/A | $ 52,258 | $ 5,768 |
| 2. Nonfederal Payables (to the Public) | 24,291 | 0 | 24,291 | 79,541 |
| **3. Total** | $ 76,549 | $ 0 | $ 76,549 | $ 85,309 |

The NWCF-MC's systems do not track intragovernmental transactions by customer at the transaction level. Therefore, internal Department of Defense buyer-side balances are adjusted to agree with internal seller-side balances for revenue, accounts receivable, and unearned revenue. Accounts payable were adjusted by reclassifying amounts between federal and nonfederal accounts payable.

## Note 13. Debt

Not applicable.

## Note 14. Environmental Liabilities and Disposal Liabilities

Not applicable.

## Environmental Disclosures

Environmental Liabilities are reported on the financial statements of the U.S. Marine Corps General Fund.

# Note 15. Other Liabilities

| As of September 30 | 2008 | | | 2007 |
|---|---|---|---|---|
| | Current Liability | Noncurrent Liability | Total | Total |
| (Amounts in thousands) | | | | |
| **1. Intragovernmental** | | | | |
| A. Advances from Others | $ 0 | $ 0 | $ 0 | $ 0 |
| B. Deposit Funds and Suspense Account Liabilities | 0 | 0 | 0 | 0 |
| C. Disbursing Officer Cash | 0 | 0 | 0 | 0 |
| D. Judgment Fund Liabilities | 0 | 0 | 0 | 0 |
| E. FECA Reimbursement to the Department of Labor | 0 | 0 | 0 | 0 |
| F. Custodial Liabilities | 1 | 0 | 1 | 0 |
| G. Employer Contribution and Payroll Taxes Payable | 1,129 | 0 | 1,129 | 858 |
| H. Other Liabilities | 0 | 0 | 0 | 0 |
| I. Total Intragovernmental Other Liabilities | $ 1,130 | $ 0 | $ 1,130 | $ 858 |
| **(Amounts in thousands)** | | | | |
| **2. Nonfederal** | | | | |
| A. Accrued Funded Payroll and Benefits | $ 10,868 | $ 0 | $ 10,868 | $ 8,720 |
| B. Advances from Others | 368 | 0 | 368 | 555 |
| C. Deferred Credits | 0 | 0 | 0 | 0 |
| D. Deposit Funds and Suspense Accounts | 0 | 0 | 0 | 0 |
| E. Temporary Early Retirement Authority | 0 | 0 | 0 | 0 |
| F. Nonenvironmental Disposal Liabilities | | | | |
| (1) Military Equipment (Nonnuclear) | 0 | 0 | 0 | 0 |
| (2) Excess/Obsolete Structures | 0 | 0 | 0 | 0 |
| (3) Conventional Munitions Disposal | 0 | 0 | 0 | 0 |
| G. Accrued Unfunded Annual Leave | 0 | 0 | 0 | 0 |
| H. Capital Lease Liability | 0 | 0 | 0 | 0 |
| I. Contract Holdbacks | 0 | 0 | 0 | (215) |
| J. Employer Contribution and Payroll Taxes Payable | 0 | 0 | 0 | 0 |
| K. Contingent Liabilities | 0 | 60 | 60 | 81 |
| L. Other Liabilities | 0 | 0 | 0 | 0 |
| M. Total Nonfederal Other Liabilities | $ 11,236 | $ 60 | $ 11,296 | $ 9,141 |
| **3. Total Other Liabilities** | $ 12,366 | $ 60 | $ 12,426 | $ 9,999 |

Contingent Liabilities includes $59.7 thousand in estimated future contract financing payments that will be paid to the contractors upon delivery and Government acceptance. In accordance with contract terms, specific rights to the contractor's work vests with the Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The NWCF-MC is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to NWCF-MC and the amount of potential future payments is estimable, NWCF-MC has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Government acceptance.

## Capital Lease Liability

Not applicable.

# Note 16. Commitments and Contingencies

The NWCF-MC is a party in various administrative proceedings and legal actions, with claims including equal opportunity matters and contractual bid protests. While the results of these legal actions may ultimately result in settlements or decisions adverse to the Federal Government, due to uncertainties of litigation, difficulty in identifying data, historical information, and methods of computation, estimates of contingent liability are not available for NWCF-MC.

Due to the identified difficulties, it was not until July 2008, when the legal actions were determined to be related to NWCF-MC. During 1st Quarter, FY 2007, DON began working with the Office of General Counsel and the Office of the Under Secretary of Defense (Comptroller) to develop and implement methodologies to identify applicable actions and produce estimates for probable Contingent Legal Liabilities at the NWCF-MC level.

The results of this process were indentified in the July 2008 DON Office of General Counsel FY 2008 Interim Legal Representation letter to the Inspector General of the Department of Defense. This letter identified eight litigation cases that met the materiality threshold of $130.3 thousand and includes matters that existed on July 1, 2007 through September 30, 2008 specifically related to NWCF-MC. As with the Interim Legal Representation letter, the Final Legal Representation Letter, received in October, 2008, provided supporting information that the Office of General Counsel could not express an opinion as to the outcome, including estimating contingent liability amounts for the eight cases against NWCF-MC.

Due to insufficient historical data at the NWCF-MC level, the developed methodology employed by the DON Office of General Counsel and Comptroller to identify appropriate litigants, was not sufficient to determine estimated contingent liabilities at the NWCF-MC level. Until such time as this can be determined, contingent liabilities will continue to be reported for the Marine Corps, at the aggregate level and included in the USMC General Fund reporting. The estimates are based on total legal cases, not individual claims. The MC management will continue to work with DON Office of General Counsel and Comptroller to identify estimated contingencies and other related disclosures, at NWCF-MC level, by the end of FY 2009.

The NWCF-MC does not have obligations related to cancelled appropriations for which a contractual commitment for payment exists.

The NWCF-MC has contractual arrangements (i.e. undelivered orders) which may require financial obligations based on contractor claims under the "disputes" clause contained in contracts. As of the end of 4th Quarter, FY 2008, undelivered orders are estimated at $154.3 million.

The NWCF-MC has contingencies that are considered both measurable and probable and have been recognized as liabilities. Refer to Note 15 for further details.

The NWCF-MC is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments of dispute resolution, that may or may not result in a future outflow of expenditures. Currently, NWCF-MC does not have a systemic process by which it captures or assesses these potential contingent liabilities; therefore, the amounts reported may not fairly present NWCF-MC contingent liabilities.

## Note 17. Military Retirement and Other Federal Employment Benefits

| As of September 30 | 2008 | | | | 2007 |
|---|---|---|---|---|---|
| | Liabilities | Assumed Interest Rate (%) | (Less: Assets Available to Pay Benefits) | Unfunded Liabilities | Liabilities |
| (Amounts in thousands) | | | | | |
| **1. Pension and Health Actuarial Benefits** | | | | | |
| A. Military Retirement Pensions | $ 0 | | $ 0 | $ 0 | $ 0 |
| B. Military Retirement Health Benefits | 0 | | 0 | 0 | 0 |
| C. Military Medicare-Eligible Retiree Benefits | 0 | | 0 | 0 | 0 |
| D. Total Pension and Health Actuarial Benefits | $ 0 | | $ 0 | $ 0 | $ 0 |
| **2. Other Actuarial Benefits** | | | | | |
| A. FECA | $ 27,219 | | $ 0 | $ 27,219 | $ 27,624 |
| B. Voluntary Separation Incentive Programs | 0 | | 0 | 0 | 0 |
| C. DoD Education Benefits Fund | 0 | | 0 | 0 | 0 |
| D. Total Other Actuarial Benefits | $ 27,219 | | $ 0 | $ 27,219 | $ 27,624 |
| **3. Other Federal Employment Benefits** | $ 0 | | $ 0 | $ 0 | $ 0 |
| **4. Total Military Retirement and Other Federal Employment Benefits:** | $ 27,219 | | $ 0 | $ 27,219 | $ 27,624 |

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

The DON actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON at the end of each fiscal year. The liability is distributed between the Navy Working Capital Fund and General Fund for DON and the Marine Corps (MC) which is based upon the number of civilian employees funded in each entity as reported in the Navy Budget Tracking System. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments.

The NWCF-MC's estimated actuarial liability is updated only at the end of each fiscal year. The change in actuarial liability for FY 2008 is an increase of $3.4 million.

The projected annual benefit payments are discounted to the present value using Office of Management and Budget's economic assumptions for ten year U.S. Treasury notes and bonds. Cost of living adjustments (COLAs) and medical inflation factors are also applied to the calculation of projected future benefits. The interest rate assumptions used in the discount calculations are as follows for September 30, 2008:

2008
4.368% in Year 1
4.770% in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensations benefits, wage inflation factors 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) 2008 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 were as follows:

| CBY | COLA | CPIM |
|---|---|---|
| 2008 | 3.03% | 4.71% |
| 2009 | 3.87% | 4.01% |
| 2010 | 2.73% | 3.86% |
| 2011 | 2.20% | 3.87% |
| 2012 | 2.23% | 3.93% |
| 2013+ | 2.30% | 3.93% |

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests:

(1) A sensitivity analysis of the model to economic assumptions,

(2) A comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments,

(3) A comparison of the incremental paid losses per case (a measure of case severity) in CBY 2008 to the average pattern observed during the most current three charge back years, and

(4) A comparison of the estimated liability per case in the 2008 projection to the average pattern for the projections of the most recent three years.

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

| As of September 30 | 2008 | | 2007 | |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| 1. Intragovernmental Costs | $ | 382,207 | $ | 264,758 |
| 2. Public Costs | | 419,574 | | 400,647 |
| **3. Total Costs** | $ | 801,781 | $ | 665,405 |
| 4. Intragovernmental Earned Revenue | $ | (656,410) | $ | (595,965) |
| 5. Public Earned Revenue | | (244) | | (12,607) |
| **6. Total Earned Revenue** | $ | (656,654) | $ | (608,572) |
| **7. Net Cost of Operations** | $ | 145,127 | $ | 56,833 |

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 the reporting entity and a nonfederal entity.

The NWCF-MC generally records transactions on an accrual basis as required by federal generally accepted accounting principles (GAAP). The NWCF-MC's systems do not track intragovernmental transactions by customer at the transaction level. Therefore, to facilitate the preparation of the Department of Defense's consolidated financial statements, NWCF-MC's buyer-side balances were adjusted to agree with internal seller-side balances for revenue. Expenses were adjusted by reclassifying accounts between federal and nonfederal expense.

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

The NWCF-MC does not report any heritage assets or stewardship land, as these entities are reported on the financial statements of the USMC-GF.

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

The Navy Working Capital Fund-Marine Corps does not have Disclosures Related to the Statement of Changes in Net Position.

# Note 20. Disclosures Related to the Statement of Budgetary Resources

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | $ 154,257 | $ 161,145 |
| 2. Available Borrowing and Contract Authority at the End of the Period | 0 | 0 |

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

The Office of Management and Budget Circular A-136 requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B, and exempt from apportionment. The NWCF-MC has a total $672.3 million in direct and reimbursable obligations incurred. Category A has $798 thousand in direct and Category B has $671.5 million in reimbursable.

The NWCF-MC does not have any legal arrangements affecting the use of unobligated balances of budget authority such as time limits, purpose, and obligation limitations.

The NWCF-MC received $798 thousand in July 2008 due to a transfer-in of cash to finance increased fuel costs.

The NWCF-MC has a $33.5 million difference between amounts reported on SBR and SF 133, Monthly Report on Budget Execution and Budgetary Resources. This is due to an adjustment for $32.4 million processed in order to correct a posting error. The original adjustment was posted to an incorrect general account in June 2007 for a supplemental direct appropriation received to finance the cost of War Reserves Materiel replenishment. In addition, an adjustment for $1.1 million posted in Employee Benefits. These adjustments processed in the quarterly financial statement compilation that were not included in the monthly budgetary reports.

# Note 21. Reconciliation of Net Cost of Operations to Budget

| As of September 30 | | 2008 | | 2007 |
|---|---|---|---|---|
| (Amounts in thousands) | | | | |
| **Resources Used to Finance Activities:** | | | | |
| Budgetary Resources Obligated: | | | | |
| 1. Obligations incurred | $ | 672,290 | $ | 595,206 |
| 2. Less: Spending authority from offsetting collections and recoveries (-) | | (720,372) | | (584,202) |
| 3. Obligations net of offsetting collections and recoveries | $ | (48,082) | $ | 11,004 |
| 4. Less: Offsetting receipts (-) | | 0 | | 0 |
| 5. Net obligations | $ | (48,082) | $ | 11,004 |
| Other Resources: | | | | |
| 6. Donations and forfeitures of property | | 0 | | 0 |
| 7. Transfers in/out without reimbursement (+/-) | | 0 | | 0 |
| 8. Imputed financing from costs absorbed by others | | 11,197 | | 12,325 |
| 9. Other (+/-) | | (0) | | (96,189) |
| 10. Net other resources used to finance activities | $ | 11,197 | $ | (83,864) |
| **11. Total resources used to finance activities** | $ | (36,885) | $ | (72,860) |
| **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 (-) | $ | 6,889 | $ | 66,595 |
| 12b. Unfilled Customer Orders | | 51,054 | | (20,222) |
| 13. Resources that fund expenses recognized in prior Periods (-) | | (405) | | (1,972) |
| 14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations | | 0 | | 0 |
| 15. Resources that finance the acquisition of assets (-) | | (92,507) | | (164,323) |
| 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 | | 0 |
| 16b. Other (+/-) | | 0 | | 96,189 |
| **17. Total resources used to finance items not part of the Net Cost of Operations** | $ | (34,969) | $ | (23,733) |
| **18. Total resources used to finance the Net Cost of Operations** | $ | (71,854) | $ | (96,593) |

| As of September 30 | 2008 | 2007 |
|---|---|---|
| (Amounts in thousands) | | |
| **Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:** | | |
| Components Requiring or Generating Resources in Future Period: | | |
| 19. Increase in annual leave liability | $ 0 | $ 0 |
| 20. Increase in environmental and disposal liability | 0 | 0 |
| 21. Upward/Downward re-estimates of credit subsidy expense (+/-) | 0 | 0 |
| 22. Increase in exchange revenue receivable from the public (-) | 0 | 0 |
| 23. Other (+/-) | 0 | 0 |
| 24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods | $ 0 | $ 0 |
| Components not Requiring or Generating Resources: | | |
| 25. Depreciation and amortization | $ 4,974 | $ 5,461 |
| 26. Revaluation of assets or liabilities (+/-) | 151,228 | 67,449 |
| 27. Other (+/-) | | |
| 27a. Trust Fund Exchange Revenue | 0 | 0 |
| 27b. Cost of Goods Sold | 60,779 | 80,516 |
| 27c. Operating Material and Supplies Used | 0 | 0 |
| 27d. Other | 0 | 0 |
| 28. Total Components of Net Cost of Operations that will not Require or Generate Resources | $ 216,981 | $ 153,426 |
| **29. Total components of Net Cost of Operations that will not Require or Generate Resources in the current period** | $ 216,981 | $ 153,426 |
| **30. Net Cost of Operations** | $ 145,127 | $ 56,833 |

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

Due to the NWCF-MC financial system limitations, budgetary data is not in agreement with proprietary expenses and assets capitalized. The difference between budgetary and proprietary data has been previously identified as a system deficiency. To bring the Reconciliation of Net Cost of Operations to Budget into balance with SNC, the following adjustment (absolute value) was made:

Resources That Finance the Acquisition of Assets: $166.2 million

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

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

## Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

## Note 23. Earmarked Funds

The NWCF-MC has no Earmarked Funds.

## Note 24. Other Disclosures

The NWCF-MC has no Other Disclosures.

## Note 25. Restatements

For FY 2008, the NWCF-MC has no Restatements.

# Navy Working Capital Fund – Marine Corps Required Supplementary Information

**Navy Working Capital Fund-Marine Corps**
**General Property, Plant, and Equipment**
**Real Property Deferred Maintenance**
For Fiscal Year Ended September 30, 2008

The Navy Working Capital Fund-Marine Corps real property deferred maintenance for fiscal year ended September 30, 2008 is reported with the U.S. Marine Corps General Fund real property deferred maintenance. See United States Marine Corps General Fund Required Supplementary Information.

# Navy Working Capital Fund – Marine Corps Other Accompanying Information

# Appropriations, Funds, and Accounts Included in the Principal Statements

## *Reporting Entity*

**Navy Working Capital Fund (NWCF)**

**Fund/Account Treasury Symbol and Title:**
97X4930.002

**Navy Working Capital Fund Activity Group Treasury Symbol and Title:**

| | |
|---|---|
| 97X4930.NA4A | Depot Maintenance - Other, Marine Corps |
| 97X4930.NC2A | Supply Management, Marine Corps |

# Audit Opinions

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

November 8, 2008

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

SUBJECT: Independent Auditor's Report on the Department of the Navy General Fund FY 2008 and FY 2007 Basic Financial Statements (Report No. D-2009-010)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy General Fund Consolidated Balance Sheets as of September 30, 2008 and 2007, and the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Department of the Navy General Fund FY 2008 and FY 2007 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

**Disclaimer of Opinion on the Financial Statements**

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy General Fund FY 2008 and FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that Department of the Navy financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2008. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended,[1] to determine whether material amounts on the financial statements were fairly presented. Prior audits have identified,

[1] OMB Memorandum M-08-24, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," August 25, 2008.

and the Department of the Navy has also acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.[2] Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information presented with the basic financial statements. Accordingly, we express no opinion on that information.

**Summary of Internal Control**

In planning our work, we considered Department of the Navy internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continued to exist in the following areas:

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

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[2] The annual financial statements include the basic financial statements, Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

We did not identify any additional material weaknesses for FY 2008.

A material weakness is a significant deficiency, or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.[3, 4]

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

The Department of the Navy General Fund reported all of these weaknesses in its 2008 Statement of Assurance except for the Statement of Net Cost and Unobligated Balances.

**Summary of Compliance with Laws and Regulations**

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

**Management's Responsibilities**

Management is responsible for:

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

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[3] The term "remote" is defined as when the chance of a future event or events occurring is slight. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.

[4] A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP. Significant deficiencies result in more than a remote likelihood that a misstatement of an entity's financial statements that is more than inconsequential will not be prevented or detected.

- complying with applicable laws and regulations.

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

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

## Report on Internal Control and Compliance with Laws and Regulations

### Internal Control

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

### Previously Identified

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

**Financial Management Systems.** Department of the Navy legacy financial management systems and feeder systems deficiencies include the inability to: comply with the Federal financial management systems requirements, implement elements of GAAP, and adequately implement the U.S. Government Standard General Ledger.

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

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

**Inventory and Related Property, Net.** The legacy systems do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and related Property." In addition, completeness issues exist because the legacy systems were not designed to provide the value of Operating Material and Supplies using the moving average cost method and to ensure that all of the items are included in the values reported on the Balance Sheet. Some Department of the Navy commands have not used the consumption method for expensing Operating Material and Supplies. Also, some commands are unable to provide Operation Material and Supplies at the detail-transaction level and only maintain beginning and ending balances.

**General Property, Plant, and Equipment.** Completeness issues may exist with recognizing internal use software and leasehold improvements. Trading partner data for capitalized assets may not always be recorded. The Department of the Navy is currently working with the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics) and Department of the Navy major commands to fully implement Statement of Federal Financial Accounting Standards No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment." In addition, the Department of the Navy is working with the Office of the Under Secretary of Defense (Comptroller)/DoD Chief Financial Officer staff to ensure that: documentation for real property is available, beginning with FY 1999; a preponderant user policy is properly implemented; and Form DD 1354, "Transfer and Acceptance of Military Property," is properly used throughout the Department of the Navy.

**Accounts Payable.** The Department of the Navy is not recording Intragovernmental Accounts Payable transactions and Accounts Payable with the Public timely, completely, or accurately. Other issues include the lack of sufficient systems, processes, and data to support reconciliation of buyer-side trading partner information.

**Environmental Liabilities.** Issues may exist with reporting current and noncurrent liabilities accounted for at the site level. In addition, deficiencies exist in the justification of data used to estimate the cost of an environmental project.

**Statement of Net Cost**. The Department of the Navy currently derives the information on the Statement of Net Cost from budgetary accounts, instead of using an accrual basis. In addition, the costs are not aligned with major programs and goals, as required in Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards," but are instead aligned with the major appropriations. Furthermore, Department of the Navy costs are not categorized and reported by the responsible Component, as required by Statement of Federal Financial Accounting Standards No. 4.

**Problem Disbursements.** Inaccurate or missing fund accounting codes have resulted in unmatched disbursements and collections requiring the use of suspense accounts. The suspense accounts cause difficulty in reconciling Department of the Navy General Fund records with Department of Treasury records.

**Unobligated Balances.** Deficiencies exist in recorded unobligated amounts because financial systems are not fully integrated, and not all commands sufficiently review unliquidated obligations. Additionally, reimbursable transactions were not properly documented or reported on the Disbursing Officer Statement of Accountability.

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

**Compliance with Laws and Regulations**

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

**Federal Financial Management Improvement Act of 1996.** The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2008, the Department of the Navy did not fully comply with the Federal Financial Management Improvement Act of 1996. The Department of the Navy acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2008.

**Audit Disclosures**

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on March 11, 2008, that Department of the Navy financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, and previously identified material weaknesses continue to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Antideficiency Act, Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, and Prompt Payment Act.

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

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

November 8, 2008

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

SUBJECT: Independent Auditor's Report on the Department of the Navy Working Capital Fund FY 2008 and FY 2007 Basic Financial Statements (Report No. D-2009-012)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy Working Capital Fund Consolidated Balance Sheets as of September 30, 2008 and 2007, and the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Department of the Navy Working Capital Fund FY 2008 and FY 2007 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

## Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy Working Capital Fund FY 2008 and FY 2007 Basic Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that the Department of the Navy financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2008. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended,[1] to determine whether material amounts on the financial statements were fairly

[1] OMB Memorandum M-08-24, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," August 25, 2008.

presented. Prior audits have identified, and the Department of the Navy has also acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.[2] Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information presented with the basic financial statements. Accordingly, we express no opinion on that information.

**Summary of Internal Control**

In planning our work, we considered Department of the Navy internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continued to exist in the following areas:

- **Financial Management Systems**
- **Fund Balance with Treasury**
- **Accounts Receivable**
- **Inventory and Related Property, Net**
- **General Property, Plant, and Equipment**
- **Accounts Payable**
- **Other Liabilities**

[2] The annual financial statements include the basic financial statements, Management's Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information.

We did not identify any additional material weaknesses in FY 2008. A material weakness is a significant deficiency,[3] or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.[4]

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

The Department of the Navy reported six of the above weaknesses in its Management Representation Letter. The additional weakness was reported in its 2008 Statement of Assurance.

## Summary of Compliance with Laws and Regulations

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

## Management's Responsibilities

Management is responsible for:

- preparing the financial statements in conformity with GAAP;

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[3] A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP. Significant deficiencies result in more than a remote likelihood that a misstatement of an entity's financial statements that is more than inconsequential will not be prevented or detected.

[4] The term "remote" is defined as when the chance of a future event or events occurring is slight. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.

- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and

- complying with applicable laws and regulations.

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management and Comptroller).

Patricia A. Marsh
Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

**Report on Internal Control and Compliance with Laws and Regulations**

## Internal Control

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

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

**Financial Management Systems.** Department of the Navy financial systems do not comply with GAAP and the U.S. Government Standard General Ledger at the transaction level. As a result, the Department of the Navy financial management and feeder systems cannot provide adequate evidence to support various material amounts on the financial statements.

**Fund Balance with Treasury.** Department of the Navy Working Capital Fund activities do not reconcile cash accounts to the Department of the Treasury cash account balance on a regular basis. In addition, system interfaces do not exist between the financial reporting systems, which results in unmatched disbursements and collections.

**Accounts Receivable.** The Department of the Navy does not reconcile subsidiary records to corresponding general ledger accounts on a regular basis, resulting in control weaknesses and no audit trail. They also post unmatched collections to accounts receivable using journal vouchers, leaving no audit trail. Trading partner adjustments posted to intragovernmental accounts receivable are not always supported by transactions. The Department of the Navy does not always record and post collections of contract overpayments, travel advances, employee debt, and other public accounts.

**Inventory and Related Property, Net.** Department of the Navy Working Capital Fund supply management activities record inventory at the latest acquisition cost. To comply with GAAP, the latest acquisition cost must be converted to an approximation of historical cost. However, the Department of the Navy does not have adequate data, processes, and methodologies to make accurate conversions. Consequently, auditors would not be able to verify the converted inventory balances.

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

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

**Other Liabilities.** Unsupported, undistributed disbursements need to be resolved. Additionally, contract accruals need to be analyzed to determine whether these amounts are posted properly to Other Liabilities.

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

**Compliance with Laws and Regulations**

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

**Federal Financial Management Improvement Act of 1996.** The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2008, the Department of the Navy did not fully comply with the Federal Financial Management Improvement Act of 1996. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2008.

**Audit Disclosures**

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on March 11, 2008, that the Department of the Navy financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, and previously identified material weaknesses continue to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: the Antideficiency Act, Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, Prompt Payment Act, and Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act of 1996).

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

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

November 8, 2008

MEMORANDUM FOR ASSISTANT DEPUTY COMMANDANT FOR PROGRAMS AND RESOURCES (FISCAL), UNITED STATES MARINE CORPS

SUBJECT: Independent Auditor's Report on the United States Marine Corps General Fund FY 2008 and FY 2007 Basic Financial Statements (Report No. D-2009-013)

Under Secretary of Defense (Comptroller) guidance implementing the Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying United States Marine Corps General Fund Consolidated Balance Sheets as of September 30, 2008 and 2007, and the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of United States Marine Corps management. The United States Marine Corps is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the United States Marine Corps General Fund FY 2008 and FY 2007 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

**Disclaimer of Opinion on the Financial Statements**

The Director, Fiscal Division, United States Marine Corps, acknowledged to us that the United States Marine Corps FY 2008 and FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP) and that United States Marine Corps financial management systems may be unable to adequately support material amounts on the financial statements as of September 30, 2008. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended,[1] to determine whether material amounts on the financial statements were fairly presented. The United States Marine Corps is a Component of the Department of Navy. Prior audits have identified, and the Director, Fiscal Division, United States Marine Corps, and the Assistant Secretary of the Navy (Financial Management and Comptroller) have also acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.[2] Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information presented with the basic financial statements. Accordingly, we express no opinion on that information.

**Summary of Internal Control**

In planning our work, we considered United States Marine Corps internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continued to exist in the following areas:

- **Financial Management Systems**
- **Fund Balance with Treasury**
- **Accounts Receivable**
- **Inventory**
- **General Property, Plant, and Equipment**
- **Accounts Payable**
- **Environmental Liabilities**
- **Statement of Net Cost**

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[1] OMB Memorandum M-08-24, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," August 25, 2008.

[2] The annual financial statements include the basic financial statements, Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

- **Problem Disbursements**
- **Unobligated Balances**

We identified an additional material weakness in FY 2008:

- **Appropriations Received**

A material weakness is a significant deficiency,[3] or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.[4]

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

The United States Marine Corps identified only General Property, Plant, and Equipment and Environmental Liabilities as material weaknesses in its FY 2008 Annual Statement of Assurance.

**Summary of Compliance with Laws and Regulations**

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

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[3] A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP. Significant deficiencies result in more than a remote likelihood that a misstatement of an entity's financial statements that is more than inconsequential will not be prevented or detected.

[4] The term "remote" is defined as when the chance of a future event or events occurring is slight. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.

**Management's Responsibilities**

Management is responsible for:

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

We provided a draft of this report to the Director, Fiscal Division, United States Marine Corps, who provided technical comments, which have been incorporated as appropriate. United States Marine Corps officials expressed their continuing commitment to address the problems this report outlines.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

## Report on Internal Control and Compliance with Laws and Regulations

### Internal Control

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

**Previously Identified Material Weaknesses.** The Director, Fiscal Division, United States Marine Corps, and Assistant Secretary of the Navy (Financial Management and Comptroller) management acknowledged that previously identified significant deficiencies, all of which are material, continued to exist in the following areas.

**Financial Management Systems.** The Marine Corps' business enterprise recognizes that feeder system documentation and internal control assessment gaps exist and may hinder accurate and reliable financial information. Although steps have been taken to implement documented compensating controls, the Marine Corps needs to ensure accurate data is transferred from feeder systems.

**Fund Balance with Treasury.** The following deficiencies are associated with Fund Balance with Treasury: (1) unmatched disbursements and collections; (2) undistributed disbursements, collections, and abnormal balances; and (3) an inability to reconcile Department of the Navy fund records with Treasury records and the Statement of Budgetary Resources.

**Accounts Receivable.** Although the Marine Corps is making progress, two deficiencies remain in this area: audit trails are inadequate and the accounts receivable subsidiary ledgers do not reconcile with the general ledger.

**Inventory.** Marine Corps legacy systems were designed for material management purposes, not accounting purposes; thus they do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property." In addition, while these legacy systems provide controls over the accountability of Operating Materials and Supplies (OM&S), they were not designed to provide the value of OM&S using the moving average cost method or to ensure that the values reported on the Balance Sheet represent all items. Also, some commands have not used the consumption method for expensing OM&S. Additionally, some commands are unable to provide OM&S at the detailed transaction level and only maintain beginning and ending balances. Finally, required inventory trading partner information may not be available.

**General Property, Plant, and Equipment.** Marine Corps has not resolved documentation and support of baseline valuations for personal property, real property, military equipment, and internal use software. Marine Corps General Fund military equipment accountability is also incomplete because of an inability to verify the existence and condition of deployed assets.

**Accounts Payable.** The Marine Corps General Fund is working to design a viable estimation process for all material vendor payment systems. These processes include estimations of major contracts, level spending, and other contract estimates based on historical cost analysis and contract projections.

**Environmental Liabilities.** The Marine Corps is implementing processes, procedures, and improved environmental liability supporting documentation to resolve weaknesses in this area.

**Statement of Net Cost.** SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards," requires that Federal agencies provide reliable and timely information on the full cost of Federal programs, activities, and outputs. Currently, the Department of Navy derives Intragovernmental Gross Costs, Gross Costs with the Public, Intragovernmental Earned Revenue, and Earned Revenue from the Public from budgetary accounts, instead of using an accrual basis. In addition, the costs are not aligned with major programs and goals, as required by SFFAS No. 4. Instead, they are aligned to major appropriations. Finally, Department of Navy costs are not itemized and reported by the responsible Component, as required by SFFAS No. 4.

**Problem Disbursements.** Inaccurate or missing fund accounting codes have resulted in: (1) unmatched disbursements and collections requiring the use of "suspense" accounts and (2) an inability to reconcile Department of Navy fund records with Treasury records.

**Unobligated Balances.** The lack of fully integrated financial systems has caused deficiencies in recorded unobligated amounts. Also, sufficient reviews of unliquidated obligations were not performed by all commands.

**Material Weaknesses Identified During FY 2008.** As a result of our financial-related work during FY 2008, we identified a significant deficiency that is material.

**Appropriations Received.** The Department of Navy allocates funds to the Marine Corps. The Marine Corps erroneously recorded the shared appropriation in the U.S. Government Standard General Ledger account 4119, "Other Appropriations Realized." This general ledger account crosswalks to the Appropriations Received line of the Statement of Budgetary Resources. Therefore, the Marine Corps General Fund Appropriations Received line is misstated by $2.1 billion.

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

**Compliance with Laws and Regulations**

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

**Federal Financial Management Improvement Act of 1996.** The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Director, Fiscal Division, United States Marine Corps, stated that the Marine Corps financial management and feeder systems substantially comply with Federal financial management systems requirements. However, the Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2008.

**Audit Disclosures**

The Director, Fiscal Division, United States Marine Corps, and the Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on March 14 and March 11 2008, respectively, that the United States Marine Corps financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, and previously identified material weaknesses continue to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Antideficiency Act, Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, Prompt Payment Act, and the Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act of 1996).

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

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

November 8, 2008

MEMORANDUM FOR ASSISTANT DEPUTY COMMANDANT FOR PROGRAMS AND RESOURCES (FISCAL) OF THE UNITED STATES MARINE CORPS

SUBJECT: Independent Auditor's Report on the Department of the Navy Working Capital Fund-Marine Corps FY 2008 and FY 2007 Basic Financial Statements (Report No. D-2009-014)

Under Secretary of Defense (Comptroller) guidance implementing the Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy Working Capital Fund-Marine Corps Consolidated Balance Sheets as of September 30, 2008 and 2007, and the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of United States Marine Corps management. The United States Marine Corps is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Department of the Navy Working Capital Fund-Marine Corps FY 2008 and FY 2007 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations. The Report on Internal Control and Compliance with Laws and Regulations is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

**Disclaimer of Opinion on the Financial Statements**

The Director, Fiscal Division, United States Marine Corps, acknowledged to us that the Department of the Navy Working Capital Fund-Marine Corps FY 2008 and FY 2007 Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (GAAP), and that the Department of the Navy Working Capital Fund-Marine Corps financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2008. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management.

Accordingly, we did not perform auditing procedures required by U.S. Government auditing standards and Office of Management and Budget (OMB) Bulletin 07-04, "Audit Requirements for Federal Financial Statements," as amended,[1] to determine whether material amounts on the financial statements were fairly presented. Prior audits have identified, and the United States Marine Corps has also acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses affect the reliability of certain information contained in the annual financial statements—much of which is taken from the same data sources as the basic financial statements.[2] Therefore, we are unable to express, and we do not express, an opinion on the basic financial statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information presented with the basic financial statements. Accordingly, we express no opinion on that information.

**Summary of Internal Control**

In planning our work, we considered United States Marine Corps internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified significant deficiencies, all of which are material, continued to exist in the following areas:

- **Financial Management Systems**
- **Fund Balance with Treasury**
- **Accounts Receivable**
- **Inventory and Related Property, Net**
- **General Property, Plant, and Equipment**
- **Accounts Payable**
- **Statement of Net Cost**
- **Statement of Changes in Net Position**
- **Statement of Budgetary Resources**

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[1] OMB Memorandum M-08-24, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," August 25, 2008.

[2] The annual financial statements include the basic financial statements, Management's Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information.

We identified the following additional material weaknesses in FY 2008:

- **Intragovernmental Eliminations**
- **Accounting Entries**
- **Operating Materials and Supplies**
- **Reconciliation of Net Cost of Operations to Budget**

A material weakness is a significant deficiency,[3] or a combination of significant deficiencies, resulting in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.[4]

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

The United States Marine Corps did not report any of the above weaknesses in its FY 2008 Statement of Assurance.

**Summary of Compliance with Laws and Regulations**

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

[3] The term "remote" is defined as when the chance of a future event or events occurring is slight. Therefore, the likelihood of an event is "more than remote" when it is at least reasonably possible.

[4] A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, adversely affecting the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP. Significant deficiencies result in more than a remote likelihood that a misstatement of an entity's financial statements that is more than inconsequential will not be prevented or detected.

**Management's Responsibilities**

Management is responsible for:

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

We provided a draft of this report to the Director, Fiscal Division, United States Marine Corps, who provided technical comments, which have been incorporated as appropriate. United States Marine Corps officials expressed their continuing commitment to address the problems this report outlines.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

## Report on Internal Control and Compliance with Laws and Regulations

### Internal Control

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

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

**Financial Management Systems.** The Navy Working Capital Fund-Marine Corps is unable to fully implement all elements of GAAP and OMB Circular A-136 because of the limitations of its financial and nonfinancial management processes and systems that feed into the financial statements. The Navy Working Capital Fund-Marine Corps derives its reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and the status of Federal appropriations, rather than for preparing financial statements in accordance with GAAP.

**Fund Balance with Treasury.** Reconciliation of the Navy Working Capital Fund-Marine Corps Fund Balance with Treasury account is not completed on a consistent basis (including inconsistent justification and verification of entries to these accounts). The Navy Working Capital Fund-Marine Corps continues to work with DFAS and other stakeholders to locate missing documentation and establish validation procedures to complete the reconciliation process. The lack of direct automated information systems interfaces between the official financial reporting system and one or more financial or feeder systems causes difficulties in the reconciliation process. This generates unmatched disbursements, abnormal balances and unsupported journal voucher entries required to reconcile Treasury records. In addition, because of obsolete feeder systems and problems related to interfacing with official financial systems, it is difficult to determine the necessary financial adjustments.

**Accounts Receivable.** Subsidiary records are not reconciled to their corresponding general ledger account on a regular basis, resulting in an internal control weakness and no audit trail. The Navy Working Capital Fund-Marine Corps has employed business processes that require routine review of outstanding accounts in order to ensure validity and proper recording. In addition, difficulty exists with trading partner adjustments being posted to intragovernmental accounts receivable. This is primarily because of communication problems with trading partners and problems with ensuring that the Marine Corps is identified as the payee of record for services rendered, instead of Department of the Navy.

**Inventory and Related Property, Net.** Legacy and migratory feeder systems supporting the Navy Working Capital Fund-Marine Corps financial management systems were not designed to retain the historical cost data required in the Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property." In addition, while these systems provide controls to ensure accountability and visibility of inventory, they were designed to record issues and receipt of inventory at the standard unit price and latest acquisition cost, instead of the moving average cost. The data and processes do not exist to convert inventory values to the moving average cost basis accurately and in a verifiable manner.

**General Property, Plant, and Equipment.** The Navy Working Capital Fund-Marine Corps General Property, Plant, and Equipment capitalization threshold is $100,000, except for real property, which is $20,000. The Navy Working Capital Fund-Marine Corps has not implemented the threshold for real property. The Navy Working Capital Fund-Marine Corps is currently using the capitalization threshold of $100,000 for all General Property, Plant, and Equipment.

**Accounts Payable.** Insufficient or inconsistent reconciliations and supporting documentation, the lack of direct-interface automated information systems, and improper trading partner information have adversely affected this line. As a result, there are unmatched or unreconciled records (including at the Treasury level), manual journal voucher postings, and unsupported validation of transactions. Also, Defense Civilian Payroll System payment data are not directly interfaced with the Defense Industrial Financial Management System, which increases the risk of reconciliation and labor-posting errors.

**Statement of Net Cost.** Current DoD processes and systems do not capture and report accumulated costs for major programs based on performance measures, as required by the Government Performance and Results Act. DoD is in the process of reviewing available data and developing a cost reporting methodology that complies with the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government."

**Statement of Changes in Net Position.** Material weaknesses related to recording accounts receivable and accounts payable have a direct effect on the recording of revenues and expenses on the Statement of Net Cost and the Statement of Changes in Net Position.

**Statement of Budgetary Resources.** Problem disbursements are responsible for the most significant deficiencies in the Statement of Budgetary Resources. The implementation of automated information systems such as Defense Travel System, Purchase Request Builder, and the Standard Procurement System has highlighted problems with electronic data feeds to the various accounting systems.

**Material Weaknesses Identified During FY 2008.** As a result of our financial-related work during FY 2008, we identified significant deficiencies, all of which are material.

**Intragovernmental Eliminations.** The Navy Working Capital Fund-Marine Corps cannot accurately eliminate intragovernmental transactions by customer because its systems do not retain transaction-level detail. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources. Although the Navy Working Capital Fund-Marine Corps is unable to fully reconcile intragovernmental transactions with all Federal partners, the Navy Working Capital Fund-Marine Corps is able to reconcile Federal Employees' Compensation Act transactions with Department of Labor data, and benefit program transactions with Office of Personnel Management data.

**Accounting Entries.** The Navy Working Capital Fund-Marine Corps does not follow DoD policy because financial feeder systems and accounting systems do not provide sufficient detail to identify Federal/nonfederal and supported/unsupported transactions. Systems enhancements are underway to provide more appropriate levels of detail.

**Operating Materials and Supplies.** Generally, the values of the Navy Working Capital Fund-Marine Corps Government Furnished Material are not included in Operating Materials and Supplies values reported in the Inventory and Related Property, Net line of the balance sheet. The DoD is reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in existing logistics systems.

**Reconciliation of Net Cost of Operations to Budget.** Because of Navy Working Capital Fund-Marine Corps financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. The difference between budgetary and proprietary data has been previously identified as a system deficiency. The various automated and manual financial management and feeder systems used for the Navy Working Capital Fund-Marine Corps do not record transfers of material purchases to the various fixed asset categories at the time of receipt.

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

## Compliance with Laws and Regulations

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

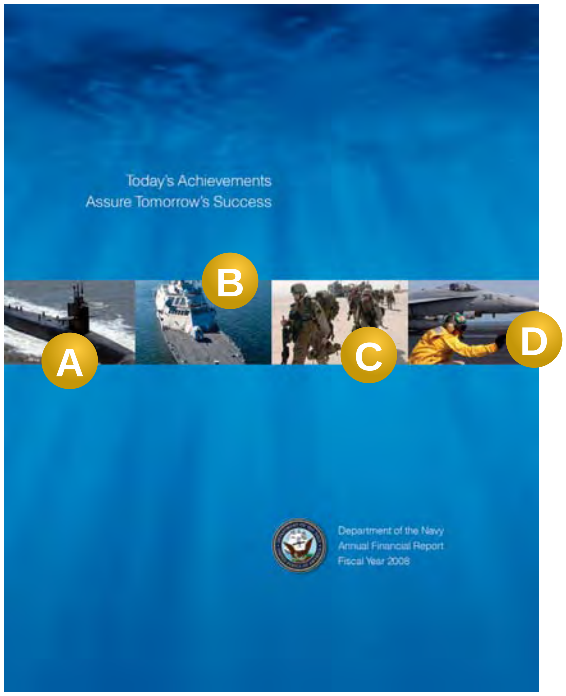
**Federal Financial Management Improvement Act of 1996.** The Federal Financial Management Improvement Act of 1996 requires DoD to establish and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2008, the United States Marine Corps did not fully comply with the Federal Financial Management Improvement Act of 1996. The Director, Fiscal Division, United States Marine Corps, acknowledged that many Marine Corps critical financial management and feeder systems did not substantially comply with Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2008.

## Audit Disclosures

The Director, Fiscal Division, United States Marine Corps, acknowledged to us on March 14, 2008, that the United States Marine Corps financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements, and previously identified material weaknesses continue to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: Antideficiency Act, Federal Credit Reform Act of 1990, Pay and Allowance System for Civilian Employees, Prompt Payment Act, and the Provisions Governing Claims of the United States Government (including provisions of the Debt Collection Improvement Act of 1996).

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

# Photo Cover Credits




**Images from left to right:**

**A** The Ohio-class guided missile submarine USS Florida (SSGN 728) makes her way through Cumberland Sound to Naval Submarine Base Kings Bay. U.S. Navy photo by Photographer's Mate 2nd Class Lynn Friant (Released)

**B** The future USS Freedom (LCS 1), the first ship in the Navy's new Littoral Combat Ship (LCS) class, is underway to begin Builder's Trials in Lake Michigan. (Released)

**C** Marines assigned to 3rd Battalion, 1st Marines, offload from a Landing Craft Air Cushion (LCAC) after disembarking USS Bonhomme Richard (LHD 6). U.S. Navy photo by Seaman Omar A. Dominquez (Released)

**D** An F/A-18C Hornet assigned to the "Stingers" on Strike Fighter Squadron (VFA) 113 gets ready to launch off the flight deck of the Nimitz-class aircraft carrier USS Ronald Reagan (CVN 76). U.S. Navy photo by Mass Communication Specialist 3rd Class Gary Prill (Released)

*Special thanks to* ***Rear Admiral Frank Thorp IV****, Chief of Naval Information;* ***Mr. Christopher Madden****, Director of the Navy Visual News Service;* ***Lieutenant Christopher Bishop****, Deputy Director of the Navy Visual News Service; and* ***the staff of the Office of the Chief of Naval Information*** *for providing the Department of the Navy photographs.*

*Many thanks also to the Financial Operations Team at the* ***Department of the Navy (DON) Office of Financial Operations****, the extended financial community at the* ***DON major commands****, and our accounting partners at the* ***Defense Finance and Accounting Service*** *for their dedicated time and effort in producing the Fiscal Year 2008 Department of the Navy Annual Financial Report. We dedicate the Fiscal Year 2008 Department of the Navy Annual Financial Report once again to* ***the men and women of our Navy and Marine Corps warfighting team****.*

## For More Information

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

### *Navy*

*http://www.navy.mil*

### *Marine Corps*

*http://www.usmc.mil*

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

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