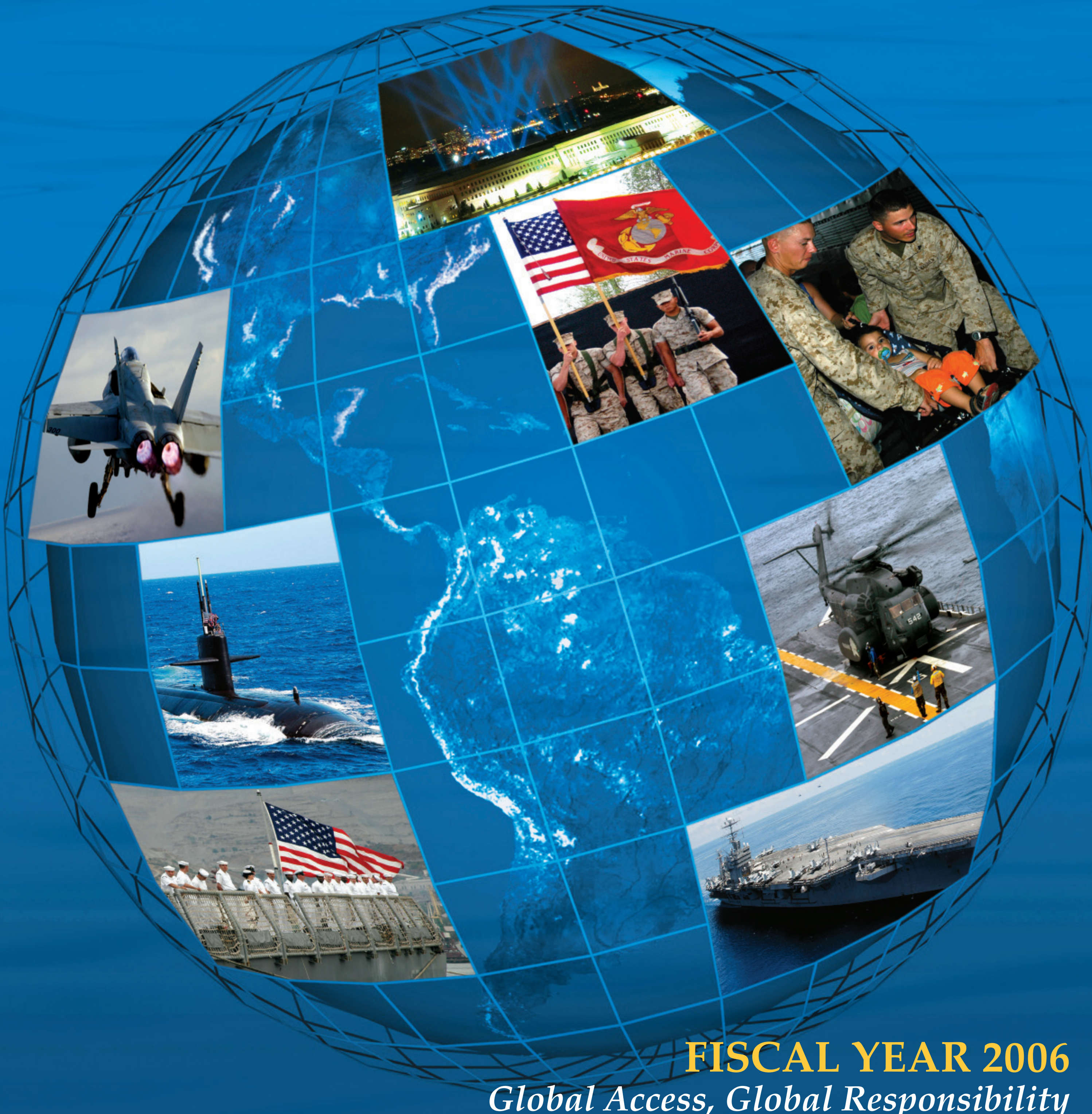
Department of the Navy

ANNUAL FINANCIAL REPORT



FISCAL YEAR 2006

Global Access, Global Responsibility

Department of the Navy

ANNUAL FINANCIAL REPORT

FISCAL YEAR 2006

Global Access, Global Responsibility

2005 Gold Vision Award

Department of the Navy

Fiscal Year 2005 Annual Financial Report

LACP TOP 100 ANNUAL REPORTS OF 2005

VISION AWARDS 2005 GOLD LACP OVERALL

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The Honorable Donald C. Winter

Secretary of the Navy

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

October 2006

The Navy-Marine Corps team continues to fight what we expect to be a prolonged international war on terror. In addition to defending our nation on the battlefield and at sea, our Sailors and Marines have performed other missions superbly, most visibly providing urgent humanitarian assistance in response to natural disasters. Working with Congressional stakeholders, we have been provided with the resources and are meeting these challenges on multiple fronts, while continuously seeking new and innovative ways to accomplish our mission. Our team is further leveraging these resources by increased reliance on partnerships with our sister services, the private sector and other nations.

In Fiscal Year 2006, we significantly broadened operational capabilities in response to our expanding role in the Global War on Terror (GWOT) and security and stability operations. Specifically, we established the Naval Expeditionary Combat Command to enable the Navy to train and operate with partner nations—efforts needed to bolster maritime dominance. Similarly, we integrated capabilities of our Special Operations Forces into the submarine community and established the Marine Corps Special Operations Command, which leverages growing irregular warfare capabilities in support of operational requirements. In addition, the Marine Corps has invested over $5 billion in Fiscal Year 2006 toward resetting the force which will mitigate the impact and demands of GWOT on its warfighting equipment. Through our partnership with industry, we are developing next generation battle force ships that will move us closer to our goal of a 313-ship Navy.

We have also made significant advances in business transformation. In particular, we have begun Department-wide integration of Lean/Six Sigma, an industry-proven methodology for harvesting efficiencies in business processes. Savings generated from these efficiencies will then be used to recapitalize our Fleet. Additionally, the Navy has begun to implement an enterprise model that will deliver war-fighting capabilities and increase productivity at reduced costs. The Navy Enterprise model includes five warfare enterprises operating as collaborative teams—Naval Aviation, Naval Surface Warfare, Naval Undersea, Naval Expeditionary Combat, and Naval NETWAR/FORCEnet. The Marine Corps, through its Financial Improvement Initiative, is on track to achieve a "clean audit" within the next two years; this will ensure our growth as a world-class enterprise.

I can assure you we take our role as public stewards of the taxpayers' money very seriously. We are responsible to the Congress and the nation for providing dependable national security as well as accountable fiscal performance. The Department of the Navy's Fiscal Year 2006 Annual Financial Report, *Global Access, Global Responsibility*, represents our enduring commitment to the proper stewardship of public resources that are critical not only for the defense of our nation but for the protection of our war-fighters.

Donald C. Winter

The Honorable Richard Greco, Jr.

The Assistant Secretary of the Navy
(Financial Management and Comptroller)

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

October 2006

The Department of the Navy financial management team made significant progress in executing our strategic plan, *Transforming Today to Win Tomorrow*, introduced in April 2005 and highlighted in last year's annual financial report. We have focused on improving business processes, on attracting and retaining the future of our financial management workforce, and on making our communication with customers and shareholders more comprehensive and transparent. The changes we have made in Fiscal Year 2006 have allowed us to provide more timely and accurate financial information to senior leaders so that they can make more-informed resource allocation decisions.

In particular, we began implementation of a standard cash forecasting tool that will reduce average levels of operating cash within the $25 billion Navy Working Capital Fund, allowing us to minimize cash on hand and maximize the purchasing power of our customers. This undertaking attracted the attention of the Harvard Business school where one of its case studies featured how commercial best practices can be effectively applied to a large, complex government business. We also implemented the Financial Efficiency Index, a scorecard that measures *ex-post* budget execution performance but also allows more informed *ex-ante* decision making, stimulating a results-oriented organizational culture. Additionally, we developed a portfolio management methodology based on leading industry best practices and academic research that provides a capability to analyze our mix of capital investments along expected military value and risk variables, with the aim of optimizing Navy-Marine Corps resource allocation. This methodology has been adopted by the Office of the Secretary of Defense and offers significant long term potential to all of DoD.

We also marked steady progress on our ambitious Financial Improvement Program (FIP), a comprehensive, bottom-up plan to transform our business and financial processes and systems. We aggressively reviewed and documented existing processes, systems, and controls and established a foundation that supports corrective actions where necessary either to eliminate or strengthen inefficient practices and ineffective systems. Our FIP is a component of the broader defense Financial Improvement and Audit Readiness (FIAR) effort, which is updated throughout the year and presented to Congress twice a year. The goals of the FIP, as well as the FIAR, are consistent with our Strategic Plan: to put better financial data into decision-makers' hands. This financial information results from better controlled, better integrated business processes that will over time, result in a favorable audit opinion.

Regarding audit, during the past year, we made significant progress within the Marine Corps, positioning it to become the first military service within Department of Defense to be "audit ready." We also proceeded according to plan with our Enterprise Resource Planning (ERP) initiative—among the world's largest—designed to automate, integrate and standardize our business processes. As part of the FIP, we issued a Department-wide manual on internal controls with the expanded focus on financial reporting as mandated by the recent revision of the Office of Management and Budget Circular A-123 This visible commitment to strong internal controls will

sustain process improvement and ensure accountability. The Department of the Navy audit committee that we established in Fiscal Year 2005 will continue to monitor and encourage our internal control efforts. In all of our financial management process improvements, consistent with the objectives of the Secretary of the Navy, we have sought to use the Lean Six Sigma methodology where applicable. Please visit our web site at www.finance.hq.navy.mil to review the details of these efforts, as well as our other products and services.

Finally, I proudly note that the Department of the Navy's 2005 Annual Financial Report, *Combat and Compassion*, received a Gold Award from a professional organization which ranked our report in the top three-percent of almost two thousand reports evaluated. Our 2006 Annual Financial Report, *Global Access, Global Responsibility*, should match the caliber of last year's, building on previous achievements and highlighting the strengths of the worldwide Navy-Marine Corps finance team. It serves to communicate the commitment to the American Public—our shareholders—that your investment in the Department of the Navy is sound. It represents an investment in our Nation's future.

Richard Greco, Jr.

Richard Greco, Jr.

Department of the Navy

Management's Discussion and Analysis

2006

2006 Annual Financial Report

The Military Sealift Command hospital ship USNS Comfort (T-AH 20) moored in the Port of Pascagoula, Mississippi to provide medical support and humanitarian aid to victims of Hurricane Katrina.

OCTOBER 2005

The 31st Marine Expeditionary Unit's Fox Company participated in PHILBEX 06, an annual bilateral exercise designed to improve interoperability, increase readiness, and continue professional relationships between the United States and Philippine Armed Forces.

NOVEMBER 2005

The amphibious assault ship USS Nassau (LHA 4), in foreground, sailed through the Suez Canal in November 2005. Nassau was the flagship for Expeditionary Strike Group Eight, which was deployed in support of the Global War on Terror.

An F/A-18F Super Hornet launched from the aircraft carrier USS Kitty Hawk (CV 63) during the bilateral Annual Exercise (ANNUALEX) conducted in November 2005. The purpose of ANNUALEX is to improve bilateral interoperability, defend Japan against maritime threats, and to improve capability for surface warfare, air defense and undersea warfare.

USS Ohio (SSGN 726) returned to Puget Sound Naval Shipyard and Intermediate Facility in Bremerton, Washington after completing sea trials. Ohio was the first ballistic missile submarine to complete conversion to the new class of guided missile submarines.

DECEMBER 2005

The Nimitz-class aircraft carrier USS George Washington (CVN 73) returned to her homeport in Norfolk, Virginia after completing sea trials. Carrier sea trials help determine the ship's material readiness and ability to rejoin the fleet as a fully operational unit.

On January 3, 2006, the Honorable Dr. Donald C. Winter, accompanied by his wife, Linda, took the oath of office as the 74th Secretary of the Navy. The Honorable Gordon England, Deputy Secretary of Defense administered the oath.

JANUARY 2006

Chief of Naval Operations Admiral Michael Mullen met with Sailors assigned to the 30th Naval Construction Regiment at Camp Fallujah, Iraq.

FEBRUARY 2006

Marine Combat Engineers boarded a CH-53 helicopter to support humanitarian relief efforts in the Philippines, where a landslide occurred on February 17, 2006.

MARCH 2006

Helicopter Anti-Submarine Squadron Two (HS-2) reviews flight details on an operational map prior to an evening combat search and rescue training evolution during Operation Foal Eagle, a joint land and maritime training operation utilizing forces from both the United States and the Republic of Korea.

A Boatswain's Mate 1st Class hugged his daughter goodbye as the amphibious transport dock USS Trenton (LPD 14), part of the Global War on Terror Surface Strike Group, prepared to depart Naval Station Norfolk.

APRIL 2006

Nine hundred eighty Midshipmen graduated from the U.S. Naval Academy in Annapolis, Maryland on May 26, 2006.

MAY 2006

The guided-missile cruiser USS Cowpens (CG 63), in foreground, followed by the guided-missile destroyers USS Lassen (DDG 82) and USS John S. McCain (DDG 56), the guided-missile frigate USS Vandegrift (FFG 48), and the Military Sealift Command underway replenishment oiler USNS Tippecanoe (T-AO 199) sailed in formation during Exercise Valiant Shield 2006. Valiant Shield focused on integrated joint training among U.S. military forces, enabling real-world proficiency in sustaining joint forces and in detecting, locating, tracking, and engaging units at sea, undersea, in the air, and on land.

JUNE 2006

Commandant of the Marine Corps General Michael Hagee delivered the first in a series of speeches at Camp Pendleton, California on the value and significance of the Marine Corps and proper decision-making.

Master Chief Petty Officer of the Navy (MCPON) Joe R. Campa Jr. received the ceremonial cutlass from MCPON Terry D. Scott during a change of charge ceremony at the Washington Navy Yard on July 10, 2006.

JULY 2006

The guided-missile destroyers USS Pinckney (DDG 91) and USS Shoup (DDG 86) sailed in formation during the Rim of the Pacific exercise (RIMPAC), which concluded July 28, 2006 after a month of intensive warfare training conducted off the coast of the Hawaiian Islands. RIMPAC, the world's largest biennial maritime exercise, brings together military forces from Australia, Canada, Chile, Peru, Japan, the Republic of Korea, the United Kingdom, and the United States.

AUGUST 2006

A Seaman stands watch on the quarter deck of the amphibious dock landing ship USS Tortuga (LSD 46) as Philippine Marines arrive to take part in the amphibious landing and training phase of exercise Cooperation Afloat Readiness and Training (CARAT). CARAT is an annual series of bilateral maritime training exercises between the United States and six Southeast Asia nations designed to build relationships and enhance the operational readiness of the participating forces.

At the request of the U.S. Ambassador to Lebanon and at the direction of the Secretary of Defense, the U.S. Central Command and elements of Task Force 59 assisted with the departure of U.S. citizens from Beirut, Lebanon.

SEPTEMBER 2006

Secretary of the Navy, Dr. Donald C. Winter presented the Navy Cross to the wife of Sonar Technician 2nd Class (SEAL) Matthew G. Axelson during a ceremony at the Navy Memorial in Washington, DC.

The F-14 Tomcat was officially retired at Naval Air Station Oceana after 36 years of honorable service in the U. S. Navy.

The nation's first Littoral Combat Ship, Freedom (LCS 1) was christened and launched on September 24, 2006 at the Marinette Marine shipyard in Wisconsin. The 377-foot Freedom will help the U.S. Navy defeat growing threats from the littorals (i.e., close-to-shore areas) and provide access and dominance in coastal water battle-space.

The official seal of the Department of the Navy is engraved on the Navy and Marine Corps Memorial. The Navy and Marine Corps Memorial is dedicated to the thousands of Americans who have perished in the sea and to those whose destiny still is linked with our naval and maritime services.

Introduction

The men and women of the U.S. Navy and the U.S. Marine Corps are deployed around the globe at sea and ashore. Operating from the sea, our Sailors and Marines use revolutionary information and dispersed, networked force capabilities to deliver unprecedented offensive power, defensive assurance, and operational independence to Joint Forces Commanders. Shore installations at key forward locations provide logistics support benefits and facilitate rapid response to threats and contingencies. When our ships, aircraft, Sailors, and Marines deploy around the globe, they carry with them what they need to accomplish the mission at hand—with or without host-nation support.

The Department of the Navy

Founded 30 April 1798

Our Mission: Maintain, train and equip combat-ready Naval forces capable of winning wars, deterring aggression and maintaining freedom of the seas.

With global access comes global responsibility. Our Sailors and Marines must sustain combat readiness to fight and win the long war on terror and other armed conflicts, deter aggression, and promote peace and security. They must keep the global sea-lanes open for the peaceful movement of international commerce, forge constructive relationships with navies and coast guards around the globe, and provide humanitarian and crisis response to natural disasters.

This global perspective begins at home with the Department of the Navy's commitment to its overall mission and the Congress' investment that makes accomplishing this mission a fiscal reality. The Fiscal Year 2006 Management's Discussion and Analysis (MD&A) provides perspective on the breadth and depth of the Department of the Navy's mission and the resources appropriated to it by Congress. Specifically, the MD&A provides an overview of the Department of the Navy's financial and performance results for the 12-month period ending September 30, 2006 and is comprised of the following sections:

- Organization and Mission
- Strategic Management
- Management Integrity
- Financial Reporting Results
- Looking Forward: Fiscal Year 2007 and Beyond

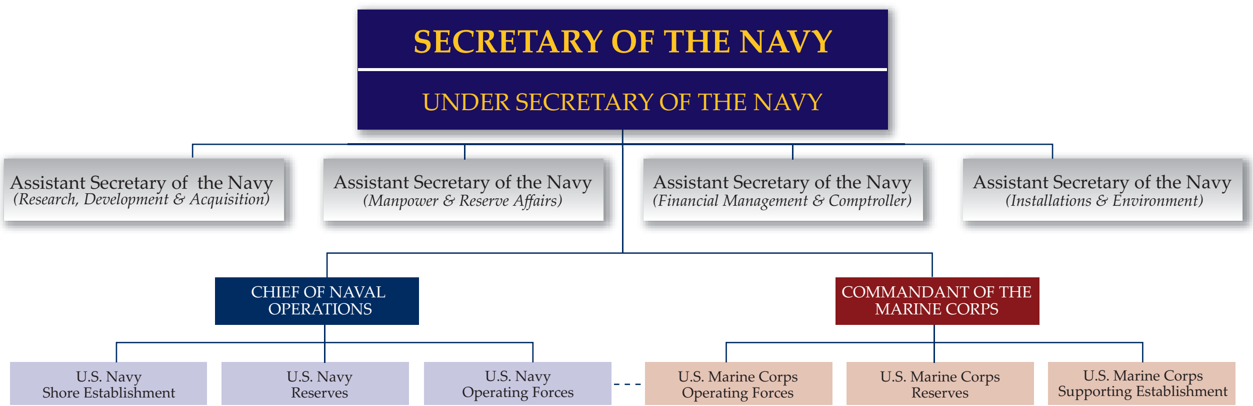
Organization and Mission

The Department of the Navy 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 (Sections 5011 and 5013, Title 10 U.S. Code).

Under the purview of the Secretary of the Navy are key military leaders—the Chief of Naval Operations, a four-star Admiral, and the Commandant of the Marine Corps, a four-star General. The Chief of Naval Operations is responsible to the Secretary of the Navy for the command and operating efficiency of the U.S. Navy and Navy shore establishment as well as their utilization of resources (Section 5033, Title 10 U.S. Code). The Commandant of the Marine Corps is responsible to the Secretary of the Navy for the performance of the U.S. Marine Corps, including the administration, discipline, internal organization, training, efficiency, and readiness of the service and for meeting all of its resource requirements (Section 5043, Title 10 U.S. Code).

The U.S. Navy and the U.S. Marine Corps together comprise the Department of the Navy's joint war-fighting team. Both services 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 Department mission.

The chart below provides a simplified illustration of the Department of the Navy organizational structure. The full structure is shown online at http://www.navy.mil under "Navy Organization."



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

United States Navy

The Navy shall be organized, trained, and equipped primarily for prompt and sustained combat incident to operations at sea. It is responsible for the preparation of naval forces necessary for the effective prosecution of war except as otherwise assigned and, in accordance with integrated joint mobilization plans, for the peacetime components of the Navy to meet the needs of war. (Section 5062, Title 10 U.S. Code)

Founded 13 October 1775
http://www.navy.mil

United States Marine Corps

The Marine Corps shall be organized, trained, and equipped to provide fleet marine forces of combined arms, together with supporting air components, for service with the fleet in the seizure or defense of advanced naval bases and for the conduct of such land operations as may be essential to the prosecution of a naval campaign. (Section 5063, Title 10 U.S. Code)

Founded 10 November 1775
http://www.usmc.mil

Navy Organization

The Navy continued its organizational transformation efforts in Fiscal Year 2006. A brief discussion of the Navy Enterprise Model and Navy organizational changes follows.

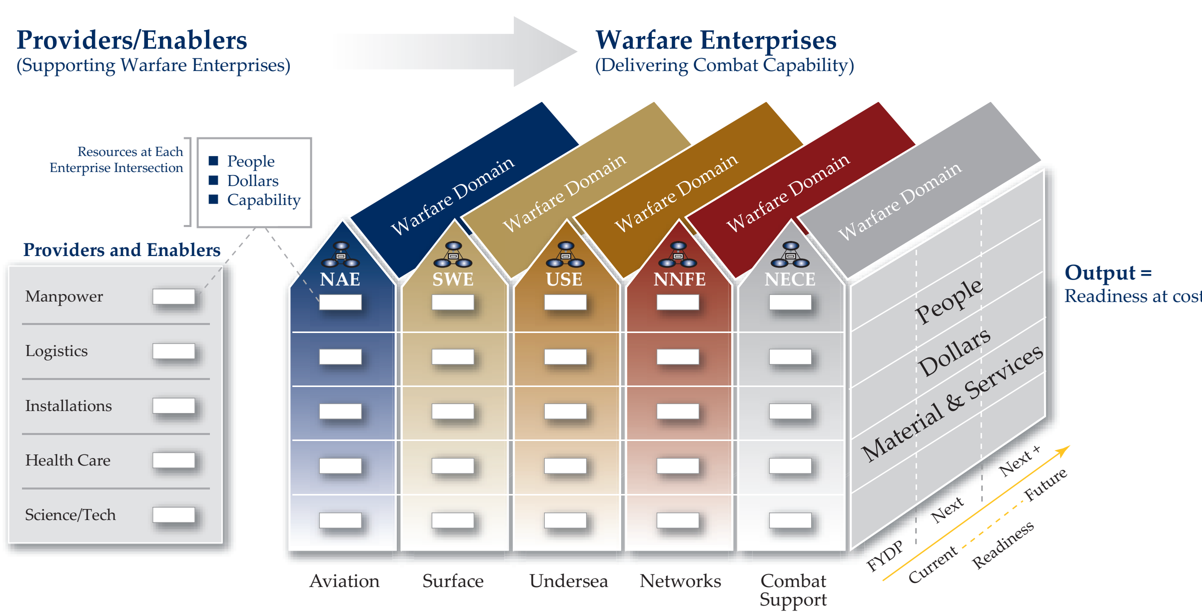
Navy Enterprise Model

The Navy Enterprise Model is an evolving, behavioral concept designed to maximize the operational efficiency and effectiveness of the Navy. Over the next four fiscal years, the Navy will undergo a management transformation that uses existing organizations and resource allocation mechanisms but applies a different construct. This management transformation also includes corporate governance, lines of business, and supporting functional units (see illustration below). This change will create incentives and produce behavior that should result in a better aligned, more effective infrastructure.

Below is a brief description of each Navy Enterprise component and the Navy Enterprise's primary customer—the Naval Components of each of the Unified Commands.

Enterprise Governance. The Navy Enterprise governance structure is comprised of senior Navy civilian and military leaders who are responsible for the strategic guidance and fiscal direction of the overall Navy Enterprise.

The Emerging Navy Enterprise Model – a behavioral construct



Chief of Naval Operations (CNO) Admiral Michael Mullen answers questions during an all-hands call in the auditorium at the Pentagon.

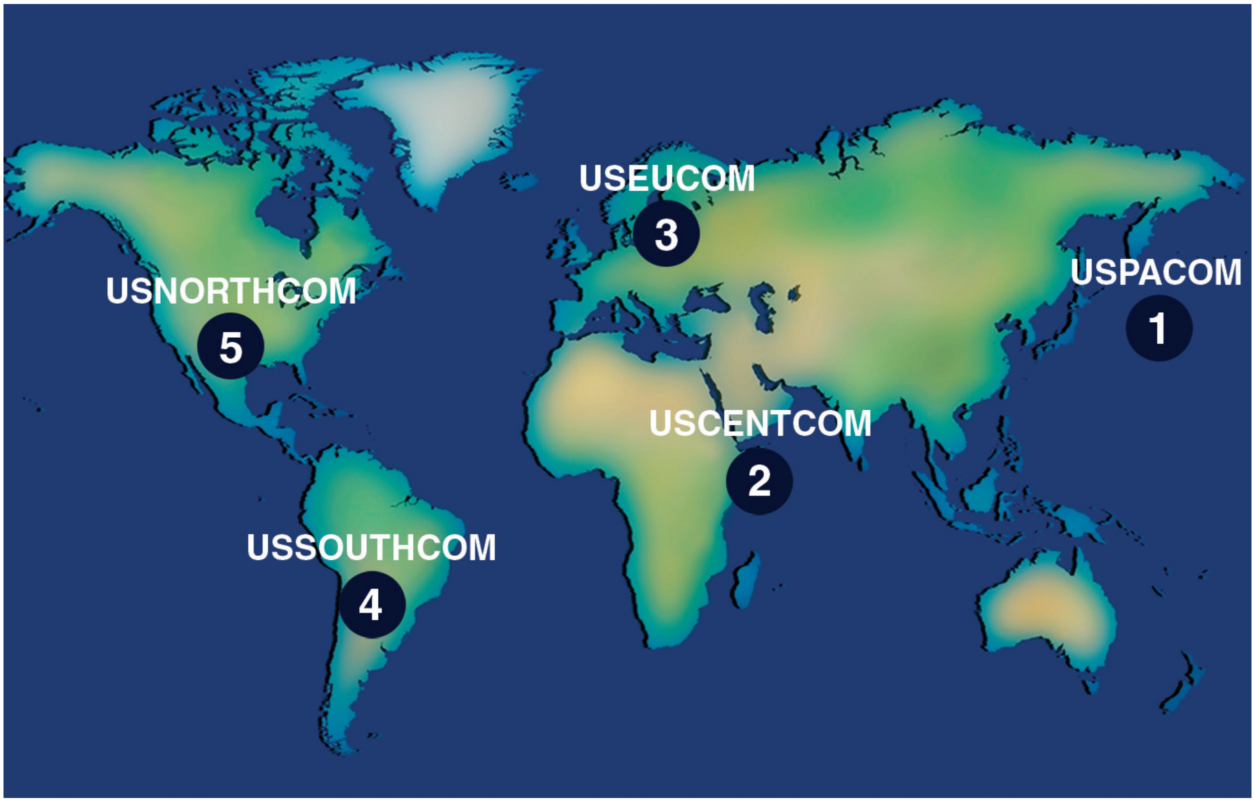
Warfare Enterprises and Supporting Organizations. The Navy Enterprise includes five Warfare Enterprises that function as lines of business to deliver war-fighting capabilities to their customers, the Naval Components of each of the Unified Commands.

- Naval Aviation Enterprise – Responsibility of Commander, Naval Air Forces (CNAF)
- Naval Surface Warfare Enterprise – Responsibility of Commander, Naval Surface Forces (CNSF)
- Naval Undersea Enterprise – Responsibility of Commander, Naval Submarine Forces (CSF)
- Naval Expeditionary Combat Enterprise – Responsibility of Naval Expeditionary Combat Command (NECC)
- Naval NETWAR/FORCEnet Enterprise – Responsibility of Naval Network Warfare Command (NETWARCOM)

Additionally, five Navy program elements will support the Warfare Enterprises in meeting their warfare requirements.

- Manpower, Personnel, Training and Education (MPT&E) – Led by the Chief of Naval Operations' Director of Naval Education and Training, and the Deputy Chief of Naval Operations for Manpower and Personnel
- Acquisition, Technical Authority and Logistics (AT&L) – Led by the Senior Commander of the Systems Commands
- Installations Management – Led by Commander, Navy Installations Command
- Health Care – Led by the Navy Surgeon General
- Science and Technology – Led by the Office of Naval Research

Warfare Enterprises' Primary Customer. The Naval Components of each of the nine Unified Commands are the Warfare Enterprises' primary customer. The nine Unified Commands are comprised of five Geographic Commands and four Functional Commands (see illustrations on the next page).



Geographic Commands

1. **U.S. Pacific Command (USPACOM):** U.S. Pacific Fleet, 3rd and 7th Fleets (*www.cpf.navy.mil*); U.S. Marine Corps Forces, Pacific and Fleet Marine Force, Pacific (*www.mfp.usmc.mil*)

2. **U.S. Central Command (USCENTCOM):** U.S. Naval Forces Central Command and 5th Fleet (*www.cusnc.navy.mil*); U.S. Marine Corps Forces Central Command (*www.marcent.usmc.mil*)

3. **U.S. European Command (USEUCOM):** U.S. Naval Forces Europe and 6th Fleet (*www.naveur.navy.mil*); U.S. Marine Corps Forces, Europe (*www.mfe.usmc.mil*)

4. **U.S. Southern Command (USSOUTHCOM):** U.S. Naval Forces Southern Command (*www.cusns.navy.mil*); U.S. Marine Corps Forces, South (*www.mfs.usmc.mil*)

5. **U.S. Northern Command (USNORTHCOM):** USNORTHCOM has few permanently assigned forces. However, naval personnel (civilians and uniformed services) are among the civil service employees and uniformed service members at USNORTHCOM headquarters (Peterson Air Force Base, Colorado) (*www.northcom.mil*)

Functional Commands

U.S. Joint Forces Command	U.S. Strategic Command
U.S. Fleet Forces Command (www.cffc.navy.mil) U.S. Marine Corps Forces Command (www.jfcom.mil/about/com_marfor.htm)	U.S. Fleet Forces Command (www.cffc.navy.mil) U.S. Marine Corps Forces, Strategic Command (www.marforstrat.usmc.mil) Ballistic Missile Submarines (www.chinfo.navy.mil)
U.S. Special Operations Command	**U.S. Transportation Command**
U.S. Naval Special Warfare Command (www.navsoc.navy.mil) U.S. Marine Corps Forces, Special Operations Command (www.marsoc.usmc.mil)	Military Sealift Command (www.msc.navy.mil)

An Airman salutes the flag during morning colors aboard the amphibious assault ship USS Tarawa (LHA 1).

Navy Organizational Changes

Our organizations are dynamic, adapting to a changing operational and business environment. Below are representative examples of significant Navy organizational changes that occurred during Fiscal Year 2006 or that are anticipated in Fiscal Year 2007. The examples are part of a broader list of Navy organizational changes.

- On January 13, 2006, the Navy Expeditionary Combat Command (NECC) was established, bringing together Explosive Ordnance Disposal, Naval Coastal Warfare, Navy Expeditionary Logistics Support functions, and the Seabees under one organization. NECC integrates all war-fighting requirements for expeditionary combat and combat support elements for naval anti-terrorism and force protection missions.

- U.S. Naval Special Warfare Command (*http://www.navsoc.navy.mil*) established U.S. coastal support activities in response to the Department of the Navy's expanding role in the Global War on Terror.

- Office of Naval Research (*http://www.onr.navy.mil*) established the Expeditionary Maneuver Warfare and Combating Terrorism Department to lead the Department of the Navy's Science and Technology effort in developing future naval combat capabilities and combating terrorism.

- Office of Naval Intelligence (*http://www.nmic.navy.mil*), in collaboration with the U.S. Coast Guard Intelligence Coordination Center, expanded its organization to include a Maritime Homeland Threat Analysis Division to support the Department of the Navy's role in Homeland Security.

- Bureau of Medicine and Surgery (*http://navymedicine.med.navy.mil*) established four regional commands to increase efficiency of Navy medical and health care services.

- Naval Facilities Engineering Command (*http://www.navfac.navy.mil*) reached the final milestone of its transformation structural realignment, consolidating 25 component commands to 16 and aligning with Commander, Navy Installations Command (*http://www.cni.navy.mil*) regions.

- Effective October 1, 2006, the Navy Personnel Command (*http://www.npc.navy.mil*) and the Naval Education and Training Command (*https://www.cnet.navy.mil*) merged to become part of the Manpower, Personnel, Training and Education (MPT&E) domain, established in July 2005.

- Space and Naval Warfare Command (*http://www.spawar.navy.mil*) Program Executive Office for Information Technology (PEO (IT)) was renamed "PEO for Enterprise Information Systems (EIS)" with leadership and oversight responsibilities for the Navy Marine Corps Intranet (NMCI), Navy Enterprise Resource Planning (ERP), Base Level Information Infrastructure/One NET (BLII/One NET) and the Global Combat Support System – Marine Corps (GCSS-MC).

- All Naval Reserve Centers were renamed "Navy Operational Support Centers" to more accurately describe the integrated role of the Navy Reserve (*http://navyreserve.navy.mil*) in the daily planning and operations of the U.S. Navy Operating Forces.

The Navy's Flight Demonstration team, the Blue Angels, performs the Fleur De Lis, a maneuver performed as an aerial salute to the men and women of the Armed Forces at Marine Corps Air Station Miramar.

Marine Corps Organization

The Marine Corps continued its organizational transformation efforts in Fiscal Year 2006. A brief discussion of Marine Corps Business Enterprise and Marine Corps organizational changes follows.

Marine Corps Business Enterprise

The Marine Corps Business Enterprise crosses all organizational boundaries and includes all resources, processes, and products and services that support the war-fighter. Sustained by the skills and knowledge of the Marine Corps workforce, the Business Enterprise drives innovation and change through end-to-end business process improvements that deliver value with fewer resources. Among the business transformation tools employed by the Business Enterprise are lean thinking, regionalization, competitive sourcing, process reengineering, divestiture, and elimination of non-core functions. Through a common business information system, the Business Enterprise will provide timely and accurate cost and performance data required for effective decision-making and command and control of business operations.

The Business Enterprise is instrumental to achieving the objectives of the President's Management Agenda, the Department of Defense Business Transformation Agency, the National Security Personnel System, the Sea Enterprise vision, and a series of congressional measures that challenge the military services to transform business practices as well as military capabilities.

Marine Corps Organizational Changes

Below are representative examples of significant Marine Corps organizational changes that occurred during Fiscal Year 2006. The examples are part of a broader list of Marine Corps organizational changes.

- The Marine Corps established a Special Operations Command, known as MARSOC, to provide direct support to current and future Special Operations Forces missions under the purview of the U.S. Special Operations Command (USSOCOM). MARSOC will train Marines to perform key tasks, such as special reconnaissance, foreign internal defense, and counterterrorism. MARSOC is expected to be fully operational by 2010.

- Marine Corps Depot Maintenance and Supply Management Activity Groups expanded their organizations to increase efficiency and improve customer support.

A Marine assigned to India Company 3rd Battalion 3rd Marines (3/3) patrols enemy positions after taking fire in a palm grove.

Strategic Management

Changes in the global security environment and the challenges that have emerged since the events of September 11, 2001 and the subsequent engagement in Afghanistan and Iraq have compelled the Department of the Navy to balance the requirements of traditional naval capabilities with those needed to confront and influence our changing world. Non-traditional missions, such as counter-terrorism, humanitarian affairs, disaster relief, and counter-piracy, have become integral to the overall Department of the Navy mission. These new missions require the Department of the Navy to change rapidly and become a more agile, effective, and efficient enterprise in support of the war-fighter.

The Department of the Navy's keystone vision document, *Naval Power 21*, focuses on the near-term development of the Navy and Marine Corps team to meet the emerging global threats and challenges of this new era. The Navy and Marine Corps have defined their respective Service strategies for achieving the *Naval Power 21* vision in *Sea Power 21* and *Marine Corps Strategy 21*. Each strategy reinforces and expands operational concepts that will enhance America's ability to project offensive power, defensive assurance, and operational independence around the globe.

The emerging Navy Enterprise model, described under "Organization and Mission," will support *Sea Power 21* by aligning, organizing, integrating, and transforming the Navy to meet 21st century challenges, especially the demands of unrestricted, irregular warfare. In particular, the Navy Enterprise strategic management process will include an integrated model that cascades to the Warfare Enterprises and supporting organizations and informs decision-making and resource allocation. Additionally, customer-driven business processes, a common set of linked metrics, integrated capabilities, transparency of information, and other factors will enable the Navy Enterprise to maximize readiness while minimizing cost.

The Department of the Navy Financial Management Strategic Plan, *Transforming Today to Win Tomorrow*, issued by the Assistant Secretary of the Navy (Financial Management and Comptroller) in April 2005, will support the Navy's transition to the Enterprise Model. The Navy and Marine Corps financial management community has sustained progress in human capital development, business practices improvement, and customer communications. These are three areas described in the strategic plan as critical to effective and efficient financial management—a key enabler for the success of the Navy Enterprise Model implementation.

Balanced Scorecard for Risk Management

The Department of the Navy uses the Balanced Scorecard for Risk Management to measure, evaluate, and improve strategic performance consistent with the goals of defense policy and the President's Management Agenda—a government-wide initiative to improve federal performance and management (*http://www.whitehouse.gov/omb/*). The scorecard is comprised of the Department of Defense's four risk dimensions, as delineated in the 2006 Quadrennial Defense Review—Force Management Risk, Operational Risk, Future Challenges Risk, and Institutional Risk—and includes corresponding performance goals and measures. The guiding principle for risk management is to balance strategic and operational decisions among and within the four risk dimensions.

Balanced Scorecard for Risk Management	
Strategic Goal 1: Balancing Force Management Risk	**Strategic Goal 2: Balancing Operational Risk**
Performance Goals: 1.1 Maintain a Quality Force 1.2 Ensure Sustainable Military Tempo & Workforce Satisfaction 1.3 Maintain Reasonable Force Costs 1.4 Shape the Force of the Future	**Performance Goals:** 2.1 Ensure Force Availability 2.2 Maintain Force Readiness 2.3 Shape Force Posture 2.4 Link Contingency Planning to Capabilities & Resources
Strategic Goal 3: Balancing Future Challenges Risk	**Strategic Goal 4: Balancing Institutional Risk**
Performance Goals: 3.1 Drive Innovative Joint Operations 3.2 Define Human Capital Skills & Competencies 3.3 Develop More Effective Organizations 3.4 Define & Develop Transformational Capabilities	**Performance Goals:** 4.1 Institutionalizing Capabilities-Based Planning, Improving Financial Management & Driving Acquisition Excellence 4.2 Improve the Readiness & Quality of Key Facilities 4.3 Manage Overhead / Indirect Cost 4.4 Realign Support to the War-fighter

Following is a discussion of Department of the Navy strategic performance in terms of the Balanced Scorecard for Risk Management. Included in the discussion are representative examples of performance for each strategic goal. Other examples are available in *Highlights of the Department of the Navy FY 2007 Budget*, found on the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) website, *http://www.finance.hq.navy.mil*.

Strategic Goal 1: Balancing Force Management Risk

"We remain focused on providing adequate pay, health care, housing, proper work environments, and career-long learning for our Sailors."

– Admiral Michael G. Mullen, Chief of Naval Operations, March 2006

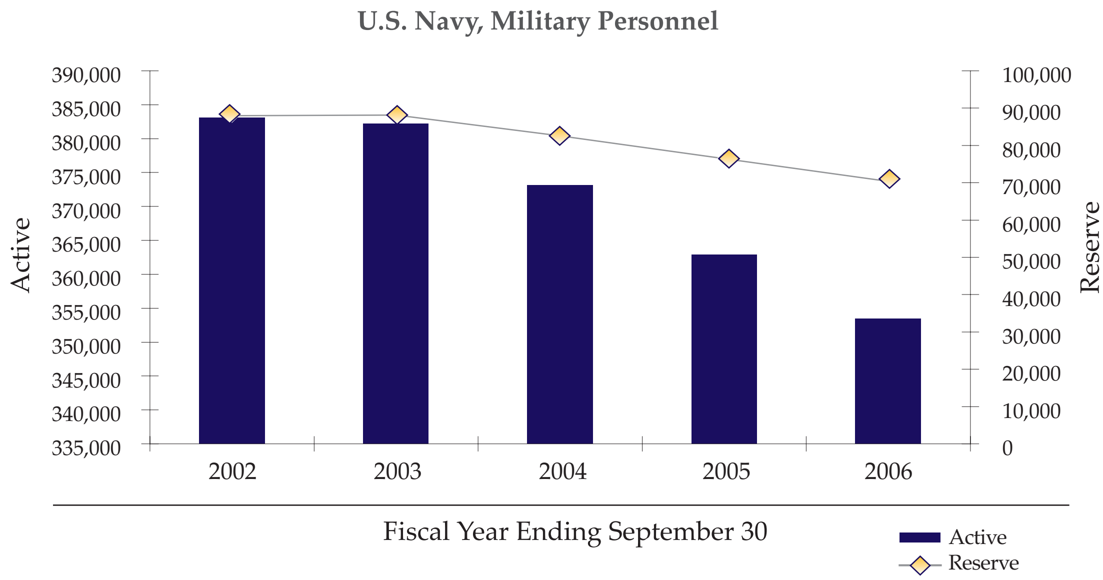
"Though the mission must always come first, we continue to search for opportunities to improve the experience of serving as a Marine both during and after their active service…."

– General Michael W. Hagee, Commandant of the Marine Corps, March 2006

The Department of the Navy continued its transformation of the military and civilian workforce in Fiscal Year 2006. Military tempo and force costs, which are discussed below, are representative areas of Navy and Marine Corps force management. Note that military tempo corresponds to performance goal 1.2 and force costs correspond to performance goal 1.3 of the Balanced Scorecard for Risk Management.

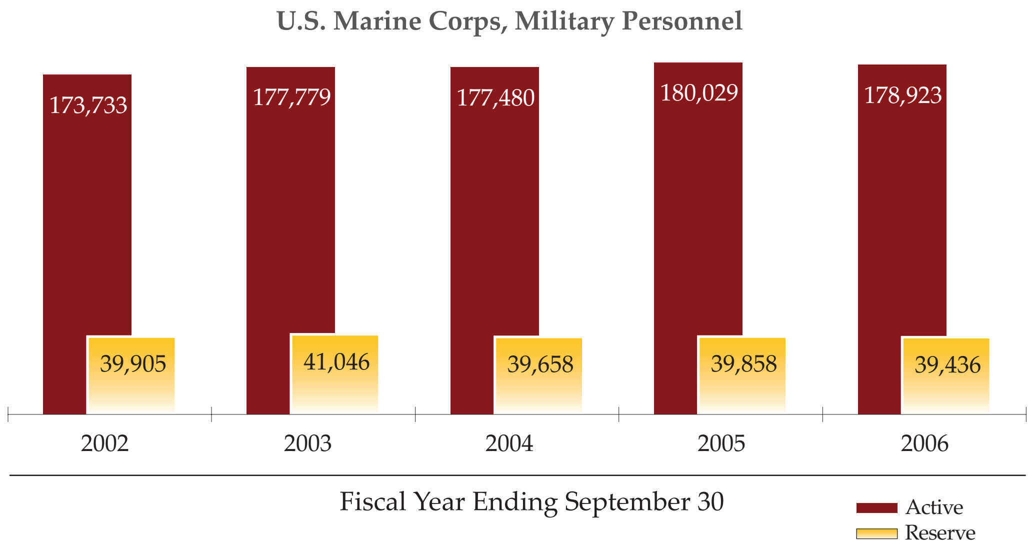
Military Tempo

Sustainment of Military Tempo. Aggressive transformation of naval forces contributed to smaller operating forces in Fiscal Year 2006, continuing a downward trend in naval end strength. Changes in force structure and workforce composition, increased efficiencies through use of technology, and new manning practices enabled the Department to sustain a force structure capable of meeting the deployment requirements of the Global War on Terror, Homeland Security, and stability operations. Sustainment of military tempo will be a critical requirement of the Navy Enterprise.



Active = Officers, Enlisted, and Midshipmen
Reserve = Selected Reserve and Full-Time Support

The Brigade of Midshipmen stand at attention during their pass-in-review ceremony at the parade grounds of the U.S. Naval Academy. Chief of Naval Operations Admiral Mike Mullen and Commandant of the Marine Corps General Michael W. Hagee reviewed the 30 companies that made up the Brigade. Besides instruction and practice in military drill, all midshipmen receive thousands of hours of education and training.

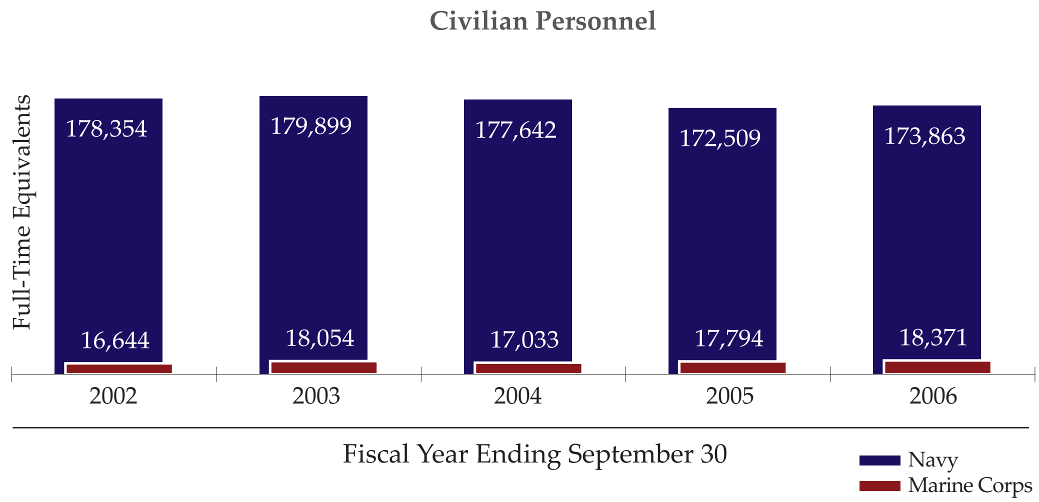


Active = Officers and Enlisted   *Reserve = Selected Reserve and Full-Time Support*

Marines stack rockets, mortars, and bags of propellant.

Force Costs

Maintaining Reasonable Force Costs. The Department of the Navy strives to achieve the most effective and efficient workload balance among its military, civilian, and support contractors. As part of the Strategic Sourcing program, the Department of the Navy will continue to study military and civilian positions and to identify military billets that are not "military essential" for conversion to civilian employees or support contractors.



Strategic Goal 2: Balancing Operational Risk

> *"The world has entered a 'new era' in which our military is confronting a highly dynamic security environment far more complex, uncertain, and potentially threatening than any we have faced before."*
>
> – Admiral Michael G. Mullen, Chief of Naval Operations, March 2006

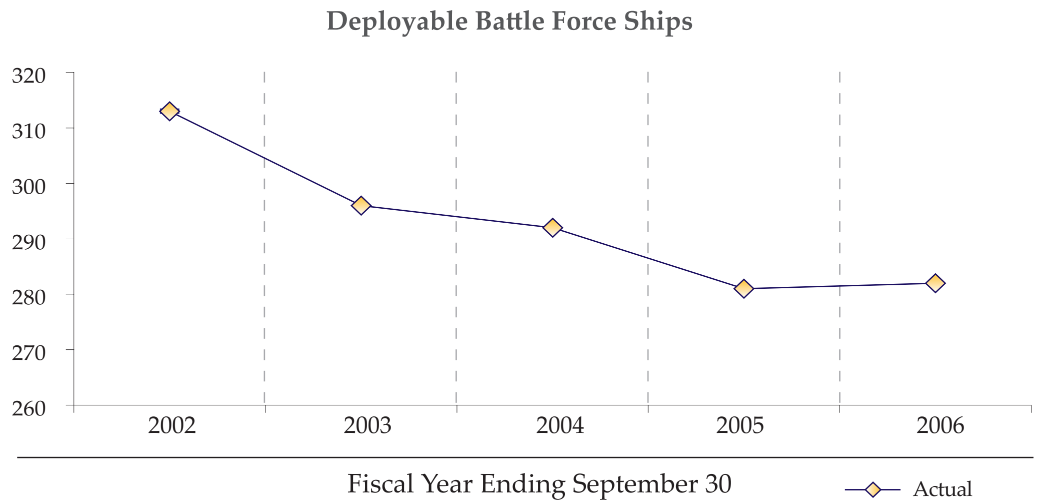
> *"In an uncertain world, readiness is the coin of the realm."*
>
> – General Michael W. Hagee, Commandant of the Marine Corps, March 2006

The Department of the Navy continued to ensure that the U.S. Navy and U.S. Marine Corps are available and ready at all times to respond to the full spectrum of joint military operations. Force availability and readiness, which are discussed below, are representative areas of naval operating performance. Note that force availability corresponds to performance goal 2.1 and readiness corresponds to performance goal 2.2 of the Balanced Scorecard for Risk Management.

Force Availability

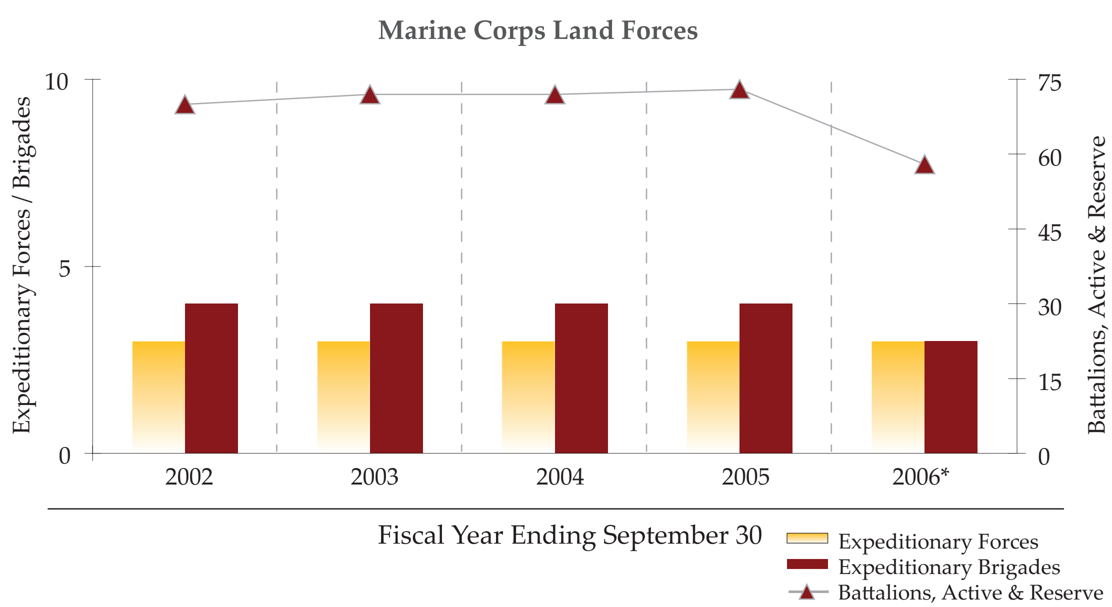
Fleet Response Plan Will Increase Ship Availability. The Department augmented its fleet of deployable battle force ships in Fiscal Year 2006, bringing the total number of battle force ships to 282. The Department's goal is to sustain a fleet of 313 ships. Battle force ships include aircraft carriers, nuclear attack submarines, and amphibious warfare ships. While the overall inventory of warships is smaller than in recent decades, the Navy's Fleet Response Plan (FRP) seeks to offset this slight decline by increasing the availability of warships. The FRP calls for the capability to deploy up to six Carrier Strike Groups (CSGs) within 30 days and one additional CSG within 90 days in response to a national emergency. For a complete list and description of U.S. Navy ships, see "Fact File" at *http://www.navy.mil*.

A tug assists the guided-missile destroyer USS Donald Cook (DDG 75) pier-side at Naval Station Norfolk. Donald Cook is returning to its homeport after a six-month deployment in support of the Global War on Terror.



A greater emphasis on research and development for next generation warships and investment in the future fleet attributed to the rise in ships from FY 2005 to FY 2006.

Realignment of Marine Corps Land Forces. The Department realigned Marine Corps land forces in Fiscal Year 2006 as part of overall naval force transformation. Land forces affected by the realignment were expeditionary brigades and total battalions. Specifically, the 4th Marine Expeditionary Brigade (Anti-Terrorism) was officially deactivated on February 24, 2006 and its major subordinate units were reassigned to other commands. This realignment enabled the Marine Corps to concentrate its resources more effectively while at the same time preserving the unique capabilities of the 4th Marine Expeditionary Brigade. Similarly, the establishment of the Marine Corps Special Operations Command (MARSOC) in FY 2006 contributed in part to the realignment of expeditionary brigades and total battalions.



** As of June 30 (third quarter-end, FY 2006)*

A brief description of Marine Corps Air-Ground Task Forces is presented below.

Marine Expeditionary Force: the largest Marine air-ground task force, with as many as 45,000 war-fighters, comprising ground forces, an air wing, and a service support group.

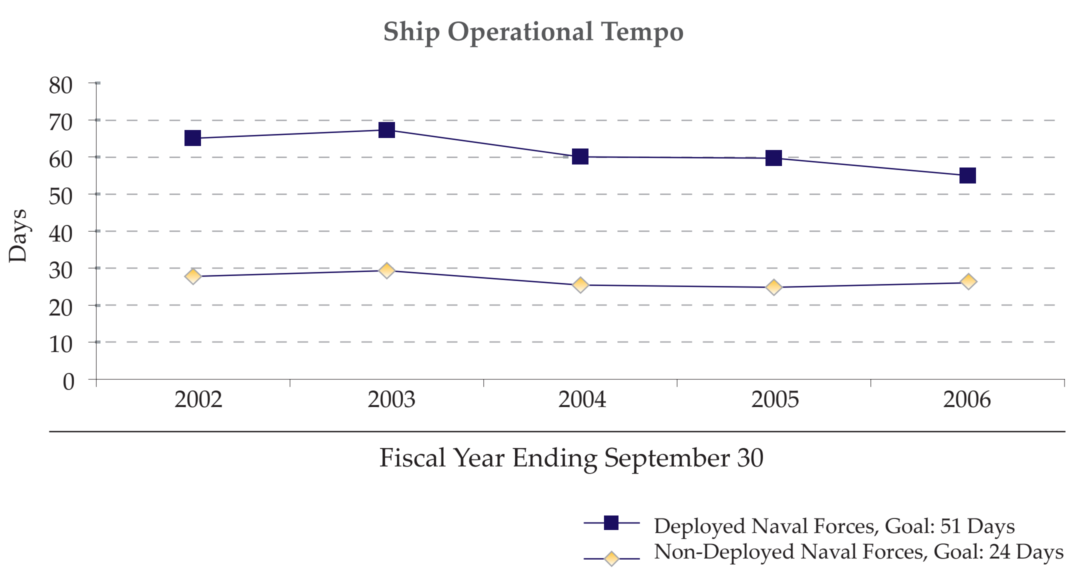
Marine Expeditionary Brigade: a Marine air-ground task force that is larger than a Marine Expeditionary Unit, but smaller than a Marine Expeditionary Force. It comprises a ground regiment, an air group, and support personnel.

Marine Expeditionary Unit: the smallest air-ground task force, built around an infantry battalion, a helicopter squadron, and a support group.

For more information on U.S. Marine Corps forces, see "Units" at [*http://www.usmc.mil*](http://www.usmc.mil).

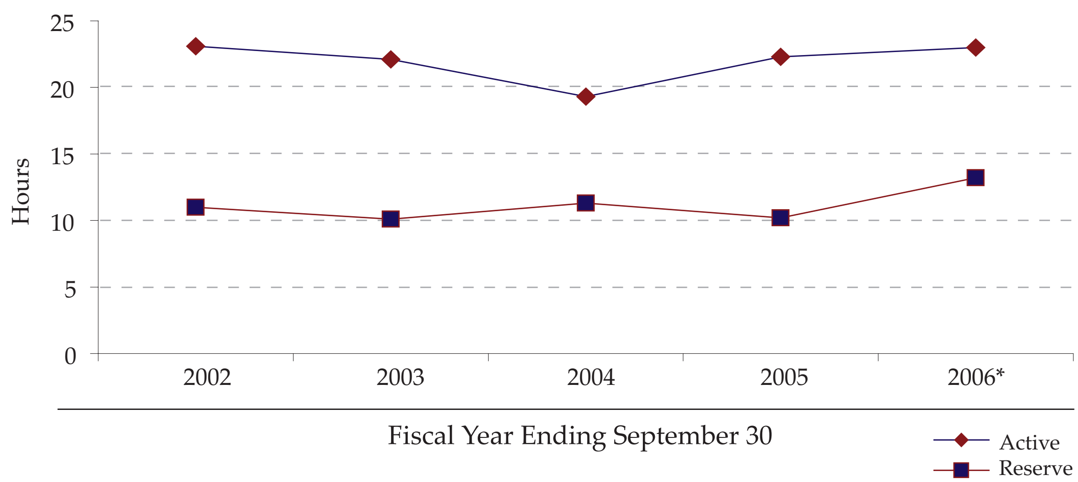
Readiness

Ship Operational Tempo. Fiscal Year 2006 marked the fifth consecutive year that the Department has exceeded ship operational tempo (OPTEMPO) goals for deployed and non-deployed naval forces. The Navy-Marine Corps team fully supported the Global War on Terror and quickly responded to other global challenges. As a result, the Navy steamed at a higher OPTEMPO than the Global Naval Force Presence Policy goal of 51 deployed days and 24 non-deployed days. Non-deployed naval forces are fleet units that participate in various training exercises. Ship OPTEMPO is the number of days that deployed and non-deployed naval forces are away from their homeport.



Aircraft Operational Tempo. Aircraft operational tempo (OPTEMPO) is the number of monthly flying hours recorded by Navy and Marine Corps active and reserve air crews. In Fiscal Year 2006, aircraft OPTEMPO for Navy and Marine Corps active and reserve air crews was 22.6 and 13.2 hours, respectively.

Aircraft Operational Tempo



** As of August 31, 2006*

Two F/A-18E Super Hornets conduct a fly-by of Mount Rushmore during a recent training exercise.

Strategic Goal 3: Balancing Future Challenges Risk

"Investing in the ships, aircraft, submarines, and Marine Corps war-fighting equipment and people to preserve this Nation's historic naval power…remains an enduring fundamental strategic requirement."

– The Honorable Donald C. Winter, Secretary of the Navy, March 2006

The Department of the Navy remained focused on human capital strategic initiatives and research and development to prepare for the challenges of an uncertain future. Progress made in human capital and research and development, which is discussed below, represents a broader list of Department accomplishments in Fiscal Year 2006. Note that human capital corresponds to performance goal 3.2 and research and development corresponds to performance goal 3.4 of the Balanced Scorecard for Risk Management.

Human Capital

Workforce Trends. Below are representative examples of Department of the Navy workforce trends.

- **Maturing Workforce.** The Department of the Navy, like many other federal departments and agencies, continues to face a workforce eligible to retire in the next five years. To counter this trend, the Department is aggressively pursuing retention and recruitment efforts.
- **War-time Expansion.** The Department of the Navy's expanding role in the Global War on Terror has created the need for additional personnel. Examples include the U.S. Naval Special Warfare Command, the Naval Criminal Investigative Service, Office of Naval Intelligence, and the Marine Corps Depot Maintenance Activity Group.
- **BRAC Reductions.** The Department of the Navy anticipates personnel reductions in response to Base Realignment and Closure (BRAC) Act of 2005.

Integration of Navy Active and Reserve Forces. Essential to force readiness have been the Department's continued efforts toward Active Reserve Integration, an initiative directed by the Chief of Naval Operations to fully integrate the Navy's Reserve Component with the active force. Increased integration provides the Navy's Reserves with a path to current equipment, concepts and tactics, maximizing combat readiness and war-fighting capability in support of the full spectrum of joint military operations.

Shift Toward Increased Military Capabilities. The Department is increasing the capabilities of the U.S. Navy and U.S. Marine Corps to maximize future combat effectiveness, pursuant to the goals and objectives of the *2006 Quadrennial Defense Review Report* and the *Department of the Navy's Strategy for Our People*. The Navy, in particular, is expanding its Foreign Area Officer program to include additional officers who have foreign language skills and cultural expertise in support of Fleet Commanders, Combatant Commanders, and Joint staffs.

Focus on Workforce Models for Financial Management Community. Following the human capital initiative outlined in the Department of the Navy Financial Management (FM) Strategic Plan, *Transforming Today to Win Tomorrow*, the Department is creating a PC-based interactive workforce model that will facilitate the development of workforce strategies for the FM community now and a decade into the future. The models will be used to predict workforce age, size and grade structure based on numerous variables, and will enable the Department to make staffing decisions nationwide. The models should be fully operational by the end of the first quarter in FY 2007.

National Security Personnel System. The Department of the Navy, in collaboration with the Department of Defense (DoD), is participating in the first group of conversions to the National Security Personnel System (NSPS). Authorized by Congress, NSPS provides DoD 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.

Research and Development

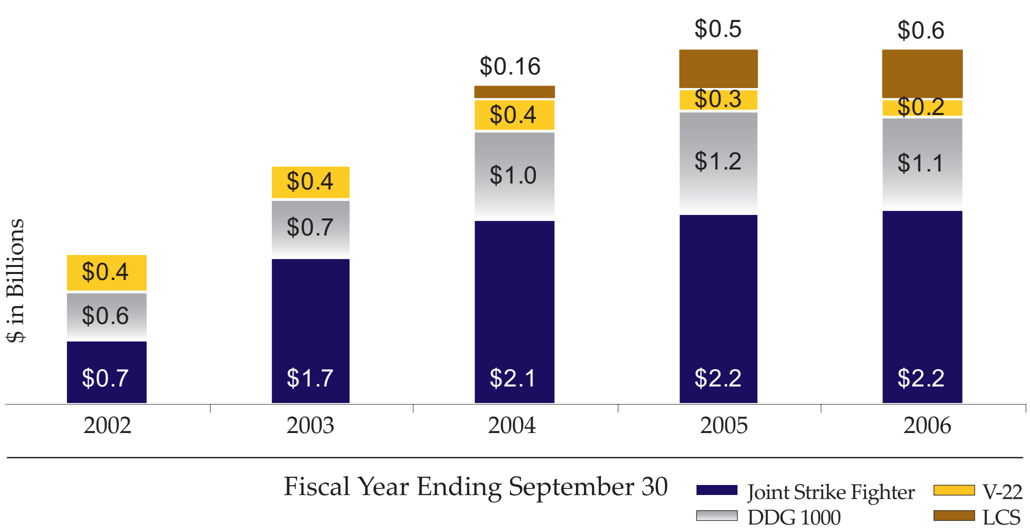
Development of Next Generation Warships and Aircraft. The Department of the Navy continued to fund development of next generation warships and aircraft. Representative examples of these war-fighting platforms include the DD(X), V-22, Littoral Combat Ship, and Joint Strike Fighter, as described below. All platform development is funded in the Research, Development, Test and Evaluation, Navy (RDT&E,N) appropriation.

- **DD(X)** – a family of advanced multi-mission warships capable of long-range firepower. The design and construction of the DDG 1000 begins in FY 2007.
- **V-22** – a joint aircraft program designed to meet the varied needs of the Navy and Marine Corps team and to supplement the U.S. Special Operations Command special mission aircraft.
- **Littoral Combat Ship** – a family of ships, optimized for war-fighting in the littorals (close-to-shore areas) that employs a unique modular architecture enabling mission-tailored tactical capabilities. Construction of the second Flight 0 design ship commenced in FY 2006.

- **Joint Strike Fighter** – a joint aircraft program designed to meet the needs of the Navy and Marine Corps team, the Air Force, and allied forces. The Joint Strike Fighter program is in the systems development and demonstration stage.

The EA-18G Growler, the Navy's next-generation electronic attack aircraft, is being developed to replace the fleet's current carrier-based EA-6B Prowler. The EA-18G is expected to enter initial operational capability in 2009.

Development Funding of Representative Next Generation Warships and Aircraft Programs



Development of Free-electron Laser for Shipboard Defense. The Office of Naval Research continued to oversee development of the free-electron laser (FEL) under its Directed Energy Program. The FEL is more powerful than a conventional laser and could be placed on next generation battle force ships, such as the DD(X) and CVN-21, for shipboard defense. The FEL is expected to be operational by 2020.

Use of Robotics for Force Protection. The Department continued to aggressively research, develop and field technologies to counter the evolving problem of improvised explosive devices (IEDs), a major hazard to military forces and civilians in Iraq and Afghanistan. In particular, the Unmanned Systems Branch of the Space and Naval Warfare Systems Center (SSC) San Diego demonstrated the robust capabilities of the Multi-Robot Operator Control Unit (MOCU) command and control software by simultaneously controlling multiple unmanned surface, ground, and aerial vehicles in a force-protection scenario.

In addition, the Marine Corps Forces Pacific Experimentation Center, in collaboration with the Naval Facilities Engineering Service Center, established the Western Area Robotics Test and Evaluation Center (WARTEC) at the Marine Corps Air/Ground Combat Center in Twenty-nine Palms, California. WARTEC is a National Unmanned Systems Experimentation Environment site and encompasses an all-purpose test center supporting year-round test, evaluation, and assessment of technology prototypes.

Strategic Goal 4: Balancing Institutional Risk

"Providing Sailors, Marines, and Department of the Navy civilians with high quality facilities, information technology, and an environment to achieve goals…will demand a revolution in management, technology and business practices to reduce redundancies and ensure the efficient flow of business processes."

– The Honorable Donald C. Winter, Secretary of the Navy, March 2006

The Department of the Navy made significant advances in business transformation, information technology, and family housing during Fiscal Year 2006. These areas of progress, which are discussed below, are part of a broader list of Departmental accomplishments in institutional management. Note that progress made in business transformation and information technology corresponds to performance goal 4.1 of the Balanced Scorecard for Risk Management; and progress in family housing corresponds to performance goal 4.2 of the scorecard.

Business Transformation

Implementation of Navy and Marine Corps Financial Improvement Plans. All major commands, including the Marine Corps, have implemented their financial improvement plans under the Department of the Navy Financial Improvement Program (DON FIP). The DON FIP is the integrating plan of DON's business transformation strategy and a key initiative under the DON Financial Management Strategic Plan, *Transforming Today to Win Tomorrow*. As part of their financial improvement plans, all organizational levels are addressing deficiencies in business processes, internal control, and systems with the primary goal of improving the quality and timeliness of financial management information. Accomplishing this goal will enable the Department's financial management community to take the steps necessary for preparing auditable Department-wide financial statements.

Additionally, the Marine Corps is on its way to becoming the first Military Service to produce auditable financial statements. The Marine Corps began preparing subsidiary financial statements for the first time in Fiscal Year 2006.

Development of Navy Enterprise Resource Planning (ERP) System Template. Under the Navy ERP Program, the Navy has developed an ERP system template that will integrate and improve Navy processes for logistics, acquisition, and financial operations. The Navy ERP Program is a cornerstone of the DON business transformation strategy and key enabler of the Navy's Sea Enterprise vision to transform business processes and generate efficiencies to improve combat capabilities. The first implementation of the Navy ERP is scheduled for October 1, 2007 at the Naval Air Systems Command.

Implementation of Wide Area Workflow. The Department of the Navy realized substantial savings in Fiscal Year 2006 from implementation of Wide Area Workflow (WAWF), the Department of Defense's web-based application for generating, capturing, and processing invoices and payments. WAWF-related savings, including lower Defense Finance and Accounting Service processing fees and reduced Prompt Payment interest charges, will increase as the Department of the Navy's user base and transaction volume increase. The Office of Naval Intelligence is among the Department of the Navy commands that implemented WAWF in Fiscal Year 2006. The Naval Surface Warfare Centers, a subordinate of the Naval Sea Systems Command, plans to implement WAWF in Fiscal Year 2007.

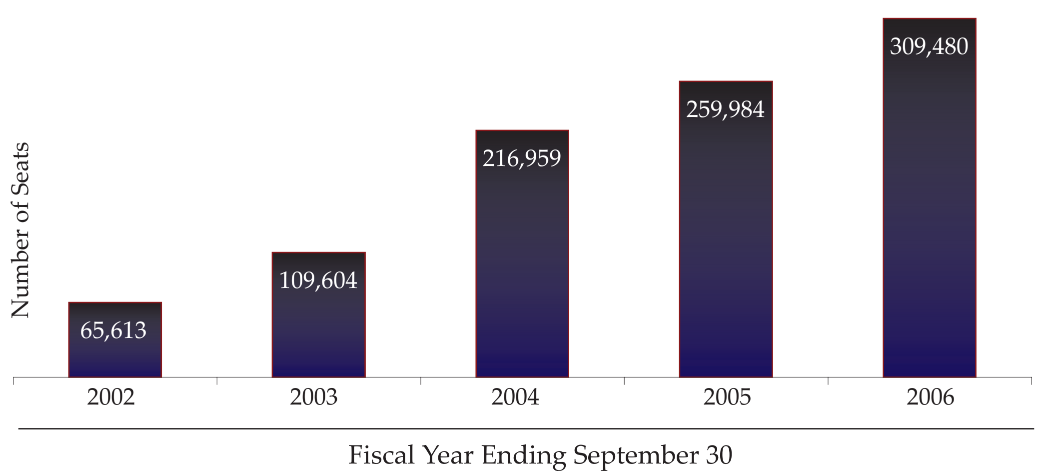
Planned Integration of Lean/Six Sigma. During Fiscal Year 2006, the Department initiated plans for broad integration of Lean/Six Sigma, one of the Secretary of the Navy's priority initiatives for improving the Department's overall effectiveness and efficiency.

Lean/Six Sigma is an industry-proven methodology for harvesting improvements in business processes. Many of the Department's major commands and related program offices and business activities have successfully implemented Lean/Six Sigma techniques in various segments of their business operations. These business segments include: Naval Air Systems Command; Supply Management, Navy under the purview of Naval Supply Systems Command; Naval Shipyards under the purview of Naval Sea Systems Command; and the Program Executive Office for Command, Control, Communications, Computers, Intelligence and Space under the Space and Naval Warfare Enterprise. Lean/Six Sigma integration will complement business process improvement initiatives under the DON FIP and Navy ERP Program.

Information Technology

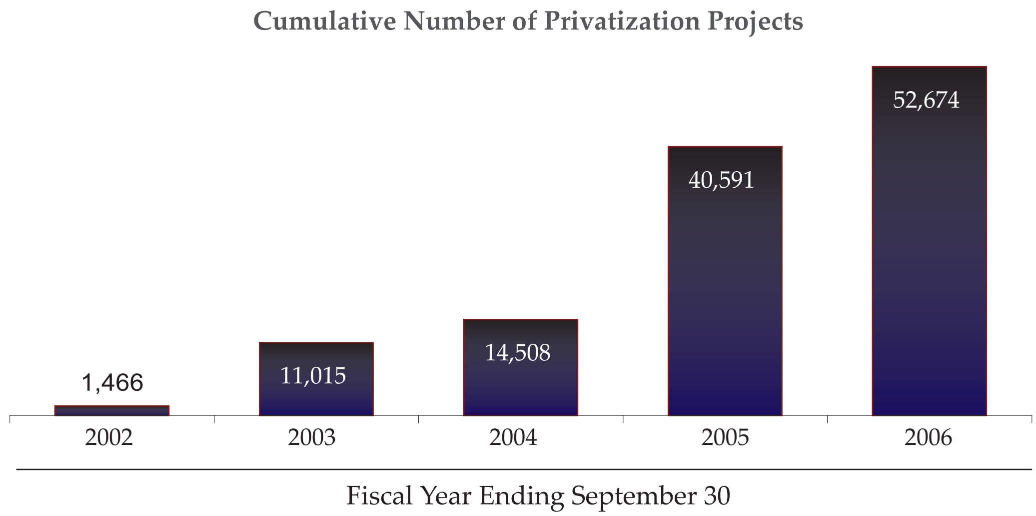
Increased Connectivity to Navy Marine Corps Intranet (NMCI). The Department has significantly increased connectivity to NMCI from Fiscal Year 2002 to Fiscal Year 2006 (see chart). NMCI is integral to the Department's plans for global knowledge management and the next generation of combat, combat support, and business operations. It has replaced numerous independent and disparate networks ashore and is vital to the Department of Defense Global Information Grid (*http://www.dod.mil/dbt/*). By Fiscal Year-end 2007, the Department expects to complete deployment of NMCI seats, transition legacy systems and servers to NMCI, and integrate sea and shore networks.

Connectivity to Navy Marine Corps Intranet



Family Housing

Planned Elimination of Inadequate Housing. The Department expects to achieve the Department of Defense (DoD) goal of eliminating inadequate housing for Sailors, Marines, and their families by Fiscal Year-end 2007. Inadequate housing is any unit that requires a major repair, component upgrade, component replacement, or total upgrade. Progress toward the DoD goal is due in part to private sector capital and expertise that the Department has leveraged through public-private ventures.



A Sailor attached to Carrier Air Wing Two (CVW-2) meets his newborn child after a deployment aboard the Nimitz-class aircraft carrier USS Abraham Lincoln (CVN 72).

Management Integrity

Commanders and managers throughout the Department must ensure the integrity of their programs and operations. Part of this responsibility entails compliance with federal requirements for financial management systems, financial reporting, and internal controls. Below is a brief discussion of Department compliance with federal requirements during Fiscal Year 2006.

Systems

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires agencies to implement and maintain financial management systems that comply with federal systems requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level. The Department continues to progress toward full compliance with FFMIA as represented by the Navy ERP system initiative. The Navy ERP will be compliant with the Department of Defense Standard Financial Information Structure, which parallels the U.S. Standard General Ledger at the transaction level.

Financial Reporting

Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994

The Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, requires agencies to produce auditable annual financial statements. The Department has been producing annual financial statements for the Navy Working Capital Fund since Fiscal Year 1991 and the General Fund since Fiscal Year 1996. Through its Financial Improvement Program, the Department will be able to take the necessary steps for preparing auditable Department-wide financial statements.

Government Performance and Results Act of 1993

The Government Performance and Results Act (GPRA) of 1993 requires agencies to engage in strategic planning and performance management for the purpose of improving the effectiveness and efficiency of programs they administer. During Fiscal Year 2006, the Department implemented the financial efficiency index (FEI), a comprehensive measure of how well the Department is executing its budget. See "Financial Reporting Results" for more information on the FEI. Improved measurements combined with NSPS implementation will move the Department forward towards an outcome-oriented, performance-based culture.

Inspector General Act of 1978

The Inspector General Act of 1978, as amended, requires agencies to provide an explanation for all audit reports that have open recommendations exceeding one year. As of September 30, 2006, the Department of the Navy, Naval Audit Service, had 66 audit reports open for more than one year, with potential monetary benefits of $105.4 million. The Department closed out and implemented recommendations from 45 audit reports in Fiscal Year 2006 with claimed monetary benefits of $244.6 million.

Improper Payments Information Act of 2002

The Improper Payments Information Act 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. Departmental programs and activities that have reporting responsibilities under the Improper Payments Information Act include Personnel Support Activities and Detachments, which calculate travel payments, and Disbursing Officers aboard ships and at other isolated locations. Note, however, that the Defense Finance and Accounting Service performs most of the Department's entitlement computation and disbursement functions.

In Fiscal Year 2006, the Department identified $2.5 million in potentially improper payments. This amount is significantly less than the threshold of $10 million, as established by the Office of Management and Budget. The Department has instituted internal controls to reduce the occurrence of improper payments in the future.

Management Controls

Federal Managers' Financial Integrity Act of 1982

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 Sarbanes-Oxley Act of 2002, which applies to publicly traded companies, led to the federal government's reevaluation of internal control policies under FMFIA. Consequently, the Office of Management and Budget issued a revised version of 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 financial reporting controls.

In Fiscal Year 2006, the Department of the Navy evaluated its management controls. The results indicate that the Department's system of administrative and operational internal controls overall, in effect as of June 30, 2006, provides qualified assurance, with the exception of material weaknesses, that controls are in place, operating effectively, and being used. For the internal control weaknesses, the Department has either initiated or planned aggressive corrective action to strengthen internal controls. Milestones have been established for ensuring corrective action, and oversight officials have been assigned responsibility for meeting such milestones.

In addition, to comply with the revised A-123 Circular, Appendix A, the Department of the Navy conducted an assessment of the effectiveness of its controls over financial reporting for the General Fund, the Working Capital Fund, and the Marine Corps. The Department conducted tests of controls over financial reporting in selected focus areas, as prescribed by the Department of Defense Financial Improvement and Audit Readiness Program. The assessment identified several weaknesses that require corrective action. Corrective actions as well as an expanded and on-going testing program will validate and sustain financial audit readiness.

The Department of the Navy's Fiscal Year 2006 FMFIA Annual Statement is available at *http://www.finance.hq.navy.mil*.

The Honorable Richard Greco, Jr., Assistant Secretary of the Navy (Financial Management and Comptroller), receives the Department of Defense Award of Excellence on behalf of the Department of the Navy from the Honorable Gordon England, Deputy Secretary of Defense, recognizing best practices in internal management controls through the Department of the Navy Managers' Internal Control Program and implementation of the revised OMB Circular A-123, Appendix A.

Financial Reporting Results

"Effective controls will enable us to do our jobs more effectively, lessen the risk of undesirable outcomes, and ensure the resources entrusted to us are used in support of the Navy-Marine Corps wartime mission."

– The Honorable Richard Greco, Jr., Assistant Secretary of the Navy (Financial Management and Comptroller), October 2005

The Fiscal Year 2006 Department of the Navy Annual Financial Report presents for the first time subsidiary financial statements and related notes for the U.S. Marine Corps. The Office of the Under Secretary of Defense (Comptroller), with support from the Department of the Navy, designated the Marine Corps a financial reporting entity in Fiscal Year 2006, which effectively allowed the Marine Corps to prepare comprehensive financial statements and related notes for its General Fund and Working Capital Fund. While the Marine Corps financial statements and related notes have been presented separately in the annual report, the Fiscal Year 2006 Department of the Navy General Fund and Navy Working Capital Fund financial statements are still consolidated statements, meaning that the line item values include dollar values from the Marine Corps General Fund and the Working Capital Fund.

A discussion follows of financial analysis relative to the Department of the Navy General Fund and the Navy Working Capital Fund consolidated financial statements for Fiscal Years 2005 and 2006.

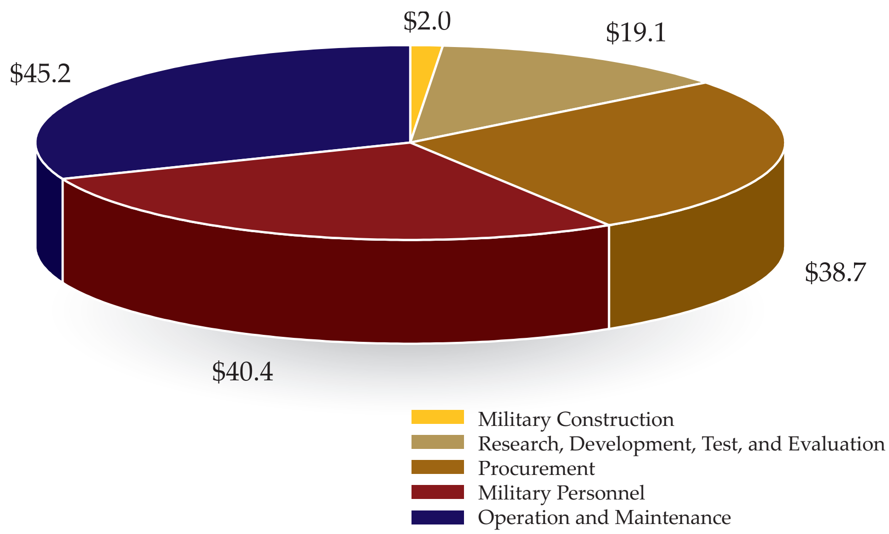
DON General Fund

Overview of Operations

The Department of the Navy (DON) General Fund, which includes the U.S. Marine Corps General Fund as a subsidiary entity, supports overall Departmental operations. Direct appropriations from Congress comprise the majority of the General Fund account structure.

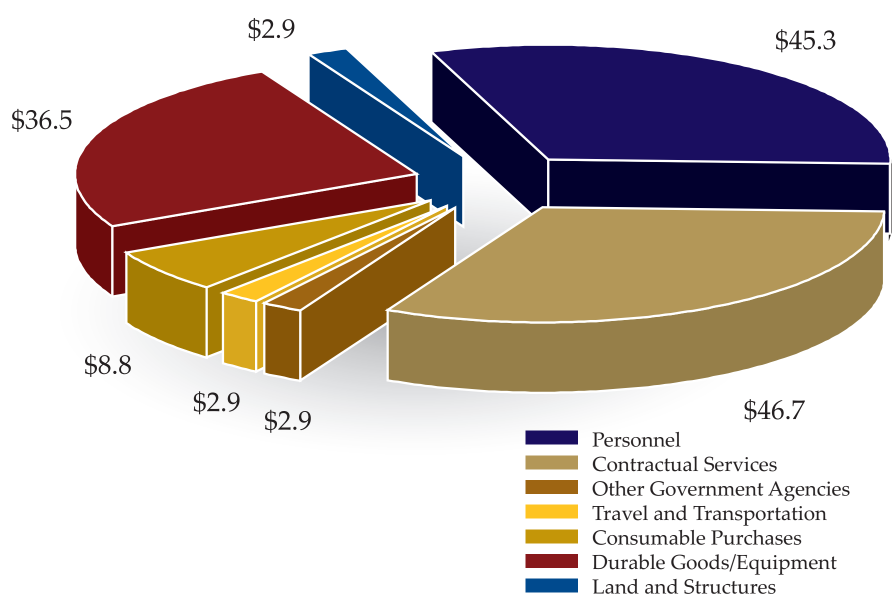
In Fiscal Year (FY) 2006, the Department was appropriated a total of $145.5 billion, which was allocated among five major appropriation groups—see chart, next page. Appropriations received flowed to the major commands, which in turn obligated the money to fund operational expenses and capital investments. Obligations represent the financial value of orders placed, contracts awarded, services provided, and similar business transactions that support the DON mission.

Major Sources of Funding in FY 2006 (*$ in Billions*)



Total obligations incurred against direct appropriations were $146.0 billion. As depicted in the chart below, the Department obligated the majority of FY 2006 funds, or $91.7 billion, to cover contractual services, such as ship construction, aircraft procurement, shore-side facilities construction, infrastructure maintenance; and personnel costs, both military and civilian. More information on Department of the Navy appropriations received and obligations incurred is available in the Combined Statement of Budgetary Resources and in Note 20 of the Department of the Navy General Fund Notes to the Principal Statements.

Major Uses of Funding in FY 2006 (*$ in Billions*)



Financial Efficiency Index

In Fiscal Year 2006, the Navy and Marine Corps Financial Management Community began to use a new metric for evaluating budget execution performance —the Financial Efficiency Index (FEI). The FEI is an innovative, real-time measurement of how well the Department of the Navy has obligated approved program funds. It is part of the Assistant Secretary of the Navy (Financial Management and Comptroller) strategic vision to measure and improve program performance. Performance measures cascade to the lowest level in the organization so that individuals can positively influence results and be rewarded accordingly under performance evaluation systems. The goal is to institutionalize a performance-based culture and lay the foundation for measurements that can be specifically tied to individuals' performance plans. This initiative is aligned with the objectives of the Department of the Navy senior leadership and the President's Management Agenda.

Expressed as a composite score, the FEI assesses how efficiently the Department's major commands are executing their funds throughout the life of an appropriation. The index reveals how well their funds are obligated during the active year(s) of an appropriation and during the funds' "lifetime" before expiration or cancellation. The Department's FY 2006 FEI was 98 percent. The FY 2006 data will be used as the baseline for future trend analysis, making the index more valuable to managers every year.

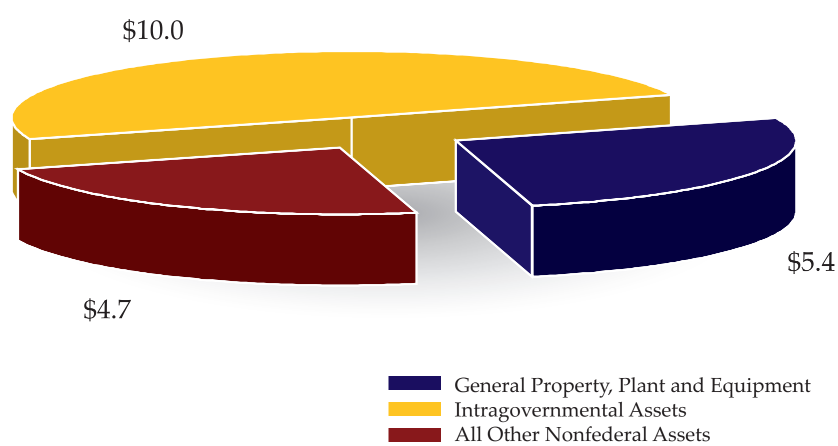
Overview of Financial Position

Discussion of financial position focuses on the Consolidated Balance Sheet. The balance sheet is similar to that used within the private sector, presenting assets, liabilities, and net position (stockholder's equity in the private sector).

Assets

The Department of the Navy (DON) reported $354.8 billion in total assets as of September 30, 2006, representing a $20.1 billion, or 6 percent, increase from the restated September 30, 2005 total asset value.

Increase in Total Assets, FY 2005 to FY 2006



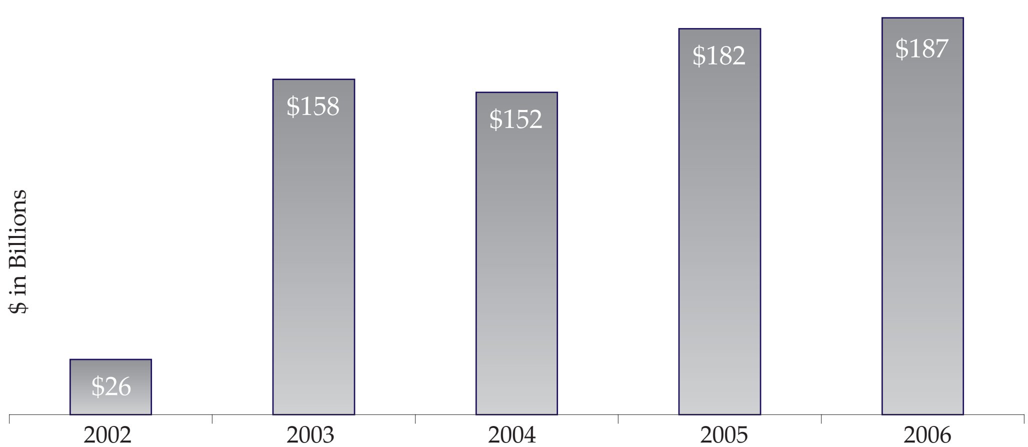
Changes in General Property, Plant and Equipment and Intragovernmental Assets, which include Fund Balance with Treasury, accounted for the majority of the $20.1 billion increase in total assets as of September 30, 2006. Following is a brief discussion of significant changes in total assets from Fiscal Years 2005 and 2006.

General Property, Plant and Equipment (PP&E). DON recognized $187.0 billion in General PP&E as of September 30, 2006, an increase of $5.4 billion, or 3 percent, from the restated September 30, 2005 value. The overall increase in General PP&E as of September 30, 2006 is primarily due to the use of a new estimation methodology (explained below) and subsequent increase in the value of Military Equipment.

DON began reporting military equipment as General PP&E according to Statement of Federal Financial Accounting Standards Number 23, "Eliminating the Category National Defense Property, Plant and Equipment" in Fiscal Year 2003. At that time, a net value of $132.7 billion in military equipment was represented on the balance sheet. Initially, the value for all DoD military equipment was based on data provided by the Bureau of Economic Analysis (BEA), Department of Commerce.

Beginning April 1, 2006, DON replaced the BEA methodology with one that uses internal records and historical costs. DON now updates the military equipment baseline value using records maintained by acquisition and logistic support personnel. This change was made through the Department of Defense Financial Improvement and Audit Readiness (DoD FIAR) Plan and the DON Financial Improvement Program (FIP) efforts and is expected to result in an auditable value for military equipment, enhance the usefulness and reliability of military equipment information, and provide better information regarding military acquisitions and disposals to decision makers.

General Property, Plant and Equipment



Fiscal Year Ending September 30

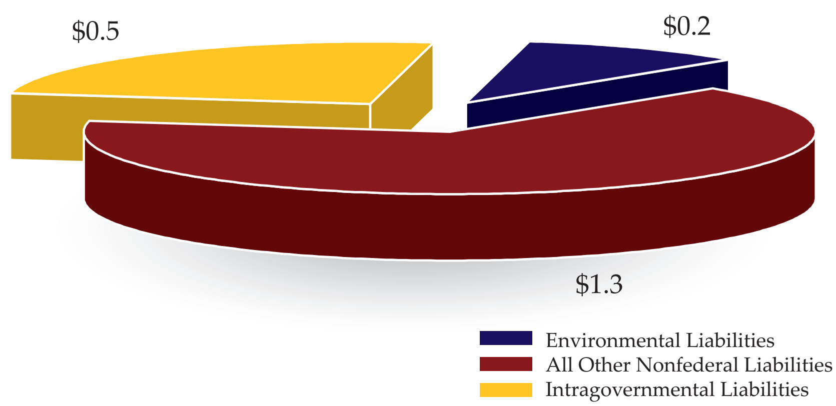
More information on General PP&E is available in Note 10 of the Department of the Navy General Fund Notes to the Principal Statements.

Intragovernmental Assets. DON recognized $97.1 billion in Intragovernmental Assets as of September 30, 2006, an increase of $10.0 billion, or 12 percent, from September 30, 2005. This increase is primarily the result of an increase to the Fund Balance with Treasury (FBWT), specifically in Appropriations Received that have not been fully executed. Of the $10.2 billion increase in FBWT, $8.1 billion was an increase in multi-year appropriations. The majority of the $8.1 billion was comprised of $6.2 billion for Procurement appropriations and $1.5 billion for Research, Development, Test, and Evaluation (RDT&E). The procurement appropriations involve addressing the requirement for the acquisition, modernization, and recapitalization of the fleet and fleet Marine forces war-fighting assets. The RDT&E appropriations are used to transition science and technology, process innovation, and general research and development to meet the acquisition community and ultimately war-fighter requirements.

Liabilities

DON reported $31.3 billion in total liabilities as of September 30, 2006, representing a $2.0 billion, or 7 percent, increase from September 30, 2005. Changes in Environmental Liabilities and All Other Nonfederal Liabilities, which include Accounts Payable, accounted for the majority of the $2.0 billion increase in total liabilities as of September 30, 2006. Following is a brief discussion of significant changes in total liabilities from Fiscal Years 2005 and 2006.

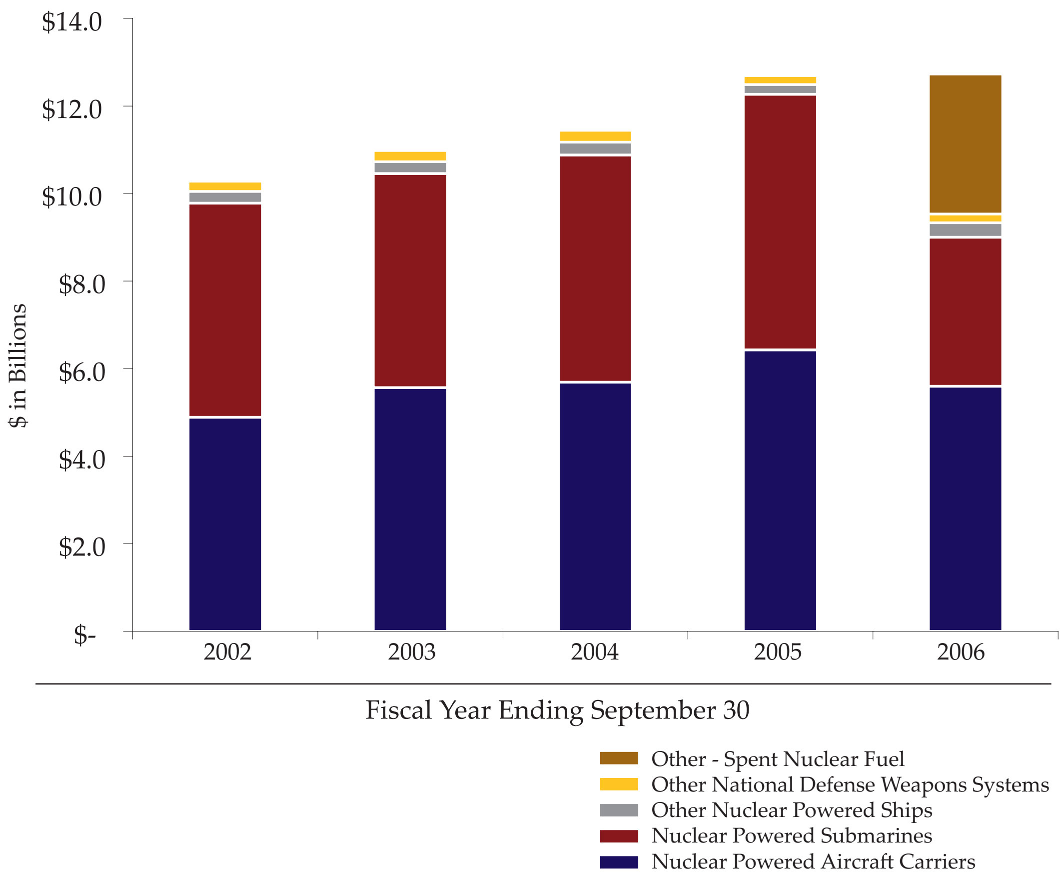
Increase in Total Liabilities, FY 2005 to FY 2006



Environmental Liabilities. DON recognized $17.3 billion in environmental liabilities for cleanup costs as of September 30, 2006, representing an increase of $0.2 billion, or 1 percent, from September 30, 2005. DON recognizes environmental liabilities based on accounting estimates because actual costs cannot be determined until completion of cleanup and disposal operations. The majority of the environmental liability is noncurrent, meaning that cleanup and disposal operations will occur subsequent to September 30, 2007. Through the Financial Improvement Program efforts, the DON revised its estimation methodology for nuclear ship and submarines. The revised methodology resulted in a more realistic estimate for managers and caused an overall decrease in the environmental liabilities estimate. However, for the first time, during

FY 2006, the DON began recognizing an environmental liability for Spent Nuclear Fuel, which offset the overall decrease. Spent Nuclear Fuel is defined as the used fuel that is removed from the nuclear reactors of nuclear powered ships and submarines.

Environmental Disposal – Weapons Systems Programs



All Other Nonfederal Liabilities. DON recognized $8.5 billion in All Other Nonfederal Liabilities as of September 30, 2006, representing an increase of $1.3 billion, or 19 percent, from September 30, 2005. This increase primarily results from a change in Department of Defense accounting policy that requires DON to estimate a contingent liability for progress payment-type contracts. In FY 2006, DON recognized a contingent liability of $1.1 billion.

Navy Working Capital Fund

The Navy Working Capital Fund (NWCF), which includes the Working Capital Fund – U.S. Marine Corps as a subsidiary, 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/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.

NWCF has five business areas: Supply Management, Depot Maintenance, Research and Development, Transportation, and Base Support. Each business area is responsible for one or more business activities (see illustration).

The goal of the 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 prices for goods and services, to protect customers from unforeseen price fluctuations.

Discussion of the financial performance of the NWCF focuses on the Consolidated Statement of Net Cost and cash management at the Departmental level.

Navy Working Capital Fund Business Activities By Business Area

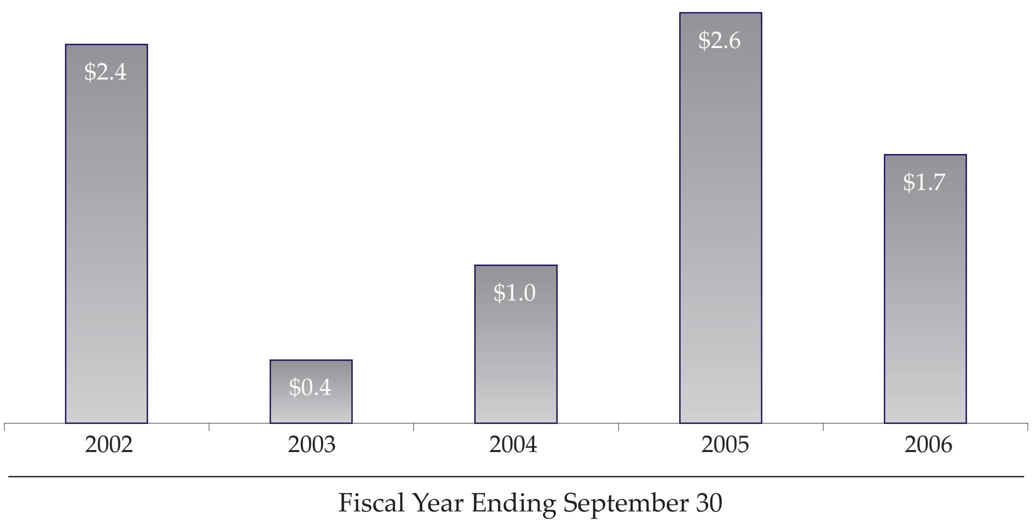
Supply Management	Depot Maintenance
Supply Management, Navy (*www.navsup.navy.mil*) Supply Management, Marine Corps (*www.logcom.usmc.mil*)	Depot Maintenance, Shipyards (*www.navsea.navy.mil*) Depot Maintenance, Aviation (*www.navair.navy.mil*) Depot Maintenance, Marine Corps (*www.logcom.usmc.mil*)
Base Support	**Transportation**
Facilities Engineering Commands (*www.navfac.navy.mil*) Naval Facilities Engineering Service Centers (*www.navfac.navy.mil*)	Military Sealift Command (*www.msc.navy.mil*)
Research and Development	
Naval Research Laboratory (*www.nrl.navy.mil*) Naval Surface Warfare Centers (*www.navsea.navy.mil*) Naval Undersea Warfare Centers (*www.navsea.navy.mil*)	Naval Air Warfare Centers (*www.navair.navy.mil*) Space and Naval Warfare Systems Centers (*www.spawar.navy.mil*)

Overview of Operations

Net cost of operations is the "bottom line" on the statement of net cost. It is similar to the private sector's net income (or net loss) on the income statement (also known as "the profit and loss statement"). Both the statement of net cost and the income statement present revenues earned and costs (or expenses) incurred for the reporting period. However, to arrive at the bottom line, federal entities calculate costs incurred less revenues earned, whereas the private sector calculates revenues earned less expenses incurred.

In Fiscal Year (FY) 2006, NWCF net cost of operations decreased by $859.4 million (or 33.3 percent). The majority of this decrease, $726.4 million, is attributed to Supply Management, Navy. There were two events during FY 2005 that caused unusually high gross costs in this business area. The two events were the reconciliation of system problems with the Depot Level Repairable Carcass Returns; and the Enterprise Resource Planning (ERP) Supply Maintenance Aviation Re-engineering Team Pilot concluding its objectives.

Combined Net Cost of Operations (*$ in Billions*)



NOTE: Totals above represent the combined total of net cost of operations for the NWCF.

Fluctuations in the combined net cost of operations from FY 2002 to FY 2005 were primarily attributable to the increase in work-related efforts supporting the ongoing Global War on Terror and Iraqi operations (FY 2002 to FY 2003); an increase in fuel consumption costs for the Transportation business area (FY 2004 to FY 2005); and the two events identified above for Supply Management, Navy (FY 2005 to FY 2006).

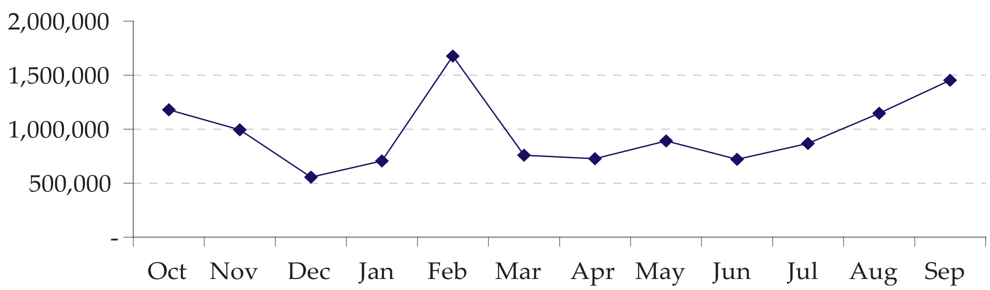
To view the combined total of program costs and earned revenue for the NWCF, see the NWCF Consolidated Statement of Net Cost. Supporting details for this statement are in the NWCF Consolidating Statement of Net Cost.

See Note 18, NWCF Notes to the Principal Statements, for more information on the FY 2006 Statement of Net Cost.

Overview of Financial Position

The Department of the Navy 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 (*http://www.dod.mil/comptroller/fmr/*). For FY 2006, the seven-day cash requirement was $782 million and the ten-day requirement was $1.1 billion.

Navy Working Capital Fund FY 2006 Monthly Cash Balances ($ in Thousands)



**NOTE: Cash balances above represent the combined total of monthly cash balances for the NWCF.*

The NWCF finished FY 2006 with an ending cash balance of $1.2 billion. Supplemental appropriations and advance billings were primary contributors to the fiscal year-end cash balance as described below.

- $218 million transfer from the National Defense Sealift Fund to fund the Military Sealift Command's purchase of three Maritime Prepositioning ships in January 2006.
- $197 million in advance billing initiated in January 2006 to enable DON to sustain an NWCF cash balance sufficient to meet expenses.
- $100.4 million in additional funding for the Public Works Centers: $35.4 million to fund fuel costs and $65 million to fund utility costs.
- $50 million Congressionally-directed transfer from the NWCF to the Operations and Maintenance, Navy appropriation, completed in September 2006.
- $27 million in additional funding for the Military Sealift Command to meet increased ship fuel costs.

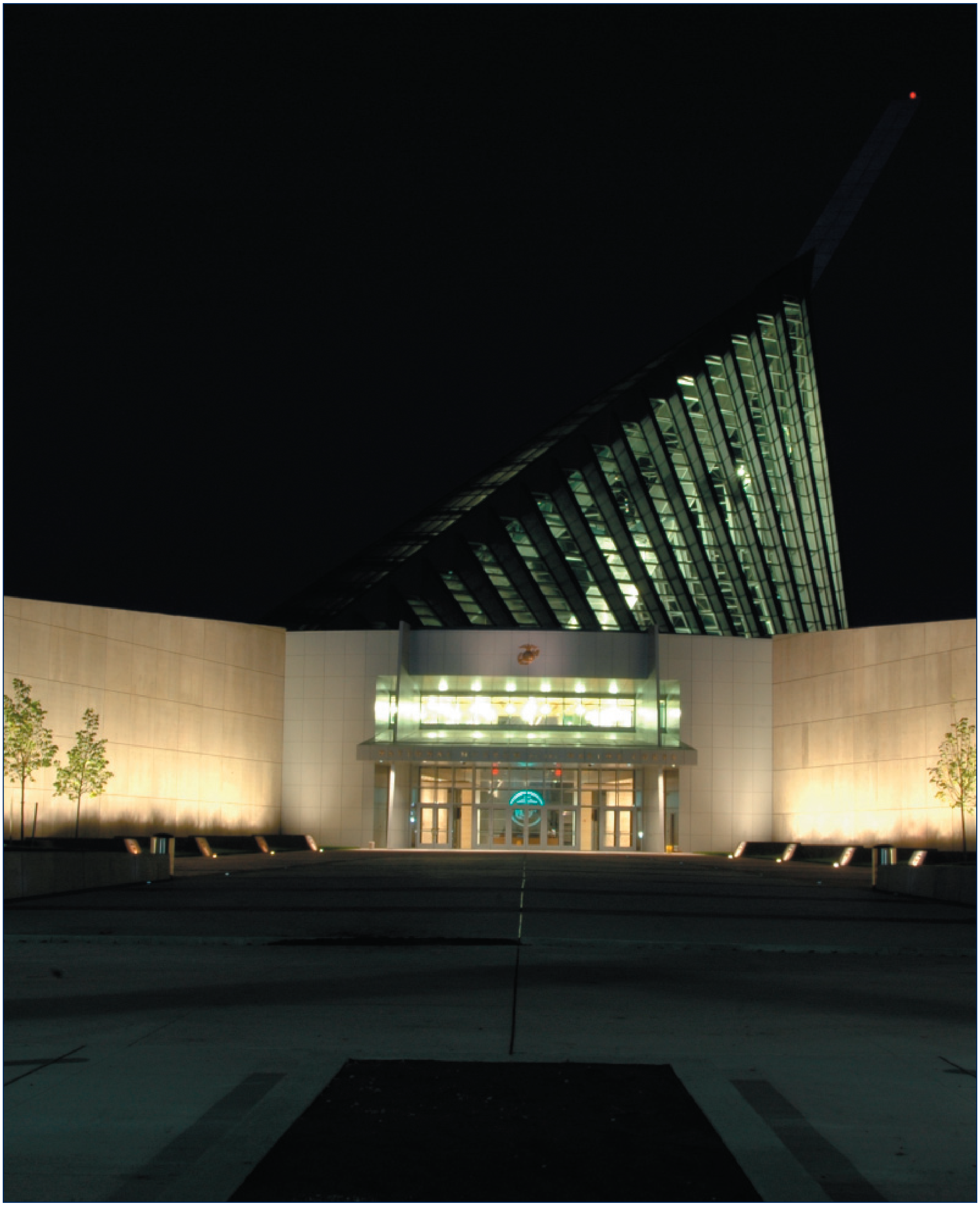
In addition, the fiscal year-end NWCF cash balance reflects $272 million for payroll accrued during the last 14 days of September 2006.

Cash Management Initiative

As part of the DON Financial Management Strategic Plan business transformation effort, the NWCF Cash Management initiative will be focusing during FY 2007 on the deployment of cash forecasting and cash reconciliation processes across NWCF activities. Preliminary identification of cash-related competencies will be made, and initial training will be developed for the workforce. Better documented and controlled business processes will produce financial information that will allow us to sustain and compress cash cycles. The desired outcome will be significantly improved cash visibility and predictability, allowing for a reduced requirement to hold cash and create the potential to reduce that element of NWCF rates that is required to sustain a higher cash level. This allows DON customers to obtain more value for their operating dollars.

Looking Forward: Fiscal Year 2007 and Beyond

An architectural rendering of the spire of the new National Museum of the Marine Corps captures the famous flag-raising at Iwo Jima. The museum will be a lasting tribute to the U.S. Marine Corps – past, present, and future.



The new National Museum of the Marine Corps, located in Quantico, Virginia, is scheduled to open on November 10, 2006, commemorating the 231st year of the founding of the U.S. Marine Corps.

Chief of Naval Operations Admiral Michael G. Mullen spoke during Recruit Graduation at Recruit Training Command Great Lakes. The Department of the Navy will continue to focus on recruitment as a means to developing the 21st century naval workforce.

An Aviation Ordnanceman 1st Class in charge of safety supervised the transfer of ammunition from the Nimitz-class aircraft carrier USS George Washington (CVN 73) to the Military Sealift Command ammunition ship USNS Mount Baker (T-AE 34). Safety will continue to be a Secretary of the Navy priority.

The artist's illustration depicts the amphibious transport dock ship USS New York (LPD 21), which is under construction and expected to be delivered in 2008. USS New York is one of three future LPD-class ships that will pay tribute to the heroes and victims of the September 11, 2001 attack. USS Arlington (LPD 24) will honor the heroes and victims of the Pentagon attack and USS Somerset (LPD 25) will pay tribute to the flight downed in Pennsylvania.

Ceremony participants stand in prayer during the ground-breaking ceremony for the Pentagon Memorial, which is expected to be completed by Fiscal Year 2008. The Pentagon Memorial will be a lasting tribute to the heroes and victims of the September 11, 2001 Pentagon attack.

Department of the Navy

General Fund
Principal Statements

2006

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 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, 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 FY 2006 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, 2006, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2005.

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 Budgetary Resources
- Combined Statement of Financing

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, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 95,941,461	$ 85,734,659
Non-entity Seized Iraqi Cash	0	0
Non-entity - Other	474,507	344,546
Investments (Note 4)	9,751	9,519
Accounts Receivable (Note 5)	159,270	281,305
Other Assets (Note 6)	468,259	672,257
Total Intragovernmental Assets	$ 97,053,248	$ 87,042,286
Cash and Other Monetary Assets (Note 7)	176,306	305,440
Accounts Receivable (Note 5)	3,231,414	3,267,657
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	58,794,634	55,584,837
General Property, Plant and Equipment (Note 10)	186,979,669	181,547,138
Investments (Note 4)	0	0
Other Assets (Note 6)	8,608,875	6,988,791
TOTAL ASSETS	$ 354,844,146	$ 334,736,149
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,035,043	$ 1,208,703
Debt (Note 13)	0	0
Other Liabilities (Note 15 & Note 16)	4,460,153	3,826,048
Total Intragovernmental Liabilities	$ 5,495,196	$ 5,034,751
Accounts Payable (Note 12)	1,265,536	1,180,034
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,513,644	1,532,819
Environmental and Disposal Liabilities (Note 14)	17,268,813	17,050,451
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	5,749,764	4,459,836
TOTAL LIABILITIES	$ 31,292,953	$ 29,257,891
NET POSITION		
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 1,550	$ 0
Unexpended Appropriations - Other Funds	99,697,752	89,739,876
Cumulative Results of Operations - Earmarked Funds	18,843	0
Cumulative Results of Operations - Other Funds	223,833,048	215,738,382
TOTAL NET POSITION	$ 323,551,193	$ 305,478,258
TOTAL LIABILITIES AND NET POSITION	$ 354,844,146	$ 334,736,149

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, 2006 and 2005

($ in thousands)

	2006 Consolidated	2005 Consolidated
Program Costs		
Gross Costs	$ 129,530,253	$ 123,610,807
(Less: Earned Revenue)	(3,912,287)	(8,181,148)
Net Costs	$ 125,617,966	$ 115,429,659
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 125,617,966	$ 115,429,659

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, 2006 and 2005
($ in thousands)

	Earmarked Funds	Other Funds
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 23,558	$ 192,496,533
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	23,218,292
Beginning balances, as adjusted	$ 23,558	$ 215,714,825
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	861	132,896,065
Nonexchange revenue	564	0
Donations and forfeitures of cash and cash equivalents	18,858	0
Transfers in/out without reimbursement (+/-)	0	50,000
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	187,068
Imputed financing from costs absorbed by others	0	578,058
Other (+/-)	0	0
Total Financing Sources	$ 20,283	$ 133,711,191
Net Cost of Operations (+/-)	24,998	125,592,968
Net Change	(4,715)	8,118,223
Ending Balances	$ 18,843	$ 223,833,048
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 2,311	$ 89,737,565
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 2,311	$ 89,737,565
Budgetary Financing Sources:		
Appropriations received	$ 100	$ 145,492,145
Appropriations transferred-in/out (+/-)	0	617,410
Other adjustments (rescissions, etc) (+/-)	0	(3,253,303)
Appropriations used	(861)	(132,896,065)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ (761)	$ 9,960,187
Net Cost of Operations (+/-)	0	0
Net Change	(761)	9,960,187
Ending Balances	$ 1,550	$ 99,697,752

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Restated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 192,520,091	$ 188,170,325
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	23,218,292	23,218,291
Beginning balances, as adjusted	$ 215,738,383	$ 211,388,616
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	132,896,926	119,015,668
Nonexchange revenue	564	205
Donations and forfeitures of cash and cash equivalents	18,858	29,518
Transfers in/out without reimbursement (+/-)	50,000	150,000
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	187,068	(1,652)
Imputed financing from costs absorbed by others	578,058	585,686
Other (+/-)	0	0
Total Financing Sources	$ 133,731,474	$ 119,779,425
Net Cost of Operations (+/-)	125,617,966	115,429,659
Net Change	8,113,508	4,349,766
Ending Balances	$ 223,851,891	$ 215,738,382
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 89,739,876	$ 79,161,774
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 89,739,876	$ 79,161,774
Budgetary Financing Sources:		
Appropriations received	$ 145,492,245	$ 130,972,538
Appropriations transferred-in/out (+/-)	617,410	164,674
Other adjustments (rescissions, etc) (+/-)	(3,253,303)	(1,543,442)
Appropriations used	(132,896,926)	(119,015,668)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ 9,959,426	$ 10,578,102
Net Cost of Operations (+/-)	0	0
Net Change	9,959,426	10,578,102
Ending Balances	$ 99,699,302	$ 89,739,876

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 17,128,479	$ 18,027,995
Recoveries of prior year unpaid obligations	5,261,990	11,446,435
Budget Authority:		
Appropriations received	145,511,602	131,002,361
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections:		
Earned		
Collected	7,767,620	8,830,639
Change in receivables from Federal sources	(948,730)	696,667
Change in unfilled customer orders	0	0
Advances received	54,329	147,708
Without advance from Federal sources	519,073	(636,393)
Anticipated for rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	$ 152,903,894	$ 140,040,982
Nonexpenditure transfers, net, anticipated and actual	667,410	314,674
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(3,253,303)	(1,543,442)
Total Budgetary Resources	$ 172,708,470	$ 168,286,644
Status of Budgetary Resources:		
Obligations incurred:		
Direct	$ 146,006,781	$ 137,694,376
Reimbursable	5,865,715	13,463,789
Subtotal	$ 151,872,496	$ 151,158,165
Unobligated balance:		
Apportioned	$ 19,197,595	$ 15,607,505
Exempt from apportionment	0	0
Subtotal	19,197,595	15,607,505
Unobligated balances not available	1,638,379	1,520,974
Total status of budgetary resources	$ 172,708,470	$ 168,286,644

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, 2006 and 2005
($ in thousands)

		2006 Combined		2005 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS				
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$	72,093,186	$	67,196,765
Less: Uncollected customer payments from Federal sources, brought forward, October 1		(3,400,814)		(3,340,541)
Total unpaid obligated balance		68,692,372		63,856,224
Obligations incurred, net (+/-)	$	151,872,496	$	151,158,165
Less: Gross outlays		(140,615,673)		(134,815,308)
Obligated balance transferred, net				
Actual transfers, unpaid obligations (+/-)		0		0
Actual transfers, uncollected customer payments from Federal sources (+/-)		0		0
Total Unpaid obligated balance transferred, net		0		0
Less: Recoveries of prior year unpaid obligations, actual		(5,261,990)		(11,446,435)
Change in uncollected customer payments from Federal sources (+/-)		429,657		(60,273)
Obligated balance, net, end of period				
Unpaid obligations		78,088,020		72,093,186
Less: Uncollected customer payments from Federal sources		(2,971,157)		(3,400,814)
Total Unpaid obligated balance, net, end of period		75,116,863		68,692,372
Net Outlays:				
Net Outlays:				
Gross Outlays		140,615,673		134,815,308
Less: Offsetting collections		(7,821,950)		(8,978,348)
Less: Distributed Offsetting receipts		(149,284)		(115,805)
Net Outlays	$	132,644,439	$	125,721,155

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 151,872,496	$ 151,158,165
Less: Spending authority from offsetting collections and recoveries (-)	(12,654,282)	(20,485,056)
Obligations net of offsetting collections and recoveries	139,218,214	130,673,109
Less: Offsetting receipts (-)	(149,284)	(115,805)
Net obligations	139,068,930	130,557,304
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	187,068	(1,652)
Imputed financing from costs absorbed by others	578,058	585,686
Other (+/-)	0	0
Net other resources used to finance activities	765,126	584,034
Total resources used to finance activities	$ 139,834,056	$ 131,141,338
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits benefits ordered but not yet provided		
Undelivered orders (-)	$ (6,657,708)	$ (13,332,332)
Unfilled Customer Orders	573,402	(488,685)
Resources that fund expenses recognized in prior periods	(101,501)	(269,715)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	149,284	0
Resources that finance the acquisition of assets	(28,364,037)	(14,697,475)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund Receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	(187,068)	1,652
Total resources used to finance items not part of the Net Cost of Operations	$ (34,587,628)	$ (28,786,555)
Total resources used to finance the Net Cost of Operations	$ 105,246,428	$ 102,354,783

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy General Fund

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	$ 43,363	$ 170,047
Increase in environmental and disposal liability	230,378	1,028,763
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	208,377	69,091
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 482,118	$ 1,267,901
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 21,243,453	$ 15,844,303
Revaluation of assets or liabilities (+/-)	1,865,416	(1,785,299)
Other (+/-)		
Trust Fund Exchange Revenue	0	(10)
Cost of Goods Sold	0	0
Operating Materials & Supplies Used	(3,209,774)	(2,244,170)
Other	(9,675)	(7,849)
Total components of Net Cost of Operations that will not require or generate resources	$ 19,889,420	$ 11,806,975
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 20,371,538	$ 13,074,876
Net Cost of Operations	$ 125,617,966	$ 115,429,659

The accompanying notes are an integral part of these statements.

Department of the Navy

General Fund
Notes to the Principal Statements

2006

2006 Annual Financial Report

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON) General Fund (GF), as required by the "Chief Financial Officers (CFO) Act of 1990," expanded by the "Government Management Reform Act (GMRA) of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of DON in accordance with the "Department of Defense Financial Management Regulation" Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible, Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which DON GF is responsible. Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernable.

The DON is unable to fully implement all elements of GAAP and OMB Circular A-136 due to limitations of its financial management processes and systems, and nonfinancial systems and processes that feed into the financial statements. The DON derives its reported values and information for major asset and liability categories, largely from nonfinancial systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with GAAP. The DON continues to implement process and system improvements addressing these limitations. The DON currently has four auditor identified financial statement material weaknesses: (1) accuracy and complete reporting of accounts payable, (2) identifying and reporting environmental disposal liabilities, (3) military equipment reporting, and (4) valuation of inventory and operating materials and supplies.

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

1.B. Mission of the Reporting Entity

The Department of the Navy (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 funds), trust, special, and deposit funds. The DON uses these appropriations and funds to execute its mission and report on resource usage.

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

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

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

Special fund accounts are used to 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 is acting as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

Certain special and trust funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish it from general revenues.

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

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

Entity Accounts:

General Accounts

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1000	Medicare Eligible Retiree Health Care Fund, Military Personnel Navy
17 1001	Medicare Eligible Retiree Health Care Fund, Military Personnel Marine Corps
17 1002	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Navy
17 1003	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Marine Corps
17 1105	Military Personnel, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps
17 1109	Procurement, Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1235	Military Construction, Navy Reserve
17 1236	Payments to Kaho'Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17 1319	Research, Development, Test and Evaluation, Navy
17 1405	Reserve Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17 1611	Shipbuilding and Conversion, Navy
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement, Navy

Revolving Funds

17 4557	National Defense Sealift Fund, Navy

Earmarked Trust Funds

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

Earmarked Special Funds

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

General Fund Receipt, Deposit, Suspense, and Clearing Accounts

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

Parent-Child (Allocation) Transfer Accounts

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

1.D. Basis of Accounting

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

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

In addition, DON identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act (GPRA). The DoD is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standard (SFFAS) No. 4, "Managerial Cost Accounting Concepts and

Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

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

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

1.F. Recognition of Expenses

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

1.G. Accounting for Intragovernmental Activities

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

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental Transaction Accounting Policy Guide" provide guidance for reporting and reconciling intragovernmental balances. While DON is unable to fully reconcile all intragovernmental transactions with all federal partners, DON is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The 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 Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

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

1.J. Foreign Currency

Cash is the total of cash resources under the control of DON, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts. Cash and foreign currency is classified as nonentity and, therefore, is restricted. Amounts reported consist primarily of cash and foreign currency held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

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

1.K. Accounts Receivable

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

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

Most of DON's Inventory and Related Property are currently reported at an approximation of historical cost using latest acquisition cost (LAC) adjusted for holding gains and losses. The DON General Fund's Inventory and Related Property consists of Operating Materials and Supplies (OM&S). The DON uses LAC and other methods as its inventory systems were designed for material management rather than accounting purposes. 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 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 beginning to transition the inventory to the moving average cost method. At this point, DON is unable to determine the value of OM&S that is being reported using moving average cost methodology. However, since the on-hand balances which transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS No. 3 and GAAP.

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

Related property includes operating materials and supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD 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, DON uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2006, DON expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. DON does not hold stockpile materials.

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

The DON recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore the net value of condemned material is zero. Potentially redistributed material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

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

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

The DON invests in nonmarketable securities. The two types of nonmarketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues nonmarketable par value intragovernmental securities. Nonmarketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

1.O. General Property, Plant and Equipment

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

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

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

Prior to fiscal year 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below $100,000 were written off DON General Fund financial statements in fiscal year 1998.

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

The DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, DON reports only government property in the possession of contractors that is maintained in DON's property systems. The DoD has issued new property accountability and reporting requirements that requires DON to maintain, in its property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with Federal accounting standards.

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The Standard provides for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost information is not practical. The DON used Bureau of Economic Analysis (BEA) to calculate the value of the military equipment for reporting periods from October 1, 2002 through March 31, 2006.

Effective with 3rd Quarter, FY 2006, the DON replaced the BEA estimation methodology with an estimation methodology for military equipment based on DON internal records. The DON initially 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 create a baseline. The military equipment baseline is updated using expenditure information, and information related to acquisition and disposals.

1.P. Advances and Prepayments

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

1.Q. Leases

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

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

1.R. Other Assets

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

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

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. 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 Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property are reported as Construction in Progress in Note 10.

1.S. Contingencies and Other Liabilities

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

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

Other liabilities arise as a result of anticipated disposal costs for DON's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of the asset based upon DoD's policy, which is consistent with SFFAS No.5 "Accounting for Liabilities of Federal Government." The DON recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed in service. Such amounts are developed in conjunction with, and not easily identifiable separately from, environmental disposal costs.

1.T. Accrued Leave

The DON reports as liabilities 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 without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DON has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The DON purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow DON continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any nonretrievable capital assets. This takes place after negotiations between U.S. and the host country have determined the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2006. Financial statement fluctuations greater than two percent of total assets on the Balance Sheet or greater than ten percent from the prior period presented are explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

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

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

1.Z. Data Collection Approach

The DON financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance Accounting Service, Cleveland (DFAS-CL) and Kansas City (DFAS-KC) collect the financial system information and incorporate it into the financial statements. The DON collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL and DFAS-KC for incorporation into the financial statements. DFAS also collects information from multiple sources, such as intragovernmental data from DON's trading partners, which is incorporated into the financial statements. For FY 2006, DON is utilizing a web-based data collection instrument (DCI) that captures certain required financial information from feeder systems for the General Fund (GF) statements. This is the seventh year DON has used the DCI to collect information from feeder systems. The DON DCI identifies the information requirements to the source provider, provides an audit trail, and integrates into the financial statement preparation process. The DON is transitioning the data collection process to the Defense Departmental Reporting System (DDRS) Data Collection Module (DCM). When the transition to DCM is complete, the stand-alone DCI legacy application will be terminated.

Note 2. Nonentity Assets

As of September 30		2006		2005 Restated
(Amounts in thousands)				
1. Intragovernmental Assets				
A. Fund Balance with Treasury	$	474,507	$	344,546
B. Accounts Receivable		0		0
C. Total Intragovernmental Assets	$	474,507	$	344,546
2. Nonfederal Assets				
A. Cash and Other Monetary Assets	$	176,306	$	305,440
B. Accounts Receivable		3,142,047		2,538,987
C. Other Assets		0		0
D. Total Nonfederal Assets	$	3,318,353	$	2,844,427
3. Total Nonentity Assets	$	3,792,860	$	3,188,973
4. Total Entity Assets	$	351,051,286	$	331,547,176
5. Total Assets	$	354,844,146	$	334,736,149

Fluctuations and Abnormalities
The DON reported an increase in Total Nonentity Assets (Line 3) of $603.9 million, 19%, in FY 2006 which is primarily attributed to accounts receivable as described below.

Nonfederal Assets.
Nonentity Nonfederal Accounts Receivable (Line 2.B): The DON reported an increase of $603.0 million, 24%. A receivable of $345.6 million that was classified in FY 2005 as "currently not collectible" was not reported as a nonentity receivable. However, DON began reporting this as an active nonentity receivable in the 1st Quarter, FY 2006, due to a change in the litigation status. Furthermore, in 4th Quarter, FY 2005, $210.8 million of out-of-service debt that should have been classified as nonentity was erroneously classified as an entity receivable. This classification error was corrected in 1st Quarter, FY 2006.

Information Related to Nonentity Assets

Definitions
Entity accounts.
Assets that DON has the authority to use, or those that management is legally obligated to use to meet entity obligations.

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

Other Disclosures
Nonentity Assets.
For FY 2006, DON holds $3.8 billion nonentity assets. These assets are not available for use by DON in its day-to-day operations but DON maintains stewardship accountability and reporting responsibility. There are three categories of significant nonentity assets held by DON: (1) the Intragovernmental Fund

Balance with Treasury, (2) the Nonfederal Cash and Other Monetary Assets, and (3) the Nonfederal Accounts Receivable.

Nonentity Nonfederal Accounts Receivable (Public).
For FY 2006, the DON holds $3.1 billion of nonentity nonfederal accounts receivable. The primary component is a principal amount of $1.3 billion, representing advance payments made to contractors and $1.3 billion in 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 go to the Department of the Treasury and not be available for DON's use in normal operations. See Note 5 for additional information.

Intragovernmental Fund Balance with Treasury.
This asset category, in the amount of $474.5 million represents amounts in DON's deposit and receipt fund accounts that are not available for DON's use in normal operations. The increase of $130.0 million, 38% from FY 2005 is primarily due to increased participation by deployed Sailors and Marines, in the savings plans that were established by Congress for their benefit while serving overseas.

Cash and Other Monetary Assets.
This asset category, in the amount of $176.3 million, represents disbursing officers' cash and undeposited collections as reported on the Statement of Accountability. These assets are held by DON disbursing officers as agents of the Treasury and are not available for DON's use in normal operations. See Note 7 for additional information.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 93,541,772	$ 83,215,340
B. Revolving Funds	2,387,470	2,501,771
C. Trust Funds	9,917	14,564
D. Special Funds	2,302	2,984
E. Other Fund Types	474,507	344,546
F. Total Fund Balances	$ 96,415,968	$ 86,079,205
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 97,613,850	$ 86,922,093
B. Fund Balance per DON	96,415,968	86,079,205
3. Reconciling Amount	$ 1,197,882	$ 842,888

Explanation of Reconciliation Amount:

Parent/ Child Allocation Accounts	$34,380
Invalid Program Years	120,524
Canceling Years	1,042,978
Total Reconciling Amount	$1,197,882

Fund Balance Per Treasury Calculation:

Undisbursed Appropriation Account Trial Balance (FMS 6654)	$97,521,347
Receipt Account Trial Balance (FMS 6655)	111,860
Less: 6655 Trust Funds Balances included in 6654	(19,153)
Less: 6655 Special Funds Balances included in 6654	(204)
Fund Balance Per Treasury	$97,613,850

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

The total reconciling amount of $1.2 billion is primarily due to $1.0 billion in FBWT for appropriations that were canceled on September 30, 2006 and thus not reported on DON's balance sheet. However, the FBWT for these canceled appropriations was reported by Treasury at September 30, 2006. Invalid program year numbers, primarily an extended availability Shipbuilding and Conversion, Navy appropriation, represent duplicative reporting at Treasury accounting for $120.5 million of the reconciling difference. The DON is working with Treasury to resolve the issue. Finally, $34.4 million of Parent/child Allocation accounts, primarily Treasury symbol 1081, International Military Education and Training with a balance of $34.0 million, comprised the remaining reconciling item. The DON, as the "child", is the recipient of allocation transfers from other Federal agencies and has determined that the allocations are not material to the DON financial statements. The providing agency, as the "parent", is responsible for reporting the FBWT for these allocations.

Fluctuations and Abnormalities

The overall increase in FBWT of $10.3 billion, 12% is directly related to the $14.5 billion, 11% increase in Appropriations Received that have not been fully executed. This increase in FBWT is primarily attributable to an increase in multi-year appropriations of $8.1 billion ($6.2 billion in Procurement and $1.5 billion in RDT&E). The increase in the procurement appropriations is to address the requirement for the acquisition, modernization, and recapitalization of the Fleet. The increase in RDT&E is to meet the requirements for process innovation, transitioning science and technology to the acquisition community and the warfighter, and general research and development use.

Status of Fund Balance with Treasury

As of September 30		2006		2005
(Amounts in thousands)				
1. Unobligated Balance				
A. Available	$	19,197,595	$	15,607,505
B. Unavailable		1,638,379		1,520,974
2. Obligated Balance not yet Disbursed	$	78,088,020	$	72,093,187
3. Nonbudgetary FBWT	$	472,698	$	267,741
4. NonFBWT Budgetary Accounts	$	(2,980,724)	$	(3,410,202)
5. Total	$	96,415,968	$	86,079,205

Other Information Related to Status of Fund Balance with Treasury

Fluctuations and Abnormalities

Total Status of FBWT increased $10.3 billion, 12% in FY 2006. The increase is a result of the Unobligated, Available Line 1.A, which represents budget authority that is currently available for new obligations, increasing $3.6 billion, 23% and Obligated Balance not yet Disbursed, representing expected future expenditures, increasing $5.9 billion, 8% in FY 2006. This increase is primarily attributable to an increase in multi-year appropriations of $8.1 billion ($6.2 billion in Procurement and $1.5 billion in RDT&E) and the residual balances associated with the multi-year appropriation that have not been fully executed.

Definitions

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

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

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

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

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

Other Disclosures

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

Although funds have been appropriated, single year appropriations such as Operation and Maintenance and Military Pay accounts, are not available for obligation because the period for obligation established by law 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.

Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
(Amounts in thousands)				
Account				
F3845 – Personal Property Proceeds	$ 0	$ 0	$ 0	$ 0
F3875 – Disbursing Officer Suspense	(253,211)	(27,725)	72	27,797
F3880 – Lost or Cancelled Treasury Checks	2,453	3,946	3,378	(568)
F3882 – Uniformed Services Thrift Savings Plan Suspense	(37,698)	32,891	46,500	13,609
F3885 – Interfund/IPAC Suspense	(133,156)	(53,025)	(5,260)	47,765
F3886 – Thrift Savings Plan Suspense	9	429	(28)	(457)
Total	$ (421,603)	$ (43,484)	$ 44,662	$ 88,146

Fluctuations and Abnormalities
The total amount in Suspense/Budget Clearing Accounts increased $88.1 million, 203%, from the prior period credit balance, in FY 2006. Account F3885 – Interfund/IPAC Suspense increased $47.8 million, 90% from the prior period credit balance, in FY 2006 as a result of a reduction of items in suspense. Account F3875 – Disbursing Officer Suspense increased $27.8 million, 100% from the prior period credit balance as a result of efforts to clear aged suspended transactions throughout FY 2006. These efforts are part of the DON Financial Improvement Plan and include an analysis of the types of inflows into the suspense accounts. Additionally, DON is establishing policies and procedures to ensure accurate and consistent use of these accounts.

Disclosures Related to Suspense/Budget Clearing Accounts
The F3875 suspense clearing account reported a positive balance of $72.0 thousand that represents the Disbursing Officer's (DO) suspense. Account F3885, which includes the Interfund/IPAC suspense, reported a negative balance of $5.3 million. The F3882 suspense clearing account reported a positive balance of $46.5 million that represents the Uniformed Services Thrift Savings Plan established in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these amounts in the military accounting systems in the following month.

Account F3886, representing the civilian Thrift Savings Plan suspense, has a credit balance of $28 thousand. The F3880 suspense account reported a positive balance of $3.4 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30		2004		2005		2006		(Decrease)/ Increase from FY 2005 to 2006
(Amounts in thousands)								
1. Total Problem Disbursements, Absolute Value								
A. Unmatched Disbursements (UMDs)	$	183,570	$	1,313,996	$	984,547	$	(329,449)
B. Negative Unliquidated Obligations (NULO)		32,110		17,086		15,396		(1,690)
2. Total In-transit Disbursements, Net	$	(23,714)	$	857,860	$	384,940	$	(472,920)

Fluctuations and Abnormalities
Since FY 2005 Unmatched Disbursements (UMDs) have decreased by $329.4 million or 25%. Negative Unliquidated Obligations (NULOs) have decreased $1.7 million, 10% since FY 2005. The DON and DFAS have partnered to reduce UMD and NULO balances and the significant reductions are reflective of those efforts. In 2nd Quarter, FY 2005, DFAS-Cleveland expanded the scope of the definition of an UMD. Formerly, transactions that had not yet reached an accounting station were defined as undistributed. Now these transactions are being defined as an UMD. This change in practice was the primary driver behind the increase from FY 2004 to FY 2005.

In-Transit Disbursements, Net decreased $472.9 million, 55%, since FY 2005. This decrease reflects a concerted effort by DON and DFAS to identify systemic errors and implement corrective actions through synchronization of edit tables to validate data between systems.

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

Definitions
An Unmatched Disbursement (UMD) occurs when a payment is not matched to a corresponding obligation in the accounting system.

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

A Negative Unliquidated Obligation (NULO) occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

In-Transit Disbursements, Net represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity which have not been posted in an accounting system. Of the $384.9 million reported for DON General Fund, only $39.8 million, 10%, is over 30 days old.

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

The DON includes Foreign Military Sales in the amount of $105.1 thousand in Problem Disbursement amounts and DON is in balance with the Problem Disbursement metric.

Note 4. Investments and Related Interest

As of September 30	2006				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
(Amounts in thousands)					
1. Intragovernmental Securities					
A. Nonmarketable, Market-Based	$ 9,633		$ (23)	$ 9,610	$ 9,610
B. Accrued Interest	141			141	141
C. Total Intragovernmental Securities	$ 9,774		$ (23)	$ 9,751	$ 9,751
2. Other Investments					
A. Total Investments	$ 0		$ 0	$ 0	N/A

As of September 30	2005				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
(Amounts in thousands)					
1. Intragovernmental Securities					
A.Nonmarketable, Market-Based	$ 9,421		$ (2)	$ 9,419	$ 9,419
B. Accrued Interest	100			100	100
C. Total Intragovernmental Securities	$ 9,521		$ (2)	$ 9,519	$ 9,519
2. Other Investments					
A. Total Investments	$ 0		$ 0	$ 0	N/A

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

Other Disclosures
The two DON Trust Funds holding interest-bearing securities are the Naval Academy General Gift Fund and the Navy General Gift Fund, which have a total Investment net value of $9.8 million (including $141.6 thousand of accrued interest). These investments are Nonmarketable Market-Based U.S. Treasury securities reported at cost, net of amortized premiums and discounts. In accordance with the Statement of Federal Financial Accounting Standards No. 27, "Identifying and Reporting Earmarked Funds," DON Trust Funds are now classified and reported as earmarked funds.

Intragovernmental Investments for Earmarked Funds.
The Federal Government does not set aside assets to pay future benefits or other expenditures associated with DON's earmarked Trust Funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to DON as evidence of its receipts. Treasury securities are an asset to the DON and a liability to the U.S. Treasury. Because DON and the U.S. Treasury are both parts of the United States Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements. U.S. Treasury securities provide the DON with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When DON requires redemption of its Treasury securities held in DON earmarked Trust Funds to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intragovernmental Receivables	$ 159,270	N/A	$ 159,270	$ 281,304
2. Nonfederal Receivables (From the Public)	$ 3,238,178	$ (6,764)	$ 3,231,414	$ 3,267,657
3. Total Accounts Receivable	$ 3,397,448	$ (6,764)	$ 3,390,684	$ 3,548,961

Information Related to Accounts Receivable

Fluctuations and Abnormalities
Intragovernmental Receivables.
The Department of the Navy (DON) General Fund (GF) acts as a seller of goods and services to other Federal agencies (DON GF's Level One trading partners) and other organizations within DoD (DON GF's Level Two trading partners). Receipt of customer orders, the resulting billing of receivables, and

the collection of those receivables from other agencies, do not consistently follow a predictable pattern. This revenue cycle is subject to the business conditions and requirements of DON's trading partners. The value of accounts receivable is also subject to the processes used for billing and collection.

The DON reported a decrease of $122.0 million, 43%, in Intragovernmental Receivables in FY 2006. The primary factors were a decrease of $40.5 million reported with the Department of Homeland Security (DHS) (Level One, business conducted with other Federal agencies), a decrease of $31.5 million reported for the Navy Working Capital Fund (Level Two), and a decrease of $21.4 million reported with Army General Fund (Level Two) as a result of Marine Corps' improved billing and collection process. The decrease with DHS represents the collection of monies for work performed for Hurricane Katrina support. The decrease with NWCF represents the completion of the conversion project, and subsequent final billing and collection for work on the USS Ohio (SSGN-726) in 2nd Quarter FY 2006.

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

Allowance Method
Based upon an extensive analysis of historic public receivables, the allowance for FY 2006 was determined to be $6.8 million.

Intragovernmental Accounts Receivable Adjustments
<u>Allocation of Undistributed Collections</u>.
Undistributed collections are allocated between federal and nonfederal categories based on the percentage of federal and nonfederal Accounts Receivable as submitted in the field level general ledgers. This allocation was suggested as appropriate in a DFAS Arlington memorandum of October 4, 2000, which required disclosure to the audit community of the applicable methodology used to allocate undistributed collections. For FY 2006 $691.8 million in undistributed collections was allocated to accounts receivable.

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

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

Aged Accounts Receivable

As of September 30	2006		2005	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
(Amounts in thousands)				
CATEGORY				
Nondelinquent				
Current	$ 381,172	$ 535,983	$ 687,784	$ 774,603
Noncurrent	30,402	7,549	89,984	6,280
Delinquent				
1 to 30 days	$ 2,188	$ 7,022	$ 7,227	$ 5,270
31 to 60 days	1,101	4,737	2,299	3,406
61 to 90 days	1,150	9,687	16,596	14,467
91 to 180 days	7,409	10,598	3,630	16,348
181 days to 1 year	5,821	26,743	12,342	35,495
Greater than 1 year and less than or equal to 2 years	2,085	44,235	32,343	58,627
Greater than 2 years and less than or equal to 6 years	31,745	58,556	82,359	21,782
Greater than 6 years and less than or equal to 10 years	259	362,476	248	14,861
Greater than 10 years	0	2,605,292	0	2,526,709
Subtotal	$ 463,332	$ 3,672,878	$ 934,812	$ 3,477,848
Less Supported Undistributed Collections	(257,152)	(434,700)	(274,637)	(204,360)
Less Eliminations	(46,910)	0	(226,962)	0
Less Other	0	0	(151,909)	5,479
Total	$ 159,270	$ 3,238,178	$ 281,304	$ 3,278,967

Nondelinquent Accounts Receivables are receivables outstanding for 30 days or less or those not yet due under the contract or billing document pertaining to the receivable. Current nondelinquent accounts receivable are those that are due in the next twelve months. Noncurrent nondelinquent accounts receivable include out-of-service debt that are due beyond the next 12 months, and are valued at $37.9 million for FY 2006. These accounts are not considered delinquent since the associated repayment schedules allow for repayment after a 30-day period. The DON is actively pursuing collection action on all accounts receivable, both public and intragovernmental, in accordance with guidance in the DoD Financial Management Regulation, Volume 4, Chapter 3 and OMB Circular A-129 "Policies for Federal Credit Programs and Non-Tax Receivables".

For public debt, these collection actions include referring delinquent vendor debt to the Debt Management Office (DMO) for servicing no later than 60 days after the payment due date, and coordinating with the DMO to further refer such debt over 180 days delinquent to the Treasury for further collection action. A current example of collection actions related to public debt is a partnership between

DON and DFAS to identify habitually delinquent public entities and develop standard processes with a goal of improving the joint business relationship. For delinquent intragovernmental debt, collection actions include detailed research of subsidiary accounting transactions with DFAS, the compilation and review of dispute packages, and consultation and negotiation with debtor agencies to resolve outstanding receivables. A current example is the extensive collaboration between DON and the Federal Emergency Management Agency to resolve delinquent receivables related to Hurricane Katrina support.

It must be recognized that, in certain instances, the status of litigation impacts the ability of the DON to actively pursue collection action on public debt.

As displayed in the previous table, the amounts reported for FY 2005 are not directly comparable to those reported for FY 2006. The methodology used to calculate delinquent receivables has changed: in FY 2005, when a receivable reached the age of 31 days, it was considered 31 days delinquent. In FY 2006 a receivable, which by terms of the repayment schedule is due in 30 days, is considered 1 day delinquent upon reaching the age of 31 days. The amounts reported in the FY 2005 "Less Other" category were required to balance the aging schedule to the financial statements. In FY 2005, there was not a requirement for an aging schedule to be published in the financial statements.

Note 6. Other Assets

As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 468,259	$ 672,257
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	$ 468,259	$ 672,257
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 8,154,326	$ 6,859,367
B. Other Assets (With the Public)	454,549	129,424
C. Total Nonfederal Other Assets	$ 8,608,875	$ 6,988,791
3. Total Other Assets	$ 9,077,134	$ 7,661,048

Fluctuations and Abnormalities

Intragovernmental Other Assets.

The DON reported a decrease of $204.0 million, 30%, in Advances and Prepayments, (Line 1.A), in FY 2006. The majority of the decrease was due to a $169.6 million decrease with the Navy Working Capital Fund (NWCF) (Trading Partner Level Two). To alleviate a cash shortage in FY 2005, NWCF Shipyards were granted authority to advance bill and DON advanced NWCF $180.9 million in FY 2005. As the NWCF cash shortage was addressed, in FY 2006 the level of advances provided by DON to NWCF has declined to $11.3 million.

Nonfederal Other Assets.

The DON reported an increase of $1.6 billion, 23%, in total nonfederal other assets in FY 2006. In 4th

Quarter FY 2006, in accordance with a DoD policy decision based on a DoD Inspector General audit finding, DON began recording an estimated asset (and corresponding contingent liability) for the value of in-process work that is expected to result in the delivery of finished goods. This estimated asset is $1.2 billion. The remaining increase is attributable to the recognition of $156.2 million in advances. The DON began recognizing these advances in 2nd Quarter, FY 2006, as a result of improved processes derived from the Financial Improvement Program.

Information Related to Other Assets

Intragovernmental Other Assets - Advances and Prepayment.

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

Nonfederal Other Assets - Outstanding Contract Financing Payments.

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

The Contract Financing Payment balance of $8.2 billion is comprised of $7.0 billion in contract financing payments and an additional $1.1 billion in estimated future funded payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

Nonfederal Other Assets, Other Assets (With the Public).

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

Note 7. Cash and Other Monetary Assets

As of September 30	2006	2005
(Amounts in thousands)		
1. Cash	$ 173,389	$ 201,999
2. Foreign Currency	2,917	103,441
3. Total Cash, Foreign Currency, & Other Monetary Assets	$ 176,306	$ 305,440

Fluctuations and Abnormalities
Total Cash, Foreign Currency and Other Monetary Assets (Line 3) decreased $129.1 million, 42%. This is reflective of a decrease of $100.5 million, 97%, in Foreign Currency. When the Marine Corps Expeditionary Forces, Camp Lejeune returned from an overseas deployment in 2nd Quarter, FY 2006, their Disbursing Officer dissolved the Limited Depositary Account that had been held in the National Bank of Kuwait. This Limited Depositary Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds.

Definitions
Cash - the total of cash resources under the control of DON, which includes coin, paper currency, purchased foreign currency, negotiable instruments, and amounts on deposit in banks and other financial institutions.

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

Restriction on Cash, Foreign Currency and Other Monetary Assets – total cash, foreign currency and other monetary assets reported are classified as nonentity, which means that the assets are not available for DON's use in normal operations. Therefore, total cash, foreign currency and other monetary assets, totaling $176.3 million is restricted.

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

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

Note 8. Direct Loan and/or Loan Guarantee Programs

Not Applicable.

Note 9. Inventory and Related Property

As of September 30	2006	2005
(Amounts in thousands)		
1. Inventory, Net	$ 0	$ 0
2. Operating Materials & Supplies, Net	58,794,634	55,584,837
3. Stockpile Materials, Net	0	0
4. Total	$ 58,794,634	$ 55,584,837

Inventory, Net

Not Applicable.

Operating Materials and Supplies, Net

As of September 30	2006			2005	
	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	$ 53,664,746	$ 0	$ 53,664,746	$ 51,202,582	SP, LAC
B. Held for Repair	6,487,827	(1,357,939)	5,129,888	4,382,255	SP, LAC
C. Excess, Obsolete, and Unserviceable	582,918	(582,918)	0	0	NRV
D. Total	$ 60,735,491	$ (1,940,857)	$ 58,794,634	$ 55,584,837	

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

2. Restrictions on Operating Materials and Supplies (OM&S):
There are no known restrictions on the use of OM&S.

3. Other Information Related to Operating Materials and Supplies

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

Information Related to Operating Material and Supplies, Net

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

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

As of September 30, 2006	
(Amounts in thousands)	
Ammunition and Munitions	$ 34,813,578
Appropriation Purchase Account (APA)	
Principal End and Secondary Items	9,474,209
Sponsor Owned Material	11,882,388
Real-time Reutilization Asset	
Management (RRAM)	2,240,183
Other	384,276
Total	$ 58,794,634

Balances.

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

Decision Criteria For Identifying The Category To Which Operating Materials And Supplies Are Assigned.

In order to standardize the reporting categories of Held for Use; Held for Repair; and Excess, Obsolete and Unserviceable, DON implemented the Office of Under Secretary of Defense (Comptroller) (OUSD(C)) condition code crosswalk as defined in the memorandum "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies" dated August 12, 2002. In addition, the condition code crosswalk was amended to include code "V" in the Excess, Obsolete, Unserviceable category in September 2002. OM&S is reported as follows:

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

Condition Codes are used for material management purposes and are defined in the Naval Supply Systems Command (NAVSUP) Publication 409.

Valuation Method for OM&S.

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

Other Disclosures

Ammunition and Munitions.

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

APA Principal End and Secondary Items.

Principal and Secondary Items include OM&S items 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: (a) essential for combat or training; (b) high dollar value; (c) difficult to procure or produce; or (d) critical basic materials or components.

Sponsor Owned Material (SOM).

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

Real-time Reutilization Asset Management (RRAM).

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

Other Operating Materials & Supplies.

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

Stockpile Materials, Net

Not Applicable.

Note 10. General PP&E, Net

As of September 30	2006							2005 Restated
	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	$	611,761		N/A	$ 611,761	$ 616,579
B. Buildings, Structures, and Facilities	S/L	20 Or 40		33,951,515	$	(20,889,320)	13,062,195	14,102,743
C. Leasehold Improvements	S/L	lease term		7,643		(749)	6,894	7,129
D. Software	S/L	2-5 Or 10		3,818		(3,712)	106	205
E. General Equipment	S/L	5 or 10		2,824,043		(2,265,692)	558,351	495,262
F. Military Equipment	S/L	Various		299,030,122		(128,686,613)	170,343,509	163,498,292
G. Assets Under Capital Lease	S/L	lease term		115		(11)	104	0
H. Construction-in-Progress	N/A	N/A		2,396,749		N/A	2,396,749	2,826,928
I. Other				0		0	0	0
J. Total General PP&E			$	338,825,766	$	(151,846,097)	$ 186,979,669	$ 181,547,138

[1]Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

S/L = Straight Line

N/A = Not Applicable

Fluctuations and Abnormalities

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

Other Information Related to General PP&E, Net

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

<u>Military Equipment.</u>

The Department changed its method of valuing military equipment in 3rd Quarter, FY 2006. Previously, military equipment was valued using Bureau of Economic Analysis (BEA) data. Beginning with the 3rd Quarter, FY 2006, military equipment is valued based on internal records. The value of military equipment for the 4th Quarter, FY 2005 was restated from $140.3 billion to $163.5 billion for comparative purposes using the new valuation method.

For 4th Quarter, FY 2006, military equipment is valued at $170.3 billion based on internal records. Under the previously used BEA valuation methodology, this equipment would have been valued at $143.7 billion.

<u>Property in the Possession of Contractors.</u>

The value of DON's General PP&E real property in the possession of contractors is included in the values reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E above DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. Per an approved strategy with Office of Management Budget (OMB), Government Accountability Office (GAO) and DoD Inspector General, DoD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with Federal General Accepted Accounting Principles (GAAP). The DON does not have any General PP&E, for which the acquisition cost is unknown, therefore no valuation method to disclose.

Heritage Assets and Stewardship Land.

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

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

- Heritage Assets are items that are unique for one of more of the following reasons: (1) historical or natural significance; (2) cultural, educational or artistic importance; or (3) significant architectural characteristics. The process used to define items as having heritage significance varies between categories and type of assets being evaluated. Subject matter experts, including historians and curators, play a significant role in the definition process. In all cases, a myriad of federal statutes, regulations, and other guidelines mandate heritage significance or provide guidance in its determination.
- Preservation considerations are incorporated into routine DON management of historic buildings, structures, districts, sites, ships, aircraft and other cultural resources. Compliance with cultural resources protection requirements is incorporated as appropriate into other DON planning processes, including but not limited to master planning, environmental planning, budgeting/programming, and facilities management. When functionally appropriate and economically prudent, DON gives preference to the rehabilitation or adaptive use of historic properties over new construction or leasing.
- The appropriate consultation is initiated with State Historic Preservation Officers, Tribal Historic Preservation Officers, Advisory Council on Historic Preservation, Native Americans, Native Hawaiians, and other interested agencies and publics whenever DON conducts or supports undertakings that may affect any National Register resource.
- DON designated staff maintain an awareness of specific legal obligations regarding its management of cultural resources such as establishing a program to locate and inventory all cultural resources under DON control and to evaluate them against National Register eligibility criteria for possible nomination to the National Register.
- Cultural resources management, including consultation, takes place at the lowest appropriate level in the chain of command.
- Archeological sites under the control of DON are excavated only to the extent required for evaluation and identification, unless scientific or programmatic considerations, or concerns about the integrity or security of a site, make more extensive excavation necessary or advisable.

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

Relationship of Stewardship Land to Department of the Navy's (DON's) Mission.
The overall mission of DON is to control and maintain freedom of the seas; project power beyond the sea; and influence events and advance U.S. interests across the full spectrum of military operations. As this mission has been executed DON has accumulated several hundred installations throughout the United States. These installations provide the capability to organize, train, and equip DON to perform its mission.

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. The DON works to develop and improve partnerships with the communities in which its installations are located, the federal regulatory agencies such as U.S. Environmental Protection Agency, state regulatory agencies, and within the military services by sharing lessons learned and transfer of technologies.

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

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

Leasehold Improvements.
The DON's real property system iNFADS does not track leasehold improvements as a separate component of a building's total value. However, DON collects this information through a data call and began recognizing the leasehold improvement values beginning in FY 2004.

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

Construction-in-Progress (CIP).
The CIP balances were obtained from the Facilities Information System (FIS). The value of construction that is performed for the benefit of external customers, such as Air Force and several of the Defense Agencies, is provided to Air Force, the Defense Agencies, and the Defense Finance and Accounting Service. The value of construction for external customers is not included in DON CIP balances.

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

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

In accordance with an Office of the Under Secretary of Defense (Comptroller) memorandum of July 5, 2005, the military departments and DoD activities meeting the criteria of preponderant user are responsible for reconciliation of preponderant use property. A milestone of the DON Financial Improvement Plan (FIP) is to reconcile with DoD activities and to ensure that the DON real property database recognizes the preponderant user. As these efforts are completed and reconciliations are documented, DON General Fund will make the adjustments to the General Property, Plant and Equipment line.

Assets Under Capital Lease

As of September 30	2006	2005
(Amounts in thousands)		
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	$ 0	$ 0
B. Equipment	115	0
C. Accumulated Amortization	(11)	0
D. Total Capital Leases	$ 104	$ 0

2. Description of Lease Arrangements
Leased assets consist primarily of personal property reported in the DPAS system.

3. Other Information Related to Assets under Capital Lease
The DON reported a net increase of $104 thousand, 100%, in Assets under Capital Lease in FY 2006. No capital leases existed in FY 2005, but one new lease was reported beginning 1st Quarter FY 2006.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006		2005	
(Amounts in thousands)				
1. Intragovernmental Liabilities				
A. Accounts Payable	$	0	$	0
B. Debt		0		0
C. Other		3,770,838		3,162,677
D. Total Intragovernmental Liabilities	$	3,770,838	$	3,162,677
2. Nonfederal Liabilities				
A. Accounts Payable	$	37,299	$	28,049
B. Military Retirement and Other Federal Employment Benefits		1,513,644		1,532,819
C. Environmental Liabilities		16,773,218		16,513,000
D. Other Liabilities		3,735,957		3,550,457
E. Total Nonfederal Liabilities	$	22,060,118	$	21,624,325
3. Total Liabilities Not Covered by Budgetary Resources	$	25,830,956	$	24,787,002
4. Total Liabilities Covered by Budgetary Resources	$	5,461,997	$	4,470,889
5. Total Liabilities	$	31,292,953	$	29,257,891

Fluctuations and Abnormalities

Intragovernmental Liabilities.

Total intragovernmental liabilities increased $608.2 million, 19%, in FY 2006. A receivable of $345.6 million that was classified in FY 2005 as "currently not collectible" was not reported as a nonentity receivable. The DON began reporting this as an active nonentity receivable in the 1st Quarter, FY 2006 due to a change in the litigation status. Furthermore, in 4th Quarter FY 2005, $210.8 million of out-of-service debt that should have been classified as nonentity was erroneously classified as an entity receivable. This classification error was corrected in 1st Quarter, FY 2006. The offsetting entry for these nonentity receivables is a liability to Department of Treasury. The associated accounts receivable balances are remitted to Treasury upon collection, and thus considered a liability to DON.

Nonfederal Liabilities.

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

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

Definitions

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

- Realized budgetary resources include:

  (1) New budget authority

  (2) Spending authority from offsetting collections (credited to an appropriation or fund account)

  (3) Recoveries of unexpired budget authority through downward adjustments of prior year obligations

  (4) Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and

  (5) Permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by OMB without further action by the Congress or without a contingency first having to be met.

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

Other Disclosures
Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Line 2.B) includes $1.5 billion in Federal Employee's Compensation Act (FECA) liabilities.

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

As of September 30, 2006	
(Amounts in thousands)	
Federal Employees'	
Compensation Act (FECA)	$557,343
Unemployment	71,447
Liabilities to Treasury	3,142,048
Total	$3,770,838

Liabilities to Treasury.
The primary component of the $3.1 billion liability to Treasury is a principal amount of $1.3 billion, representing advance payments made to contractors and $1.3 billion in associated accrued interest which remains in litigation. This amount in litigation is reported as an unfunded liability to Department of the Treasury. Collections on this debt will be due and payable to Treasury as the original appropriation is in a cancelled status. See Notes 2 and 5 for further disclosure.

<u>Nonfederal Liabilities – Other</u> (Not covered by Budgetary Resources) (Line 2.D) includes the following:

As of September 30, 2006	
(Amounts in thousands)	
Annual Leave	$2,738,551
Military Equipment – Non-nuclear Non Environmental Disposal Liabilities	285,200
Disposal Liabilities for Excess/Obsolete Structures	635,835
Contract Incentives	76,371
Total	$3,735,957

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intragovernmental Payables	$ 1,035,043	$ N/A	$ 1,035,043	$ 1,208,703
2. Nonfederal Payables (to the Public)	1,265,536	0	1,265,536	1,180,034
3. Total	$ 2,300,579	$ 0	$ 2,300,579	$ 2,388,737

4. Other Information Related to Accounts Payable

Fluctuation and Abnormalities
<u>Intragovernmental Payables.</u>
The DON reported a decrease of $173.7 million, 14%, in Intragovernmental payables in FY 2006. The trading partner process largely drives the balances in Intragovernmental payables. Upon receipt of accounts receivable data reported by our trading partners, DON records compensating accounts payable. For agencies that do not provide account receivable data, DON records accounts payable estimates based upon historical data. The total Level One (business conducted with other Federal Agencies) Intragovernmental accounts payable amount recorded in FY 2006 was $347.8 million. The Level One estimate is updated quarterly.

The majority of the decrease was with the General Services Administration and Department of Energy (Level One) for the amounts of $50.3 million and $10.3 million respectively, as a result of improving the oversight for non-Economy Act orders. The decrease with the Navy Working Capital Fund (Level Two, business conducted with other DoD organizations) for the amount of $85.0 million was a result of implementing a business practice that allowed the NWCF to charge the appropriations directly when making contract payments. This change took place throughout FY 2006.

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

Definitions

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

Nonfederal Payables (to the Public).
This line represents amounts owed to nonfederal government entities and individuals.

Undistributed Disbursements.
Undistributed Disbursements are the difference between disbursements recorded at the detailed level to a specific obligation or payable in the activity field records versus those reported by the Department of the Treasury. This should agree with the undistributed disbursements reported on monthly accounting reports. Generally, timing issues between systems cause undistributed disbursements. In-transit disbursements are payments that have been made by other agencies, entities, or systems that have not yet been recorded in DON's accounting records. For FY 2006, total supported undistributed disbursements were $1.8 billion.

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

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

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

Other Disclosures

Payables, more than any other liability, are subject to the vagaries of the business cycle, contract terms, the timing of the receipt of invoices for goods and services, and the subsequent liquidation of those invoices; thus variances from the previous reporting period are not uncommon. Payables are temporary liabilities and are expected to be liquidated within the next payment cycle.

Judgment Fund Liabilities.
The DON must reimburse the Department of the Treasury for payments made from the Judgment Fund on its behalf. These payments are a result of claims being resolved under the Contracts Dispute Act. In addition, the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR) was implemented on October 1, 2003. This law requires all agencies to reimburse the Judgment Fund for cases covered by the No FEAR Act. For FY 2006, DON reported $167.0 thousand for No FEAR Act liabilities.

Note 13. Debt

Not Applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2006			2005
	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)	$ 330,987	$ 1,998,233	$ 2,329,220	$ 2,666,516
2. Active Installations—Military Munitions Response Program (MMRP)	54,700	630,300	685,000	554,455
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—Active Installations				
1. Environmental Corrective Action	0	40,637	40,637	0
2. Environmental Closure Requirements	289	185,544	185,833	0
3. Environmental Response at Operational Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. Installation Restoration Program	98,805	1,018,288	1,117,093	1,079,256
2. Military Munitions Response Program	11,103	101,746	112,849	65,236
3. Environmental Corrective Action / Closure Requirements	18,074	49,388	67,462	0
4. Other	0	0	0	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	5,604,268	5,604,268	6,426,100
2. Nuclear Powered Submarines	0	3,377,665	3,377,665	5,837,200
3. Other Nuclear Powered Ships	0	277,608	277,608	223,900
4. Other National Defense Weapons Systems	0	233,772	233,772	197,788
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	3,237,406	3,237,406	0
2. Total Environmental Liabilities	$ 513,958	$ 16,754,855	$ 17,268,813	$ 17,050,451

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

In addition to the liabilities reported above, the Department of the 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.

Other Category Disclosure Comparative

	2006	2005
(Amounts in thousands)		
Other Accrued Environmental Costs- Other	$0	$0
Total	$0	$0
Base Realignment and Closure- Other	$0	$0
Total	$0	$0
Environmental Disposal for Weapon Systems Programs- Other- Spent Nuclear Fuel	$3,237,406	$0
Total	$3,237,406	$0

The "Other" type of environmental liabilities is Spent Nuclear Fuel (Line1.D.6). Per a Government Accountability Office audit recommendation and completion of a milestone of the DON Financial Improvement Program, DON began recognizing an estimated environmental disposal liability associated with Spent Nuclear Fuel during 3rd Quarter, FY 2006. Spent Nuclear Fuel is the used fuel that is removed from the nuclear reactors of nuclear powered ships and submarines. The estimate includes shipping, processing, and storing the spent nuclear fuel. The total estimated liability for spent nuclear fuel is $3.2 billion.

Other Information Related to Environmental Liabilities

1. Applicable Laws and Regulations of Cleanup Requirements
The following is a summary of significant laws that affect DON's conduct of environmental policy and regulations.

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

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), commonly referred to as the Superfund legislation, provided Federal agencies authority to respond to the release or the substantial threat of release of hazardous substances into the environment. CERCLA was amended several times; one of the amendments was the Superfund Amendments and Reauthorization Act (SARA) of 1986. This amendment established procedures to ensure that actual or threatened hazardous substance releases have proper responses. The procedures address reporting, investigations, remedy selection, and responsive provisions. Another amendment to CERCLA was the Community Environmental Response Facilitation Act (CERF) of 1992. The DON must identify real property on each facility that is not contaminated and that offers the greatest opportunity for expedited reuse and redevelopment. When property is transferred, DON is still responsible for any remediation or corrective action or any response action found to be necessary after the transfer.

The Clean Water Act (CWA) of 1977, Section 405 Disposal of Sewage Sludge, amended the Federal Water Pollution Control Act. The purpose of CWA is to restore and maintain the integrity of the nation's waters. The CWA implementing regulations established closure and post closure requirements for sewage sludge disposal. To help protect the nation's drinking water supply, including underground injections through a permitting scheme, is the purpose of the Safe Drinking Water Act of 1974 (Well Head Protection Areas).

The Clean Air Act (CAA) of 1990 established standards/limitations to prevent and control air pollutant discharges that could harm human health and natural resources. Requirements ensure that units can no longer operate when they are shutdown. Finally, the Toxic Substances Control Act (TSCA) of 1976 was implemented to understand the health risks of chemical substances by developing production and health risk data from the manufacturers. Based on the data, the Environmental Protection Agency has promulgated regulations for specific chemicals. The control of polychlorinated biphenyls (PCBs) is a good example. The control addresses spill cleanup and removal and disposal of units containing PCBs.

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

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

<u>Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) Funded Liabilities</u>.

Active Installations – Environmental Restoration (ER): Accrued restoration (cleanup) liabilities represent the cost to correct past environmental areas that are funded under the Defense Environmental Restoration Program in accordance with "Management Guidance for DERP," and "Environmental and Non-Environmental Liabilities," Chapter 13 of Volume 4 of Department of Defense Financial Management Regulation (DoD FMR). These liabilities relate to Plant, Property and Equipment, including acquired land and Stewardship Land, as those major asset categories are described in Chapter 6 of Volume 4 of DoD FMR. Environmental restoration activities may be conducted at operating installations, at Formerly Used Defense Sites (FUDS), and at Closed, Transferred, and Transferring Ranges. Environmental restoration measurements involve the use of cost estimates that consider, on a current cost basis, the anticipated costs of the level of effort required to affect the restoration, as well as applicable legal and/or regulatory requirements. Program management and support costs are included in the estimates. The estimates are based on DON's cost-to-complete (CTC) module of the Normalization of Data System (NORM). Verification, validation, and accreditation (VV&A) of CTC module was completed in FY 2002. Such cost estimates are based on the current technology available. The DON, as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services), used the site inventory and estimated cost data prepared for DERP report to the Congress. The Accrued Environmental Restoration (Cleanup) Costs do not include the costs of environmental compliance; pollution prevention, conservation activities, contamination or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations. The DON Environmental Restoration (ER, N) Program includes 3,700 clean-up sites at active installations while those installations covered by Base Realignment and Closure (BRAC) funding include 1,148 clean-up sites. The Marine Corps is included in these programs. In addition, the DON Environmental Corrective Action Program at BRAC installations included 610 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 (M&S) Verification, Validation, and

Accreditation (VV&A)" of May 2003. Total liabilities (cost-to-complete) are not estimated until there is sufficient site-specific data available to estimate the total liability. However, the 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. The inventory was completed September 2002 and currently contains 216 closed ranges at active installations and 28 sites (transferring ranges) 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, 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. This change in estimating methodology resulted in an overall decrease in the estimated environmental liability for nuclear powered ships and submarines and conventional ships in 3rd Quarter, FY 2006. However this decrease was offset by recognizing an estimated liability for spent nuclear fuel beginning in 3rd Quarter, FY 2006.

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

<u>Accrued Environmental Restoration (DERP Funded) Cost Liabilities.</u>

The DON Environmental Restoration includes those sites that have been identified as legacy cleanup sites. For FY 2006, DON estimated and reported $3.0 billion for environmental restoration liabilities. This amount is comprised of $2.3 billion in Active Installations - Environmental Restoration (ER) liabilities and $685.0 million in Active Installations – ER for Closed Ranges, liabilities, which represents UXO. The DoD FMR, Volume 6B, Chapter 10 requires that "any estimate produced must be based on site specific information and use cost models validated in accordance with DoD Instruction 5000.61." The DON is supporting this requirement by continuing to validate its range inventory as well as by pursuing the process of obtaining valid cost estimates for each range.

<u>Other Accrued Environmental Costs (Non-DERP funds)</u>.

The DON defines Non-DERP environmental units as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retrofill, and/or disposal of polychlorinated biphenyls (PCBs) transformers, underground storage tank remedial investigation and closure. As part of the DON Financial Improvement Program efforts, DON completed surveying, identifying, and estimating, Non-DERP units and expects to recognize the estimate 1st Quarter FY 2007. The Marine Corps completed its survey of on-going operations and their estimated total liability for Non-DERP is $226.5 million.

<u>Base Realignment and Closure (BRAC).</u>

BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated Base Realignment and Closure process. For FY 2006, DON estimated and reported $1.2 billion for BRAC funded environmental restoration liabilities. This amount includes $1.1 billion for environmental restoration (ER) program, $112.8 million for Military Munitions Response Program, and $67.5 million for corrective action and closure requirements. Military Munitions Response Program includes military munitions, chemical residues from military munitions, and munitions scrap at locations on or associated on or associated with a military range on a BRAC installation.

<u>Environmental Disposal for Weapons Systems Programs</u>.

Environmental Disposal for Weapon Systems are those estimates associated with the environmental disposal costs for DON nuclear weapons programs that includes Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. The

DON reported an environmental disposal liability for Weapons Systems Programs of $12.7 billion in FY 2006. This amount includes nuclear powered aircraft carriers of $5.6 billion, nuclear powered submarines of $3.4 billion, other nuclear powered ships of $277.6 million, other national defense weapons systems (conventional ships) of $233.7 million, and spent nuclear fuel (Other) of $3.2 billion.

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

For both current and prior periods, the changes due to price growth (inflation) and increases in labor rates and materials have been offset by a change in the estimating methodology for weapons systems. This change in estimating methodology resulted in an overall decrease in the estimated environmental disposal liability. However, this decrease was offset by recognizing an estimated liability for spent nuclear fuel during 3rd Quarter, FY 2006 Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of FY 2006, there are no changes to the environmental liability estimates due to changes in laws, regulations, and in agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

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

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

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

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

Environmental Disclosures

As of September 30	2006	2005
(Amounts in thousands)		
A. Amount of operating and capital expenditures used to remediate legacy waste. Legacy wastes are the remediation efforts covered by IRP, MMRP, and BD/DR regardless of funding source.	567,536	356,165
B. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment.	1,423,683	0
C. The estimated cleanup costs associated with general property, plant, and equipment placed into service during each fiscal year.	0	0
D. Changes in total cleanup costs due to changes in laws, regulations, and/or technology.	0	0
E. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.	0	0

Explanations

Line A. For FY 2006, of the total $567.5 million, $296.4 million is related to DERP while $271.1million is related to BRAC corrective action and restoration programs. When compared with FY 2005, the increase of $211.4 million, 59% is a result of increased funding (BRAC appropriation and increased revenue from land sales) and therefore the BRAC office was able throughout FY 2006 to execute a greater amount of environmental corrective actions and environmental restoration cleanup than in FY 2005.

Line B. The unrecognized portion of the estimated total cleanup costs is associated with Nuclear Powered Carriers and Submarines, Conventional Ships, Spent Nuclear Fuel, and Non-DERP. Of the total, $36.0 million is associated with conventional ships while the remainder, $1.3 billion is associated with Nuclear Powered Carriers and Submarines and Spent Nuclear Fuel and $14.3 million is associated with Non-DERP. For FY 2005, DON was not accruing the liability as required by DoD FMR, Volume 4, Chapter 13 and therefore did not have any unrecognized portion for Weapons Systems Programs and Non-DERP environmental liabilities.

Line C. For FY 2005, DON recognized the entire environmental liability for Weapons Systems Programs and did not accrue the liability. For FY 2006, DON can determine the unrecognized portion, and is working on a methodology to identify the individual assets and units by year. This effort will be completed by 2nd Quarter FY 2007.

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

Note 15. Other Liabilities

As of September 30	2006 Current Liability	2006 Noncurrent Liability	2006 Total	2005 Total
(Amounts in thousands)				
1. Intragovernmental				
A. Advances from Others	$ 0	$ 0	$ 0	$ 0
B. Deposit Funds and Suspense Account Liabilities	474,507	0	474,507	311,227
C. Disbursing Officer Cash	176,306	0	176,306	305,441
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	237,791	319,552	557,343	554,280
F. Other Liabilities	3,251,997	0	3,251,997	2,655,100
G. Total Intragovernmental Other Liabilities	$ 4,140,601	$ 319,552	$ 4,460,153	$ 3,826,048
(Amounts in thousands)				
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 445,018	$ 0	$ 445,018	$ 566,829
B. Advances from Others	205,544	0	205,544	151,215
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	42,257	0	42,257	0
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	285,201	285,201	683,514
(2) Excess/Obsolete Structures	59,412	626,206	685,618	235,897
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	2,738,551	0	2,738,551	2,650,745
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	181,648	1,165,927	1,347,575	171,636
J. Total Nonfederal Other Liabilities	$ 3,672,430	$ 2,077,334	$ 5,749,764	$ 4,459,836
3. Total Other Liabilities	$ 7,813,031	$ 2,396,886	$ 10,209,917	$ 8,285,884

Fluctuations and Abnormalities

Intragovernmental Other Liabilities.

Total intragovernmental liabilities increased $634.1 million, 17%, in FY 2006. A receivable of $345.6 million that was classified in FY 2005 as "currently not collectible" was not reported as a nonentity receivable. The DON began reporting this as an active nonentity receivable in the 1st Quarter, FY 2006 due to a change in the litigation status. Furthermore, in 4th Quarter FY 2005, $210.8 million of out-of-service debt that should have been classified as nonentity was erroneously classified as an entity receivable. This classification error was corrected in 1st Quarter, FY 2006. The offsetting entry for these nonentity receivables is a liability to Department of Treasury. The associated accounts receivable balances are remitted to Treasury upon collection, thus considered a liability to DON.

Nonfederal Other Liabilities.

The DON reported an increase of $1.3 billion, 29%, in Nonfederal Other Liabilities in FY 2006. In 4th Quarter FY 2006, in accordance with a DoD policy decision based on a DoD Inspector General audit finding, DON began recording an estimated contingent liability (and corresponding asset) for the value of unbilled contractor costs on specified contracts. This contingent liability balance includes $1.1 billion in estimated contract financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. 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, thereby protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Department is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance of a satisfactory product. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to the Department and the amount of potential payments are estimable, the Department has recognized a contingent liability for estimated payments, which are conditional pending delivery and Government acceptance of a satisfactory product.

Other Disclosures

In response to the Department of Defense, Inspector General audit, "Financial Management: DoD Process for Reporting Contingent Legal Liabilities", the DON developed a methodology during 4th Quarter FY 2006 that provides an estimate for those legal cases that are considered probable or reasonably possible to be settled against the government. The DON is testing the methodology with the objective to begin reporting in 2nd Quarter FY 2007.

For FY 2006, the DON does not have any delinquent amounts due to the Department of Labor (DOL) for the FECA bill. The FY 2007 FECA bill is due to DOL 30 days after the appropriation bill is passed and signed.

Intragovernmental Other Liabilities:

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

As of September 30, 2006	
(Amounts in thousands)	
Liability to Treasury & Others	$3,144,045
Unemployment	71,447
Employment Benefit	36,505
Total Intragovernmental Other Liabilities	$3,251,997

Nonfederal Other Liabilities:

Other Liabilities - Other (Line 2.I) includes the following:

As of September 30, 2006	
(Amounts in thousands)	
Contract Holdbacks	$151,188
Litigation Settlement	$4,000
Employer Contributions (taxes)	3,508
Contract Incentives	76,371
Liability for In-Process Assets	1,112,508
Total Intragovernmental Other Liabilities	$1,347,575

Capital Lease Liability

Not applicable.

Note 16. Commitments and Contingencies

Legal Contingencies:

The Department of the Navy (DON) is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON will accrue contingent liabilities for legal actions in those instances where the DON's Office of General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from DON's resources, either directly or by reimbursement to the Judgment Fund. The DON records Judgment Fund liabilities in Accounts Payable, which are detailed in Note 12.

For fiscal years 2006 and 2005, the DON General Fund materiality threshold for reporting litigation, claims, or assessments was $56.1 million and $53.2 million, respectively. Based on information contained in the FY 2006 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.

The DON currently has sixteen cases; fifteen against the Navy and one against the United States Marine Corps, that meet the FY 2006 DON General Fund materiality threshold. DON legal counsel was unable to express an opinion concerning the likely outcome of these sixteen cases. Therefore, no contingent liabilities were accrued nor is any disclosure of estimated contingencies required. This declaration is fully supported by the Preliminary and Final Legal Representation letters and the subsidiary management summary schedule.

In response to the Department of Defense, Inspector General audit, "Financial Management: DoD Process for Reporting Contingent Legal Liabilities", the DON developed a methodology during 4th Quarter FY 2006 that provides an estimate for those legal cases that are considered probable or reasonably possible to be settled against the government. The DON is testing the methodology with the objective to begin reporting in 2nd Quarter FY 2007.

Other Commitments and Contingencies
The DON has recorded a contingent liability in the amount of $37.3 million for obligations related to cancelled appropriations.

The DON has recorded a contingent liability in the amount of $76.4 million for Contract Incentives.

Note 17. Military Retirement and Other Federal Employment Related Benefits

As of September 30	2006				2005
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
(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	$ 1,513,644		$ 0	$ 1,513,644	$ 1,532,819
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	$ 1,513,644		$ 0	$ 1,513,644	$ 1,532,819
3. Other Federal Employment Benefits	$ 0		$ 0	$ 0	$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	$ 1,513,644		$ 0	$ 1,513,644	$ 1,532,819

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

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

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

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

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

Federal Employees' Compensation Act (FECA).
Actuarial Cost Method Used and Assumptions:
The DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON at the end of each fiscal year. The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

FY 2006
5.170 % in Year 1
5.313 % 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) 2006 were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

The model's resulting projections were analyzed to insure 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 loses per case (a measure of case-severity) in CBY 2006 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 2006 projection to the average pattern for the projections of the most recent three years.

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

	Personnel	Allocation %
DON General Fund	84,068	44%
Navy Working Capital Fund	108,166	56%
Total	192,234	100%

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

Intragovernmental Costs and Exchange Revenue				
As of September 30		2006		2005
(Amounts in thousands)				
1. Intragovernmental Costs	$	40,177,296	$	39,245,020
2. Public Costs		89,352,957		84,365,787
3. Total Costs	$	129,530,253	$	123,610,807
4. Intragovernmental Earned Revenue	$	(2,551,473)	$	(3,480,214)
5. Public Earned Revenue		(1,360,814)		(4,700,934)
6. Total Earned Revenue	$	(3,912,287)	$	(8,181,148)
7. Net Cost of Operations	$	125,617,966	$	115,429,659

Net Costs of Operations
The DON reported an increase in the Net Cost of Operations of $10.2 billion, 9% in FY 2006. The pertinent changes are described below in the disclosure for Total Costs and Earned Revenue.

Total Costs
Total Costs increased $5.9 billion, 5% in FY 2006. Public Costs increased $5.0 billion, 6%, which represents the majority of the increase in Total Costs, while Intragovernmental Costs increased $932.3 million.
Total Earned Revenue
Total Earned Revenue decreased $4.3 billion, 52%. The majority of the total decrease is in Public Earned Revenue which decreased $3.3 billion, 71%, in FY 2006. The two major drivers behind the decrease in

Public Earned Revenue were:

- Marine Corps real property additions decreased $462.0 million due to completion of construction projects and increased additions during FY 2005 that were not reflected in FY 2006.

- Navy Military construction real property asset capitalization decreased $2.0 billion due to completion of construction projects and increased additions during FY 2005 that were not reflected in FY 2006. FY 2005 increases in acquisition value of General PP&E were recorded in Other Gains (USSGL 7190), which had a positive impact on public revenues. In FY 2006 General PP&E did not increase to the same level as during FY 2005, hence the decrease in revenue between years.

- Work performed for nonfederal customers decreased $825.0 million from FY 2005.

Other Disclosures Related to the Statement of Net Cost
The DON recorded a prior period adjustment due to a change in the methodology for reporting of military equipment. The FY 2005 restatement impacts the value of general property, plant, and equipment and associated accumulated depreciation reported on the balance sheet. The DON has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

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

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

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

The DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Generally Accepted Accounting Principles (GAAP) for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of DON's legacy systems were designed to record information on a budgetary basis. Considering these systems limitations, DON is unable to compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental trading partners.

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

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

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

As of September 30	2006		2005 Restated	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	$ 0	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	23,218,292	0	23,218,292	0
C. Total Prior Period Adjustments	$ 23,218,292	$ 0	$ 23,218,292	$ 0
				0
2. Imputed Financing				0
A. Civilian CSRS/FERS Retirement	$ 219,410	$ 0	$ 232,513	$ 0
B. Civilian Health	327,916	0	319,112	0
C. Civilian Life Insurance	1,066	0	1,038	0
D. Judgment Fund	29,666	0	33,023	0
E. IntraEntity	0	0	0	0
				0
F. Total Imputed Financing	$ 578,058	$ 0	$ 585,686	$ 0

Disclosures

The Department of the Navy (DON) recorded a $23.2 billion prior period adjustment due to a change in the methodology for reporting of military equipment, resulting in a $23.2 billion restatement for FY 2005. The FY 2005 restatement impacts the value of general property, plant, and equipment and associated accumulated depreciation reported on the balance sheet. The DON has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, the DON reported military equipment values in the financial statements beginning in FY 2003. As an interim measure, while DON worked to develop its military equipment baseline from internal records, the military equipment values reported were based on information obtained from the Bureau of Economic Analysis (BEA).

Effective 3rd Quarter, FY 2006, DON replaced the BEA estimation methodology with a valuation based on internal DON records. During the process of establishing a baseline, it was discovered that the BEA estimates had failed to consider disposals, thresholds, and construction in process. While an estimation methodology is acceptable per SFFAS No. 23, due to the nature of the BEA omissions, DON considers the method previously used noncompliant with Generally Accepted Accounting Principles (GAAP), and thus have treated the adjustment as correction of a material error.

Appropriations Received on the Statement of Changes in Net Position (SOCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $19.4

million between the SOCNP Appropriations Received and the Statement of Budgetary Resources Appropriations Received is primarily due to the values for Trust Funds and Special Receipt Accounts in Appropriated Trust or Special Fund Receipts (USSGL 4114) not being included in the Appropriations Received line of SOCNP.

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

Judgment Fund.
Treasury provided information related to amounts paid for Judgment Fund liabilities under the Contracts Dispute Act and the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR Act) on behalf of DON, which DON is required to repay. Judgment Fund payments made out of the following Treasury appropriations do not require reimbursement and therefore represent imputed financing to DON: 20X1740 and 20X1742. Only those payments made from Treasury appropriation 20X1743 and that portion of 20X1741 that is related to the No FEAR Act are required to be repaid by DON.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 83,047,974	$ 76,392,061
2. Available Borrowing and Contract Authority at the End of the Period	0	0

3. Other Information Related to the Statement of Budgetary Resources (SBR)

Apportionment Categories for Obligations Incurred
On the Statement of Budgetary Resources: Obligations Incurred includes $146.0 billion of Direct Program Obligations and $5.9 billion of Reimbursable Program Obligations.

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

- Direct Obligations, Category A, amounts apportioned quarterly, are $85.1 billion.
- Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are $60.9 billion.

- Total Direct Obligations are therefore $146.0 billion.
- Category B Reimbursable Obligations are $5.9 billion.

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

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

National Defense Sealift Fund.
The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet (NDRF) including the acquisition, alteration or conversion of vessels built in U.S. shipyards for NDRF. As of September 30, 2006, one transfer for $1.0 million from the Defense Working Capital Fund to the NDSF was recorded; no transfers from NDSF have occurred.

Environmental Restoration, Navy.
Environmental Restoration, Navy (ER, N) is a transfer account that funds environmental restoration, reduction and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds are to remain available until transferred, and remain available for the same purpose and same time period as the appropriations to which transferred. As of September 30, 2006, $296.4 million has been transferred to Operations and Maintenance, Navy and $5.1 million has been transferred to Operations and Maintenance, Defense Agencies from ER, N. No transfers to ER, N have occurred.

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

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

Other Disclosures
Unobligated budget authority is the difference between the obligated balance and the total unexpended balance. It represents that portion of the unexpended balance unencumbered by recorded obligations. Appropriations are provided on an annual, multi-year, and no-year basis. An appropriation expires on the last day of its period of availability and is no longer available for new obligations when in an expired status. Unobligated balances retain their fiscal year identity in an expired account for an additional five fiscal years. The unobligated balance remains available to make legitimate obligation adjustments, i.e., to record previously unrecorded obligations and to make upward obligation adjustments in previously underestimated obligations for five years. At the end of the fifth year the budget authority is canceled. Thereafter, the budget authority is not available for any purpose.

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

As noted above, the NDSF, a revolving fund, received a transfer of $1.0 million in September 2006 from the Defense Working Capital Fund per Public Law 109-148. A transfer of resources to a revolving fund is considered a capital infusion.

Note 21. Disclosures Related to the Statement of Financing

Fluctuations and Abnormalities

Budgetary data is not in agreement with proprietary expenses and assets capitalized. This causes a difference in net cost between the Statement of Net Cost and the Statement of Financing. Adjustments are posted to the Statement of Financing for these differences. For FY 2006, an adjustment of $9.6 million was made to Resources that Finance the Acquisition of Assets of the Statement of Financing so that proprietary accounts reconcile with the budgetary accounts. The alignment was made per Office of the Under Secretary of Defense (Comptroller) guidance.

Other Disclosures

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

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

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

Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the "Adjustments" line on the Statement of Budgetary Resources), are not included in "Spending Authority From Offsetting Collections and Adjustments" line on the Statement of Budgetary Resources or on the Statement of Financing. The Statement of Financing was expanded to further articulate and detail the relationship between new obligations from budgetary accounting and net cost of operations from proprietary accounting.

<u>Description of the Other lines.</u>

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

The Other resources or adjustments to net obligated resources that do not affect the net cost of operations balance of $187.1 million consists primarily of a transfer of Construction in Progress from other Defense Agencies in the amount of $96.7 million and a transfer of property from Marine Corps Working Capital Fund to Marine Corps General Fund in the amount of $91.5 million.

Components Requiring or Generating Resources –

The Other is related to future periods and the balance of $208.4 million consists primarily of unfunded liabilities for employment related programs.

Components not Requiring or Generating Resources –
The Other not requiring or generating resources has a balance of $9.7 million, which consists primarily of bad debt expense related to the allowance for doubtful accounts.

The amount reflected on the Statement of Financing of $482.1 million reports changes in accruals of unfunded liabilities, which included but are not limited to: unused annual leave, environmental and non-environmental disposal, litigation, Federal Employees' Compensation Act (FECA), unemployment compensation, canceled year accounts payable, and contract incentives. The total of $25.8 billion in Liabilities Not Covered by Budgetary Resources included on the Balance Sheet includes the aforementioned items and liabilities to Treasury for nonentity accounts receivable of the DON. Collections on nonentity receivables would not require or generate resources for the DON as they are deposited at Treasury and belong to the general cash balances of the United States Government.

Reconciling Item for Allocation Transfers.
There is $34.4 million of Parent/child Allocation accounts, primarily Treasury symbol 1081, International Military Education and Training with a balance of $34.0 million. The DON, as the "child," is the recipient of allocation transfers from other Federal agencies and has determined that the allocations are not material to the DON Financial Statements. The providing agency, as the "parent," is responsible for reporting for these allocations.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not applicable.

Note 23. Earmarked Funds

BALANCE SHEET As of September 30 *(Amounts in thousands)*	MRF	MERHCF	Other Earmarked Funds	Eliminations	Total
ASSETS					
Fund balance with Treasury	$ 0	$ 0	$ 12,218	$ 0	$ 12,218
Investments	0	0	9,751	0	9,751
Accounts and Interest Receivable	0	0	0	0	0
Other Assets	0	0	22	0	22
Total Assets	$ 0	$ 0	$ 21,991	$ 0	$ 21,991
LIABILITIES and NET POSITION *As of September 30*					
Military Retirement Benefits and Other Employment Related Actuarial Liabilities	$ 0	$ 0	$ 0	$ 0	$ 0
Other Liabilities	0	0	1,598	0	1,598
Unexpended Appropriations	0	0	1,550	0	1,550
Cumulative Results of Operations	0	0	18,843	0	18,843
Total Liabilities and Net Position	$ 0	$ 0	$ 21,991	$ 0	$ 21,991
STATEMENT OF NET COST *As of September 30*					
Program Costs	$ 0	$ 0	$ 24,998	$ 0	$ 24,998
Less Earned Revenue	0	0	0	0	0
Net Program Costs	$ 0	$ 0	$ 24,998	$ 0	$ 24,998
Less Earned Revenues Not Attributable to Programs	0	0	0	0	0
Net Cost of Operations	$ 0	$ 0	$ 24,998	$ 0	$ 24,998
STATEMENT OF CHANGES IN NET POSITION *As of September 30*					
Net Position Beginning of the Period	$ 0	$ 0	$ 25,869	$ 0	$ 25,869
Net Cost of Operations	0	0	24,998	0	24,998
Other Nonexchange Revenue	0	0	19,522	0	19,522
Other Financing Sources	0	0	0	0	0
Change in Net Position	$ 0	$ 0	$ (5,476)	$ 0	$ (5,476)
Net Position End of Period	$ 0	$ 0	$ 20,393	$ 0	$ 20,393

Fluctuation and Abnormalities
Earmarked funds were required to be reported and disclosed separately from other funds beginning 1st Quarter, FY 2006. For DON General Fund, a reclassification to the new earmarked funds reporting attribute was performed, beginning balances were transferred from the previous attributes, and the status of the earmarked funds is displayed in this Note to the financial statements. However, prior year amounts were not remapped to the new earmarked funds reporting attributes.

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

<u>Special Earmarked Funds</u>
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 United States 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.

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

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

<u>Trust Earmarked Funds</u>
Department of the Navy General Gift Fund –
This trust fund is authorized by 10 United States Code 2601. Under the provisions of this statute, the Secretary of the Navy may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that they be used for the benefit, or in connection with the

establishment, operation, or maintenance of a school, hospital, library, museum, cemetery, or other institution under the jurisdiction of the Department of the Navy.

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

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

Note 24. Other Disclosures

As of September 30	2006 Asset Category			
	Land and Buildings	Equipment	Other	Total
(Amounts in thousands)				
1. ENTITY AS LESSEE- Operating Leases				
Future Payments Due				
Fiscal Year				
2007	$ 14,317	$ 0	$ 464	$ 14,781
2008	14,722	0	476	15,198
2009	15,230	0	487	15,717
2010	15,164	0	500	15,664
2011	15,690	0	512	16,202
After 5 Years	0	0	0	0
Total Future Lease Payments Due	$ 75,123	$ 0	$ 2,439	$ 77,562

Fluctuations and Abnormalities
Although a comparative column is not shown, the DON reported a decrease of $28.4 million in Operating Leases Future Payments Due in FY 2006. This decrease is due to the ongoing effort to validate operating leases throughout the Navy shore establishment.

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

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

Other Disclosure

The values reported for operating leases is derived from DON data collection process. This process only provides summary level values at this time. Lease periods vary and are not expected to be renewed at the end of the lease term. There are no material escalation clauses or contingent rental restrictions. Data is gathered from existing leases, General Service Administration bills, and Interservice Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI more accurately impacts increases to the leases, especially those at commercial lease sites.

Department of the Navy

General Fund
Supporting Consolidating/Combining Statements

2006

2006 Annual Financial Report

General Fund Supporting Consolidating/Combining Statements

Department of Defense
Department of the Navy

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005
($ in thousands)

	Navy	Marine Corps	Combined Total
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 84,567,726	$ 11,373,735	$ 95,941,461
Non-entity Seized Iraqi Cash	0	0	0
Non-entity - Other	356,131	118,376	474,507
Investments (Note 4)	9,751	0	9,751
Accounts Receivable, Net (Note 5)	138,151	37,983	176,134
Other Assets (Note 6)	462,485	5,774	468,259
Total Intragovernmental Assets	$ 85,534,244	$ 11,535,868	$ 97,070,112
Cash and Other Monetary Assets (Note 7)	116,657	59,649	176,306
Accounts Receivable (Note 5)	3,209,853	21,561	3,231,414
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property, Net (Note 9)	58,324,063	470,571	58,794,634
General Property, Plant and Equipment, Net (Note 10)	178,481,762	8,497,907	186,979,669
Investments (Note 4)	0	0	0
Other Assets (Note 6)	8,109,607	499,268	8,608,875
TOTAL ASSETS	$ 333,776,186	$ 21,084,824	$ 354,861,010
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 945,180	$ 106,727	$ 1,051,907
Debt (Note 13)	0	0	0
Other Liabilities (Note 15 & Note 16)	4,197,133	263,020	4,460,153
Total Intragovernmental Liabilities	$ 5,142,313	$ 369,747	$ 5,512,060
Accounts Payable (Note 12)	$ 789,577	$ 475,959	$ 1,265,536
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	1,299,211	214,433	1,513,644
Environmental and Disposal Liabilities (Note 14)	17,042,343	226,470	17,268,813
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	4,815,278	934,486	5,749,764
TOTAL LIABILITIES	$ 29,088,722	$ 2,221,095	$ 31,309,817
NET POSITION			
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 1,550	$ 0	$ 1,550
Unexpended Appropriations - Other Funds	88,640,658	11,057,094	99,697,752
Cumulative Results of Operations - Earmarked Funds	18,843	0	18,843
Cumulative Results of Operations - Other Funds	216,026,413	7,806,635	223,833,048
TOTAL NET POSITION	$ 304,687,464	$ 18,863,729	$ 323,551,193
TOTAL LIABILITIES AND NET POSITION	$ 333,776,186	$ 21,084,824	$ 354,861,010

Department of Defense
Department of the Navy

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005
($ in thousands)

	Eliminations	2006 Consolidated	2005 Restated
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 0	$ 95,941,461	$ 85,734,659
Non-entity Seized Iraqi Cash	0	0	0
Non-entity - Other	0	474,507	344,546
Investments (Note 4)	0	9,751	9,519
Accounts Receivable, Net (Note 5)	16,864	159,270	281,305
Other Assets (Note 6)	0	468,259	672,257
Total Intragovernmental Assets	$ 16,864	$ 97,053,248	$ 87,042,286
Cash and Other Monetary Assets (Note 7)	0	176,306	305,440
Accounts Receivable (Note 5)	0	3,231,414	3,267,657
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property, Net (Note 9)	0	58,794,634	55,584,837
General Property, Plant and Equipment, Net (Note 10)	0	186,979,669	181,547,138
Investments (Note 4)	0	0	0
Other Assets (Note 6)	0	8,608,875	6,988,791
TOTAL ASSETS	$ 16,864	$ 354,844,146	$ 334,736,149
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 16,864	$ 1,035,043	$ 1,208,703
Debt (Note 13)	0	0	0
Other Liabilities (Note 15 & Note 16)	0	4,460,153	3,826,048
Total Intragovernmental Liabilities	$ 16,864	$ 5,495,196	$ 5,034,751
Accounts Payable (Note 12)	$ 0	$ 1,265,536	$ 1,180,034
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	0	1,513,644	1,532,819
Environmental and Disposal Liabilities (Note 14)	0	17,268,813	17,050,451
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	0	5,749,764	4,459,836
TOTAL LIABILITIES	$ 16,864	$ 31,292,953	$ 29,257,891
NET POSITION			
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 1,550	$ 0
Unexpended Appropriations - Other Funds	0	99,697,752	89,739,876
Cumulative Results of Operations - Earmarked Funds	0	18,843	0
Cumulative Results of Operations - Other Funds	0	223,833,048	215,738,382
TOTAL NET POSITION	$ 0	$ 323,551,193	$ 305,478,258
TOTAL LIABILITIES AND NET POSITION	$ 16,864	$ 354,844,146	$ 334,736,149

Department of Defense
Navy General Fund

CONSOLIDATING STATEMENT OF NET COST

For the Periods ended September 30, 2006 and 2005
($ in thousands)

	Navy	Marine Corps	Combined Total
Program Costs			
A. Military Personnel			
Gross Costs	$ 29,263,834	$ 10,661,165	$ 39,924,999
(Less: Earned Revenue)	(256,353)	(20,664)	(277,017)
Net Program Costs	29,007,481	$ 10,640,501	$ 39,647,982
B. Operation and Maintenance			
Gross Costs	$ 39,871,491	$ 7,158,553	$ 47,030,044
(Less: Earned Revenue)	(3,832,715)	(471,263)	(4,303,978)
Net Program Costs	36,038,776	$ 6,687,290	$ 42,726,066
C. Procurement			
Gross Costs	$ 22,209,626	$ 2,032,386	$ 24,242,012
(Less: Earned Revenue)	(1,283,614)	(142,289)	(1,425,903)
Net Program Costs	20,926,012	$ 1,890,097	$ 22,816,109
D. Research, Development, Test & Evaluation			
Gross Costs	$ 18,109,762		$ 18,109,762
(Less: Earned Revenue)	(275,798)		(275,798)
Net Program Costs	17,833,964		$ 17,833,964
E. Military Construction/Family Housing			
Gross Costs	$ 3,401,265		$ 3,401,265
(Less: Earned Revenue)	(621,156)		(621,156)
Net Program Costs	2,780,109		$ 2,780,109
F. Other			
Gross Costs	$ (2,644,581)	$ (130,233)	$ (2,774,814)
(Less: Earned Revenue)	2,366,799	221,751	2,588,550
Net Program Costs	(277,782)	$ 91,518	$ (186,264)
G. Total Program Costs			
Gross Costs	$ 110,211,397	$ 19,721,871	$ 129,933,268
(Less: Earned Revenue)	(3,902,837)	(412,465)	(4,315,302)
Net Program Costs	106,308,560	$ 19,309,406	$ 125,617,966
Cost Not Assigned to Programs	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0
Net Cost of Operations	$ 106,308,560	$ 19,309,406	$ 125,617,966

Department of Defense
Navy General Fund

CONSOLIDATING STATEMENT OF NET COST

For the Periods ended September 30, 2006 and 2005
($ in thousands)

	Eliminations	2006 Consolidated	2005 Consolidated
Program Costs			
A. Military Personnel			
Gross Costs	$ 0	$ 39,924,999	$ 39,845,683
(Less: Earned Revenue)	0	(277,017)	(501,540)
Net Program Costs	$ 0	$ 39,647,982	$ 39,344,143
B. Operation and Maintenance			
Gross Costs	$ 0	$ 47,030,044	$ 47,538,207
(Less: Earned Revenue)	0	(4,303,978)	(6,896,322)
Net Program Costs	$ 0	$ 42,726,066	$ 40,641,885
C. Procurement			
Gross Costs	$ 0	$ 24,242,012	$ 20,464,820
(Less: Earned Revenue)	0	(1,425,903)	(1,627,506)
Net Program Costs	$ 0	$ 22,816,109	$ 18,837,314
D. Research, Development, Test & Evaluation			
Gross Costs	$ 0	$ 18,109,762	$ 16,105,552
(Less: Earned Revenue)	0	(275,798)	(382,732)
Net Program Costs	$ 0	$ 17,833,964	$ 15,722,820
E. Military Construction/Family Housing			
Gross Costs	$ 0	$ 3,401,265	$ 3,957,738
(Less: Earned Revenue)	0	(621,156)	(2,686,605)
Net Program Costs	$ 0	$ 2,780,109	$ 1,271,133
F. Other			
Gross Costs	$ 403,015	$ (3,177,829)	$ (4,301,193)
(Less: Earned Revenue)	(403,015)	2,991,565	3,913,557
Net Program Costs	$ 0	$ (186,264)	$ (387,636)
G. Total Program Costs			
Gross Costs	$ 403,015	$ 129,530,253	$ 123,610,807
(Less: Earned Revenue)	(403,015)	(3,912,287)	(8,181,148)
Net Program Costs	$ 0	$ 125,617,966	$ 115,429,659
Cost Not Assigned to Programs	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0
Net Cost of Operations	$ 0	$ 125,617,966	$ 115,429,659

Department of Defense
Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005
($ in thousands)

	Navy	Marine Corps
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources		
Unobligated balance, brought forward, October 1	$ 15,113,721	$ 2,014,758
Recoveries of prior year unpaid obligations	3,722,816	1,539,174
Budget Authority:		
Appropriation received	121,543,102	23,968,500
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections:		
Earned		
Collected	7,190,245	577,375
Change in receivables from Federal sources	(888,223)	(60,507)
Change in unfilled customer orders		
Advances received	54,329	0
Without advance from Federal sources	567,102	(48,029)
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	$ 128,466,555	$ 24,437,339
Nonexpenditure transfers, net, anticipated and actual	774,316	(106,906)
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(3,000,805)	(252,498)
Total Budgetary Resources	$ 145,076,603	$ 27,631,867
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	$ 121,584,596	$ 24,422,185
Reimbursable	5,050,915	814,800
Subtotal	$ 126,635,511	$ 25,236,985
Unobligated balance:		
Apportioned	$ 17,058,081	$ 2,139,514
Exempt from apportionment	0	0
Subtotal	17,058,081	2,139,514
Unobligated balances not available	1,383,011	255,368
Total, status of budgetary resources	$ 145,076,603	$ 27,631,867

Department of Defense
Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005
($ in thousands)

	Navy	Marine Corps
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources		
Unobligated balance, brought forward, October 1	$ 15,113,721	$ 2,014,758
Recoveries of prior year unpaid obligations	3,722,816	1,539,174
Budget Authority:		
Appropriation received	121,543,102	23,968,500
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections:		
Earned		
Collected	7,190,245	577,375
Change in receivables from Federal sources	(888,223)	(60,507)
Change in unfilled customer orders		
Advances received	54,329	0
Without advance from Federal sources	567,102	(48,029)
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	$ 128,466,555	$ 24,437,339
Nonexpenditure transfers, net, anticipated and actual	774,316	(106,906)
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(3,000,805)	(252,498)
Total Budgetary Resources	$ 145,076,603	$ 27,631,867
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	$ 121,584,596	$ 24,422,185
Reimbursable	5,050,915	814,800
Subtotal	$ 126,635,511	$ 25,236,985
Unobligated balance:		
Apportioned	$ 17,058,081	$ 2,139,514
Exempt from apportionment	0	0
Subtotal	17,058,081	2,139,514
Unobligated balances not available	1,383,011	255,368
Total, status of budgetary resources	$ 145,076,603	$ 27,631,867

Department of Defense
Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005
($ in thousands)

	Navy	Marine Corps
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in obligated balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 65,559,102	$ 6,534,084
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(3,083,852)	(316,962)
Total unpaid obligated balance	62,475,250	6,217,122
Obligations incurred, net (+/-)	$ 126,635,511	$ 25,236,985
Less: Gross outlays	(119,571,057)	(21,044,616)
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
Total Unpaid obligated balance transferred, net	0	0
Less: Recoveries of prior year unpaid obligations, actual	(3,722,816)	(1,539,174)
Change in uncollected customer payments from Federal sources (+/-)	321,121	108,536
Obligated balance, net, end of period		
Unpaid obligations	68,900,741	9,187,279
Less: Uncollected customer payments from Federal sources	(2,762,731)	(208,426)
Total, unpaid obligated balance, net, end of period	66,138,010	8,978,853
Net Outlays:		
Net Outlays:		
Gross Outlays	119,571,057	21,044,616
Less: Offsetting collections	(7,244,575)	(577,375)
Less: Distributed Offsetting receipts	(149,284)	0
Net Outlays	$ 112,177,198	$ 20,467,241

Department of Defense
Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005
($ in thousands)

	Navy	Marine Corps
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in obligated balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 65,559,102	$ 6,534,084
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(3,083,852)	(316,962)
Total unpaid obligated balance	62,475,250	6,217,122
Obligations incurred, net (+/-)	$ 126,635,511	$ 25,236,985
Less: Gross outlays	(119,571,057)	(21,044,616)
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
Total Unpaid obligated balance transferred, net	0	0
Less: Recoveries of prior year unpaid obligations, actual	(3,722,816)	(1,539,174)
Change in uncollected customer payments from Federal sources (+/-)	321,121	108,536
Obligated balance, net, end of period		
Unpaid obligations	68,900,741	9,187,279
Less: Uncollected customer payments from Federal sources	(2,762,731)	(208,426)
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Net Outlays:		
Net Outlays:		
Gross Outlays	119,571,057	21,044,616
Less: Offsetting collections	(7,244,575)	(577,375)
Less: Distributed Offsetting receipts	(149,284)	0
Net Outlays	$ 112,177,198	$ 20,467,241

Department of Defense
Navy General Fund

CONSOLIDATING STATEMENT OF FINANCING

For the Periods ended September 30, 2006 and 2005
($ in thousands)

	Navy	Marine Corps
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 126,635,511	$ 25,236,985
Less: Spending authority from offsetting collections and recoveries (-)	(10,646,269)	(2,008,013)
Obligations net of offsetting collections and recoveries	115,989,242	23,228,972
Less: Offsetting receipts (-)	(149,284)	0
Net obligations	115,839,958	23,228,972
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	96,689	90,379
Imputed financing from costs absorbed by others	510,817	67,241
Other (+/-)	0	0
Net other resources used to finance activities	607,506	157,620
Total resources used to finance activities	$ 116,447,464	$ 23,386,592
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	(3,830,416)	(2,827,292)
Unfilled Customer Orders	621,431	(48,029)
Resources that fund expenses recognized in prior periods	(101,474)	(27)
Budgetary offsetting collections and receipts that do not affect net cost of operations	149,284	0
Resources that finance the acquisition of assets	(25,488,612)	(2,875,425)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	0	0
Other (+/-)	(96,689)	(90,379)
Total resources used to finance items not part of the net cost of operations	$ (28,746,476)	$ (5,841,152)
Total resources used to finance the net cost of operations	$ 87,700,988	$ 17,545,440
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 Periods:		
Increase in annual leave liability	$ 43,363	$ 0
Increase in environmental and disposal liability	3,908	226,470
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	103,016	105,361
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 150,287	$ 331,831
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 19,784,673	$ 1,458,780
Revaluation of assets and liabilities (+/-)	1,890,592	(25,176)
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	0	0
Operating Material & Supplies Used	(3,209,710)	(64)
Other	(8,270)	(1,405)
Total components of Net Cost of Operations that will not require or generate resources	$ 18,457,285	$ 1,432,135
Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$ 18,607,572	$ 1,763,966
Net Cost of Operations	$ 106,308,560	$ 19,309,406

Combined Total	Eliminations	2006 Consolidated	2005 Consolidated
$ 151,872,496	$ 0	$ 151,872,496	$ 151,158,165
(12,654,282)	0	(12,654,282)	(20,485,056)
139,218,214	0	139,218,214	130,673,109
(149,284)	0	(149,284)	(115,805)
139,068,930	0	139,068,930	130,557,304
0	0	0	0
187,068	0	187,068	(1,652)
578,058	0	578,058	585,686
0	0	0	0
765,126	0	765,126	584,034
$ 139,834,056	$ 0	$ 139,834,056	$ 131,141,338
(6,657,708)	0	(6,657,708)	(13,332,332)
573,402	0	573,402	(488,685)
(101,501)	0	(101,501)	(269,715)
149,284	0	149,284	0
(28,364,037)	0	(28,364,037)	(14,697,475)
0	0	0	0
(187,068)	0	(187,068)	1,652
$ (34,587,628)	$ 0	$ (34,587,628)	$ (28,786,555)
$ 105,246,428	$ 0	$ 105,246,428	$ 102,354,783
$ 43,363	$ 0	$ 43,363	$ 170,047
230,378	0	230,378	1,028,763
0	0	0	0
0	0	0	0
208,377	0	208,377	69,091
$ 482,118	$ 0	$ 482,118	$ 1,267,901
$ 21,243,453	$ 0	$ 21,243,453	$ 15,844,303
1,865,416	0	1,865,416	(1,785,299)
0	0	0	(10)
0	0	0	0
(3,209,774)	0	(3,209,774)	(2,244,170)
(9,675)	0	(9,675)	(7,849)
$ 19,889,420	$ 0	$ 19,889,420	$ 11,806,975
$ 20,371,538	$ 0	$ 20,371,538	$ 13,074,876
$ 125,617,966	$ 0	$ 125,617,966	$ 115,429,659

Department of the Navy

General Fund
Required Supplementary Stewardship Information

2006

General Fund Required Supplementary Stewardship Information

INVESTMENTS IN RESEARCH AND DEVELOPMENT
Yearly Investment in Research and Development
For Fiscal Years 2002 through 2006
(In Millions of Dollars)

(a)	(b)	(c)	(d)	(e)	(f)
Categories	FY02	FY03	FY04	FY05	FY06
1. Basic Research	$378	$399	$431	$437	$449
2. Applied Research	647	743	686	692	739
3. Development					
Advanced Technology Development	779	836	967	951	912
Advanced Component Development And Prototypes	2,415	2,536	2,361	3,030	3,223
System Development and Demonstration	2,836	4,200	6,115	7,094	7,819
Research, Development, Test, and Evaluation Management Support	838	797	906	955	1,022
Operational Systems Development	2,417	2,385	1,820	3,775	3,399
Total	$10,310	$11,896	$13,286	$16,934	$17,563

Narrative Statement

Investments in Research and Development
Investment values included in this Report are based on Research and Development (R&D) outlays (expenditures). Outlays are used because current Department of Navy (DON) systems are unable to fully capture and summarize costs in accordance with FASAB standards.

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 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.

Cosmic Battle Creates Milky-Way Sized Tunnel
The National Aeronautics and Space Administration, the Naval Research Laboratory's radio astronomy researchers, the National Radio Astronomy Observatory, and the National Science Foundation (NSF), under a cooperative agreement with Associated Universities, Inc., supported a team of astronomers who discovered a giant Milky Way-sized tunnel filled with high energy particles in a distant galaxy cluster. These new findings are of special interest to astronomers as they may provide the missing evolutionary link necessary to understand the cycle of cosmic birth and death, as well as the environmental impact of radio jets, which result from ravenous super-massive black holes within giant galaxies.

Using the Chandra X-ray Observatory to study the multi-million degree gas in the galaxy cluster, Abell 2597, the research scientists discovered an unusual X-ray tunnel large enough to fit the entire Milky Way galaxy inside. The cluster, located at a distance of roughly one billion light years from the Earth, contains a tunnel in the hot gas, which measures nearly 110 thousand light years by 36 thousand light years in size. The tunnel, which appears to originate near the core of the central giant galaxy in the cluster, may be more than 200 million years old. A constant battle is being waged in the central regions of clusters of galaxies. The hot gas invades the core of the cluster and feeds the super-massive black hole that is lurking there.

The fact that the tunnel connects back to the super-massive black hole suggests that the black hole is trying to breach the cluster's defenses in the same area where it has been successful in the past. Astronomers are far from understanding the complex interactions between radio jets and the hot gas in galaxy clusters. Further progress in the field will require sensitive observations at even longer wavelengths, but unfortunately the current suite of low frequency radio telescopes are already at their limits of sensitivity and resolution.

To address this shortcoming, astronomers at several institutions, collectively known as the Southwest Consortium, are contributing to an effort to build the world's largest and most sensitive low-frequency telescope, called the Long Wavelength Array (LWA). The LWA will operate at wavelengths between 15 and 3.75 meters (or 20 and 80 Megahertz) and has the potential to revolutionize future studies of radio galaxies and galaxy clusters. Current plans call for the LWA to be sited near the Very Large Array in New Mexico. Ironically, the LWA will operate at the same frequencies at which the first extra-terrestrial radio emissions were discovered, thus representing a return to the very roots of radio astronomy.

Bering Sea Ecosystem Responding to Changes in Arctic Climate
The Western Shelf-Basin Interactions (SBI) research project conducted a series of research cruises to observe changes in the carbon balance of the offshore areas of the Alaskan Arctic and their effects on the food chain. The cruises included a number of researchers supported by the Office of Naval Research (ONR), the NSF, and the National Oceanic and Atmospheric Administration. The group also funded researchers who contributed data collected by the Bering Strait Environmental Observatory, which annually samples waters in the northern Bering Sea to assess the biological status of productive animal communities on the sea floor.

Physical changes, including rising air and seawater temperatures and decreasing seasonal ice cover, appear to be the cause of a series of biological changes in the northern Bering Sea ecosystem that could have long range and irreversible effects on the animals that live there and on the people who depend on them for their livelihoods. In a paper published in the journal, Science, a team of U.S. and Canadian researchers used data from long-term observations of physical properties and biological communities to conclude that previously documented physical changes in the Arctic in recent years are profoundly affecting Arctic life. The northern Bering Sea provides critical habitat for large populations of sea ducks, gray whales, bearded seals, and walruses, all of which depend on small bottom-dwelling creatures for sustenance.

While the climatic changes researchers are observing are not uniform throughout the Bering Sea, the changes are tied to the nature of the sea ice. In the southeast Bering Sea, fish population and bottom-dwelling animal changes are taking place in the context of a complete loss of sea ice. But in the northern Bering Sea, ecological changes are occurring in the context of shifts in the quality of the sea ice. Satellite observations and other measurements, combined with observations of native Yupik hunters, confirm that sea ice extent and thickness have become greatly reduced in recent years. Also, observations by scientists on the SBI research cruises confirm that walrus mothers were leaving their pups when sea ice the animals normally use as a summer resting platform, retreated to the north. Shifts in fish populations have also been observed, including the appearance of juvenile pink salmon in rivers that drain into the Arctic Ocean, much farther north than normal.

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 also 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 of applied research 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.

Nanorobot Fabrication Makes Ultrasmall Sensors Possible

Researchers at the ONR are using nanotechnology to help answer the question of how to build an infrared (IR) camera that is small enough to fit on a mini-unmanned aerial vehicle (UAV) without cryogenic cooling. Nanotechnology is the understanding and control of matter at dimensions of roughly 1 to 100 nanometers and involves imaging, measuring, modeling, and manipulating matter at this length scale. As a point of reference, a nanometer is one-billionth of a meter; a single sheet of paper is about 100,000 nanometers thick.

Researchers working with the ONR developed a way to build extremely small sensors using nanorobot fabrications. ONR researchers created this new process and Michigan State University scientists implemented it. This technology allows a human operator to use a powerful microscope and a hand-held controller to manipulate nano-sized contact points remotely—similar to using extremely small hands—to construct the pixel elements that will form the heart of the sensor.

The reason for making such a small sensor has to do with the largest of things—protecting multibillion-dollar aircraft carriers and other ships and their thousands of Sailors and Marines. To improve the ability of carrier strike groups to detect enemy missiles over the horizon, the U.S. Navy is searching for ways to augment its surveillance capabilities with a covert team of mini-UAVs, also known as drones, equipped with passive sensors that can cruise near the ocean surface at slow speeds for many hours. A small UAV is possible with the advent of nano-based sensors.

Free-Electron Laser Being Developed For Shipboard Defense

The Free-Electron Laser (FEL), currently housed at the Energy Department's Thomas Jefferson National Accelerator Facility in Newport News, Virginia, is funded by the Office of Naval Research's Directed Energy Program. It is also used by the Army, Air Force, industry, and academia for research. The FEL could be ready for deployment as a shipboard defense against enemy missiles onboard ships like DD(X) next-generation destroyers and CVN-21-class carriers by 2020. The flexibility and range of the laser has been one of the main reasons these varying partners are interested in pursuing the technology.

The FEL's ability to tune to different wavelengths makes it more desirable for shipboard defense – whether to detect missiles or to destroy them – because its beam is not affected by atmospheric interference, which is thickest over the sea's surface. During FY 2006, FEL achieved 10 kilowatts of infrared laser light, 10 million times more powerful than grocery store scanners, making the laser the most powerful of its kind in the world.

The level of output of a FEL, which works best for the Navy at sea level and in a humid environment, has increased in order of magnitude every three years. Within the next five years, the output level is expected to be 100,000 watts, which is the cusp of lethality. Researchers are confident that within an additional three to five years, the FEL's output will be one megawatt (one million watts).

The weapon's precision and power make the FEL particularly desirable for Navy needs. The FEL's range of 100 meters to "multiple kilometers," and power to adjust provide capability to tackle threats from missiles to small fishing boats, make it a good candidate for asymmetric defense.

The Army's Night Vision Laboratory is interested in the laser's ability to create very long wavelengths or terahertz light, which can penetrate the ground, to aid in the detection of improvised explosive devices (IEDs) and land mines. The Air Force would like to use the technology to produce shorter wavelengths or ultraviolet light to be used in making materials for picosatellites.

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 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 development testing.

4. RDT&E 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 R&D program.

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

Plumbing the Chemistry of Iraq IEDs

The ONR is sponsoring a research project at the Massachusetts Institute of Technology (MIT), which is analyzing the molecular interaction of explosive materials. The goal of the three-year program is to study the physics and chemistry of IEDs and find techniques to detonate or short-circuit them before they cause harm.

Two objectives of this project are developing countermeasures and developing safer and more reliable materials for our own use to defend against the IEDs. MIT researchers are conducting with research partners at Washington State University and Michigan Technological University. The funding is part of a military program called the Multidisciplinary University Research Initiative, which is designed to support technology advances and academic work in subjects representing exceptional opportunities for future military applications.

Composed of leftover Iraqi Army mortars, artillery shells, TNT, and a variety of other explosives readily available in Iraq, IEDs pose perhaps the most troublesome problem for U.S. troops on the ground. The bombs, hidden along patrol and convoy routes, are relatively cheap to make, yet have become increasingly sophisticated, more powerful, and harder for the military to defend against. Increasingly skilled insurgents have disguised IEDs as rocks or tucked them inside roadside debris and dead animals.

Other research includes testing different ways that explosives can be stimulated, or triggered – such as through heat, radiation, or mechanics. The goal from this research is to use the knowledge to make IEDs on the side of the road more vulnerable to preemptive stimuli, thereby disabling the explosive devices before they cause harm to U.S. service members.

Program Underway to Develop an Electromagnetic Rail Gun
The ONR instituted a five-year program to break through a historically elusive barrier in the field of weapons technology – a tactically useful electromagnetic (EM) rail gun. The potential of electromagnetic power to shatter the speed and range limits of traditional artillery fired by exploding gas weapons has captivated naval and land warfare visionaries for nearly a century, but the promise has always outpaced a number of stubborn technical obstacles.

The Navy has established a goal of demonstrating the feasibility of a rail gun launcher with muzzle energy of 32 megajoules (MJ), or about half the power output needed for an operational weapon, by 2011. The key metric for determining the feasibility of the rail gun is whether the launcher's containment bore – the protective shroud encapsulating the gun's twin rails and movable armature – is strong enough to survive 100 shots before needing to be replaced due to metal fatigue.

If the project succeeds, ONR predicts that a demonstration of a full-scale 64 MJ launcher could occur by 2015, followed by the fielding of an operational weapon in the year 2020. The Navy's ultimate goal is to replace traditional indirect fire weapons on attack ships with EM rail guns.

NON-FEDERAL PHYSICAL PROPERTY
The Department of the Navy does not fund this type of Activity.

Department of the Navy

General Fund
Required Supplementary Information

2006

2006 Annual Financial Report

Department of Defense
Navy General Fund
DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Other	Research, Development, Test, & Evaluation	Operation and Maintenance	Procurement
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 23,638	$ 1,623,910	$ 771,488	$ 13,511,782
Recoveries of prior year unpaid obligations	354	395,523	2,759,040	1,639,323
Budget Authority:				
Appropriation received	324,023	19,132,442	44,902,797	38,728,922
Borrowing authority	0	0	0	0
Contract authority	0	0	0	0
Spending authority from offsetting collections:				
Earned				
Collected	0	470,976	4,974,223	1,127,268
Change in receivable from Federal sources	0	(86,963)	(636,293)	(30,564)
Change in unfilled customer orders				
Advances received	0	(2,208)	22,671	0
Without advance from Federal sources	0	82,227	348,410	3,219
Anticipated for the 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	$ 324,023	$ 19,596,474	$ 49,611,808	$ 39,828,845
Nonexpenditure transfers, net, anticipated and actual	(301,520)	144,891	733,249	34,389
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	(3,046)	(368,881)	(996,920)	(1,337,565)
Total Budgetary Resources	$ 43,449	$ 21,391,917	$ 52,878,665	$ 53,676,774
Status of Budgetary Resources:				
Obligations Incurred:				
Direct	$ 24,174	$ 19,133,972	$ 47,785,754	$ 36,913,814
Reimbursable	0	130,542	3,885,085	931,526
Subtotal	$ 24,174	$ 19,264,514	$ 51,670,839	$ 37,845,340
Unobligated balance:				
Apportioned	$ 19,276	$ 1,962,250	$ 247,077	$ 15,490,588
Exempt from apportionment	0	0	0	0
Subtotal	19,276	1,962,250	247,077	15,490,588
Unobligated Balance not available	0	165,154	960,749	340,846
Total status of budgetary resources	$ 43,450	$ 21,226,764	$ 51,917,916	$ 53,335,928
Change in obligated balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 60,037	$ 7,881,595	$ 18,006,235	$ 43,170,095
Less: Uncollected customer payments from Federal sources, brought forward, October 1	0	(377,933)	(1,988,640)	(133,235)
Total unpaid obligated balance	60,037	7,503,662	16,017,595	43,036,860
Obligations incurred, net (+/-)	$ 24,174	$ 19,264,514	$ 51,670,839	$ 37,845,340
Less: Gross outlays	(24,630)	(17,892,010)	(47,807,868)	(32,496,411)
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	(354)	(395,524)	(2,759,040)	(1,639,323)
Change in uncollected customer payments from Federal sources (+/-)	0	4,736	287,884	27,345
Obligated balance, net, end of period				
Unpaid obligations	59,227	8,858,576	19,110,166	46,879,702
Less: Uncollected customer payments from Federal sources	0	(373,196)	(1,700,757)	(105,891)
Total, unpaid obligated balance, net, end of period	59,227	8,485,380	17,409,409	46,773,811
Net Outlays:				
Net Outlays:				
Gross outlays	24,630	17,892,010	47,807,868	32,496,411
Less: Offsetting collections	0	(468,768)	(4,996,895)	(1,127,268)
Less: Distributed Offsetting receipts	(12,699)	0	(136,585)	0
Net Outlays	$ 11,931	$ 17,423,242	$ 42,674,388	$ 31,369,143

Department of Defense
Navy General Fund

DISAGGREGATED STATEMENT OF BUDGETAR

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Military Personnel	Military Construction/Family Housing	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 165,732	$ 1,031,929	$ 17,128,479	$ 18,027,995
Recoveries of prior year unpaid obligations	441,101	26,649	5,261,990	11,446,435
Budget Authority:				
Appropriation received	40,433,914	1,989,504	145,511,602	131,002,361
Borrowing authority	0	0	0	0
Contract authority	0	0	0	0
Spending authority from offsetting collections:				
Earned				
Collected	376,531	818,622	7,767,620	8,830,639
Change in receivable from Federal sources	(99,514)	(95,395)	(948,729)	696,667
Change in unfilled customer orders				
Advances received	0	33,866	54,329	147,708
Without advance from Federal sources	5,298	79,919	519,073	(636,393)
Anticipated for the 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	$ 40,716,229	$ 2,826,516	$ 152,903,895	$ 140,040,982
Nonexpenditure transfers, net, anticipated and actual	190,649	(134,248)	667,410	314,674
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	(413,185)	(133,706)	(3,253,303)	(1,543,442)
Total Budgetary Resources	$ 41,100,524	$ 3,617,140	$ 172,708,471	$ 168,286,644
Status of Budgetary Resources:				
Obligations Incurred:				
Direct	$ 40,530,339	$ 1,618,729	$ 146,006,782	$ 137,694,376
Reimbursable	370,706	547,855	5,865,714	13,463,789
Subtotal	$ 40,901,045	$ 2,166,584	$ 151,872,496	$ 151,158,165
Unobligated balance:				
Apportioned	$ 88,443	$ 1,389,961	$ 19,197,595	$ 15,607,505
Exempt from apportionment	0	0	0	0
Subtotal	88,443	1,389,961	19,197,595	15,607,505
Unobligated Balance not available	111,036	60,594	1,638,379	1,520,974
Total status of budgetary resources	$ 41,100,524	$ 3,617,139	$ 172,708,468	$ 168,286,644
Change in obligated balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 746,627	$ 2,228,597	$ 72,093,186	$ 67,196,765
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(121,321)	(779,684)	(3,400,813)	(3,340,541)
Total unpaid obligated balance	625,306	1,448,913	68,692,373	63,856,224
Obligations incurred, net (+/-)	$ 40,901,045	$ 2,166,583	$ 151,872,495	$ 151,158,165
Less: Gross outlays	(40,296,475)	(2,098,279)	(140,615,673)	(134,815,308)
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	(441,101)	(26,649)	(5,261,991)	(11,446,435)
Change in uncollected customer payments from Federal sources (+/-)	94,216	15,476	429,657	(60,273)
Obligated balance, net, end of period				
Unpaid obligations	910,097	2,270,253	78,088,021	72,093,186
Less: Uncollected customer payments from Federal sources	(27,105)	(764,208)	(2,971,157)	(3,400,814)
Total, unpaid obligated balance, net, end of period	882,992	1,506,045	75,116,864	68,692,372
Net Outlays:				
Net Outlays:				
Gross outlays	40,296,476	2,098,279	140,615,674	134,815,308
Less: Offsetting collections	(376,531)	(852,488)	(7,821,950)	(8,978,348)
Less: Distributed Offsetting receipts	0	0	(149,284)	(115,805)
Net Outlays	$ 39,919,945	$ 1,245,791	$ 132,644,440	$ 125,721,155

Department of the Navy (DON) General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and Restoration Tables
As of September 30, 2006
($ in Millions)

Annual Sustainment FY 2006				
	Required	Actual	Difference	
Navy	1,399	1,289	110	
Marine Corps	561	524	37	
Building, Structures, and Utilities	1,960	1,813	147	

Annual Deferred Sustainment Trend				
	FY 2003	FY 2004	FY 2005	FY 2006
Navy	-	488	248	110
Marine Corps	-	24	30	37
Building, Structures, and Utilities	-	512	278	147

Restoration and Modernization Requirements				
	End FY 2005	End FY 2006	Change	
Navy	-	2,021	2,021	
Marine Corps	-	256	256	
Building, Structures, and Utilities	-	2,277	2,277	

Narrative Statement:

Fiscal Year 2006 represents the fifth year the Facility Sustainment Model (FSM) was utilized for the Department of the Navy (DON) General Fund. Sustainment is defined as the maintenance and repair activities necessary to keep a typical facility in good working order over its service life. It includes regularly scheduled adjustments and inspections (such as for fire sprinkler heads and HVAC systems), regulatory inspections (for example, of elevators and bridges), emergency and routine preventive maintenance tasks, and major repair or replacement of facility components, such as roof replacement, refinishing wall surfaces, repairing and replacing electrical, heating, and cooling systems, and replacing tile and carpeting. In FY 2006, FSM Version 7.2 was used for programming and budgeting for facilities sustainment. Deferred amounts were calculated in accordance with the methodology provided by Department of Defense Financial Management Regulation, Volume 6B, Chapter 12.

Restoration and Modernization is currently not modeled. Restoration includes repair and replacement work to restore facilities damaged by inadequate sustainment, excessive age, disaster, accident, or other causes. Modernization includes alteration of facilities solely to implement new or higher standards and regulatory changes, to accommodate new functions including base realignment and closure (BRAC), or to renew building components that typically last more than 50 years, such as foundations and structural members. Requirements listed on the table are actual expenditures for restoration and modernization by year. The program growth evident in the funding trend reflects the impact of Hurricanes Ivan and Katrina and BRAC.

The DON General Fund has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

Military Equipment
Deferred Maintenance Amounts
As of September 30, 2006
($ in Thousands)

Major Type	Amount
1. Aircraft	$70,000
2. Ships	26,000
3. Missiles	78,000
4. Combat Vehicles	83,000
5. Other Weapons Systems	240,000
6. Total	$497,000

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 aircrafts 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, which are 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.

Ship 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.

Missile 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.

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

Other Weapons Systems
The Other Weapons Systems 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 differ in the methodology in defining requirements, all programs define deferred maintenance as the difference between validated requirements and funding.

Software Maintenance
Software maintenance requirements and deferred maintenance for aircraft, missiles, and other equipment are determined using the same methodology and therefore will not be addressed separately for each Military Equipment Deferred Maintenance reporting categories. 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 2006

	Measurement Quantity	As of Oct 1, 2005	Additions	Deletions	As of Sep 30, 2006
Museums	Each	27	-	-	27
Monuments & Memorials	Each	526	26	-	552
Cemeteries	Sites	60	1	-	61
Archeological Sites	Sites	23,941	-	6,153	17,788
Buildings and Structures	Each	9,092	-	-	9,092
Major Collections	Each				

(See Supplemental Reporting, pg. 156)

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 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

In general, the DON defines Heritage Assets as 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. Monetary values are not required for Heritage Asset reporting; only physical units of measure are reported.

Explanation for adjustments, additions, and deletions. In FY 2006, adjustments to Archeological Sites were made after a reconciliation to the DON Federal Archeology Report was performed.

Accurate inventories of archaeological artifacts, archaeological sites, and buildings and structures are dependent on full implementation of tracking systems, notably the Internet Naval Facilities Asset Database Store (iNFADS) and the Department of the Navy Heritage Asset Management System (DONHAMS), and related use of historic property data elements for buildings and structures.

Process used to define assets as Heritage Assets. The processes used to define items as having heritage significance varies between categories and type of assets being evaluated. Subject matter experts, including historians and curators, play a significant role in the definition process in addition to other criteria such as being listed on 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 Financial Management Regulation (FMR) Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," Multi-Use Heritage Assets are reported as Heritage Assets on the RSSI and on the Balance Sheet as Real Property.

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 DON collection, and general display and storage standards for historic collections. The overall condition of the collection objects is good.

Museums
Museums are buildings, places, or institutions devoted to the acquisition, conservation, study, exhibition, and educational interpretation of objects having scientific, historical, or artistic value. Secretary of the Navy Instruction 5755.1A, Navy Museums, defines the scope of the Navy Museum program.

Monuments and Memorials
Monuments and Memorials have significant monetary and/or historical value to DON.

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

Archeological Sites
Archeological Sites are lands on which items of significance are located.

Buildings and Structures
Buildings and Structures are listed as or determined eligible for listing on the National Register of Historic Places, including Multi-Use Heritage Assets. Criteria for evaluating National Register eligibility of these sites may be referenced at 36 CFR 60.4.

Supplemental Reporting. In addition to the data presented in the table above, the following supplemental information on Major Collections was reported as of September 30, 2006:

Category	Measurement Quantity	As of Oct 1, 2005	Additions	Deletions	As of Sep 30, 2006
Archeological Artifacts	Cubic Feet	14,271	3,779	-	18,050
Archival	Linear Feet	97,289	859	-	98,148
Artwork	Item	38,478	335	11	38,802
Historical Artifacts	Item	1,145,715	2,360	340	1,145,735

Archeological Artifacts
In FY 2006 an adjustment of 3,779 cubic feet of Archeological Artifacts was made subsequent to the completion of a reconciliation with DON Federal Archeology Report.

Archival
The FY 2006 increase of 859 linear feet of Archival items is primarily due to the receipt of additional Command Chronology reports.

Artwork
The FY 2006 net increase of 324 Artwork items reflects normal acquisitions and donations.

Historical Artifacts
The net increase of 2,020 Historical Artifacts reflects normal acquisitions and donations.

STEWARDSHIP LAND
For Fiscal Year Ended September 30, 2006
(Acres in Thousands)

(a) Land Use	(b) As of Oct 1, 2005	(c) Additions	(d) Deletions	(e) As of Sep 30, 2006
1. Mission	2,026	0	0	2,026
2. Parks & Historic Sites	0	0	0	0
Totals	2,026	0	0	2,026

Narrative Statement

The DON followed the definition of Stewardship Land per DoD FMR to include Public Domain, Land Set Aside, and Donated Land. The iNFADS was used to derive acres for Stewardship Land. Within the definition of Stewardship Land, land can be further categorized as Improved, Semi-Improved or in the Other Category of land.

Schedule, Part A DoD Intragovernmental Asset Balances *($ Amounts in Thousands)*	Treasury Index:	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		2,671			
Department of Commerce	13					2,165
Department of the Interior	14		10			80,587
Department of Justice	15		4,922			
United States Postal Service	18		13			
Department of State	19		2,853			
Department of the Treasury	20	96,415,968	355		9,751	
Army General Fund	21		16,144			73
Resolution Trust Corporation	22		1			
Office of Personnel Management	24					37,062
Nuclear Regulatory Commission	31		97			
Department of Veterans Affairs	36					
Government Printing Office	4		2			
General Service Administration	47		3			11,887
National Science Foundation	49		263			92
Air Force General Fund	57		13,973			184,167
Environmental Protection Agency	68					2,250
Department of Transportation	69		688			116,132
Homeland Security	70		20,082			
Agency for International Development	72		27			
Small Business Administration	73					107
Department of Health and Human Services	75		71			24
National Aeronautics and Space Administration	80		1,946			696
Department of Housing and Urban Development	86		20			
Department of Energy	89		371			551
Department of Education	91		356			
US Army Corps of Engineers	96		518			
Other Defense Organizations General Funds	97		36,417			25
Other Defense Organizations Working Capital Funds	97-4930		23,090			21,046
Army Working Capital Fund	97-4930.001		1,745			
Navy Working Capital Fund	97-4930.002		32,128			11,393
Air Force Working Capital Fund	97-4930.003		502			
Totals might not match the Principal Statements	**Totals**	$96,415,968	$159,268	$0	$9,751	$468,257

Schedule, Part B DoD Intragovernmental Entity Liabilities *($ Amounts in Thousands)*	Treasury Index:	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Department of Agriculture	12	906		
Department of Commerce	13	1,701		
Department of the Interior	14	5,900		
Department of Justice	15	1,408		
Department of Labor	16			628,791
Department of State	19	16,601		
Department of the Treasury	20	28,357		
Army General Fund	21	52,816		
Office of Personnel Management	24			36,505
Nuclear Regulatory Commission	31	21		
Department of Veterans Affairs	36	2,901		
General Service Administration	47	154,926		
National Science Foundation	49	1,518		
Air Force General Fund	57	44,066		
Tennessee Valley Authority	64	492		
Environmental Protection Agency	68	245		
Department of Transportation	69	32,791		
Homeland Security	70	13,876		
Small Business Administration	73	170		
Department of Health and Human Services	75	57		
National Aeronautics and Space Administration	80	6,852		
Department of Energy	89	99,131		
US Army Corps of Engineers	96	770		
Other Defense Organizations General Funds	97	13,568		1,997
Other Defense Organizations Working Capital Funds	97-4930	236,564		
Army Working Capital Fund	97-4930.001	11,884		
Navy Working Capital Fund	97-4930.002	301,721		
Air Force Working Capital Fund	97-4930.003	5,802		
The General Fund of the Treasury	99			3,792,860
Totals might not match the Principal Statements	**Totals**	$1,035,044	$0	$4,460,153

Schedule, Part C DoD Intragovernmental Revenue and Related Costs *($ Amounts in Thousands)*	Treasury Index:	Earned Revenue
Executive Office of the President	11	114,310
Department of Agriculture	12	24,608
Department of Commerce	13	2,220
Department of the Interior	14	68
Department of Justice	15	16,958
United States Postal Service	18	2
Department of State	19	9,282
Department of the Treasury	20	771
Army General Fund	21	282,160
Resolution Trust Corporation	22	18
Office of Personnel Management	24	1
Nuclear Regulatory Commission	31	2,996
Department of Veterans Affairs	36	16
Government Printing Office	4	91
General Service Administration	47	193
National Science Foundation	49	664
Air Force General Fund	57	219,519
Consumer Product Safety Commission	61	17,901
Environmental Protection Agency	68	75
Department of Transportation	69	4,701
Homeland Security	70	112,914
Agency for International Development	72	99
American Battle Monuments	74	4,359
National Aeronautics and Space Administration	80	13,886
Department of Housing and Urban Development	86	338
Department of Energy	89	2,237
Selective Service System	90	7
Department of Education	91	752
US Army Corps of Engineers	96	46,196
Other Defense Organizations General Funds	97	581,442
Other Defense Organizations Working Capital Funds	97-4930	210,978
Army Working Capital Fund	97-4930.001	
Navy Working Capital Fund	97-4930.002	728,998
Air Force Working Capital Fund	97-4930.003	1,781
DoD Medicare-Eligible Retiree Health Care Fund		125,220
Totals might not match the Principal Statements	**Totals**	$2,525,761

Schedule, Part E DoD Intragovernmental Non-exchange Revenues *($ Amounts in Thousands)*	**Treasury Index:**	**Transfers In**	**Transfers Out**
Air Force General Fund	57	123	
Other Defense Organizations General Funds	97	96,666	
Other Defense Organizations Working Capital Funds	97-4930	38	
Navy Working Capital Fund	97-4930.002	141,492	1,251
Totals might not match the Principal Statements	**Totals**	$238,319	$1,251

Department of the Navy

General Fund
Other Accompanying Information

2006

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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

17 4557	National Defense Sealift Fund, Navy

Earmarked Trust Funds

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

Earmarked Special Funds

17X5095	Wildlife 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 47X0535	Embassy Security, Defense Relocation Program, State Department
17 11 1081	International Military Education and Training Funds, appropriated to the President
17 11X1081	International Military Education and Training Funds, appropriated to the President
17 11 1082	Foreign Military Financing Program, Funds appropriated to the President
17 12X1105B	State and Private Forestry, Forest Service
17 69X8083	Federal-Aid Highways (Liquidation of Contract Authorization), Federal Highway Administration

Department of the Navy

Navy Working Capital Fund
Principal Statements

2006

2006 Annual Financial Report

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 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, 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 FY 2006 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 activity groups and activities within the Navy Working Capital Fund for the fiscal year ending September 30, 2006, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2005.

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 Budgetary Resources
- Combined Statement of Financing

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, 2006 and 2005
($ in thousands)

		2006 Consolidated		2005 Consolidated
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	$	1,244,509	$	977,865
Non-entity Seized Iraqi Cash		0		0
Non-entity - Other		0		0
Investments (Note 4)		0		0
Accounts Receivable (Note 5)		444,251		494,499
Other Assets (Note 6)		1,941		374
Total Intragovernmental Assets	$	1,690,701	$	1,472,738
Cash and Other Monetary Assets (Note 7)		0		0
Accounts Receivable, net (Note 5)		69,356		29,686
Loans Receivable (Note 8)		0		0
Inventory and Related Property, net (Note 9)		13,806,149		15,610,774
General Property, Plant and Equipment, net (Note 10)		3,769,854		3,730,522
Investments (Note 4)		0		0
Other Assets (Note 6)		363,465		536,741
TOTAL ASSETS	$	19,699,525	$	21,380,461
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$	143,723	$	199,606
Debt (Note 13)		173,224		381,518
Other Liabilities (Note 15 & Note 16)		230,190		457,477
Total Intragovernmental Liabilities	$	547,137	$	1,038,601
Accounts Payable (Note 12)		1,485,833		2,152,112
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)		1,185,039		1,192,551
Environmental and Disposal Liabilities (Note 14)		0		0
Loan Guarantee Liability (Note 8)		0		0
Other Liabilities (Note 15 and Note 16)		3,549,935		3,450,673
TOTAL LIABILITIES	$	6,767,944	$	7,833,937
NET POSITION				
Unexpended Appropriations - Earmarked Funds (Note 23)	$	0	$	0
Unexpended Appropriations - Other Funds		2,896		6,286
Cumulative Results of Operations - Earmarked Funds		0		0
Cumulative Results of Operations - Other Funds		12,928,685		13,540,238
TOTAL NET POSITION	$	12,931,581	$	13,546,524
TOTAL LIABILITIES AND NET POSITION	$	19,699,525	$	21,380,461

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, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Program Costs		
Gross Costs	$ 24,097,994	$ 24,824,369
(Less: Earned Revenue)	(22,373,405)	(22,240,414)
Net Costs	$ 1,724,589	$ 2,583,955
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 1,724,589	$ 2,583,955

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, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 13,540,239	$ 16,021,873
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 13,540,239	$ 16,021,873
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	121,857	287,964
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	(46,097)	(84,615)
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(89,398)	0
Imputed financing from costs absorbed by others	559,297	552,597
Other (+/-)	567,376	(653,626)
Total Financing Sources	$ 1,113,035	$ 102,320
Net Cost of Operations (+/-)	1,724,589	2,583,955
Net Change	(611,554)	(2,481,635)
Ending Balances	$ 12,928,685	$ 13,540,238
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 6,286	$ 0
Prior Period Adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 6,286	$ 0
Budgetary Financing Sources:		
Appropriations received	$ 118,467	$ 298,000
Appropriations transferred-in/out (+/-)	0	(3,750)
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	(121,857)	(287,964)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers-in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers-in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ (3,390)	$ 6,286
Net Cost of Operations (+/-)	0	0
Net Change	(3,390)	6,286
Ending Balances	$ 2,896	$ 6,286

Department of Defense
Navy Working Capital Fund

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 2,816,660	$ 2,749,720
Recoveries of prior year unpaid obligations	0	0
Budget Authority:		
Appropriations received	118,467	298,000
Borrowing authority	0	0
Contract authority	4,903,708	865,296
Spending authority from offsetting collections:		
Earned		
Collected	24,056,575	23,151,266
Change in receivables from Federal sources	108,975	(233,654)
Change in unfilled customer orders		
Advances received	(159,907)	8,239
Without advance from Federal sources	(371,044)	249,981
Anticipated for rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure Transfers from trust funds	0	0
Subtotal	$ 28,656,774	$ 24,339,128
Nonexpenditure Transfers, net, anticipated and actual	(46,097)	(88,365)
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(5,936,931)	(247,828)
Total Budgetary Resources	$ 25,490,406	$ 26,752,655
Status of Budgetary Resources:		
Obligations incurred:		
Direct	$ 39,985	$ 0
Reimbursable	22,902,470	23,935,997
Subtotal	$ 22,942,455	$ 23,935,997
Unobligated balance:		
Apportioned	$ 2,796,842	$ 2,768,052
Exempt from apportionment	(441,211)	(143,714)
Subtotal	2,355,631	2,624,338
Unobligated balances not available	192,320	192,321
Total status of budgetary resources	$ 25,490,406	$ 26,752,656

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, 2006 and 2005
($ in thousands)

	2006 Combined	2005 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net	$ 12,667,320	$ 11,860,610
Unpaid obligations, brought forward, October 1	(7,638,329)	(7,621,902)
Less: Uncollected customer payments from Federal sources, brought forward, October 1	$ 5,028,991	$ 4,238,708
Total unpaid obligated balance	$ 22,942,454	$ 23,935,997
Obligations incurred, net (+/-)	(23,497,266)	(23,129,285)
Less: Gross outlays		
Obligated balance transferred, net	0	0
Actual transfers, unpaid obligations (+/-)	(1)	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	(1)	0
Total Unpaid obligated balance transferred, net	0	0
Less: Recoveries of prior year unpaid obligations, actual	262,068	(16,325)
Change in uncollected customer payments from Federal sources (+/-)		
Obligated balance, net, end of period	12,112,506	12,667,320
Unpaid obligations	(7,376,260)	(7,638,229)
Less: Uncollected customer payments from Federal sources	4,736,246	5,029,091
Total Unpaid obligated balance, net, end of period		
Net Outlays:		
Net Outlays:	23,497,266	23,129,285
Gross Outlays	(23,896,668)	(23,159,504)
Less: Offsetting collections	0	0
Less: Distributed Offsetting receipts	$ (399,402)	$ (30,221)
Net Outlays		

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 22,942,454	$ 23,935,997
Less: Spending authority from offsetting collections and recoveries (-)	(23,634,600)	(23,175,830)
Obligations net of offsetting collections and recoveries	(692,146)	760,167
Less: Offsetting receipts (-)	0	0
Net obligations	(692,146)	760,167
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(89,397)	0
Imputed financing from costs absorbed by others	559,297	552,597
Other (+/-)	567,376	(653,626)
Net other resources used to finance activities	1,037,276	(101,029)
Total resources used to finance activities	$ 345,130	$ 659,138
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits benefits ordered but not yet provided		
Undelivered orders (-)	$ (113,368)	$ (684,742)
Unfilled Customer Orders	(530,951)	258,220
Resources that fund expenses recognized in prior periods	(10,441)	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0
Resources that finance the acquisition of assets	(3,154,696)	(4,342,345)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund Receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	(477,979)	653,626
Total resources used to finance items not part of the Net Cost of Operations	$ (4,287,435)	$ (4,115,241)
Total resources used to finance the Net Cost of Operations	$ (3,942,305)	$ (3,456,103)

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	$ 0	$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	2,928	24,326
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 2,928	$ 24,326
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 221,880	$ 205,205
Revaluation of assets and liabilities (+/-)	1,583,686	1,236,002
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	3,858,204	4,574,426
Operating Material & Supplies Used	0	0
Other	194	99
Total components of Net Cost of Operations that will not require or generate resources	$ 5,663,964	$ 6,015,732
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 5,666,892	$ 6,040,058
Net Cost of Operations	$ 1,724,587	$ 2,583,955

The accompanying notes are an integral part of these statements.

Department of the Navy

Navy Working Capital Fund
Notes to the Principal Statements

2006

2006 Annual Financial Report

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, the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible generally accepted accounting principles (GAAP). The accompanying financial statements account for all resources for which the NWCF is responsible. Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernable.

The NWCF is unable to fully implement all elements of GAAP and the OMB Circular A-136, due to limitations of its financial management processes and systems and nonfinancial systems and processes 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 processes and system improvements addressing these limitations many of which are detailed below. The NWCF currently has one auditor identified financial statement weakness: valuation of inventory and operating materials and supplies.

1.B. Mission of the Reporting Entity

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

The NWCF has prepared annual financial statements pursuant to the CFO Act of 1990, as amended, for the past sixteen years. The Act requires that financial statements be prepared and audited for each revolving fund and account that performed substantial commercial functions, such as those performed by the NWCF.

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 their missions and report on resource usage.

Working capital funds (WCF) receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. The WCF entities provide goods and services on a reimbursable basis. Reimbursable receipts fund ongoing operations and generally are available in their entirety for use without further congressional action.

1.D. Basis of Accounting

For FY 2006, 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.

The Department 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 United States 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 based on transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses and accounts payable.

In addition, the NWCF identifies program costs based upon major business areas. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act (GPRA). The NWCF is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

Depot Maintenance and Ordnance WCF activities recognize revenue according to the percentage of completion method for depot maintenance activities. Research and Development activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Supply Management WCF activities recognize revenue from the sale of inventory items and at the time service is rendered for base support activities. The Transportation Activity, Military Sealift Command (MSC) 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 reimbursables, some per diems, and point-to-point voyages, the revenue is accrued in the month services are rendered and collection is made the following month.

The NWCF does not include nonmonetary support provided by US allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Statement of Financing. The US has cost sharing agreements with other countries. Examples include countries where there is a mutual or reciprocal defense agreement, where US troops are stationed, or where the US 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, accrual adjustments are made for major items such as payroll expenses, accounts payable, and unbilled revenue. The NWCF's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within the DoD or between two or more federal agencies. However, the NWCF cannot accurately identify most of its intragovernmental transactions by customer because the NWCF's systems do not track buyer and seller data needed to match related transactions. Seller entities within the DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra DoD intragovernmental balances are then eliminated. The NWCF properly eliminates the revenue resulting from intra DoD sales of capitalized assets. The DoD is developing long-term system improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the DoD and other federal agencies. The Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental 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 investments in federal securities, borrowings from the US Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD's proportionate share of public debt and related expenses to the federal government are 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 Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

Each year the 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, the DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the US Government. Payment is required in advance.

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

The NWCF's monetary financial resources are maintained in US Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the US 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 US Treasury on check issues, electronic fund transfers, interagency transfers, and deposits.

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

1.J. Foreign Currency

Not Applicable.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for doubtful accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated doubtful amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4 CFR 101).

The NWCF bases the estimate of doubtful accounts receivable from the public on a percentage of the total that was billed after the total project cost has been adjusted to reflect the advance deposit. The NWCF requires an advance deposit from all public entities prior to the commencement of work. Therefore, an assumption is made that the amount of doubtful accounts should be negligible.

1.L. Direct Loans and Loan Guarantees

Not Applicable.

1.M. Inventories and Related Property

Most of the NWCF's inventories are currently reported 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 material 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 the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new system development processes, the NWCF has transitioned, and is continuing to transition, the inventory to the moving average cost method. By utilizing new systems development processes, the NWCF is transitioning the inventory to the moving average cost method.

The NWCF manages only military or government specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in the NWCF material management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The NWCF holds material based on military need and support for contingencies. Therefore, 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.

Related property includes OM&S and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD 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 aircraft 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, materials and supplies are expensed when purchased. During FY 2006, 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.

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

The NWCF recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned material is zero. Potentially redistributed material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

Past audits identified uncertainties about completeness and existence of reported values of inventory. 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. It is more economical to repair than to procure these inventory items. Because the NWCF often relies on weapon systems and machinery no longer in production, 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 pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of material ordered but not delivered. 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 Department is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property Plant and Equipment (PP&E) to one that is specific for each individual category. The capitalization threshold was revised from $100,000 to $20,000 for real property. The DON has not implemented the $20,000 real property capitalization threshold yet pending an evaluation of real property systems, processes, and procedures that will have to be revised in order to implement the lowered threshold. Therefore, the $100,000 capitalization threshold remains unchanged for the remaining general PP&E categories.

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. The DoD also requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 for general PP&E. The DoD depreciates all general PP&E, other than land, on a straight-line basis.

Prior to FY 1996, general PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998. No adjustment was made for NWCF assets. These assets remain capitalized and reported on NWCF financial statements.

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, it must be reported on the NWCF Balance Sheet.

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

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," established generally accepted accounting principles for valuing and reporting military equipment (e.g. ships, aircraft, combat vehicles, weapons) in federal financial statements. The standard provides for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost information is not practical. The Department estimated historical cost using the Bureau of Economic Analysis (BEA) estimates to calculate the value of the military equipment for reporting periods from October 1, 2002 through September 30, 2006.

Effective 3rd Quarter, FY 2006, the Department replaced the BEA estimation methodology with military equipment values based on internal Departmental records. The Department initially 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 create baseline. The military equipment baseline is updated using expenditure information, and information related to acquisition and logistics to identify acquisitions and disposals.

1.P. Advances and Prepayments

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

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), the 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 or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Office space and leases entered into by the NWCF in support of contingency operations are the largest component of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and 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. Equipment leases have a variety of lease terms, which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases. The NWCF expects to continue to reduce the level of owned assets while increasing the number of leased assets. The NWCF will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

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, the NWCF provides financing payments. One type of financing payment that the NWCF makes for real property is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the general PP&E line on the Balance Sheet and in the related note.

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

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. 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 Acquisitions Regulations Supplement (DFARS) 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 in Note 10.

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 collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The NWCF's loss contingencies arise as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

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 transfer in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

The NWCF has the use of the land, building, 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. This takes place after negotiations between the US and the host country have determined the amount to be paid the US for such capital investments.

1.W. Comparative Data

Financial statement fluctuations greater than two percent of total assets on the Balance Sheet or ten percent from the previous period presented are explained within the notes to the financial statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

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

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

Note 2. Nonentity Assets

As of September 30	2006		2005	
(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		2,822		2,725
C. Other Assets		0		0
D. Total Nonfederal Assets	$	2,822	$	2,725
3. Total Nonentity Assets	$	2,822	$	2,725
4. Total Entity Assets	$	19,696,703	$	21,377,736
5. Total Assets	$	19,699,525	$	21,380,461

6. Other Information Related to Nonentity Assets

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

Definitions
Nonentity accounts are assets that are held by Navy Working Capital Fund (NWCF), but not available for use in the operations of NWCF.

Composition of Nonentity Assets
The Nonentity Assets amount of $2.8 million represents interest, penalties, fines and administrative fees. These fees do not belong to NWCF and will be distributed directly to the Department of Treasury.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 0	$ 0
B. Revolving Funds	1,244,509	977,865
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	$ 1,244,509	$ 977,865
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 1,244,509	$ 977,865
B. Fund Balance per NWCF	1,244,509	977,865
3. Reconciling Amount	$ 0	$ 0

4. Explanation of Reconciliation Amount:

No reconciling amount to report this period.

5. Information Related to Fund Balance with Treasury:

Fluctuations and Abnormalities
Fund Balance with Treasury (FBWT) increased $266.6 million, 27%, in FY 2006. The majority of this increase is attributed to Supply Management, Navy for the following reasons:

- An increase of $159.6 million in the recovery of costs of operations and the sale of material in excess of inventory replenishment throughout FY 2006. This is a result of the financial lead time of the disbursements for inventory replenishments. For FY 2006 ending, replenishment orders were executed later in the fiscal year and the related cash disbursement had not been executed as compared to the previous fiscal year.

- A cash warrant was received in the amount of $83.1 million in 2nd Quarter, FY 2006.

Composition of Fund Balance with Treasury
The FBWT of $1.2 billion reflects the FY 2005 ending balance of $977.9 million plus current FY 2006 collections, disbursements, and other cash transactions recorded in the Navy Working Capital Fund (NWCF) Treasury sub-limit 97X4930.002. The following table details the amounts recorded as of September 30, 2006:

(Amounts in thousands)	
Collections	$ 23,897,667
Disbursements	$ (23,497,266)
Other Cash Transactions, Net	$ (132,756)

The following table provides a breakout of other cash transactions, net:

(Amounts in thousands)

Business Activity	Description	Amount
Base Support, Navy	Public Law 109-62	$70
Depot Maintenance, Aviation	Public Law 109-62	$23
Supply Management, Navy	Public Law 109-62	$243
Component	Public Law 109-62	$802
Research and Development, Naval Research Lab	Public Law 109-62	$2,765
Research and Development, Space and Naval Warfare Systems	Public Law 109-148	$(50,000)
Supply Management, Navy	Public Law 109-148	$83,067
Base Support, Navy	Public Law 109-234	$35,400
Transportation (Military Sealift Command)	Payment of Debt	$(205,126)
Total		**$(132,756)**

Other Disclosures Related to Fund Balance with Treasury
As a part of the DON's Financial Management Strategic Plan, the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) competitively engaged an accounting firm to conduct a review of NWCF cash management practices and make recommendations for improvement. The review identified NWCF cash management challenges and inconsistencies from not applying the same policies and procedures throughout the NWCF for reconciling cash. Opportunities were also identified to assist activities in reducing the rework required to resolve unmatched disbursements and unmatched collections, which distort cash balances.

One of the primary outcomes of this review is insight into how to level cash balances throughout the fiscal year so as to eliminate the second quarter downward spiral and fourth quarter upward spiral, which create extreme spikes in the cash balance. Short and long-term tasks were identified to improve the timeliness of cash reporting. An evaluation of the risk of maintaining separate vice consolidated NWCF cash balances determined that consolidated balances avoid increases to the total cash requirement. This finding supports implementation of the Department of Defense (DoD) Management Initiative Decision 903. The team also made recommendations to improve the Department's Quick Ratio measure assessed quarterly by DoD.

The focus during FY 2007 will be the initial deployment of cash forecasting and cash reconciliation processes across NWCF activities. Furthermore, cash will be baselined via the write-off of historical unsupported undistributed values, and via the rebalancing of activity cash levels. Preliminary identification of cash related competencies will be made, and initial training will be developed for the workforce.

Status of Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	$ 2,355,631	$ 2,624,338
B. Unavailable	192,321	192,321
2. Obligated Balance not yet Disbursed	$ 12,112,507	$ 12,667,320
3. Nonbudgetary FBWT	$ 0	$ 0
4. NonFBWT Budgetary Accounts	$ (13,415,951)	$ (14,535,420)
5. Total	$ 1,244,508	$ 948,559

6. Information Related to Status of Fund Balance with Treasury:

Fluctuations and Abnormalities
Total Status of Fund Balance with Treasury (FWBT) increased $295.9 million, 31%, in FY 2006. The majority of this increase is attributed to Supply Management, Navy for the following reasons:

- An increase of $159.6 million in the recovery of costs of operations and the sale of material in excess of inventory replenishment throughout FY 2006. This is a result of the financial lead time of the disbursements for inventory replenishments.
- A cash warrant was received in the amount of $83.1 million in 2nd Quarter, FY 2006.

There was an overall NWCF difference between total Status of FWBT for FY 2005 and FWBT for FY 2005 of $29.3 million. This difference was researched and analyzed by NWCF and DFAS during the 3rd and 4th quarters in FY 2006 and has been resolved. These differences resulted from various system problems throughout the history of the NWCF and have been resolved as they have been identified.

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

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

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

Non-Budgetary FBWT includes entity and nonentity FBWT accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

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

Disclosure of Restrictions
Certain unobligated unavailable balances may be restricted to future use and are not apportioned for current use.

Differences Between the Status of FWBT **and the Total of the Fund Balance with Treasury**
The NWCF does not report a difference between Status of Fund Balance with Treasury and the Total of the FWBT at the overall NWCF level. However, there are differences internal to the NWCF at the major command levels. These differences are a result of various system issues and the internal weakness of the NWCF of creating budgetary accounts from the proprietary accounts. The NWCF and DFAS are researching these internal command level differences and plan to correct during FY 2007.

Disclosures Related to Suspense/Budget Clearing Accounts

The NWCF Suspense/Budget Clearing Accounts are being reported under DON General Funds, Index 17.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
(Amounts in thousands)				
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDs)	$ 126,000	$ 67,703	$ 50,181	$ (17,522)
B. Negative Unliquidated Obligations (NULO)	0	0	14	14
2. Total In-transit Disbursements, Net	$ 0	$ (29,618)	$ (56,516)	$ (26,898)

3. Information Related to Disclosures Related to Problem Disbursements and In-Transit Disbursements

Abnormalities and Fluctuations
UMDs decreased $17.5 million, 26%, in FY 2006. This decrease is a direct result of an ongoing initiative to clean up aged UMDs. In order to comply with Under Secretary of Defense, (Comptroller)'s (OUSD(C)) direction to eliminate DON's UMDs over 120 days old by June 30, 2006, an initiative began during 4th Quarter, FY 2005, which increased coordination between DFAS and NWCF activities concerning the reduction of UMDs. As part of this initiative, DFAS and NWCF activities performed root cause analysis that discovered several system and process weaknesses. Some examples of these weaknesses and related corrections of UMDs are:

- Several different root causes have been identified throughout FY 2006. These include the need for strict system edits for processing material bills and accounts payable not being established correctly in Mechanization of Contract Administration System . Additionally, another root cause was incorrect data elements on data entry and system timing issues. DON and DFAS have implemented several changes to working capital fund accounting systems to prevent UMDs. DFAS and DON activities have manually cleared the aged UMDs as these system weaknesses were identified.

- The Transportation Activity, Military Sealift Command identified incorrectly charged transactions due to a system weakness in the Visual Interfund System Transaction Accountability. The deficiencies in the system were corrected by the end of 4th Quarter, FY 2005. DON and DFAS manually cleared the aged UMDs that were a result of this weakness in the 1st Quarter, FY 2006 and the system correction has prevented future UMDs from occurring.

NULOs increased $14.0 thousand, 100%, in FY 2006. The breakdown of this information was not identifiable and reported in previous years. The DON submitted a plan of action and milestones in March 2006 to the OUSD(C) that describes how DON will resolve this reporting issue. The DON and DFAS have incorporated all NULOs as part of the UMD corrective action plan.

Total In-transit Disbursements, Net decreased $26.9 million, 91% in FY 2006. The breakdown of this information was reported but not identifiable in detail in the previous year. These amounts are due to disbursements and collections made by a Department of Defense (DoD) disbursing activity and have not yet been posted to the accounting system. DFAS and NWCF activities are working together to align system process schedules that minimize the amount of these transactions each month.

The NWCF does not report problem disbursements related to Foreign Military Sales (FMS). These problem disbursements are reported by DFAS Denver, FMS Branch.

A portion of the amounts reported on the metric furnished by DFAS Arlington is not supported by NWCF accounting systems. These discrepancies exist within DFAS Columbus reports. Therefore, discrepancies of $527 thousand in UMDs, $12 thousand in NULOs, and $14.8 million in in-transit disbursements exist for this reporting period.

Definitions
An UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

In-transit disbursements represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not yet been posted to the accounting system.

Note 4. Investments and Related Interest

Not Applicable.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intragovernmental Receivables	$ 444,251	N/A	$ 444,251	$ 494,499
2. Nonfederal Receivables (From the Public)	$ 69,383	$ (27)	$ 69,356	$ 29,686
3. Total Accounts Receivable	$ 513,634	$ (27)	$ 513,607	$ 524,185

4. Other Information Related to Accounts Receivable:

Fluctuations and Abnormalities

Intragovernmental Accounts Receivable decreased $50.2 million, 10%, in FY 2006. The primary drivers attributing to this decrease are described below:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Base Support, Public Works Centers		32,603	This reduction is a direct result of ongoing efforts throughout FY 2006 by both the Department of the Navy (DON) and Defense Finance and Accounting Service (DFAS) to dedicate resources to review and analyze the aged abnormal unsupported undistributed values. As a result of this review and analysis, balances related to aged unsupported undistributed collections have been identified and cleared, thus reducing accounts receivable balances.
Research and Development, Naval Surface Warfare Center		10,670	A Daily Expenditure File (DEF) liquidating receivables for September 2005 business was not received and posted until October 2005. A timelier posting of DEF files occurred in September 2006, thus reducing accounts receivable. Additional decreases are a result of ongoing efforts to validate and reduce accounts receivables through research and analysis by DON and DFAS.
Totals		**$43,273**	

Nonfederal accounts receivable increased $39.7 million, 134%, during FY 2006. The primary drivers attributing to this increase are described below:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Supply Management, Navy	42,955		The increase is primarily the result of the liquidation of Stabilized Unsupported Undistributed. This adjustment is a one time event that received Office of Under Secretary of Defense (Comptroller) (OUSD(C)) approval in September 2006 that was in accordance with new guidance provided by OUSD(C) of July 31, 2006.
Base Support, Public Works Centers		7,928	This reduction is a direct result of ongoing efforts throughout FY 2006 by both Navy Working Capital Fund (NWCF) and DFAS to dedicate resources to review and analyze the aged abnormal unsupported undistributed values. As a result of this review and analysis, balances related to aged unsupported undistributed collections have been identified and cleared, thus reducing accounts receivable balances.
Totals	**$42,955**	**$7,928**	

Aged Accounts Receivable

As of September 30	2006				2005			
	Intragovernmental		Nonfederal		Intragovernmental		Nonfederal	
(Amounts in thousands)								
CATEGORY								
Nondelinquent								
Current	$	699,170	$	40,407	$	751,493	$	45,374
Noncurrent		0		0		29		8,072
Delinquent								
1 to 30 days	$	2,765	$	2,419	$	18,570	$	100
31 to 60 days		1,220		3,792		1,379		1,269
61 to 90 days		3,095		953		406		2,450
91 to 180 days		2,118		2,135		5,180		4,656
181 days to 1 year		470		2,031		1,553		2,866
Greater than 1 year and less than or equal to 2 years		699		3,262		6,769		3,047
Greater than 2 years and less than or equal to 6 years		3		2,410		405		2,472
Greater than 6 years and less than or equal to 10 years		0		1,845		55		1,452
Greater than 10 years		0		4,597		0		4,847
Subtotal	$	709,540	$	63,851	$	785,839	$	76,605
Less Supported Undistributed Collections		(148,182)		(8,724)		(310,557)		(9,185)
Less Eliminations		(106,136)		0		(80,817)		0
Less Other		(10,971)		14,256		100,036		(37,733)
Total	$	444,251	$	69,383	$	494,499	$	29,686

Information Related to Aged Accounts Receivable
The NWCF systems do not age accounts receivable, but rather it is a manual process to generate the aging reports. Though the total accounts receivable amount is correct, there is the possibility of misrepresentation of an amount for a particular aging category. The NWCF is working on a systems solution that should be achieved during FY 2007.

The Other line referenced in the chart above for intragovernmental receivables in the amount of $11.0 million and nonfederal receivables in the amount of $14.3 million consists of:

- For intragovernmental and nonfederal receivables there is $10.2 million reflected as a reclassification for Foreign Military Sales (FMS) from intragovernmental to public as required per the change in Department of Defense Financial Management Regulation, Volume 15, Chapter 3. The NWCF is unable to properly categorize all FMS sales due to varying methods for compiling the data. Therefore, some FMS sales appear differently on the Monthly Receivables Report (MRR) than is reported on the Seller Elimination Report (SER). The aging information in this footnote is produced from the MRR; the general ledger account reflects information in the SER. Therefore this adjustment is required in order to balance the two areas.

- The remaining $732 thousand and $4.0 million in intragovernmental and nonfederal receivables respectively, is reflected as manual adjustments for differences between the SER and the Accounts Receivable Single Source Submission Report (ARSSR). The ARSSR is the report used to create the MRR. The aging information in this footnote is produced from the MRR; the general ledger account reflects information in the SER. Therefore, this adjustment is required in order to balance.

The top portion of this chart is derived from MRR, which is manually maintained by DFAS and NWCF activities. The bottom portion of this chart is derived from the accounting adjustments required in the preparation of the financial statements. In order to prepare this chart, NWCF must make adjustments to the "other" line on this chart in order to reconcile the two portions. The DFAS is working with the field sites to eliminate the differences between these two areas.

The eliminations line in this chart reflects the amount of internal NWCF eliminations as reported in the financial statements. The $106 million represents the amounts attributable to other NWCF activities.

NonDelinquent Aged Accounts Receivable
The NWCF does not report any nondelinquent noncurrent accounts receivable.

Delinquent Aged Accounts Receivable
Delinquent Intragovernmental and Nonfederal Receviables over 30 days old totaled $10.4 and $23.4 million respectfully in 4th Quarter, FY 2006.

There are various reasons for the existence of intragovernmental and nonfederal receivables greater than 30 days old. Some of these reasons include, but are not limited to:

- Standard Accounting and Reporting System (STARS) rejects that are being researched by DFAS. When errors occur that result in STARS rejects, additional time is needed to resolve the error, thus resulting in a longer period before the receivable is liquidated. Efforts are underway at all Commands to team with DFAS in clearing existing rejects and implementing business rules/processes that will reduce or eliminate these rejects in the future.

- Reimbursable bills processed in Centralized Expenditure Reimbursable Processing System as of September 28, 2006 did not post to Activities' ledger prior to year-end closing.

- Transactions contain non-standard lines of accounting that do not pass system edits, resulting in errors that take additional time to research and correct.

The DON is taking corrective actions to eliminate the existence of intragovernmental and nonfederal receivables older than 30 days. Some of these corrective actions include, but are not limited to:

- The NWCF and DFAS are working together to ensure timely collection/resolution of delinquent receivables, as well as timely submission of receivables to debt collection in accordance with guidance. The DON is also expecting to develop and implement instructions on the use of the Delinquent Aged Accounts Receivable Report to resolve receivables.

- NWCF Commands are actively monitoring and establishing business rules and processes that ensure that receivables are liquidated in a timely manner. NWCF Commands are also teaming with local nonfinancial personnel to reduce the number of errors that arise from nonfinancial feeder systems.
- DFAS is setting up a Government Receivables Debt Collection Office to act as a liaison between government agencies, ensuring timely collection of government receivables.

Note 6. Other Assets

As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 1,941	$ 374
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	$ 1,941	$ 374
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 27,898	$ 0
B. Other Assets (With the Public)	335,567	536,741
C. Total Nonfederal Other Assets	$ 363,465	$ 536,741
3. Total Other Assets	$ 365,406	$ 537,115

4. Information Related to Other Assets:

Fluctuations and Abnormalities

Intragovernmental Other Assets, Advances and Prepayments increased $1.6 million, 418% in FY 2006. This increase is the result of buyer side trading partner adjustments for Advances to Others that exceeded the value of similar adjustments made in FY 2005. The trading partner contributing the largest amount to this adjustment is the Defense Logistics Agency (DLA). It was discovered in September 2006 that inconsistent business processes between DLA and Navy Working Capital Fund (NWCF) caused this adjustment. The DLA, as per their business processes, is recording transactions as advances; however, NWCF, per their business processes, is recording the transactions as expenses. The NWCF, Defense Finance and Accounting Service (DFAS), and DLA are working together to resolve these issues during 1st Quarter, FY 2007.

Nonfederal Other Assets, Outstanding Contract Financing Payments increased $27.9 million, 100%, in FY 2006. The balance of this line is the estimated future funded payments that will be paid to the contractor upon future delivery and Government acceptance of a satisfactory product. This amount is a direct result of a manual Journal Voucher directed by the Office of Under Secretary of Defense (Comptroller) (OUSD(C)) to satisfy the Department of the Defense, Inspector General (DoDIG) Audit "Financial Management: Report on Recording and Accounting for DoD Contract Financing Payment," of May 10, 2005. The data that was provided to determine the amount of the manual entry was derived from OUSD(C) query of the Mechanization of Contract Administration System (MOCAS) data. The NWCF compared the MOCAS query data to NWCF account data, but was unable to reconcile with the MOCAS query data. Therefore, NWCF is unable to substantiate the balance on this line for 4th Quarter, FY 2006.

Nonfederal Other Assets, Other Assets (With the Public) decreased $201.2 million, 37%, in FY 2006. The drivers attributing to this decrease are described below:

Business Activity	Increases	Decreases	Explanations
Transportation Activity, Military Sealift Command		204,898	The decrease is attributable to the purchase of three ships under the Afloat Prepositioning Force Program and the payments applied in January and July 2006 to the Federal Financing Bank (FFB).
Supply Management, Navy	12,274		The increase is a result of increased progress payments made to contractors in support of aviation weapon systems (for example, the FA-18 Hornet, E-2/C-2 Hawkeye, and P3 Orion) in 4th Quarter, FY 2006.
Totals	**$12,274**	**$204,898**	

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

Note 7. Cash and Other Monetary Assets

Not Applicable.

Note 8. Direct Loan and/or Loan Guarantee Programs

Not Applicable

Note 9. Inventory and Related Property

As of September 30		2006		2005
(Amounts in thousands)				
1. **Inventory, Net**	$	13,378,039	$	14,888,574
2. **Operating Materials & Supplies, Net**		428,110		722,200
3. **Stockpile Materials, Net**		0		0
4. **Total**	$	13,806,149	$	15,610,774

Fluctuations and Abnormalities
Total Inventory and Related Property decreased $1.8 billion, 12%, in FY 2006. The majority of this decrease is attributable to Inventory, Net. The decrease is described in the following sections.

Inventory, Net

As of September 30	2006 Inventory, Gross Value	2006 Revaluation Allowance	2006 Inventory, Net	2005 Inventory, Net	Valuation Method
(Amounts in thousands)					
1. Inventory					
A. Available and Purchased for Resale	$ 24,236,931	$ (24,541,675)	(304,744)	$ 1,918,988	LAC,MAC
B. Held for Repair	11,429,158	1,859,138	13,288,296	12,558,056	LAC,MAC
C. Excess, Obsolete, and Unserviceable	1,161,329	(1,161,329)	0	0	NRV
D. Raw Materials	0	0	0	0	MAC.SP.LA
E. Work in Process	394,487	0	394,487	411,530	AC
F. Total	$ 37,221,905	$ (23,843,866)	13,378,039	$ 14,888,574	

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

2. Information Related to Inventory, Net:

Fluctuations and Abnormalities
Total Inventory, Net decreased by $1.5 billion, 10%, in FY 2006. The primary driver of this decrease is attributed to Supply Management, Navy's (NAVSUP) normal business practice of disposing of obsolete weapon systems and inventory that is beyond economic repair or above required retention level. A portion of these disposals, which began in the 3rd Quarter, FY 2006 is due to the retirement of an aircraft program (F-14). The Navy Working Capital Fund (NWCF) anticipates additional disposal due to the retirement of the F-14 aircraft though FY 2007 and estimates completion of these disposals early in FY 2008.

Restrictions on Inventory Use, Sale, or Disposition
Generally, there are no restrictions with regard to the use, sale, or disposition to applicable Department of Defense (DoD) activities and personnel. Other than certain safety and war reserve levels, inventory may be sold to foreign, state and local governments, private parties and contractors in accordance with DoD and the Department of the Navy (DON) policies and guidance or at the direction of the President.

There are no restrictions on disposition of inventory as related to environmental or other liabilities. Any disposal of inventory is accomplished in accordance with current disposal regulations that allow for the disposal of materials with environmental concerns.

Composition of Inventory
Except for the Work in Process, all inventory categories shown in the table above apply to the Supply Management Activities only.

Inventory Categories
Inventory represents property that is (1) held for sale, (2) in the process of production for sale or (3) to be consumed in the production of goods for sale or in the provision of services for a fee. Inventory Available and Purchased for Resale includes consumable spare and repair parts and repairable items owned and managed by the DON. In some cases, the consumable and repairable items are managed by other Military Services, the Defense Logistics Agency, or the General Services Administration. Material available and purchased for resale includes material held due to a managerial determination that it should be retained to support military or national contingencies. Federal Accounting Standards requires disclosure of the amount of Inventory Held for "Future Sale." The Navy Working Capital Fund currently has no inventory held for future sale reported for FY 2006 in Inventory Held for Sale, Net. All inventory is currently planned for sale next fiscal year. There is no management or valuation difference between the two categories.

Inventory Held for Repair is inventory that requires repair to make it suitable for sale. Many of the inventory items are more economical to repair than to procure. In addition, because the DON often relies on weapon systems and machinery no longer in production, the DON supports a process that encourages the repair and rebuilding of certain items. This repair cycle is an essential part of maintaining a ready, mobile, and armed military force.

Excess, Obsolete, and Unserviceable inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal. The NWCF does not anticipate recovering any significant costs as a result of final disposal of these items. Therefore, excess, obsolete, and unserviceable inventory has a net realizable value of zero.

Work in process balance includes costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending billing to the customer. The 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.

Decision Criteria for Identifying the Category to which Inventory is Assigned
In order to standardize reporting of the categories held for use; held for repair; and excess, obsolete, unserviceable, DON implemented the Under Secretary of Defense (Comptroller) (USD(C)) condition code crosswalk as defined in the memorandum "accounting for excess, unserviceable, and obsolete inventory and operating materials and supplies," of August 12, 2002. In addition, the condition code crosswalk was amended to include code "V" in the excess, obsolete, unserviceable category in September 2002.

Inventory Category	Condition Code
Available and Purchased for Resale	A, B, C, D
Held for Repair	E, F, G, J, K, L, M, N, R
Excess, Obsolete, Unserviceable	P, H, S, V

Other Disclosures Related to Inventory
The general ledger values in the accounting system do not reconcile with the supporting detail record in NAVSUP logistics system. NAVSUP has determined that program changes must be made to the Material Financial Control System (MFCS) to correct systemic posting problems, which contribute to a reconciling difference between the systems. Twenty-four reconciliation System Change Requests (SCR) for Phase Two have been implemented at the NAVSUP field activity. The NAVSUP is working with the field activity to determine journal voucher accounts and values. Once that is completed, the journal vouchers will be submitted to the Office of Financial Operations (FMO) and the Defense Finance and Accounting

Service (DFAS). Once the journal vouchers and the adjustments posting logic SCR are approved, funded, and developed, the final adjustments will be made to inventory and financial systems to align data. Adjustments are planned to occur during FY 2007.

The NAVSUP inventory is currently being reported at an approximation of historical cost using the latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed to capture material 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 Systems (SFFAS) No. 3, "Accounting for Inventory and Related Property." Since the implementation of the Office of Under Secretary of Defense Comptroller (OUSD(C)) Inventory Valuation and Cost of Goods Sold (COGS) 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 Practices (GAAP). The Navy ERP will value inventory at moving average cost and will be compliant with necessary guidance.

Operating Materials and Supplies, Net

As of September 30	2006 OM&S Gross Value	2006 Revaluation Allowance	2006 OM&S, Net	2005 OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories					
A. Held for Use	$ 428,110	$ 0	$ 428,110	$ 722,200	SP, LAC
B. Held for Repair	0	0	0	0	SP, LAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
D. Total	$ 428,110	$ 0	$ 428,110	$ 722,200	

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

2. Information Related to Operating Materials and Supplies (OM&S), Net:

Fluctuations and Abnormalities
Total Operating Materials and Supplies, Net decreased $294 million, 41%, in FY 2006. The primary drivers attributing to this decrease are described below:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Depot Maintenance, Aviation		314,663	The primary reason for this decrease is due to a transfer of inventory to NAVSUP in June 2006. This decrease is an effort to improve supply chain management by leveraging NAVSUP efficiencies for inventory management and replenishment.
Depot Maintenance, Marine Corps	30,625		The majority of the increase took place in June 2006, and is due to purchasing material in bulk with long lead time, to ensure the material was delivered in a timely manner to support the production schedule; and to take advantage of opportunities for better pricing and vendor market. Examples of these items include armor plating, Light Armor Vehicles, and radars.
Total	**$30,625**	**$314,663**	

Restrictions on OM&S

Generally, there are no restrictions with regard to the use, sale, or disposition of OM&S applicable to the Department of Defense (DoD) activities.

Composition of OM&S

The 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. Federal Accounting Standards require disclosure of the amount of OM&S held for "future use." The NWCF reports that $11.3 million of OM&S categorized as held for future use and is included in the "held for use" category.

Decision Criteria for Identifying OM&S Category

In order to standardize reporting of the categories held for use, held for repair, and excess, obsolete, unserviceable, DODN implemented the Under Secretary of Defense (Comptroller) (USD(C) condition code crosswalk as defined in the memorandum "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies," of August 12, 2002. In addition, the condition code crosswalk was amended to include code "V" in the excess, obsolete, unserviceable category in September 2002.

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

Stockpile Materials, Net

Not Applicable.

Note 10. General PP&E, Net

As of September 30	2006					2005
	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	$ 45,822	N/A	$ 45,822	$ 45,848
B. Buildings, Structures, and Facilities	S/L	20 Or 40	6,131,252	$ (4,053,308)	2,077,944	2,007,984
C. Leasehold Improvements	S/L	lease term	302	(224)	78	100
D. Software	S/L	2-5 Or 10	474,721	(278,577)	196,144	211,122
E. General Equipment	S/L	5 or 10	3,301,129	(2,572,577)	728,552	773,536
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	718,491	N/A	718,491	681,761
I. Other			2,823	0	2,823	10,171
J. Total General PP&E			$ 10,674,540	$ (6,904,686)	$ 3,769,854	$ 3,730,522

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

2. Information Related to General Property, Plant and Equipment (GPP&E):

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

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

Heritage Assets and Stewardship Land
Heritage assets and stewardship land are reported on the financial statements of the DON General Fund.

Other Disclosures Related to General PP & E
There are no known restrictions on the use or convertibility of General PP&E, nor are there any adjustments resulting from changes in the accounting standards.

A Supply Management, Navy milestone of the DON Financial Improvement Plan is to identify corrective actions for the reporting of land, buildings, and software during FY 2007.

Assets Under Capital Lease

Information Related to Assets Under Capital Lease:
Navy Working Capital Fund has no assets under capital lease.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Other	2,822	2,725
D. Total Intragovernmental Liabilities	$ 2,822	$ 2,725
2. Nonfederal Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,185,040	1,192,552
C. Environmental Liabilities	0	0
D. Other Liabilities	0	0
E. Total Nonfederal Liabilities	$ 1,185,040	$ 1,192,552
3. Total Liabilities Not Covered by Budgetary Resources	$ 1,187,862	$ 1,195,277
4. Total Liabilities Covered by Budgetary Resources	$ 5,580,082	$ 6,638,660
5. Total Liabilities	$ 6,767,944	$ 7,833,936

6. Information Related to Liabilities Not Covered and Covered by Budgetary Resources:

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

Other Disclosures Related to Liabilities Not Covered by Budgetary Resources
The Other Intragovernmental Liabilities amount of $2.8 million represents interest, penalties, fines and administrative fees. These fees do not belong to Navy Working Capital Fund (NWCF) and will be distributed directly to the Department of Treasury.

The $1.2 billion included in Military Retirement Benefits and Other Employment-Related Actuarial Liabilities represents Federal Employees' Compensation Act liabilities.

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intragovernmental Payables	$ 143,723	$ N/A	$ 143,723	$ 199,605
2. Nonfederal Payables (to the Public)	1,485,833	0	1,485,833	2,152,112
3. Total	$ 1,629,556	$ 0	$ 1,629,556	$ 2,351,717

4. Information Related to Accounts Payable:
Fluctuations and Abnormalities
Intragovernmental Accounts Payable decreased $55.9 million, 28%, in FY 2006. The primary drivers of the decrease are summarized below:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Supply Management, Navy		268,236	The decrease is primarily the result of the liquidation of Stabilized Unsupported Undistributed (SUU). This adjustment is a one time event that received the Office of Under Secretary of Defense (Comptroller) (OUSD(C)) approval in September 2006. This is in accordance with new guidance that was provided by OUSD(C) of July 31, 2006.
Research and Development, Navy Research Labs		5,868	The decrease is due to ongoing efforts to validate and reduce aged accounts payable during FY 2006. These efforts have resulted in the liquidation of accounts payable balances for intragovernmental orders that have been completed.
Component	230,589		Buyer side trading partner adjustments and adjustments for unsupported undistributed during the current period was greater than similar adjustments made previously in FY 2005.
Totals	**$230,589**	**$274,104**	

Nonfederal Accounts Payable decreased $666.3 million, 31%, in FY 2006. A decrease of $486 million was the result of the liquidation of SUU. This adjustment is a one time event that received the OUSD(C) approval in September 2006. This is in accordance with new guidance that was provided by OUSD(C) of July 31, 2006.

Note 13. Debt

As of September 30	2006			2005	
	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	381,518	(208,294)	173,224	(124,759)	381,518
C. Total Agency Debt	$ 381,518	$ (208,294)	$ 173,224	$ (124,759)	$ 381,518
2. Total Debt	$ 381,518	$ (208,294)	$ 173,224	$ (124,759)	$ 381,518

3. Information Related to Debt:

Fluctuations and Abnormalities
Intragovernmental Debt decreased $208.3 million, 55%, in FY 2006. This decrease is a result of:

- The Transportation Activity, Military Sealift Command (MSC) exercised an option in January 2006 to purchase three Maritime Prepositioning Ships (MPS) that had previously been under long-term charter.
- MSC in January and July 2006 paid semi-annual principal payments to the Federal Financing Bank (FFB) for MPS ships.

Other Information Related to Debt
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, non-government 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 FFB is one of the institutions that provided loans to the vessel owners. The FFB reports that the MSC has a debt in the amount of $173.2 million, which represents an outstanding principal balance of $170.6 million and accrued interest payable of $2.6 million. The MSC does not owe this debt to the FFB. This debt is a public debt owed by the private vessel owners. In order to simplify the payments to the FFB and to meet its requirements, the FFB cross-disburses the semi-annual principal and interest payments directly from the Navy Working Capital Fund (NWCF). This is done instead of having the MSC make

Capital Hire payments to the vessel owners, who would in turn make loan obligation payments to the FFB.

It is not uncommon for the government to make payments directly to the bank (FBB) and mirrors other time charters where payment is assigned directly to a bank. This occurred when the ownership of these vessels was transferred to private vessel owners; however, when establishing the loan, FBB coded the loan as a government debt.

As required by the Office of Under Secretary of Defense (Comptroller) (OUSD(C)) memorandum of January 22, 1999, the Transportation Activity Group is correctly recording these payments as an operating expense. The outstanding debt principal amount is reported in the NWCF Balance Sheet as an other asset in order to reconcile with the amount 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.

Note 15. Other Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Intragovernmental				
A. Advances from Others	$ 190,427	$ 0	$ 190,427	$ 416,448
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. Other Liabilities	39,763	0	39,763	41,029
G. Total Intragovernmental Other Liabilities	$ 230,190	$ 0	$ 230,190	$ 457,477
(Amounts in thousands)				
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 843,552	$ 0	$ 843,552	$ 795,598
B. Advances from Others	207,797	0	207,797	141,884
C. Deferred Credits	0	0	0	11,800
D. Deposit Funds and Suspense Accounts	95,694	0	95,694	151,206
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. Other Liabilities	2,374,987	27,905	2,402,892	2,350,185
J. Total Nonfederal Other Liabilities	$ 3,522,030	$ 27,905	$ 3,549,935	$ 3,450,673
3. Total Other Liabilities	$ 3,752,220	$ 27,905	$ 3,780,125	$ 3,908,150

4. Information Related to Other Liabilities:
Fluctuations and Abnormalities
Total Intragovernmental Other Liabilities decreased by $227.3 million, 50%, in FY 2006. (The primary drivers attributing to Intragovernmental Advances from Others (Line 1.A.) decreasing are as follows:)

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Depot Maintenance, Shipyards		114,444	This decrease is primarily attributable to two events. The decrease in advance billings throughout FY 2006 is due to work being completed on orders that were advance billed by Portsmouth and Norfolk Naval Shipyards in February 2005 and February 2006. The decrease in progress billings throughout FY 2006 is due to work being completed by Puget Sound Naval Shipyard. Puget Sound began transitioning from working capital fund to mission funding in FY 2004; this reduction in progress billings is consistent with the transition process.
Research and Development, Space and Naval Warfare Systems Center		49,639	FY 2005 execution was higher than normal due to emergent workload from other non DoD agencies (US Homeland Security, for example) associated with the Global War on Terror. FY 2006 results reflect a return to more normal execution levels.
Total		**$164,083**	

Composition of Intragovernmental Other Liabilities (Line 1.F)
Intragovernmental other liabilities represents liabilities of:

(Thousands)	
Health Benefits	$ 16,257
Life Insurance	365
Retirement Benefits	20,319
Custodial Liabilities	2,822
Total	$ 39,763

Nonfederal Deposit Funds and Suspense Account Liabilities include amounts for unsupported undistributed collections.

Composition of Nonfederal Other Liabilities (Line 2.I.)
Nonfederal other liabilities totaled $2.4 billion in 4th Quarter, FY 2006, which includes amounts that are significant portions of the total liabilities presented in the Navy Working Capital Fund (NWCF) Balance Sheet. A breakout of the major components of nonfederal other liabilities follow:

a. Accrual of Contractual Services represents an accrued liability for direct work performed by contractors or material and supplies purchased for a direct order in which a request for payment has not been received. The accrual is based on the level of effort performed for the direct order on a monthly basis.

b. Depot Level Repairable Carcass Return Liability represents the value of returned items that have been received by an accountable activity from an end-use activity, but a serviceable asset has not been issued.

c. In addition, the portion of other liabilities that consists of progress billings are maintained to show the balance of payments taken for accrued costs charged to work in process or the value of material procured and held for specific orders received from customers within Department of Defense.

d. Liability for Future Funded Payments, per the Department of the Defense, Inspector General (DoDIG) Audit. "Financial Management: Report on Recording and accounting for DoD Contract Financing Payment," of May 10, 2005 and OUSD(C) direction, a contingent liability for outstanding contract financing payments based on cost in excess of progress payments was recognized for the first time in 4th Quarter, FY 2006. The recognized data was derived from an OUSD(C) query of the Mechanization of Contract Administration System (MOCAS). The NWCF field level account data does not reconcile with the MOCAS data, therefore, the NWCF cannot support this OUSD(C) directed adjustment. Also, current business processes and contract clauses do not support this OUSD(C) directed adjustment.

e. The remainder of the other liabilities amount includes Property Furnished by Other Liability.

Intragovernmental Reconciliation for Fiduciary Transactions with Department of Labor (DOL)
For FY 2006, the DON does not have any delinquent amounts due to the Department of Labor (DOL) for the Federal Employees' Compensation Act (FECA) bill. The FY 2007 FECA bill is due to DOL 30 days after the appropriation bill is passed and signed.

Capital Lease Liability

Not Applicable.

Note 16. Commitments and Contingencies

Legal Contingencies:
The Department of the Navy (DON) is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON will accrue contingent liabilities for legal actions in those instances where the DON's Office of 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 15, "Other Liabilities," and Note 12 "Accounts Payable." See Notes 15 and 12 for details.

For fiscal years 2006 and 2005, the Navy Working Capital Fund (NWCF) materiality threshold for reporting litigation, claims, or assessments was $5.0 million and $6.0 million, respectively. Based on information contained in the FY 2006 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.

The NWCF currently has five cases that meet the FY 2006 NWCF materiality threshold, with all five cases against the Navy and none against the United States Marine Corps. DON legal counsel was unable to express an opinion concerning the likely outcome of these cases. Therefore, no contingent liabilities were accrued nor is any disclosure of estimated contingencies required. This declaration is fully supported by the Preliminary and Final Legal Representation letters and the subsidiary management summary schedule.

In response to the Department of Defense, Inspector General audit, "Financial Management: DoD Process for Reporting Contingent Legal Liabilities," the DON developed a methodology during 4th Quarter, FY 2006 that provides an estimate for those legal cases that are considered probable or reasonably possible to be settled against the government. The DON is testing the methodology with the objective to begin reporting in 2nd Quarter, FY 2007.

Other Commitments and Contingencies
The NWCF does not have obligations related to cancelled appropriations for which the reporting entity has a contractual commitment for payment.

The NWCF has contractual arrangements which may require future financial obligations (i.e. undelivered orders). These undelivered orders are estimated at $7.7 billion as of September 30, 2006. Included in this total is $27.9 million also included in the balance for nonfederal other liabilities related to contracting financing payments. No budgetary adjustments were considered in the Office Under Secretary Defense (Comptroller) direction for the Journal Voucher to adjust contingent liabilities. The NWCF has difficulties creating budgetary accounts from proprietary accounts. This has been reported as an internal weakness. Defense Finance and Accounting Service (DFAS) is working with the DON in the Financial Improvement Plan to correct this weakness. In FY 2007, the NWCF plans to start reporting budgetary accounts from the field level accounting systems.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2006				2005
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
(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	$ 1,185,039		$ 0	$ 1,185,039	$ 1,192,551
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	$ 1,185,039		$ 0	$ 1,185,039	$ 1,192,551
3. Other Federal Employment Benefits	$ 0		$ 0	$ 0	$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	$ 1,185,039		$ 0	$ 1,185,039	$ 1,192,551

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

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

Actuarial Cost Method Used
The Department of the Navy (DON) actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON at the end of each fiscal year. The liability is

distributed between the NWCF 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.

Assumptions
The assumptions relate to Federal Employees' Compensation Act (FECA). The projected annual benefit payments are discounted to the present value using OMB'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:

2006
5.170% in Year 1
5.313% 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) 2006 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
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

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 loses per case (a measure of case-severity) in CBY 2006 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 2006 projection to the average pattern for the projections of the most recent three years.

Market Value of Investments in Market-based and Marketable Securities
Not Applicable.

Changes in Actuarial Liability
There have been no changes in the calculation of Actuarial Liability since last reporting period.

Other Employment – Related Actuarial Liabilities
Other Employment – Related Actuarial Liabilities did not have any abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of Actuarial Liabilities to explain for this reporting period. The balance of other employment-related actuarial liabilities is $1.2 billion, all of which is attributable to FECA.

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

Intragovernmental Costs and Exchange Revenue				
As of September 30		2006		2005
(Amounts in thousands)				
1. Intragovernmental Costs	$	4,523,181	$	5,567,550
2. Public Costs		19,574,813		19,256,819
3. Total Costs	$	24,097,994	$	24,824,369
4. Intragovernmental Earned Revenue	$	(21,367,634)	$	(20,715,924)
5. Public Earned Revenue		(1,005,772)		(1,524,490)
6. Total Earned Revenue	$	(22,373,406)	$	(22,240,414)
7. Net Cost of Operations	$	1,724,588	$	2,583,955

8. Information Related to the Statement of Net Cost:

Fluctuations and Abnormalities

Net Cost of Operations decreased $859.4 million, 33%, in FY 2006. The primary driver of this decrease is attributable to Gross Costs decreasing during FY 2006 by $726.4 million when compared with FY 2005. The gross costs for FY 2006 reflect a return to normal business. There were two events during FY 2005 that increased the gross costs for Supply Management, Navy and therefore caused unusually high gross costs. The two events that resulted in increased costs in FY 2005 were:

- The reconciliation of system problems with the Depot Level Repairable Carcass Returns, which occurred in the 2nd Quarter, FY 2005.
- The Enterprise Resource Planning Supply Maintenance (ERP) Aviation Re-engineering Team Pilot concluded its objectives in 3rd Quarter, FY 2005.

Composition of Statement of Net Cost

The NWCF generally records transactions on an accrual basis as required by Federal Generally Accepted Accounting Principles (GAAP). Information presented on the Statement of Net Cost represents the net result of post closing adjustments and eliminating entries made in compiling and consolidating the NWCF financial statements. These entries significantly affected the reported amounts of Intragovernmental Program Cost, Program Cost with the Public, Earned Revenue and Net Program Cost. The post closing adjustments were made in order to increase or decrease certain NWCF account balances reported as of September 30, 2006 to ensure agreement with related balances reported by other Department of Defense (DoD) and other federal reporting entities. Eliminating entries are required adjustments made as part of the financial process. This process enables the matching of trading partner data recorded at each financial statement consolidation level: NWCF, DoD and Federal Government levels.

Other Disclosures Related to the Statement of Net Cost

This statement is unique because its principles are driven by an understanding of net cost of programs and or organizations that the Federal Government supports through appropriations. This statement provides gross and net cost information that can relate to the amount of output for a given program and/or organization administered by a responsible reporting entity.

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.

Although NWCF is able to compare its intragovernmental costs and revenues with corresponding balances of its intragovernmental trading partners, it is unable to validate these balances. There were no material differences identified during the 4th Quarter, FY 2006.

The NWCF does not report any heritage assets or stewardship land, as these entities are reported on the financial statements of the Department of the Navy General Fund.

For FY 2006, 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. The NWCF 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 US 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 based on transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, the NWCF identifies program costs based upon business areas. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act (GPRA). The NWCF is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information, as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

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

As of September 30	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	$ 0	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	0	0
C. Total Prior Period Adjustments	$ 0	$ 0	$ 0	$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 225,349	$ 0	$ 234,870	$ 0
B. Civilian Health	332,920	0	316,724	0
C. Civilian Life Insurance	1,028	0	1,004	0
D. Judgment Fund	0	0	0	0
E. IntraEntity	0	0	0	0
F. Total Imputed Financing	$ 559,297	$ 0	$ 552,598	$ 0

3. Information Related to the Statement of Changes in Net Position:

Imputed Financing

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System, Federal Employee Retirement System, Federal Employee Health Benefits Program and the Federal Employee Group Life Insurance Program do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employees and contributions made by and for them. OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006		2005	
(Amounts in thousands)				
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$	7,699,219	$	7,585,850
2. Available Borrowing and Contract Authority at the End of the Period		6,039,690		6,897,192

3. Information Related to the Statement of Budgetary Resources

Intraentity Transactions
The Statement of Budgetary Resources (SBR) does include intraentity transactions, which have not been eliminated because the statements are presented as combined and combining.

Apportionment Categories
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. These amounts are as follows:

(Amounts in thousands)		
Obligations Incurred – Direct	Line 8.A.	$39,985
Obligations Incurred – Reimbursable	Line 8.B.	$22,902,469
Exempt from apportionment	Line 9.B.	$0

Undelivered Orders
Undelivered Orders presented in the SBR includes Undelivered Orders, Unpaid for both direct and reimbursable funds.

Other Disclosures Related to Statement of Budgetary Resources
The SBR is an image of the monthly Report on Budget Execution, Standard Form 133 (SF 133). These reports should be produced using budgetary accounts. However, the Navy Working Capital Fund (NWCF) uses proprietary accounts because its financial accounting systems were not designed to produce budgetary accounting data. All field level accounting systems have been updated to include budgetary accounts. The Department of the Navy (DON) and the Defense Finance and Accounting Service (DFAS) have implemented a process that allows the field level accounting systems to report budgetary accounts to Defense Departmental Reporting System (DDRS). However, at the end of FY 2006, only two commands have implemented this interface. During FY 2007, the remaining commands will implement interfaces.

Note 21. Disclosures Related to the Statement of Financing

Information Related to the Statement of Financing:
The Statement of Financing 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 and obligation-based amounts used in the Statement of Budgetary Resources (SBR). The computations and presentation of items in the Statement of Financing demonstrate that the budgetary and proprietary information in an entity's financial management system is in agreement.

The Defense Finance and Accounting Service (DFAS), Navy Working Capital Fund (NWCF) accounting systems, and Navy Enterprise Resource Planning include budgetary accounts. Because some of the legacy accounting systems do not include budgetary accounts, however, NWCF budgetary data is not in agreement with proprietary expenses and assets capitalized. The detailed level of information required to appropriately complete the SBR is being developed for those activities that cannot provide the data due to system deficiencies. As a result, the SBR is generated by DFAS using data extracted from the proprietary accounts.

As a result of these system deficiencies, Resources that Finance the Acquisition of Assets on the Statement of Financing was adjusted upward by $921.7 million at the end of 4th Quarter, FY 2006 to bring it into balance with the Statement of Net Cost.

The following Statement of Financing lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

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

Composition of Other Lines
There are four "Other" lines on the Consolidated Statement of Financing during FY 2006. The compositions of those lines are described below:

Resources Used to Finance Items not Part of the Net Cost of Operations
The amount reported as other is the result of the financial closure of three Navy Working Capital Fund (NWCF) activities during FY 2006. On October 1, 1999, the Naval Weapons Station, Seal Beach and the Naval Weapons Station, Yorktown migrated from the NWCF to the Navy General Fund. Closure of the residual financial records occurred in the 2nd Quarter, FY 2006. Public Works Center, San Francisco was operationally closed on September 27, 1997. Closure of the residual financial records occurred in the 3rd Quarter, FY 2006. The closure of the residual financial records for these activities resulted in a net loss posted to deferred accumulated operating results.

Other Resources Used to Finance Items not Part of the Net Cost of Operations, Other
The amount reported as other resources used to finance items not part of the net cost of operations is comprised of transfers of assets out of NWCF.

Components Not Requiring or Generating Resources from Cost of Goods Sold
The amount reported as other components not requiring or generating resources from cost of goods sold consists of the amount of NWCF cost of goods sold.

Components Not Requiring or Generating Resources, Other
The amount reported as other components not requiring or generating resources from other consist of adjustments to inventory held for repair valuation accounts.

Other Disclosures
There were no allocation transfers.

Liabilities not covered by budgetary resources consist of nonentity assets (interest, penalties, fines and administrative fees) and Military Retirement Benefits and Other Employment Actuarial Liabilities for the Navy Working Capital Fund. There are no amounts for resources in future periods for the Navy Working Capital Fund, as revenues are generated to cover liabilities during current years. Therefore, amounts reported as requiring resources in future periods do not have a relationship to liabilities not covered by budgetary resources.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 23. Earmarked Funds

Not applicable.

Note 24. Other Disclosures

Not Applicable.

Department of the Navy

Navy Working Capital Fund
Supporting Consolidating/Combining Statements

2006

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Department of Defense
Navy Working Capital Fund

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Ordnance
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 326,388	$ 203,214	$ 0
Non-entity Seized Iraqi Cash	0	0	0
Non-entity - Other	0	0	0
Investments (Note 4)	0	0	0
Accounts Receivable (Note 5)	4,837	63,644	0
Other Assets (Note 6)	0	0	0
Total Intragovernmental Assets	$ 331,225	$ 266,858	$ 0
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0
Accounts Receivable, net (Note 5)	117	1,410	0
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property, net (Note 9)	177,221	130,470	0
General Property, Plant and Equipment, net (Note 10)	629,183	340,396	0
Investments (Note 4)	0	0	0
Other Assets (Note 6)	27,288	4,546	0
TOTAL ASSETS	$ 1,165,034	$ 743,680	$ 0
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ (3,875)	$ 125,397	$ 0
Debt (Note 13)	0	0	0
Other Liabilities (Note 15 & Note 16)	13,432	5,620	0
Total Intragovernmental Liabilities	$ 9,557	$ 131,017	$ 0
Accounts Payable (Note 12)	$ 54,522	$ 12,734	$ 0
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	0	0	0
Environmental and Disposal Liabilities (Note 14)	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	314,305	249,788	0
TOTAL LIABILITIES	$ 378,384	$ 393,539	$ 0
NET POSITION			
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0	$ 0
Unexpended Appropriations - Other Funds	0	0	0
Cumulative Results of Operations - Earmarked Funds	0	0	0
Cumulative Results of Operations - Other Funds	786,650	350,141	0
TOTAL NET POSITION	$ 786,650	$ 350,141	$ 0
TOTAL LIABILITIES AND NET POSITION	$ 1,165,034	$ 743,680	$ 0

Department of Defense
Navy Working Capital Fund

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005
($ in thousands)

	Transportation	Base Support	Research & Development
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 363,363	$ 268,183	$ 1,039,328
Non-entity Seized Iraqi Cash	0	0	0
Non-entity - Other	0	0	0
Investments (Note 4)	0	0	0
Accounts Receivable (Note 5)	114,034	121,291	(26,895)
Other Assets (Note 6)	0	0	0
Total Intragovernmental Assets	$ 477,397	$ 389,474	$ 1,012,433
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0
Accounts Receivable, net (Note 5)	229	33,387	8,769
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property, net (Note 9)	2,092	28,950	356,437
General Property, Plant and Equipment, net (Note 10)	38,014	774,337	1,448,498
Investments (Note 4)	0	0	0
Other Assets (Note 6)	172,010	2,014	9,710
TOTAL ASSETS	$ 689,742	$ 1,228,162	$ 2,835,847
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 105,275	$ 42,188	$ (2,412)
Debt (Note 13)	173,224	0	0
Other Liabilities (Note 15 & Note 16)	2,973	5,368	210,887
Total Intragovernmental Liabilities	$ 281,472	$ 47,556	$ 208,475
Accounts Payable (Note 12)	$ 276,372	$ 208,548	$ 573,258
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	0	0	0
Environmental and Disposal Liabilities (Note 14)	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	63,673	76,311	2,084,016
TOTAL LIABILITIES	$ 621,517	$ 332,415	$ 2,865,749
NET POSITION			
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0	$ 0
Unexpended Appropriations - Other Funds	0	0	507
Cumulative Results of Operations - Earmarked Funds	0	0	0
Cumulative Results of Operations - Other Funds	68,225	895,747	(30,409)
TOTAL NET POSITION	$ 68,225	$ 895,747	$ (29,902)
TOTAL LIABILITIES AND NET POSITION	$ 689,742	$ 1,228,162	$ 2,835,847

Department of Defense
Navy Working Capital Fund

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005
($ in thousands)

	Supply Management	Component Level	Marine Corps - NWCF	Combined Total
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	$ (747,777)	$ (238,383)	$ 30,193	$ 1,244,509
Non-entity Seized Iraqi Cash	0	0	0	0
Non-entity - Other	0	0	0	0
Investments (Note 4)	0	0	0	0
Accounts Receivable (Note 5)	143,180	(9,687)	33,906	444,310
Other Assets (Note 6)	0	1,941	0	1,941
Total Intragovernmental Assets	$ (604,597)	$ (246,129)	$ 64,099	$ 1,690,760
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0	$ 0
Accounts Receivable, net (Note 5)	13,736	11,381	327	69,356
Loans Receivable (Note 8)	0	0	0	0
Inventory and Related Property, net (Note 9)	12,552,911	0	558,068	13,806,149
General Property, Plant and Equipment, net (Note 10)	491,151	0	48,275	3,769,854
Investments (Note 4)	0	0	0	0
Other Assets (Note 6)	121,923	25,455	519	363,465
TOTAL ASSETS	$ 12,575,124	$ (209,293)	$ 671,288	$ 19,699,584
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$ 202,053	$ (331,226)	$ 6,382	$ 143,782
Debt (Note 13)	0	0	0	173,224
Other Liabilities (Note 15 & Note 16)	0	(9,007)	917	230,190
Total Intragovernmental Liabilities	$ 202,053	$ (340,233)	$ 7,299	$ 547,196
Accounts Payable (Note 12)	$ 59,085	$ 233,468	$ 67,846	$ 1,485,833
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	0	1,155,444	29,595	1,185,039
Environmental and Disposal Liabilities (Note 14)	0	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0	0
Other Liabilities (Note 15 and Note 16)	608,079	123,090	30,673	3,549,935
TOTAL LIABILITIES	$ 869,217	$ 1,171,769	$ 135,413	$ 6,768,003
NET POSITION				
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0	$ 0	$ 0
Unexpended Appropriations - Other Funds	0	2,389	0	2,896
Cumulative Results of Operations - Earmarked Funds	0	0	0	0
Cumulative Results of Operations - Other Funds	11,705,907	(1,383,451)	535,875	12,928,685
TOTAL NET POSITION	$ 11,705,907	$ (1,381,062)	$ 535,875	$ 12,931,581
TOTAL LIABILITIES AND NET POSITION	$ 12,575,124	$ (209,293)	$ 671,288	$ 19,699,584

Department of Defense
Navy Working Capital Fund

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005
($ in thousands)

	Eliminations	2006 Consolidated	2005 Consolidated
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 0	$ 1,244,509	$ 977,865
Non-entity Seized Iraqi Cash	0	0	0
Non-entity - Other	0	0	0
Investments (Note 4)	0	0	0
Accounts Receivable (Note 5)	59	444,251	494,499
Other Assets (Note 6)	0	1,941	374
Total Intragovernmental Assets	$ 59	$ 1,690,701	$ 1,472,738
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0
Accounts Receivable, net (Note 5)	0	69,356	29,686
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property, net (Note 9)	0	13,806,149	15,610,774
General Property, Plant and Equipment, net (Note 10)	0	3,769,854	3,730,522
Investments (Note 4)	0	0	0
Other Assets (Note 6)	0	363,465	536,741
TOTAL ASSETS	$ 59	$ 19,699,525	$ 21,380,461
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ 59	$ 143,723	$ 199,605
Debt (Note 13)	0	173,224	381,518
Other Liabilities (Note 15 & Note 16)	0	230,190	457,477
Total Intragovernmental Liabilities	$ 59	$ 547,137	$ 1,038,600
Accounts Payable (Note 12)	$ 0	$ 1,485,833	$ 2,152,112
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	0	1,185,039	1,192,551
Environmental and Disposal Liabilities (Note 14)	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	0	3,549,935	3,450,673
TOTAL LIABILITIES	$ 59	$ 6,767,944	$ 7,833,936
NET POSITION			
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0	$ 0
Unexpended Appropriations - Other Funds	0	2,896	6,286
Cumulative Results of Operations - Earmarked Funds	0	0	0
Cumulative Results of Operations - Other Funds	0	12,928,685	13,540,239
TOTAL NET POSITION	$ 0	$ 12,931,581	$ 13,546,525
TOTAL LIABILITIES AND NET POSITION	$ 59	$ 19,699,525	$ 21,380,461

Department of Defense
Navy Working Capital Fund

CONSOLIDATING STATEMENT OF NET COST

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Combined Total	Eliminations
Program Costs		
Gross Costs	$ 730,863	$ 662
(Less: Earned Revenue)	(708,962)	(686)
Net Program Costs	$ 21,901	$ (24)
A. Base Support		
Gross Costs	$ 2,099,170	$ 0
(Less: Earned Revenue)	(2,005,275)	0
Net Program Costs	$ 93,895	$ 0
B. Component Level		
Gross Costs	$ (1,377,706)	$ 686
(Less: Earned Revenue)	1,902,406	(662)
Net Program Costs	$ 524,700	$ 24
C. Depot Maintenance, Aviation		
Gross Costs	$ 1,844,712	$ 0
(Less: Earned Revenue)	(1,837,155)	0
Net Program Costs	$ 7,557	$ 0
D. Depot Maintenance, Shipyards		
Gross Costs	$ 1,778,663	$ 0
(Less: Earned Revenue)	(1,732,033)	0
Net Program Costs	$ 46,630	$ 0
E. Ordnance		
Gross Costs	$ 22	$ 0
(Less: Earned Revenue)	0	0
Net Program Costs	$ 22	$ 0
F. Transportation		
Gross Costs	$ 2,378,339	$ 0
(Less: Earned Revenue)	(2,479,253)	0
Net Program Costs	$ (100,914)	$ 0
G. Research & Development		
Gross Costs	$ 10,097,710	$ 0
(Less: Earned Revenue)	(10,064,473)	0
Net Program Costs	$ 33,237	$ 0
H. Supply Management		
Gross Costs	$ 6,547,569	$ 0
(Less: Earned Revenue)	(5,450,008)	0
Net Program Costs	$ 1,097,561	$ 0
I. Total Program Costs		
Gross Costs	$ 24,099,342	$ 1,348
(Less: Earned Revenue)	(22,374,753)	(1,348)
Net Program Costs	$ 1,724,589	$ 0
Cost Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 1,724,589	$ 0

Department of Defense
Navy Working Capital Fund

CONSOLIDATING STATEMENT OF NET COST

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Program Costs		
Gross Costs	$ 730,201	$ 659,655
(Less: Earned Revenue)	(708,276)	(683,205)
Net Program Costs	$ 21,925	$ (23,550)
A. Base Support		
Gross Costs	$ 2,099,170	$ 1,693,763
(Less: Earned Revenue)	(2,005,275)	(1,739,097)
Net Program Costs	$ 93,895	$ (45,334)
B. Component Level		
Gross Costs	$ (1,378,392)	$ (777,277)
(Less: Earned Revenue)	1,903,068	1,779,340
Net Program Costs	$ 524,676	$ 1,002,063
C. Depot Maintenance, Aviation		
Gross Costs	$ 1,844,712	$ 1,962,339
(Less: Earned Revenue)	(1,837,155)	(1,818,993)
Net Program Costs	$ 7,557	$ 143,346
D. Depot Maintenance, Shipyards		
Gross Costs	$ 1,778,663	$ 1,686,929
(Less: Earned Revenue)	(1,732,033)	(1,656,365)
Net Program Costs	$ 46,630	$ 30,564
E. Ordnance		
Gross Costs	$ 22	$ (12,144)
(Less: Earned Revenue)	0	0
Net Program Costs	$ 22	$ (12,144)
F. Transportation		
Gross Costs	$ 2,378,339	$ 2,002,735
(Less: Earned Revenue)	(2,479,253)	(1,951,860)
Net Program Costs	$ (100,914)	$ 50,875
G. Research & Development		
Gross Costs	$ 10,097,710	$ 10,032,416
(Less: Earned Revenue)	(10,064,473)	(10,036,814)
Net Program Costs	$ 33,237	$ (4,398)
H. Supply Management		
Gross Costs	$ 6,547,569	$ 7,575,953
(Less: Earned Revenue)	(5,450,008)	(6,133,420)
Net Program Costs	$ 1,097,561	$ 1,442,533
I. Total Program Costs		
Gross Costs	$ 24,097,994	$ 24,824,369
(Less: Earned Revenue)	(22,373,405)	(22,240,414)
Net Program Costs	$ 1,724,589	$ 2,583,955
Cost Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 1,724,589	$ 2,583,955

Department of Defense
Navy Working Capital Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 577,355	$ 842,461
Recoveries of prior year unpaid obligations	0	0
Budget Authority:		
Appropriations Received	0	0
Borrowing Authority	0	0
Contract Authority	27,346	74,617
Spending Authority from offsetting collections:		
Earned		
Collected	1,756,460	1,827,635
Change in receivable from Federal sources	(1,882)	(3,231)
Change in unfilled customer orders		
Advance received	(115,624)	11,734
Without advance from Federal sources	(238,536)	105,136
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	$ 1,427,764	$ 2,015,891
Nonexpenditure transfers, net, anticipated and actual	0	23
Temporarily not available pursuant to Public Law	0	0
Permanently not available	0	0
Total Budgetary Resources	$ 2,005,119	$ 2,858,375
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	$ 0	$ 0
Reimbursable	1,935,302	1,484,089
Subtotal	$ 1,935,302	$ 1,484,089
Unobligated balance:		
Apportioned	$ 94,818	$ 1,374,286
Exempt from apportionment	(25,000)	0
Subtotal	69,818	1,374,286
Unobligated Balances Not Available	(1)	0
Total status of budgetary resources	$ 2,005,119	$ 2,858,375

Department of Defense
Navy Working Capital Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Ordnance	Transportation	Base Support
BUDGETARY FINANCING ACCOUNTS			
Budgetary Resources:			
Unobligated balance, brought forward, October 1	$ 35,172	$ 193,421	$ 313,041
Recoveries of prior year unpaid obligations	0	0	0
Budget Authority:			
Appropriations Received	0	0	35,400
Borrowing Authority	0	0	0
Contract Authority	0	16,019	18,400
Spending Authority from offsetting collections:			
Earned			
Collected	65	2,459,145	2,047,656
Change in receivable from Federal sources	(65)	20,070	(8,924)
Change in unfilled customer orders			
Advance received	0	0	(5,423)
Without advance from Federal sources	0	(229,781)	(228,490)
Anticipated for the rest of year, without advances	0	0	0
Previously unavailable	0	0	0
Expenditure transfers from trust funds	0	0	0
Subtotal	$ 0	$ 2,265,453	$ 1,858,619
Nonexpenditure transfers, net, anticipated and actual	(32,107)	0	70
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	(3,043)	(205,126)	0
Total Budgetary Resources	$ 22	$ 2,253,748	$ 2,171,730
Status of Budgetary Resources:			
Obligations Incurred:			
Direct	$ 0	$ 0	$ 35,400
Reimbursable	22	2,172,132	2,214,423
Subtotal	$ 22	$ 2,172,132	$ 2,249,823
Unobligated balance:			
Apportioned	$ 0	$ 131,616	$ 178,386
Exempt from apportionment	0	(50,000)	(256,479)
Subtotal	0	81,616	(78,093)
Unobligated Balances Not Available	0	0	0
Total status of budgetary resources	$ 22	$ 2,253,748	$ 2,171,730

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Research & Development	Supply Management	Component Level
BUDGETARY FINANCING ACCOUNTS			
Budgetary Resources:			
Unobligated balance, brought forward, October 1	$ 1,368,048	$ 601,538	$ (1,342,076)
Recoveries of prior year unpaid obligations	0	0	0
Budget Authority:			
Appropriations Received	0	83,067	0
Borrowing Authority	0	0	0
Contract Authority	140,894	4,609,892	0
Spending Authority from offsetting collections:			
Earned			
Collected	10,103,375	5,241,004	10
Change in receivable from Federal sources	(8,384)	85,136	8,670
Change in unfilled customer orders			
Advance received	(52,127)	1,643	0
Without advance from Federal sources	188,040	43,751	0
Anticipated for the rest of year, without advances	0	0	0
Previously unavailable	0	0	0
Expenditure transfers from trust funds	0	0	0
Subtotal	$ 10,371,798	$ 10,064,493	$ 8,680
Nonexpenditure transfers, net, anticipated and actual	(15,128)	243	802
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	3,043	(5,731,805)	0
Total Budgetary Resources	$ 11,727,761	$ 4,934,469	$ (1,332,594)
Status of Budgetary Resources:			
Obligations Incurred:			
Direct	$ 4,585	$ 0	$ 0
Reimbursable	9,705,252	4,609,892	86,953
Subtotal	$ 9,709,837	$ 4,609,892	$ 86,953
Unobligated balance:			
Apportioned	$ 2,132,326	$ 132,256	$ (1,424,217)
Exempt from apportionment	(114,401)	0	4,669
Subtotal	2,017,925	132,256	(1,419,548)
Unobligated Balances Not Available	(1)	192,321	1
Total status of budgetary resources	$ 11,727,761	$ 4,934,469	$ (1,332,594)

Department of Defense
Navy Working Capital Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Marine Corps - NWCF	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS			
Budgetary Resources:			
Unobligated balance, brought forward, October 1	$ 227,700	$ 2,816,660	$ 2,749,720
Recoveries of prior year unpaid obligations	0	0	0
Budget Authority:			
Appropriations Received	0	118,467	298,000
Borrowing Authority	0	0	0
Contract Authority	16,540	4,903,708	865,296
Spending Authority from offsetting collections:			
Earned			
Collected	621,225	24,056,575	23,151,268
Change in receivable from Federal sources	17,585	108,975	(233,655)
Change in unfilled customer orders			
Advance received	(110)	(159,907)	8,239
Without advance from Federal sources	(11,164)	(371,044)	249,980
Anticipated for the rest of year, without advances	0	0	0
Previously unavailable	0	0	0
Expenditure transfers from trust funds	0	0	0
Subtotal	$ 644,076	$ 28,656,774	$ 24,339,128
Nonexpenditure transfers, net, anticipated and actual	0	(46,097)	(88,365)
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	0	(5,936,931)	(247,828)
Total Budgetary Resources	$ 871,776	$ 25,490,406	$ 26,752,655
Status of Budgetary Resources:			
Obligations Incurred:			
Direct	$ 0	$ 39,985	$ 0
Reimbursable	694,405	22,902,470	23,935,997
Subtotal	$ 694,405	$ 22,942,455	$ 23,935,997
Unobligated balance:			
Apportioned	$ 177,371	$ 2,796,842	$ 2,768,052
Exempt from apportionment	0	(441,211)	(143,714)
Subtotal	177,371	2,355,631	2,624,338
Unobligated Balances Not Available	0	192,320	192,320
Total status of budgetary resources	$ 871,776	$ 25,490,406	$ 26,752,655

Department of Defense
Navy Working Capital Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Change in obligated balance:		
Obligated Balance, net		
Unpaid obligations, brought forward, October 1	$ 703,958	$ 904,864
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(654,380)	(653,986)
Total unpaid obligated balance	$ 49,578	$ 250,878
Obligations incurred, net (+/-)	$ 1,935,302	$ 1,484,089
Less: Gross outlays	(1,705,838)	(1,831,176)
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
Total Unpaid obligated balance transferred, net	0	0
Less: Recoveries of prior year unpaid obligations, actual	0	0
Change in uncollected customer payments from Federal sources (+/-)	240,417	(101,904)
Obligated balance, net, end of period		
Unpaid obligations	933,421	557,777
Less: Uncollected customer payments from Federal sources	(413,963)	(755,890)
Total, unpaid obligated balance, net, end of period	519,458	(198,113)
Net Outlays:		
Net Outlays:		
Gross Outlays	1,705,838	1,831,176
Less: Offsetting collections	(1,640,836)	(1,839,370)
Less: Distributed Offsetting receipts	0	0
Net Outlays	$ 65,002	$ (8,194)

Department of Defense
Navy Working Capital Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Ordnance	Transportation	Base Support
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:			
Change in obligated balance:			
Obligated Balance, net			
Unpaid obligations, brought forward, October 1	$ 551	$ 706,018	$ 420,405
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(33)	(475,319)	(346,036)
Total unpaid obligated balance	$ 518	$ 230,699	$ 74,369
Obligations incurred, net (+/-)	$ 22	$ 2,172,132	$ 2,249,823
Less: Gross outlays	(46)	(2,137,676)	(2,015,016)
Obligated balance transferred, net			
Actual transfers, unpaid obligations (+/-)	(526)	0	(32,968)
Actual transfers, uncollected customer payments from Federal sources (+/-)	(33)	0	497
Total Unpaid obligated balance transferred, net	(559)	0	(32,471)
Less: Recoveries of prior year unpaid obligations, actual	0	0	0
Change in uncollected customer payments from Federal sources (+/-)	65	209,711	237,413
Obligated balance, net, end of period			
Unpaid obligations	0	740,474	622,244
Less: Uncollected customer payments from Federal sources	0	(265,609)	(108,125)
Total, unpaid obligated balance, net, end of period	0	474,865	514,119
Net Outlays:			
Net Outlays:			
Gross Outlays	46	2,137,676	2,015,016
Less: Offsetting collections	(65)	(2,459,145)	(2,042,233)
Less: Distributed Offsetting receipts	0	0	0
Net Outlays	$ (19)	$ (321,469)	$ (27,217)

Department of Defense
Navy Working Capital Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Research & Development	Supply Management	Component Level
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:			
Change in obligated balance:			
Obligated Balance, net			
Unpaid obligations, brought forward, October 1	$ 4,962,336	$ 4,768,956	$ (92,493)
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(4,645,513)	(538,066)	8,654
Total unpaid obligated balance	$ 316,823	$ 4,230,890	$ (83,839)
Obligations incurred, net (+/-)	$ 9,709,836	$ 4,609,892	$ 86,953
Less: Gross outlays	(10,063,636)	(5,083,238)	(7,209)
Obligated balance transferred, net			
Actual transfers, unpaid obligations (+/-)	0	0	33,494
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	(465)
Total Unpaid obligated balance transferred, net	0	0	33,029
Less: Recoveries of prior year unpaid obligations, actual	0	0	0
Change in uncollected customer payments from Federal sources (+/-)	(179,656)	(128,887)	(8,670)
Obligated balance, net, end of period			
Unpaid obligations	4,608,537	4,295,609	20,745
Less: Uncollected customer payments from Federal sources	(4,825,169)	(666,952)	(481)
Total, unpaid obligated balance, net, end of period	(216,632)	3,628,657	20,264
Net Outlays:			
Net Outlays:			
Gross Outlays	10,063,636	5,083,238	7,209
Less: Offsetting collections	(10,051,247)	(5,242,648)	(9)
Less: Distributed Offsetting receipts	0	0	0
Net Outlays	$ 12,389	$ (159,410)	$ 7,200

Department of Defense
Navy Working Capital Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Marine Corps - NWCF	2006 Combined	2005 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:			
Change in obligated balance:			
Obligated Balance, net			
Unpaid obligations, brought forward, October 1	$ 292,725	$ 12,667,320	$ 11,860,610
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(333,650)	(7,638,329)	(7,621,902)
Total unpaid obligated balance	$ (40,925)	$ 5,028,991	$ 4,238,708
Obligations incurred, net (+/-)	$ 694,405	$ 22,942,454	$ 23,935,997
Less: Gross outlays	(653,431)	(23,497,266)	(23,129,284)
Obligated balance transferred, net			
Actual transfers, unpaid obligations (+/-)	0	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	(1)	0
Total Unpaid obligated balance transferred, net	0	(1)	0
Less: Recoveries of prior year unpaid obligations, actual	0	0	0
Change in uncollected customer payments from Federal sources (+/-)	(6,421)	262,068	(16,325)
Obligated balance, net, end of period			
Unpaid obligations	333,699	12,112,506	12,667,320
Less: Uncollected customer payments from Federal sources	(340,071)	(7,376,260)	(7,638,229)
Total, unpaid obligated balance, net, end of period	(6,372)	4,736,246	5,029,091
Net Outlays:			
Net Outlays:			
Gross Outlays	653,431	23,497,266	23,129,284
Less: Offsetting collections	(621,115)	(23,896,668)	(23,159,505)
Less: Distributed Offsetting receipts	0	0	0
Net Outlays	$ 32,316	$ (399,402)	$ (30,221)

Department of Defense
Navy Working Capital Fund

CONSOLIDATING STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 1,935,302	$ 1,484,089
Less: Spending authority from offsetting collections and recoveries (-)	(1,400,419)	(1,941,274)
Obligations net of offsetting collections and recoveries	534,883	(457,185)
Less: Offsetting receipts (-)	0	0
Net obligations	534,883	(457,185)
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(37,210)	(124,774)
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Net other resources used to finance activities	(37,210)	(124,774)
Total resources used to finance activities	$ 497,673	$ (581,959)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	$ (179,769)	174,539
Unfilled Customer Orders	(354,160)	116,870
Resources that fund expenses recognized in prior periods	0	0
Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0
Resources that finance the acquisition of assets	(7,381)	158,633
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0
Other (+/-)	37,210	124,774
Total resources used to finance items not part of the net cost of operations	$ (504,100)	$ 574,816
Total resources used to finance the net cost of operations	$ (6,427)	$ (7,143)
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 Periods:		
Increase in annual leave liability	$ 0	$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	0	0
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 0	$ 0
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 20,311	$ 38,141
Revaluation of assets and liabilities (+/-)	0	0
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	32,745	(23,442)
Operating Material & Supplies Used	0	0
Other	0	0
Total components of Net Cost of Operations that will not require or generate resources	$ 53,056	$ 14,699
Total components of net cost of operations that will not require or generate resources in the current period	$ 53,056	$ 14,699
Net cost of operations	$ 46,629	$ 7,556

Department of Defense
Navy Working Capital Fund

CONSOLIDATING STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Ordnance	Transportation	Base Support	Research & Development
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
Obligations incurred	$ 22	$ 2,172,132	$ 2,249,823	$ 9,709,836
Less: Spending authority from offsetting collections and recoveries (-)	0	(2,249,435)	(1,804,819)	(10,230,903)
Obligations net of offsetting collections and recoveries	22	(77,303)	445,004	(521,067)
Less: Offsetting receipts (-)	0	0	0	0
Net obligations	22	(77,303)	445,004	(521,067)
Other Resources				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	(129,618)	203,738	102,781	29,808
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	18,995	0	(3,190)	6,184
Net other resources used to finance activities	(110,623)	203,738	99,591	35,992
Total resources used to finance activities	$ (110,601)	$ 126,435	$ 544,595	$ (485,075)
Resources Used to Finance Items not Part of the Net Cost of Operations:				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided				
Undelivered orders (-)	0	2,774	(145,934)	395,824
Unfilled Customer Orders	0	(229,781)	(233,913)	135,913
Resources that fund expenses recognized in prior periods	0	0	0	0
Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0	0	0
Resources that finance the acquisition of assets	0	185,200	11,584	(74,639)
Other resources or adjustments to net obligated resources that do not affect net cost of operations				
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0	0	0
Other (+/-)	110,623	(203,738)	(99,591)	(35,992)
Total resources used to finance items not part of the net cost of operations	$ 110,623	$ (245,545)	$ (467,854)	$ 421,106
Total resources used to finance the net cost of operations	$ 22	$ (119,110)	$ 76,741	$ (63,969)
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 Periods:				
Increase in annual leave liability	$ 0	$ 0	$ 0	$ 0
Increase in environmental and disposal liability	0	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0	0
Other (+/-)	0	0	0	0
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 0	$ 0	$ 0	$ 0
Components not Requiring or Generating Resources:				
Depreciation and amortization	$ 0	$ 18,196	$ 17,041	$ 113,808
Revaluation of assets and liabilities (+/-)	0	0	112	(6,832)
Other (+/-)				
Trust Fund Exchange Revenue	0	0	0	0
Cost of Goods Sold	0	0	0	(9,770)
Operating Material & Supplies Used	0	0	0	0
Other	0	0	0	0
Total components of Net Cost of Operations that will not require or generate resources	$ 0	$ 18,196	$ 17,153	$ 97,206
Total components of net cost of operations that will not require or generate resources in the current period	$ 0	$ 18,196	$ 17,153	$ 97,206
Net cost of operations	$ 22	$ (100,914)	$ 93,894	$ 33,237

Department of Defense
Navy Working Capital Fund

CONSOLIDATING STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Supply Management	Component Level	Marine Corps - NWCF	Combined Total
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
Obligations incurred	$ 4,609,892	$ 86,953	$ 694,405	$ 22,942,454
Less: Spending authority from offsetting collections and recoveries (-)	(5,371,534)	(8,680)	(627,536)	(23,634,600)
Obligations net of offsetting collections and recoveries	(761,642)	78,273	66,869	(692,146)
Less: Offsetting receipts (-)	0	0	0	0
Net obligations	(761,642)	78,273	66,869	(692,146)
Other Resources				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	(43,672)	(210)	(90,240)	(89,397)
Imputed financing from costs absorbed by others	0	546,970	12,327	559,297
Other (+/-)	741,944	(196,557)	0	567,376
Net other resources used to finance activities	698,272	350,203	(77,913)	1,037,276
Total resources used to finance activities	$ (63,370)	$ 428,476	$ (11,044)	$ 345,130
Resources Used to Finance Items not Part of the Net Cost of Operations:				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided				
Undelivered orders (-)	(333,175)	0	(27,627)	(113,368)
Unfilled Customer Orders	45,394	0	(11,274)	(530,951)
Resources that fund expenses recognized in prior periods	0	(10,441)	0	(10,441)
Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0	0	0
Resources that finance the acquisition of assets	(3,160,771)	(90,102)	(177,220)	(3,154,696)
Other resources or adjustments to net obligated resources that do not affect net cost of operations				
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0	0	0
Other (+/-)	(698,272)	196,767	90,240	(477,979)
Total resources used to finance items not part of the net cost of operations	$ (4,146,824)	$ 96,224	$ (125,881)	$ (4,287,435)
Total resources used to finance the net cost of operations	$ (4,210,194)	$ 524,700	$ (136,925)	$ (3,942,305)
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 Periods:				
Increase in annual leave liability	$ 0	$ 0	$ 0	$ 0
Increase in environmental and disposal liability	0	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0	0
Other (+/-)	0	0	2,928	2,928
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 0	$ 0	$ 2,928	$ 2,928
Components not Requiring or Generating Resources:				
Depreciation and amortization	$ 10,823	$ 0	$ 3,560	$ 221,880
Revaluation of assets and liabilities (+/-)	1,629,241	0	(38,835)	1,583,686
Other (+/-)				
Trust Fund Exchange Revenue	0	0	0	0
Cost of Goods Sold	3,667,498	0	191,173	3,858,204
Operating Material & Supplies Used	0	0	0	0
Other	194	2	0	196
Total components of Net Cost of Operations that will not require or generate resources	$ 5,307,756	$ 2	$ 155,898	$ 5,663,966
Total components of net cost of operations that will not require or generate resources in the current period	$ 5,307,756	$ 2	$ 158,826	$ 5,666,894
Net cost of operations	$ 1,097,562	$ 524,702	$ 21,901	$ 1,724,589

Department of Defense
Navy Working Capital Fund

CONSOLIDATING STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Eliminations	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations incurred	$ 0	$ 22,942,454	$ 23,935,997
Less: Spending authority from offsetting collections and recoveries (-)	0	(23,634,600)	(23,175,830)
Obligations net of offsetting collections and recoveries	0	(692,146)	760,167
Less: Offsetting receipts (-)	0	0	0
Net obligations	0	(692,146)	760,167
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	0	(89,397)	0
Imputed financing from costs absorbed by others	0	559,297	552,597
Other (+/-)	0	567,376	(653,626)
Net other resources used to finance activities	0	1,037,276	(101,029)
Total resources used to finance activities	$ 0	$ 345,130	$ 659,138
Resources Used to Finance Items not Part of the Net Cost of Operations:			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered orders (-)	0	(113,368)	(684,742)
Unfilled Customer Orders	0	(530,951)	258,220
Resources that fund expenses recognized in prior periods	0	(10,441)	0
Budgetary offsetting collections and receipts that do not affect net cost of operations	0	0	0
Resources that finance the acquisition of assets	0	(3,154,696)	(4,342,345)
Other resources or adjustments to net obligated resources that do not affect net cost of operations			
Less: Trust or Special Fund Receipts Related to Exchange in the Entity's Budget (-)	0	0	0
Other (+/-)	0	(477,979)	653,626
Total resources used to finance items not part of the net cost of operations	$ 0	$ (4,287,435)	$ (4,115,241)
Total resources used to finance the net cost of operations	$ 0	$ (3,942,305)	$ (3,456,103)
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 Periods:	$ 0	$ 0	$ 0
Increase in annual leave liability	0	0	0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0
Increase in exchange revenue receivable from the public (-)	0	2,928	24,326
Other (+/-)			
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 0	$ 2,928	$ 24,326
Components not Requiring or Generating Resources:	$ 0	$ 221,880	$ 205,205
Depreciation and amortization	0	1,583,686	1,236,002
Revaluation of assets and liabilities (+/-)			
Other (+/-)	0	0	0
Trust Fund Exchange Revenue	0	3,858,204	4,574,426
Cost of Goods Sold	0	0	0
Operating Material & Supplies Used	0	196	99
Other			
Total components of Net Cost of Operations that will not require or generate resources	$ 0	$ 5,663,966	$ 6,015,732
Total components of net cost of operations that will not require or generate resources in the current period	$ 0	$ 5,666,894	$ 6,040,058
Net cost of operations	$ 0	$ 1,724,589	$ 2,583,955

Department of the Navy

Navy Working Capital Fund
Required Supplementary Information

2006

2006 Annual Financial Report

Navy Working Capital Fund General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and Restoration Tables
As of September 30, 2006
($ in Millions)

Annual Sustainment FY 2006			
	Required	Actual	Difference
Navy	1,748	266	1,482
Marine Corps	8	5	3
Building, Structures, and Utilities	1,756	271	1,485

Annual Deferred Sustainment Trend				
	FY 2003	FY 2004	FY 2005	FY 2006
Navy	-	-	-	1,482
Marine Corps	-	-	-	3
Building, Structures, and Utilities	-	-	-	1,485

Restoration and Modernization Requirements			
	End FY 2005	End FY 2006	Change
Navy	-	136	136
Marine Corps	-	8	8
Building, Structures, and Utilities	-	144	144

Narrative Statement:

Fiscal Year 2006 represents the fifth year the Facility Sustainment Model (FSM) was utilized for the Navy Working Capital Fund (NWCF). Sustainment is defined as the maintenance and repair activities necessary to keep a typical facility in good working order over its service life. It includes regularly scheduled adjustments and inspections (such as for fire sprinkler heads and HVAC systems), regulatory inspections (of elevators, bridges, and the like), emergency and routine preventive maintenance tasks, and major repair or replacement of facility components, such as roof replacement, refinishing wall surfaces, repairing and replacing electrical, heating, and cooling systems, and replacing tile and carpeting. In FY 2006, FSM Version 7.2 was used for programming and budgeting for facilities sustainment. Deferred amounts were calculated in accordance with the methodology provided by DoD Financial Management Regulation, Volume 6B, Chapter 12. Since sustainment execution is tied to the NWCF rate structure, the full requirement cannot be budgeted in a single year because the rate structure would not be affordable to NWCF customers.

Restoration and Modernization is currently not modeled. Restoration includes repair and replacement work to restore facilities damaged by inadequate sustainment, excessive age, disaster, accident, or other causes. Modernization includes alteration of facilities solely to implement new or higher standards and regulatory changes, to accommodate new functions including base realignment and closure (BRAC), or to renew building components that typically last more than 50 years, such as foundations and structural members. Requirements listed on the table are actual expenditures for restoration and modernization by year. The requirements include restoration and modernization that is part of minor construction projects.

The NWCF has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

Schedule, Part A DoD Intragovernmental Asset Balances ($ Amounts in Thousands)	Treasury Index:	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Executive Office of the President	11		0			
Department of Agriculture	12		(3)			
Department of Commerce	13		525			
Department of the Interior	14		206			
Department of Justice	15		378			
Navy General Fund	17		301,721			
United States Postal Service	18		16			
Department of State	19		17			
Department of the Treasury	20	1,244,509	54			
Army General Fund	21		23,849			
Office of Personnel Management	24		54			
Federal Communications Commission	27		3			
Nuclear Regulatory Commission	31		2			
Department of Veterans Affairs	36		194			
Pennsylvania Avenue Development Corp	42		21			
General Service Administration	47		202			
National Science Foundation	49		117			
General Accounting Office	5		1,317			
Advisory Commission on Intergovernmental Relations	55		13			
Air Force General Fund	57		22,079			
Consumer Product Safety Commission	61		30			
Tennessee Valley Authority	64		8			
Environmental Protection Agency	68		303			
Department of Transportation	69		2,825			
Homeland Security	70		7,993			
Department of Health and Human Services	75		63			
Independent Agencies	76		0			
Farm Credit	78		2			
National Aeronautics and Space Administration	80		6,394			
National Archives and Records Administration	88		33			
Department of Energy	89		1,854			
Independent Agencies	95		47			
US Army Corps of Engineers	96		338			
Other Defense Organizations General Funds	97		49,280			
Other Defense Organizations Working Capital Funds	97-4930		17,568			1,941
Army Working Capital Fund	97-4930.001		4,607			
Air Force Working Capital Fund	97-4930.003		2,135			
Architect of the Capitol			4			
Totals might not match the Principal Statements	**Totals**	$1,244,509	$444,249	$0	$0	$1,941

Schedule, Part B DoD Intragovernmental Entity Liabilities *($ Amounts in Thousands)*	Treasury Index:	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Executive Office of the President	11			23
Department of Agriculture	12	8	(2,638)	205
Department of Commerce	13	25		224
Department of the Interior	14	(41)		1,105
Department of Justice	15	11		55,320
Department of Labor	16			248
Navy General Fund	17	32,128		11,393
United States Postal Service	18	2,631		
Department of State	19			9,757
Department of the Treasury	20		175,862	1,508
Army General Fund	21	6,572		
Office of Personnel Management	24		0	36,940
National Credit Union Administration	25			181
Federal Communications Commission	27	5,215		2
Library of Congress	3	0		6,933
Nuclear Regulatory Commission	31			1,437
John F. Kennedy Center	33			2
Department of Veterans Affairs	36	21		(119)
General Service Administration	47	7,765		40
National Science Foundation	49	410		14,984
Air Force General Fund	57	1,219		3
Environmental Protection Agency	68			178
Department of Transportation	69	809		1,512
Homeland Security	70	(52)		80,168
Agency for International Development	72			191
Department of Health and Human Services	75	600		2,155
Independent Agencies	76			0
National Aeronautics and Space Administration	80	579		260
Department of Energy	89	47		2,498
Other Defense Organizations General Funds	97	2,179		214
Other Defense Organizations Working Capital Funds	97-4930	77,854		
Army Working Capital Fund	97-4930.001	2,474		
Air Force Working Capital Fund	97-4930.003	3,269		
The General Fund of the Treasury	99			2,826
Architect of the Capitol				0
Totals might not match the Principal Statements	**Totals**	$143,723	$173,224	$230,188

Schedule, Part C DoD Intragovernmental Revenue and Related Costs ($ Amounts in Thousands)	Treasury Index:	Earned Revenue
Executive Office of the President	11	15
Department of Agriculture	12	991
Department of Commerce	13	10,238
Department of the Interior	14	6,037
Department of Justice	15	136,363
Department of Labor	16	447
Navy General Fund	17	18,736,169
United States Postal Service	18	34
Department of State	19	8,039
Department of the Treasury	20	5,742
Army General Fund	21	260,829
Resolution Trust Corporation	22	5
Office of Personnel Management	24	84
National Credit Union Administration	25	260
Federal Retirement Thrift Investment Board	26	6
Federal Communications Commission	27	30
Library of Congress	3	4,191
Nuclear Regulatory Commission	31	1,050
John F. Kennedy Center	33	1,175
Department of Veterans Affairs	36	1,244
Pennsylvania Avenue Development Corp	42	672
General Service Administration	47	682
National Science Foundation	49	13,457
General Accounting Office	5	3,574
Advisory Commission on Intergovernmental Relations	55	91
Air Force General Fund	57	367,740
National Foundation on the Arts and Humanities	59	18,412
Consumer Product Safety Commission	61	132
Tennessee Valley Authority	64	33
Environmental Protection Agency	68	4,706
Department of Transportation	69	12,202
Homeland Security	70	172,122
Agency for International Development	72	(117)
Department of Health and Human Services	75	2,466
Independent Agencies	76	231
Congressional Budget Office	8	1
National Aeronautics and Space Administration	80	52,119
National Archives and Records Administration	88	249
Department of Energy	89	33,135
Selective Service System	90	12
Independent Agencies	95	27
US Army Corps of Engineers	96	5,032
Other Defense Organizations General Funds	97	1,055,939
Other Defense Organizations Working Capital Funds	97-4930	96,529
Army Working Capital Fund	97-4930.001	0
Air Force Working Capital Fund	97-4930.003	284,020
Architect of the Capitol		38
Totals might not match the Principal Statements	**Totals**	$21,296,453

Schedule, Part E DoD Intragovernmental Non-exchange Revenues *($ Amounts in Thousands)*	Treasury Index:	Transfers In	Transfers Out
Navy General Fund	17	1,251	141,492
Other Defense Organizations General Funds	97	3,903	
Other Defense Organizations Working Capital Funds	97-4930	842	
Totals might not match the Principal Statements	**Totals**	$5,996	$141,492

Department of the Navy

Navy Working Capital Fund
Other Accompanying Information

2006

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Appropriations, Funds, and Accounts Included in the Financial 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
97X4930.NA2*	Depot Maintenance-Aviation
97X4930.NA4A*	Depot Maintenance- Other, Marine Corps
97X4930.NA3*	Ordnance
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 - 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.

Department of the Navy Subsidiary Financial Statements

United States Marine Corps General Fund
Principal Statements

2006

2006 Annual Financial Report

USMC 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 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, 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 Department of the 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 2006 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, 2006.

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 Budgetary Resources
- Combined Statement of Financing

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
Marine Corps - Marine Corps GF

CONSOLIDATED BALANCE SHEET

As of September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 12,774,224	$ 8,231,880
Non-entity Seized Iraqi Cash	0	0
Non-entity - Other	118,017	0
Investments (Note 4)	0	0
Accounts Receivable (Note 5)	37,837	62,428
Other Assets (Note 6)	5,774	11,214
Total Intragovernmental Assets	$ 12,935,852	$ 8,305,522
Cash and Other Monetary Assets (Note 7)	59,649	196,180
Accounts Receivable, net (Note 5)	21,282	16,108
Loans Receivable (Note 8)	0	0
Inventory and Related Property, net (Note 9)	5,121,038	470,506
General Property, Plant and Equipment, net (Note 10)	8,497,885	6,965,708
Investments (Note 4)	0	0
Other Assets (Note 6)	519,651	293,375
TOTAL ASSETS	$ 27,155,357	$ 16,247,399
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 111,464	$ 168,814
Debt (Note 13)	0	0
Other Liabilities (Note 15 & Note 16)	243,876	278,663
Total Intragovernmental Liabilities	$ 355,340	$ 447,477
Accounts Payable (Note 12)	520,609	505,949
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	214,433	210,850
Environmental and Disposal Liabilities (Note 14)	226,470	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	938,012	676,705
TOTAL LIABILITIES	$ 2,254,864	$ 1,840,981
NET POSITION		
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0
Unexpended Appropriations - Other Funds	12,443,304	7,801,648
Cumulative Results of Operations - Earmarked Funds	383	0
Cumulative Results of Operations - Other Funds	12,456,806	6,604,770
TOTAL NET POSITION	$ 24,900,493	$ 14,406,418
TOTAL LIABILITIES AND NET POSITION	$ 27,155,357	$ 16,247,399

The accompanying notes are an integral part of these statements.

Department of Defense
Marine Corps - Marine Corps GF

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Program Costs		
Gross Costs	$ 20,496,639	$ 20,160,841
(Less: Earned Revenue)	(414,698)	(1,066,992)
Net Costs	$ 20,081,941	$ 19,093,849
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 20,081,941	$ 19,093,849

The accompanying notes are an integral part of these statements.

Department of Defense
Marine Corps - Marine Corps GF

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	Earmarked Funds	Other Funds
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 240	$ 7,758,322
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	3,158,868
Beginning balances, as adjusted	$ 240	$ 10,917,190
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	0	21,463,922
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	158	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	90,379
Imputed financing from costs absorbed by others	0	67,241
Other (+/-)	0	0
Total Financing Sources	$ 158	$ 21,621,542
Net Cost of Operations (+/-)	15	20,081,926
Net Change	143	1,539,616
Ending Balances	$ 383	$ 12,456,806
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 0	$ 8,857,933
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 0	$ 8,857,933
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 25,417,616
Appropriations transferred in/out (+/-)	0	(106,906)
Other adjustments (rescissions, etc) (+/-)	0	(261,417)
Appropriations used	0	(21,463,922)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ 0	$ 3,585,371
Net Cost of Operations (+/-)	0	0
Net Change	0	3,585,371
Ending Balances	$ 0	$ 12,443,304

The accompanying notes are an integral part of the statements.

Department of Defense
Marine Corps - Marine Corps GF

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Restated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 7,758,562	$ 3,060,673
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	3,158,868	3,158,867
Beginning balances, as adjusted	$ 10,917,430	$ 6,219,540
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	21,463,922	19,415,135
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	158	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	90,379	21
Imputed financing from costs absorbed by others	67,241	63,923
Other (+/-)	0	0
Total Financing Sources	$ 21,621,700	$ 19,479,079
Net Cost of Operations (+/-)	20,081,941	19,093,849
Net Change	1,539,759	385,230
Ending Balances	$ 12,457,189	$ 6,604,770
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 8,857,933	$ 6,534,483
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 8,857,933	$ 6,534,483
Budgetary Financing Sources:		
Appropriations received	$ 25,417,616	$ 21,089,769
Appropriations transferred in/out (+/-)	(106,906)	(244,582)
Other adjustments (rescissions, etc) (+/-)	(261,417)	(162,886)
Appropriations used	(21,463,922)	(19,415,135)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ 3,585,371	$ 1,267,166
Net Cost of Operations (+/-)	0	0
Net Change	3,585,371	1,267,166
Ending Balances	$ 12,443,304	$ 7,801,649

The accompanying notes are an integral part of the statements.

Department of Defense
Marine Corps - Marine Corps GF

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 2,111,332	$ 2,460,325
Recoveries of prior year unpaid obligations	1,569,189	4,770,516
Budget Authority:		
Appropriations received	25,417,774	21,089,769
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections:		
Earned		
Collected	580,388	2,106,013
Change in receivables from Federal sources	(61,287)	18,751
Change in unfilled customer orders		
Advances received	0	0
Without advance from Federal sources	(47,838)	70,421
Anticipated for rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure Transfers from trust funds	0	0
Subtotal	$ 25,889,037	$ 23,284,954
Nonexpenditure Transfers, net, anticipated and actual	(106,906)	(244,582)
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(261,418)	(162,886)
Total Budgetary Resources	$ 29,201,234	$ 30,108,327
Status of Budgetary Resources:		
Obligations incurred:		
Direct	$ 25,801,864	$ 25,721,916
Reimbursable	817,242	2,371,654
Subtotal	$ 26,619,106	$ 28,093,570
Unobligated balance:		
Apportioned	$ 2,298,754	$ 1,816,603
Exempt from apportionment	0	0
Subtotal	2,298,754	1,816,603
Unobligated balances not available	283,374	198,154
Total status of budgetary resources	$ 29,201,234	$ 30,108,327

The accompanying notes are an integral part of these statements.

Department of Defense
Marine Corps - Marine Corps GF

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Combined	2005 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 7,499,117	$ 4,594,921
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(316,775)	(227,791)
Total unpaid obligated balance	7,182,342	4,367,130
Obligations incurred, net (+/-)	$ 26,619,106	$ 28,093,570
Less: Gross outlays	(22,130,495)	(21,383,890)
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
Total Unpaid obligated balance transferred, net	0	0
Less: Recoveries of prior year unpaid obligations, actual	(1,569,189)	(4,770,516)
Change in uncollected customer payments from Federal sources (+/-)	109,126	(89,171)
Obligated balance, net, end of period		
Unpaid obligations	10,418,539	6,534,084
Less: Uncollected customer payments from Federal sources	(207,650)	(316,962)
Total Unpaid obligated balance, net, end of period	10,210,889	6,217,122
Net Outlays:		
Net Outlays:		
Gross Outlays	22,130,495	21,383,890
Less: Offsetting collections	(580,388)	(2,106,014)
Less: Distributed Offsetting receipts	3,296	0
Net Outlays	$ 21,553,403	$ 19,277,876

The accompanying notes are an integral part of these statements.

Department of Defense
Marine Corps - Marine Corps GF

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 26,619,106	$ 28,093,570
Less: Spending authority from offsetting collections and recoveries (-)	(2,040,452)	(6,965,701)
Obligations net of offsetting collections and recoveries	24,578,654	21,127,869
Less: Offsetting receipts (-)	3,296	0
Net obligations	24,581,950	21,127,869
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	90,379	21
Imputed financing from costs absorbed by others	67,241	63,923
Other (+/-)	0	0
Net other resources used to finance activities	157,620	63,944
Total resources used to finance activities	$ 24,739,570	$ 21,191,813
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits benefits ordered but not yet provided		
Undelivered orders (-)	$ (3,066,878)	$ (1,783,153)
Unfilled Customer Orders	(47,838)	70,421
Resources that fund expenses recognized in prior periods	(27)	(14,138)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	(3,296)	0
Resources that finance the acquisition of assets	(2,875,425)	0
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund Receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	(90,379)	(21)
Total resources used to finance items not part of the Net Cost of Operations	$ (6,083,843)	$ (1,726,891)
Total resources used to finance the Net Cost of Operations	$ 18,655,727	$ 19,464,922

The accompanying notes are an integral part of these statements.

Department of Defense
Marine Corps - Marine Corps GF

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	$ 0	$ 0
Increase in environmental and disposal liability	226,470	0
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	106,134	21,458
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 332,604	$ 21,458
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 1,458,802	$ 184,822
Revaluation of assets and liabilities (+/-)	(25,176)	(578,725)
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	0	0
Operating Material & Supplies Used	(338,188)	7,483
Other	(1,828)	(6,111)
Total components of Net Cost of Operations that will not require or generate resources	$ 1,093,610	$ (392,531)
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 1,426,214	$ (371,073)
Net Cost of Operations	$ 20,081,941	$ 19,093,849

The accompanying notes are an integral part of these statements.

Department of the Navy Subsidiary Financial Statements

United States Marine Corps General Fund
Notes to the Principal Statements

2006

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), prepared these financial statements to report the financial position and results of operations, as required by the "Chief Financial Officers (CFO) Act of 1990," expanded by the "Government Management Reform Act of 1994," and other appropriate legislation. First Quarter, Fiscal Year 2006 was the first time USMC produced General Fund financial statements as a stand alone entity. Though reporting as a stand alone entity, USMC financial statements are a subsidiary of DON financial statements and reporting process. The financial statements have been prepared from the books and records of USMC in accordance with the "Department of Defense (DoD) Financial Management Regulation," 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 is responsible. 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 also prepares financial reports that are used to monitor and control the use of budgetary resources.

The USMC is unable to fully implement all elements of GAAP and OMB Circular No. A-136, due to limitations of its financial management processes and systems and nonfinancial systems and processes that feed into the financial statements. The USMC 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 continues to implement process and system improvements addressing the limitations, many of which are detailed below. As a first time financial statements preparer, USMC has no auditor identified financial statements material weaknesses, other than as part of DON financial statements. The DoD currently has 11 auditor identified financial statement weaknesses: (1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and Material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing.

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 U.S. 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 U.S. 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 receives appropriations and funds as general, special (earmarked), and deposit funds. These appropriations and funds may be either provided solely to USMC or shared with the U.S. Navy. The USMC uses these appropriations and funds to execute their missions and 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 fund accounts are used to record government receipts reserved for a specific purpose.

Certain special and trust funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish them from general revenues.

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

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

Entity Accounts:

General Accounts

17 0703	Family Housing, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and 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 1319	Research and Development, Test and Evaluation, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps

Special Funds

17X5095	Wildlife Conservation

Non-Entity Accounts:

Deposit Funds

17 3XXX	Receipt Accounts
17X6XXX	Deposit Funds

1. D. Basis of Accounting

The USMC operates a single general fund accounting system – the Standard Accounting, Budgeting, and Reporting System (SABRS). Through this system USMC records the majority of the financial transactions reflected in these financial statements. The SABRS is a transaction driven general ledger accounting system that utilizes standardized transactions for processing. General ledger postings are derived from centralized posting logic maintained in a table within the accounting system and applied against detail transactions. The posting logic in this table is maintained in accordance with all applicable guidance and attempts to meet the standards of GAAP. Both budgetary and proprietary general ledgers are maintained and utilized for reporting. Transactions are either entered manually into the accounting system or generated via interfaces with financial feeder systems.

For FY 2006, USMC's financial management systems are unable to meet all requirements for full accrual accounting. Many of USMC'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's legacy systems were designed to record information on a budgetary basis. The USMC has undertaken efforts to determine the actions required to bring financial and nonfinancial feeder systems and processes into compliance with all elements of GAAP. The USMC accounting system, SABRS is US Standard General Ledger (USSGL) and Standard Financial Information Structure (Phase 1) compliant.

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 USSGL. Until all of USMC's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, USMC's financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DoD identifies program costs based upon major appropriation groups provided by Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government and Performance and Results Act. The DoD is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1. E. Revenues and Other Financing Sources

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

The USMC does not include nonmonetary support provided by U.S. allies for common defense and mutual security in the Statement of Net Cost and the Statement of Financing. The U.S. has cost sharing agreements with other countries that include both direct and indirect sharing of costs that each country incurs in support of the same general purpose. 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 financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The USMC's expenditures for capital and other long term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate toward consumption method for recognizing OM&S expenses. Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

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, USMC cannot accurately identify most of its intragovernmental transactions by customer because USMC's systems do not track buyer and seller data needed to match related transactions. Seller entities within DoD provided summary seller side balances for revenue, accounts receivable, and unearned revenue to the buyer side internal DoD accounting offices. In most cases, the buyer side records are adjusted to agree with DoD seller side balances. IntraDoD intragovernmental balances are then eliminated. The USMC properly eliminates the revenue results from intraDoD sales of capitalized assets. The DoD is developing long term system improvements that will include sufficient up front edits and controls to eliminate the need for after the fact reconciliations. The volume of intragovernmental transactions is so large that after the fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The USMC, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to USMC as though the agency was a stand alone entity.

The USMC civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The USMC funds a portion of the civilian and military pensions. Reporting civilian pension liabilities under CSRS and FERS is the responsibility of the Office of Personnel Management (OPM). The USMC recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits that was funded by OPM in the Statement of Net Cost; and recognizes corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

To prepare reliable financial statements, transactions occurring between components or activities within USMC must be eliminated. However, USMC, as well as the majority of the federal government, cannot consistently and accurately identify all intragovernmental transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of USMC. Since FY 1999, 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 have been adjusted to recognize unrecorded costs and accounts payable. IntraDoD intragovernmental balances were then eliminated.

The Department of the Treasury, Financial Management Services (FMS) is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual, Part 2 Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental Transactions Accounting Policy Guide," provide guidance for reporting and reconciling intragovernmental transactions balances. While USMC is unable to fully reconcile intragovernmental transactions with all federal partners, USMC is able to reconcile balances pertaining to investments in federal securities, borrowing from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with Department of Labor (DOL) and benefit program transactions with OPM. The DoD's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The 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 Department of Treasury does not allocate such interest costs to the benefiting agencies.

1. H. Transactions with Foreign Governments and International Organizations

Each year, USMC 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 this 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. Customers are required to make payment in advance.

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

The USMC's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of 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's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports, which 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 Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between USMC/DON's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1. J. Foreign Currency

Cash is the total of cash resources under the control of 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, therefore, is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions. Cash seized during Operation Iraqi Freedom is restricted for use to assist the Iraqi people and support the restoration of Iraq.

The USMC 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. For those accounts, USMC does not separately identify currency fluctuations.

1. K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for 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 (per Code of Federal Regulations 4 CFR 101).

The USMC bases the estimate of uncollectible accounts receivable from the public on extensive analysis of historical Treasury Report on Receivables data. Undistributed collections are initially allocated to federal accounts receivable as that greater than 93% of all reimbursable receivables are federal. In an undistributed state, it is impossible to determine an appropriate breakdown for the collections. Due to the relatively small value of undistributed collections, the financial statements are still materially accurate.

1. L. Loans Receivable

Not applicable.

1. M. Inventories and Related Property

Most of USMC's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The USMC uses the latest acquisition cost method as its inventory systems were designed for materiel management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104 208). By utilizing new systems development processes, USMC plans to transition its inventory to the moving average cost method. The USMC's inventory value is now being reported from systems that have not transitioned to moving average cost functionality.

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

Related property includes OM&S and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD 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, USMC uses the purchase method. Under this method materiel and supplies are expensed when purchased. During FY 2006, USMC expensed significant amounts using the purchase method either because the systems could not support the consumption method or because management deemed that the item is in the hands of the end user. The USMC determined that the recurring high value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high dollar items, (e.g. engines) are categorized as OM&S rather than military equipment.

The DoD implemented new policy in FY 2002 to account for condemned materiel (only) as "Excess, Obsolete, and Unserviceable." The USMC recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned material is zero. Potentially redistributed material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

1. N. Investment and U.S. Treasury Securities

Not Applicable.

1. O. General Property, Plant and Equipment

The DoD is moving away from a standard capitalization threshold for all categories (e.g., real property, military equipment, etc.) of General PP&E to one that is specific for each individual category. The DoD revised the capitalization threshold from $100,000 to $20,000 for real property. The current $100,000 capitalization threshold remains unchanged for the remaining General PP&E categories. Although, DoD revised the capitalization threshold from $100,000 to $20,000 for real property, USMC capitalization threshold for real property currently remains $100,000. General PP&E, exclusive of military equipment, is capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds DoD capitalization threshold. The DoD also requires capitalization of improvement costs over DoD capitalization threshold for General PP&E. The DoD depreciates all General P&E, other than land, on a straight-line basis. Land is not depreciated.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimate useful life of two or more years. General PP&E previously capitalized at amounts below $100,000 were written off in the FY 1998.

When it is in the best interest of the government, USMC provides government property to contractors to complete contracted work. The USMC either owns or leases such property, or the contractor purchases it for the government based on the contract terms. When the value of contractor procured General PP&E exceeds DoD capitalization threshold, it must be reported on USMC's Balance Sheet. The DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, USMC currently reports only government property in the possession of contractors that is maintained in USMC's property systems. DoD has issued new property accountability and reporting requirements that require USMC components 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.

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," established Generally Accepted Accounting Principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The Standard provided for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost information is not practical. The DoD used Bureau of Economic Analysis (BEA) to calculate the value of the military equipment for reporting periods from October 1, 2002 through March 31, 2006.

Effective with 3rd Quarter, FY 2006, DoD replaced the BEA estimation methodology with an estimation methodology for military equipment based on DoD internal records. The DoD initially 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 create a baseline. The military equipment baseline is updated using expenditure information, and information related to acquisition and disposals.

1. P. Advances and Prepayments

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

1. Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), USMC should records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The USMC deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. The USMC as the lessee receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all 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 in support of contingency operations are the largest component operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases. The USMC expects to continue to reduce the level of owned assets while increasing the number of leased assets. The USMC will strive to displace commercial leases with more economical GSA leases.

1. R. Other Assets

The USMC conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursement. To alleviate the potential financial burden on the contractor that long-term contracts can cause, USMC provides financing payments. The USMC does not make financing payments for real property construction; USMC construction projects are managed by U.S. Navy and reported in the DON Balance Sheet and in the related notes.

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

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. 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 Acquisitions Regulations Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair.

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

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by the 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/DON recognizes a liability when a past event or exchange transaction has occurred, a future loss is probable and the amount of loss can be reasonably estimated. Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The USMC/DON loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes. The USMC contingent liabilities related to legal claims are reported at DON entity level.

Other liabilities arise as a result of anticipated disposal costs for USMC'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. Based upon the policies and consistent with SFFAS No. 5 "Accounting for Liabilities of Federal Government," a nonenvironmental disposal liability is recognized for an asset when management makes a decision to dispose of the asset. The DoD recognizes nonenvironmental disposal liability for nuclear powered assets when the asset is placed in service. Such amounts are developed in conjunction with, and are not easily identifiable separately from, environmental disposal costs.

1. T. Accrued Leave

The USMC 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 yet been incurred. Cumulative results of operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also included donations and transfer in and out of assets without reimbursement.

1. V. Treaties for Use of Foreign Bases

The USMC has the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. The USMC purchases capital assets overseas with appropriated funds; however, the host country retains the title to land and improvements. Generally, treaty terms allow USMC continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases prohibited, losses are recorded for the value of any nonretrievable capital assets. This takes place after negotiations between the U.S. and the host country have determined the amount to be paid for such capital investments.

1. W. Comparative Data

Financial statement fluctuations greater than two percent of the total assets on the Balance Sheet or ten percent from the previous period presented are explained within the notes to the financial statements.

It should be noted that when using these financial statements and notes, the prior year FY 2005 comparative column in some cases may not allow for an accurate comparison because the shared appropriations were not included. First Quarter, FY 2006 was the first time USMC produced General Fund financial statements as a stand-alone entity. Though reporting as a stand alone entity, USMC

General Fund financial statements are a subsidiary of DON financial statements and reporting process. The USMC General Fund financial statements include those appropriations specifically designated as USMC and the applicable portion of those DON level appropriations where USMC and Navy receive allocations for program execution, referred to as shared appropriations (i.e., Family Housing Operation and Maintenance, Navy and Marine Corps; Procurement of Ammunition, Navy and Marine Corps; and Research and Development, Test and Evaluation, Navy). Prior to FY 2006, shared appropriations were only reported on DON level statements.

1. X. Unexpended Obligations

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

1. Y. Undistributed Disbursements and Collections

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

1. Z. Data Collection Approach

The USMC financial statements include information from both financial systems and feeder systems. The DFAS collects the financial information and incorporates it into the financial statements. The USMC, in coordination with DON, collects financial information from feeder systems through a data call process and submits it to DFAS for incorporation into the financial statements. The USMC utilizes a DON web-based data collection instrument and the Defense Departmental Reporting System-Data Collection Module to collect required financial information from feeder systems. The USMC identifies the information requirements to the source provider, provides an audit trail, and integrates these steps into the financial statement preparation process.

Note 2. Nonentity Assets

As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	$ 118,017	$ 0
B. Accounts Receivable	0	0
C. Total Intragovernmental Assets	$ 118,017	$ 0
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ 59,649	$ 196,180
B. Accounts Receivable	199	152
C. Other Assets	0	0
D. Total Nonfederal Assets	$ 59,848	$ 196,332
3. Total Nonentity Assets	$ 177,865	$ 196,332
4. Total Entity Assets	$ 26,977,492	$ 16,051,067
5. Total Assets	$ 27,155,357	$ 16,247,399

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

Other Information
The Nonentity Fund Balance with Treasury represents amounts in the United States Marine Corps (USMC) 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 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 United States Treasury, and are not available for use in USMC's operations.

The nonentity nonfederal accounts receivable represents interest, fines and penalties receivable on aged debt. Once collected, nonentity receivables go to the Department of Treasury as miscellaneous receipts.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 12,773,794	$ 8,231,880
B. Revolving Funds	0	0
C. Trust Funds	0	0
D. Special Funds	430	0
E. Other Fund Types	118,017	0
F. Total Fund Balances	$ 12,892,241	$ 8,231,880
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 11,573,192	$ 8,339,576
B. Fund Balance per (United States Marine Corps (USMC))	12,892,241	8,231,880
3. Reconciling Amount	$ (1,319,049)	$ 107,696

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

Entity fund balance with treasury increased $4.5 billion, 55%. The inclusion of the United States Marine Corps (USMC) portion of Department of Navy (DON) appropriations caused an increase of $1.4 billion. Prior to FY 2006, these appropriations were reported only on DON level statements. The remaining increase is attributable to an increase in appropriated funds in FY 2006 for the Global War on Terror (GWOT). This increase in funding was to acquire enhanced weapons, armored vehicles, and protective gear for fighting the GWOT.

Nonentity fund balance with treasury increased $118.0 million due to USMC portion of nonentity treasury deposit accounts being reported only on DON level statements prior to 1st Quarter, FY 2006. The majority of this amount is the Pay of the Marine Corps Deposit Fund. This fund is comprised of such items as taxes withheld, payroll savings allotments, and garnishments prior to disbursement to the designated recipient.

Explanation of Reconciliation Amount:

(In thousands)	
Shared Appropriations per USMC*	$1,419,282
Suspense and Deposit Accounts per USMC**	(19,152)
Canceling Year Appropriations***	(81,080)
Total Reconciling Amount	$1,319,050

*This amount is the fund balance with treasury for USMC portion of appropriations shared with DON: Research and Development, Test and Evaluation; Procurement of Ammunition; Wildlife Conservation on

Military Reservations, Navy; and Family Housing Operation and Maintenance, Navy and Marine Corps. The Department of Treasury does not separately identify USMC 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/ Intergovernmental Payment and Collection (IPAC) Suspense Account; and Small Escrow Amounts Deposit Account. The Department of Treasury does not separately identify the USMC 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 canceling in FY 2006. This amount is not included in the final reports per applicable guidance.

Status of Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	$ 2,298,754	$ 1,816,603
B. Unavailable	283,374	198,154
2. Obligated Balance not yet Disbursed	$ 10,418,539	$ 6,534,084
3. Nonbudgetary FBWT	$ 99,224	$ 0
4. NonFBWT Budgetary Accounts	$ (207,650)	$ (316,961)
5. Total	$ 12,892,241	$ 8,231,880

Fluctuations and Abnormalities
There are no abnormalities to disclose for this reporting period.

Total Status of Fund Balance with Treasury increased $4.7 billion, 57% from 4th Quarter, FY 2005 to 4th Quarter, FY2006. This is primarily attributable to the increase in Obligated Balance not yet Disbursed due to the following:

1. $1.3 billion increase for addition of the USMC portion of appropriations shared with DON. Prior to FY 2006, shared appropriations were reported only on DON level statements.

2. $1.8 billion increase in obligated balances not disbursed is a direct reflection of the increase in funding for Procurement, Marine Corps appropriation in FY 2006 in support of the GWOT.

3. $207.6 million increase due to the required removal of unfilled customer orders without advance and reimbursements and other income earned receivable from this line item. These amounts previously reduced the total of this line.

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

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

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

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

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

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 has no restrictions on unavailable balances at this time.

Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
(Amounts in thousands)				
Account				
F3845 – Personal Property Proceeds	$ 0	$ 0	$ 0	$ 0
F3875 – Disbursing Officer Suspense	0	(15,167)	(18,771)	(3,604)
F3880 – Lost or Cancelled Treasury Checks	0	(43)	(32)	11
F3882 – Uniformed Services Thrift Savings Plan Suspense	0	0	0	0
F3885 – Interfund/IPAC Suspense	0	(287)	9	296
F3886 – Thrift Savings Plan Suspense	0	0	0	0
Total	$ 0	$ (15,497)	$ (18,794)	$ (3,297)

Fluctuations and/or Abnormalities
The Suspense and Clearing account balance increased $3.2 million, 17%, primarily due to the increase in the Disbursing Officers Suspense account related to the revenues of two unfunded reimbursable programs operating at USMC bases. Both the unfunded reimbursable forestry and unfunded recyclable materials programs posted increases in revenue. The increases in the forestry and recyclable materials programs occurred incrementally over the past fiscal year with revenues (collections) exceeding expenditures (disbursements) in the current fiscal year.

Other Information
The F3875 suspense clearing represents the Disbursing Officer's (DO) suspense. Account F3885, represents the Interfund/IPAC suspense. These suspense accounts temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation.

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

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
(Amounts in thousands)				
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDs)	$ 0	$ 36,589	$ 34,640	$ (1,949)
B. Negative Unliquidated Obligations (NULO)	0	5,633	2,905	(2,728)
2. Total In-transit Disbursements, Net	$ 0	$ 443,285	$ 310,005	$ (133,280)

Fluctuations and Abnormalities
Negative Unliquidated Obligations (NULO) decreased $2.7 million, 48%, primarily due to correction of standard document number differences between public vendor contracts in the vendor pay system and the accounting system. Beginning 1st Quarter, FY 2006, we are correcting these differences prior to processing transactions. This results in a reduction of transactions posting to incorrect standard document numbers and creating NULOs in the accounting system.

In-transit disbursements decreased $133.3 million, 30%, primarily due to the processing of detail transactions into the accounting system through September 30, 2006. In 4th Quarter, FY 2005 daily input of transactions into SABRS was stopped on September 28, 2005. This additional interface of transactions into the accounting system significantly reduced the overall in-transit disbursements.

Other Information
An UMD occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

A NULO occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The In-transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity and have not been posted to the accounting system.

The problem disbursement and in-transit disbursement metrics furnished to DFAS Arlington included Treasury Index 97 appropriations that will not be reported on USMC financial statements. Amounts will be reported on the appropriate Treasury Index 97 financial statements.

Note 4. Investments and Related Interest

The Marine Corps General Fund does not have investments and related interest.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intragovernmental Receivables	$ 37,837	N/A	$ 37,837	$ 62,428
2. Nonfederal Receivables (From the Public)	$ 22,168	$ (886)	$ 21,282	$ 16,108
3. Total Accounts Receivable	$ 60,005	$ (886)	$ 59,119	$ 78,536

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

The United States Marine Corps (USMC) reported a decrease of $24.6 million, 39%, in intragovernmental receivables. Of the decrease, $14.6 million is the result of a collection received in 1st Quarter, FY 2006. The collection offset a receivable established in 4th Quarter, FY 2005 for the sale of vehicles through the Foreign Military Sales (FMS) program. Additional decreases are primarily the result of concentrated efforts to process bills and collections in a timely manner. These improvements included a reduction of $21.7 million reported from the Army General Fund and $8.7 million from the Navy Working Capital Fund, which occurred incrementally throughout the past fiscal year. These decreases were offset by an increase of $18.7 million in USMC to USMC elimination entries during 4th Quarter, FY 2005 as a result of incorrect coding of intragovernmental receivables. The incorrect coding was corrected as of 2nd Quarter, FY 2006.

Nonfederal accounts receivable increased $5.2 million, 32%. An increase of approximately $2.5 million is a direct result of the privatization of family housing at USMC installations which originated during 1st Quarter, FY 2006. An additional $2.0 million is attributable to an increase in unbilled revenues. The increase was a result of fluctuations in the billing cycle at the end of 4th Quarter, FY 2006.

Other Information

Allocation of Undistributed Collections.

Undistributed collections are allocated to federal accounts receivable based on management determination and the fact that historically, greater than 93% of all reimbursable receivables are federal. In an undistributed state, it is impossible to determine an appropriate breakdown for the collections. This approach does not materially impact statement accuracy. For 4th Quarter, FY 2006, $2.1 million in supported undistributed collections was allocated to federal accounts receivable.

Trading Partners Adjustments.

Intrafund transactions are eliminated based upon trading partner information obtained from the Standard Accounting, Budgeting, and Reporting System (SABRS). The Reimbursable Module of SABRS captures the data necessary to perform these eliminations. That data includes seller appropriation, grantor (buyer) appropriation, grantor subhead, grantor code, reimbursable source code, accounts receivable, revenue, unearned revenue, and amount collected. However, other Department of Defense (DoD) accounting systems do not consistently capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, USMC was unable to reconcile intragovernmental accounts receivable balances with its trading partners. Through the Business Transformation Agency, DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations.

Trading Partner Process

The USMC records adjustments to bring intragovernmental accounts receivable into agreement with the intragovernmental accounts payable of those trading partners that have obtained a waiver. This is in accordance with the DoD Financial Management Regulation, Volume 6B, Chapter 13.

Aged Accounts Receivable

As of September 30	2006		2005	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
(Amounts in thousands)				
CATEGORY				
Nondelinquent				
Current	$ 46,286	$ 12,684	$ 149,884	$ 4,522
Noncurrent	0	0	0	0
Delinquent				
1 to 30 days	$ 743	$ 2,034	$ 0	$ 0
31 to 60 days	8	537	0	0
61 to 90 days	135	1,659	20,673	1,153
91 to 180 days	85	1,574	445	3,085
181 days to 1 year	22	2,096	4,117	1,436
Greater than 1 year and less than or equal to 2 years	35	798	401	846
Greater than 2 years and less than or equal to 6 years	0	691	(0)	475
Greater than 6 years and less than or equal to 10 years	0	59	0	110
Greater than 10 years	0	36	0	55
Subtotal	$ 47,314	$ 22,168	$ 175,520	$ 11,682
Less Supported Undistributed Collections	(2,130)	0	(89,221)	0
Less Eliminations	(7,347)	0	(47,420)	0
Less Other	0	0	23,549	5,477
Total	$ 37,837	$ 22,168	$ 62,428	$ 17,159

Information Related to Aged Accounts Receivable
The USMC currently has no nondelinquent accounts receivable over 30 days old.

Approximately $4.5 million of the total delinquent balance is a result of outstanding receivables in the USMC reimbursable program. Unbilled revenues account for $2 million and will be billed in the 1st Quarter, FY 2007 of the remaining balance, $1.4 million has been submitted for write-off with anticipation that the remaining $1.1 million will be submitted for write-off during the 1st Quarter, FY 2007.

Approximately $6 million of the current balance is a result of refund receivables and is being managed by the Debt Management Offices (DMO) in Columbus and Denver. The DMOs have referred $5.1 million to the U.S. Treasury for collection and are working the remaining amounts for off-set or due process.

The "Less Other" amount reported in the FY 2005 column is an adjustment to bring the Balance Sheet amounts into agreement with the aged receivables as reported on the Monthly Receivables Report. As of 2nd Quarter, FY 2006, amounts are reconciled prior to reporting.

Note 6. Other Assets

As of September 30	2006		2005	
(Amounts in thousands)				
1. Intragovernmental Other Assets				
A. Advances and Prepayments	$	5,774	$	11,214
B. Other Assets		0		0
C. Total Intragovernmental Other Assets	$	5,774	$	11,214
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	$	505,172	$	274,754
B. Other Assets (With the Public)		14,479		18,621
C. Total Nonfederal Other Assets	$	519,651	$	293,375
3. Total Other Assets	$	525,425	$	304,589

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

Intragovernmental other assets decreased $5.4 million, 49%, primarily due to a decrease in advances paid to the Defense Information Systems Agency (DISA). In 4th Quarter, FY 2005, the United States Marine Corps (USMC) paid DISA $9.8 million in advances for services requested from the Information Processing Center. During the 1st Quarter, FY 2006, DISA delivered a significant portion of services requested decreasing the amount of the advance reported by $4.1 million.

Nonfederal other assets increased $226.3 million, (77%). This is partially attributable to a $101.0 million increase in outstanding contract financing payments in the Procurement, Marine Corps appropriation. This increase is due to increased procurement funding to acquire enhanced weapons, armored vehicles, and protective gear for the Global War on Terror. The majority funding was received during 1st Quarter and 3rd Quarter, FY 2006, for the amounts, $98.2 million and $127.2 million, respectively. The remaining increase in nonfederal other assets is attributable to the first time recording of an estimated value of future outstanding contract payments that will be paid to the contractor upon delivery and government acceptance of a satisfactory product. As a result of the implementation of new Department of Defense (DoD) procedures in 4th Quarter, FY 2006, USMC recorded $108.8 million in estimated assets for unpaid future outstanding contract payments.

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

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

The Contract Financing Payment balance of $505.2 million is comprised of $396.4 million in contract financing payments and an additional $108.8 million in estimated future funded 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	2006		2005	
(Amounts in thousands)				
1. Cash	$	59,639	$	93,077
2. Foreign Currency		10		103,103
3. Total Cash, Foreign Currency, & Other Monetary Assets	$	59,649	$	196,180

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

Cash and other monetary assets decreased by $136.5 million, 70%. This is primarily attributable to a $103.1 million decrease in foreign currency held in the Marine Corps Expeditionary Forces, Camp Lejeune, Limited Depositary Account (LDA) for use in Iraq. The decrease in foreign currency is due to an increase in expenditures for contract payments and service member pay support during deployment in Iraq. Upon completion of the disbursing officer's deployment that LDA was closed, the remaining amounts were withdrawn and subsequently deposited back into the U.S. Treasury during 2nd Quarter, FY 2006.

Other Disclosures
Cash and foreign currency are nonentity assets and, as such, are considered restricted assets that are held by the United States Marine Corps (USMC) but not available to use in its operations. Cash of $59.6 million and foreign currency of $10.0 thousand are restricted. These assets are held by USMC disbursing officers as agents of the Treasury.

The amounts reported as cash and foreign currency consist primarily of cash held by disbursing officers to carry out their payment, collection, and foreign currency accommodation exchange mission. The primary source of the amounts reported is the Statement of Accountability, a Department of Defense disbursing officer's report.

The amount of foreign currency reported was valued using the Department of the Treasury's prevailing rate of exchange, the most favorable rate available to the U.S. Government when acquiring foreign currency. Foreign currency is used to make official disbursements and to provide foreign currency for the exchange of U.S. dollars for military personnel.

Note 8. Direct Loan and/or Loan Guarantee Programs

The Marine Corps General Fund does not have Direct Loan and/or Loan Guarantee Programs.

Note 9. Inventory and Related Property

As of September 30	2006	2005
(Amounts in thousands)		
1. Inventory, Net	$ 0	$ 0
2. Operating Materials & Supplies, Net	5,121,038	470,506
3. Stockpile Materials, Net	0	0
4. Total	$ 5,121,038	$ 470,506

Inventory, Net

Not applicable.

Operating Materials and Supplies, Net

As of September 30	2006 OM&S Gross Value	2006 Revaluation Allowance	2006 OM&S, Net	2005 OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories					
A. Held for Use	$ 4,553,141	$ 0	$ 4,553,141	$ 412,926	SP, LAC
B. Held for Repair	567,897	0	567,897	57,580	SP, LAC
C. Excess, Obsolete, and Unserviceable	14,375	(14,375)	0	0	NRV
D. Total	$ 5,135,413	$ (14,375)	$ 5,121,038	$ 470,506	

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

Fluctuation and Abnormalities

Operating Materials and Supplies (OM&S), Net

There are no abnormalities to disclose for this reporting period.

The United States Marine Corps (USMC) reported an increase of $4.7 billion, 988%, in 4th Quarter, FY 2006. This increase is attributed to reporting the Procurement of Ammunition, Navy and Marine Corps shared appropriation. Prior to 1st Quarter, FY 2006, shared appropriations were only reported at DON level; USMC did not prepare standalone statements.

Information Related to Operating Material and Supplies, Net

General Composition of Operating Materials and Supplies

The OM&S includes (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, fuel, clothing and textiles, medical and dental supplies.

Balances

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

Decision Criteria for Identifying the Category to Which Operating Materials and Supplies Are Assigned

In order to standardize reporting of the categories Held for Use, Held for Repair, and Excess, Obsolete, Unserviceable, USMC implemented the Under Secretary of Defense (Comptroller) (USD(C)) condition code crosswalk as defined in the memorandum "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies" dated August 12, 2002. In addition, the condition code crosswalk was amended to include code "V" in the Excess, Obsolete, Unserviceable category in September 2002. The OM&S was reported as follows:

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

Valuation Method for OM&S

On July 6, 2001, USD(C) issued a memo requiring Moving Average Cost (MAC) as the approved valuation method for Inventory Held for Sale and Operating Materials and Supplies. "Each Military Department and Defense Agency responsible for material amounts of inventory or operating materials and supplies shall implement the valuation method as systems are enhanced or replaced." The USMC is participating in DoD Business Transformation Agency (BTA) efforts to bring legacy and target systems into compliance with the Business Enterprise Architecture (BEA). The BEA provides for a master plan that includes guidance on transition plan strategy concepts, considerations, processes, and principles. The MAC will be implemented as systems are enhanced or replaced. Until then, USMC continues to value OM&S Held for Use or Held for Repair using the standard purchase price. The USMC does not include a revaluation allowance for OM&S Held for Use or Held for Repair, but transfers items from these categories to Excess, Obsolete, and Unserviceable where the revaluation allowance is reported. Ammunition and Munitions are valued using the Latest Acquisition Cost.

Government Furnished Material (GFM) and Contractor Acquired Material (CAM)

Generally, the value of USMC GFM and CAM in the hands of contractors is 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.

Restrictions on Operating Materials and Supplies

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

Other Disclosures
Ammunition and Munitions
Ammunition and Munitions are maintained and valued in the Marine Ammunition and Reporting System Two. The USMC anticipates migrating to solutions, as identified in BTA's transition plan in accordance with its current policy of adopting, implementing, and migrating from current legacy systems to approved systems.

APA Secondary Inventory
APA Secondary Inventory includes OM&S items such as, spare and repair parts, fuel, clothing and textiles, medical and dental supplies. These items are of such importance that central inventory control is required. They normally possess one of the following characteristics: (a) essential for combat or training, (b) high dollar value, (c) difficult to procure or produce, or (d) critical basic materials or components.

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

Real-time Reutilization Asset Management (RRAM)
Material maintained and valued in RRAM is considered excess to the owner, but may not be excess to DON. Standard price is used to value all stock-numbered items. Part-numbered items are valued by best available information.

Other Operating Materials & Supplies
Not Applicable to USMC General Fund.

Stockpile Materials, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30	2006					2005
	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	$ 155,378	N/A	$ 155,378	$ 156,463
B. Buildings, Structures, and Facilities	S/L	20 Or 40	7,687,028	$ (4,157,596)	3,529,432	3,604,002
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	175,980	(141,656)	34,324	46,376
F. Military Equipment	S/L	Various	6,474,100	(1,695,349)	4,778,751	3,158,867
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			$ 14,492,486	$ (5,994,601)	$ 8,497,885	$ 6,965,708

[1] Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

Fluctuation and Abnormalities

There are no abnormalities to disclose for this reporting period.

In 4th Quarter, FY 2006, General PP&E increased by $1.5 billion, 22%, primarily due to a $1.6 billion increase in military equipment. The reason for the increase is that prior to FY 2006, military equipment was only reported by the Department of the Navy (DON) because USMC did not began to prepare standalone financial statements until 1st Quarter, FY 2006.

Restrictions on General Property, Plant, and Equipment (General PP&E), Net

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

Other Information Related to General PP&E, Net

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 addition to other criteria such as being listed on 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.

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

Any additional information regarding heritage assets, multi-use heritage assets and stewardship land is reported in Required Supplementary Information.

Museums
Museums are buildings, places, or institutions devoted to the acquisition, conservation, study, exhibition, and educational interpretation of objects having scientific, historical, or artistic value. The Secretary of the Navy Instruction 5755.1A, "Navy Museums," defines the scope of the Navy Museum program.

Stewardship Land
The USMC follows the Department of Defense (DoD) Financial Management Regulation (DoD FMR) 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.

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

The DoD changed its method of valuing military equipment in 3rd Quarter, FY 2006. Previously, military equipment was valued using Bureau of Economic Analysis (BEA) data. Beginning with the 3rd Quarter, FY 2006, military equipment is valued based on internal records. This value of military equipment for the 4th Quarter, FY 2005 was restated from a zero balance to $3.2 billion for comparative purposes using the new valuation method.

For 4th Quarter, FY 2006, military equipment is valued at $4.8 billion based on internal records. Under the previously used BEA valuation methodology, this equipment would have been valued at $7.9 billion.

Property in the Possession of Contractors.
The value of USMC General PP&E real property in the possession of contractors is included in the values reported above for the major asset classes of land and buildings, structures, and facilities. The value of General PP&E personal property, major asset classes of software and equipment does not include all of the General PP&E above DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. Per DoD FMR Volume 6B Chapter 10, USMC is not supplementing General PP&E information with values from the Defense Contract Management Agency's Contract Property Management System database. In accordance with an approved strategy with Office of Management and Budget, Government Accountability Office, and DoD Inspector General (DoDIG), DoD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with Federal GAAP.

Other Disclosures
Preponderant Use.
Per DoD FMR, Volume 4, Chapter 6, legal ownership is not always the determining factor when establishing which DoD Component recognizes a particular General PP&E asset for accounting and

reporting purposes. If the following four criteria are met, the preponderant user should report the property regardless of legal ownership or funding source:

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

Per the Office of the Under Secretary of Defense (Comptroller) memo of July 5, 2005, the Military Departments and DoD activities meeting the criteria of preponderant user are responsible for reconciliation of preponderant use property. As reconciliation's are completed and documented, USMC General Fund will make the adjustments to General PP&E.

Internal Use Software.
The USMC is in the process of establishing procedures to account for internal use software in accordance with DoD FMR, Volume 4, Chapter 6, "Plant, Property and Equipment," SFFAS No. 6, "Accounting for Property, Plant, and Equipment" and SFFAS No. 10, "Accounting for Internal Use Software." The USMC anticipates implementation of these procedures during FY 2007. The inventory of software utilized within USMC is being identified in ongoing Business Transformation Agency initiatives and will be leveraged by USMC to identify, validate, value, and account for internal use software assets. The USMC does not expect that internal use software is of a material amount

Assets Under Capital Lease

Not applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Other	79,677	76,953
D. Total Intragovernmental Liabilities	$ 79,677	$ 76,953
2. Nonfederal Liabilities		
A. Accounts Payable	$ 2,186	$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	214,433	210,850
C. Environmental Liabilities	226,470	0
D. Other Liabilities	651,450	553,789
E. Total Nonfederal Liabilities	$ 1,094,539	$ 764,639
3. Total Liabilities Not Covered by Budgetary Resources	$ 1,174,216	$ 841,592
4. Total Liabilities Covered by Budgetary Resources	$ 1,080,648	$ 999,389
5. Total Liabilities	$ 2,254,864	$ 1,840,981

Other Information Related to Liabilities Not Covered by Budgetary Resources

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

The United States Marine Corps (USMC) reported an increase of $332.6 million, 40%, in total liabilities not covered by budgetary resources. This was mostly attributable to nonfederal liabilities, $226.5 million in environmental liabilities, $97.7 million increase in other liabilities and $2.19 million in accounts payable from cancelled appropriations.

Prior to FY 2006, environmental liabilities, accounts payable from canceled appropriations and other liabilities related to shared appropriations were reported only on DON financial statements because USMC did not prepare standalone financial statements until 1st Quarter, FY 2006.

In addition, nonfederal other liabilities grew due to a $58.3 million increase in annual leave liability, because of an expansion of the category of reportable leave liability in FY 2006 to update annual leave liability at each quarter-end. Leave types that must be accrued are: annual leave restored annual leave, restored Base Realignment and Closure leave, compensatory leave, and credit hours earned. Also, contributing to this increase was $39.4 million in nonfederal in excess/obsolete structures liabilities. Prior to FY 2006, nonfederal excess/obsolete liabilities were only on DON financial statements. During this reporting period, 4th Quarter, FY 2006, DON implemented procedures to identify USMC's excess/obsolete structures liabilities.

Other Disclosures
Intragovernmental liabilities – other (not covered by budgetary resources) includes Federal Employees Compensation Act, $50 million, and Unemployment Compensation, $29.3 million

Nonfederal liabilities - other liabilities include civilian and military annual leave liability, $612.1 thousand, and excess and obsolete structure liability, $39.4 million.

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

Realized budgetary resources include:

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

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

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intragovernmental Payables	$ 111,464	$ N/A	$ 111,464	$ 168,814
2. Nonfederal Payables (to the Public)	520,609	0	520,609	505,949
3. Total	$ 632,073	$ 0	$ 632,073	$ 674,763

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

Intragovernmental Payables
In 4th Quarter, FY 2006, the United States Marine Corps (USMC) reported a decrease of $57.4 million, 34%, in intragovernmental payables.

The largest portion of the decrease, $34.3 million, is directly attributable to a reduction in the intragovernmental payables owed the Navy Working Capital Fund (WCF). This reduction occurred in 1st Quarter, FY 2006. A change in business practice was implemented that allowed the Navy WCF to charge USMC appropriations directly when making contract payments. This change eliminated the need for Navy WCF to pay the contract and then collect from USMC via a reimbursable billing process.

Additionally, a reduction of $12.7 million in intragovernmental payables owed the Defense Logistics Agency (DLA) Supply Management Fund occurred in 1st Quarter, FY 2006. This reduction occurred when DLA began automatically billing USMC through the interdepartmental billing process. Use of the interdepartmental billing process reduces the number of days necessary to liquidate the accounts payable.

Note 13. Debt

The Marine Corps General Fund has no Debt.

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2006			2005
	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—Active Installations				
1. Environmental Corrective Action	0	40,637	40,637	0
2. Environmental Closure Requirements	289	185,544	185,833	0
3. Environmental Response at Operational Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
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. Other	0	0	0	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	0	0	0
2. Nuclear Powered Submarines	0	0	0	0
3. Other Nuclear Powered Ships	0	0	0	0
4. Other National Defense Weapons Systems	0	0	0	0
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	0	0	0
2. Total Environmental Liabilities	$ 289	$ 226,181	$ 226,470	$ 0

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

In 4th Quarter, FY 2006, the United States Marine Corps (USMC) Total Environmental Liabilities reported increased $226.5 million, 100%, because prior to FY 2006, NonDefense Environmental Restoration Program (NonDERP) liabilities were reported in the DON financial statements. First Quarter, FY 2006 was the first time USMC produced financial statements as a stand-alone entity.

Other Category Disclosure
The USMC does not have any “Other” environmental liabilities to report. As a subsidiary of DON, USMC only reports nonDERP environmental liabilities, all remaining environmental liabilities are reported at DON level only.

Current Liability
The USMC has identified $289.5 thousand as current liabilities as required by the Department of Defense Financial Management Regulation, Volume 6B, Chapter 10

Environmental Liabilities Nonfederal
Other Accrued Environmental Liabilities – Active Installations
In the 4th Quarter, FY 2006, USMC reported $40.6 million in Environmental Corrective Action and $185.5 million in Environmental Closure Requirements. This is attributed to USMC continuing efforts to complete their survey and estimations of USMC environmental liabilities of closure/decommissioning requirements for on-going operations.

Other Information Related to Environmental Liabilities
Applicable Laws and Regulations of Cleanup Requirements
The following is a summary of significant laws that affect USMC’s conduct of environmental policy and regulations. 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 the 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 Amendments 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 purpose of 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 (Well Head 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.

Methodology Used to Estimate 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
Other Accrued Environmental Costs (NonDERP funds), Cost, Base Realignment and Closure (BRAC), and Environmental Disposal for Weapons systems Programs
The USMC 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 (Polychlorinated Biphenyls) transformers, underground storage tank remedial investigation and closure. The USMC has reported nonDERP environmental liabilities for USMC 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 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 fall into 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 (DERP Funded)
The DON centrally manages and executes (Defense Environmental Restoration Program) DERP and BRAC portion at DON level. Therefore, USMC does not report DERP or BRAC environmental liabilities. The USMC is in the process of evaluating if there are environmental liabilities associated with disposal of their weapons systems programs.

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 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

Explanations

A. The DON administers the program and expenditures to remediate legacy wastes. The USMC does not have any amounts to disclose.

B. and C. The USMC reported an estimate for Other Environmental Liabilities (OEL). The USMC is in the process of determining what portion of the OEL relates to units put into service after October 1, 1997. Therefore, detailed data is not available at this time.

D. and E. The USMC does not have any changes in the environmental liability estimates due to changes in laws, regulations, and technology.

Note 15. Other Liabilities

As of September 30	2006			2005
	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	99,224	0	99,224	0
C. Disbursing Officer Cash	59,649	0	59,649	196,180
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	20,976	29,105	50,081	49,635
F. Other Liabilities	34,922	0	34,922	32,848
G. Total Intragovernmental Other Liabilities	$ 214,771	$ 29,105	$ 243,876	$ 278,663
(Amounts in thousands)				
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 173,846	$ 0	$ 173,846	$ 122,916
B. Advances from Others	0	0	0	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	0
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	608,058	0	608,058	553,789
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	7,950	108,766	116,716	0
J. Total Nonfederal Other Liabilities	$ 795,136	$ 142,876	$ 938,012	$ 676,705
3. Total Other Liabilities	$ 1,009,907	$ 171,981	$ 1,181,888	$ 955,368

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

Intragovernmental other liabilities
The United States Marine Corps (USMC) reported a decrease of $34.8 million, 12%, in total intragovernmental other liabilities.

Attributing to the decrease of intragovernmental other liabilities is a decrease of $136.5 million to the disbursing officer cash account, due to the cash and other monetary assets decreasing. This is primarily attributable to a $103 million decrease in foreign currency held in the Marine Corps Expeditionary Forces, Camp Lejeune, Limited Depositary Account (LDA) for use in Iraq. Upon completion of the disbursing officer's deployment that LDA was closed, the remaining amounts were withdrawn and subsequently deposited back into the U.S. Treasury during 2nd Quarter, FY 2006.

The decrease in the cash and other monetary assets is offset by an increase of $99.2 million in deposit funds and suspense account liabilities due to the USMC portion of Treasury suspense accounts only being reported at DON level in prior years. The USMC prepared standalone financial statements for the first time in 1st Quarter, FY 2006 as a subsidiary of DON.

Intragovernmental other liabilities-others includes liabilities to Treasury, unemployment, and employee benefits.

Nonfederal other liabilities.
The United States Marine Corps (USMC) reported an increased $261.2 million, (39%) in nonfederal other liabilities.

This increase is due to reporting $116.7 million, 100%, increase in contingent liabilities for estimated future contract financing payments that will be paid to the contractor upon delivery and government acceptance of satisfactory product. This is the first time reporting due to newly implemented DoD procedures. In accordance with contract terms, specific rights to the contractor work vests with the government when a specific type of contract financing payments is made, thereby protect taxpayer's funds in the event of the contract nonperformance. These rights should not be misconstrued as the right of ownership. The Department of Defense (DoD) is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and government acceptance of a satisfactory product. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to the DoD and the amount of potential future payments are estimated; DoD has recognized a contingent liability for estimated future payments, which are conditional pending delivery and government acceptance of a satisfactory product.

Also contributing to the increase in nonfederal other liabilities is a $54.3 million increase in accrued unfunded annual leave. The accrued unfunded annual leave increase is attributable to unused leave for Marines who have been deployed and were unable to utilize their current leave. For 4th Quarter, FY 2006 nearly 22,000 of the 138,000 troops in Iraq were Marines. Additionally, a $50.9 million increase in accrued funded payroll and benefits contributed to the increase in nonfederal liabilities. This increase in accrued funded payroll and benefits is due to correcting an overstated 3rd Quarter, FY 2005 amount. Prior to 3rd Quarter, FY 2005, USMC did not separate accrued funded payroll liabilities from accounts payable. However, at first reporting, 3rd Quarter, FY2005, USMC overstated the accrued funded payroll liabilities. The USMC had to reconcile the accounts payable general ledgers to the proper accrued funded payroll and benefits ledgers to correct the overstatement. The 4th Quarter, FY 2005 accrued funded payroll and benefits was understated due to problems from the manual reporting processes during the reconciliation of proprietary accounts payable.

The intragovernmental nonenvironmental disposal liabilities/excess/obsolete structures current liability posted an increase of $39.4 million, as the proprietary general ledgers are being reconciled to account for these discrepancies with an estimated completion date prior to reporting 4th Quarter, FY 2006.

In response to the Department of Defense, Inspector General audit, "Financial Management: DoD Process for Reporting Contingent Legal Liabilities," the Department of the Navy (DON) completed a methodology during 4th Quarter, FY 2006, that provides an estimate for those cases that are probable and reasonably possible. The DON is testing the methodology with the objective to begin reporting 2nd Quarter, FY 2007.

Nonfederal other liabilities-other includes contract holdbacks, employer contributions and payroll taxes, and legal claims.

Capital Lease Liability

Not applicable.

Note 16. Commitments and Contingencies

Legal Contingencies:
The United States Marine Corps (USMC), a sub-entity of 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. For USMC cases, DON has accrued contingent liabilities for legal actions where DON Office of 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. In addition to DON statements, USMC records judgment fund liabilities in Note 15, "Other Liabilities" and Note 12, "Accounts Payable."

The Office of the Navy General Counsel conducted a review of litigation and claims threatened or asserted involving the USMC General Fund to which Office of General Counsel lawyers devoted substantial attention in the form of legal consultation or representation. This review utilizes a threshold of materiality of $1.2 million applied to individual and aggregate claims, litigation, assessments, or contingencies arising out of a single event or a series of events.

The USMC has 2 cases that meet the existing materiality threshold. In response to the Department of Defense, Inspector General audit, "Financial Management: DoD process for Reporting Contingent Legal Liabilities," the DON completed a methodology during 4th Quarter, FY 2006 that provides an estimate for those cases that are probable and reasonable possible. The DON is testing the methodology with the objective to begin reporting 2nd Quarter FY 2007.

Other Commitments and Contingencies
The USMC contingent liabilities for obligations related to undelivered orders for open contracts citing canceled appropriations and for contractual arrangements are reported at the DON level. The DON and USMC have not fully implemented procedures to separate and report USMC's contingencies.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2006							2005	
	Present Value of Benefits		Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)		Unfunded Liability		Present Value of Benefits	
(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	$	214,433		$	0	$	214,433	$	210,850
B. Voluntary Separation Incentive Programs		0			0		0		0
C. DoD Education Benefits Fund		0			0		0		0
D. Total Other Actuarial Benefits	$	214,433		$	0	$	214,433	$	210,850
3. Other Federal Employment Benefits	$	0		$	0	$	0	$	0
4. Total Military Retirement and Other Federal Employment Benefits:	$	214,433		$	0	$	214,433	$	210,850

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

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

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

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

<u>Military Retirement Pensions.</u>
The portion of the military retirement benefits actuarial liability applicable to the United States Marine Corps (USMC) is reported on the financial statements of the Military Retirement Fund.

<u>Military Retirement Health Benefits.</u>
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 is reported only on DoD Agency-wide Financial Statements.

<u>Federal Employees Compensation Act (FECA).</u>
Actuarial Cost Method Used and Assumptions: The USMC actuarial liability for workers' compensation benefits is developed by Department of Labor and provided to USMC 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 Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Fiscal Year 2006
5.170% in Year 1
5.313% 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) 2006 were also used to adjust the methodology's historical payments to current year constant dollars.

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

CBY	COLA	CPIM
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid loses per case (a measure of case-severity) in CBY 2006 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 2006 projection to the average pattern for the projections of the most recent three years.

The estimate was allocated between General Fund and Navy Working Capital Fund, Marine Corps based on the number of civilian employees taken from the Navy Budget Tracking System.

	Personnel
USMC General Fund	15,094
Navy Working Capital Fund, Marine Corps	1,909
Total	17,003

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

Intragovernmental Costs and Exchange Revenue				
As of September 30		2006		2005
(Amounts in thousands)				
1. Intragovernmental Costs	$	5,829,850	$	6,671,583
2. Public Costs		14,666,789		13,489,258
3. Total Costs	$	20,496,639	$	20,160,841
4. Intragovernmental Earned Revenue	$	(304,356)	$	(410,525)
5. Public Earned Revenue		(110,342)		(656,467)
6. Total Earned Revenue	$	(414,698)	$	(1,066,992)
7. Net Cost of Operations	$	20,081,941	$	19,093,849

Fluctuation and Abnormalities
There are no abnormalities to disclose for this reporting period.

Total earned revenue decreased $652.3 million, 61%, primarily attributable to a gradual decrease in the capitalization of land and buildings from FY 2005 to FY 2006 by a total of $554.9 million. This change in assets affects earned revenue due to application of proper accounting practices. Assets are accounted for on the quarterly financial statements, but not accounted for in the accounting system. An expense vice an asset is recorded in the accounting system when the asset is received. Therefore, when the asset data is received from the asset accountability system for financial statement recording, an adjustment must be made to reduce expenses and increase assets. Since the expense cannot directly be decreased for the amount of the asset due to timing issues, the proper accounting requires an increase to the other gains account. This account is included in computation of revenue for the year, and also increases the results of operations. The results of operation are not actually affected by this since the amount is “negated” by the earlier expensing of the assets.

The United States Marine Corps (USMC) has partially implemented a direct interface from the property accountability system to the accounting system. Full implementation will eliminate the requirement to make these accounting adjustments.

Other Information
The USMC recorded a prior period adjustment due to a change in the methodology for reporting of military equipment. The FY 2005 restatement impacts the value of general property, plant, and

equipment and associated accumulated depreciation reported on the balance sheet. The Department of Defense has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

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 and a nonfederal entity.

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

Currently, USMC is unable to identify its intragovernmental trading partners for costs. An initiative is currently underway to enhance the accounting system to identify trading partners on each obligating transaction. Revenue trading partners can be identified.

The USMC accounting system meets accounting standards and records transactions based on the US Standard General Ledger. The information presented is not based on budgetary obligations, disbursements, and collection transactions.

The USMC does not report any amounts for the costs of acquiring, constructing, improving, reconstructing, or renovating heritage assets (other than multi-use heritage assets), and the cost of acquiring stewardship land and any costs to prepare stewardship for its intended use.

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

As of September 30	2006 Cumulative Results of Operations	2006 Unexpended Appropriations	2005 Cumulative Results of Operations	2005 Unexpended Appropriations
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	$ 0	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	3,158,868	0	3,158,868	0
C. Total Prior Period Adjustments	$ 3,158,868	$ 0	$ 3,158,868	$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 23,303	$ 0	$ 24,235	$ 0
B. Civilian Health	42,640	0	39,408	0
C. Civilian Life Insurance	141	0	129	0
D. Judgment Fund	1,157	0	151	0
E. IntraEntity	0	0	0	0
F. Total Imputed Financing	$ 67,241	$ 0	$ 63,923	$ 0

Errors and Omissions in Prior Year Accounting Reports
In the 4th Quarter, FY 2006, the United States Marine Corps (USMC) recorded a $3.2 billion prior period adjustment due to a change in Department of Defense (DoD) methodology for reporting military equipment that resulted in a $3.2 billion restatement for FY 2005. The FY 2005 restatement impacts the value of general property, plant, and equipment and associated accumulated depreciation reported on the Balance Sheet. The DoD has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," DoD reported military equipment values in the financial statements beginning in FY 2003. As an interim measure, while DoD worked to develop its military equipment baseline from internal records, the military equipment values reported were based on information obtained from the Bureau of Economic Analysis (BEA).

Effective 3rd Quarter, FY 2006, DoD replaced the BEA estimation methodology with a valuation based on internal DoD records. During the process of establishing a baseline, we discovered that the BEA estimates had failed to consider disposals, thresholds, and construction in process. While an estimation methodology is acceptable per SFFAS 23, due to the nature of the BEA omissions, DoD considers the method previously used not compliant with Generally Accepted Accounting Principles (GAAP), and thus have treated the adjustment as correction of a material error.

Other Information
Imputed financing is the difference between the Government's cost of providing benefits to employees and contributions made by and for them. The amounts remitted to Office of Personnel Management by and for employees covered by Civil Service Retirement System, Federal Employee Retirement System, Federal Employees Health Benefits Program and Federal Employee Group Life Insurance Program do not fully cover the Government's cost to provide these benefits.

For the judgment fund, USMC recognizes liabilities and expenses when unfavorable litigation outcomes are probable and the amounts can be estimated. The Treasury provides the dollar amount of the imputed financing. The Treasury based the imputed financing on the amount the judgment fund is expected to pay for settlements

The difference of $157.7 thousand between appropriations received on the Statement of Budgetary Resources (SBR) and appropriations received on the Statement of Change of Net Position (SOCNP) is the amount of US Standard General Ledger 4114, appropriated trust or special receipts, from USMC portion of the Wildlife Conservation on Military Reservations appropriation. This account is included on the appropriations received on the SBR, but not on the SOCNP.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 10,014,842	$ 5,988,046
2. Available Borrowing and Contract Authority at the End of the Period	0	0

Other Information
United States Marine Corps (USMC) Report on Budget Execution accurately reflects $19.5 billion direct obligations in category A, $6.5 billion direct obligations in category B, and $606.4 million reimbursable obligations in category B. The Statement of Budgetary Resources (SBR) reflects a total direct obligations amount of $25.8 billion and $0.8 billion in reimbursable obligations. Distribution of obligations between direct and reimbursable on the two reports is different, but total obligations are the same.

The discrepancy in amounts reported between direct and reimbursable obligations is due to a change in business process that occurred with the implementation of Defense Departmental Reporting System (DDRS)-Budgetary in 1st Quarter, FY 2006. Prior to that time the trial balances were derived from the Report on Budget Execution which did not distribute amounts between total direct and reimbursable obligations. Balances that could not be derived from other general ledger accounts were distributed based on management discretion. Beginning 1st Quarter, FY 2006 we began importing the general ledgers directly from the accounting system to DDRS Budgetary to DDRS-Audited Financial Statements (AFS). This allowed proper reimbursable general ledger amounts to flow from the accounting system to the financial statements. Due to the previous distribution method, the beginning balances in DDRS-AFS were not divided correctly between direct and reimbursable obligations. These balances will be corrected in 1st Quarter, FY 2007.

Intraentity transactions have not been eliminated because this statement is presented as combined and combining.

There are no legal arrangements affecting the use of unobligated balances of budget authority. The USMC received no capital infusions during the reporting period.

Note 21. Disclosures Related to the Statement of Financing

Other Information

The following Statement of Financing (SOF) 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

The SOF line “Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations, Other” is primarily comprised of the transfer-in of general equipment from Navy Working Capital Fund, Marine Corps.

The SOF line “Components Requiring or Generating Resources in Future Period, Other” is comprised of unpaid leave that military personnel have earned that will be funded from future year’s appropriations. This line also includes the fiscal year-to-date change of nonenvironmental disposal liability.
The SOF line “Components not Requiring or Generating Resources, Other” is comprised of the year-to-date change in the back out of expenses for nonfederal refund receivables. The refund receivables and abnormal expenses do not require or generate resources in the current period. Additionally, it includes the bad debt expense for public accounts receivables.

Components requiring or generating resources in future periods are costs not funded in the period the costs are incurred. The expense and the corresponding liability are recognized in the current period but the budgetary resource will not be provided until a subsequent period. The amount of liabilities not covered by budgetary resources for 4th Quarter, FY 2006 is $1.2 billion. In general, the changes in liabilities not covered by budgetary resources as shown on the Balance Sheet are reflected on the Statement of Financing. Differences are a result of custodial liabilities covered by current unobligated budgetary resources.

Note 22. Disclosures Related to the Statement of Custodial Activity

The Marine Corps General Fund has no disclosures related to the statement of custodial activity.

Note 23. Earmarked Funds

BALANCE SHEET As of September 30 *(Amounts in thousands)*	MRF	MERHCF	Other Earmarked Funds	Eliminations	Total
ASSETS					
Fund balance with Treasury	$ 0	$ 0	$ 430	$ 0	$ 430
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	$ 430	$ 0	$ 430
LIABILITIES and NET POSITION *As of September 30*					
Military Retirement Benefits and Other Employment Related Actuarial Liabilities	$ 0	$ 0	$ 0	$ 0	$ 0
Other Liabilities	0	0	47	0	47
Unexpended Appropriations	0	0	0	0	0
Cumulative Results of Operations	0	0	383	0	383
Total Liabilities and Net Position	$ 0	$ 0	$ 430	$ 0	$ 430
STATEMENT OF NET COST *As of September 30*					
Program Costs	$ 0	$ 0	$ 15	$ 0	$ 15
Less Earned Revenue	0	0	0	0	0
Net Program Costs	$ 0	$ 0	$ 15	$ 0	$ 15
Less Earned Revenues Not Attributable to Programs	0	0	0	0	0
Net Cost of Operations	$ 0	$ 0	$ 15	$ 0	$ 15
STATEMENT OF CHANGES IN NET POSITION *As of September 30*					
Net Position Beginning of the Period	$ 0	$ 0	$ 240	$ 0	$ 240
Net Cost of Operations	0	0	15	0	15
Other Nonexchange Revenue	0	0	158	0	158
Other Financing Sources	0	0	0	0	0
Change in Net Position	$ 0	$ 0	$ 143	$ 0	$ 143
Net Position End of Period	$ 0	$ 0	$ 383	$ 0	$ 383

Wildlife Conservation, Military Reservations, 16 USC 6706
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 or subsequent to 4th Quarter, FY 2006, legislation regarding the purpose and use of the Wildlife Conservation, Military Reservation has not changed.

The amount of intragovernmental activity that is not reported on the note schedule is the difference between the amounts reported in the total column of the note schedule and the amounts reported on the face of the Balance Sheet and Statement of Changes in Net Position.

The Non Exchange Revenue in the amount of $157.7 thousand for 4th Quarter, FY 2006 is from the proceeds of the sale of fishing and hunting permits.

No amount of the Earmarked Funds are removed or eliminated between other Marine Corps funds.

Note 24. Other Disclosures

The Marine Corps General Fund has no other disclosures.

United States Marine Corps General Fund
Supporting Consolidating/Combining Statements

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The United States Marine Corps, as a sub-entity of the Department of the Navy (DON), does not prepare Supporting/Consolidating Statements and therefore is included at the DON General Fund level.

United States Marine Corps General Fund
Required Supplementary Stewardship Information

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INVESTMENT IN RESEARCH AND DEVELOPMENT
Yearly Investment in Research and Development
For Fiscal Year 2006
(In Millions of Dollars)

(a)	(b)
Categories	FY06
1. Development	
Advanced Technology Development	36,188
Advanced Component Development and Prototypes	302,237
System Development and Demonstration	12,864
Research, Development, Test, and Evaluation Management Support	48,194
Operational Systems Development	283,725
Total	683,208

Narrative Statement

Investments in Research and Development
Fiscal Year (FY) 2006 is the first year that the United States Marine Corps (USMC) is reporting as a separate entity and therefore only is reporting one year for the Investment in Research and Development (R&D) schedule. The USMC investments are all Development; no Research Investments. The values included in this report are based on Development outlays (expenditures). Outlays are used because current USMC systems are unable to fully capture and summarize financial data in accordance with Federal Accounting Standards Advisory Board (FASAB) standards.

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 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 the 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 development testing.

4. Research, Development, Test, and Evaluation (RDT&E) 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 R&D program.

5. Operational Systems Development is concerned with development projects in support of programs or upgrades 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 three representative program examples for the Development category:

1. Plumbing the chemistry of Iraq Improvised Explosive Devices (IEDs)
The Office of Naval Research (ONR) is sponsoring a research project at the Massachusetts Institute of Technology (MIT) that is analyzing the molecular interaction of explosive materials. The goal of the three-year program is to study the physics and chemistry of IEDs and find techniques to detonate or short-circuit them before they cause harm.

Two objectives of this project are developing countermeasures and developing safer and more reliable materials for our own use to defend against the IEDs. The MIT researchers are conducting with research partners at Washington State University and Michigan Technological University. The funding is part of a military program called the Multidisciplinary University Research Initiative, which is designed to support technology advances and academic work in subjects representing exceptional opportunities for future military applications.

Composed of leftover Iraqi Army mortars, artillery shells, TNT (trinitrotoluene), and a variety of other explosives readily available in Iraq, IEDs pose perhaps the most troublesome problem for U.S. troops on the ground. The bombs, hidden along patrol and convoy routes, are relatively cheap to make, yet have become increasingly sophisticated, more powerful, and harder for the military to defend against. Increasingly skilled insurgents have disguised IEDs as rocks or tucked them inside roadside debris and dead animals.

Other research includes testing different ways that explosives can be stimulated or triggered – such as, through heat, radiation, or mechanics. The goal from this research is to use the knowledge to make IEDs on the side of the road more vulnerable to preemptive stimuli, thereby disabling the explosive devices before they cause harm to U.S. service members.

2. The New Breed of Soldier: Robots with Guns
Pentagon testing devices in effort to slash casualties

Spurred by the risks from roadside bombs and terrorist ambushes, the military is aggressively seeking to replace troops with battlefield robots, including new versions armed with machine guns.

Although the Pentagon initially focused on aircrafts, such as the Predator drone, new ground and sea based robots are being developed and tested. For example:

- The Mobile Detection Assessment Response System is an unmanned vehicle intended to patrol around domestic bases.
- Self-driving convoy trucks. Some variants follow preplanned routes or the vehicle in front. The Defense Advanced Research Projects Agency has held a competition among advanced, satellite-guided versions that plan their own routes and maneuver around roadblocks.
- Robots that can enter a building, look for an enemy, and send back a map of the interior are being tested.

Already in Iraq and Afghanistan are hundreds of small robots to help bomb squads examine or disarm explosives from a safe distance. To better detect and stop IEDs, new sensors are being attached to those robots. The Pentagon is testing a new version of the Talon robot that carries a remote-control machine gun.

Much larger and more ambitious robot weapons are in testing, including a tank-like, 1,600-pound vehicle called the Gladiator, which can fire a variety of guns, tear gas or almost anything else that fits. It also has loudspeakers to "shout" instructions, such as those to calm a mob.

The goal now is helping troops in the field as quickly as possible. In the long term, the Gladiator and other robots will be transitional, as the military shifts to robotic technologies that will revolutionize warfare.

3. U.S. Military Selects Oshkosh Truck for Joint Light Tactical Vehicle Program
Oshkosh truck has been selected by the ONR to perform a conceptual design and mockup science and technology program for the Joint Light Tactical Vehicle (JLTV) program. The ONR, in concert with the U.S. Army and USMC, is supporting the JLTV program to develop a family of light tactical wheeled vehicles with superior survivability characteristics and enhanced payload.

Specifications defined by the U.S. Army and the USMC for the JLTV family of vehicles address capability gaps and increase force protection, survivability, fuel-efficiency, capacity, maneuverability and automotive safety, balanced with the total cost of ownership. Vehicles also must meet current weight and dimension requirements for transportability aboard ships and aircraft. The work that Oshkosh truck will perform involves a component technology review and the development of modeling and simulation programs, as well as conceptual designs of future technologies for the JLTV program.

NON-FEDERAL PHYSICAL PROPERTY
The USMC does not maintain any nonfederal physical property.

Department of the Navy Subsidiary Financial Statements

United States Marine Corps General Fund
Required Supplementary Information

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USMC General Fund Required Supplementary Information

United States Marine Corps General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and Restoration Tables
As of September 30, 2006
($ in Millions)

Annual Sustainment FY 2006				
	Required	Actual	Difference	
Marine Corps	561	524	37	
Building, Structures, and Utilities	561	524	37	

Annual Deferred Sustainment Trend				
	FY 2003	FY 2004	FY 2005	FY 2006
Marine Corps	-	24	30	37
Building, Structures, and Utilities	-	24	30	37

Restoration and Modernization Requirements				
	End FY 2005	End FY 2006	Change	
Marine Corps	-	256	256	
Building, Structures, and Utilities	-	256	256	

Narrative Statement:

Fiscal Year (FY) 2006 is the first year the United States Marine Corps (USMC) is reporting as a separate entity. Sustainment is defined as the maintenance and repair activities necessary to keep a typical facility in good working order over its service life. It includes regularly scheduled adjustments and inspections (such as for fire sprinkler heads and Heating Ventilation Air Conditioning (HVAC) systems), regulatory inspections (of elevators, bridges, and the like), emergency and routine preventive maintenance tasks, and major repair or replacement of facility components, such as roof replacement, refinishing wall surfaces, repairing and replacing electrical, heating, and cooling systems, and replacing tile and carpeting. In FY 2006, FSM Version 7.2 was used for programming and budgeting for facilities sustainment. Deferred amounts were calculated in accordance with the methodology provided by DoD Financial Management Regulation, Volume 6B, Chapter 12, "Required Supplementary Information."

Restoration and Modernization is not currently modeled. Restoration includes repair and replacement work to restore facilities damaged by inadequate sustainment, excessive age, disaster, accident, or other causes. Modernization includes alteration of facilities solely to implement new or higher standards and regulatory changes, to accommodate new functions including base realignment and closure (BRAC), or to renew building components that typically last more that 50 years, such as foundations and structural members. Requirements listed on the table are actual expenditures for restoration and modernization by year. The program growth evident in the funding trend reflects the impact of Hurricanes Ivan and Katrina, and BRAC.

The USMC General Fund has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

Military Equipment
Deferred Maintenance Amounts
As of September 30, 2006
($ in Thousands)

Major Type	Amount
Combat Vehicles	83,000
Total	$83,000

Narrative Statement:

Combat Vehicles

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

HERITAGE ASSETS
For Fiscal Year Ended September 30, 2006

(A)	(B) Measurement Quantity	(C) As of Sep 30, 2005	(D) Additions	(E) Deletions Sep 30, 2005	(F) As of Sep 30, 2005
Museums	Each	6	-	-	6
Monuments & Memorials	Each	0	-	-	-
Cemeteries	Sites	0	-	-	-
Archeological Sites	Sites	0	-	-	-
Buildings and Structures	Each	0	-	-	-
Major Collections	Each	0	-	-	-

(See Supplemental Reporting)

Narrative Statement:

Fiscal Year 2006 is the first year that USMC is reporting as a separate entity. The USMC 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
- Archaeological Resources Protection Act of 1979
- Native American Graves Protection & Repatriation Act of 1990
- Presidential Memorandum for Heads of Executive Departments and Agencies: Government Relations with Native American Tribal Governments Act of 1994

- 36 CFR 79 – Curation of Federally Owned and Administered Archaeological Collections
- 36 CFR 60.4 – National Register of Historic Places
- Federal Accounting Standards Advisory Board (FASAB) Standard 29, "Heritage Assets and Stewardship Land"
- Executive Order 13237 – Preserve America – of 2003
- Executive Order 13327 – Federal Real Property Asset Management – of 2004

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. 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 between 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 being listed on 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 Financial Management Regulation (FMR), Volume 6B, "Form and Content of the Department of Defense Audited Financial Statements," Multi-Use Heritage Assets are reported both as Heritage Assets on the Required Stewardship Supplementary Information (RSSI) and on the Balance Sheet as real property 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 a visual assessment of the objects, historic value to USMC collection, and general display and storage standards for historic collections. The overall condition of the collection objects is good.

Museums

Museums are buildings, places, or institutions devoted to the acquisition, conservation, study, exhibition, and educational interpretation of objects having scientific, historical, or artistic value. Secretary of the Navy Instruction 5755.1A, "Navy Museums," defines the scope of the Navy Museum program.

Supplemental Reporting. In addition to the data presented in the table above, the following supplemental information was reported as of September 30, 2006:

Category	Measurement Quantity	As of Oct 1, 2005	Additions	Deletions	As of Sep 30, 2006
Archeological Artifacts	Cubic Feet	914	1	0	915
Archival	Linear Feet	24,980	746	0	25,726
Artwork	Item	8,725	221	0	8,946
Historical Artifacts	Item	52,007	1,425	0	53,432

STEWARDSHIP LAND
For Fiscal Year Ended September 30, 2006
(Acres in Thousands)

(a)	(b)
Land Use	As of Sep 30, 2006
1. Mission	680
2. Parks & Historic Sites	0
Totals	680

Narrative Statement

Per the DoD FMR, USMC Stewardship Land includes Public Domain, Land Set Aside, and Donated Land. Within the definition of Stewardship Land, land can be further categorized as Improved, Semi-Improved or Other.

Department of the Navy Subsidiary Financial Statements

United States Marine Corps General Fund
Other Accompanying Information

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Appropriations, Funds, and Accounts Included in the Principal Statements

Entity Accounts

General Accounts

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 US 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

Department of the Navy Subsidiary Financial Statements

Navy Working Capital Fund – Marine Corps
Principal Statements

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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 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, 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 Fiscal Year 2006.

The Marine Corps shares appropriations with the Department of the Navy and 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 2006 Marine Corps Working Capital Fund 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 the financial information for individual activity groups and activities within the Marine Corps Working Capital Fund for the fiscal year ending September 30, 2006.

The following statements comprise the Marine Corps Working Capital Fund Principal Statements:

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

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, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 30,193	$ 62,510
Non-entity Seized Iraqi Cash	0	0
Non-entity - Other	0	0
Investments (Note 4)	0	0
Accounts Receivable (Note 5)	33,906	17,144
Other Assets (Note 6)	0	70
Total Intragovernmental Assets	$ 64,099	$ 79,724
Cash and Other Monetary Assets (Note 7)	0	0
Accounts Receivable, net (Note 5)	327	199
Loans Receivable (Note 8)	0	0
Inventory and Related Property, net (Note 9)	558,068	636,951
General Property, Plant and Equipment, net (Note 10)	48,275	50,524
Investments (Note 4)	0	0
Other Assets (Note 6)	519	(416)
TOTAL ASSETS	$ 671,288	$ 766,982
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 6,382	$ 41,637
Debt (Note 13)	0	0
Other Liabilities (Note 15 & Note 16)	917	18,222
Total Intragovernmental Liabilities	$ 7,299	$ 59,859
Accounts Payable (Note 12)	67,846	30,947
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	29,595	26,667
Environmental Disposal Liabilities (Note 14)	0	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	30,673	13,819
TOTAL LIABILITIES	$ 135,413	$ 131,292
NET POSITION		
Unexpended Appropriations - Earmarked Funds (Note 23)	$ 0	$ 0
Unexpended Appropriations - Other Funds	0	0
Cumulative Results of Operations - Earmarked Funds	0	0
Cumulative Results of Operations - Other Funds	535,875	635,690
TOTAL NET POSITION	$ 535,875	$ 635,690
TOTAL LIABILITIES AND NET POSITION	$ 671,288	$ 766,982

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, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Program Costs		
Gross Costs	$ 730,863	$ 659,655
(Less: Earned Revenue)	(708,962)	(683,205)
Net Program Costs	$ 21,901	$ (23,550)
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 21,901	$ (23,550)

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, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 635,690	$ 623,953
Prior period adjustments (+/-)		
Changes in Accounting Principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 635,690	$ 623,953
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	0	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(90,240)	(21,892)
Imputed financing from costs absorbed by others	12,327	10,079
Other (+/-)	0	0
Total Financing Sources	$ (77,913)	$ (11,813)
Net Cost of Operations (+/-)	21,901	(23,550)
Net Change	(99,814)	11,737
Ending Balances	$ 535,876	$ 635,690
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 0	$ 0
Prior period adjustments:		
Changes in Accounting Principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	$ 0	$ 0
Budgetary Financing Sources:		
Appropriations received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	0	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ 0	$ 0
Net Cost of Operations (+/-)	0	0
Net Change	0	0
Ending Balances	$ 0	$ 0

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, 2006 and 2005
($ in thousands)

	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 227,700	$ 148,373
Recoveries of prior year unpaid obligations	0	0
Budget Authority:		
Appropriations received	0	0
Borrowing authority	0	0
Contract authority	16,540	22,582
Spending authority from offsetting collections:		
Earned		
Collected	621,225	685,552
Change in receivables from Federal sources	17,585	(4,900)
Change in unfilled customer orders		
Advances received	(110)	(472)
Without advance from Federal sources	(11,164)	67,559
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	$ 644,076	$ 770,321
Nonexpenditure transfers, net, anticipated and actual	0	0
Temporarily not available pursuant to Public Law	0	0
Permanently not available	0	0
Total Budgetary Resources	$ 871,776	$ 918,694
Status of Budgetary Resources:		
Obligations incurred:		
Direct	$ 0	$ 0
Reimbursable	694,405	690,994
Subtotal	$ 694,405	$ 690,994
Unobligated balance:		
Apportioned	$ 177,371	$ 227,700
Exempt from apportionment	0	0
Subtotal	177,371	227,700
Unobligated balances not available	0	0
Total status of budgetary resources	$ 871,776	$ 918,694

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, 2006 and 2005
($ in thousands)

	2006 Combined	2005 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 292,725	$ 262,375
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(333,650)	(270,891)
Total Unpaid obligated balance	(40,925)	(8,516)
Obligations incurred, net (+/-)	$ 694,405	$ 690,994
Less: Gross outlays	(653,431)	(660,643)
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0
Total Unpaid obligated balance transferred, net	0	0
Less: Recoveries of prior year unpaid obligations, actual	0	0
Change in uncollected customer payments from Federal sources (+/-)	(6,421)	(62,659)
Obligated balance, net, end of period		
Unpaid obligations	333,699	292,725
Less: Uncollected customer payments from Federal sources	(340,071)	(333,550)
Total Unpaid obligated balance, net, end of period	(6,372)	(40,825)
Net Outlays:		
Net Outlays:		
Gross Outlays	653,431	660,643
Less: Offsetting collections	(621,115)	(685,079)
Less: Distributed Offsetting receipts	0	0
Net Outlays	$ 32,316	$ (24,436)

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Marine Corps

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

		2006 Consolidated		2005 Consolidated
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
Obligations incurred	$	694,405	$	690,994
Less: Spending authority from offsetting collections and recoveries (-)		(627,536)		(747,738)
Obligations net of offsetting collections and recoveries		66,869		(56,744)
Less: Offsetting receipts (-)		0		0
Net obligations		66,869		(56,744)
Other Resources				
Donations and forfeitures of property		0		0
Transfers in/out without reimbursement (+/-)		(90,240)		(21,892)
Imputed financing from costs absorbed by others		12,327		10,079
Other (+/-)		0		0
Net other resources used to finance activities		(77,913)		(11,813)
Total resources used to finance activities	$	(11,044)	$	(68,557)
Resources Used to Finance Items not Part of the Net Cost of Operations:				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided				
Undelivered orders (-)	$	(27,627)	$	(5,175)
Unfilled Customer Orders		(11,274)		67,088
Resources that fund expenses recognized in prior periods		0		0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		0		0
Resources that finance the acquisition of assets		(177,220)		(193,226)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations				
Less: Trust or Special Fund Receipts related to exchange in the entity's budget (-)		0		0
Other (+/-)		90,240		21,892
Total resources used to finance items not part of the Net Cost of Operations	$	(125,881)	$	(109,421)
Total resources used to finance the Net Cost of Operations	$	(136,925)	$	(177,978)

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Marine Corps

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005
($ in thousands)

	2006 Consolidated	2005 Consolidated
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	$ 0	$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	2,928	4,302
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 2,928	$ 4,302
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 3,560	$ 3,509
Revaluation of assets and liabilities (+/-)	(38,835)	41,690
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	191,173	104,921
Operating Materials & Supplies Used	0	0
Other	0	7
Total components of Net Cost of Operations that will not require or generate resources	$ 155,898	$ 150,127
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 158,826	$ 154,429
Net Cost of Operations	$ 21,901	$ (23,549)

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 (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 NWCF, MC in accordance with the "Department of Defense Financial Management Regulation," the Office of Management and Budget Circular (OMB) 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. 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 NWCF, MC is unable to fully implement all elements of GAAP and the OMB Circular A-136, due to limitations of its financial management processes and systems and nonfinancial systems and processes 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 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 NWCF, MC continues to implement processes and system improvements addressing these limitations. The NWCF, MC currently has eleven auditor identified financial statement weaknesses:

(1) Financial Management Systems, (2) Intragovernmental Eliminations, (3) Accounting Entries, (4) Fund Balance with Treasury, (5) Environmental Liabilities, (6) General Property, Plant and Equipment, (7) Government Property and Material in Possession of Contractors, (8) Inventory, (9) Operating Materials and Supplies, (10) Statement of Net Cost, and (11) Statement of Financing.

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 and responsive maintenance support services required to support mobilization, surge and reconstitution requirements to DON, and other Department of Defense (DoD), customers to ensure the operating forces are equipped for war in accordance with mobilization plans. In addition, NWCF, MC supports other government and nongovernmental customers.

The NWCF, MC has prepared annual financial statements pursuant to CFO Act of 1990, as amended for the past fourteen years. The Act requires that financial statements be prepared and audited for each revolving fund and account that performed substantial commercial functions, such as those performed by NWCF, MC.

1.C. Appropriations and Funds

The United States Marine Corps (USMC) receives its appropriations and funds as general, working capital (revolving funds), trust, special, and deposit funds. The components use these appropriations and funds to execute their missions and report on resource usage.

The NWCF, MC receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. The Working Capital Fund entities provide goods and services on a reimbursable basis. Reimbursable receipts fund ongoing operations and are generally available in their entirety for use without further congressional action.

1.D. Basis of Accounting

For Fiscal Year (FY) 2006, NWCF, MC 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. Most of NWCF, MC's 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 United States Standard General Ledger (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 financial data will be based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DoD identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government and Performance and Results Act (GPRA). The DoD is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

Depot Maintenance activities recognize revenue according to the percentage of completion method. Supply Management activities recognize revenue from the sale of inventory items.

The NWCF, MC does not include nonmonetary support provided by US allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Net Cost and the Statement of Financing. The US has agreements with foreign countries that include either direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where US troops are stationed, or where US fleets are 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 NWCF, MC's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The NWCF, MC's expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of operating materials and supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. 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 identify most of its intragovernmental transactions by customer because NWCF, MC's systems do not track buyer and seller data needed to match related transactions.

Seller entities within DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices.

In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. IntraDoD intragovernmental balances are then eliminated. Starting in FY 2005, NWCF, MC properly eliminates the revenue results from intraDoD sales of capitalized assets. The DoD is developing long-term system improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS), is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual, Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" and the Treasury's "Federal Intragovernmental 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 investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD's proportionate share of public debt and related expenses of the federal government are not included. The Federal Government does not apportion debt and its related costs to federal agencies. The 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 Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

Each year, 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 US Government. Payment is required in advance.

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

The NWCF, MC's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U.S. Army Corps of Engineers (USACE) and the Department of State's financial service centers process the majority of NWCF, MC 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 Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury records this information to the applicable fund balance with treasury (FBWT) account. Differences in NWCF, MC recorded balance in FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency
Not Applicable.

1.K. Accounts Receivable
As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for 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 (per Code of Federal Regulations 4CFR 101).

DoD Components use a variety of techniques for estimating the allowance for uncollectible accounts receivable from the public. The NWCF, MC bases the estimate of uncollectible accounts receivable on a percentage of the total that was billed 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.

1.L. Direct Loans and Loan Guarantees
Not Applicable.

1.M. Inventories and Related Property
Most of NWCF, MC inventories are currently reported at an approximate historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The remaining inventory is valued at Moving (Weighted) Average Cost (MAC). The LAC method is used because legacy inventory systems were designed for material 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). The NWCF, MC plans to utilize new systems development processes to transition the inventory to the moving average cost method.

SFFAS No. 3 requires separate accounting for "inventory held for sale" and "inventory held in reserve for future sale." The NWCF, MC manages only military or government specific materiel under normal conditions. Therefore, there is no management or valuation difference between the two USSGL accounts. Items commonly used in and available from the commercial sector are not managed in NWCF, MC material management activities.

Related property includes operating materials and supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD 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, NWCF, MC uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2006, NWCF, MC expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user.

The NWCF, MC recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned material is zero. Potentially redistributed material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

Past audits identified uncertainties about completeness and existence of reported values of inventory. Inventory available and purchased for resale includes consumable spares, 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. It is more economical to repair than to procure these inventory items. Because NWCF, MC often relies on weapon systems and machinery no longer in production, 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 pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of material ordered but not delivered. 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 DoD is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property Plant and Equipment (PP&E) to one that is specific for each individual category.

The capitalization threshold was revised from $100,000 to $20,000 for real property. The current $100,000 capitalization threshold remains unchanged for the remaining General PP&E categories. Although, DoD revised the capitalization threshold from $100,000 to $20,000 for real property, USMC capitalization threshold for real property currently remains $100,000, except for Minor Construction threshold for NWCF, which is at $20,000.

General Property, Plant and Equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost equals or exceeds DoD capitalization threshold of $100,000. The DoD also requires capitalization of improvement costs over the DoD capitalization threshold of $100,000 for General PP&E. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

Prior to FY 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below $100,000 were written off General Fund financial statements in FY 1998. No adjustment was made for NWCF, MC assets. These assets remain capitalized and reported on NWCF, MC financial statements.

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The Standard provided for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost information is not practical. The DoD used Bureau of Economic Analysis (BEA) to calculate the value of the military equipment for reporting periods from October 1, 2002 through March 31, 2006.

Effective with 3rd Quarter, FY 2006, the DDoD replaced the BEA estimation methodology with an estimation methodology for military equipment based on DoD internal records. The DoD initially 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 create a baseline. The military equipment baseline is updated using expenditure information, and information related to acquisition and disposals.

1.P. Advances and Prepayments

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

1.Q. Leases

Not Applicable.

1.R. Other Assets

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 provides financing payments.

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

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. 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 Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair.

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.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The NWCF, MC loss contingencies arise as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes. Such amounts are developed in conjunction with, and not easily identifiable separately from, environmental disposal costs.

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 (CRO). 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.

The CRO represents 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 transfer in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

Not Applicable.

1.W. Comparative Data

Financial statement fluctuations greater than two percent of total assets on the Balance Sheet or ten percent from the previous period presented are explained within the notes to the financial statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collections

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

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The NWCF, MC does not follow this procedure. Collections are allocated to federal accounts receivable and disbursements to nonfederal accounts payable.

Note 2. Nonentity Assets

As of September 30		2006		2005
(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		0		0
C. Other Assets		0		0
D. Total Nonfederal Assets	$	0	$	0
3. Total Nonentity Assets	$	0	$	0
4. Total Entity Assets	$	671,288	$	766,982
5. Total Assets	$	671,288	$	766,982

6. Information Related to Nonentity and Entity Assets

Fluctuations and Abnormalities
The Navy Working Capital Fund, Marine Corps (NWCF, MC) does not have nonentity assets.

Composition of Nonentity Assets
Not Applicable.

Other Disclosures Related to Nonentity Assets
No disclosures required.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 0	$ 0
B. Revolving Funds	30,193	62,510
C. Trust Funds	0	0
D. Special Funds	0	0
E. Other Fund Types	0	0
F. Total Fund Balances	$ 30,193	$ 62,510
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 30,193	$ (10,870)
B. Fund Balance per United States Marine Corps (USMC)	30,193	62,510
3. Reconciling Amount	$ 0	$ (73,380)

4. Explanation of Reconciliation Amount:

Fund Balance per Treasury, negative $10.9 million, was incorrectly stated in Fiscal Year (FY) 2005. The correct amount should have been $62.5 million.

5. Information Related to Fund Balance with Treasury:

Fluctuations and Abnormalities
In FY 2006, fund balance with treasury (FBWT) decreased $32.3 million 52%, due to a decrease of $29.1 million for Depot Maintenance and $3.2 million for Supply Management, as compared to FY 2005. The primary drivers of the decrease in FBWT are explained as follows:

Depot Maintenance Activity Group (DMAG)
The FBWT decreased $29.1 million in FY 2006, as compared to FY 2005. This is the result of increased disbursements to pay for operating material and supplies, purchased by the Maintenance Centers to support customer workload related to the Global War on Terror (GWOT). The majority of the material was purchased in 1st Quarter, FY 2006, billed and liquidated in 2nd through 4th Quarters, FY 2006. The increase in the material being purchased is due to the severely damaged warfighting weapon systems that require above average repair parts to complete restoration to a ready for issue warfighting condition. In addition, for workload related to the armor plating project, the Maintenance Centers purchased material in bulk due to the following reasons:

- ensure the material was delivered in a timely manner,
- to support the production schedule,
- to take advantage of opportunities for better pricing and,
- to ensure available vendor market from reliable resources

It is anticipated that as the workload is completed and customers are billed, revenue will be earned and fund balance with treasury will increase.

In contrast, DMAG collections were significantly increased during the 4th Quarter, FY 2006. The previously discussed armor project, where customers due to GWOT engagements, required the workload to be completed by the Maintenance Centers on an accelerated rate thus increasing billings to and collection/payment from customers. The accelerated effort increased DMAG activity and led to an increase to FBWT through collections on reimbursable orders.

Supply Management, Marine Corps (SMAG)
FBWT decreased $3.2 million in FY 2006, as compared to FY 2005. This is a direct result of overall customer orders decreasing due to the following:

During the 3rd Quarter, FY 2005, Twenty Nine Palms Marine Corps Organization awarded a contract to General Services Administration (GSA) to provide vendor owned, vendor managed consumable operational supplies and material to its customers who were previously making purchases via the Direct Support Stock Center (Retail Activity) where NWCF received obligation authority to procure and sell to its customers. Camp Butler Marine Corps Organization awarded the same type of contract in the 1st Quarter, FY 2006. Supply Management WCF considers this a permanent reduction to sales targets.

In addition, FBWT decreased as a result of retail organizations at Albany, Georgia and Barstow, California who procured packing supplies, in 3rd Quarter, FY 2006 to support their customers (Maintenance Centers (DMAG)) in shipping completed workload related to producing armor kits for DMAG customers. The packing supplies were anticipated to be received and sold to DMAG during 4th Quarter, but was not received and sold until October, FY 2007.

Composition of Fund Balance with Treasury
FBWT of $30.2 million reflects FY 2005 ending balance of $62.5 million plus current FY 2006 collections, disbursements, and other cash transactions recorded in the Navy Working Capital Fund, Marine Corps (NWCF, MC) Treasury sub-limit 97X4930.002. The following table details the amounts recorded as of September 30, 2006.

(Amounts in thousands)	
Collections	$ 621,115
Disbursements	$ (653,431)

Intragovernmental Payment and Collection (IPAC)
The IPAC differences are reconcilable differences that represent amounts recorded by Treasury but not reported by the organization. The IPAC differences for the U.S. Marine Corps (USMC) cannot be differentiated between NWCF, MC and General Funds; therefore no IPAC differences are being reported for NWCF, MC. All amounts, if applicable, will be reported on the USMC General Fund statement.

Status of Fund Balance with Treasury

As of September 30		2006		2005
(Amounts in thousands)				
1. Unobligated Balance				
A. Available	$	177,371	$	227,700
B. Unavailable		0		0
2. Obligated Balance not yet Disbursed	$	333,699	$	292,725
3. Nonbudgetary FBWT	$	0	$	0
4. NonFBWT Budgetary Accounts	$	(1,572,615)	$	(1,549,554)
5. Total	$	(1,061,545)	$	(1,029,129)

Fluctuations and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent to explain for FY 2006.

Definitions

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

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

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

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

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

The difference between total fund balance on the FBWT schedule and total of the status of funds schedule is primarily due to the $1.6 billion nonbudgetary FBWT. This is being addressed by DFAS in which it is believed to be related to Navy's distribution of Contract Authority/Cash sometime around 1995. The Navy is researching this issue. In addition, this difference is cumulative of various problems, as well as, an internal weakness of creating budgetary accounts from proprietary accounts in footnotes. The DFAS is working with Department of Navy (DON) in the Financial Improvement Plan and in the Cash Initiative to standardize cash forecasting methods; standardize cash reconciliation processes; perform a cash rebuild for DON; and, populate budgetary accounts at the field activity level. The accumulation of these efforts will correct this difference. It is anticipated that the Marine Corps will be provided an explanation of this issue when the review is completed.

Disclosures Related to Suspense/Budget Clearing Accounts

Information Related to Suspense/Budget Clearing Accounts:
NWCF, MC Suspense/Budget Clearing Accounts are being reported under Marine Corps General Funds.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
(Amounts in thousands)				
1. Total Problem Disbursements, Absolute Value				
A. Unmatched Disbursements (UMDs)	$ 0	$ 5,719	$ 4,088	$ (1,631)
B. Negative Unliquidated Obligations (NULO)	0	0	2	2
2. Total In-transit Disbursements, Net	$ 0	$ (6,565)	$ 6,346	$ 12,911

Information Related to Disclosures Related to Problem Disbursements and In-Transit Disbursements

Fluctuations and Abnormalities
In FY 2006, Total Unmatched Disbursements, decreased $1.6 million, 29%, as compared to FY 2005. This is due to elements of operations and processes, incorporated by the Marine Corps Depots, to work credit card payments for material that was placed on order. Difficulties exist in being able to utilize the current financial management system (Defense Industrial Financial Management System) and the various inventory management systems to identify, at the document level, credit cards as the source of payment. In FY 2004, an interim process was worked out to mitigate this problem. Beginning in late 1st Quarter, FY 2006, due to DFAS problems described above, delays in completing actions outlined to work and clear unmatched disbursements from credit card sources, was experienced. This caused the unmatched disbursement to increase substantially beginning in 2nd Quarter, FY 2006. The level of unmatched disbursements by the end of 4th Quarter, FY 2006 decreased drastically due to the collaborative and concentrated efforts of both the Marine Corps and DFAS.

In FY 2006, Negative Unliquidated Obligations increased $2.4 thousand, 100%, and In-Transit Disbursements, Net increased $12.9 million, 195%, as compared to FY 2005. This is due to an intensive analysis performed by DFAS in 1st Quarter, FY 2006 that resulted in the identification of the causes and systems creating increased numbers of undistributed disbursements. The intensive analysis also allowed DFAS to identify the undistributed values by the proper categories such as supported and unsupported, in–transit or problem disbursements and to complete processes necessary to clear the unmatched/ undistributed in a timelier manner. In addition, process improvements were implemented to avoid future significant increases in this category.

Unmatched Disbursements (UMDs)
An unmatched disbursement (UMD) occurs when a payment is not matched to a corresponding obligation in the accounting system. Absolute value is the sum of positive values of debit and credit transactions without regard to the sign (plus or minus).

Negative Unliquidated Obligations (NULOs)
A negative unliquidated obligation (NULO) occurs when a payment is made against a valid obligation. However, the payment is greater than the amount of the obligation recorded in the accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

In-transit Disbursements
In-transit disbursements represent the net value of disbursements and collections made by a Department of Defense disbursing activity on behalf of an accountable activity and have not yet been recorded in the accounting system.

Other Disclosures
The NWCF, MC problem disbursements reported have no amounts related to Foreign Military Sales. The problem disbursement and in-transit disbursement metrics furnished to DFAS Arlington included Treasury Index 97 (TI97) appropriations that will not be reported on Marine Corps' financial statements. Amounts will be reported on the appropriate TI97 financial statements.

Note 4. Investments and Related Interest

The Navy Working Capital Fund, Marine Corps (NWCF, MC) does not have investments and related interest.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intragovernmental Receivables	$ 33,906	N/A	$ 33,906	$ 17,144
2. Nonfederal Receivables (From the Public)	$ 327	$ 0	$ 327	$ 199
3. Total Accounts Receivable	$ 34,233	$ 0	$ 34,233	$ 17,343

4. Other Information Related to Accounts Receivable:

Fluctuations and Abnormalities
Intragovernmental accounts receivable increased $16.8 million, 98%, in Fiscal Year (FY) 2006 as compared to FY 2005. The primary driver of the increase is due to Depot Maintenance Activity Group (DMAG)

receiving and billing additional workload in FY 2006. The DMAG intragovernmental accounts receivable increased $20.3 million, 204%, due to increased operating tempo resulting from the additional workload completed and revenue billed in order to meet customer required delivery timeframes for repair and return of equipment engaged in the Global War on Terror (GWOT). Although bills processed during FY 2006 were collected in order to relieve the intragovernmental accounts receivable, the majority of the increase occurred in September 2006. Some of the bills to customers that were processed the last week of FY 2006 were not collected to relieve the accounts receivable until 1st Quarter, FY 2007. The additional workload was received from Procurement, Marine Corps, Operation and Maintenance, Marine Corps/ Marine Corps Reserve, and the Army customers. The average revenue bill in FY 2006 increased from $7.4 million in FY 2005 to $19.4 million in FY 2006.

Nonfederal accounts receivable increased $128.3 thousand, 65%, in FY 2006. The primary driver of the increase is attributed to DMAG. Nonfederal accounts receivable increased due to unplanned workload associated with repair and return of Amphibious Assault Vehicles and machine guns owned by foreign military sales customers. This occurred at the end of 3rd Quarter, FY 2006 as a result of the workload being completed and revenue billed. Collections from the billings will not be received until 1st Quarter, FY 2007.

Allowance Method

The Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," and Department of Defense (DoD) Financial Management Regulation require that federal agencies establish an allowance for uncollectible accounts receivable nonfederal. This account has been established within Navy Working Capital Fund, Marine Corps (NWCF, MC). This amount is low, as NWCF requires an advance deposit from all nonfederal entities prior to the commencement of work. Therefore, an assumption is made that the amount of uncollectible accounts should be negligible. The allowance amount represents a percentage of the total that was billed after the total project cost has been adjusted to reflect the advance deposit. Based on the assumption of negligible risk of loss for uncollectible accounts, there is no reserve for uncollectible accounts presented in the accompanying financial statements.

Allocation of Undistributed Collections

DoD policy is to allocate supported undistributed collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts receivable. Unsupported undistributed collections should be recorded in United States Standard General Ledger account 2400, liability for deposit funds, clearing accounts, and undeposited collections. NWCF, MC does not follow this allocation procedure. Collections are allocated to federal accounts receivable. This is required because of the potential that some of the unsupported undistributed collections do not belong to NWCF and will have to be transferred to the appropriate fund holder.

Trading Partner Data

NWCF, MC's accounting systems do not capture specific trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, NWCF, MC is unable to reconcile intragovernmental accounts receivable balances with most trading partners. Through an ongoing Business Management Modernization Program, DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations. The Department of the Navy (DON) is also working on short-term solutions to gather the required information as outlined in DON Financial Improvement Plan.

Aged Accounts Receivable

As of September 30	2006 Intragovernmental	2006 Nonfederal	2005 Intragovernmental	2005 Nonfederal
(Amounts in thousands)				
CATEGORY				
Nondelinquent				
Current	$ 33,633	$ 320	$ 16,968	$ 193
Noncurrent	0	0	0	0
Delinquent				
1 to 30 days	$ 9	$ 0	$ 2	$ 0
31 to 60 days	322	(0)	40	2
61 to 90 days	254	0	15	0
91 to 180 days	131	2	91	4
181 days to 1 year	89	2	51	0
Greater than 1 year and less than or equal to 2 years	163	3	0	0
Greater than 2 years and less than or equal to 6 years	0	0	0	0
Greater than 6 years and less than or equal to 10 years	0	0	0	0
Greater than 10 years	0	0	0	0
Subtotal	$ 34,601	$ 327	$ 17,167	$ 199
Less Supported Undistributed Collections	0	0	(23)	0
Less Eliminations	(695)	0	0	0
Less Other	0	0	0	0
Total	$ 33,906	$ 327	$ 17,144	$ 199

Current systems do not allow for the identification of the aging of the undistributed amounts. Aging information is not automatically generated and readily available in all feeder financial systems and therefore must be manually reported.

The Monthly Receivables Report is manually maintained by DFAS and NWCF, MC organizations. The bottom portion of this chart is derived from the accounting adjustments required in the preparation of the financial statements. In order to prepare this chart, NWCF, MC must make adjustments to the "other" line on this chart in order to reconcile the two portions. The DFAS is working with the field sites to eliminate the differences between these two areas.

The eliminations line in this chart is the amount of internal NWCF, MC eliminations as reported in the financial statements. The $695.6 thousand represents the amounts attributable to other NWCF activities.

The amount of delinquent intragovernmental receivables greater than 30 days old totaled is $958.4 thousand. The amount represents the dollar amount expected from customers, which is generated from the sale of excess material and goods and services.

The amount of nonfederal accounts receivable over 30 days is $6.8 thousand. The amount represents the dollar amount expected from customers and generated from the sale of goods and services to foreign military sales and nonfederal customers.

DFAS Kansas City and the Marine Corps continue to research and contact bill payers in an effort to resolve the delinquent aged receivables over 30 days.

Nonfederal Refunds Receivable
The total amount of nonfederal refunds receivables does not exceed 10% of the nonfederal accounts receivable, net amount on the Balance Sheet.

Other Disclosures Related to Accounts Receivable
No further disclosures required.

Note 6. Other Assets

As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 0	$ 70
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	$ 0	$ 70
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 501	$ 0
B. Other Assets (With the Public)	18	(416)
C. Total Nonfederal Other Assets	$ 519	$ (416)
3. Total Other Assets	$ 519	$ (346)

Fluctuations and Abnormalities
Intragovernmental Other Assets, Advances and Prepayments decreased $70.4 thousand, 100%, in FY 2006. During 4th Quarter, FY 2005, $70.4 thousand in travel advances supporting Depot Maintenance Activity Group (DMAG) civilian employees were erroneously posted as intragovernmental other assets. These costs were reclassified and correctly posted as nonfederal other assets with the public beginning in the 1st Quarter, FY 2006 reducing intragovernmental assets to zero. The error was identified as a result of functions required to separate U.S. Marine Corps (USMC) financial records from the Navy beginning in the 1st Quarter, FY 2006.

Total Nonfederal Other Assets increased $935.4 thousand, 225%, in 4th Quarter, FY 2006 as compared to FY 2005. The primary driver for this increase is Supply Management Activity Group (SMAG). SMAG increased $917.4 thousand. During FY 2005, $416.2 thousand for expected material returns from the sale of excess material was erroneously recorded as nonfederal other assets. As a result of a review of accounts conducted by Defense Finance and Accounting Service and USMC during 1st Quarter, FY 2006 a posting error was identified and corrected, decreasing nonfederal other assets and reclassified as an increase to refund receivables. Due to a manual process implemented to correctly identify material credits, the refund receivable was not cleared until 2nd Quarter, FY 2006. Also in September 2006, $501.2 thousand was recorded for anticipated future contract financing payments.

Composition of Other Assets (With the Public)
Other Assets (With the Public) includes amounts paid to DMAG civilian employees for the reimbursement of meals, incidental expenses, mileage, and other expenses while in and official government travel status. Other assets with the public also include all authorized expenses related to expenses incurrent by employees to relocate from one duty station to another.

Other Disclosures
Contract terms and conditions for certain types of contract financing payments convey certain rights to the Department of Defense (DoD) 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 work, except as provided in contract clauses related to termination or acceptance, and DoD is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

The Contract Financing Payment balance of $501.2 thousand is comprised of estimated future funded 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

Not Applicable.

Note 8. Direct Loan and/or Loan Guarantee Programs

Not Applicable.

Note 9. Inventory and Related Property

As of September 30	2006	2005
(Amounts in thousands)		
1. Inventory, Net	$ 431,512	$ 541,020
2. Operating Materials & Supplies, Net	126,556	95,932
3. Stockpile Materials, Net	0	0
4. Total	$ 558,068	$ 636,952

Fluctuations and Abnormalities
Total Inventory and Related Property decreased $78.9 million, 12%, from Fiscal Year (FY) 2005 to FY 2006. The majority of this decrease is attributable to Net Inventory and Operating Material & Supplies, primarily in the area of Navy Working Capital Fund, Marine Corps (NWCF, MC), Supply Management Activity Group (SMAG). These decreases are described in the follow-on explanations of this note.

Inventory, Net

As of September 30	2006 Inventory, Gross Value	2006 Revaluation Allowance	2006 Inventory, Net	2005 Inventory, Net	Valuation Method
(Amounts in thousands)					
1. Inventory Categories					
A. Available and Purchased for Resale	$ 325,731	$ (89,478)	236,253	$ 327,928	LAC, MAC
B. Held for Repair	194,387	0	194,387	212,258	LAC, MAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
D. Raw Materials	0	0	0	0	MAC, SP, LAC
E. Work in Process	872	0	872	834	AC
F. Total	$ 520,990	$ (89,478)	431,512	$ 541,020	

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

2. Information Related to Inventory, Net:

Fluctuations and/or Abnormalities
Total Inventory, Net decreased by $109.5 million, 20%, from FY 2005 to FY 2006. The explanations for the majority of this variance are addressed below.

Inventory category: Available and Purchased for Resale: From FY 2005 to FY 2006, decreased $91.7 million, 28%.

The inventory allowance account increased $86.4 million from FY 2005 to FY 2006. This is due to posting corrective actions resulting from a review, conducted in the 4th Quarter, FY 2005, by the Defense Finance and Accounting Service (DFAS) for all prior period inventory transactions. The result of this review was the creation and posting of two journal vouchers (JV) totaling $91.1 million, which decreased the book value of the inventory financial line account. These two journal vouchers were recorded to adjust inventory values, which had previously been erroneously recorded as prior period adjustments during the previous inventory revaluations. The prior period adjustment transactions resulting from the inventory revaluation had not accounted for the decrease in inventory values.

Inventory Held for Repair: decreased $17.9 million, 8%, from FY 2005 to FY 2006. This decrease is due to the completion and receipt of spare parts, which were sent to the Marine Corps' Maintenance Centers for repair and return. Upon return of these items, an adjustment is made to reflect the transfer of inventory from repair status and increase inventory available for resale. The majority of these adjustments were done in 1st Quarter, FY 2006, $6.0 million and 4th Quarter, FY 200, $10.0 million.

Restrictions of Inventory Use, Sale, or Disposition
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 Marine Corps regulatory operations, inventory may be sold to foreign countries, state and local governments, private parties and contractors in accordance with DoD and Marine Corps policies and guidance or at the direction of the President.

Composition of Inventory
Except for the work in process, all inventory categories shown in the table above apply to the Supply Management Activities.

Inventory Categories. Inventory represents property that is held for (a) sale to customers, (b) in the process of supporting production for eventual sale to customers (c) to be consumed in the production of goods for sale or (d) 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 NWCF, MC as well as consumable and repairable items are managed by other Military Services, such as the Defense Logistics Agency or the General Services Administration where NWCF, MC has permission to stock, store and sale. Material available and purchased for resale includes material held, due to various managerial decisions to support military or national contingencies.

Included in "Inventory Available and Purchased for Resale," is an amount of $39.1 million for War Reserve Material for Supply Management, Marine Corps.

Federal Accounting Standards requires 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 2006 is currently planned for sale to customers in FY 2007 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. The Marine Corps, for it's warfighting readiness, relies upon weapon systems and machinery that are no longer in commercial production. The NWCF, MC supports its customers' requests for certain items by repairing or rebuilding these items vice new acquisitions. This 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 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 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.

Inventory Work in Process
Work in Process at Depot Maintenance activities is $872.1 thousand and is included as inventory. This amount represents work that has been completed, expenses incurred, and waiting to be billed to the customer.

Operating Materials and Supplies, Net

As of September 30	2006			2005	
	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	$ 126,556	$ 0	$ 126,556	$ 95,932	SP, LAC
B. Held for Repair	0	0	0	0	SP, LAC
C. Excess, Obsolete, and Unserviceable	0	0	0	0	NRV
D. Total	$ 126,556	$ 0	$ 126,556	$ 95,932	

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

2. Information Related to Operating Materials and Supplies (OM&S), Net:

Fluctuations and Abnormalities
The OM&S Held for Use increased $30.6 million, 32%, in FY 2006. The increase is attributable to Depot Maintenance Activity Group, Marine Corps. The increase in Operating Material and Supplies, Held for Use is attributable to an increase in material and supplies purchased for repairing/rebuilding battled damaged equipment returning from war. Some of the equipment returning from war is very material intensive due to missing or heavily damaged major component parts, requiring replacing or complete rebuild of some assets. In addition, the Armor Plating project has caused OM&S to increase substantially because of the materials required to build the Armor Kits to be installed on weapons systems. As a result of the diminishing supply of steel, the depots had to order the material in bulk to ensure the material was delivered in a timely manner to support the production schedule for armor. The most notable increases occurred in the 1st Quarter, FY 2006, $14.0 million, 16.6% and the 2nd Quarter, FY 2006, $23.5 million, 27.8%.

Restrictions on OM&S
Generally, there are no restrictions with regard to the use, sale, or disposition of OM&S applicable to the Department of Defense (DoD) activities.

Composition of OM&S
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 requires disclosure of the amount of OM&S Held for "Future Use." The NWCF, MC reports that $126.6 million of OM&S is categorized as Held for Future Use. All Inventory categories shown in the table above apply to the Depot Maintenance Activity Group, Marine Corps only.

Government Furnished Material (GFM) and Contractor Acquired Material (CAM)
Generally, the values of the NWCF, MC's GFM and CAM in the hands of contractors are not included in the 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.

Other Disclosures Related to OM&S
No further disclosures required.

Stockpile Materials, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30	2006					2005
	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		20 Or 40	70,872	$ (39,340)	31,532	29,519
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	66,235	(55,089)	11,146	12,569
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	5,597	N/A	5,597	8,436
I. Other			0	0	0	0
J. Total General PP&E			$ 142,704	$ (94,429)	$ 48,275	$ 50,524

[1]Note 15 for additional information on Capital Leases
Legend for Valuation Methods:
S/L = Straight Line
N/A = Not Applicable

2. Information Related to General Property, Plant and Equipment (GPP&E):

Fluctuations and Abnormalities
There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for FY 2006.

Military Equipment
Military equipment is reported on the financial statements of the United States Marine Corps (USMC) General Fund.

Heritage Assets and Stewardship Land
Heritage assets and stewardship land are reported on the financial statements of USMC General Fund.

Other Disclosures
Generally, with the Navy Working Capital Fund, Marine Corps, there are no restrictions on General PP&E.

Assets Under Capital Lease

Information Related to Assets Under Capital Lease:
The Navy Working Capital Fund, Marine Corps has no assets under capital lease.

Other Disclosures Related to Assets under Capital Lease
No further disclosures required.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Debt	0	0
C. Other	0	0
D. Total Intragovernmental Liabilities	$ 0	$ 0
2. Nonfederal Liabilities		
A. Accounts Payable	$ 0	$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	29,595	26,667
C. Environmental Liabilities	0	0
D. Other Liabilities	0	0
E. Total Nonfederal Liabilities	$ 29,595	$ 26,667
3. Total Liabilities Not Covered by Budgetary Resources	$ 29,595	$ 26,667
4. Total Liabilities Covered by Budgetary Resources	$ 105,818	$ 104,625
5. Total Liabilities	$ 135,413	$ 131,292

6. Information Related to Liabilities Not Covered and Covered by Budgetary Resources:

Fluctuations and Abnormalities
Nonfederal Liabilities, Military Retirement Benefits and Other Employment-Related Actuarial Liabilities increased $2.9 million, 11%. This increase is attributable to liabilities supporting the Navy Working Capital Fund, Depot Maintenance Activity Group (DMAG) in which 319 additional personnel were reported by Department of Labor (DOL) from FY 2005 to FY 2006. This account is adjusted at the end of each fiscal year based on DOL reported endstrength levels. While the actuarial liabilities are properly recorded, based on policy; the actual endstrength levels for DMAG contrasts with DOL data. The United Marine Corps (USMC) data reflects an FY 2006 decrease of 121 personnel.

Definitions
Liabilities Not Covered by Budgetary Resources are unfunded liabilities, which are not considered covered by budgetary resources. Unfunded liabilities are those in which budget authority has not been received and congressional action is needed before budgetary resources can be provided.

Other Disclosures Related to Liabilities Not Covered by Budgetary Resources
The $29.6 million included in Military Retirement Benefits and Other Employment-Related Actuarial Liabilities represents Federal Employees' Compensation Act liabilities.

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intragovernmental Payables	$ 6,382	$ N/A	$ 6,382	$ 41,637
2. Nonfederal Payables (to the Public)	67,846	0	67,846	30,947
3. Total	$ 74,228	$ 0	$ 74,228	$ 72,584

4. Information Related to Accounts Payable:

Fluctuations and Abnormalities
Intragovernmental accounts payable decreased $35.3 million, 85%, from FY 2005 to FY 2006. The decrease is primarily due to Defense Finance and Accounting Service (DFAS) recording a journal voucher to adjust intragovernmental accounts payables. For the period beginning in the 1st Quarter, FY 2006 and continuing through 4th Quarter, FY 2006, a DFAS originated Journal Voucher (JV) was recorded that reduced the United States Marine Corps (USMC) intragovernmental accounts payables to match the balances identified and reported by trading partners as intragovernmental liabilities. These entries assume that the reported accounts payables, prior to the entry, are misclassified between federal and non federal and are cumulative in the resulting inception to date accounts payable balances. The JV, recorded in the 4th Quarter, FY 2006 in the amount of $41.5 million, reduced intragovernmental accounts payables for USMC and increased nonfederal accounts payable by the same amount.

Similar JVs were not processed in FY 2005 due to the fact that trading partner adjustments was being performed at the Navy Defense Working Capital Fund (DWCF) level not at the lower USMC level. If the $41.5 million journal voucher had not occurred, the intragovernmental accounts payable would have increased $6.2 million primarily due to Depot Maintenance Activity Group (DMAG) operations as explained below:

The DMAG intragovermental accounts payable increased $5.4 million from FY 2005 to FY 2006. This is primarily due to procuring increased levels of required material that supports Global War on Terror (GWOT) operations, related to the USMC Maintenance Centers performing repair workload on battle damaged equipment and requiring increased replacement of spare parts or material to complete the rebuild/repair. The majority of the material was ordered in the 1st Quarter, FY 2006 for the repair and return of major warfighting weapon systems and such as tanks, trucks, trailers and machine guns. These procurements to support GWOT continued throughout FY 2006 resulting in increased levels of accounts payable at the end of the FY.

Nonfederal accounts payable increased $36.9 million, 119%, in FY 2006. This increase is primarily due to the DFAS journal voucher discussed above. The journal voucher processed in the 4th Quarter, FY 2006 for nonfederal accounts payable of $41.5 million for trading partners is the major contributor of this increase. The trading partner journal vouchers were not processed in FY 2005 because trading partner and eliminating entries information were being performed at the Navy DWCF level not at the lower USMC level.

If the $41.5 million journal vouchers had not occurred, nonfederal accounts payable would have increased $2.0 million for Supply Management Activity Group (SMAG) and decreased $5.9 million for DMAG as explained below:

The SMAG increased $2.0 million from FY 2005 to FY 2006. This is due to receiving, primarily in the 4th Quarter, FY 2006, inventory purchased from commercial vendors for which an accounts payable liability was unliquidated as of the end of FY 2006. The inventory was purchased on government issued contracts to commercial sources to rebuild/repair spare parts such as radios and hydraulic steering units. The contracts were issued due to diminishing available inventory in SMAG accounts that were depleted due to high sales demand from customers requesting to purchase these items from SMAG to support the repair of weapons systems needed by the warfighters engaged in GWOT.

The DMAG decreased $5.9 million from 4th Quarter, FY 2005 to 4th Quarter, FY 2006. This is due to disbursements made between 2nd and 4th Quarters, FY 2006, to complete receipt and payment of billings from vendors, thus relieving the accounts payable. The accounts payable was established, for the most part, in the 4th Quarter, FY 2005 when USMC Maintenance Centers purchased material and supplies to support GWOT established production line to produce for various customers multiple variations of armor plating for major warfighting weapon systems.

In summary, overall account payable increased $1.6 million.

Undistributed Disbursements
Undistributed disbursements are the difference between disbursements/collections recorded 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. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on the accounting reports. In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end.

Allocation of Undistributed Disbursements
The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable. Unsupported undistributed disbursements are recorded in United States Standard General Ledger account 2120, disbursements in transit. The Navy Working Capital Fund, Marine Corps (NWCF, MC) does not follow this allocation policy. NWCF, MC allocates undistributed disbursements to nonfederal accounts payable.

Trading Partner Data
For the majority of intra-agency sales, NWCF, MC accounting systems does not capture specific trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, NWCF, MC is unable to reconcile the majority of its intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payable. Through an ongoing Business Management Modernization Program, DoD intends to develop long-term systems improvements that will capture the data necessary to perform the required reconciliations. The USMC has outlined specific processes for review and implementation in DON Financial Improvement Plan that should provide some near-term solutions for this process.

Eliminating Adjustments
The DoD summary level seller accounts receivables were compared to NWCF, MC's accounts payable. An adjustment was posted to NWCF, MC's accounts payable based on the comparison with the accounts receivable of DoD Components providing goods and services to NWCF, MC. As required, adjustments were made to reclassify accounts payable from federal to nonfederal.

Other Disclosures Related to Accounts Payable
No further disclosures required.

Note 13. Debt

Not Applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

This is not applicable to the Marine Corps Navy Working Capital Fund. Environmental Liabilities are captured under the United States Marine Corps General Fund.

Environmental Disclosures

Not Applicable.

Note 15. Other Liabilities

As of September 30	2006 Current Liability	2006 Noncurrent Liability	2006 Total	2005 Total
(Amounts in thousands)				
1. Intragovernmental				
A. Advances from Others	$ 0	$ 0	$ 0	$ 11,945
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.Other Liabilities	917	0	917	6,277
G. Total Intragovernmental Other Liabilities	$ 917	$ 0	$ 917	$ 18,222
(Amounts in thousands)				
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	$ 10,236	$ 0	$ 10,236	$ 13,811
B. Advances from Others	35	0	35	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	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. Other Liabilities	19,894	508	20,402	7
J. Total Nonfederal Other Liabilities	$ 30,165	$ 508	$ 30,673	$ 13,818
3. Total Other Liabilities	$ 31,082	$ 508	$ 31,590	$ 32,040

4. Information Related to Other Liabilities:

Fluctuations and Abnormalities
Intragovernmental
Total intragovernmental other liabilities had an overall decrease of $17.3 million, 95%, in fiscal year (FY) 2006 due to the following:

Intragovernmental other liabilities for advances from others decreased $11.9 million (100%), in FY 2006. This is due to instructions, provided by the Office of Secretary of the Defense (OSD), to correct the posting of advance payments for War Reserve Materials (WRM). The instructions provided that a FY 2005 posting of $11.8 million advance payment for WRM was incorrectly posted and should be moved from intragovernmental advances to other gains and losses thus not affecting liabilities. The journal voucher (JV) to complete this action was completed in the 4th Quarter, FY 2006 as a part of the Supply Management Activity Group (SMAG) operations.

In addition, intragovernmental other liabilities for advances from others decreased due to corrective actions, taken in the 2nd Quarter, FY 2006 to properly post advances of $145.1 thousand, collected for Depot Maintenance Activity Group (DMAG) operations from private industry to perform electronic repair work on radars as nonfederal advances from others.

Intragovernmental other liabilities decreased $5.4 million, 85%, in FY 2006. This is primarily due to corrective actions taken, beginning in 1st Quarter, FY 2006, to reclassify $5.2 million in accrued liabilities for commercial contracts, base support, and travel advances from intragovernmental other liabilities to nonfederal other liabilities. This was in support of DMAG operations.

Nonfederal
Total nonfederal other liabilities had an overall increase of a net $16.9 million, 122 %, in FY 2006. The net change is attributable to increases in operations of $16.8 million for DMAG and $501.2 thousand for SMAG due to the following reasons:

Nonfederal other liabilities for accrued funded payroll and benefits decreased $3.6 million, 25% in FY 2006. This is primarily due to a personnel decrease of 46 temporary civilian employees beginning in June 2006 thus reducing accrued benefits by $3.2 million. The employees chose to seek permanent positions outside of DMAG.

Nonfederal advances from others increased $34.6 thousand, 100%, in FY 2006. This is due to a combination of the following:

a. Collection and billing, in FY 2006, advances from private industry for DMAG operations to perform various workload.

b. Posting actions to correct a FY 2005 advance from private industry that was erroneously posted as intragovernmental vice nonfederal other liabilities: advances from others.

As of September 30, 2005, a balance of $145.1 thousand remained from an advance collection from an advance collection provided for DMAG to perform work as explained above. The corrective action to properly post this advance increased nonfederal advances from others.

In addition, during the 1st and 3rd Quarters, FY 2006, advances totaling $276.5 thousand were received from private industriy. The major portion of these advances was for DMAG operations to perform repair work on transmissions.

Billings, during FY 2006 that decreased nonfederal advances, totaled $387 thousand. The majority of the billings occurred during the 1st and 4th Quarters, FY 2006.

The net amount of the corrective action, advance collections and billings resulted in a September 30, 2006 advance collection balance of $32.6 thousand.

Nonfederal other liabilities increased $20.4 million, 285%, in FY 2006. This is due to the accrual of $19.9 million for commercial contracts, host base support and travel advances. The increase began in 3rd Quarter, FY 2005, in order to support the increased workload related to Global War of Terror (GWOT).

For Supply Management, nonfederal other liabilities increased in FY 2006, $501.2 thousand, 100%, due to the recording of anticipated future contract financing payments per OSD direction in September 2006.

In summary, total other liabilities decreased by $451.4 thousand, 1.4%, due to explanations provided above.

Composition of Other Liabilities
Intragovernmental other liabilities represent liabilities for health and life insurance, retirement and other benefits and entitlements representing government contributions.

Nonfederal other liabilities include amounts that are significant portions of the total liabilities presented in the Navy Working Capital Fund, Marine Corps (NWCF, MC) Balance Sheet. A breakout of the major components of nonfederal other liabilities are as follows:

Other liabilities consists of accrued cost for travel advances, base support, and contracts for work performed by civilian personnel, contractors and other agencies in which a request for payment has not been received.

Per the Department of the Defense, Inspector General (DoDIG) Audit: "Financial Management: Report on Recording and accounting for DoD Contract Financing Payment, of May 10, 2005 and the Office of the Under Secretary of Defense (Comptroller) OUSD(C) direction, a contingent liability for outstanding contract financing payments based on cost in excess of progress payments was recognized for the first time in 4th Quarter, FY 2006. The recognized liability was derived from an OUSD(C) query of the Mechanization of Contract Administration System (MOCAS). The NWCF, MC field level account data does not reconcile with the MOCAS data, therefore the NWCF, MC cannot support this OUSD(C) directed adjustment. Also, current business processes and contract clauses do not support this OUSD(C) directed adjustment.

The remaining other liabilities consists of liabilities for progress payments, which are maintained to show the balance of payments taken for accrued costs charged to work in process. It was reclassified from contra-assets account to nonfederal other liabilities.

Intragovernmental Reconciliation for Fiduciary Transactions with Department of Labor (DOL)
With respect to the major fiduciary balances, NWCF, MC was able to reconcile with DOL.

For FY 2006, the Department of the Navy does not have any delinquent amounts due to the DOL for the FECA bill. The FY 2007 FECA bill is due to DOL 30 days after the appropriation bill is passed and signed.

Capital Lease Liability

Not Applicable.

Note 16. Commitments and Contingencies

Information Related to Commitments and Contingencies:

Legal Contingencies:

The Navy Working Capital Fund - Marine Corps (NWCF, MC), a sub-entity of the Navy Working Capital 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. For NWCF, MC cases, the Department of the Navy (DON) will accrue contingent liabilities for legal actions where DON Office of 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. In addition to DON statements, NWCF, MC records judgment fund liabilities in Note 15, "Other Liabilities" and Note 12, "Accounts Payable."

The Office of the Navy General Counsel conducted a review of litigation and claims threatened or asserted involving the NWCF, MC to which Office of General Counsel attorneys devoted substantial attention in the form of legal consultation or representation. This review utilizes a threshold of materiality of $170.0 thousand applied to individual and aggregate claims, litigation, assessments, or contingencies arising out of a single event or a series of events.

The NWCF, MC has no cases that meet the existing materiality threshold. Therefore, no contingent liabilities were recorded nor is any disclosure of estimated contingencies required. This declaration is fully supported by the Preliminary and Final Legal Representation letters and the subsidiary management summary schedule.

In response to the Department of Defense, Inspector General audit, "Financial Management: DoD process for Reporting Contingent Legal Liabilities," the DON completed a methodology during FY 2006 that provides an estimate for those cases that are considered probable or reasonably possible to be settled against the government. The DON is testing the methodology with the objective to begin reporting 2nd Quarter FY 2007.

Other Commitments and Contingencies

The NWCF, MC does not have obligations related to cancelled appropriations for which the reporting entity has a contractual commitment for payment.

The NWCF, MC has contractual arrangements which may require future financial obligations (i.e. undelivered orders). These undelivered orders are estimated at $333.6 million as of September 30, 2006. Included in this total is $501.2 thousand, posted in the 4th Quarter, FY 2006 as a Defense Finance and Accounting Service (DFAS) Journal Voucher (JV) directed by the Office of the Under Secretary of Defense (OUSD) for Financial Management. This amount, which is included in the balance for nonfederal other liabilities is in support of contracting and related financing payments. As directed by the OUSD, no budgetary adjustments were considered to record the JV which adjusted contingent liabilities. The NWCF, MC has an internal weakness of creating budgetary accounts from proprietary accounts. The DFAS is currently working with the Department of Navy, as a part of its Financial Management Improvement Plan, to correct this weakness.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2006 Present Value of Benefits	2006 Assumed Interest Rate (%)	2006 (Less: Assets Available to Pay Benefits)	2006 Unfunded Liability	2005 Present Value of Benefits
(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	$ 29,595		$ 0	$ 29,595	$ 26,667
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	$ 29,595		$ 0	$ 29,595	$ 26,667
3. Other Federal Employment Benefits	$ 0		$ 0	$ 0	$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	$ 29,595		$ 0	$ 29,595	$ 26,667

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

5. Information Related to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities:

Fluctuations and/or Abnormalities:
Military retirement benefits and other employment-related actuarial liabilities increased $2.9 million, 11%. This increase is attributable to liabilities supporting the Navy Working Capital Fund, Depot Maintenance Activity Group (DMAG) in which 319 additional personnel were reported by Department of Labor (DOL) from FY 2005 to FY 2006. This account is adjusted at the end of each fiscal year based on DOL reported endstrength levels. While the actuarial liabilities are properly recorded, in accordance with policy, the actual endstrength levels for DMAG contrasts with DOL data. The United States Marine Corps data reflects a FY 2006 decrease of 121 personnel.

Actuarial Cost Method Used
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, Marine Corps 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.

Assumptions
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 applied to the calculation of projected future benefits. The interest rate assumptions used in the discount calculations are as follows for September 30, 2006:

2006
5.170% in Year 1
5.313% 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 (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) 2006 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
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

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 loses per case (a measure of case-severity) in CBY 2006 to the average pattern observed during the most current three charge back years,

(4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

Market Value of Investments in Market-based and Marketable Securities
Not Applicable.

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

Other Employment – Related Actuarial Liabilities
Other employment – related actuarial liabilities did not have any abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of Actuarial Liabilities to explain for this reporting period. The balance of other employment-related actuarial liabilities is $29.6 million, all of which is attributable to Federal Employees Compensation Act.

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

Intragovernmental Costs and Exchange Revenue		
As of September 30	2006	2005
(Amounts in thousands)		
1. Intragovernmental Costs	$ 255,735	$ 523,005
2. Public Costs	475,129	136,650
3. Total Costs	$ 730,864	$ 659,655
4. Intragovernmental Earned Revenue	$ (617,997)	$ (684,468)
5. Public Earned Revenue	(90,965)	1,263
6. Total Earned Revenue	$ (708,962)	$ (683,205)
7. Net Cost of Operations	$ 21,902	$ (23,550)

8. Information Related to the Statement of Net Cost:

Fluctuations and Abnormalities
Net Cost of Operations increased $45.5 million, 193%, in FY 2006. This increase is attributable to total costs increasing by $71.2 million and total earned revenue increasing by $25.7 million in FY 2006 when compared with FY 2005. The primary drivers for the $71.2 million, 11%, increase in total costs are explained below:

- Depot Maintenance Activity Group (DMAG) experienced an increase of $30.6 million in Operating Material and Supplies (OM&S) purchased for repairing/rebuilding battled damaged equipment returning from war. Some of the equipment returning from war is very material intensive due to missing or heavily damaged major component parts, requiring replacing or complete rebuild of some assets. In addition, the Armor Plating project has caused OM&S to increase substantially because of the materials required to build the Armor Kits to be installed on weapons systems. The most notable increases occurred in the 1st Quarter, FY 2006, $14.0 million and the 2nd Quarter, FY 2006, $23.5 million.

- Due to the high demand during 3rd Quarter, FY 2005 from the Supply Management Activity Group (SMAG) customers to purchase inventory to support their engagement in the Global War on Terror (GWOT). This caused inventory levels, available for sale, to significantly deplete. As a result, SMAG obligated funds totaling $22.2 million during the month of September 2006 to purchase inventory in order to replenish its inventory levels thus ensuring sufficient inventory availability in time to meet its customers' needs.

- During 3rd Quarter, FY 2006, the United States Marine Corps made a conscious decision to purchase, in bulk, chemical biological warfighting protective gear (gas masks) in anticipation of increased demand from customers of the SMAG. As a result, $4.7 million was obligated to make a bulk purchase which took advantage of both cost and risk reduction strategies. The anticipated increase in demand was based on the anticipated change in enemy warfighting tactics from ground fighting to chemical airfare as well as identified concern based on limited available sources of supply for this type of gear.

The primary drivers for the $25.7 million, 4%, which is over 2% of total assets, increase in total earned revenue are explained below:

- The Depot Maintenance Activity Group (DMAG) experienced an increase of $5.2 million in total earned revenue due to billing additional direct labor hours an material cost associated with completion of workload as result of additional personnel hired to support the GWOT surge in customers orders. This resulted in an increase of $27.6 million in FY 2006, as compared to FY 2005. The most notable increases occurred in the 4th Quarter, FY 2006, in which $187.4 million in revenue was gained. In addition, a decrease adjustment for elimination entries of $22.4 million occurred in the 4th Quarter, FY 2006 to reconcile the trial balance to USMC trading partner data. This was reported at the Department of the Navy level vice USMC Corp level prior to FY 2006.

- The Supply Management Activity Group (SMAG) experienced an increase of $20.5 million in total earned revenue due to an inventory adjustment in the 4th Quarter, FY 2006 to correct the posting of advance payment for war reserves material in accordance to Office of Secretary of the Defense guidance. The instructions provided that a FY 2005 posting of $11.8 million advance payment for War Reserve Material was incorrectly posted and should be moved from intragovernmental advances to other gains and losses thus not affecting liabilities. The remaining balance of $8.7 million is primarily due to the net adjustment for elimination entries to reconcile the trial balance to USMC trading partner data in the 4th Quarter, FY 2006.

Composition of Statement of Net Cost

The NWCF, MC generally records transactions on an accrual basis as required by federal Generally Accepted Accounting Principles (GAAP). Information presented on the statement of net cost represents the net result of post-closing adjustments and eliminating entries made in compiling and consolidating NWCF, MC financial statements. These entries significantly affected the reported amounts of intragovernmental program cost, program cost with the public, earned revenue and net program cost. The post-closing adjustments were made in order to increase or decrease certain NWCF, MC account balances reported as of September 30, 2006 to ensure agreement with related balances reported by other Department of Defense (DoD) and other federal reporting entities. Eliminating entries are required adjustments made as part of the financial process. This process enables the matching o trading partner data recorded at each financial statement consolidation level: NWCF, DoD, and Federal Government levels.

Other Disclosures Related to the Statement of Net Cost

This statement is unique because its principles are driven by an understanding of net cost of programs and or organizations that the Federal Government supports through appropriations. This statement provides gross and net cost information that can relate to the amount of output for a given program and or organization administered by a responsible reporting entity.

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.

Although NWCF, MC is able to compare its intragovernmental costs and revenues with corresponding balances of its intragovernmental trading partners, it is unable to validate these balances. There were no material differences identified during FY 2006.

The NWCF, MC does not report any heritage assets or stewardship land, as these entities are reported on the financial statements of the Department of the Navy General Fund.

For FY 2006, 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 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 US Standard General Ledger. 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 based on transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, NWCF, MC identifies program costs based upon business areas. 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 NWCF, MC is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information, as required by the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

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

As of September 30	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	$ 0	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	0	0
C. Total Prior Period Adjustments	$ 0	$ 0	$ 0	$ 0
2. Imputed Financing				
A. Civilian CSRS/FERS Retirement	$ 3,426	$ 0	$ 3,116	$ 0
B. Civilian Health	8,879	0	6,945	0
C. Civilian Life Insurance	22	0	18	0
D. Judgment Fund	0	0	0	0
E. IntraEntity	0	0	0	0
F. Total Imputed Financing	$ 12,327	$ 0	$ 10,079	$ 0

3. Information Related to the Statement of Changes in Net Position:

Fluctuations and Abnormalities
Total Imputed Financing increased $2.2 million, 22%, in Fiscal Year (FY) 2006. The variance is due to the increased government estimated cost/allocation process related to the civilian employee entitlements for retirement and insurance and any increase or decrease in the estimated cost/allocation factors and the actual amounts provided by Office of Personnel Management (OPM) on a quarterly basis. The estimated and actual cost variance is primarily driven by the increase in personnel within the Marine Corps' Depot Maintenance Activity Group beginning in 2nd Quarter, FY 2005 and has progressively increased through 4th Quarter, FY 2006. The additional employees are primarily temporary and term employees who were hired to complete workload requested by the customers supporting Global War on Terror (GWOT).

Imputed Financing
The amounts remitted to OPM by and for employees covered by the Civil Service Retirement System, Federal Employee Retirement System, Federal Employee Health Benefits Program and the Federal

Employee Group Life Insurance Program do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employees and contributions made by and for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. The DFAS provides the costs to Office of the Under Secretary of Defense (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 227,740	$ 200,113
2. Available Borrowing and Contract Authority at the End of the Period	1,232,543	1,216,003

3. Information Related to the Statement of Budgetary Resources:

The Statement of Budgetary Resources (SBR) is an image of the monthly Report on Budget Execution. These reports should be produced using budgetary accounts. However, Navy Working Capital Fund, Marine Corps (NWCF, MC) uses proprietary accounts because its financial accounting systems were not initially designed to produce budgetary accounting data. The United States Marine Corps (USMC) and 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 US Standard General Ledger (USSGL).

Change in Receivables from Federal Sources includes USSGL 4251 account, reimbursements and other income earned. The amount presented on this line is the ending balance less the beginning balance for the current fiscal year. In this case the ending balance is less than the beginning balance, which nets to a negative value change for this fiscal year. The net negative value change is a reflection of USMCs' aggressive efforts to collect on reimbursable operations; the fuel business transferred to Defense Logistics Agency; collections of aged outstanding fuel receivables and the continuing efforts between DFAS partnering with USMC to reduce accounts receivable.

For SBR, Supply Management's revenue is defined as gross sales less credit returns. For the balance sheet, revenue does not include credit returns because the inventory valuation model considers credit returns as inventory allowances. The difference in "meanings" causes variances in the reports.

As of September 30, 2006, the differences between U.S. Treasury and NWCF, MC activity ledgers have been minimal. The principal cause of the difference is related to timing issues or type of transactions. The differences are recorded as undistributed disbursements and collections on the departmental reports. While there may be no impact upon U.S. Treasury balance, the above differences have created distortions in the accounts receivable and accounts payable on SBR. Accounting and accounting relationship issues involving the treatment of undistributed collections and disbursements have created abnormal balances for accounts receivable and accounts payable on SBR.

Intra-entity Transactions
The SBR does include intra-entity transactions, which have not been eliminated because the statements are presented as combined and combining.

Apportionment Categories
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. These amounts are as follows:

(Amounts in thousands)	
Obligations Incurred – Direct	$0
Obligations Incurred – Reimbursable	$694,405
Exempt from apportionment	$0

Undelivered Orders
Undelivered Orders presented in SBR includes undelivered orders-unpaid for both direct and reimbursable funds.

Spending Authority from Offsetting Collections
Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available, are not included in the Spending Authority from Offsetting Collections and Adjustments line on SBR or the Spending Authority for Offsetting Collections and Adjustments line on the Statement of Financing.

Other Disclosures Related to the Statement of Budgetary Resources
The information contained in this note represents a subset of the information portrayed in, “Unpaid Obligations” and “Gross Outlays” of the Statement of Budgetary Resources and is reconcilable back to the applicable general ledger accounts.

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 did not receive any capital infusion during the reporting period including the amount, the source, and the reason for these additional funds.

Note 21. Disclosures Related to the Statement of Financing

Information Related to the Statement of Financing:
The Statement of Financing 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 and obligation-based amounts used in the Statement of Budgetary Resources (SBR). The computations and presentation of items in the Statement of Financing demonstrate that the budgetary and proprietary information in an entity’s financial management system are in agreement.

Due to the 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 Statement of Financing into balance with the Statement of Net Cost, the following adjustments (absolute value) were made:

Resources That Finance the Acquisition of Assets: $177.2 million

The following Statement of Financing lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

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

Resources That Finance the Acquisition of Assets:
For Navy Working Fund, Capital Marine Corps (NWCF, MC), the various automated and manual financial management and feeder systems do not record transfers of material purchases to the various fixed asset categories at the time of receipt. The current financial process produces the proprietary general ledger account transactions that result in amounts equating to the value of inventory received, recorded as a asset prior to being expensed and thereafter, during the month, applied to cost of goods sold depending on time of sale and financial system updates..

Composition of Other Lines
There are four "Other" lines on the Consolidated Statement of Financing during FY 2006. The compositions of those lines are described below:

Resources Used to Finance Items not Part of the Net Cost of Operations
The amount reported as "Other" is related to inventories, included in Supply Management Activity Group (SMAG), that are the United States Marine Corps (USMC) pecial project inventory which is not owned nor purchased by SMAG. This inventory is replenishment and repair parts supporting the Fleet Marine Forces warfighting weapon systems that were received at the USMCs' Intermediate Level Supply Warehouse as an interim storage for special projects and other management decisions of supply management. These items are included in SMAG as it is the single source for the USMC to comply with the Department of Defense regulations for total asset visibility requirements are not a part of SMAG operations and separately identified in the supply management system by project codes. At the end of each month, this inventory is decapitalized in order to reduce the inventory value to the amount purchased and owned by SMAG.

Resources Used to Finance Items not Part of the Net Cost of Operations, Other
The amount reported as other resources is transfers of assets out of NWCF, MC inventory.

Components Not Requiring or Generating Resources in Future Period, Other
The amount reported is the NWCF, MC actuarial liabilities for military retirement benefits.

Components Not Requiring or Generating Resources from Cost of Goods Sold
The amount reported as other consists of the NWCF, MC cost of goods sold.

Other Disclosures
There were no allocation transfers and abnormal balances to disclose.

Liabilities not covered by budgetary resources consist of nonentity assets (interest, penalties, fines and administrative fees) and Military Retirement Benefits and Other Employment Actuarial Liabilities for the Navy Working Capital Fund, Marine Corps (NWCF, MC). There are no amounts for resources in future periods for the Navy Working Capital Fund, as revenues are generated to cover liabilities during current years. Therefore, amounts reported as requiring resources in future periods do not have a relationship to liabilities not covered by budgetary resources.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 23. Earmarked Funds

Not Applicable.

Note 24. Other Disclosures

Not Applicable.

Department of the Navy Subsidiary Financial Statements

Navy Working Capital Fund – Marine Corps
Supporting Consolidating/Combining Statements

2006

2006 Annual Financial Report

The United States Marine Corps, as a sub-entity of the Department of the Navy (DON), does not prepare Supporting/Consolidating Statements and therefore is included at the Navy Working Capital Fund level.

Department of the Navy Subsidiary Financial Statements

Navy Working Capital Fund – Marine Corps
Required Supplementary Information

2006

2006 Annual Financial Report

Navy Working Capital Fund, Marine Corps
General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and Restoration Tables
As of September 30, 2006
($ in Millions)

Annual Sustainment FY 2006				
	Required	Actual	Difference	
Marine Corps	8	5	3	
Building, Structures, and Utilities	8	5	3	

Annual Deferred Sustainment Trend				
	FY 2003	FY 2004	FY 2005	FY 2006
Marine Corps	-	-	-	3
Building, Structures, and Utilities	-	-	-	3

Restoration and Modernization Requirements				
	End FY 2005	End FY 2006	Change	
Marine Corps	-	8	8	
Building, Structures, and Utilities	-	8	8	

Narrative Statement:

Fiscal Year (FY) 2006 represents the fifth year the Facility Sustainment Model (FSM) was utilized for the Navy Working Capital Fund (NWCF). However, Fiscal Year 2006 is the first year that the United States Marine Corps (USMC) is reporting as a separate entity. Sustainment is defined as the maintenance and repair activities necessary to keep a facility in good working order over its service life. Sustainment includes regularly scheduled adjustments and inspections (such as for fire sprinkler heads and Heat Ventilation Air Condition systems), regulatory inspections (of elevators, bridges, and the like), emergency and routine preventive maintenance tasks, and major repair or replacement of facility components, such as roof replacement, refinishing wall surfaces, repairing and replacing electrical, heating, and cooling systems, and replacing tile and carpeting. In FY 2006, FSM Version 7.2 was used for programming and budgeting for facilities sustainment. Deferred amounts were calculated in accordance with the methodology provided by the Department of Defense (DoD) Financial Management Regulation, Volume 6B, Chapter 12. Since sustainment execution is tied to the NWCF, Marine Corps (MC) rate structure, the full requirement cannot be budgeted in a single year because the rate structure would not be affordable to NWCF, MC customers.

Restoration and Modernization is currently not modeled. Restoration includes repair and replacement work to restore facilities damaged by inadequate sustainment, excessive age, disaster, accident, or other causes. Modernization includes alteration of facilities solely to implement new or higher standards and regulatory changes, to accommodate new functions including base realignment and closure, or to renew building components that typically last more that 50 years such as foundations and structural members. Requirements listed in the table are actual expenditures for restoration and modernization by year. The requirements include restoration and modernization that is part of minor construction projects.

The NWCF, MC has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

Navy Working Capital Fund – Marine Corps
Other Accompanying Information

2006

Appropriations, Funds, and Accounts Included in the Financial 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

Notes

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

Audit Opinions

2006

2006 Annual Financial Report

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

November 8, 2006

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

SUBJECT: Independent Auditor's Report on the Fiscal Year 2006 Department of the Navy General Fund Financial Statements (Report No. D-2007-011)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy General Fund Consolidated Balance Sheet as of September 30, 2006 and 2005, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Navy General Fund Fiscal Year 2006 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 the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies still exist in the Navy General Fund financial statements. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Navy has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also 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.[1] 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 the information accompanying the basic financial statements. Accordingly, we express no opinion on the accompanying information.

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[1] The annual financial statements include the basic financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

Summary of Internal Control

In planning our audit, we considered Navy internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget 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. However, previously identified reportable conditions, all of which are material, continued to exist in the following areas:

- Accounting and Financial Management Systems
- Fund Balance With Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Environmental Liabilities
- Problem Disbursements
- Unobligated Balances

Material weakness are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal assigned functions.

Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements. We performed financial-related audit work in DoD that was not part of the Chief Financial Officers audit in which we identified weaknesses in Accounts Receivable and Accounts Payable transactions, which we consider to be reportable conditions.

Our internal control work (conducted during prior audits) would not necessarily disclose all reportable conditions. The Attachment offers additional details on reportable conditions, most of which we consider to be material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of applicable laws and regulations related to financial reporting was limited because management acknowledged, and prior audits confirm, that instances of noncompliance continue to exist. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level, as required under the Federal Financial Management Improvement Act of 1996. Therefore, we did not determine whether the Navy was in compliance 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 Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- 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.

Paul J. Granetto

Paul J. Granetto, CPA
Assistant Inspector General and Director
Defense Financial Auditing Service

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; the requirements of applicable laws and regulations are met; and 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 and reportable conditions that could adversely affect a favorable opinion on internal control.

Material Weaknesses. Management acknowledged that previously identified reportable conditions, all of which are material, continue to exist.

Accounting and Financial Management Systems. Navy financial system deficiencies include the inability to implement elements of generally accepted accounting principles and inadequate implementation of the U.S. Government Standard General Ledger.

Fund Balance With Treasury. Deficiencies associated with the Fund Balance With Treasury include: unmatched disbursements and collections; "suspense" accounts not cleared in a timely manner; check discrepancies; undistributed disbursements, collections, and abnormal balances; and an inability to reconcile Navy records with the Department of Treasury's records.

Accounts Receivable. Intragovernmental accounts receivable may be overstated because of outstanding, over-aged reimbursable work orders. Seller-side trading partner data are neither captured nor maintained at a transaction-level detail, or may be missing or incomplete because of system deficiencies. Accounts receivable balances with the public may not be complete or accurate and unmatched collections are posted to the accounts receivable account, leaving no audit trail.

Inventory and Related Property, Net. The legacy systems currently used 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 these legacy systems were not designed to ensure that all of the inventory items are included in the values reported on the Balance Sheet. Some Navy commands have not used the consumption method for expensing Operating Materials and Supplies as specified in Statement of Federal Financial Accounting Standards No. 3. Also, some commands are unable to provide Operating Materials and Supplies at the detailed transaction level and only maintain beginning and ending balances.

General Property, Plant, and Equipment. Completeness issues still exist associated with recognizing internal use software and leasehold improvements. Trading partner data for capitalizing assets may not always be recorded. The Navy is currently working with the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics) and 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 Navy is working with the Office of the Under Secretary of Defense (Comptroller) to ensure that documentation for real property is available beginning with FY 1999 and that Form DD 1354, "Transfer and Acceptance of Military Real Property" is properly used throughout the Department of the Navy.

Accounts Payable. Intragovernmental accounts payable such as Military Standard Requisition and Issue Procedures, fuel payables, and non-PowerTrack transportation charges are not being recorded timely, completely, or accurately. The Navy lacks sufficient systems, processes, and data to support reconciliation of buyer-side trading partner information. Accounts payable with the public are not being recorded timely, completely, or accurately. Also, some Navy accounting procedures create abnormal balances.

Environmental Liabilities. Non-Defense Environmental Restoration Program liabilities are not being reported.

Problem Disbursements. Inaccurate or missing fund accounting codes have resulted in unmatched disbursements and collections requiring use of suspense accounts. The suspense accounts cause difficulty in reconciling Navy General Fund records with the Department of Treasury's records.

Unobligated Balances. Deficiencies exist in recorded unobligated amounts because financial systems are not fully integrated and not all commands sufficiently reviewed unliquidated obligations. Additionally, reimbursable transactions were not properly documented or reported on the Disbursing Officer Statement of Accountability.

Other Reportable Conditions. We noted deficiencies related to Accounts Receivable and Accounts Payable transactions during our FY 2006 financial-related audits. Our audit, "Accounting for Department of the Navy General Fund Accounts Receivable," Report No. D-2007-004, reported that unsupported departmental-level trading partner adjustments were processed. Additionally, a universe of Accounts Receivable transactions was not provided timely, which impacted our ability to perform the audit. Our audit, "Navy General Fund Vendor Payments Processed by Defense Finance and Accounting Service," Project No. D2005-D000FC-0151.000, reported that Accounts Payable transactions were not established timely, resulting in a potential misstatement. In addition, our audit identified transactions that were unsupported or contained material errors.

These financial management deficiencies are indications of material weaknesses and reportable conditions in internal control that may adversely affect any decision by the Navy that is based, in whole or in part, on information that is inaccurate because of these deficiencies. 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. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether 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 compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996. The Navy is required to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Navy acknowledged to us that many of the financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level.

Federal Managers' Financial Integrity Act of 1982. The Navy is required to evaluate its systems of internal accounting and administrative control and to report annually on whether those systems are in compliance with applicable requirements. The Navy performed an assessment of the effectiveness of the Navy General Fund internal controls regarding the reliability of financial reporting, compliance with applicable laws and regulations, and reliability of performance reporting. As a result of this assessment, the Navy identified material weaknesses related to financial reporting of the following:

- Accounts Payable,
- Environmental Liabilities,
- Military Equipment,
- Inventory and Operating Materials and Supplies,
- Fund Balance With Treasury, and
- Real Property Assets.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on November 8, 2006, that the Navy General Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. 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: Provisions Governing Claims of the United States Government, Pay and Allowance System for Civilian Employees, the Antideficiency Act, and the Federal Credit Reform Act.

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

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

November 8, 2006

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

SUBJECT: Independent Auditor's Report on the Fiscal Year 2006 Department of the Navy Working Capital Fund Financial Statements (Report No. D-2007-012)

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 Sheet as of September 30, 2006 and 2005, the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Navy is also responsible for implementing effective internal control and for complying with laws and regulations. We are unable to give an opinion on the Navy Working Capital Fund Fiscal Year 2006 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 the audit.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies still exist in the Navy Working Capital Fund financial statements. Therefore, we did not perform auditing procedures to determine whether material amounts on the financial statements were fairly presented. We did not perform these and other auditing procedures because Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to perform only audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Navy has also acknowledged, and prior audits have identified, the material weaknesses listed in the Summary of Internal Control. These material weaknesses also 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.[1] 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 the information accompanying the basic financial statements. Accordingly, we express no opinion on the accompanying information.

[1] The annual financial statements include the basic financial statements, management discussion and analysis, consolidating and combining financial statements, Required Supplementary Information, and Other Accompanying Information.

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- Accounting and Financial Management Systems
- Fund Balance With Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- Accounts Payable
- Other Liabilities

Material weakness are reportable conditions in which internal controls do not reduce (to a relatively low level) the risk of misstatements that are material to the financial statements and that might not be timely detected by employees while performing their normal assigned functions.

Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

Our internal control work (conducted during prior audits) would not necessarily disclose all reportable conditions. The Attachment offers additional details on reportable conditions, most of which we consider to be material internal control weaknesses.

Summary of Compliance with Laws and Regulations

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Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- 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.

Paul J. Granetto
Paul J. Granetto, CPA
Assistant Inspector General and Director
Defense Financial Auditing Service

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; the requirements of applicable laws and regulations are met; and 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 and reportable conditions that could adversely affect a favorable opinion on internal control.

Material Weaknesses. Management acknowledged that previously identified reportable conditions, all of which are material, continue to exist.

Accounting and Financial Management Systems. Navy financial systems do not comply fully with generally accepted accounting principles and the U.S. Government Standard General Ledger at the transaction level. As a result, Navy financial management and feeder systems cannot provide adequate evidence supporting various material amounts on the financial statements.

Fund Balance With Treasury. Navy Working Capital Fund activities do not reconcile cash accounts to the Department of Treasury cash account balance on a consistent basis. In addition, system interfaces do not exist between the financial reporting systems, which results in unmatched disbursements and collections.

Accounts Receivable. Navy does not reconcile subsidiary records to corresponding general ledger accounts, resulting in a control weakness and the loss of an audit trail. Navy also posts 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 detailed transactions. Navy also does not always record recognition and collection of public accounts for contract overpayments, travel advances, and employee debt.

Inventory and Related Property, Net. Navy Working Capital Fund Supply Management activities record inventory at latest acquisition cost. To comply with generally accepted accounting principles, latest acquisition cost must be converted to approximations of historical cost. Navy processes and methodologies do not accurately convert such approximations of historical cost.

Accounts Payable. The Accounts Payable line item is adversely affected by insufficient and inconsistent reconciliations and a lack of direct system interfaces, resulting in matching difficulties, undistributed disbursements, and the inability to capture trading partner information. Unmatched disbursements are transferred to accounts payable using journal vouchers, leaving no audit trail and often causing an abnormal balance.

Other Liabilities. Unsupported, undistributed disbursements need to be resolved. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Defense Finance and Accounting Service Cleveland, and Navy staff need to work this issue jointly, analyzing amounts posted for contract accruals to determine whether they are properly recorded in this line item.

Effect on Reporting. These financial management deficiencies may adversely affect any decision by the Navy that is based, in whole or in part, on information that is inaccurate because of these deficiencies. 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. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether 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 compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996. The Navy is required to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. The Navy acknowledged to us that many of the financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level.

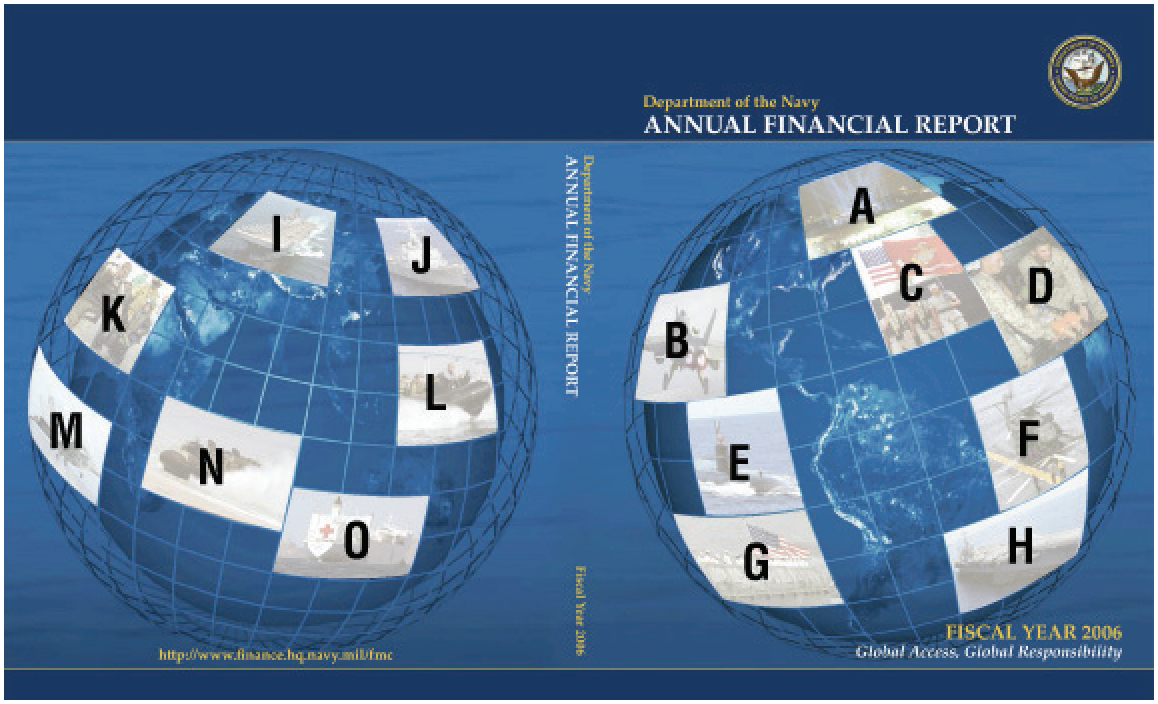
Federal Managers' Financial Integrity Act of 1982. The Navy is required to evaluate its systems of internal accounting and administrative control and to report annually on whether those systems comply with applicable requirements. The Navy performed an assessment of the effectiveness of the Navy Working Capital Fund internal controls regarding the reliability of financial reporting, compliance with applicable laws and regulations, and reliability of performance reporting. As a result of this assessment, the Navy identified material weaknesses related to financial reporting of the following:

- Financial Reporting of Environmental Liabilities,
- Financial Reporting of Military Equipment,
- Financial Reporting of Inventory and Operating Materials and Supplies,
- Financial Reporting of Fund Balance With Treasury, and
- Financial Reporting of Real Property Assets.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on November 8, 2006, that the Navy Working Capital Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. 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: Provisions Governing Claims of the United States Government, Pay and Allowance System for Civilian Employees, the Antideficiency Act, and the Federal Credit Reform Act.

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



FRONT COVER

Images from top to bottom, left to right:

A: Washington, D.C. (Sept. 11, 2006) – One Hundred Eighty-Four beams of light projected from the Pentagon courtyard commemorate each life lost at the Pentagon on the five-year anniversary of the Sept. 11 terrorist attacks. *U.S. Navy photo by Chief Mass Communication Specialist Johnny Bivera*

B: Indian Ocean (Aug. 22, 2006) – An F/A-18C Hornet assigned to the "Knighthawks" of Strike Fighter Squadron One Three Six (VFA-136) launches aboard the nuclear-powered aircraft carrier USS Enterprise (CVN 65). *U.S. Navy photo by Lt. Peter Scheu*

C: Beirut, Lebanon (July 22, 2006) - Marines from the 24th Marine Expeditionary Unit's (MEU) Command Element (CE) and the MEU Service Support Group (MSSG) assist the departure of American citizens from an Evacuation Control Center (ECC) in Beirut. *U.S. Marine Corps photo by Lance Cpl. Andrew J. Carlson*

D: Beirut, Lebanon (July 21, 2006) - Sailors assigned to the transport dock ship USS Trenton (LPD 14) assist two young American citizens as they arrive aboard the ship from Lebanon. *U.S. Navy photo by Lt. Karen Eifert*

E: Pacific Ocean (July 25, 2006) - USS Key West (SSN 722) sails in formation with a group of 28 ships and submarines at the conclusion of Exercise Rim of the Pacific (RIMPAC) 2006, the world's largest biennial maritime exercise. *U.S. Navy photo by Mass Communication Specialist 1st Class M. Jeremie Yoder*

F: Caribbean Sea (Aug. 26, 2006) - An MH-53E Sea Dragon prepares for take-off from the flight deck to conduct mine countermeasures. *U.S. Navy photo by Mass Communication Specialist Seaman Christopher Newsome*

G: Novorossiysk, Russia (Sept. 7, 2006) - The Sailors aboard the guided missile frigate USS Elrod (FFG 55) man the rails as the ship pulls in to Novorossiysk, Russia. *U.S. Navy photo by Mass Communication Specialist 2nd Class Michael Lavender*

H: South China Sea (May 8, 2006) - The Nimitz-class aircraft carrier USS Abraham Lincoln (CVN 72) and aircraft assigned to Carrier Air Wing Two (CVW-2) perform an aerial demonstration in the South China Sea. *U.S. Navy photo by Photographer's Mate 3rd Class Jordon R. Beesley*

BACK COVER

Images from top to bottom, left to right:

I: Arabian Sea (Sept. 7, 2006) – The amphibious assault ship USS Iwo Jima (LHD 7) conducts flight operations in the Arabian Sea. *U.S. Navy photo by Mass Communication Specialist Airman Michael Minkler*

J: Gulf of Aden (Aug. 29, 2006) – The guided-missile destroyer USS Cole (DDG 67) underway patrolling the Gulf of Aden as part of the Iwo Jima Expeditionary Strike Group (ESG). *U.S. Navy Photo By Mass Communication Specialist Seaman Christopher L. Clark*

K: Beirut, Lebanon (July 21, 2006) - Sailors assigned to the transport dock ship USS Trenton (LPD 14) assist two young American citizens as they arrive aboard the ship from Lebanon. *U.S. Navy photo by Lt. Karen Eifert*

L: Coronado, Calif. (Jan 12, 2006) - Marine Staff Sgt. David Cleaves, an instructor with Expeditionary Warfare Training Group Pacific, drives a Combat Inflatable Craft, (CRIC), with soldiers from Japan Ground Self-Defense Force (JGSDF) during Exercise "Iron Fist." *U.S. Navy Photo by Photographer 2nd Class Erich J. Ryland*

M: Fighter Squadron One Zero Two (VFA-102) launches off the flight deck during flight operations aboard USS Kitty Hawk (CV 63). *U.S. Navy photo by Mass Communication Specialist Seaman Joshua Wayne LeGrand*

N: Hat Yao, Thailand (May 15, 2006) - Landing Craft Air Cushion Five Eight (LCAC-58) assigned to Assault Craft Unit Five (ACU-5), arrives on the beach in Thailand as part of the 25th anniversary of the annual U.S./Thai exercise Cobra Gold 2006. *U.S. Navy photo by Journalist 2nd Class Brian P. Biller*

O: Dili, Timor Leste (Aug. 29, 2006) - The Military Sealift Command hospital ship USNS Mercy (T-AH 19) sits off the coast of Dili. *U.S. Navy photo by Chief Mass Communication Specialist Edward G. Martens*

*Special thanks to **Admiral Gregory Smith**, the Chief of Naval Information; **Mr. Christopher Madden**, the Director of the Navy Visual News Service; **Lieutenant Christopher Bishop**, the Deputy Director of the Navy Visual News Service; and the s**taff of the Office of the Chief of Naval Information** for providing 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 Department of the Navy Fiscal Year 2006 Annual Financial Report. This FY 2006 Department of the Navy Annual Financial Report is dedicated to the men and women of our Navy and Marine Corps war-fighting team.

Department of the Navy

ANNUAL FINANCIAL REPORT

FISCAL YEAR 2006

Global Access, Global Responsibility

http://www.finance.hq.navy.mil