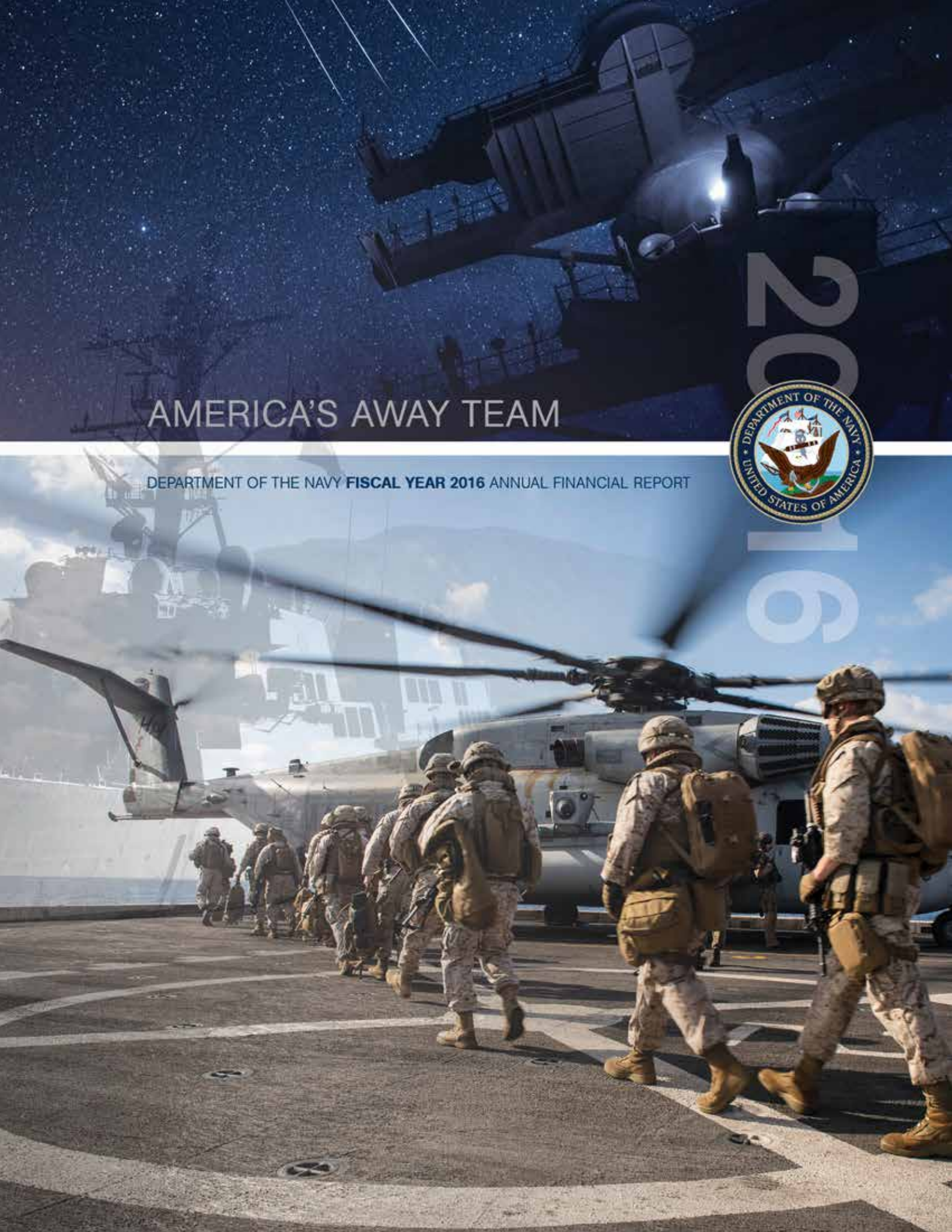


# AMERICA'S AWAY TEAM

DEPARTMENT OF THE NAVY FISCAL YEAR 2016 ANNUAL FINANCIAL REPORT

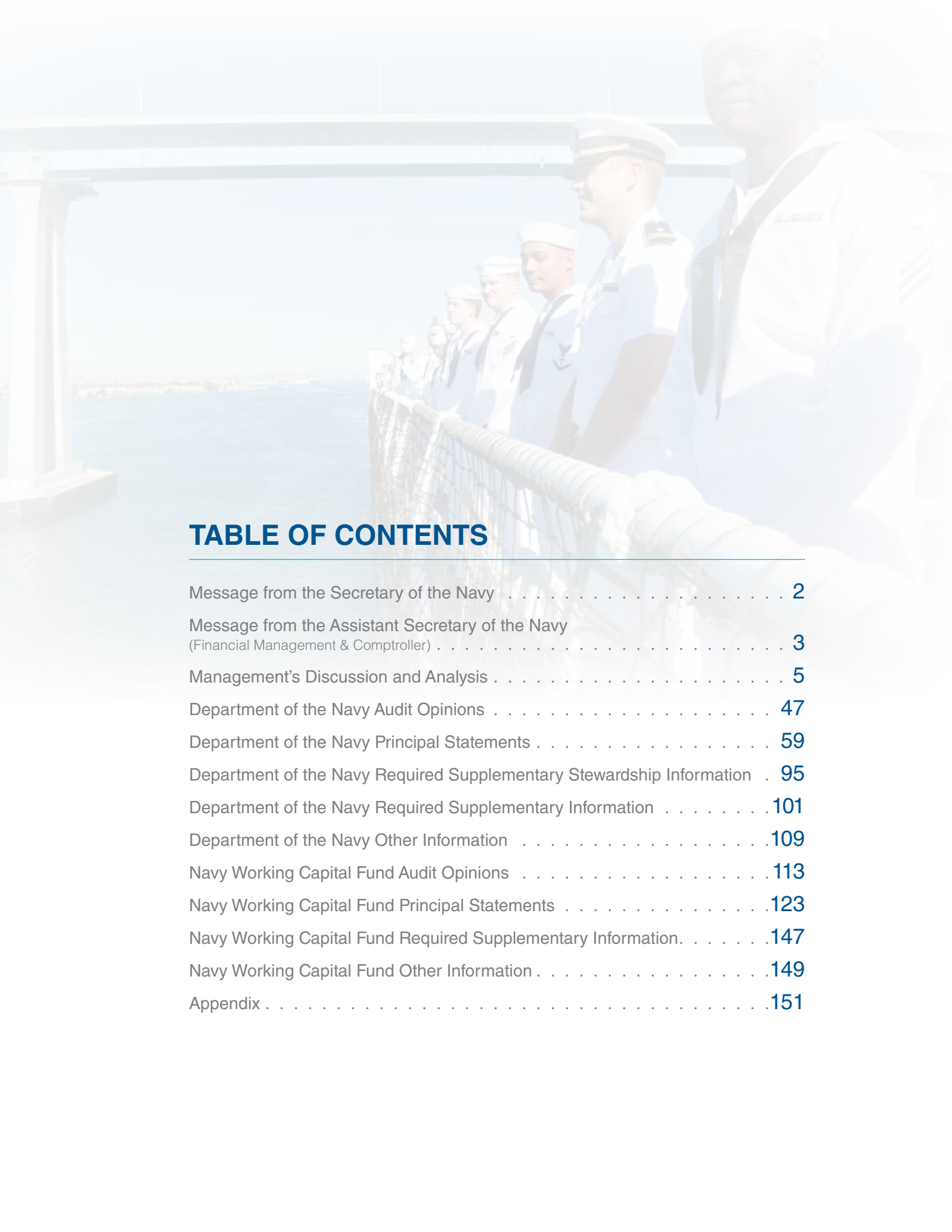


2016





AMERICA'S AWAY TEAM



## TABLE OF CONTENTS

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|                                                                                                    |     |
|----------------------------------------------------------------------------------------------------|-----|
| Message from the Secretary of the Navy . . . . .                                                   | 2   |
| Message from the Assistant Secretary of the Navy<br>(Financial Management & Comptroller) . . . . . | 3   |
| Management's Discussion and Analysis . . . . .                                                     | 5   |
| Department of the Navy Audit Opinions . . . . .                                                    | 47  |
| Department of the Navy Principal Statements . . . . .                                              | 59  |
| Department of the Navy Required Supplementary Stewardship Information . . . . .                    | 95  |
| Department of the Navy Required Supplementary Information . . . . .                                | 101 |
| Department of the Navy Other Information . . . . .                                                 | 109 |
| Navy Working Capital Fund Audit Opinions . . . . .                                                 | 113 |
| Navy Working Capital Fund Principal Statements . . . . .                                           | 123 |
| Navy Working Capital Fund Required Supplementary Information. . . . .                              | 147 |
| Navy Working Capital Fund Other Information . . . . .                                              | 149 |
| Appendix . . . . .                                                                                 | 151 |





NOVEMBER 2016

The Department of the Navy fervently continues its mission to maintain, train, and equip combat-ready naval forces capable of winning wars, deterring aggression, and maintaining freedom of the seas. United States Sailors and Marines are "America's Away Team," deploying around the world in times of peace and war to be at the right place all the time, ready and able to respond when called upon. This presence includes deploying forces, building global partnerships, and conducting routine deployments. Four fundamental principles have guided me as Secretary of the Navy in sustaining this global presence: *People, Platforms, Power, and Partnerships*.

**People – Sustaining the World's Most Formidable Expeditionary Fighting Force:** Our Sailors, Marines, and civilians all contribute to executing the mission of the DON. We must ensure we're able to recruit and retain the best and most capable people. To do this, we have expanded meritorious advancements, improved the Career Intermission Program, increased

maternity leave, and are opening all billets to every member of the Navy and Marine Corps. The opportunities we provide to the warfighter are investments in sustainment of the world's most formidable expeditionary fighting force.

**Platforms – Growing Our Fleet Despite Shrinking Budgets:** Platforms enable our people to perform their mission. Having the right number of ships, submarines, and aircraft is critical. Since 2009 we have reversed the decline in shipbuilding. We will have a 300 ship fleet by the end of the decade, despite budget constraints, while continuing to invest in next generation innovations.

**Power – Alternative Energy Fueling the Fight:** The Navy has a history of energy innovation, advancing from sail, to coal, to oil, and to nuclear power. This year we launched the Great Green Fleet 2016, steaming on a blend of conventional and alternative fuels. Additionally, during this fiscal year, the DON completed procurement of one gigawatt of alternative energy for shore bases. The use of alternative energies at sea and ashore improves security and advances stability for our fighting forces.

**Partnerships – Building Partnerships to Advance our Shared Values:** Partnerships with the American people, our allies, foreign partners, and industry allow us to carry out our mission. Joint exercises improve interoperability with foreign navies, building understanding and trust. Improved procurement of long-lead items such as ships provides stability to our nation's industrial base. Most critically, we partner with the American people to provide for the future of naval security.

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*United States Sailors and Marines are "America's Away Team," deploying around the world in times of peace and war to be at the right place all the time.*

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Despite ever-tightening fiscal constraints, the DON continues to provide the nation with a strong global presence. As stewards of resources entrusted to us by Congress on behalf of the American people, we are aggressively pursuing the Congressional mandate to improve the reliability of our financial data and achieve audit readiness. The DON's Fiscal Year 2016 Annual Financial Report, "America's Away Team," conveys this commitment to, and our partnership with, the American People. Detailed discussion of identified weaknesses and ongoing remediation efforts are disclosed in the DON Statement of Assurance and within the Management's Discussion and Analysis section.

Ray Mabus





NOVEMBER 2016

I am pleased to present the Department of the Navy's (DON) 2016 Annual Financial Report, *America's Away Team*, reflecting the hard work performed by Sailors, Marines, and civil servants in executing the Department's mission. Deploying in times of peace and in times of ensuring they are where it matters, when it matters, our people are the most critical component to success as an organization.

Despite shrinking budgets, the DON financial community is working to ensure that resources are efficiently executed to support the needs of the Department today. We are focused on planning for the fiscal future to enable the DON to achieve its objectives: to protect the homeland, build global security, project power and win decisively when called upon. This requires making hard choices to focus investments while continuing to innovate. In an environment of budget constraints and instability, we must protect procurement of long lead items such as ships and aircraft while simultaneously maintaining a high operating tempo. We remain committed to

ensuring budget requests balance mission readiness, sustaining the world's most formidable expeditionary fighting force.

Financial improvement and audit readiness continue to be important elements of DON financial operations. After years of preparation, the Navy shifted from preparing for audit to being under audit in FY 2015 marking a significant milestone on our path to a full financial statement audit. I have observed the rapidly increasing pace of learning as Navy meets the demands of audit, including creation of an effective audit response network and aggressive remediation of findings, eliminating root causes, not simply resolving the symptoms. While complex long-standing issues are being resolved through diligence and hard work, much work remains.

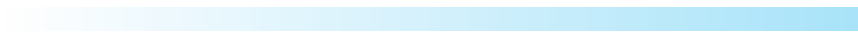
As we drive toward full financial statement audit, the DON's civilian and military leadership demonstrate their enduring commitment to be accountable to Congress and the American people for sound stewardship of the funds entrusted to them and along with it, greater accountability, transparency, and efficiency.

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*We are focused on planning for the fiscal future to enable the DON to achieve its objectives.*

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S. J. Rabern



2016



## MANAGEMENT'S DISCUSSION AND ANALYSIS

### *America's Away Team*







(U.S. Navy photo by Petty Officer 3rd Class Nathan Burke/Released)

## OVERVIEW

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The Department of Defense (DoD) includes three military departments (Department of the Army, Department of the Navy, and Department of the Air Force); however, there are four separate service branches (Army, Navy, Marine Corps, and Air Force). Since 1834, the Navy and Marine Corps have been housed together under the Department of the Navy (DON).

The Department of the Navy was established on April 30, 1798. The DON has three principal components: the Navy Department, consisting of executive offices mostly in Washington, DC; the operating forces, including the Marine Corps, the reserve components, and, in time of war, the U.S. Coast Guard (in peace, a component of the Department of Homeland Security); and the shore establishment. The Department of the Navy consists of two uniformed Services: the United States Navy and the United States Marine Corps.

The United States Navy was founded on October 13, 1775. The Navy's core responsibilities are to deter aggression and, if deterrence fails, win the nation's wars. The Navy employs the global reach and persistent presence of forward-stationed and rotational forces to secure the nation from direct attack, assure Joint operational access, and retain global freedom of action. Along with global partners, the Navy protects the maritime freedom that is the basis for global prosperity and fosters and sustains cooperative relationships with an expanding set of allies and international partners to enhance global security.

The United States Marine Corps (USMC) was founded by an act of the Continental Congress on November 10, 1775. As the nation's Expeditionary Force in Readiness, the Marine Corps provides power projected from the sea, utilizing the mobility of the Navy to rapidly deliver combined-arms task forces in coastal regions or emergent global crises. The Marine Corps has evolved into a balanced air-ground task force with significant logistical capabilities to forward deployed and forward engaged areas shaping, training, deterring, and responding to all manner of crises and contingencies.

The Department of the Navy Annual Financial Report (AFR) includes two separate sets of financial statements, the DON General Fund (GF) and the Navy Working Capital Fund (NWCF). The DON GF accounts for appropriations and funds as general, working capital (revolving), trust, special, and deposit funds. The DON uses these funds (excluding deposit funds) to execute its mission. The National Defense Sealift Fund is the only





# 2016



## AMERICA'S AWAY TEAM

revolving fund within DON GF and receives an annual appropriation. The DON GF is comprised of those federal account symbols beginning with agency number 17 within the United States Treasury's Federal Account Symbols and Titles (FAST) Book. The NWCF is a revolving fund that provides goods, services, and infrastructure to the DON and other DoD customers on a reimbursable basis, based on a relationship between operating units and NWCF support organizations. NWCF activities strive to break even over the budget cycle. NWCF has five programs: Depot Maintenance, Supply Management, Research and Development, Base Support, and Transportation. The NWCF is comprised of federal account symbol 97 4930.002, "Defense Working Capital Fund, Navy." The GF and NWCF financial statements report consolidated or combined financial information for both the Navy and Marine Corps. A listing of DON General Fund and Navy Working Capital Fund federal account symbols is included within each applicable Other Information section.

The DON recognizes the importance of its continued financial improvement and audit readiness as part of the DoD mission. Following the FY 2015 Schedule of Budgetary Activity (SBA) audit, the Navy received a significant number of Notices of Findings and Recommendations over internal controls, information technology systems, and the financial reporting compilation process. Deficiencies and the corrective actions addressing them receive the highest level of visibility in both military and civilian lines of authority. We are focused on identifying root causes and correcting them, rather than merely treating their symptoms. While under audit of the FY 2016 SBA, the Navy worked earnestly to remediate these audit findings by continuing improvement of our business processes and internal controls. Among lessons learned throughout the Department is the need for awareness of financial statement audits and the roles individuals play in them to become a part of the business culture. There is a growing organizational awareness over the impact and significance of audit. While there remains a significant amount of work to be done, the successes and experiences gained from the SBA audits are foundational to undergoing an audit of the DON's full financial statements in the future.

The DON FY 2016 objectives and goals focus on four key areas of the Department: **People, Platforms, Power, and Partnerships**. Success in these areas will provide real benefits to the nation in fulfillment of the DON's responsibilities to maintain a capable Navy and Marine Corps presence. It will increase the effectiveness and efficiencies of the entire Department, improve the lives of Sailors and Marines, and result in greater security for the United States. The Strategic Management section of this report highlights some of the significant organizational activities and accomplishments from the past year which support the DON's objectives and goals.

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

– Department of the Navy Mission



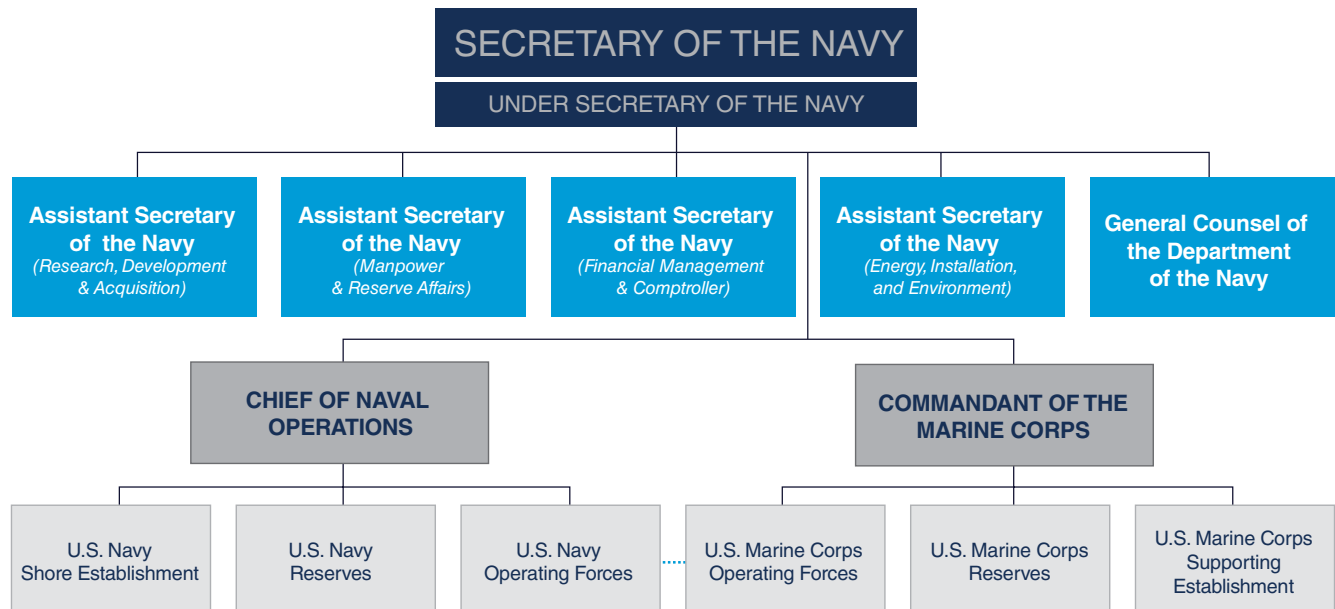
(U.S. Navy photo by Petty Officer 2nd Class Travis DiPerna/Released)





Founded 30 April 1798

Title 10 U.S. Code, Section 5061



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

## ORGANIZATION AND MISSION

The Department of the Navy, established on April 30, 1798, has three principal components: the Department headquarters, consisting of executive offices mostly in Washington, DC, the Naval and Marine Corps operating and reserve components, and the shore establishment. In time of war, the U.S. Coast Guard (a component of the Department of Homeland Security during peacetime) is under the operational control of the DON. All are structured to respond to a broad range of mission priorities that preserve the nation’s freedom and protect U.S. global interests.

The Secretary of the Navy (SECNAV), a civilian appointed by the President, is responsible for, and has authority under Title 10 of the United States Code, to conduct all the affairs of the DON, including: recruiting, organizing, supplying, equipping, training, mobilizing, and demobilizing. The SECNAV also oversees the construction, outfitting, and repair of naval ships, equipment, and facilities. The SECNAV is responsible for the formulation and implementation

of policies and programs that are consistent with the national security policies and objectives established by the President and the Secretary of Defense. Under the purview of the SECNAV are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, the General Counsel, and two key military leaders—the Chief of Naval Operations, a four-star Admiral, responsible for the command and operating efficiency of the Navy, and the Commandant of the Marine Corps, a four-star General, responsible for the performance of the Marine Corps.

The Navy and the Marine Corps have numerous commands that operate under the authority and responsibility of a commander or other designated official and typically support a network of subordinate commands. Each command has a clearly defined mission that supports the overall DON mission in support of the DoD’s responsibilities. Both Services provide ready forces to support the U.S. joint military commands in conducting their worldwide missions.

The United States Navy was founded on October 13, 1775. The mission of the Navy is to maintain, train, and equip combat-ready naval forces capable of winning wars, deterring aggression, and maintaining freedom of the seas. It is overseen by the CNO, and consists of the operating forces and shore establishment. The CNO is the senior military officer in the Navy, a member of the Joint Chiefs of Staff, and is the principal naval advisor to the President and to the SECNAV on the conduct of war. He is also the principal advisor and naval executive to the Secretary on the conduct of naval activities of the DON. The CNO's office is responsible for the command, utilization of resources, and operating efficiency of the operating forces of the Navy and of the Navy shore activities assigned by the Secretary. The Navy operating forces commanders and fleet commanders have a dual chain of command. Administratively, they report to the Chief of Naval Operations and provide, train, and equip naval forces. Operationally, they provide naval forces and report to the appropriate Unified Combatant Commanders. The Commander of the Fleet Forces Command controls fleet assets on both the Atlantic and Pacific coasts for interdeployment training cycle purposes. As units of the Navy enter the area of responsibility for a particular navy area commander, they are operationally assigned to the appropriate numbered fleet. All Navy units also have an administrative chain of command with the various ships reporting to the appropriate type commander. The shore establishment provides support to the operating forces (known as "the fleet") in the form of: facilities for the repair of machinery and electronics; communications centers; training areas and simulators; ship and aircraft repair; intelligence and meteorological support; storage areas for repair parts, fuel, and munitions; medical and dental facilities; and air bases.



### BUREAU OF MEDICINE AND SURGERY

The Navy Bureau of Medicine and Surgery (BUMED) provides high-quality health care to beneficiaries in wartime and in peacetime, under the leadership of the Navy Surgeon General. Highly trained Navy Medicine personnel deploy with Sailors and Marines worldwide—providing critical mission support aboard ship, in the air, under the sea, and on the battlefield. The Navy Medicine team of physicians, dentists, nurses, corpsmen, allied health providers, and support personnel work in tandem with the Army and Air Force medical personnel and coalition forces to ensure the physical and mental wellbeing of service members and civilians. Navy Medicine's military and civilian health care professionals also provide care for uniformed services' family members and retirees at military treatment facilities around the globe. This care is provided via the Defense Health Program and coordinated by the Office of Assistant Secretary of Defense (Health Affairs) with support from the Defense Health Agency. BUMED has 63,000 active duty personnel and reservists, government civilians, and contractors engaged in all aspects of expeditionary medical operations in support of the warfighter. BUMED is headquartered in Falls Church, VA.



### BUREAU OF NAVAL PERSONNEL

The Bureau of Naval Personnel (BUPERS) provides administrative leadership, policy planning, general oversight, training and education for all Navy personnel. BUPERS strives to support the needs of the DON by providing the fleet with the right person with the right skill set in the right place at the right time, using the most efficient human resource processes possible. BUPERS also provides support services to Sailors and is dedicated to ensuring Sailor readiness and quality of life through its myriad of professional and personal/family focused programs. BUPERS has six subordinate commands: Naval Education Training Command (NETC); Navy Recruiting Command (NRC); Navy Personnel Command (NPC); United States Naval Academy (USNA); Naval Postgraduate School (NPS); and Naval War College (NWC). BUPERS and its subordinate commands have a total of 9,517 authorized full time equivalent (FTE) civilian employees. BUPERS is headquartered in Arlington, VA.



## COMMANDER, NAVY INSTALLATIONS COMMAND

Commander, Navy Installations Command (CNIC) is responsible for Navy-wide Shore installation management as the Navy's shore integrator, designing and developing integrated solutions for sustainment and development of Navy shore infrastructure. CNIC enables and sustains naval forces from the Shore by providing effective and efficient Shore installation services and support to sustain and improve current and future fleet readiness and mission execution. CNIC has 54,000 employees in 11 regions, 70 Installations, and 123 Naval Operations Support Centers. CNIC has overall Shore installation management responsibility and authority as the Budget Submitting Office (BSO) for assigned base operating support functions, military and civilian personnel, infrastructure, and budget. CNIC is headquartered in Washington, DC.



## COMMANDER, NAVY RESERVE FORCE

Commander, Navy Reserve Force (CNRF), also known as the Commander U.S. Navy Reserve Force, delivers strategic depth and operational capability to the Navy, Marine Corps, and Joint Forces by providing mission-capable units and individuals in support of the full range of operations, from peace to war. The 57,400 personnel of the Navy Reserve represent approximately 15% of the Navy Total Force. The Navy Reserve provides essential warfighting capabilities and expertise, strategically aligned with mission requirements, and is valued for readiness, innovation, and agility. The military component of the Navy Reserve represents only 6% of the Navy's total military personnel budget but is a significant force multiplier for Active Component. CNRF is headquartered in Norfolk, VA.



## DEPARTMENT OF THE NAVY ASSISTANT FOR ADMINISTRATION

The Department of the Navy Assistant for Administration (DON/AA) provides administrative management and support to the Office of the SECNAV, its approximate 4,600 member Secretariat, staff offices, field activities and supported organizations. The command is comprised of administrative divisions focused on customer service, directives and records management, contract management, executive dining, facilities and support services, financial management, human resources, information technology, and security. The DON/AA has 127 personnel and is headquartered at the Pentagon in Arlington, VA.



## FIELD SUPPORT ACTIVITY

Field Support Activity (FSA) establishes, maintains, and provides a system of financial services as the BSO and Principal Administering Office (PAO) for Navy's assigned unified command (PACOM), Navy Headquarters and activities (Navy Band, Naval Safety Center, Naval History and Heritage Command, Naval Legal Service Command), Commander Operational Test and Evaluation Force, the National Defense Sealift Fund, and Department of the Navy Centrally-Managed Bills. FSA initiates action in matters pertaining to the provision of funds and manpower; evaluates resource utilization; and initiates or recommends appropriate corrective actions. FSA has 38 personnel and is headquartered at the Washington Navy Yard in Washington, DC. Additionally, FSA (DNS-F) plans and programs for current and future resource requirements for activities within the Director, Navy Staff (DNS) sponsorship and also provides contract support for DNS/CNO activities.





## MILITARY SEALIFT COMMAND

The Military Sealift Command (MSC) operates approximately 120 noncombatant, civilian-crewed ships that replenish Navy ships at sea, conduct specialized missions, strategically preposition combat cargo at sea around the world, perform a variety of support services, and move military equipment and supplies to deployed U.S. forces and coalition partners. MSC operates five subordinate commands worldwide that are aligned with the numbered fleet logistics staffs in the Atlantic, Pacific, Europe/Africa, Central, and Far East areas. MSC is headquartered in Norfolk, VA, with approximately 9,500 Department of the Navy civilian employees supporting its mission worldwide.



## NAVAL AIR SYSTEMS COMMAND

The Naval Air Systems Command (NAVAIR) has a force of 29,000 personnel focused on research, design, development, and systems engineering; acquisition management; test and evaluation; training facilities and equipment; repair and modification; and in-service engineering and logistics support of naval aviation aircraft and weapon systems operated by Sailors and Marines. NAVAIR is organized into eight “competencies” or communities of practice including Program Management, Contracts, Research and Engineering, Test and Evaluation, Logistics and Industrial Operations, Corporate Operations, Comptroller, and Counsel. NAVAIR provides support (people, processes, tools, training, mission facilities, and core technologies) to Naval Aviation Program Executive Officers and their assigned program managers, who are responsible for meeting the cost, schedule, and performance requirements of their assigned programs. NAVAIR is the principal provider for the Naval Aviation Enterprise, which maintains top combat effectiveness by smartly managing precious resources and attack readiness degraders, while collaborating across organization boundaries to deliver ready forces where and when they are needed. NAVAIR is headquartered in Patuxent River, MD with military and civilian personnel stationed at eight locations across the continental United States and one site overseas.



## NAVAL FACILITIES ENGINEERING COMMAND

The Naval Facilities Engineering Command (NAVFAC) delivers and maintains quality, sustainable facilities; acquires and manages capabilities for the Navy’s expeditionary combat forces; provides contingency engineering response; and enables energy security and environmental stewardship. NAVFAC is a global organization with an annual volume of business in excess of \$15 billion. NAVFAC has 18,000 Civil Engineer Corps officers, civilians, and contractors, who serve as engineers, architects, contract specialists and professionals to manage the planning, design, construction, contingency engineering, real estate, environmental, and public works support for Navy shore facilities around the world. As a major Navy systems command and an integral member of the Navy and Marine Corps team, NAVFAC delivers timely and effective facilities engineering solutions worldwide. NAVFAC has 13 component commands and is headquartered at the Washington Navy Yard in Washington, DC.



## NAVAL INTELLIGENCE ACTIVITY

The Naval Intelligence Activity (NIA) is the leading provider of maritime intelligence to the U.S. Navy and joint warfighting forces, as well as national decision makers and other consumers in the Intelligence Community. NIA specializes in the oversight, collection, analysis, production and dissemination of vital, timely and accurate scientific, technical, geopolitical and military intelligence information for key consumers worldwide. Under the authority and guidance of the Director of Naval Intelligence (DNI), NIA is an Echelon II organization headed by the Deputy Director of Naval Intelligence (DDNI) and charged with overseeing all intelligence activities within the Navy.



## NAVAL SEA SYSTEMS COMMAND

The Naval Sea Systems Command (NAVSEA) has a force of 60,000 civilian and military personnel including personnel assigned at public shipyards and regional maintenance centers where NAVSEA is the operating agent and technical authority. NAVSEA provides material support to the Navy, Marine Corps, and other agencies, as assigned, for ships, submarines, and other sea platforms; shipboard combat systems and components; and other surface and undersea warfare and weapons systems including ship and aviation interface systems; and surface and submarine expendable ordnance. NAVSEA exercises technical authority and certification authority for ship, submarine, diving, and weapon systems. NAVSEA reports to CNO and the Commandant of the Marine Corps, as appropriate, for the execution of logistics sustainment and operating forces responsibilities. NAVSEA acts for, and exercise the authority of, the Navy Acquisition Executive to manage assigned programs; and reports directly to Assistant Secretary of the Navy, Research, Development, & Acquisition (ASN (RD&A)) for all matters pertaining to research, development and acquisition. The organization is located at the Washington Navy Yard in Washington, DC and is responsible for chartering two warfare centers, Naval Surface Warfare Center and Naval Undersea Warfare Center, and 10 working capital fund divisions located throughout the U.S. NAVSEA is also responsible for 9 general fund field activities including 4 Supervisors of Shipbuilding who administer contracts with private sector shipbuilders.



## NAVAL SPECIAL WARFARE COMMAND

The Naval Special Warfare Command (NSWC) mission is to man, train, equip, deploy and sustain Naval Special Warfare (NSW) forces for operations and activities abroad in support of combatant commanders and U.S. national interests. The NSW community encompasses the Echelon II headquarters, Naval Special Warfare Command, and seven Echelon III commands (seven NSW Groups and the NSW Center), as well as the Echelon IV commands subordinate to the Echelon IIIs. Echelon IV commands include operational forces i.e. Special Warfare Operators (SEAL) Teams and Special Boat Teams, logistics commands, training commands and detachments, mobile communications teams, NSW Units (OCONUS), and a National Mission Force.

NSWC is currently comprised of 10,793 total funded billets (Active Duty, Reserve, Government Civilian, and Contractors), including 2,885 active-duty SEAL billets, 809 Special Warfare Boat Operator billets, 4,457 support billets, 1,012 reserve billets, 1,283 Government civilian FTE and 347 contractor FTE. The NSW Force is organized around 8 SEAL teams, one SEAL Delivery Vehicle Team, three Special Boat Teams and supporting commands which deploy forces worldwide to meet the requirements of theater commanders. NSWC constitutes 11% of U.S. Special Operations Forces and less than 2% of Navy forces. NSWC is headquartered in San Diego, CA.



## NAVAL SUPPLY SYSTEMS COMMAND

Naval Supply Systems Command's (NAVSUP) mission is to provide supplies, services, and quality-of-life support to the Navy and Joint warfighter. With headquarters in Mechanicsburg, Pennsylvania, and employing a diverse, worldwide workforce of more than 22,500 military and civilian personnel, NAVSUP oversees logistics programs in the areas of supply operations, conventional ordnance, contracting, resale, fuel, transportation, and security assistance. NAVSUP is also responsible for food service, postal services, Navy Exchanges, and movement of household goods. In addition to its headquarters activity, the NAVSUP enterprise is comprised of four major organizations with 12 commands located worldwide.



## OFFICE OF NAVAL RESEARCH

Naval science and technology (S&T) delivers new capabilities to the Navy and Marine Corps that ensure continued superiority of U.S. naval forces today and warfighters in the future. In keeping with its mandate, the Office of Naval Research (ONR) plans, fosters, and encourages scientific research in recognition of its paramount importance to future naval power and national security. Led by the Chief of Naval Research, ONR provides technical advice to the CNO and SECNAV and oversees the execution of Naval S&T objectives to support a Navy and Marine Corps that is capable of prevailing in any environment. This is done through focusing on S&T areas with big payoffs, encouraging innovative thinking and business processes, and striving to improve the transition of S&T into acquisition programs in the most cost-effective means possible, striking the right balance between responsive near-term technology insertion and long-term basic research. ONR organization employs approximately 1,050 people, comprising uniformed, civilian, and contract personnel. Additional employees staff the Naval Research Lab in Washington, DC. ONR is headquartered in Arlington, VA.



## SPACE AND NAVAL WARFARE SYSTEMS COMMAND

As the Navy's Information Warfare systems command, the Space and Naval Warfare Systems Command (SPAWAR) develops, delivers, and sustains advanced cyber capabilities for the warfighters. SPAWAR, along with its system centers, space field activity, and three program executive offices, provides the hardware and software needed to execute Navy missions. With nearly 10,000 active duty military and civilian professionals located around the world and close to the fleet, SPAWAR is at the forefront of research, engineering, and acquisition, keeping the forces connected around the globe. As one of the Department of the Navy's major acquisition commands, SPAWAR's realm of expertise is in information technology. SPAWAR creates products and services that transform ships, aircraft, and vehicles from individual platforms into integrated warfighting networks, delivering and enhancing information awareness among all key players. SPAWAR pursues cutting-edge research and development for the Navy's growing cyberspace capabilities and provides the hardware and software that support manned and unmanned systems in the air, at sea, on land, and in space. SPAWAR is headquartered in San Diego, CA.



## STRATEGIC SYSTEMS PROGRAM

Strategic Systems Programs (SSP) directs the end-to-end effort of the Navy's Strategic Weapons Systems to include training, systems, equipment, facilities and personnel, and fulfill the terms of the United States/United Kingdom Polaris Sales Agreement. SSP's lines of business include The Strategic Weapons System, Nuclear Weapons Security and Safety, Guided Missile Submarine (SSGN) Attack Weapons System, and Navy Treaty Implementation Program. In addition, Director SSP has been assigned the responsibility and authority as Nuclear Weapons Regulator via SECNAVINST 8120.1A. SSP is headquartered at the Washington Navy Yard in Washington, DC.





## U.S. FLEET FORCES COMMAND

The U.S. Fleet Forces Command (COMUSFLTFORCOM) supports both the CNO and Combatant Commanders worldwide by providing responsive, relevant, sustainable Naval forces ready-for-tasking. COMUSFLTFORCOM provides operational and planning support to Combatant Commanders and integrated warfighter capability requirements to the CNO. Additionally, U.S. Fleet Forces Command serves as the CNO's designated Executive Agent for Anti-Terrorism/Force Protection (ATFP), Individual Augmentees (IA), and Sea Basing. In collaboration with U.S. Pacific Fleet, U.S. Fleet Forces Command organizes, mans, trains, maintains, and equips Navy forces; develops and submits budgets; and executes readiness and personnel accounts to develop both required and sustainable levels of fleet readiness. The U.S. Fleet Forces Command has over 120,000 personnel serving around the world. COMUSFLTFORCOM is headquartered in Norfolk, VA.



## U.S. PACIFIC FLEET

The Commander, U.S. Pacific Fleet (COMPACFLT) is the world's largest fleet command, encompassing 100 million square miles, more than half the Earth's surface. The Pacific Fleet consists of approximately 200 ships, 1,200 operational aircraft and more than 140,000 Sailors and civilians. U.S. Commands that fall directly under the Pacific Fleet include "type" commands for surface ships, submarines, aircraft, and Navy construction with an annual budget of \$12 billion. Operational commands that report directly to the U.S. Pacific Fleet include Third Fleet in the Eastern Pacific and Seventh Fleet in Western Pacific and Indian Ocean. U.S. Pacific Fleet protects and defends the collective maritime interests of the United States and its allies and partners in the Asia-Pacific region. In support of U.S. Pacific Command and with allies and partners, U.S. Pacific Fleet enhances stability, promotes maritime security and freedom of the seas, deters aggression and when necessary, fights to win. The U.S. Pacific Fleet is headquartered at Pearl Harbor, HI.

## U.S. MARINE CORPS

The Marine Corps, established on 10 November 1775, has an FY 2016 end-strength of 183,600 Active Duty Marines; and 38,500 Select Reserve Marines. At any given time, approximately 30,000 Marines are forward deployed in operations supporting our nation's defense.

Headquarters, Marine Corps (HQMC) consists of the Commandant of the Marine Corps and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law and higher authority. This includes the administration, discipline, internal organization, training, requirements, efficiency and readiness of the service. Headquarters Marine Corps is spread throughout the Washington, D.C metro area, including the Pentagon, Marine Barracks Washington, Marine Corps Base Quantico, and the Washington Navy Yard.

The Operating Forces are subdivided into four categories: Marine Corps Forces, including all Marine ground, aviation, and combat logistics; Marine Corps Reserves, Marines who support the Active Component by fielding deployable units; Security Forces, which protect key installations, vessels, units and assets of the United States Government; and Special Activity Forces, who guard United States embassies and foreign posts.

The Supporting Establishment includes all bases, air stations, and installations. They assist in training, sustainment, equipping, and embarkation of deploying Marine Forces.



## HEADQUARTERS, U. S. MARINE CORPS

Headquarters, U.S. Marine Corps (HQMC) consists of the Commandant of the Marine Corps (CMC) and those staff agencies that advise and assist him in discharging his responsibilities prescribed by law. The Commandant is directly responsible to the Secretary of the Navy for the overall performance of the Marine Corps. This includes the administration, discipline, internal organization, training requirements, efficiency, and readiness of the service. Also, as the Commandant is a member of the Joint Chiefs of Staff, HQMC supports him in his interaction with the Joint Staff. The Commandant also is responsible for the operation of the Marine Corps material support system.



## U.S. MARINE CORPS FORCES COMMAND

Located in Norfolk, Virginia, Commander, U.S. Marine Corps Forces Command (COMMARFORCOM), commands Active Component (AC) Service-retained operating forces; executes USMC force generation actions across the AC/RC Components in provisioning of joint capable Marine Corps forces, and directs deployment planning and execution of Service-retained operating forces in support of Combatant Commander (CCDR) and Service requirements; serves as Commanding General, Fleet Marine Forces Atlantic (CG FMFLANT) and commands embarked Marine Corps forces; coordinates Marine Corps-Navy integration of operational initiatives and advises Commander, U.S. Fleet Forces Command (USFF) on support to Marine Corps forces assigned to U.S. Navy ships, bases, and installations; and conducts Service-directed operational tasks as required.



## U.S. MARINE CORPS FORCES, CYBERSPACE COMMAND

The Secretary of Defense recognized the significance of the cyberspace domain to national security, and directed the establishment of U.S. Cyber Command (USCYBERCOM) as a sub-unified command under U.S. Strategic Command (USSTRATCOM). USCYBERCOM's primary objective is to plan, coordinate, integrate, synchronize and conduct activities to: direct the operations and defense of specified Department of Defense information networks and; prepare to, and when directed, conduct full spectrum military cyberspace operations in order to enable actions in all domains, ensure US/Allied freedom of action in cyberspace and deny the same to the adversary. In response, the Marine Corps established Marine Forces Cyber Command (MARFORCYBER) in October 2009 (this was complemented by the establishment of the Navy's U.S. Fleet Cyber Command (FLTCYBER), Army Cyber Command (ARCYBER), and Air Force Cyber Command (AFCYBER). MARFORCYBER's mission is to conduct full spectrum Cyberspace Operations; to include operating and defending the Marine Corps Enterprise Network (MCEN), conducting Defensive Cyberspace Operations (DCO), and when directed, conducting Offensive Cyberspace Operations (OCO) in support of Joint and Coalition Forces in order to enable freedom of action across all warfighting domains, and deny the same to adversarial forces.



## U.S. MARINE CORPS FORCES, PACIFIC

U.S. Marine Corps Forces, Pacific (MARFORPAC) has three command roles and responsibilities. The command serves as U.S. Marine Corps components to U.S. Pacific Command (USPACOM), U.S. Marine Corps component to U.S. Forces Korea (USFK), and Fleet Marine Forces Commander to Pacific Fleet. In addition to its service component responsibilities, MARFORPAC could be tasked to act as a joint task force command element. With its headquarters located aboard Camp H. M. Smith, HI, MARFORPAC is the largest field command in the Marine Corps, having control of two-thirds of Marine Corps operational forces. Commander; MARFORPAC commands all U.S. Marine Corps forces assigned to USPACOM operating in a diverse geographic area stretching from Yuma, Arizona to Goa, India.



### U.S. MARINE CORPS FORCES RESERVE

Headquartered in New Orleans, LA U.S. Marine Corps Forces Reserve (MARFORRES) is responsible for providing trained units and qualified individuals for active-duty service in times of war, National emergency, or in support of contingency operations. Marine Corps force expansion is made possible by activation of the Marine Corps Reserve. As an operational reserve, MARFORRES provides personnel and operational tempo relief for active component forces during times of peace. Like the active component, MARFORRES is a combined-arms force with balanced ground, aviation, and logistics combat support units. MARFORRES capabilities are managed through MARFORCOM as part of its global force management responsibilities for the Commandant. Commander, MARFORRES is also Commander, Marine Forces Northern Command (MARFORNORTH) and serves as the Marine component of Northern Command (NORTHCOM).



### U.S. MARINE CORPS FORCES, SPECIAL OPERATIONS COMMAND

U.S. Marine Corps Forces, Special Operations Command (MARFORSOC) was formally established February 23, 2006 and is the Marine Corps component of U.S. Special Operations Command (USSOCOM). Headquartered at Camp Lejeune, NC, MARSOC trains, organizes, equips, and when directed by the Commander USSOCOM, deploys task organized, scalable and responsive Marine Corps special operation forces (SOF) worldwide in support of combatant commanders and other agencies. MARFORSOC includes three subordinate commands; the Marine Raider Regiment (MRR); the Marine Raider Support Group (MRSO); and the Marine Special Operations School (MSOS) located at Camp Lejeune, NC.



### MARINE CORPS INSTALLATIONS COMMAND

Marine Corps Installations Command (MCICOM) is the single authority for all installation matters. MCICOM consists of a headquarters and four subordinate commands: Marine Corps Installations Pacific, Marine Corps Installations West, Marine Corps Installations East, and Marine Corps Installations the National Capital Region. The forces assigned to MCICOM provide timely support to the Marines, Sailors and families from the operating forces and maintenance depots. MCICOM directly supports Marine Corps Operating Forces, individual Marines and family members. They are essential components in the foundation of national defense as they are the force projection platforms that support training, sustainment, mobilization, deployment, embarkation, redeployment, reconstitution, and force protection.



### MARINE CORPS LOGISTICS COMMAND

Headquartered in Albany, GA, Marine Corps Logistics Command (LOGCOM) provides worldwide, integrated logistics, supply chain, and distribution management; maintenance management; and strategic prepositioning capability in support of the operating forces and other supported units. The services and support provided by LOGCOM maximize supported unit readiness, synchronize distribution processes, and support Marine Corps enterprise and program-level total lifecycle management. LOGCOM is the Marine Corps Executive Agent for the tactical coordination, planning, and execution of ground equipment reset. LOGCOM manages the enterprise lifecycle maintenance program that resets designated ground weapon systems, and provides critical sustainment logistics support to Marine forces.



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## DEPARTMENT OF THE NAVY PERSONNEL COUNT

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**U.S. Navy Civilians:**  
(Full-time Equivalents)

**183,443**

**U.S. Marine Corps Civilians:**  
(Full-time Equivalents)

**20,523**

**U.S. Navy Active:**  
(Officers, Enlisted, and Midshipmen)

**324,557**

**U.S. Marine Corps Active:**  
(Officers and Enlisted)

**183,604**

**U.S. Navy Reserve:**  
(Drilling Reserve and Full-time Support)

**57,980**

**U.S. Marine Corps Reserve:**  
(Drilling Reserve and Full-time Support)

**38,453**

*Personnel Data as of Fiscal Year Ended September 30, 2016*



Sailors and Marines man the rails as an amphibious transport dock ship pulls into Hong Kong. (U.S. Navy photo by Petty Officer 3rd Class Patrick Dionne/Released)



2016



## AMERICA'S AWAY TEAM

(U.S. Navy photo by Mass Communication Specialist 3rd Class Holly L. Herline/Released)

### STRATEGIC MANAGEMENT

The DON is committed to constant improvement and innovation to perform the core capabilities that support the U.S. maritime strategy, “A Cooperative Strategy for 21st Century Seapower.” Updated since first being published in 2007, changes in the security and fiscal environments along with new strategic guidance, including the 2012 Defense Strategic Guidance and the 2014 Quadrennial Defense and Homeland Security Reviews, mandate an updated maritime strategy to ensure that we continue to advance our national interests.

The cooperative strategy was developed to be a unified and enduring approach applying maritime power to the crucial responsibility of protecting vital U.S. interests in an increasingly interconnected and uncertain world. It binds the three maritime services – U.S. Navy, U.S. Marine Corps, and U.S. Coast Guard (during wartime) – closer together in a mission to more fully safeguard maritime interests at home and abroad.

These core capabilities are critical to U.S. maritime power and reflect an increased emphasis on activities that prevent war and build partnerships. This maritime strategy reaffirms two foundational principles. First, U.S. forward naval presence is essential to

accomplishing the following naval missions derived from national guidance: defend the homeland, deter conflict, respond to crises, defeat aggression, protect the maritime commons, strengthen partnerships, and provide humanitarian assistance and disaster response. Second, naval forces are stronger when we operate jointly and together with allies and partners.

The following DON goals and objectives for FY 2016 and beyond focus on four key areas for the Department: People, Platforms, Power, and Partnerships. Success in these areas increases the effectiveness and efficiency of the entire Department, improves the lives of Sailors and Marines, and results in greater security for the United States. Tracking progress and monitoring change in these key areas will continue to provide real benefits to the nation’s strategic imperatives and preserve its ability to maintain presence, not just at the right time, but all the time. A summary of key accomplishments by objective begins below.

#### GOAL 1: People

Sailors and Marines are the sea services’ greatest advantage and most important asset. The Navy and Marine Corps have the best people in the world.



Sailors and Marines are well known for the ability to exercise independent judgment, flexibly to adapt to changing circumstances or environments that were unanticipated at the start of a deployment, but for which their training has fully prepared them. Providing the Sailors, Marines, and civilian workforce the resources to deal with the uncertainties they will certainly face and providing the support that they need to do their jobs is one of the DON's most important responsibilities. This also extends to helping their dedicated families and ensuring support of wounded or injured veterans.

### SUPPORT HEALTH AND QUALITY OF LIFE FOR MILITARY AND CIVILIANS

Improving healthy lifestyles of Sailors and Marines is a top priority for the DON as it enhances quality of life, improves resilience, and reduces long-term health care costs. The DON's Employee Assistance Program (EAP) is designed to help employees combat difficulties with stress, family, relationships, alcohol, work, or other issues which impact their quality of life. The Department of the Navy has partnered with the Department of Health and Human Services Federal Occupational Health to provide a new centralized EAP and work/life program for employees and their families. This program provides a wide range of services to employees and their families including short-term problem solving, crisis management, psychological first aide, grief groups, consultation, and education. Other resources available include childcare, eldercare, and legal and financial assistance.

In May, the Navy and Marine Corps Public Health Center recognized 443 Navy and Marine Corps organizations as recipients of the Navy Surgeon General's Health Promotion and Wellness Award, known as "the Blue H." The Blue H award, managed by the Navy and Marine Corps Public Health Center, encourages and rewards the promotion of primary prevention policies and activities in the DON workplaces, communities and medical treatment facilities, which are critical to maintaining a fit and ready force. Since its inception in 2007, the number of applicants for the Blue H award have increased every year; demonstrating the value placed on this workplace-level health promotion tool within the DON. Health topics covered by Blue H criteria include alcohol abuse prevention, injury and violence-free living, nutrition, physical activity, psychological

health, sexual health, tobacco cessation and weight management.

### PRESERVE THE ACQUISITION WORKFORCE

The DON's Acquisition Workforce (AWF) is responsible for translating military requirements into material solutions through designing, building, sustaining, modernizing, and maintaining complex ships, aircraft, and vehicles with associated equipment, combat systems, weapons, and ordnance to support Sailors and Marines 24/7 anywhere around the globe. The FY 2016-2022 DON AWF Strategic Plan establishes a strategic vision for a right-sized, high-performing, and agile workforce. It emphasizes that the AWF cannot focus solely on today's acquisitions, but must also plan for the future, and must understand related threats, challenges, and technology.

The AWF profile focuses on three key components:

- **Composition** – the size of the AWF along several dimensions (command, career field, career level, education level),
- **Qualifications** – three key metrics assess whether the workforce has the foundational education, training, and experience to be successful (career field certification, continuous learning achievement, and acquisition corps membership), and
- **Size vs. Requirement** – the size of the AWF is compared to funded AWF requirements to quantify staffing sufficiency. This metric is provided by command, by career field, and for the DON AWF overall.

This Strategic Plan sets a course to deliver an improved, forward thinking workforce that is well-managed, highly trained, and fully qualified. Significant efforts are underway to realize the vision of world class acquisition professionals for today and tomorrow that are Energized, Focused, Responsible, and Accountable.

### ORGANIZE, TRAIN, EQUIP, AND MAINTAIN RESILIENT COMBAT-READY FORCES

Each September, Suicide Prevention Month serves as an extended launch for sustainable and tailored local engagement throughout the upcoming fiscal year. Through its Every Sailor, Every Day campaign, the



Navy Suicide Prevention Branch provides tools and resources designed to empower behavioral change by engaging Sailors and their families with strategies to build resilience, navigate stress, recognize risk, seek help and intervene early. The campaign continues to encourage ways to build strong relationships and communities by remaining actively engaged with others, focusing on individual self-care practices and coping skills, and supporting societal prevention and intervention strategies.

Preventing and limiting the effects of operational stress on Sailors is a top priority for the U.S. Navy, a priority being met through the Operational Stress Control (OSC) Program. The program seeks to help create an environment where Sailors, commands, and their families are able to thrive during stressful operations. It aims to teach Sailors that asking for help and guidance for stress issues is not a sign of weakness, but is instead a sign of strength. It accomplishes this mission by educating Sailors, families, and command leaders to take care of themselves by remaining fit and healthy, to look after one another, and to take action if they see others reacting negatively to stress. The Navy's OSC

Program Instruction (OPNAVINST 6520.1), details policy, guidelines, procedures, and responsibilities to standardize the program across the Navy. It promotes an understanding of stress, awareness of support resources, and provides practical stress navigation tools to help build resilience of Sailors, families, and commands.

### CORRECTLY SIZE AND DEPLOY THE NAVAL SERVICES TO MEET OPERATIONAL DEMANDS AND REBALANCE THE FORCE

To provide Sailors, Marines, and their families with more stability and predictability, the Optimized Fleet Response Plan (OFRP) was developed. OFRP is designed to ready the fleet to fight and win, delivering rotational forces for routine deployments, surging forces in times of war or significant crisis, while enabling maintenance & modernization to achieve the planned service lives of our platforms. OFRP balances fiscal realities and Combatant Commanders requests, while enhancing stability and predictability, and improving quality of life for our Sailors. Entering its third year since implementation, OFRP is beginning to fully demonstrate its advantages to the Fleet. The USS EISENHOWER Carrier Strike Group and USS MAKIN ISLAND Expeditionary Strike Group will be first to deploy later this year entirely under the OFRP. Our men and women know there is no way to completely eliminate the unexpected, because events around the world can and do take on a life of their own. However, increasing the predictability of deployments will help improve resilience in our Sailors, Marines, and their families. It also has the added benefit of helping the DON properly support its maintenance requirements and readiness posture.

The Navy announced in September several key changes to the projected 28-ship littoral combat ship (LCS) class over the next five years that will simplify crewing, stabilize testing, and increase overseas deployment availability. To facilitate these changes across the class, LCS ships will form into six divisions with three divisions on each coast. Each division will have a single warfare focus and will consist of three Blue/Gold-crewed ships that deploy overseas and one single-crewed training ship. Under this construct, each division's training ship will remain available locally to certify crews preparing to deploy. The Blue/Gold model will simplify ownership of maintenance responsibilities and enhance continuity as the same two crews rotate

Camp Pendleton 2nd annual Suicide Awareness and Prevention Walk 2016. (U.S. Marine Corps photo by Sgt. Abbey Perria/Released)



on a single ship. Single-crewed training ships will complement shore-based training facilities and ensure crews have enough time at sea before deployment.

### ADVOCATE AND REMOVE BARRIERS TO PROMOTE GENDER-NEUTRAL COMBAT FORCE

The Secretary of Defense announced beginning in January 2016, all military occupations and positions will be open to women, without exception. The Navy will have no closed occupations, very limited number of closed positions, and equal professional opportunity for females in every officer designator and enlisted rating in the Navy. This will allow military services to better harness the skills and perspectives that talented women have to offer. Previously, about 10 percent of military positions had remained closed to women. These included infantry, armor, reconnaissance, and some special operations units. Over the past three years, senior civilian and military leaders across the services have studied the integration of women into these positions and found that no positions warranted a continued exemption from being opened to women. The Navy supports integrating women into newly opened positions and units as expeditiously as possible, considering good order and judicious use of fiscal resources. The Navy's deliberate approach to reducing gender-based barriers to women's service will provide the time necessary to integrate women into occupational fields so they can succeed and flourish. As the full integration of women into all military positions gradually takes place, there will be some challenges to overcome, both domestically and internationally. But, overall, the process will only make the U.S. armed forces better and stronger in the long run.

An example of removing barriers is the Navy's continued initiative to integrate female enlisted and officers onboard submarines. Female officers have successfully been integrated on a small scale and enlisted Sailors are being selected and trained for service onboard female officer-integrated ballistic missile submarines (SSBNs) and SSGNs. Additional crews will continue to be added roughly over a five-year period through 2021. This plan minimizes operational impacts, and provides optimal flexibility, equity, and timeliness at reasonable cost. These steps are just the beginning of a longer-term plan to integrate the submarine force and provide opportunities for women in the Navy to serve in all types of

Families run out to greet their returning loved ones following a seven-month deployment. (U.S. Navy photo by Mass Communication Specialist 2nd Class Stephanie Smith/Released)



The first female enlisted Sailor to earn the "dolphins" (U.S. Navy photo by my Chief Mass Communication Specialist Kenneth G. Takada/Released)





submarines in support of all missions in the undersea warfare domain.

### PROMOTE AND ENFORCE A CULTURE FREE OF SEXUAL ASSAULT

The DON's Sexual Assault Prevention & Response (SAPR) program is committed to end sexual assault through education, response, advocacy, and adjudication. While sexual assault is on the decline, the SAPR's mission will be considered a success when this crime is eliminated. Admiral John M. Richardson, the CNO, has initiatives in place to help put an end to sexual assault such as the implementation of interactive bystander training and utilizing technology to eliminate the social barriers associated with assault reporting and victim counselling. The quantity and quality of prevention programs continued to grow during Fiscal Year (FY) 2016 with in-person training provided across the globe and the expansion of online resources. The DON sponsored "Pure Praxis," an interactive social theater group that provided bystander intervention and survivor retaliation to over 45,000 Sailors and Marines. This training targets those

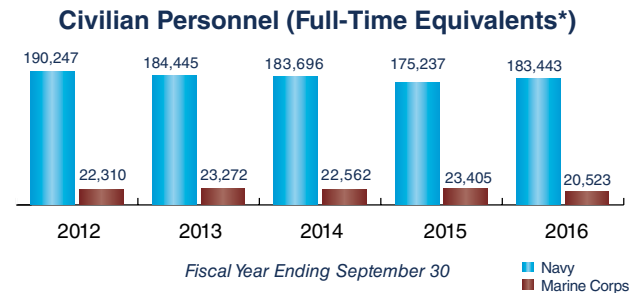
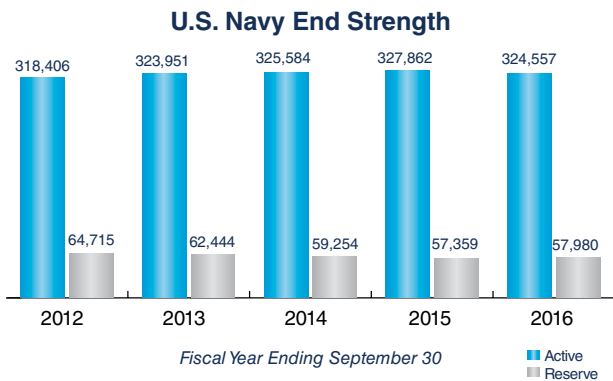
most susceptible to perpetration and victimization, demonstrates positive bystander intervention behaviors, and promotes the prevention of social retaliation against sexual assault survivors. Over 50,000 Sailors and Marines, across 220 venues, received similar training through the InterACT Bystander Intervention Training Program. The goal for both of these programs is to provide the necessary skills to intervene in volatile situations that could lead to sexual assault.

### U.S. Navy

The Navy continues to resize and reshape its forces to meet its mission requirements more efficiently and effectively. This is especially important in an environment of limited budgetary resources and rising personnel costs. Over the last five years, the Navy has resized its active and reserve components by 2% and -10%, respectively. The Navy has been able to accomplish all assigned missions at this level because of force structure changes, efficiencies gained through technology, modifications in workforce mix, and new manning practices.



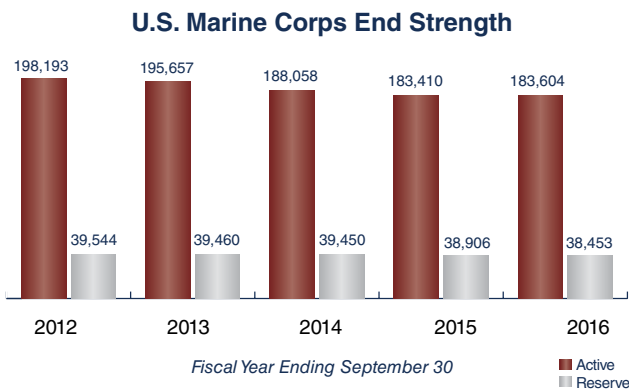
USS Chancellorsville Sexual Assault Prevention (SAPR) Month. (U.S. Navy photo by Fire Controlman 2nd Class Monica Strickler/Released)



\*Full-time equivalents are the total number of regular straight-time hours (i.e., not including overtime or holiday hours) worked by employees divided by the number of compensable hours applicable to each fiscal year.

## U.S. Marine Corps

The Marines Corps continues to provide a balanced force adequately postured for future National Security Strategy requirements. The Marine Corps ready and capable force structure will provide a strategically mobile, middleweight force optimized for rapid crisis response and forward-presence. Over the last five years, the Marine Corps have resized its active and reserve components by -7% and -3%, respectively.



## Navy and Marine Corps Civilian Personnel

The size of the civilian workforce, which has decreased by 3.6% and 8.0% for the Navy and Marine Corps, respectively, over the last five fiscal years, continues to support the mission and daily functions of the Navy and Marine Corps. Civilian personnel provide various types of support, such as research and development, engineering, acquisition, depot maintenance, and financial management and budget.

## GOAL 2: Platforms

Presence requires platforms for our Sailors and Marines to successfully complete their missions. Ensuring the DON has the right number and composition of vessels to have an adequate presence enables the DON to uphold national security. Despite decreasing defense budgets, a variety of different platforms (surface ships, submarines, aviation, and technological interfaces) must be maintained to support the needs of the nation. The commitment to have a properly sized Fleet and the proper platforms is a high priority for the DON, in addition to focusing on unmanned systems, cyber security, and financial management; this helps the DON ensure its ability to execute its mission in a more effective and efficient manner.

## SHIPS AND AIRCRAFT

The DON has several shipbuilding efforts currently in progress. Given the need for naval power presence across the globe, there is an impetus to have as many ships forward deployed as possible. Striking a balance between deploying ships to meet operational demands and keeping them in port to perform needed maintenance and provide relief to Sailors is a constant challenge.

During FY 2016, the DON took delivery of the USS Zumwalt, the lead ship of a class of next-generation multi-mission surface combatants tailored for land attack and littoral dominance with capabilities to defeat current and projected threats. The USS Zumwalt will triple naval surface fire coverage, add an improved SONAR system to track deep and shallow water threats, as well as pace current anti-ship cruise missile threats. For today's warfighter, the USS Zumwalt fills an immediate and critical naval warfare gap. The multi-



USS Zumwalt (DDG 1000). (U.S. Navy/Released)



mission ship is tailored for sustained operations in the littorals and land attack, and will provide independent forward presence and deterrence, support special operations forces, and operate as an integral part of joint and combined expeditionary forces. Its multi-mission design and littoral capabilities make it a 100 percent globally deployable asset to the Fleet. The USS Zumwalt was commissioned in October 2016.

The replacement of Ohio-class submarines with a new class of SSBN, is a top priority for the DON. This replacement effort will look to recapitalize the

Osprey with 3-D printed titanium link. (U.S. Navy photo/Released)



nation's sea-based strategic deterrent in a cost-effective manner. The current SSBN fleet and the future 12 Ohio replacement class SSBNs support our nation's deterrent mission by ensuring survivability. It is often understated what a major role the stealth and the size of the SSBN force play in our sea-based deterrent survivability. With a large enough SSBN force, adversary planning becomes complicated, operations are less predictable, and operational intervals (time between underway and return to port events) can be varied as well as the nature of at-sea patrols. This replacement effort is an essential investment for our nation and will continue to be a national imperative ensuring stability and security for our country and our allies.

The DON is continuing to strengthen its Naval Aviation force through the re-capitalization of every major aviation platform. NAVAIR recently marked its first successful flight demonstration of a flight critical aircraft component built using additive manufacturing techniques. An MV-22B Osprey aircraft completed a test flight outfitted with a titanium, 3-D printed link and fitting assembly for the engine nacelle. This link and fitting assembly is one of four that secure a V-22's engine nacelle to the primary wing structure and will remain on the aircraft for continued evaluation. Additive manufacturing uses digital 3-D design data to build components in layers of metal, plastic, and other materials. Naval Aviation has employed additive manufacturing as a prototyping tool since the early 1990s and in recent years has begun the process of printing non-flight critical parts and tools. Navy officials envision a future where all parts can be made on-demand globally by fleet maintainers and operators, and our industry partners, stocking digital data instead of ordering, stocking and shipping parts. Even with the success of the flight, more work is needed before deployed aircraft are flying with 3-D printed, safety-critical parts.

## UNMANNED SYSTEMS

The Department of the Navy officially established the Unmanned Warfare Systems Division (N99) as part of the OPNAV staff. This division is a reflection of the priority the DON is placing on this emerging capability, and how critical it is that there is centralized leadership for these unmanned programs. N99 is responsible for developing and accelerating unmanned systems into the Navy's warfighting capabilities as well

as assessing integration of unmanned systems within the Navy. Through this new approach, resources are optimized and technical risk is reduced, saving time and money.

The USS Carl Vinson (CVN 70) marked a historical milestone this year after installing the first unmanned aerial vehicle (UAV) command center aboard an aircraft carrier. While, the completion of all phases of installation isn't scheduled until 2022, the MQ-XX program will deliver a high-endurance unmanned aircraft that will replace today's F/A-18E/F aircraft in its role as the aerial tanker for the Navy's carrier air wing, preserving the strike fighter's flight hours for its primary mission. It will also leverage the range and payload capacity of high-endurance unmanned aircraft to provide critically needed support.

## CYBER SECURITY

As the cyber security risks around the world increase, we are seeing threats related to the control of machines—from large systems like electric power grids and industrial plants, to transportation assets like cars, trains, planes or even ships at sea. In response, the U.S. Navy is developing the Resilient Hull, Mechanical, and Electrical Security (RHIMES) system, a cyber protection system designed to make its shipboard mechanical and electrical control systems resilient to cyber attacks. This technology is designed to prevent an attacker from disabling or taking control of programmable logic controllers—the hardware components that interface with physical systems on the ship. Traditionally, computer security systems protect against previously identified malicious code. When new threats appear, security firms have to update their databases and issue new signatures. Because security companies react to the appearance of new threats, they are always one step behind. A hacker can make small changes to their virus to avoid being detected by a signature. Instead, RHIMES relies on advanced cyber resiliency techniques to introduce diversity and stop entire classes of attacks at once. This technology will help the Navy protect its shipboard physical systems, but will also have important applications to protecting our nation's physical infrastructure.

## THE DON FINANCIAL IMPROVEMENT AND AUDIT READINESS PROGRAM

The DON Financial Improvement and Audit Readiness (FIAR) Program and the Marine Corps Financial

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

Our FIAR efforts align with the new priorities and associated strategy established by the Under Secretary of Defense (Comptroller) for bringing DoD into a state of financial audit readiness and in compliance with the Chief Financial Officers Act of 1990 (as amended). These priorities focus on improving processes, controls, and systems that support information most often used and relied upon by both civilian and military leaders in daily business operations—budgetary information, as reported on the Statement of Budgetary Resources (SBR), and mission critical asset information, such as general property, plant, and equipment and real property, as reported on the Balance Sheet. These priorities demonstrate the value of these financial statements to our daily business operations, particularly for funds control and resource utilization.

In FY 2016, the Navy, along with an Independent Public Accounting (IPA) firm continued its audit journey with the FY 2016 SBA audit. This audit expanded the SBA audit scope to include an additional year's appropriations (i.e., FY 2016 and FY 2015 appropriations). Regardless of the outcome, the FY 2016 SBA audit has brought the Navy many benefits.

Undergoing an audit, allows the Navy to focus on improving business discipline and the quality of financial information. Continuous auditor scrutiny provides valuable insight for further improvement and helps the Navy measure progress. It also increases efficiency by improving the Navy's ability to support auditor requests. As Secretary of Defense Carter has made clear, the American taxpayer and our men and women in uniform deserve nothing less than accurate financial information and auditable annual financial statements. The Navy remains committed to the goal of undergoing a full financial statement audit in FY 2018.

To support full financial statement audit readiness, the Navy is building beginning balances through assessments of Balance Sheet lines and Statement of Budgetary Resources lines. In January 2016, the Navy began internal assessment testing of material lines to identify deficiencies and root causes and implement corrective actions for an FY 2017 beginning balance audit of the Balance Sheet and Statement of Budgetary Resources. The internal assessment testing concluded with baselining corrective actions on a series of foundational building blocks. Navy is working diligently to implement these building blocks to support a first year beginning balance audit in FY 2017.

During FY 2016, the DoDIG engaged an IPA to initiate an audit of the Marine Corps FY 2017 General Fund financial statements and required notes and disclosures. Similar to previous efforts, such as the audits of the Statement of Budgetary Resources and the SBA, the Marine Corps is leading the way for the Department of Defense on a multi-year mission to achieve U.S. generally accepted accounting principles (USGAAP) compliance. This mission has not been easy and will continue to be challenging. The Marine Corps anticipates multiple audit findings from the audit of the FY 2017 financial statements. Achieving full financial statement auditability is a tremendous undertaking and success requires patience and consistent focus on corrective actions.

The Marine Corps will initially measure itself not by the opinion received, but by the reduction in number of corrective actions from year to year, the velocity of corrective action remediation, improved execution of funds, and improved property accountability and utilization in support of the Warfighter.

### GOAL 3: Power

Energy is necessary for all that the Navy and Marine Corps does. It powers our platforms and enables us to be where it matters, when it matters. In order to provide this global presence, we must have reliable and diverse sources of energy. Innovations in power sources improve our security and make us a more efficient fighting force.

As the DON separates itself from petroleum dependency, it strengthens the strategic position of our country and the tactical performance of our forces. The global supply of oil is finite and it is becoming increasingly difficult to find and exploit. For the past several years, the DON has been engaged in an aggressive approach to meet the energy goals established by the SECNAV;

- (1) Energy Efficient Acquisition,
- (2) Sailing of the “Great Green Fleet,”
- (3) Reduce Non-Tactical Petroleum Use,
- (4) Increase Alternative Energy Ashore, and
- (5) Increase Alternative Energy Use DON-Wide.

Work continues on these goals to ensure global energy security, promote environmental change initiatives, and discover more alternative energy sources. The DON energy goals continue to be a top priority as they contribute towards providing the global presence necessary to ensure stability, deter potential adversaries, and present options in times of crisis.

### SAIL THE GREAT GREEN FLEET



The DON kicked off the Great Green Fleet during FY 2016 with the deployment of the USS John C. Stennis Carrier Strike Group (JCS CSG). The Great Green Fleet is a year-long DON initiative that demonstrates the sea service's efforts to transform its energy use. As one of the SECNAV's key energy goals, the purpose of the Great Green Fleet is to make Sailors and Marines better warfighters, able to go farther, stay longer, and deliver more firepower. The centerpiece of the Great Green Fleet is the JCS CSG that deploys on alternative fuels, including nuclear power for the carrier and a blend of advanced biofuel made from beef fat and traditional petroleum for its escort ships.



These biofuels have been procured by DON at prices that are on par with conventional fuels, as required by law, and are certified as “drop-in” replacements that require no engine modifications or changes to operational procedures. The JCS CSG also uses energy efficient technologies and operating procedures during the course of its normal operations. The Navy’s use of renewable energy in the Great Green Fleet represents its ability to deploy using diverse sources of energy, and also the nation’s ability to take what would be a waste product and create homegrown, clean, advanced biofuels to support a variety of transportation needs.

### INCREASE ALTERNATIVE ENERGY SOURCES

The Renewable Energy Program Office (REPO) led energy efficient acquisitions to achieve the DON’s goal of producing one gigawatt (GW) of renewable energy generation capacity by the end of 2015—an important milestone towards meeting the Navy’s overall goal of 50 percent of total energy consumption coming from alternative sources by 2020. The SECNAV established REPO to oversee efforts across the DON in support of this energy goal. The DON considers all sources of renewable energy, such as energy produced from sunlight, wind, biomass, landfill gas, oceans, geothermal, municipal solid waste, and new hydroelectric generation capacity. While the construction and deployment of renewable energy benefits the environment, the motivation for the renewable energy strategy is primarily to enhance energy security and better support warfighters.

The DON continues to search for new solar energy programs while maintaining existing initiatives. With the goal to produce one GW of renewable energy generation capacity achieved, the Department continues to be on pace to have 25% of total DoD facility energy from renewable sources by 2025. These renewable energy generation projects improve energy security, strategic flexibility, and resource availability. In 2015, the DON and Georgia Power Company broke ground on a large-scale solar facility at Naval Submarine Base Kings Bay. Work continues on standing up the approximately 136,000 solar photovoltaic panels to be installed on 258 acres which will generate up to 42 megawatts (MW) of direct current power when fully operational. This new source of solar energy will help meet future energy needs of our customers, and improve both reliably and affordably. Diversifying power generation enables

Gulfport solar ground breaking. (U.S. Navy photo by Sue Brink/Released)



the area to remain operational regardless of grid disturbance and promotes the ability to maintain operational readiness.

The DON also just broke ground on a large-scale solar facility at Naval Construction Battalion Center (NCBC) Gulfport in March 2016. The facility will have roughly 13,000 panels, providing enough electricity to supply the equivalent of 450 homes. To be installed on 23 acres of base land, the facility will generate up to four megawatts of direct current power once operational. This is one of three utility-scale solar projects that have been approved by the Mississippi Public Service Commission. Partnerships, like the one between Mississippi Power and the Department of the Navy, make us stronger, enabling us to better serve and complete our mission, and make all of our bases more resilient and secure.

### INCREASE ENERGY INNOVATION

In addition to procuring renewable energy, the DON is also taking advantage of new construction and renovation projects to incorporate more energy-efficient designs, materials, and equipment into buildings. These changes reduce operating expenses, improve employee productivity, and have a smaller environmental footprint.

The DON recently completed flight testing of the EA-18G “Green Growler” with a 100-percent advanced biofuel. The flight is one more step for the

Department in incorporating alternative fuel into operational supplies to increase mission capability and flexibility. The process used to produce this fully synthetic fuel does not need to be blended in with the petroleum based JP-5 fuel; as that requires the biofuel manufacturer to blend its biofuel with a petroleum-based JP-5, which requires more time, additional facilities, and higher costs. The DON is collaborating with several commercial activities such as the American Society for Testing and Materials and the Commercial Aviation Alternative Fuels Initiative, which seeks to enhance energy security and environmental sustainability for aviation through jet fuel produced from alternatives to petroleum. These strides in finding alternative fuel sources, demonstrates the DON's continued commitment to staying in the forefront of energy innovation.

During 2016, the Marine Corps Expeditionary Energy Office (E2O) was recognized for innovation in energy technology and leadership from the 2016 Business Intelligence Group (BIG) Innovation Awards and the 2016 Edison Awards. These awards acknowledge the major impact and accomplishment of the E2O led effort to create the Joint Infantry Company Prototype (JIC-P). The JIC-P technology features an electricity generating backpack and a device worn over the knees that generates power as a person walks. Integrating these energy harvesting technologies into a personal power system significantly increases the warfighters' ability to generate, manage, and store their own electricity to power common electronics and gear such as radios, night-vision goggles, global positioning

system, laptops, and other equipment. This technology can allow Marines to operate farther, longer, and lighter with less spare batteries and logistical re-supply. Integrated energy harvesting and water purification capabilities have the potential to dramatically reduce that personal risk in austere locations and on the battlefield.

In order to continue breaking new ground in alternative energy, the DON and the ONR have launched the Naval Enterprise Partnership Teaming with Universities for National Excellence initiative, or NEPTUNE. This initiative increases educational opportunities for the military community and bolsters science, technology, engineering, and mathematics (STEM) outreach. NEPTUNE is a two-year pilot program providing funding to four universities, the U.S. Naval Academy and the Naval Postgraduate School. Its goals are to help the Navy and Marine Corps discover ways to improve energy conservation, generate renewable energy, and implement energy-efficient technologies—while giving active-duty military, military students, and veterans the chance to immerse themselves in university-level research. NEPTUNE aligns with the vision of the SECNAV, who has made it a top priority to change the way the DON uses, produces, and acquires energy. Two schools are already set to receive funding from the program. By working to improve STEM education, the DON is inspiring a new generation of scientists and engineers to consider careers and professional opportunities in support of the Navy and Marine Corps.

Growler with alternative biofuel. (U.S. Navy photo by Adam Skoczylas/Released)



## GOAL 4: Partnerships

Establishing effective partnerships is essential to fostering and sustaining cooperative relationships that are critical to ensuring global security. These relationships are designed to broaden responsibility for security, diffuse tensions, reduce misunderstanding, and limit conflict. This assures that our forces can provide the necessary presence to maintain freedom of navigation and maritime security around the world.

### BUILD AND STRENGTHEN PARTNERSHIP CAPACITY AND KEY ALLIANCES

This past June, Sailors and Marines aboard the amphibious assault ship USS America (LHA 6) arrived in Pearl Harbor, Hawaii in preparation for the Rim of the Pacific 2016 Exercise (RIMPAC). This is the world's largest international maritime exercise, and provides a unique training opportunity that helps participants understand the importance of strengthening ties with our partners throughout the globe. Twenty-six nations, more than 40 ships and submarines, more than 200 aircraft, and 25,000 personnel participated. This is the 25th exercise of RIMPAC since the series began in 1971. During this exercise, America served as the command and control platform for the amphibious task force, which conducted several training activities in the Hawaiian Islands and Southern California. These training opportunities were very important for the future of the Navy and Marine Corps team, and also for sustaining strong international relationships in wartime and peacetime environments. The strategic impact of this exercise is immeasurable as Sailors and Marines learned more about the benefits of operating and growing with foreign partners.

In May, Maritime forces from Europe, North Africa, and the United States began the tenth iteration of the multinational maritime exercise Phoenix Express 2016. This collaboration is designed to improve regional cooperation, increase maritime domain awareness, information-sharing practices, and operational capabilities to enhance efforts to achieve safety and security in the Mediterranean Sea. It is part of a comprehensive strategy to provide collaborative opportunities amongst African forces and international partners that addresses maritime security concerns. Phoenix Express is sponsored by U.S. Africa Command (AFRICOM) and facilitated by U.S. Naval Forces Europe-Africa/U.S. 6th Fleet. Fourteen naval officers

Rim of the Pacific (RIMPAC). (U.S. Navy photo by Mass Communication Specialist 2nd Class Ryan J. Batchelder/Released)



Closing ceremonies at Phoenix Express. (U.S. Navy photo by Mass Communication Specialist 2nd Class Justin Stumberg/Released)



from nine different countries formed a Combined Maritime Operations Center to manage the at-sea operations portion of the exercises. These exercises helped build communication techniques between the different nations' navies; enforcing the need to cooperate in a joint environment where no one nation has singular authority. Participating nations in Phoenix Express include Algeria, Egypt, Greece, Italy, Malta, Mauritania, Morocco, Spain, Tunisia, Turkey, and the United States.

### IMPLEMENT THE DON INNOVATION VISION AND TRANSFORMATION INITIATIVES

The Navy and Marine Corps have always been at the cutting edge of technology. Constant innovation



has enabled our Sailors and Marines to be the most formidable expeditionary force in the world and to keep ahead of the accelerating global rate of change. The SECNAV created the DON Innovation Vision and Transformation Initiatives to provide opportunities for fostering and capturing new ideas to improve the way we accomplish our missions.

SECNAV Innovation Action Memos are the primary means of implementing the DON Innovation Vision. The memos direct coordinated and bold action on key future enablers, programs, and technologies or concepts (for example, 3-D printing, robotics, unmanned systems, virtual environments, and modernizing the civilian hiring process). Each SECNAV Innovation Action Memo aligns directly with one or more of the five elements in the DON Innovation Vision.

- (1) Build the Naval Innovation Network,
- (2) Manage the Talent of the DON Workforce,
- (3) Transform How the DON Uses Information,
- (4) Accelerate New Capabilities to the Fleet, and
- (5) Develop Game-Changing Warfighting Concepts.

The DON recognizes top talented Sailors, Marines and civilians who are continually creating innovative solutions for complex problems in the fleet through the SECNAV's Innovation Awards Program. Not all innovation must come through advanced technological breakthroughs. In February, the commanding officer of the USS Preble (DDG 88) was recognized as the winner of 2015's SECNAV Innovation Awards

USS Preble (DDG 88). (U.S. Navy Photo by Mass Communication Specialist 1st Class Phillip Pavlovich/Released)



Program's innovation leadership category. Since taking command in December 2014, he and his crew have developed more than 54 innovative concepts directly resulting in his winning of this Award. One idea developed and implemented on board the ship was an innovative lunch event called the "Mess Decks Mash Up," designed to improve crew morale during long deployments. This simple but innovative idea brought together shipmates who otherwise would not interact with each other.

## INCREASE COST EFFECTIVENESS THROUGH ENHANCED COMPETITION

Increasing cost effectiveness through enhanced competition is achieved through the following principles:

- Stable requirements and plans at the program level,
- Open architectures, early prototyping, and spiral development,
- Effective use of incentives and fixed price contracts, and
- Competitive and small business opportunities

The Navy continues to consider and, when appropriate, use innovative acquisition strategies that assure ship construction workload and sustain the vendor base while imposing cost competition. We are investing in design for affordability, modularity, and open systems architectures while incentivizing optimal build plans, shipyard facility improvements, and supporting shipbuilding capability preservation agreements. These initiatives support affordability, minimize life-cycle costs, improve and ensure quality products, facilitate effective and efficient processes, and promote competition.

One non-shipbuilding procurement program to show innovation this year was the Defense Healthcare Management System Modernization (DHMSM) program office for the acquisition of electronic health record (EHR) solutions. It was recognized by the National Contract Management Association with the Innovation in Contracting Award for implementing a performance-based licensing structure. The performance-based approach simplifies the administrative burden on the government so

that as EHR is deployed, there is no need to track and purchase additional licenses. As the solution is deployed to DoD hospitals and clinics, the contractor is awarded a task order that acquires the next corresponding increment, proposed by the contractor, of the enterprise license on a fixed-price basis. By the end deployment, the government owns a perpetual enterprise-wide license that covers the use of the EHR for all DoD users regardless of user count or user location. This unique approach allows DoD clinicians to focus on caring for service members and their beneficiaries and not about which license applies to which user, computer, location, facility or device.

### FOSTER AN INNOVATIVE CULTURE THAT ADVANCES DIVERSITY AND INCLUSION IN THE WORKFORCE

Our military forces are the most powerful in the world today, showing that a more diverse force is a stronger force. Continuing to recruit, train, and develop a force from all of America's talent means that the Navy and

Marine Corps team is a force representative of the nation they defend. Inclusion of all Americans gives us a diversity of background and diversity of thought so that we're a more effective fighting force.

In February, the SECNAV issued an updated Department of the Navy Diversity and Inclusion Policy statement and met with several key military service organizations, veterans service organizations, and stakeholders at the Pentagon to discuss the topic. The meeting was the first in a planned series of engagements during which the SECNAV will discuss Navy and Marine Corps issues with leaders in the civilian and military communities. The DON last updated its Diversity and Inclusion Policy statement in 2010, and since then, the Department of Defense has made significant personnel policy changes including the repeal of "Don't Ask, Don't Tell," and rescinding the direct ground combat exclusion policy, which now allows women to serve in military occupational specialties that were previously closed to them.

## SYSTEMS, CONTROLS AND LEGAL COMPLIANCE

The DON Commanders, senior leaders, and managers are obligated to safeguard the integrity of their respective programs and operations. Adherence to Federal Financial Management Improvement Act (FFMIA) and the Federal Managers' Financial Integrity Act (FMFIA) enforces the statutory requirements to comply with internal controls that address financial reporting, financial systems, and non-financial operations. Statutory requirements support the production of timely, reliable, and accessible financial information, which facilitate the development and implementation of effective and efficient internal controls. Quantifiable financial information in conjunction with sufficient controls create efficiencies to standardize processes and ultimately preserves the DON's limited resources, which is critical to the Department's commitment to national defense and public stewardship.

Included in this section are internal control elements encompassed in the DON's annual Statement of Assurance (SOA), which provides management's FMFIA and FFMIA assessment on the current state of internal control. The DON's overview of internal controls over non-financial operations, financial

reporting, and financial systems is described within the enclosed sections.

### MANAGEMENT ASSURANCES

The objectives of the system of internal controls of the DON are to provide reasonable assurance of:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting;
- Compliance with applicable laws and regulations; and
- Financial information systems are compliant with the FFMIA (Public Law 104-208).

### INTERNAL CONTROL OVER NON-FINANCIAL OPERATIONS

The DON's Managers' Internal Control Program (MICP) is the administrative vehicle for monitoring Internal Control over Non-financial Operations. To mitigate fraud, waste, and misuse of DON resources, the evaluation and execution of effective and efficient internal control extends to internal stakeholders and external shared service providers.

Responsibility for program execution and reporting resides within a network of 17 Major Assessable Units (MAU), which includes the Assistant Secretaries of the Navy, the Chief of Naval Operations, the Commandant of the Marine Corps, Secretariat Staff Offices, and other entities that report directly to the SECNAV or Under Secretary of the Navy.

This year, the DON built upon the MICP governance structure to align with the FMFIA and the Office of Management and Budget (OMB) Circular No. A-123 requirements. The governance structure includes a Senior Management Council (SMC) and Senior Assessment Team (SAT). The SMC oversees the DON MICP and advises the SECNAV and Assistant Secretary of the Navy (Financial Management and Comptroller (ASN (FM&C)) on program implementation, effectiveness, and reporting.

The DON MICP provides the required framework and guidance for MAUs to effectively implement a system of internal controls, complete assessments, and provide accurate and timely reporting. The MAUs identify the organizational objectives and the business processes used to achieve their mission. They identify the risk inherent in these business processes and the controls in effect to mitigate them. The MAUs perform control assessments to determine conditions that may significantly affect the DON's missions and objectives, and communicate their level of assurance via the certification statement. Certification statements

are used as the primary source documents for the SECNAV's determination of reasonable assurance over the effectiveness of the DON's non-financial operations and processes.

To complement the MAU self-reporting, the SMC periodically directs assessments to determine whether identified operational control deficiencies are pervasive across the DON. These assessments are the result of combined efforts of the DON MICP, Naval Audit Service (NAVAUDSVC), and Naval Inspector General (NAVINSGEN), which perform the quarterly control environment analysis. This analysis summarizes deficiencies identified in audit reports from the Government Accountability Office (GAO), Department of Defense Inspector General (DoDIG), and NAVAUDSVC. The findings and trends from these analyses are briefed quarterly to the SMC by the Deputy Assistant Secretary of the Navy for Financial Operations (DASN FO) and the Auditor General.

In FY 2016, we identified seven ICONO material weaknesses in the following internal control reporting categories: (1) acquisition, (2) communications/intelligence/security, (3) contract administration/procurement, (4) comptroller and resource management, (5) manufacturing, maintenance, and repair, and (6) personnel and organizational management. The following table lists the material weaknesses:

### FY 2016 Outstanding Material Weaknesses

| INTERNAL CONTROL REPORTING CATEGORY     | MATERIAL WEAKNESS                                                 | TARGET CORRECTION YEAR |
|-----------------------------------------|-------------------------------------------------------------------|------------------------|
| Acquisition                             | Attenuating Hazardous Noise in Acquisition & Weapon System Design | FY 2017                |
| Communications/Intelligence/Security    | Personally Identifiable Information (PII)                         | FY 2017                |
| Contract Administration/Procurement     | Contract Management – Service Contracts                           | FY 2017                |
| Contract Administration/Procurement     | Execution of Husbanding Contracts – Husbanding Service Providers  | FY 2017                |
| Comptroller and Resource Management     | DON Oversight and Management of Improper Payments                 | FY 2017                |
| Manufacturing, Maintenance, and Repair  | Depot Level Maintenance                                           | FY 2018                |
| Personnel and Organizational Management | Military Pay and Personnel                                        | FY 2021                |

In addition to ICONO assessments described above, the DON MICP encompasses Internal Control over Financial Reporting (ICOFR) and Internal Controls

over Financial Systems (ICOFS) into the department's annual SOA to support the Office of the Secretary of Defense (OSD) report to Congress and the President.



## INTERNAL CONTROL OVER FINANCIAL REPORTING

The DON continues to build upon prior year progress in improving ICOFR. The DON maintains focus on its audit objectives and understands that a robust internal control program is key to success and sustainability in an audit environment. The DON has made internal controls a cornerstone of its audit readiness program and a key input to its many audit related initiatives.

The DON is executing its beginning balance approach to achieve audit readiness over all principal financial statements, including: the Balance Sheet, Statement of Budgetary Resources, Statement of Net Costs, and Statement of Changes in Net Position. The DON's ICOFR program implements OMB Circular No. A-123, Appendix A, *Internal Control Over Financial Reporting*, through three key tenets: (1) integration of interrelated testing efforts, (2) expansion of the sphere of accountability across the enterprise, and (3) implementation of strong oversight and program governance.

### Integration of Testing Efforts

The DON leverages its audit readiness and other governance programs to test business processes and account balances and validate that key financial reporting controls are in place and operating effectively. Validating control effectiveness helps the DON assess and prioritize its audit and financial reporting resources to the best and most effective uses. The DON uses the following programs to carry out control testing and evaluation:

- Audit Readiness testing through the Independent Verification and Validation (IV&V) effort,
- Evaluation, Prioritization, and Remediation (EPR) validation of implemented corrective actions,
- Business Process Improvement (BPI), and
- Command-Level Sustainment Testing.

### Expanding the Sphere of Accountability

The DON established a new business practice which assigns an accountable official, at the Senior Executive Service (SES) or Flag Officer level, to be the Office of Primary Responsibility (OPR). Their

charge is to address FY 2015 SBA NFRs by driving corrective action, development, and implementation. The OPR executes this charge by facilitating the collaboration and communication necessary among senior leaders and major stakeholders supporting CAP implementation and resource allocation. OPRs also manage a Plan of Action & Milestones to track the timely execution of required remediation steps and escalate potential challenges to senior leadership, which expedites the adjudication process and prevents delays in implementation. The DON further drives ownership and accountability down to the lowest level of the organization by placing the responsibility for control execution at the working level.

### Implementing Strong Oversight and Program Governance

As a subset to the SMC, the DON established an SAT to focus on ICOFR and ICOFS. The SAT instills proper oversight and program governance by assisting BSOs in risk identification and analysis and aligning testing efforts to enterprise risk areas. The SAT will monitor, validate, and provide recommendations on the effectiveness of ICOFR and ICOFS programs to the ASN (FM&C) through the SMC. Furthermore, the SAT monitors and approves all ICOFR material weaknesses and related CAPs, emphasizing an enterprise-wide culture of robust internal controls that produces timely, accurate, and reliable financial reporting.

In FY 2016, we identified 23 material weaknesses in Fund Balance with Treasury, Financial Reporting Compilation, Military Pay, Accounts Receivable, Contract/Vendor Pay, Reimbursable Work Orders, Transportation of Things, Equipment Assets, Real Property Assets, Inventory, Operating Materials and Supplies, and Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures).

## INTERNAL CONTROLS OVER FINANCIAL SYSTEMS

The DON made considerable progress during the FY 2016 reporting period towards improving ICOFS. In conjunction with the OSD and service providers, we continue to assess relevant financial system controls to ensure compliance with OMB Circular No. A-123, Appendix D, and FFMIA. ICOFS is the foundation of auditability for financial statements. Consequently, the following ICOFS efforts to facilitate an auditable financial systems environment are underway:

- Establishment of Universe of Information Technology (IT) Systems,
  - Assessments of Key Financial Systems,
  - Assessments of Ancillary Systems,
  - Establishment of IT Control Governance,
  - Sustainment of Financial Management Improvements to Risk Management Framework, and
  - Information System Continuous Monitoring.
- Issues for segregation of duties with ERP system,
  - Non-compliance of ERP system with the Standard Financial Information Structure,
  - Deficiencies in multiple Federal Information System Controls Audit Manual domains, Standard Accounting and Reporting System – Field Level, and Global Combat Support System - Marine Corps,
  - DoD Information Assurance Accreditation and Certification Process issues,
  - Lack of standardized and specific control criteria guidance, and
  - No governance forum to address financial systems planning and control implementation and management at the Enterprise level.

In FY 2016, the DON identified nine non-conformances in IT controls across key and ancillary IT systems. The DON noted the following:

*The following page is the management assurance letter for FY 2016.*



Preparing to secure an MH-60S Sea Hawk helicopter. (U.S. Navy photo by Mass Communication Specialist 3rd Class Pasquale Sena/Released)



THE SECRETARY OF THE NAVY  
WASHINGTON DC 20350-1000

August 29, 2016

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2016

As Secretary of the Navy, I recognize that the Department of the Navy (DON) is responsible for establishing and maintaining effective internal controls to meet the objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). Tab A provides specific information on how the DON conducted the assessment of operational internal controls, in accordance with the Office of Management and Budget Circular No. A-123, Management's Responsibility for Internal Control (OMB Circular No. A-123), and provides a summary of the significant accomplishments and actions taken to improve the DON's internal controls during the past year.

The DON conducted its assessment of the effectiveness of internal controls over non-financial operations in accordance with the FMFIA and the Department of Defense Instruction 5010.40, Managers' Internal Control Program Procedures (DoDI 5010.40). Tab A-1 provides specific information on how the DON conducted this assessment. Based on the results of this assessment, the DON is able to provide a modified statement of assurance that the Internal Controls Over Non-financial Operations (ICONO) as of September 30, 2016, were operating effectively with the exception of seven material weaknesses noted in Tab B.

The DON conducted its assessment of the effectiveness of internal controls over financial reporting in accordance with OMB Circular No. A-123, Appendix A, Internal Control Over Financial Reporting. Tab A-1 provides specific information on how the DON conducted this assessment. Based on the results of this assessment, the DON is able to provide a modified statement of assurance that the Internal Controls over Financial Reporting (ICOFR) as of June 30, 2016, were operating effectively with the exception of 23 material weaknesses noted in Tab C. The annex of classified and Special Access Programs' (SAP) material weaknesses has been forwarded through special access channels and is being held at the Office of the Secretary of Defense SAP Classified Office.

The DON also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with the Federal Financial Management Improvement Act (FFMIA) of 1996 (Public Law 104-208) and the DoDI 5010.40. Tab A-1 provides specific information on how the DON conducted this assessment. Based on the results of this assessment, the DON is able to provide a modified statement of assurance that the Internal Controls Over Financial



**SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2016**

Systems as of June 30, 2016, are in compliance with the FFMIA and OMB Circular No. A-123 Appendix D, Compliance with the Federal Financial Management Improvement Act of 1996, with the exception of nine nonconformances noted in Tab D.

My point of contact is Captain Milton Troy, Internal Review and Evaluation Division Director (FMO-4), who may be reached at (202) 433-9228 or [milton.troy@navy.mil](mailto:milton.troy@navy.mil).

*Janet Pave*  
*for the SecNav*



(U.S. Navy photo by Mass Communications Specialist 3rd Class Janweb B. Lagazo/Released)

## FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The accompanying financial statements and related disclosures represent the DON's enduring commitment to fiscal accountability and transparency. Through the FIAR plan and related business transformation initiatives discussed earlier, the Department has made significant progress toward improving the quality and timeliness of financial information. However, the DON is currently unable to fully implement all elements of U.S. generally accepted accounting principles and OMB Circular A-136, "Financial Reporting Requirements," due to limitations of financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the DoD, Office of Inspector General, was unable to express an opinion on the FY 2016 financial statements. It should be noted that these limitations exist primarily in the proprietary accounting processes and less so in the budgetary accounting performed to manage and report on the application of budget authority to the purposes and programs approved in appropriations acts. Despite documented material weaknesses and because of compensating measures and close oversight, the DON believes the budgetary information used for decision-making is accurate and reliable.

For financial reporting purposes, the DON is organized into two reporting entities: The DON General Fund and Navy Working Capital Fund, which includes financial information for both the Navy and

the Marine Corps. Each reporting entity has a separate set of financial statements and related disclosures.

### DEPARTMENT OF THE NAVY GENERAL FUND

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

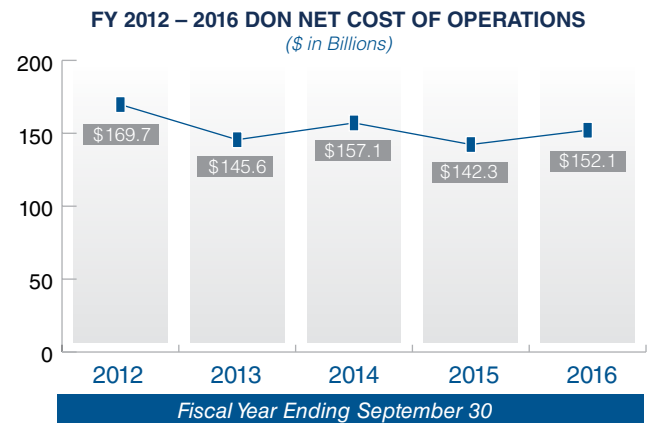
- Operation and Maintenance,
- Military Personnel,
- Procurement,
- Research, Development, Test, and Evaluation, and
- Military Construction.

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

## Results of Operations

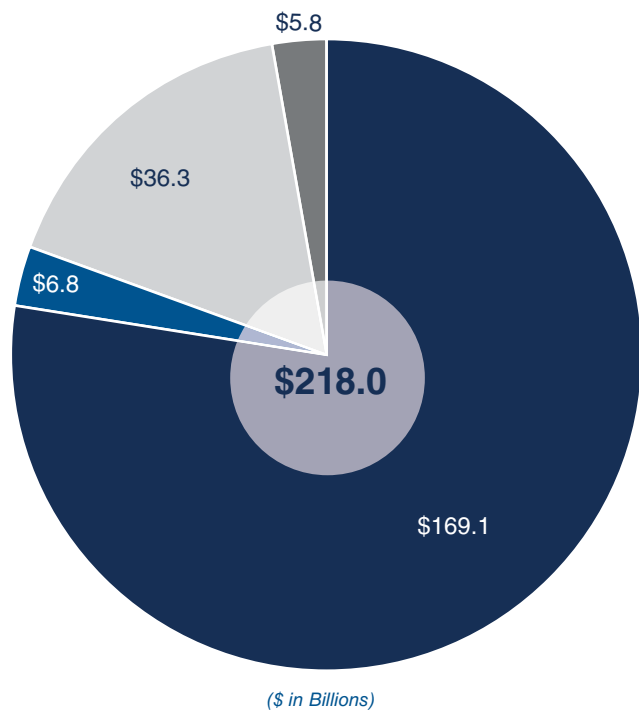
The Combined SBR presents total budgetary resources of \$218 billion that were available to the DON during FY 2016 and the status of those resources at fiscal year-end. Total budgetary resources were up \$9.2 billion, a 4.4 percent increase in FY 2016 compared to FY 2015. The enacted appropriations of \$169.1 billion represent 77.6 percent of total budgetary resources and increase of \$9.4 billion from FY 2015. The increase in total budgetary resources is attributable to the increase of 5.9% in appropriations. The DON obligated \$177.7 billion of the \$218 billion total resources in FY 2016, which is an increase of \$5.1 billion or 3% compared to FY 2015.

The Consolidated Statement of Net Cost presents net cost of operations of \$152.1 billion during FY 2016. During FY 2016, the Navy restated balances affecting the FY 2015 Consolidated Statement of Net Cost, presenting a restated net cost of operations of \$142.3 billion. Note 23 contains further details of the restatement. Net cost of operations represents gross costs incurred by the DON less earned revenue. Including the affect of the restatement, net cost of operations increased \$9.8 billion, which represents a 6.9 percent increase over FY 2015.



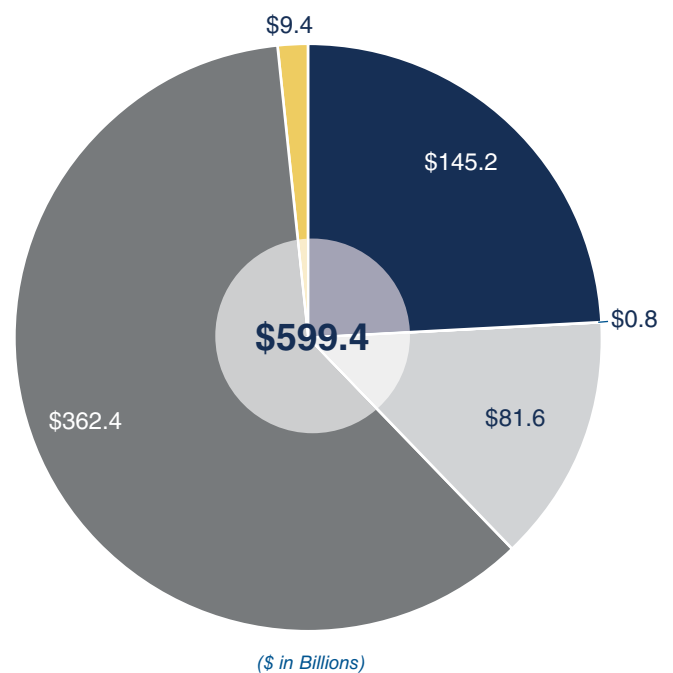
## Financial Position

The DON continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. During FY 2016, the Navy restated balances affecting the FY 2015 Consolidated Balance Sheet and the Consolidated Statement of Changes in Net Position. Note 23 contains further details of the restatement. As of September 30, 2016, net position totaled \$565.3 billion and a restated FY 2015 net position of \$559 billion which represents a \$6.3 billion or 1.1 percent increase from FY 2015. The overall increase in net position is attributed to increases of \$5.5 billion in total assets and a decrease of \$0.7 billion in total liabilities.



### FY 2016 DON Sources of Funds

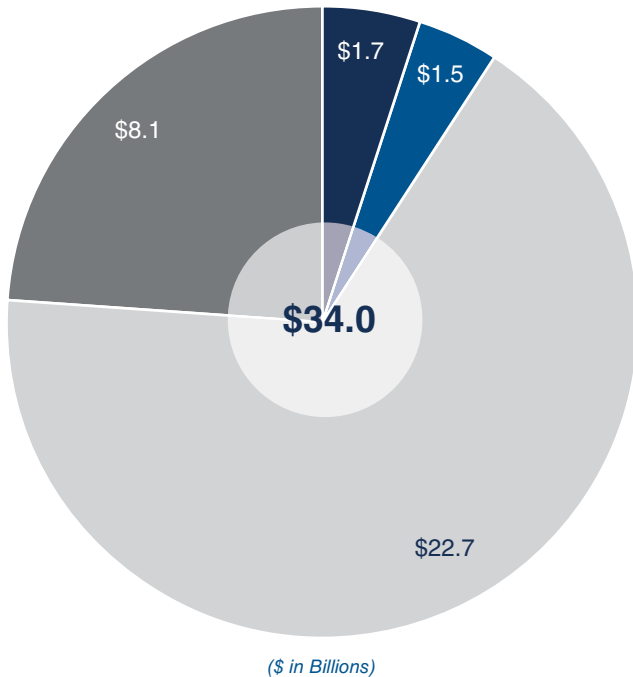
- Appropriations
- Spending Authority from Offsetting Collections
- Unobligated Balance Forward from Prior Years
- Other



### FY 2016 DON Total Assets

- Fund Balance with Treasury
- Accounts Receivable
- Inventory & Related Property
- General Property, Plant & Equipment
- Remaining Assets





**FY 2016 DON Total Liabilities**

- Accounts Payable
- Military Retirement and Other Federal Employment Benefits
- Environmental and Disposal Liabilities
- Remaining Liabilities

**NAVY WORKING CAPITAL FUND**

NWCF is a revolving fund established to meet the diverse requirements of the Navy and Marine Corps operating forces. Under the revolving fund concept, an appropriation or a transfer of funds finances initial NWCF operations. General or appropriated fund payments from customers for goods delivered or services performed subsequently replenish this initial working capital investment and sustain a continuous cycle of operations, minimizing the need for additional annual appropriations by Congress. The goal of NWCF is to break even over time by matching revenues earned to costs incurred. Achievement of this goal is occasionally complicated by the requirement that NWCF business areas maintain stable budget-driven prices for goods and services, to protect customers from unforeseen price fluctuations.

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

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| <p><b>SUPPLY MANAGEMENT</b><br/>Supply Management, Navy<br/><a href="https://www.navsup.navy.mil">https://www.navsup.navy.mil</a></p> <p>Supply Management, Marine Corps<br/><a href="http://www.logcom.usmc.mil">http://www.logcom.usmc.mil</a></p> <p><b>DEPOT MAINTENANCE</b><br/>Depot Maintenance, Aviation<br/><a href="http://www.navair.navy.mil">http://www.navair.navy.mil</a></p> <p>Depot Maintenance, Marine Corps<br/><a href="http://www.logcom.usmc.mil">http://www.logcom.usmc.mil</a></p> | <p><b>BASE SUPPORT</b><br/>Facilities Engineering Commands<br/><a href="https://portal.navfac.navy.mil">https://portal.navfac.navy.mil</a></p> <p>Naval Facilities Engineering Service Center<br/><a href="https://portal.navfac.navy.mil">https://portal.navfac.navy.mil</a></p> <p><b>TRANSPORTATION</b><br/>Military Sealift Command<br/><a href="http://www.msc.navy.mil">http://www.msc.navy.mil</a></p> | <p><b>RESEARCH AND DEVELOPMENT</b><br/>Naval Research Laboratory*<br/><a href="http://www.nrl.navy.mil">http://www.nrl.navy.mil</a></p> <p>Naval Surface Warfare Center<br/><a href="http://www.navsea.navy.mil">http://www.navsea.navy.mil</a></p> <p>Naval Undersea Warfare Center<br/><a href="http://www.navsea.navy.mil">http://www.navsea.navy.mil</a></p> <p>Naval Air Warfare Center<br/><a href="http://www.navair.navy.mil">http://www.navair.navy.mil</a></p> <p>Space and Naval Warfare Systems Centers<br/><a href="http://spawar.navy.mil">http://spawar.navy.mil</a></p> |
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\*Also see Office of Naval Research (<http://www.onr.navy.mil>)

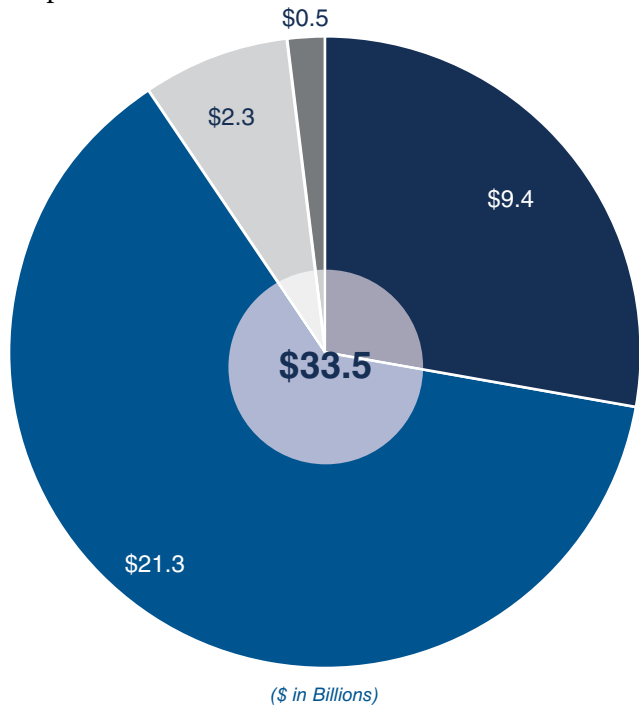
**Results of Operations**

The Combined SBR presents total budgetary resources of \$33.5 billion that were available to NWCF during FY 2016 and the status of those resources at fiscal year-end. Total budgetary resources increased \$1.4 billion, which was a 4.4% increase over FY 2015. NWCF budget authority is comprised of contract authority and spending authority from offsetting collections of which the latter accounts for 63.6% of total budgetary resources. The majority of the increase in overall budget authority is due to a \$1.4 billion increase in

Contract Authority in FY 2016. NWCF business activities obligated \$31.2 billion of the \$33.5 billion total resources in FY 2016 which represents an increase of \$1.4 billion or 4.7% over FY 2015.

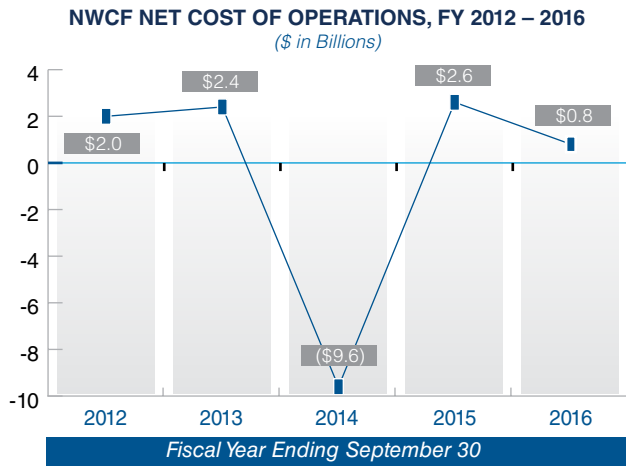
The Consolidated Statement of Net Cost presents net cost of operations of \$832 million during FY 2016. Net cost of operations represents gross costs incurred by NWCF less earned revenue. Sources of earned revenue include the DON; Army and Air Force General Funds; Defense Working Capital Funds; other Navy and DoD

appropriations; and non-DoD fund sources. The Navy had a decrease of \$1.8 billion in net costs in FY 2016 over FY 2015, which results in a positive net cost of operations.



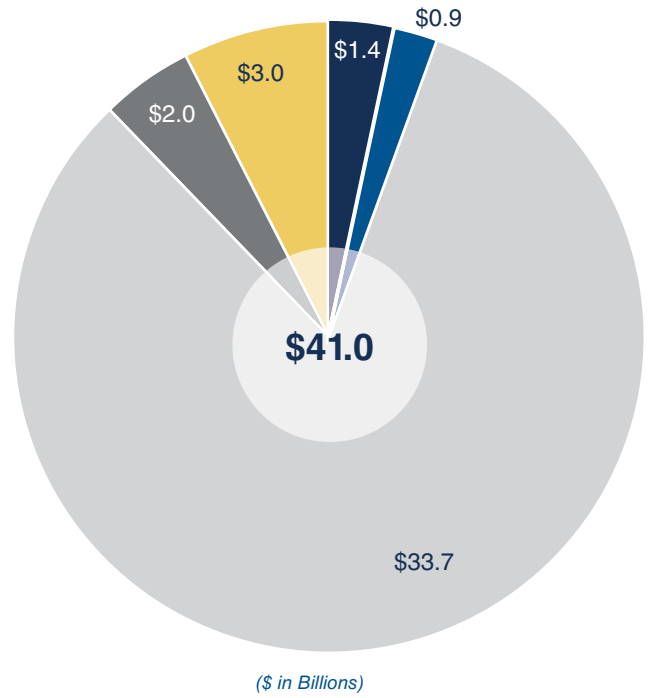
**FY 2016 NWCF Sources of Funds**

- Contract Authority
- Spending Authority from Offsetting Collections
- Unobligated Balance Forward from Prior Years
- Other



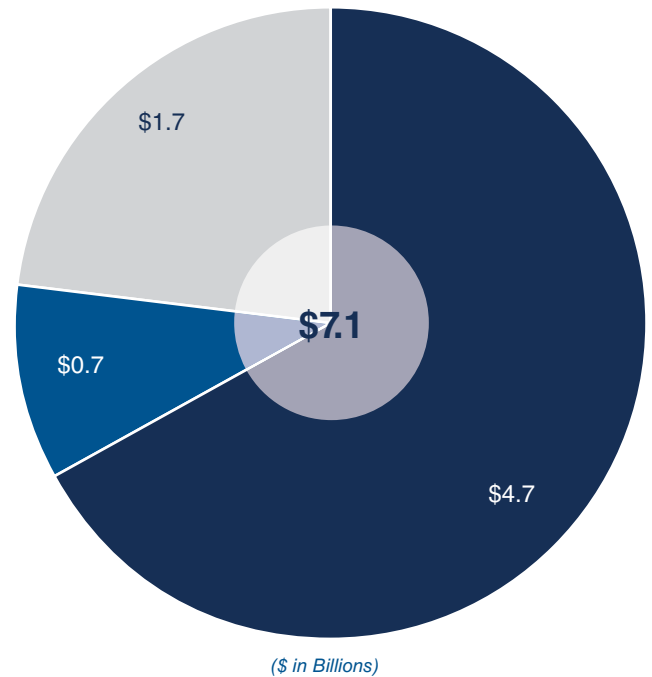
**Financial Position**

The NWCF continued to report a positive net position in its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. As of September 30, 2016, net position totaled \$33.9 billion, which represents an increase of \$2.4 billion and a 7.7% increase from FY 2015. An



**FY 2016 NWCF Total Assets**

- Fund Balance with Treasury
- Accounts Receivable
- Inventory & Related Property
- General Property, Plant & Equipment
- Remaining Assets



**FY 2016 NWCF Total Liabilities**

- Accounts Payable
- Military Retirement and Other Federal Employment Benefits
- Remaining Liabilities

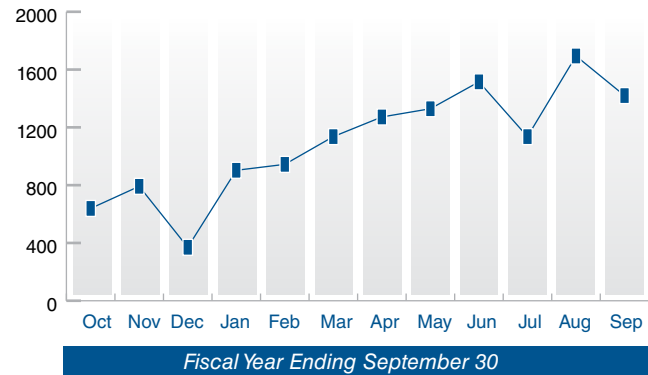
increase of \$2.7 billion in total assets and \$0.3 billion in total liabilities contributed to the overall increase in net position.

## Cash Management

The NWCF manages working capital fund cash at the Departmental level. It must maintain the minimum cash balance necessary to meet operations, capital investment, and other justified requirements, as required by the DoD Financial Management Regulation. The NWCF has established a high and low cash requirement based on business events and activities relevant to its operations.

For FY 2016, the high cash requirement was \$1.66 billion and the low cash requirement was \$1.18 billion.

NWCF CASH BALANCES  
OCTOBER 1, 2015 TO SEPTEMBER 30, 2016  
(\$ in Millions)



Sailors prepare to launch a rigid-hull inflatable boat from the boat deck. (U.S. Navy photo by Petty Officer 3rd Class Bill Dodge/Released)





An underwater construction team ascends after performing maintenance on undersea cables. (U.S. Navy combat camera photo by Mass Communication Specialist 1st Class Charles E. White/Released)

## LOOKING FORWARD

The DON's achievements during FY 2016 established a firm foundation that will assure future success in executing the mission of the Navy and Marine Corps, and building a sound business operating environment. In FY 2017, the DON will focus on six objectives. First, maintain a credible and modern sea-based strategic deterrent. Second, sustain a forward global presence to ensure the ability to impact world events. Third, preserve the capability to defeat a regional adversary in a larger-scale, multi-phased campaign, while denying the objectives of - or imposing unacceptable costs on - a second aggressor in another region. Fourth, ensure that the force is ready for these operations through critical afloat and shore readiness and personnel issues. Fifth, continue and affordably enhance asymmetric capabilities. Finally, sustain industrial base to ensure future capabilities, particularly in shipbuilding. In FY 2017 the DON will balance current readiness needed to execute assigned missions while sustaining a highly capable Fleet, all within a continually constrained and unpredictable fiscal climate.

### Personnel

Sailors, Marines, Civilians, and their families enable the Navy and Marine Corps to remain ready, forward, and engaged in challenging times. The men and women who comprise today's all-volunteer military are of superb caliber, and the DON continues to invest

to sustain this impressive force. Over the next five years the Navy will continue to make adjustments to properly size manpower accounts to reflect force structure decisions, reduce manning gaps at sea, and improve Fleet readiness. Critical to success is a continued focus in FY 2017 on recruiting, developing, retaining, and promoting the best Sailors, to maintain the optimal mix of personnel with the right skills and experience to man the Fleet. To fight and win, the DON needs a force that draws from the broadest talent pools, values health and fitness, attracts and retains innovative thinkers, provides flexible career paths, and prioritizes merit over tenure. In FY 2017 the DON will begin to fully invest in the Sailor 2025 Ready Relevant Learning initiative, which through pilot programs will begin to create a new way of training Sailors through mobile, modularized learning, re-engineered content, and a distributed Learning Continuum IT infrastructure. The DON will manage personnel strength to deliver a naval force that produces leaders and teams who learn and adapt to achieve maximum possible performance, and who achieve and maintain high standards to be ready for decisive operations and combat.

### Readiness

The DON continues to support requirements for the Carrier Strike Groups, Amphibious Ready Groups, and

Marine Expeditionary Forces to respond to persistent and emerging threats. The Navy deploys full-spectrum-ready forces to further security objectives in support of U.S. interests. Every day, more than 100 ships and submarines, embarked and shore based air squadrons, and Navy personnel ashore, are on watch around the globe. The Marine Corps will maintain current readiness and conduct modernization required to keep pace with constantly evolving and capable adversaries.

### **Procurement**

To maintain a robust Fleet and adaptable Marine Corps, the DON invests in platforms and systems to address today's wide-range of operations. The DON continues aggressive efforts to reduce acquisition costs and builds capability that supports the industrial base and provides the required level to maintain advantage in advanced technologies and weapons, allowing the Navy to operate in every region across the full spectrum of conflict. In FY 2017, the DON budget procures seven battle force ships, including two *Virginia* Class submarines, two DDG 51 *Arleigh Burke* destroyers, two Littoral Combat Ships, and one Amphibious Warfare Assault Ship. Navy and Marine Corps aviation provides forward deployed air presence in support of national strategy. The FY 2017 budget procures 94 manned and unmanned aircraft.

### **Development**

The Department of the Navy's Research, Development, Test and Evaluation program supports DON missions by giving the Department asymmetric and technological advantages against adversaries in all environments and spectrums. Science and technology research is vital to provide for future technologies that support innovative capabilities in shipbuilding, aviation, weapons, and ground equipment. Investment in R&D is also fundamental in the *Ohio* Replacement Program, *Virginia* Payload Module, unmanned systems, electromagnetic warfare, and protecting national interests across space and cyberspace.

### **Infrastructure**

The mission of the Department could not be achieved without high quality facilities that support Sailors, Marines, and their families. Further, the ability to rapidly deploy around the globe is directly connected to an effective shore infrastructure. For FY 2017 the Department's critical goals include financing 36 military construction projects, including

33 baseline projects and 3 overseas contingency operations projects. Key tenets in the Department's facilities investment strategy for FY 2017 are as follows: Improving Quality of Life and Safety, Enhancing the Global Defense Posture, Replacing Aging Facilities, Supporting New Systems, Upgrading Operations, Training and Security Facilities, and Upgrade Infrastructure.

### **Overseas Contingency Operations**

The Navy and Marine Corps overseas force posture is shaped by ongoing and projected operational commitments. The DON continues to counter the Islamic State of Iraq and the Levant and operations in Afghanistan, the Horn of Africa, and other locations in theater, as well as the European Reassurance Initiative. The FY 2017 request includes incremental costs to sustain operations, manpower, equipment, and infrastructure repair, as well as equipment repair and replacement. These costs include aviation and ship operations and maintenance, combat support, base support, Marine Corps operations and field logistics, mobilized reservists, and other special pays. Beyond the Marines participating in counterinsurgency, security cooperation, and civil-military operations, on any given day there are 4,600 Sailors ashore and another 10,000 afloat. These Sailors are conducting operations such as air operations, maritime infrastructure protection, explosive ordnance disposal, combat construction engineering, cargo handling, combat logistics, maritime security, detainee operations, customs inspections, civil affairs, base operations, and other forward presence activities. For the foreseeable future, the demand for naval presence in theater remains high as the DON upholds commitments to allies and partner states. The Navy has active and reserve forces continually deployed in support of contingency operations overseas serving as members of Carrier Strike Groups, Expeditionary Strike Groups, Special Operating Forces, Seabee units, Marine forces, medical units, and Individual Augmentees.

### **Financial Operations**

The Department's transformation of the DON's business enterprise is of paramount importance, ensuring that all available resources are directed to Sailors and Marines. The Department's drive to provide stronger financial management and to achieve auditability will continue its momentum across

FY 2017. The DON's plan to achieve compliance with financial audit standards is the Department's most comprehensive business transformation initiative to date. The purpose of the congressional mandate to achieve financial auditability is to improve the accuracy and accessibility of Departmental financial information. These improvements in turn will: provide DON leaders with more-accurate data to make resource decisions; increase accountability for funds appropriated and reduce the risk of funds misuse; and reduce the number of unsuccessfully-processed financial transactions causing re-work. The result will be improved efficiency, better capability to manage resources, and a business culture based on increased accountability. The focal point of the DON's auditability strategy is upgrading the quality of data flowing from the Department's business and accounting systems. Audit standards require this information to be accurate, timely and completely

captured as it flows end-to-end – from origination of a business transaction to its endpoint on a financial statement. Without this proven, reliable, automated data stream, enhanced accountability will not be attainable and a favorable audit of the large, complex DON will not be possible. In addition to improving the capability and compliance of its business system suite, the Navy has other major steps to take to arrive at full financial statement auditability. These include strengthening business process controls governing working capital fund operations and increasing the accountability for mission essential major assets. The DON continues to make steady progress toward meeting congressional and DoD mandates for DON financial audit readiness. The Navy reached the first required audit milestone by undergoing audit on its FY 2015 SBA, a big step toward full financial auditability – or, audit readiness on all four of the DON financial statements.

## LIMITATIONS TO THE FINANCIAL STATEMENTS

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles for Federal

entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.



Marines with Marine Aerial Refueler Transport Squadron (VMGR) perform air to air refueling. (U.S. Marine Corps photo by Cpl. Nathan Wicks/Released)



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**INSPECTOR GENERAL**  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

November 7, 2016

**MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL  
MANAGEMENT AND COMPTROLLER)**

**SUBJECT: Independent Auditor’s Report on the Department of the Navy General Fund  
FY 2016 and FY 2015 Basic Financial Statements  
(Project No. D2016-D000FS-0123.000, Report No. DODIG-2017-008)**

***Report on the Basic Financial Statements***

Public Law 101-576, “Chief Financial Officers Act of 1990,” as amended, requires the DoD Inspector General to audit the accompanying Department of the Navy General Fund consolidated balance sheet as of September 30, 2016, and 2015, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the basic statements (basic financial statements).

***Management’s Responsibility for the Annual  
Financial Statements***

The Department of the Navy management is responsible for the annual financial statements. Management is responsible for: (1) preparing financial statements that conform with U.S. generally accepted accounting principles (U.S. GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that they met broad control objectives of Public Law 97-255, “Federal Managers’ Financial Integrity Act of 1982” (FMFIA); (3) ensuring that the Department of the Navy’s financial management systems substantially comply with Public Law 104-208, “Federal Financial Management Improvement Act of 1996” (FFMIA) requirements; and (4) complying with applicable laws and regulations.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the basic financial statements based on conducting the audit in accordance with generally accepted government auditing standards and the Office of Management and Budget (OMB) Bulletin No. 15-02, "Audit Requirements for Federal Financial Statements," August 4, 2015. However, based on the matters described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### ***Basis for Disclaimer of Opinion***

Section 1008(d) of the FY 2002 National Defense Authorization Act limits the DoD Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Department of the Navy management asserted to us that the Department of the Navy General Fund FY 2016 and FY 2015 Basic Financial Statements would not substantially conform to U.S. GAAP and that the Department of the Navy General Fund financial management and feeder systems were unable to adequately support material amounts on the basic financial statements as of September 30, 2016. Accordingly, we did not perform all the auditing procedures required by generally accepted government auditing standards and OMB Bulletin No. 15-02 to determine whether material amounts on the basic financial statements were presented fairly. We considered the scope limitation in forming our conclusions on the basic financial statements.

### ***Disclaimer of Opinion***

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we could not obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Department of the Navy General Fund FY 2016 and FY 2015 Basic Financial Statements. Thus, the basic financial statements may have undetected misstatements that are both material and pervasive.

### ***Emphasis of Matter***

As discussed in Note 23, the Department of the Navy restated the FY 2015 General Fund Basic Financial Statements and related notes to correct errors in the General Property, Plant, and Equipment balance on the September 30, 2015 financial statements. The error was identified during ongoing audit readiness efforts. The balance on the September 30, 2015 financial statements does not accurately or



completely represent expenditures associated with Construction in Progress in the amount of \$31.4 billion. This amount impacted the General Property, Plant and Equipment and Cumulative Results of Operations lines of the September 30, 2015 financial statements. We did not modify our disclaimer report on the FY 2015 Basic Financial Statements with respect to this matter.

### ***Other Information in the Annual Financial Statements***

We performed our audit to form an opinion on the basic financial statements as a whole. The Department of the Navy management presented the Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Information for additional analysis as part of the annual financial statements. These elements are not required parts of the basic financial statements. Therefore, we do not express an opinion or provide any assurance on the information. We reviewed the other information for inconsistencies with the audited basic financial statements. Based on our limited review, we did not find any material inconsistencies between the information and the basic financial statements and applicable sections of OMB Circular No. A-136 (Revised), "Financial Reporting Requirements," October 7, 2016, and DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6b, "Form and Content of the Department of Defense Audited Financial Statements."

### ***Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements***

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have a direct and material effect on the basic financial statements, and compliance with OMB regulations and audit requirements for financial reporting because management represented that instances of noncompliance identified in prior audits continue to exist. Therefore, we did not determine whether the Department of the Navy General Fund complied with all applicable laws and regulations, contracts, and grant agreements related to financial reporting. It was not our objective to provide an opinion on compliance with certain provisions of laws and regulations, contracts, and grant agreements, and accordingly, we do not express such an opinion.

See Attachment 1 for additional details on internal control and compliance with legal and other regulatory requirements.

## ***Agency Comments and Our Evaluation***

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management and Comptroller). The Department of the Navy officials expressed their continuing commitment to address the problems this report outlines.

This report will be made publicly available pursuant to section 8M, paragraph (b)(1)(A) of the Inspector General Act of 1978, as amended. However, this report is intended solely for the information and use of Congress, the OMB, the U.S. Government Accountability Office, the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, the Department of the Navy management, and the DoD Office of Inspector General. It is not intended to be used and should not be used by anyone else.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 or (DSN) 329-5945.



Lorin T. Venable, CPA

Assistant Inspector General

Financial Management and Reporting

Attachment: As stated

# Report on Internal Control Over Financial Reporting

## ***Internal Control Compliance***

In planning our audit, we considered the Department of the Navy General Fund internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances for the purposes of expressing our opinion on the basic financial statements but not appropriate to the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on internal control over financial reporting.

## ***Management Responsibilities***

Management is responsible for implementing and maintaining effective internal controls to include providing reasonable assurance that the Department of the Navy personnel recorded, processed, and summarized accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

## ***Auditor's Responsibilities***

Our purpose was not to express an opinion on internal controls over financial reporting, and we do not do so. However, the following material weaknesses continue to exist that could adversely affect the Department of the Navy's General Fund financial operations.

## ***Previously Identified Material Weaknesses***

Management acknowledged that previously identified material weaknesses continued to exist. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Department of the Navy General Fund financial statements will not be prevented, or detected and corrected, on a timely basis. The following material weaknesses continue to exist.

**Fund Balance With Treasury.** The Department of the Navy Fund Balance with Treasury reconciliation does not effectively reconcile field-level general ledger balances to reported amounts on budgetary reports and the financial statements. The Department of the Navy does not perform effective oversight of the Fund Balance with Treasury process performed by the Defense Finance and Accounting Service.



**Financial Statement Compilation and Reporting.** The Department of the Navy management identified the following material weaknesses.

- The Fund Receipt and Distribution reconciliation process requires improvements and timely preparation. Field-level general ledgers do not reconcile to funding authorization documents.
- Sufficient procedures have not been established to provide oversight of the third-party shared service providers that process, store, or transmit Navy financial information. In addition, there is no comprehensive set of governance and oversight agreements. The Department of the Navy also lacks service-level agreements, memorandums of understanding, or other documents to clearly outline its roles and responsibilities, as well as its service providers, with respect to controls over processes performed. Controls over financial information technology systems are insufficient.
- The Department of the Navy is unable to provide detailed transaction data to support the history of cumulative transactions. The Department of the Navy's beginning balances are unsupported.
- Transactions resident in the business transaction systems cannot be reconciled to the Department of the Navy general ledger accounting systems. Process variances, the system interface, and configuration management issues present a risk that the Department of the Navy could overstate or understate obligations, accounts receivable, accounts payable, and disbursements.
- General ledger accounting system posting logic does not produce expected financial and budgetary accounting relationships.
- The Department of the Navy has inconsistent procedures to record journal vouchers and standard Business transactions.
- Building Partner Capacity is funded through a variety of government appropriations with various periods of availability. Building Partner Capacity funds are transferred to the Foreign Military Sales Trust Fund for execution, which shows a no-year appropriation. DoD appropriations within the Foreign Military Sales Trust Fund have expiration dates. Contracts written in support

of Building Partner Capacity cases show the no-year line of accounting, which does not correctly display the expiration date of the funds. This increases the risk of obligations being made past the funds expiration date; potentially resulting in an Antideficiency Act violation.

**Transportation of Things.** Effective controls are not in place to prevent unauthorized use of transportation account codes, or prevent unauthorized shipments from occurring. Transportation officers across the DoD do not have the capability to determine whether the shipping requestor is authorized to use the transportation account codes cited on the shipping document or validate sufficient funds are available prior to releasing for shipment. Additionally, interfaces among transportation and financial systems do not support exchange of all required transactional data. Department of the Navy standard document numbers may be altered as transportation transactions enter other services' financial and transportation systems.

Transportation service providers and other services own the majority of Transportation of Things systems. These differences in system requirements result in lost or corrupted transference of data, increased risk of incorrect financial reporting, and extreme difficulty and inability to trace transactions from the general ledger to source documentation. This results in transportation services being charged to the wrong organization, which may lead to potential Antideficiency Act violations and overstatement or understatement in the lines of accounting. In addition, the DoD does not have a centralized process to maintain, store, and retrieve transportation documentation that is required to support Transportation of Things transactions, management evaluation, and future examination or audits.

**General Equipment.** The Department of the Navy cannot establish or support ownership and valuation of General Equipment due to lack of supporting documentation, improper interpretation of guidance, underutilization of the Accountable Property System of Record, and system limitations. In addition, the Department of the Navy cannot substantiate that the Accountable Property System of Record represents a complete inventory of General Equipment assets. The inability to reconcile property accountability systems with financial systems equates to inaccurate asset disclosure and presentation.

**Reimbursable Work Orders.** The Department of the Navy identified lack of controls over Reimbursable Work Orders – Grantor, and Reimbursable Work Orders – Performer processes. The Department of the Navy's control environment is not designed or

operating effectively to verify or validate Reimbursable Work Orders – Grantor, and Reimbursable Work Orders – Performer transactions are authorized, approved, properly posted, accurate, and complete. There is a potential audit risk that the Department of the Navy’s financial statements do not accurately account for undelivered orders, accounts receivables, or yearend accruals, which could result in invalid or unauthorized transactions.

**Military Standard Requisitioning and Issue Procedures.** The Department of the Navy’s control environment is not designed and/or operating effectively in the following areas.

***Shipyards.*** Naval Shipyard requisitions cannot be reconciled to the general ledger. Key Supporting Documents to support administrative receipt processing and monitoring of disbursements to detect invalid, fraudulent, or improper billings are not retained in accordance with standard policy. As a result, Naval Shipyards could overstate or understate financial statement obligations and disbursements.

***Unliquidated Obligations.*** The Department of the Navy internal control reconciliation process for unliquidated obligations is not designed to effectively monitor open Military Standard Requisitioning and Issue Procedures commitments and obligations to determine whether a bona fide need exists.

***Visual Inter-fund System Transaction Accountability.*** The Defense Finance and Accounting Service has insufficient controls to validate Visual Inter-fund System Transaction Accountability functionality when assigning a line of accounting to inter-fund bills for Military Standard Requisitioning and Issue Procedures obligations or disbursements on the general ledger.

***Offline Requisitions.*** The Defense Logistics Agency and the General Services Administration established offline requisition systems to access and purchase cataloged or General Services Administration schedule products. These systems did not include the necessary interfaces with the Marine Corps supply and financial automated systems; therefore, incomplete information resulted in invalid accounting entries and Prompt Payment Act violations. This issue is one of the causes relating to the weakness in timely recording of obligations.



**Contract Vendor Pay.** The Department of the Navy's control environment is not designed or operating effectively, as individuals without properly documented authority are approving purchase requests, purchase orders, and certifying invoices for payment. The Department of the Navy is unable to consistently provide documentation supporting receipt and acceptance for procure-to-pay outlays. In addition, obligations are not recorded in the general ledger system within 10 days following obligation activity. The probable audit risk is that obligations may be understated in the financial statements.

**Real Property.** The Department of the Navy had insufficient standard internal controls and supporting documentation for real property and construction-in-progress.

**Operating Material and Supplies.** The Department of the Navy cannot demonstrate the ability to consistently perform and document annual physical inventories of Operating Material and Supplies and maintain audit trails to permit the tracing of transactions from source documentation in order to comply with the policy requiring source documentation for the reported Operating Material and Supplies dollar values. The Department of the Navy has not maintained historical cost data in legacy financial systems to comply with generally accepted accounting principles and Statements of Federal Financial Accounting Standards because legacy systems were designed for material management purposes but not to capture any financial information.

**Military Pay.** The Department of the Navy has multiple, widespread issues with governance, oversight, quality of service, supportability, systems and control over pay and personnel functions, resulting in lack of timely, accurate, and supported, pay and personnel transactions. Insufficient internal controls and oversight regarding roles and responsibilities, separation of duties, enforcement, and system access to identify trends, deficiencies, and corrective actions have been identified. Additionally, the Department of the Navy military pay and financial management system lacks modern capabilities to support auditability.

These financial management material weaknesses may cause inaccurate management information. As a result, the Department of the Navy management decisions based in whole or in part on this information may be adversely affected. Financial information reported by the Department of the Navy may also contain misstatements resulting from these deficiencies. Internal control work we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies. We did not identify material weaknesses that were not reported as such in the Department of the Navy's FMFIA report.

## **Report on Compliance with Applicable Provisions of Law, Regulations, Contracts, and Grant Agreements**

U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for compliance with existing laws and regulations, contracts, and grant agreements related to financial reporting. Management has also acknowledged to us that previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Department of the Navy General Fund complied with selected provisions of all applicable laws and regulations, contracts, and grant agreements related to financial reporting. We caution that other noncompliance may have occurred and not been detected. Furthermore, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Because of other scope limitations discussed in this report, we limited our work to determining compliance with selected provisions of the applicable laws and regulations.

### ***Antideficiency Act***

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]), limits the Department of the Navy and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Department of the Navy or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As stated in 31 U.S.C. § 1517 (2004), the Department of the Navy and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act, the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2016, the Department of the Navy General Fund reported six Antideficiency Act violations within two completed cases.

## ***Compliance With FFMIA Requirements***

The FFMIA requires the Department of the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For areas in which an agency is not in compliance, OMB Circular No. A-136 requires the agency to identify remediation activities planned or underway to bring the systems into substantial compliance with the FFMIA. The Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), the Department of the Navy Chief Information Officer, the Department of the Navy commands, the Department of the Navy activities, and the Defense Finance and Accounting Service are jointly responsible for implementing and maintaining financial management systems that comply substantially with the Federal financial management system requirements in OMB Circular No. A-127, "Financial Management Systems," January 9, 2009, applicable U.S. generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. The Department of the Navy management states the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to comply substantially with the Federal financial management systems requirements, U.S. generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. The Department of the Navy has based its assessment on system requirements promulgated by OMB in Circular No. A-127 and by the Office of the Secretary of Defense through the DoD Business Enterprise Architecture laws, regulations, and policies. The Department of the Navy staff recognizes that legacy systems were, in some cases, substantively not compliant and therefore did not perform system reviews for selected legacy systems.

For FY 2016, the Department of the Navy General Fund did not substantially comply with the FFMIA. The Department of the Navy acknowledged to us that the Department of the Navy General Fund financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements and that previously identified material weaknesses continue. The financial management and feeder systems did not substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2016. Therefore, based on the representation of the Department of the Navy, we did not substantiate whether the Department of the Navy General Fund complied with FFMIA and OMB implementation guidance.



## Recommendations

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



Sanding corrosion off metal on the boat davit. (U.S. Navy photo by Mass Communication Specialist Seaman Apprentice Neo Greene III/Released)

## PRINCIPAL STATEMENTS

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### DEPARTMENT OF THE NAVY GENERAL FUND

The fiscal year 2016 Department of the Navy (DON) 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 DON for the fiscal year ending September 30, 2016, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2015.

The following statements comprise the DON General Fund principal statements:

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

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

\*Note that amounts may vary slightly due to rounding.

Department of Defense  
**DEPARTMENT OF THE NAVY**

## CONSOLIDATED BALANCE SHEET

*As of September 30, 2016 and 2015 (\$ in Thousands)*

|                                                             | 2016 Consolidated | Restated<br>2015 Consolidated |
|-------------------------------------------------------------|-------------------|-------------------------------|
| <b>ASSETS:</b>                                              |                   |                               |
| Intragovernmental:                                          |                   |                               |
| Fund Balance with Treasury (Note 3)                         | \$ 145,212,868    | \$ 140,494,819                |
| Investments (Note 4)                                        | 5,664             | 6,543                         |
| Accounts Receivable (Note 5)                                | 181,481           | 212,630                       |
| Other Assets (Note 6)                                       | 580,268           | 444,466                       |
| <b>Total Intragovernmental Assets</b>                       | 145,980,281       | 141,158,458                   |
| Cash and Other Monetary Assets (Note 7)                     | 93,929            | 106,034                       |
| Accounts Receivable, Net (Note 5)                           | 631,548           | 571,763                       |
| Inventory and Related Property, Net (Note 8)                | 81,577,809        | 78,851,740                    |
| General Property, Plant and Equipment, Net (Note 9)         | 362,367,317       | 324,375,957                   |
| Other Assets (Note 6)                                       | 8,675,162         | 48,724,034                    |
| <b>TOTAL ASSETS</b>                                         | \$ 599,326,046    | \$ 593,787,986                |
| <b>Stewardship Property, Plant and Equipment (Note 9) *</b> |                   |                               |
| <b>LIABILITIES</b>                                          |                   |                               |
| Intragovernmental:                                          |                   |                               |
| Accounts Payable (Note 11)                                  | \$ 1,387,186      | \$ 1,398,696                  |
| Other Liabilities (Note 13)                                 | 1,122,166         | 887,244                       |
| <b>Total Intragovernmental Liabilities</b>                  | 2,509,352         | 2,285,940                     |
| Accounts Payable (Note 11)                                  | 348,127           | 725,613                       |
| Federal employee and Veteran Benefits (Note 15)             | 1,460,768         | 1,537,559                     |
| Environmental and Disposal Liabilities (Note 12)            | 22,717,646        | 21,120,540                    |
| Other Liabilities (Note 13 & Note 14)                       | 7,023,849         | 9,125,671                     |
| <b>TOTAL LIABILITIES</b>                                    | \$ 34,059,742     | \$ 34,795,323                 |
| <b>Commitments and Contingencies (Note 14) *</b>            |                   |                               |
| <b>NET POSITION</b>                                         |                   |                               |
| Unexpended Appropriations - Other Funds                     | \$ 148,179,076    | \$ 182,429,593                |
| Cumulative Results of Operations - Dedicated Collections    | 44,228            | 30,290                        |
| Cumulative Results of Operations - Other Funds              | 417,043,000       | 376,532,780                   |
| <b>TOTAL NET POSITION</b>                                   | \$ 565,266,304    | \$ 558,992,663                |
| <b>TOTAL LIABILITIES AND NET POSITION</b>                   | \$ 599,326,046    | \$ 593,787,986                |

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

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



Department of Defense  
**DEPARTMENT OF THE NAVY**

## CONSOLIDATED STATEMENT OF NET COST

*For the Years Ended September 30, 2016 and 2015 (\$ in Thousands)*

|                                           | 2016 Consolidated     | Restated<br>2015 Consolidated |
|-------------------------------------------|-----------------------|-------------------------------|
| <b>Program Costs</b>                      |                       |                               |
| Gross Costs                               |                       |                               |
| Military Personnel                        | \$ 45,970,073         | \$ 46,294,677                 |
| Operations, Readiness, & Support          | 60,487,437            | 59,199,665                    |
| Procurement                               | 35,141,110            | 28,478,453                    |
| Research, Development, Test, & Evaluation | 16,456,987            | 14,976,204                    |
| Family Housing & Military Construction    | 1,570,367             | 1,516,441                     |
| Less: Earned Revenue                      | (7,527,243)           | (8,160,633)                   |
| <b>Net Cost of Operations</b>             | <u>\$ 152,098,731</u> | <u>\$ 142,304,807</u>         |

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

Department of Defense  
**DEPARTMENT OF THE NAVY**

## CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

*For the Year Ended September 30, 2016 (\$ in Thousands)*

|                                                    | 2016 Dedicated Collections | 2016 Other Funds | 2016 Eliminations | 2016 Consolidated |
|----------------------------------------------------|----------------------------|------------------|-------------------|-------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>            |                            |                  |                   |                   |
| <b>Beginning Balances</b>                          | \$ 30,290                  | \$ 345,149,425   | \$ -              | \$ 345,179,715    |
| <b>Prior Period Adjustments:</b>                   |                            |                  |                   |                   |
| Changes in accounting principles                   | -                          | (1,855,470)      | -                 | (1,855,470)       |
| Corrections of errors                              |                            | 31,383,355       |                   | 31,383,355        |
| <b>Beginning Balances, as adjusted</b>             | \$ 30,290                  | \$ 374,677,310   | \$ -              | \$ 374,707,600    |
| <b>Budgetary Financing Sources:</b>                |                            |                  |                   |                   |
| Appropriations Used                                | -                          | 200,779,939      | -                 | 200,779,939       |
| Non-exchange Revenue                               | 177                        | -                | -                 | 177               |
| Donations & Forfeitures of Cash & Cash Equivalents | 37,332                     | 971              | -                 | 38,303            |
| Transfers-In/Out without Reimbursement             | -                          | 295,339          | 108               | 295,447           |
| <b>Other Financing Sources:</b>                    |                            |                  |                   |                   |
| Donations and Forfeitures of Property              | -                          | -                | -                 | -                 |
| Transfers-In/Out without Reimbursement             | -                          | (1,187,460)      | (108)             | (1,187,568)       |
| Imputed Financing from Costs Absorbed by Others    | -                          | 714,199          | -                 | 714,199           |
| Other                                              | -                          | (6,162,138)      | -                 | (6,162,138)       |
| <b>Total Financing Sources</b>                     | 37,509                     | 194,440,850      | -                 | 194,478,359       |
| <b>Net Cost of Operations</b>                      | 23,571                     | 152,075,160      | -                 | 152,098,731       |
| <b>Net Change</b>                                  | 13,938                     | 42,365,690       | -                 | 42,379,628        |
| <b>Cumulative Results of Operations</b>            | \$ 44,228                  | \$ 417,043,000   | \$ -              | \$ 417,087,228    |
| <b>UNEXPENDED APPROPRIATIONS</b>                   |                            |                  |                   |                   |
| <b>Beginning Balances</b>                          | \$ -                       | \$ 182,429,593   | \$ -              | \$ 182,429,593    |
| <b>Budgetary Financing Sources:</b>                |                            |                  |                   |                   |
| Appropriations Received                            | -                          | 170,094,696      | -                 | 170,094,696       |
| Appropriations Transferred-In/Out                  | -                          | 555,695          | -                 | 555,695           |
| Other Adjustments (Rescissions, etc.)              | -                          | (4,120,969)      | -                 | (4,120,969)       |
| Appropriations Used                                | -                          | (200,779,939)    | -                 | (200,779,939)     |
| <b>Total Budgetary Financing Sources</b>           | -                          | (34,250,517)     | -                 | (34,250,517)      |
| <b>Unexpended Appropriations</b>                   | -                          | 148,179,076      | -                 | 148,179,076       |
| <b>Net Position</b>                                | \$ 44,228                  | \$ 565,222,076   | \$ -              | \$ 565,266,304    |

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

Department of Defense  
**DEPARTMENT OF THE NAVY**

## CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

*For the Year Ended September 30, 2015 (\$ in Thousands)*

|                                                    | 2015 Dedicated Collections | Restated 2015 Other Funds | 2015 Eliminations | Restated 2015 Consolidated |
|----------------------------------------------------|----------------------------|---------------------------|-------------------|----------------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>            |                            |                           |                   |                            |
| <b>Beginning Balances</b>                          | \$ 27,545                  | \$ 326,068,662            | \$ -              | \$ 326,096,207             |
| <b>Prior Period Adjustments:</b>                   |                            |                           |                   |                            |
| Changes in accounting principles                   | -                          | -                         | -                 | -                          |
| Corrections of errors                              | -                          | 19,701,232                | -                 | 19,701,232                 |
| <b>Beginning Balances, as adjusted</b>             | <u>\$ 27,545</u>           | <u>\$ 345,769,894</u>     | <u>\$ -</u>       | <u>\$ 345,797,439</u>      |
| <b>Budgetary Financing Sources:</b>                |                            |                           |                   |                            |
| Appropriations Used                                | -                          | 161,884,208               | -                 | 161,884,208                |
| Non-exchange Revenue                               | 198                        | 1,178                     | (1,178)           | 198                        |
| Donations & Forfeitures of Cash & Cash Equivalents | 23,560                     | 204                       | -                 | 23,764                     |
| Transfers-In/Out without Reimbursement             | -                          | 127,399                   | -                 | 127,399                    |
| <b>Other Financing Sources:</b>                    |                            |                           |                   |                            |
| Donations and Forfeitures of Property              | -                          | -                         | -                 | -                          |
| Transfers-In/Out without Reimbursement             | -                          | (1,012,788)               | -                 | (1,012,788)                |
| Imputed Financing from Costs Absorbed by Others    | -                          | 704,140                   | -                 | 704,140                    |
| Other                                              | -                          | 11,343,517                | -                 | 11,343,517                 |
| <b>Total Financing Sources</b>                     | <u>23,758</u>              | <u>173,047,858</u>        | <u>(1,178)</u>    | <u>173,070,438</u>         |
| <b>Net Cost of Operations</b>                      | <u>21,013</u>              | <u>142,284,972</u>        | <u>(1,178)</u>    | <u>142,304,807</u>         |
| <b>Net Change</b>                                  | <u>2,745</u>               | <u>30,762,886</u>         | <u>-</u>          | <u>30,765,631</u>          |
| <b>Cumulative Results of Operations</b>            | <u>\$ 30,290</u>           | <u>\$ 376,532,780</u>     | <u>\$ -</u>       | <u>\$ 376,563,070</u>      |
| <b>UNEXPENDED APPROPRIATIONS</b>                   |                            |                           |                   |                            |
| <b>Beginning Balances</b>                          | \$ -                       | \$ 187,208,169            | \$ -              | \$ 187,208,169             |
| <b>Budgetary Financing Sources:</b>                |                            |                           |                   |                            |
| Appropriations Received                            | -                          | 159,223,179               | -                 | 159,223,179                |
| Appropriations Transferred-In/Out                  | -                          | 949,498                   | -                 | 949,498                    |
| Other Adjustments (Rescissions, etc.)              | -                          | (3,067,045)               | -                 | (3,067,045)                |
| Appropriations Used                                | -                          | (161,884,208)             | -                 | (161,884,208)              |
| <b>Total Budgetary Financing Sources</b>           | <u>-</u>                   | <u>(4,778,576)</u>        | <u>-</u>          | <u>(4,778,576)</u>         |
| <b>Unexpended Appropriations</b>                   | <u>-</u>                   | <u>182,429,593</u>        | <u>-</u>          | <u>182,429,593</u>         |
| <b>Net Position</b>                                | <u>\$ 30,290</u>           | <u>\$ 558,962,373</u>     | <u>\$ -</u>       | <u>\$ 558,992,663</u>      |

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



Department of Defense  
**DEPARTMENT OF THE NAVY**

## COMBINED STATEMENT OF BUDGETARY RESOURCES

*For the Years Ended September 30, 2016 and 2015 (\$ in Thousands)*

|                                                                       | 2016 Combined         | 2015 Combined         |
|-----------------------------------------------------------------------|-----------------------|-----------------------|
| <b>Budgetary Resources:</b>                                           |                       |                       |
| Unobligated Balance, Brought Forward, October 1                       | \$ 36,275,135         | \$ 35,245,619         |
| Recoveries of Prior Year Unpaid Obligations                           | 8,060,027             | 9,719,355             |
| Other Changes in Unobligated Balance                                  | (2,256,062)           | (2,443,706)           |
| Unobligated Balance from Prior Year                                   |                       |                       |
| Budget Authority, Net                                                 | 42,079,100            | 42,521,268            |
| Appropriations                                                        | 169,125,260           | 159,724,368           |
| Spending Authority from Offsetting Collections                        | 6,804,244             | 6,590,193             |
| <b>Total Budgetary Resources</b>                                      | <b>\$ 218,008,604</b> | <b>\$ 208,835,829</b> |
| <b>Status of Budgetary Resources:</b>                                 |                       |                       |
| New obligations and upward adjustments (total)                        | \$ 177,694,316        | \$ 172,560,694        |
| Unobligated Balance, End of Year                                      |                       |                       |
| Apportioned, unexpired accounts                                       | 32,436,455            | 30,084,039            |
| Exempt from apportionment, unexpired accounts                         | 1,671,491             | 25,813                |
| Unapportioned, unexpired accounts                                     | -                     | -                     |
| Unexpired unobligated balance, end of year                            | 34,107,946            | 30,109,852            |
| Expired unobligated balances, end of year                             | 6,206,342             | 6,165,283             |
| Total Unobligated Balance, End of Year                                | 40,314,288            | 36,275,135            |
| <b>Total Budgetary Resources</b>                                      | <b>\$ 218,008,604</b> | <b>\$ 208,835,829</b> |
| <b>Change in Obligated Balance:</b>                                   |                       |                       |
| Unpaid Obligations                                                    |                       |                       |
| Unpaid Obligations, Brought Forward, October 1                        | \$ 107,370,622        | \$ 110,665,931        |
| New obligations and upward adjustments (total)                        | 177,694,316           | 172,560,694           |
| Outlays, Gross                                                        | (168,849,679)         | (166,136,648)         |
| Recoveries of Prior Year Unpaid Obligations                           | (8,060,027)           | (9,719,355)           |
| Unpaid Obligations, End of Year, Gross                                | \$ 108,155,232        | \$ 107,370,622        |
| Uncollected Payments                                                  |                       |                       |
| Uncollected Payments from Federal Sources, Brought Forward, October 1 | \$ (3,437,866)        | \$ (3,274,255)        |
| Change in Uncollected Payments from Federal Sources                   | (87,517)              | (163,611)             |
| Uncollected Payments from Federal Sources, End of Year                | (3,525,383)           | (3,437,866)           |
| Obligated Balance, Start of Year                                      | 103,932,756           | 107,391,676           |
| <b>Obligated Balance, End of Year</b>                                 | <b>\$ 104,629,849</b> | <b>\$ 103,932,756</b> |
| <b>Budget Authority and Outlays, Net:</b>                             |                       |                       |
| Budget Authority, Gross                                               | \$ 175,929,504        | \$ 166,314,561        |
| Actual Offsetting Collections                                         | (6,723,315)           | (6,450,446)           |
| Change in Uncollected Payments from Federal Sources                   | (87,517)              | (163,611)             |
| Recoveries of prior year paid obligations                             | 6,588                 | 23,864                |
| Budget Authority, Net                                                 | \$ 169,125,260        | \$ 159,724,368        |
| Outlays, Gross                                                        | \$ 168,849,679        | \$ 166,136,648        |
| Actual Offsetting Collections                                         | (6,723,315)           | (6,450,446)           |
| Outlays, Net                                                          | 162,126,364           | 159,686,202           |
| Distributed Offsetting Receipts                                       | (97,310)              | (196,776)             |
| <b>Agency Outlays, Net</b>                                            | <b>\$ 162,029,054</b> | <b>\$ 159,489,426</b> |

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

# NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

## 1.A. BASIS OF PRESENTATION

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act (GMRA) of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the DON in accordance with, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB); the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements;" and the Department of Defense (DoD), Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the DON is responsible unless otherwise noted.

Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernible. The DON financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance and Accounting Service, Cleveland (DFAS-CL) collects information from the financial system and incorporates it into the financial statements for the DON. The DON collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL for incorporation into the financial statements. On behalf of the DON, DFAS-CL also collects information from multiple sources, such as intragovernmental data from the DON's trading partners, which is incorporated into the financial statements. The Defense Departmental Reporting System Data Collection Module (DDRS DCM) captures certain required financial information from non-integrated systems for the DON financial statements. The DDRS DCM identifies the information requirements to the source provider, and integrates data into the financial statement preparation process.

The DON is unable to fully implement all elements of USGAAP and OMB Circular No. A-136, due to limitations of financial and nonfinancial management processes and systems that support the financial statements. The DON derives reported values and information for major asset and liability categories largely from nonfinancial systems such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with USGAAP. The DON continues to

implement process and system improvements addressing these limitations.

The DON General Fund currently has 10 auditor-identified financial statement areas with material weaknesses: (1) Financial Statement Compilation and Reporting; (2) Fund Balance with Treasury; (3) Military Standard Requisitioning and Issue Procedures; (4) Contract Vendor Pay; (5) Transportation of Things; (6) Real Property; (7) General Equipment; (8) Reimbursable Work Orders; (9) Operating Materials & Supplies; (10) Military Pay.

## 1.B. MISSION OF THE REPORTING ENTITY

The DON was created on April 30, 1798 by an act of Congress (1 Stat. 533; 5 U.S.C. 411-12). The overall mission of the DON is to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression, and maintaining freedom of the seas.

## 1.C. APPROPRIATIONS AND FUNDS

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

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

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

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

Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as funds from dedicated collections. Funds from dedicated collections are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes,

and remain available over time. The DON is required to separately account for and report on the receipt, use and retention of revenues and other financing sources for funds from dedicated collections.

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

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

The DON receives allocation transfers from the U.S. Forest Service and the Federal Highway Administration. The activities for these funds are reported separately from DON financial statements and reported to the parent.

Additionally, the DON receives allocation transfers for the Foreign Military Financing Program, the International Military Education and Training Program, and the Security Assistance Programs which each meet the OMB exception for EOP funds. These funds are reported separately from the DON's financial statements based on an agreement with OMB.

#### **1.D. BASIS OF ACCOUNTING**

The DON's financial management systems are unable to meet all full accrual accounting requirements. This is primarily because many of the DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the legislative mandate to produce financial statements in accordance with USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by USGAAP. Most of DON's financial and nonfinancial legacy systems were designed to record information on a budgetary basis.

Due to differences in recording under the accrual method and budgetary basis, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

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

The DoD is continuing the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the current revision of accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Until all DON financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by USGAAP, there will be instances when the DON's financial data will be derived from budgetary transactions or data from nonfinancial feeder systems.

The preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

#### **1.E. REVENUES AND OTHER FINANCING SOURCES**

The DON receives congressional appropriations as financing sources for general funds that expire annually, some on a multi-year basis, or do not expire. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The DON recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full-cost pricing is the DON's standard policy for services provided as required by OMB Circular A-25, "User Charges." The DON recognizes revenue when earned within the constraints of its current system capabilities. In some 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 Note 19, Reconciliation of Net Cost of Operations



to Budget. The U.S. has cost sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

The DON records donations in trust funds and special funds as nonexchange revenue in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 7 “Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.” The DON recognizes nonexchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not directly receive value in return.

### **1.F. RECOGNITION OF EXPENSES**

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For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items such as payroll expenses, accounts payable, environmental liabilities, FECA liabilities, and environmental liabilities. In the case of Operating Materials & Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses. Under the consumption method, OM&S would be expensed when consumed. Due to system limitations, in some instances, expenditures for capital and other long-term assets may be recognized as operating expenses. The DON continues to implement process and system improvements to address these limitations.

### **1.G. ACCOUNTING FOR INTRAGOVERNMENTAL ACTIVITIES**

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Accounting standards require an entity to eliminate intra-entity activity and balances from consolidated financial statements to prevent overstatement for business with itself. However, the DON cannot accurately identify intragovernmental transactions by customer because the DON’s systems do not track buyer and seller data at the transaction level. Generally, seller entities within DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances and are then eliminated. The DoD is implementing replacement systems and a standard financial information structure incorporating the necessary elements to enable DoD to correctly report, reconcile, and eliminate intragovernmental balances.

The Treasury Financial Manual (TFM) Part 2 – Chapter 4700, “Agency Reporting Requirements for the Financial Report of the United States Government” provides guidance for reporting and reconciling intragovernmental balances. While the DON is unable to fully reconcile intragovernmental transactions with all federal agencies, the DON is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, FECA transactions with the U.S. Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management.

Imputed financing represents the costs paid on behalf of the DON by another Federal entity. The DON recognizes imputed costs for (1) employee pension, post-retirement health, and life insurance benefits; (2) post-employment benefits for terminated and inactive employees to include unemployment and workers compensation under the FECA; (3) losses in litigation proceedings; and (4) military payroll for service members assigned to the DON.

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

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

### **1.H. TRANSACTIONS WITH FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS**

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

#### **1.I. FUNDS WITH THE U.S. TREASURY**

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The DON’s monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of DFAS, the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State’s financial service centers process the majority of the DON’s cash

collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits. The disbursing station monthly reports are consolidated at the disbursing office level for financial reporting purposes.

In addition, DFAS and the USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis, DFAS performs reconciliation between DON's FBWT and the U.S. Treasury.

### **1.J. CASH AND OTHER MONETARY ASSETS**

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

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

The DON conducts a significant portion of operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations: (1) operations and maintenance; (2) military personnel; (3) military construction; (4) family housing operation and maintenance; and (5) family housing construction. The gains and losses are calculated as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The DON does not separately identify currency fluctuation transactions.

### **1.K. ACCOUNTS RECEIVABLE**

Accounts receivable from other federal entities or the public include accounts receivable, claims receivable, and refunds receivable. In accordance with SFFAS No. 1, "Accounting for Selected Assets and Liabilities," the methodology for losses due to uncollectable amounts are based on an individual account analysis and/or group analysis. The analysis is based on three years of receivable data. This data is used to determine the

historical percentage of collections in each age category of receivables. The DON does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the TFM Part 2, Chapter 4700, Appendix 10, "Intragovernmental Business Rules."

### **1.L. INVENTORIES AND RELATED PROPERTY**

SFFAS No. 3, "Accounting for Inventory and Related Property" defines "Inventory" as tangible personal property that is held for sale, in the process of production for sale, or to be consumed in the production of goods for sale or in the provision of services for a fee. The term "held for sale" is interpreted to include items for sale or transfer to entities outside the Federal Government, or other federal entities. All inventory is funded and reported under the Navy Working Capital Fund financial statements. The DON General Fund does not maintain inventory.

General Fund OM&S primarily consists of related spares and repair parts for materiel. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, support equipment, etc. The DON categorizes its OM&S as Held for Use, Held for Repair and Excess, Obsolete, and Unserviceable. Many high-dollar items, such as aircraft engines, are categorized as OM&S rather than general equipment. The DON determined the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category.

The DON uses a combination of the Consumption Method and Purchase Method to account for OM&S. DON Budget Submitting Offices (BSO) use the Consumption Method unless the use of the Purchase Method is authorized. The use of the Purchase Method is only available to DON BSOs when OM&S they maintain is (1) not material, (2) in the hands of the end user, or (3) if it is not cost-beneficial to apply the Consumption Method.

In accordance with SFFAS No. 3, the DON categorizes its OM&S as held for use, held in reserve for future use (held for repair) and excess, obsolete and unserviceable. The DON values OM&S assets held for use and held for repair with multiple valuation methods: Latest Acquisition Cost (LAC), Moving Average Cost (MAC) and replacement price. Excess, obsolete, and unserviceable OM&S are valued using Net Realizable Value (NRV). Currently these items are valued at a NRV of zero.

The DON standard valuation method is MAC. In general, the LAC method is used for OM&S accounted for in legacy logistics systems that were designed specifically

for material management rather than accounting purposes. The legacy systems provide visibility and accountability over inventory and related property items but do not allow for MAC valuations. The DON is in the process of resolving these weaknesses and transitioning to MAC. Both LAC and MAC are allowable valuation methods within SFFAS No. 3.

During FY 2016 and 2015, the DON expensed significant amounts of OM&S using the purchase method because legacy systems could not support the consumption method. The DON currently performs an entry to record previously expensed OM&S as an asset on the Balance Sheet based on amounts obtained via data call. This is a material weakness for DoD and long-term system corrections are in the process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

## **1.M. INVESTMENTS IN U.S. TREASURY SECURITIES**

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The DON reports investments in accordance with SFFAS No. 1. The DON reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments 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, a provision is not made for unrealized gains or losses on these securities.

The DON invests in nonmarketable market-based U.S. Treasury securities, issued to federal agencies by the U.S. Treasury's Bureau of Fiscal Services. These securities are not traded on any financial exchange but are priced consistently with publicly traded U.S. Treasury securities.

## **1.N. GENERAL PROPERTY, PLANT AND EQUIPMENT**

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General Property, Plant and Equipment (PP&E) assets are capitalized in accordance with SFFAS No. 6, "Accounting for Property, Plant and Equipment," as amended by SFFAS No. 10 "Accounting for Internal Use Software," SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," and SFFAS No. 35, "Estimating the Historical Cost of General Property, Plant, and Equipment: Amending SFFAS No. 6 and 23," when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD's capitalization threshold. The DoD capitalizes improvements to existing general PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size,

efficiency, or capacity of the asset. The DON depreciates all general PP&E on a straight-line basis.

The DON's general PP&E capitalization threshold is \$1 million, with the exception of USMC, who retained the \$100 thousand dollar threshold. The DON capitalizes Real Property and Internal Use Software that exceeds \$250 thousand. The capitalization threshold applies to asset acquisitions and modifications/improvements placed into service after September 30, 2013. General PP&E assets acquired prior to October 1, 2013 were capitalized at prior threshold levels (\$100 thousand for equipment and \$20 thousand for real property) and are carried at the remaining book value.

The DON uses a combination of actual expenditure data, program funding, and cost factors to estimate the value for general PP&E in accordance with SFFAS No. 35. For Real Property, the DON used plant replacement value. For aircraft, the DON utilized historical budgetary information. The DON is developing a process to track and record actual general equipment costs in accordance with SFFAS No. 6.

When it is in the best interest of the government, the DON provides government property to contractors 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 meets or exceeds the DoD capitalization threshold, federal accounting standards require that it be reported on the DON's Balance Sheet.

The DoD developed policy and a reporting process for contractors with government furnished equipment that provides appropriate general PP&E information for financial statement reporting. In accordance with Federal Acquisition Regulations (FAR), DoD requires the DON maintain, in their property systems, information on all property furnished to contractors. These actions are structured to capture and report the information necessary for compliance with federal accounting standards. The DON has not fully implemented this policy primarily due to system limitations and is in the process of developing a business process to record and track all contractor held property in DON accountable property systems of record (APSR).

## **1.O. ADVANCES AND PREPAYMENTS**

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When advances are permitted by law, legislative action, or presidential authorization, DoD's policy as prescribed in SFFAS No.1 is to record advances or prepayments in accordance with USGAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets



when the related goods and services are received. The DON has not implemented this policy primarily due to system limitations.

Due to inconsistencies in the posting logic for Nonfederal Advances and Prepayments, the DON is noncompliant with the FFMTA, which requires agencies to comply with the Federal financial management system requirements, standards promulgated by the FASAB, and the USSGL at the transaction level.

## **1.P. LEASES**

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In accordance with SFFAS No. 5, "Accounting for Liabilities of the Federal Government," lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, the DON records the applicable asset as though purchased, with an offsetting liability, and depreciates it.

The DON records the asset and the liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The DON, as the lessee, receives the use and possession of leased property; for example, real estate or equipment from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are expensed over the lease term as they become payable.

Office space and leases entered into by the DON are the largest component of operating leases and are based on costs gathered from existing leases, General Services Administration (GSA) bills, and interservice support agreements. Future year projections use the Consumer Price Index.

## **1.Q. OTHER ASSETS**

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Other assets include those assets such as military and civil service employee pay advances and certain contract financing payments not reported elsewhere on the DON's Balance Sheet. The DON maintains this classification in accordance with SFFAS No. 1.

Advances are cash outlays made by the DON to its employees, contractors, or others to cover a part or all of the recipients' anticipated expenses. Military pay advances are advance payments authorized for purposes intended to ease hardships imposed by the lack of regular

payments when a military member is mobilized, ordered to duty at distant stations, or deployed aboard ships for more than 30 days. Civilian pay advances are payments advanced to full time DON civilians intended to finance unusual employee expenses associated with overseas assignments that are not otherwise reimbursed and to aid foreign assignment recruitment and retention. Travel advances are disbursed to employees prior to business trips. Travel advances are subsequently reduced when travel expenses are actually incurred.

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 may provide financing payments. Contract financing payments are defined in the FAR, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on costs, and interim payments under certain cost-reimbursement contracts. It is DoD policy to record certain contract financing payments as other assets. The DON has not fully implemented this policy primarily due to system limitations.

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

## **1.R. CONTINGENCIES AND OTHER LIABILITIES**

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The DON is party to various administrative proceedings, legal actions, and claims. Under SFFAS No. 5, as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," the Balance Sheet should include estimated liabilities for these items when an adverse decision is probable, reasonably possible, and estimable. When the amount of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is remote, the contingency is not disclosed.

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

contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship, and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities also arise as a result of anticipated disposal costs for the DON's assets. Consistent with SFFAS No. 6, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. The DON adheres to DoD's policy, which is consistent with SFFAS No. 5. Nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. In addition, DoD recognizes nonenvironmental disposal liabilities for nuclear-powered military equipment when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

### **1.S. ACCRUED LEAVE**

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The DON reports military leave, compensatory leave, and annual leave earned by civilians, but not yet used, as accrued liabilities. The accrued balance is adjusted annually to reflect current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

### **1.T. NET POSITION**

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Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative results of operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

### **1.U. TREATIES FOR USE OF FOREIGN BASES**

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The DoD has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The DON purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. Treaty terms generally allow the DON continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, use of the foreign bases is prohibited and losses are recorded for the

value of any nonretrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

### **1.V. UNDISTRIBUTED DISBURSEMENTS AND COLLECTIONS**

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Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported undistributed disbursement and collections have corroborating documentation for the summary-level adjustments made to accounts payable and receivable. Unsupported undistributed disbursements and collections do not have supporting documentation for the transactions and most likely would not meet audit scrutiny. However, both supported and unsupported adjustments may have been made to the DON's accounts payable and receivable trial balances prior to validating that the underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD generally cannot determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements and collections are also applied to reduce accounts payable and receivable accordingly.

### **1.W. FIDUCIARY ACTIVITIES**

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Fiduciary cash and other assets are not assets of the DON and are not recognized on the balance sheet. Fiduciary activities are reported on the financial statement note schedules.

### **1.X. MILITARY RETIREMENT AND OTHER FEDERAL EMPLOYMENT BENEFITS**

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For financial reporting purposes, the DON's actuarial liability for worker's compensation benefits is developed by the DOL and provided to the DON at the end of each fiscal year. Military retirement is accounted for in the audited financial statements of the Military Retirement fund as the DON does not record any liabilities or obligations for pensions or healthcare retirement benefits.

## NOTE 2. NONENTITY ASSETS

| As of September 30<br>(Amounts in thousands) | 2016           | Restated 2015  |
|----------------------------------------------|----------------|----------------|
| <b>Intragovernmental Assets</b>              |                |                |
| Fund Balance with Treasury                   | \$ 253,241     | \$ 237,752     |
| <b>Nonfederal Assets</b>                     |                |                |
| Cash and Other Monetary Assets               | 93,929         | 106,034        |
| Accounts Receivable                          | 528,056        | 98,655         |
| <b>Total Nonentity Assets</b>                | \$ 875,226     | \$ 442,441     |
| <b>Total Entity Assets</b>                   | \$ 598,450,820 | \$ 593,345,545 |
| <b>Total Assets</b>                          | \$ 599,326,046 | \$ 593,787,986 |

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

### Intragovernmental Fund Balance with Treasury

This nonentity asset category primarily represents amounts in DON's Suspense Funds, Withheld State and Local Taxes Fund, and Withheld Allotment of Compensation for Payment of Employee Organization Dues Fund.

### Nonfederal Cash and Other Monetary Assets

This nonentity asset category represents disbursing officers' cash, foreign currency, and undeposited collections as reported on the Disbursing Officer's Statement of Accountability. These assets are held by DON disbursing officers on behalf of other agencies and are not available for DON's use in normal operations.

### Nonfederal Accounts Receivable (Public)

The primary components of nonentity accounts receivable are contractor debts owed to canceled general fund accounts. The balance also includes out-of-service employee debts owed to canceled general funds accounts, and interest, penalty, and administrative charges for all other public debts. As debts are repaid, they are deposited to Treasury Miscellaneous Receipts.

### Restatements

During an audit readiness initiative, a Notice of Finding and Recommendation (NFR) was issued where the General PP&E balance on the September 30, 2015 financial statements does not accurately or completely represent expenditures associated with the Construction in Progress in the amount of \$31.3 billion. This amount impacted the Total Entity Assets line. See Note 23, Restatements for further information.

## NOTE 3. FUND BALANCE WITH TREASURY

| As of September 30<br>(Amounts in thousands) | 2016           | 2015           |
|----------------------------------------------|----------------|----------------|
| <b>Fund Balances</b>                         |                |                |
| Appropriated Funds                           | \$ 144,758,375 | \$ 139,974,541 |
| Revolving Funds                              | 140,877        | 203,384        |
| Trust Funds                                  | 37,854         | 22,459         |
| Special Funds                                | 2,360          | 2,295          |
| Other Fund Types                             | 273,402        | 292,140        |
| <b>Total</b>                                 | \$ 145,212,868 | \$ 140,494,819 |

Other Fund Types consists primarily of amounts in the following deposit funds and receipt accounts: General Fund Proprietary Receipts, Pay of the Navy Deposit Fund, and Pay of the Marine Corps Deposit Fund. These funds represent receipts held temporarily for distribution to another fund or entity or held as an agent for others.



## OTHER

| As of September 30<br>(Amounts in thousands)    | 2016             | 2015             |
|-------------------------------------------------|------------------|------------------|
| <b>Fund Balances Per Treasury Versus Agency</b> |                  |                  |
| Fund Balance per Treasury                       | \$ 145,279,120   | \$ 140,539,966   |
| Fund Balance per DON                            | 145,212,868      | 140,494,819      |
| <b>Reconciling Amount</b>                       | <u>\$ 66,252</u> | <u>\$ 45,147</u> |

The total reconciling amount of \$66.3 million in FBWT is due to saving deposit program differences and parent-child transactions. The reconciling difference related to allocation transfers results from instances in which DON allocates to or is allocated funds from various governmental entities. In cases in which DON is allocated funds, the amount is excluded from the Fund Balance per DON, but included in Fund Balance per Treasury. In cases in which DON allocates funds, the amount is included in the Fund Balance per DON, but it is excluded from the Fund Balance per Treasury. See Note 21, Fiduciary Activities for further information regarding the deposit funds.

## STATUS OF FUND BALANCE WITH TREASURY

| As of September 30<br>(Amounts in thousands) | 2016                  | 2015                  |
|----------------------------------------------|-----------------------|-----------------------|
| <b>Unobligated Balance</b>                   |                       |                       |
| Available                                    | \$ 34,107,946         | \$ 30,109,852         |
| Unavailable                                  | 6,207,329             | 6,166,591             |
| <b>Obligated Balance not yet Disbursed</b>   | 108,155,231           | 107,370,622           |
| <b>Non-Budgetary FBWT</b>                    | 273,402               | 292,140               |
| <b>Non-FBWT Budgetary Accounts</b>           | <u>(3,531,040)</u>    | <u>(3,444,386)</u>    |
| <b>Total</b>                                 | <u>\$ 145,212,868</u> | <u>\$ 140,494,819</u> |

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

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

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

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

## DEPOSIT & CLEARING (SUSPENSE) ACCOUNTS

| As of September 30                                              | 2016      |               | 2015      |                |
|-----------------------------------------------------------------|-----------|---------------|-----------|----------------|
| <i>(Amounts in thousands)</i>                                   |           |               |           |                |
| <b>Fund Balances Per Treasury Versus Agency</b>                 |           |               |           |                |
| 17F3875.001 Budget Clearing Account                             | \$        | 13,970        | \$        | (605)          |
| 17F3875.002 Budget Clearing Account                             |           | 45,912        |           | 44,815         |
| 17F3875.004 Treasury Suspense Account                           |           | (43,367)      |           | 13,232         |
| 17F3880.000 Unavailable Check Cancellations and Overpayments    |           | 2,314         |           | 2,961          |
| 17F3882 Thrift Savings Plan                                     |           | 53,604        |           | 66,843         |
| 17F3885.000 Intragovernmental Payment and Collection -Interfund |           | (246)         |           | 328            |
| 17F3885.007 Intragovernmental Payment and Collection -IPAC      |           | 1,578         |           | (6,343)        |
| 17F3886 Thrift Savings Plan                                     |           | -             |           | (7)            |
| <b>Total</b>                                                    | <b>\$</b> | <b>73,765</b> | <b>\$</b> | <b>121,224</b> |

Other Fund Types includes deposit fund accounts used to record monies that do not belong to the Federal Government and budget clearing (suspense) accounts used to temporarily hold unidentifiable general, special, or trust fund expenditures or collections that belong to the Federal Government. The deposit and suspense account balances are also included within the Non-budgetary FBWT amount reported under the Status of FBWT. Due to the nature of the suspense accounts, which temporarily hold transactions pending clearance to the applicable account, there is a potential risk that reported transactions may resolve to other DoD or Federal Agencies. DON budget clearing account 17F3875.002 used to record revenues from agricultural and grazing leases, the sale of forest products and recyclable materials, and income from royalties and trademarks is currently under a corrective action plan to be moved into appropriate funds prior to the generation of the FY 2019 Annual Financial Report. Thrift Savings Plan accounts 17F3882 and 17F3886 are also under corrective action to be moved into a deposit account 17X6228 by FY 2017. DON's suspense account balances are shown above.

Non-FBWT Budgetary Accounts reduces the Status of FBWT. This amount is comprised of Trust Fund investments in U.S. Treasury securities, unfilled customer orders without advance, and reimbursements receivable. Due to DON systems' inability to segregate Budgetary FBWT balances, Non-FBWT Budgetary Accounts are used to reconcile the Status of FBWT.

## NOTE 4. INVESTMENTS AND RELATED INTEREST

| As of September 30                  | 2016            |                                  |                  |                            |
|-------------------------------------|-----------------|----------------------------------|------------------|----------------------------|
|                                     | Cost            | Amortized (Premium)/<br>Discount | Investments, Net | Market Value<br>Disclosure |
| <i>(Amounts in thousands)</i>       |                 |                                  |                  |                            |
| <b>Intragovernmental Securities</b> |                 |                                  |                  |                            |
| Nonmarketable, Market-Based         | \$ 5,656        | \$ 3                             | \$ 5,659         | \$ 5,662                   |
| Other Funds                         |                 |                                  |                  |                            |
| Accrued interest                    | 5               | -                                | 5                | 5                          |
| <b>Total</b>                        | <b>\$ 5,661</b> | <b>\$ 3</b>                      | <b>\$ 5,664</b>  | <b>\$ 5,667</b>            |
| As of September 30                  | 2015            |                                  |                  |                            |
|                                     | Cost            | Amortized (Premium)/<br>Discount | Investments, Net | Market Value<br>Disclosure |
| <i>(Amounts in thousands)</i>       |                 |                                  |                  |                            |
| <b>Intragovernmental Securities</b> |                 |                                  |                  |                            |
| Nonmarketable, Market-Based         | \$ 6,540        | \$ (16)                          | \$ 6,524         | \$ 6,531                   |
| Other Funds                         |                 |                                  |                  |                            |
| Accrued interest                    | 19              | -                                | 19               | 19                         |
| <b>Total</b>                        | <b>\$ 6,559</b> | <b>\$ (16)</b>                   | <b>\$ 6,543</b>  | <b>\$ 6,550</b>            |

Other Funds represents DON Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the Navy General Gift Fund. These investments are Nonmarketable Market-Based U.S. Treasury securities reported at cost, net of amortized premiums and discounts. In accordance with the SFFAS No. 27, "Identifying and Reporting Funds from Dedicated Collections," DON Trust Funds are reported as funds from dedicated collections.

The U.S. Treasury securities are issued to the funds from dedicated collections as evidence of its receipts and are an asset to the DON and a liability to the U.S. Treasury. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with funds from dedicated collections. The cash generated from funds from dedicated collections are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Since the DON and the U.S. Treasury are both part of the Federal Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, they do not represent an asset or liability in the U.S. Government financial statements.

The U.S. Treasury securities provide the DON with authority to access funds to make future benefit payments or other expenditures. When the DON requires redemption of securities to make expenditures, the Federal Government will meet the requirement by using accumulated cash balances, raising taxes or other receipts, borrowing from the public or repaying less debt, or curtailing other expenditures. The Federal Government used the same method to finance all other expenditures.

## NOTE 5. ACCOUNTS RECEIVABLE

| As of September 30                              | 2016              |                                        |                          |
|-------------------------------------------------|-------------------|----------------------------------------|--------------------------|
|                                                 | Gross Amount Due  | Allowance For Estimated Uncollectibles | Accounts Receivable, Net |
| <i>(Amounts in thousands)</i>                   |                   |                                        |                          |
| <b>Intragovernmental Receivables</b>            | \$ 181,481        | \$ -                                   | \$ 181,481               |
| <b>Nonfederal Receivables (From the Public)</b> | 637,927           | (6,379)                                | 631,548                  |
| <b>Total</b>                                    | <u>\$ 819,408</u> | <u>\$ (6,379)</u>                      | <u>\$ 813,029</u>        |
| As of September 30                              | 2015              |                                        |                          |
| <i>(Amounts in thousands)</i>                   |                   |                                        |                          |
| <b>Intragovernmental Receivables</b>            | \$ 212,630        | \$ -                                   | \$ 212,630               |
| <b>Nonfederal Receivables (From the Public)</b> | 580,363           | (8,600)                                | 571,763                  |
| <b>Total</b>                                    | <u>\$ 792,993</u> | <u>\$ (8,600)</u>                      | <u>\$ 784,393</u>        |

Accounts receivable represent the DON's claim for payment from other entities. Intra-governmental Receivables primarily represents amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules. The DON only recognizes an allowance for uncollectible amounts from the public. The methodology used in determining the allowance amount is discussed in Note 1.K, Accounts Receivable. Refer to Note 2, Nonentity Assets for additional information on Nonfederal Accounts Receivable.

## NOTE 6. OTHER ASSETS

| As of September 30                             | 2016                | 2015                 |
|------------------------------------------------|---------------------|----------------------|
| <i>(Amounts in thousands)</i>                  |                     |                      |
| <b>Intragovernmental Other Assets</b>          |                     |                      |
| Advances and Prepayments                       | \$ 580,268          | \$ 444,466           |
| <b>Outstanding Contract Financing Payments</b> | 8,436,660           | 48,447,272           |
| <b>Advances and Prepayments</b>                | 232,036             | 271,158              |
| <b>Other Assets (With the Public)</b>          | 6,466               | 5,604                |
| <b>Total Nonfederal Other Assets</b>           | <u>8,675,162</u>    | <u>48,724,034</u>    |
| <b>Total</b>                                   | <u>\$ 9,255,430</u> | <u>\$ 49,168,500</u> |

### Intragovernmental and Nonfederal Other Assets - Advances and Prepayments

Advances are cash outlays made by a federal entity to cover a part or all of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity receives. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.



### Nonfederal Other Assets - Outstanding Contract Financing Payments (OCFP)

Contract terms and conditions for certain types of contract financing payments convey certain rights to the DON protecting the contract work from state or local taxation, liens or attachment by the contractors' 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 DON. The DON does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DON is not obligated to make payment to the contractor until delivery and acceptance. Some of the amounts reported as OCFP may be progress payments based on percentage or stage of completion. However, DON is unable to identify these due to system limitations, thus all amounts are reported as OCFP.

The difference in OCFP was due to a change in recording Construction in Progress (CIP). During FY 2016, as a result of efforts to improve the financial reporting of general equipment balances, the DON changed its method for recording Construction in Progress (CIP). The construction of ships occurs primarily through contract financing payments that were previously recorded to Advances and Prepayments instead of to CIP. Adjustments were recorded during FY 2016 to reverse prior entries recorded to Advances and Prepayments and posted the current inception to date amount for Shipbuilding and Conversion to CIP in the amount of \$37 billion. Accounting processes were changed to record future Shipbuilding and Conversion costs to CIP.

OCFP includes \$6.8 billion in contract financing payments and an additional \$1.6 billion in estimated future payments to contractors upon delivery and government acceptance of a satisfactory product. (See additional discussion in Note 13, Other Liabilities).

### Nonfederal Other Assets - Other Assets (With the Public)

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

## NOTE 7. CASH AND OTHER MONETARY ASSETS

| As of September 30<br>(Amounts in thousands) | 2016             | 2015              |
|----------------------------------------------|------------------|-------------------|
| <b>Cash</b>                                  | \$ 64,929        | \$ 85,178         |
| <b>Foreign Currency</b>                      | 29,000           | 20,856            |
| <b>Total</b>                                 | <u>\$ 93,929</u> | <u>\$ 106,034</u> |

Cash and Foreign Currency consist primarily of cash held by DON Disbursing Officers to carry out their payment, collection, and foreign currency accommodation exchange mission. Foreign Currency is also held in overseas banks in support of contingency operations. The primary source of the amounts reported is the Disbursing Officers Statements of Accountability.

Total Cash, Foreign Currency, and Other monetary assets reported are nonentity assets that are not available for DON's use in normal operations. Therefore, the entire Cash and Foreign Currency balance is restricted to its use.

## NOTE 8. INVENTORY AND RELATED PROPERTY

| As of September 30<br>(Amounts in thousands)  | 2016                 | 2015                 |
|-----------------------------------------------|----------------------|----------------------|
| <b>Inventory, Net</b>                         | \$ -                 | \$ -                 |
| <b>Operating Material &amp; Supplies, Net</b> | 81,577,809           | 78,851,740           |
| <b>Total</b>                                  | <u>\$ 81,577,809</u> | <u>\$ 78,851,740</u> |

## INVENTORY AND RELATED PROPERTY

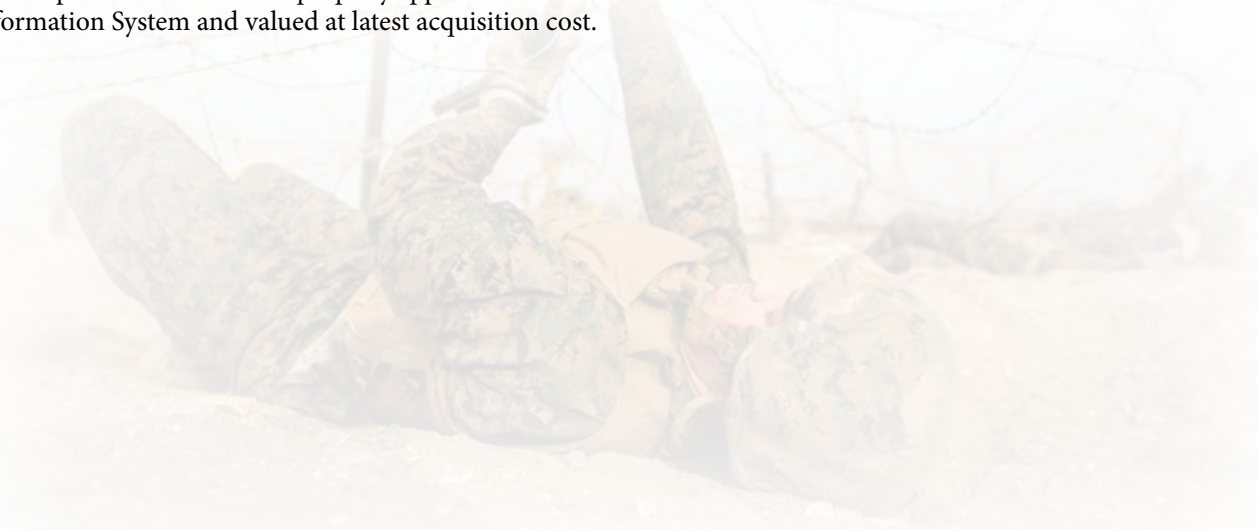
| As of September 30                  | 2016                 |                       |                      | Valuation Method |
|-------------------------------------|----------------------|-----------------------|----------------------|------------------|
|                                     | OM&S Gross Value     | Revaluation Allowance | OM&S, Net            |                  |
| <i>(Amounts in thousands)</i>       |                      |                       |                      |                  |
| <b>OM&amp;S Categories</b>          |                      |                       |                      |                  |
| Held for Use                        | \$ 65,582,218        | \$ 25,286             | \$ 65,607,504        | SP, LAC, MAC     |
| Held for Repair                     | 15,970,305           | -                     | 15,970,305           | SP, LAC, MAC     |
| Excess, Obsolete, and Unserviceable | 1,004,675            | (1,004,675)           | -                    | NRV              |
| <b>Total</b>                        | <b>\$ 82,557,198</b> | <b>\$ (979,389)</b>   | <b>\$ 81,577,809</b> |                  |
| <br>                                |                      |                       |                      |                  |
| As of September 30                  | 2015                 |                       |                      | Valuation Method |
|                                     | OM&S Gross Value     | Revaluation Allowance | OM&S, Net            |                  |
| <i>(Amounts in thousands)</i>       |                      |                       |                      |                  |
| <b>OM&amp;S Categories</b>          |                      |                       |                      |                  |
| Held for Use                        | \$ 59,568,266        | \$ -                  | \$ 59,568,266        | SP, LAC, MAC     |
| Held for Repair                     | 19,283,583           | (109)                 | 19,283,474           | SP, LAC, MAC     |
| Excess, Obsolete, and Unserviceable | 1,038,618            | (1,038,618)           | -                    | NRV              |
| <b>Total</b>                        | <b>\$ 79,890,467</b> | <b>\$ (1,038,727)</b> | <b>\$ 78,851,740</b> |                  |

### Legend for Valuation Methods:

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

OM&S includes the related spares and repair parts for materiel. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, support equipment, etc. OM&S also includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The DON assigns OM&S to a category based upon the type and condition of the asset in accordance with SFFAS No. 3 "Accounting for Inventory and Related Property." DON categorizes its OM&S as Held for Use and Held for Repair, and Excess, Obsolete, and Unserviceable. OM&S Held for Use includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal.

The DON uses a combination of the Consumption Method and Purchase Method to account for OM&S. DON BSOs use the Consumption Method unless the use of the Purchase Method is authorized. The use of the Purchase Method is only available to DON BSOs when OM&S they maintain is (1) not material, (2) in the hands of the end user, or (3) if it is not cost-beneficial to apply the Consumption Method. Legacy accounting systems cannot support the consumption method of accounting, thus the various reporting activities are currently using the purchase method. As financial reporting entities begin to purchase and manage materiel in Navy Enterprise Resource Planning (ERP), the consumption method will be properly applied. Ammunition and Munitions are maintained in the DON Ordnance Information System and valued at latest acquisition cost.



## NOTE 9. GENERAL PP&E, NET

| As of September 30                    | 2016                                    |              |                       |                                                |                       |
|---------------------------------------|-----------------------------------------|--------------|-----------------------|------------------------------------------------|-----------------------|
|                                       | Depreciation/<br>Amortization<br>Method | Service Life | Acquisition Value     | (Accumulated<br>Depreciation/<br>Amortization) | Net Book Value        |
| <i>(Amounts in thousands)</i>         |                                         |              |                       |                                                |                       |
| <b>Major Asset Classes</b>            |                                         |              |                       |                                                |                       |
| Land                                  | N/A                                     | N/A          | \$ 571,409            | \$ -                                           | \$ 571,409            |
| Buildings, Structures, and Facilities | S/L                                     | 20 or 40     | 147,098,280           | (111,141,098)                                  | 35,957,182            |
| Leasehold Improvements                | S/L                                     | lease term   | 6,530                 | (3,961)                                        | 2,569                 |
| Software                              | S/L                                     | 2-5 or 10    | 3,593                 | (2,647)                                        | 946                   |
| General Equipment                     | S/L                                     | Various      | 482,743,607           | (253,669,377)                                  | 229,074,230           |
| Construction-in-Progress              | N/A                                     | N/A          | 86,532,261            | -                                              | 86,532,261            |
| Other                                 | N/A                                     | N/A          | 10,228,720            | -                                              | 10,228,720            |
| <b>Total General PP&amp;E</b>         |                                         |              | <u>\$ 727,184,400</u> | <u>\$ (364,817,083)</u>                        | <u>\$ 362,367,317</u> |

| As of September 30                    | Restated 2015                           |              |                       |                                                |                       |
|---------------------------------------|-----------------------------------------|--------------|-----------------------|------------------------------------------------|-----------------------|
|                                       | Depreciation/<br>Amortization<br>Method | Service Life | Acquisition Value     | (Accumulated<br>Depreciation/<br>Amortization) | Net Book Value        |
| <i>(Amounts in thousands)</i>         |                                         |              |                       |                                                |                       |
| <b>Major Asset Classes</b>            |                                         |              |                       |                                                |                       |
| Land                                  | N/A                                     | N/A          | \$ 780,121            | \$ -                                           | \$ 780,121            |
| Buildings, Structures, and Facilities | S/L                                     | 20 or 40     | 51,493,603            | (26,022,858)                                   | 25,470,745            |
| Leasehold Improvements                | S/L                                     | lease term   | 6,530                 | (3,650)                                        | 2,880                 |
| Software                              | S/L                                     | 2-5 or 10    | 5,341                 | (3,639)                                        | 1,702                 |
| General Equipment                     | S/L                                     | Various      | 483,192,904           | (229,914,151)                                  | 253,278,753           |
| Construction-in-Progress              | N/A                                     | N/A          | 44,413,020            | -                                              | 44,413,020            |
| Other                                 | N/A                                     | N/A          | 428,736               | -                                              | 428,736               |
| <b>Total General PP&amp;E</b>         |                                         |              | <u>\$ 580,320,255</u> | <u>\$ (255,944,298)</u>                        | <u>\$ 324,375,957</u> |

### Legend for Depreciation/Amortization Methods:

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

DON General PP&E is comprised of: Real Property (Land and Buildings, Structures, and Facilities), Improvements to Assets Under Lease, Internal Use Software, General Equipment (Vessels, Satellites, Trident Missiles, Aircraft, and Other Long-lived Tangible Equipment), and Construction in Progress (both Real Property and General Equipment). Any General PP&E that does not fall within the aforementioned categories is classified as Other General PP&E.

Other General PP&E consists of Real Property held in Caretaker Status. Caretaker is defined as those properties that DON still owns, but which are being held awaiting further disposal action to another entity, such as Defense Base Closure and Realignment Commission (BRAC) property awaiting sale or transfer to another Federal agency.

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 DON continued use of these properties until the treaties expire. There are no other known restrictions on General PP&E.

For FY 2016, the DON's General Equipment decreased by \$449.2 million. The DON implemented new policy and accounting treatments that affected the reported value of its General PP&E. Under the authority in SFFAS No. 35, the DON estimated the historical cost of its Aircraft and Real Property. For Aircraft, DON utilized budgetary information from the President's Budget Exhibit values to estimate the historical cost.

The majority of Stricken Aircraft are in reclamation and awaiting final disposal. However, in FY 2016, DON determined that Stricken Aircraft designated in "Stricken Section 2 - CNO Special Project, War Reserve," or "Stricken Section 3 - Foreign Military Sales" are operationally capable and have a likelihood of returning to service or being sold to a foreign military service. Therefore, the DON determined to report these Aircraft in General PP&E.

The DON also implemented a new useful life structure and depreciation method for Aircrafts based on the Operating and Support (O&S) Cost-Estimating Guide published by the Office of the Secretary of Defense (OSD) Director of Cost Assessment and Program Evaluation (CAPE). In FY 2016, DON changed its depreciation method from a flight-hours method to the straight-line method of depreciation utilizing estimated useful life of 20 years, assuming no residual

value for most aircraft of the fleet. This useful life can, however, be extended to 25 years for some aircraft. In addition, the DON was not capturing aircraft depreciation in DPAS for several years. The depreciation methodology conversion of aircraft from DPAS to Navy-ERP resulted in the recording of “catch-up” depreciation. As a result, the net book value of general equipment decreased by \$24.2 billion.

For Real Property, DON utilized a Plant Replacement Value (PRV) methodology to estimate the value of its financially reportable Real Property assets as of September 30, 2016. PRV was applied to all financially reportable assets placed in service prior to October 1, 2014. All other assets are valued by utilizing historical cost. PRV resulted in a net \$36 billion real property net book value as of September 30, 2016.

For FY 2016 and prior, DON did not record Construction-in-Progress (CIP) for General Equipment. These costs were either erroneously expensed or classified as a prepaid asset. The correction of this error resulted in an increase in CIP net value by \$42.1 billion as of September 30, 2016.

Significant accounting adjustments have been made to DON’s mission critical assets as a result of the Department’s ongoing audit readiness efforts. These accounting adjustments were recognized in current year gain/loss accounts when auditable data was not available to support restatement of prior period financial statements.

## HERITAGE ASSETS

| As of September 30                                        | Measure Quantity | As of September 30, 2015 | Addition | Deletions | As of September 30, 2016 |
|-----------------------------------------------------------|------------------|--------------------------|----------|-----------|--------------------------|
| <b>Categories</b>                                         |                  |                          |          |           |                          |
| Building and Structures                                   | Each             | 10,035                   | -        | -         | 10,035                   |
| Archaeological Sites                                      | Each             | 18,534                   | -        | -         | 18,534                   |
| Museum Collection Items (Objects, Not Including Fine Art) | Each             | 518,723                  | 17,437   | 3         | 536,157                  |
| Museum Collection Items (Objects, Fine Art)               | Each             | 43,747                   | 22       | 62        | 43,707                   |

| As of September 30                           | As of September 30, 2015    | Additions | Deletions                 | As of September 30, 2016 |
|----------------------------------------------|-----------------------------|-----------|---------------------------|--------------------------|
| <i>Stewardship Land (Acres in thousands)</i> |                             |           |                           |                          |
| <b>Facility Code</b>                         | <b>Facility Title</b>       |           |                           |                          |
| 9110                                         | Government Owned Land       | 5         | -                         | 4                        |
| 9111                                         | State Owned Land            | 13        | -                         | 12                       |
| 9120                                         | Withdrawn Public Land       | 2,776     | 3                         | -                        |
| 9130                                         | Licensed and Permitted Land | 25        | -                         | 2                        |
|                                              |                             |           |                           | 23                       |
|                                              |                             |           | Grand Total               | 2,804                    |
|                                              |                             |           | TOTAL - All Other Lands   | 24                       |
|                                              |                             |           | TOTAL - Stewardship Lands | 2,780                    |

### Heritage Assets and Stewardship Land

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





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

Heritage assets within DON consist of buildings and structures, archeological sites, and museum collections. The DON defines these as follows:

**Buildings and Structures.** Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets.

**Archeological Sites.** Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Historical Places in accordance with Section 110 National Historical Preservation Act.

**Museum Collection Items.** Items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics.

The DON's stewardship land consists mainly of mission essential land acquired by donation or devise. The DON held the above acres of land as of September 30, 2016.

**Restatements**

During an audit readiness initiative, a Notice of Finding and Recommendation (NFR) was issued where the General PP&E balance on the September 30, 2015 financial statements does not accurately or completely represent expenditures associated with the Construction in Progress in the amount of \$31.3 billion. This amount impacted the General Property, Plant and Equipment and Cumulative Results of Operations lines. See Note 23, Restatements for further information.

**NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES**

| As of September 30<br>(Amounts in thousands)                | 2016          | 2015          |
|-------------------------------------------------------------|---------------|---------------|
| <b>Intragovernmental Other Liabilities</b>                  | \$ 370,197    | \$ 400,156    |
| <b>Accounts Payable</b>                                     | \$ (113,241)  | \$ (102,291)  |
| <b>Federal Employee and Veteran Benefits</b>                | 1,459,377     | 1,536,102     |
| <b>Environmental and Disposal Liabilities</b>               | 22,717,646    | 21,120,540    |
| <b>Other Liabilities</b>                                    | 3,474,702     | 4,580,858     |
| <b>Total Liabilities Not Covered by Budgetary Resources</b> | \$ 27,908,681 | \$ 27,535,365 |
| <b>Total Liabilities Covered by Budgetary Resources</b>     | \$ 6,151,061  | \$ 7,259,958  |
| <b>Total Liabilities</b>                                    | \$ 34,059,742 | \$ 34,795,323 |

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through Congressional appropriations or earnings of the entity.

Intragovernmental Other Liabilities consist primarily of unfunded Federal Employees' Compensation Act (FECA) liabilities due to the Department of Labor and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

### Nonfederal Liabilities

Accounts Payable is related to cancelled year accounts payable that are not budgeted. The Accounts Payable value includes balances comprised of accounts payable transactions recorded in the Navy's field accounting system and departmental reporting system. In addition, this value is impacted by the value of the Navy's undistributed disbursements. Undistributed disbursements are defined as the difference between the amount of disbursements reported by the Treasury finance network and the amount of disbursements recorded by the Department's (i.e. Navy's) disbursement and collection activities. Financial reporting procedures and system logic for the Navy have been established to apply the undistributed disbursement value against the outstanding Accounts Payable balance. When the undistributed exceeds the recorded Accounts Payable, the result is an abnormal balance. The Navy continues to partner with its service provider to research and correct undistributed transactions to reduce the negative impact on the Accounts payable balance.

Military Retirement and Other Federal Employment Benefits consist of unfunded FECA actuarial liabilities not due and payable during the current fiscal year. Refer to Note 15, Military Retirement and Other Federal Employment Benefits, for additional details.

Environmental and Disposal Liabilities are estimates related to future events, and consist of liabilities related to active installations, Defense Base Closure and Realignment Commission sites, equipment and weapons programs, and chemical weapons disposal. See Note 12, Environmental and Disposal Liabilities, for additional details.

Other Liabilities include annual leave, estimated legal contingent liabilities, and the disposal of excess structures that are not currently budgeted for but will become funded as future events occur.

## NOTE 11. ACCOUNTS PAYABLE

| As of September 30                         | 2016                |                                              |                     |
|--------------------------------------------|---------------------|----------------------------------------------|---------------------|
|                                            | Accounts Payable    | Interest, Penalties, and Administrative Fees | Total               |
| <i>(Amounts in thousands)</i>              |                     |                                              |                     |
| <b>Intragovernmental Payables</b>          | \$ 1,387,186        | \$ -                                         | \$ 1,387,186        |
| <b>Nonfederal Payables (to the Public)</b> | 348,082             | 45                                           | 348,127             |
| <b>Total</b>                               | <u>\$ 1,735,268</u> | <u>\$ 45</u>                                 | <u>\$ 1,735,313</u> |

| As of September 30                         | 2015                |                                              |                     |
|--------------------------------------------|---------------------|----------------------------------------------|---------------------|
|                                            | Accounts Payable    | Interest, Penalties, and Administrative Fees | Total               |
| <i>(Amounts in thousands)</i>              |                     |                                              |                     |
| <b>Intragovernmental Payables</b>          | \$ 1,398,696        | \$ -                                         | \$ 1,398,696        |
| <b>Nonfederal Payables (to the Public)</b> | 725,613             | -                                            | 725,613             |
| <b>Total</b>                               | <u>\$ 2,124,309</u> | <u>\$ -</u>                                  | <u>\$ 2,124,309</u> |

Accounts Payable includes amounts owed to federal and nonfederal entities for goods and services received by the DON. The DON's systems do not track intragovernmental accounts payable transactions by customer. Buyer-side accounts payable are adjusted to agree with interagency seller-side accounts receivable. This is accomplished by 1) reclassifying amounts between federal and nonfederal cost categories, 2) accruing additional accounts payable and expenses, and 3) applying both supported and unsupported undistributed disbursements at the reporting entity level.



## NOTE 12. ENVIRONMENTAL AND DISPOSAL LIABILITIES

| As of September 30<br>(Amounts in thousands)                                                                     | 2016                 | 2015                 |
|------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| <b>Environmental Liabilities - Nonfederal</b>                                                                    |                      |                      |
| Accrued Environmental Restoration Liabilities                                                                    |                      |                      |
| Active Installations - Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR) | \$ 3,429,145         | \$ 2,618,322         |
| Active Installations - Military Munitions Response Program (MMRP)                                                | 2,185,945            | 2,016,833            |
| Other Accrued Environmental Liabilities - Non-BRAC                                                               |                      |                      |
| Environmental Corrective Action                                                                                  | \$ 520               | \$ 55,505            |
| Environmental Closure Requirements                                                                               | 480,455              | 473,907              |
| Environmental Response at Operational Ranges                                                                     | -                    | 13,690               |
| Asbestos                                                                                                         | 305,214              | 298,412              |
| Non-Military Equipment                                                                                           | -                    | 253,592              |
| Other                                                                                                            | -                    | 743                  |
| Base Realignment and Closure Installations                                                                       |                      |                      |
| Installation Restoration Program                                                                                 | \$ 1,464,018         | \$ 1,267,645         |
| Military Munitions Response Program                                                                              | 95,886               | 96,251               |
| Environmental Corrective Action / Closure Requirements                                                           | 7,223                | 8,868                |
| Environmental Disposal for Military Equipment/Weapons Programs                                                   |                      |                      |
| Nuclear Powered Military Equipment / Spent Nuclear Fuel                                                          | \$ 14,546,847        | \$ 13,814,600        |
| Other Weapons Systems                                                                                            | 202,393              | 202,172              |
| <b>Total</b>                                                                                                     | <b>\$ 22,717,646</b> | <b>\$ 21,120,540</b> |

The above table excludes estimated total cleanup costs associated with General Property, Plant, and Equipment of \$2.6 billion for FY 2016 and \$2.7 billion for FY 2015.

The prior year "Other" category of environmental liabilities under Other Accrued Environmental Liabilities represents an environmental estimate for disposal of Polychlorinated Biphenyls (PCB) transformers located at various Naval installations. This liability is being reported under the "Environmental Closure Requirements" category for FY 2016.

For FY 2016, Other Accrued Environmental Liabilities, Non-Military Equipment is being reported in Environmental Closure Requirements category. The Navy does not have active ranges with off-site migration and therefore does not have a liability for Environmental Response at Operational Ranges.

In addition to the liabilities reported above, the 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.

### Applicable Laws and Regulations for Cleanup Requirements

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

- Superfund Amendments and Reauthorization Act of 1986
- The Clean Water Act of 1977, amended the Federal Water Pollution Control Act
- The Safe Drinking Water Act of 1974
- The Clean Air Act, as amended in 1990
- The Atomic Energy Act of 1954
- The Nuclear Waste Policy Act of 1982
- The Low Level Radioactive Waste Policy Amendments Act of 1986
- The National Environmental Policy Act of 1969

- Comprehensive Environmental Response, Compensation, and Liability Act
- Medical Waste Tracking Act of 1988
- Toxic Substances Control Act of 1976
- Resource Conservation and Recovery Act of 1976

### **Methods for Assigning Total Cleanup Costs to Current Operating Periods**

Active Installations - Defense Environmental Restoration Program (DERP) Funded: Accrued DERP cleanup liabilities represent the cost to correct past releases of hazardous constituents to Property, Plant, and Equipment, including acquired land and Stewardship Land. Environmental cleanup of past releases is funded by DERP and carried out under applicable regulatory laws and procedural guidance.

Environmental restoration activities may be conducted at operating installations under the Installation Restoration Program (IRP) and at Closed, Transferred, and Transferring Munitions Ranges under the Military Munitions Response Program (MMRP). Determining total environmental cleanup cost considers, on a current cost basis, the anticipated actions required to complete the cleanup, as well as applicable legal and/or regulatory requirements. Program management and support costs are also included in the estimates. The estimate produced is based on site-specific information and use of cost models. The cost estimates are developed and maintained in DON's Normalization of Data System (NORM) database. Such cost estimates are based on the current technology available.

MMRP liabilities are specific to the identification, investigation, 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. Cost to Complete (CTC) is not estimated until there is sufficient site-specific data available to estimate the total CTC. However, DON uses the cost of the study as the estimate until the study is completed.

The Accrued environmental restoration costs do not include the costs of environmental compliance, pollution prevention, conservation activities, contamination, or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations.

Environmental Disposal for Weapons Systems Programs: This area represents environmental liabilities associated with the Nuclear Powered Aircraft Carriers and Submarines, Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. During FY 2006, under the DON Financial Improvement Program (FIP), DON completed a review of the estimating methodology for determining the cost for disposal of ships and submarines. This review resulted in an environmental and non-environmental liability estimate that more accurately reflects the true costs of disposal. The estimating methodology is based on average cost per class of ship rather than an average applied to all ships regardless of class.

### **Description of the Types of Environmental Liabilities and Disposal Liabilities**

#### *Accrued Environmental Restoration Liabilities*

The DON environmental cleanup cost estimate was based on 4,027 IRP and 398 MMRP sites at 207 active installations. As of September 30, 2016, DON estimated and reported \$5.6 billion for environmental restoration liabilities. This amount is comprised of \$3.4 billion in Active Installations-IRP liabilities and \$2.2 billion in Active Installations-MMRP liabilities. The \$1.1 billion in revaluations includes \$483 million in program management costs that weren't previously included before 4th quarter, which complies with OSD's requirement to estimate PM costs through the life of the Environmental Restoration, Navy (ER,N) program.

#### *Other Accrued Environmental Liabilities – Non-BRAC*

The DON defines Non-BRAC environmental units as those sites associated with on-going operations such as solid/hazardous waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retro fill, and/or disposal of PCB transformers, underground storage tank remedial investigation and closure.



This report estimates environmental clean-up or disposal costs for hazardous waste associated with future closure of General Property, Plant and Equipment (GPP&E) assets. Such costs are categorized in the Navy financial statements as environmental corrective action, closure of facilities, remediation of operational range contamination, asbestos abatement, and disposal of non-military equipment. DON estimates totaled \$786.2 million. Estimates for Navy “Other Accrued Environmental Liabilities – Non-BRAC” (OEL) totaled \$597.0 million and for U.S. Marine Corps OEL totaled \$189.2 million as of September 30, 2016.

Environmental conditions that result from current operations and require immediate cleanup (like oil spills or routine hazardous waste removal) are not considered environmental liabilities and are part of current operating expenses.

#### *Base Realignment and Closure Installations*

BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated BRAC process. As of September 30, 2016, DON has estimated and reported \$1.6 billion for BRAC funded environmental liabilities. This amount includes \$1.5 billion for IRP, \$0.1 billion for MMRP, and \$0.007 billion for environmental corrective action and closure requirements. MMRP includes military munitions, chemical residues from military munitions, and munitions scrap at locations on a BRAC installation.

#### *Environmental Disposal for Military Equipment / Weapons Programs*

Environmental Disposal for Weapons Systems are those estimates associated with the environmental disposal costs for DON Nuclear Weapons Programs that include Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel.

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

Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. As of September 30, 2016, there are no changes to the environmental liability estimates due to deflation, changes in laws, regulations, agreements with regulatory agencies, and advances in technology. The DON is not aware of any pending changes but the liability can change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

#### *Description of the Level of Uncertainty Regarding the Accounting Estimates used to calculate the Reported Environmental Liabilities*

The environmental liabilities for DON are based on accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

At this time, the DON estimates asbestos clean-up costs (Friable and NonFriable) for property, plant, and general equipment via extrapolation of historical costs and cost estimates for similar real property and believes these estimates to be reasonable.



## NOTE 13. OTHER LIABILITIES

| As of September 30<br>(Amounts in thousands)           | 2016                     |                             |                      |
|--------------------------------------------------------|--------------------------|-----------------------------|----------------------|
|                                                        | Current Liability        | Noncurrent Liability        | Total                |
| <b>Intragovernmental</b>                               |                          |                             |                      |
| Advances from Others                                   | \$ 56,099                | \$ -                        | \$ 56,099            |
| Disbursing Officer Cash                                | 95,356                   | -                           | 95,356               |
| Judgment Fund Liabilities                              | 8,959                    | -                           | 8,959                |
| FECA Reimbursement to the Dept of Labor                | 140,399                  | 171,135                     | 311,534              |
| Custodial Liabilities                                  | 526,629                  | -                           | 526,629              |
| Employer Contribution and Payroll Taxes Payable        | 73,714                   | -                           | 73,714               |
| Other Liabilities                                      | 49,875                   | -                           | 49,875               |
| <b>Total Intragovernmental</b>                         | <b>951,031</b>           | <b>171,135</b>              | <b>1,122,166</b>     |
| <b>Accrued Funded Payroll and Benefits</b>             | <b>387,614</b>           | <b>-</b>                    | <b>387,614</b>       |
| <b>Advances from Others</b>                            | <b>976,883</b>           | <b>-</b>                    | <b>976,883</b>       |
| <b>Deposit Funds and Suspense Accounts</b>             | <b>273,402</b>           | <b>-</b>                    | <b>273,402</b>       |
| <b>Nonenvironmental Disposal Liabilities</b>           |                          |                             |                      |
| Military Equipment (Nonnuclear)                        | 154,732                  | 46,979                      | 201,711              |
| Excess/Obsolete Structures                             | -                        | -                           | -                    |
| <b>Accrued Unfunded Annual Leave</b>                   | <b>2,853,010</b>         | <b>-</b>                    | <b>2,853,010</b>     |
| <b>Contract Holdbacks</b>                              | <b>220,551</b>           | <b>543</b>                  | <b>221,094</b>       |
| <b>Employer Contribution and Payroll Taxes Payable</b> | <b>34,839</b>            | <b>-</b>                    | <b>34,839</b>        |
| <b>Contingent Liabilities</b>                          | <b>22,540</b>            | <b>2,028,208</b>            | <b>2,050,748</b>     |
| <b>Other Liabilities</b>                               | <b>24,548</b>            | <b>-</b>                    | <b>24,548</b>        |
| <b>Total Other Liabilities</b>                         | <b>\$ 5,899,150</b>      | <b>\$ 2,246,865</b>         | <b>\$ 8,146,015</b>  |
| <b>As of September 30</b><br>(Amounts in thousands)    | <b>2015</b>              |                             |                      |
|                                                        | <b>Current Liability</b> | <b>Noncurrent Liability</b> | <b>Total</b>         |
| <b>Intragovernmental</b>                               |                          |                             |                      |
| Advances from Others                                   | \$ 227,724               | \$ -                        | \$ 227,724           |
| Disbursing Officer Cash                                | 107,313                  | -                           | 107,313              |
| Judgment Fund Liabilities                              | 5,516                    | -                           | 5,516                |
| FECA Reimbursement to the Dept of Labor                | 148,052                  | 180,806                     | 328,858              |
| Custodial Liabilities                                  | 97,376                   | -                           | 97,376               |
| Employer Contribution and Payroll Taxes Payable        | 54,433                   | -                           | 54,433               |
| Other Liabilities                                      | 66,024                   | -                           | 66,024               |
| <b>Total Intragovernmental</b>                         | <b>706,438</b>           | <b>180,806</b>              | <b>887,244</b>       |
| <b>Accrued Funded Payroll and Benefits</b>             | <b>1,666,412</b>         | <b>-</b>                    | <b>1,666,412</b>     |
| <b>Advances from Others</b>                            | <b>971,459</b>           | <b>-</b>                    | <b>971,459</b>       |
| <b>Deposit Funds and Suspense Accounts</b>             | <b>292,140</b>           | <b>-</b>                    | <b>292,140</b>       |
| <b>Nonenvironmental Disposal Liabilities</b>           |                          |                             |                      |
| Military Equipment (Nonnuclear)                        | 173,537                  | 49,200                      | 222,737              |
| Excess/Obsolete Structures                             | 18,005                   | 278,790                     | 296,795              |
| <b>Accrued Unfunded Annual Leave</b>                   | <b>2,869,279</b>         | <b>-</b>                    | <b>2,869,279</b>     |
| <b>Contract Holdbacks</b>                              | <b>239,441</b>           | <b>866</b>                  | <b>240,307</b>       |
| <b>Employer Contribution and Payroll Taxes Payable</b> | <b>18,382</b>            | <b>-</b>                    | <b>18,382</b>        |
| <b>Contingent Liabilities</b>                          | <b>18,350</b>            | <b>2,470,129</b>            | <b>2,488,479</b>     |
| <b>Other Liabilities</b>                               | <b>59,681</b>            | <b>-</b>                    | <b>59,681</b>        |
| <b>Total Other Liabilities</b>                         | <b>\$ 7,033,124</b>      | <b>\$ 2,979,791</b>         | <b>\$ 10,012,915</b> |

Advances from Others represent liabilities for collections received to cover future expenses or acquisitions of assets.

Deposit funds and Suspense Accounts represent liabilities for receipts held in suspense temporarily for distribution to another fund or entity or held as an agent for others and paid at the direction of the owner.

Disbursing Officers Cash represents liabilities for currency on hand, cash on deposit at designated depositories, cash in the hands of depositories, cash in the hands of deputy disbursing officers, cashiers and agents, negotiable instruments on hand, etc.

Custodial Liabilities represent liabilities for collections reported as non-exchange revenues where DON is acting on behalf of another Federal entity.

Intragovernmental Other Liabilities consists primarily of Unemployment Compensation unfunded liabilities.

Non-Federal Other Liabilities primarily consist of accruals for services, accrued liabilities for inventory owned and managed on behalf of foreign governments, and undistributed international tariff receipts.

Contingent Liabilities includes \$1.6 billion related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The DON is under no obligation to pay contractors for amounts in excess of progress payments authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but not yet paid are estimable, the DON has recognized a contingent liability for the estimated unpaid costs considered conditional for payment pending delivery and government acceptance.

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

## NOTE 14. COMMITMENTS AND CONTINGENCIES

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The DON is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown.

For FY 2016, DON materiality threshold for reporting litigation, claims, or assessments is \$63.2 million. The DON Office of General Counsel (OGC) and Office of the Judge Advocate General (OJAG) conduct reviews of litigation and claims threatened or asserted involving DON to which the OGC and OJAG attorneys devoted substantial attention in the form of legal consultation or representation.

The DON has accrued contingent legal liabilities for legal actions where the OGC and the OJAG considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The DON records contingent liabilities in Note 13, Other Liabilities. The amounts included in Contingent Liabilities for these legal liabilities are \$240.4 million for OGC cases and \$0.8 million for OJAG cases.

Also included in the contingent legal liability amount in our financial statements and Note 13 is an estimate of all cases below the assessment threshold of \$63.2 million. Total number of open cases below the threshold is 2,519 with an aggregate value of \$2.2 billion. The DON uses a three year historical weighted average paid out percentage to calculate the liability related to unassessed (below the threshold) cases. This estimate for FY 2016 is \$184.3 million.

The DON currently has 21 cases that meet the existing FY 2016 materiality threshold. The DON legal counsels were unable to express an opinion concerning the likely outcome on 5 of 21 cases. The legal counsels indicate that five cases are probable for an adverse decision. Of these five probable cases, one case (\$56.2 million) will be potentially paid out of the DON general fund. The other four probable cases will be paid out of the U.S. Treasury Judgment Fund (JF) without reimbursement from DON.

Of the remaining 11 cases that were assessed, 4 are assessed as reasonably possible for an adverse decision. Two of the reasonably possible cases (\$411.0 million) will be paid out of the DON general fund and two of the cases (\$598.4 million) will be paid out the Treasury JF if an adverse decision should occur. The remaining seven assessed cases were identified as remote with no financial impact noted.

The DON is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the DON's automated system processes have limited capability to capture these potential liabilities; therefore, the amounts reported may not fairly present DON's commitments and contingencies.

## NOTE 15. MILITARY RETIREMENT AND OTHER FEDERAL EMPLOYMENT BENEFITS

| As of September 30            | 2016                |                                          |                      |
|-------------------------------|---------------------|------------------------------------------|----------------------|
|                               | Liability           | (Less: Assets Available to Pay Benefits) | Unfunded Liabilities |
| <i>(Amounts in thousands)</i> |                     |                                          |                      |
| <b>Other Benefits</b>         |                     |                                          |                      |
| FECA                          | \$ 1,459,377        | \$ -                                     | \$ 1,459,377         |
| Other                         | 1,391               | (1,391)                                  | -                    |
| <b>Total Other Benefits</b>   | <b>\$ 1,460,768</b> | <b>\$ (1,391)</b>                        | <b>\$ 1,459,377</b>  |
| <b>Total</b>                  | <b>\$ 1,460,768</b> | <b>\$ (1,391)</b>                        | <b>\$ 1,459,377</b>  |
| As of September 30            | 2015                |                                          |                      |
|                               | Liability           | (Less: Assets Available to Pay Benefits) | Unfunded Liabilities |
| <i>(Amounts in thousands)</i> |                     |                                          |                      |
| <b>Other Benefits</b>         |                     |                                          |                      |
| FECA                          | \$ 1,536,102        | \$ -                                     | \$ 1,536,102         |
| Other                         | 1,457               | (1,457)                                  | -                    |
| <b>Total Other Benefits</b>   | <b>\$ 1,537,559</b> | <b>\$ (1,457)</b>                        | <b>\$ 1,536,102</b>  |
| <b>Total</b>                  | <b>\$ 1,537,559</b> | <b>\$ (1,457)</b>                        | <b>\$ 1,536,102</b>  |

The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department of Defense level.

### 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 the DON only at the end of each fiscal year.

The estimate 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.

The "Other" category under Other Benefits represents other post-employment benefits which can include salary continuation, severance benefits, counseling, training, funded unemployment liability for Federal employees, funded Federal Employees' Compensation Act liability, and the current portion of veterans' disability compensation benefits.





## NOTE 16. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF NET COST

| As of September 30<br><i>(Amounts in thousands)</i> | 2016                  | Restated 2015         |
|-----------------------------------------------------|-----------------------|-----------------------|
| <b>Intragovernmental Costs</b>                      | \$ 46,286,419         | \$ 46,902,797         |
| <b>Nonfederal Cost</b>                              | 113,339,555           | 103,562,643           |
| <b>Total Cost</b>                                   | <u>\$ 159,625,974</u> | <u>\$ 150,465,440</u> |
| <b>Intragovernmental Revenue</b>                    | \$ (2,381,355)        | \$ (2,392,638)        |
| <b>Nonfederal Revenue</b>                           | (5,145,888)           | (5,767,995)           |
| <b>Total Revenue</b>                                | <u>\$ (7,527,243)</u> | <u>\$ (8,160,633)</u> |
| <b>Total Net Cost</b>                               | <u>\$ 152,098,731</u> | <u>\$ 142,304,807</u> |

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department of Defense's (DoD) current processes and systems capture costs based on appropriations groups as presented in the schedule above. The lower level costs for major programs are not present as required by the Government Performance and Results Act (GPRA). The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 30, "Inter-entity Cost Implementation."

Intra-governmental costs and revenue represent transactions made between two reporting entities within the Federal Government.

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

The DON'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 (USGAAP) for federal agencies. Most of DON's legacy systems were designed to record information on a budgetary basis and do not track intra-governmental transactions by customer at the transaction level. Considering these systems limitations, DON is unable to accurately compare its intra-governmental costs and revenues with the corresponding balances of its intra-governmental trading partners. Buyer-side accounts payable and expenses were adjusted to match seller-side accounts receivable and revenues. This is accomplished by reclassifying amounts between federal and public cost categories, and accruing additional costs when necessary. Intra-department revenues and expenses are then eliminated.

In conjunction with the DoD, DON has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of USGAAP. One such action is the revision of its accounting systems to record transactions based on the U.S. Standard General Ledger. 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 USGAAP, 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.

The DON's accounting systems generally do not capture information relative to Heritage Assets separately and distinctly from normal operations. The DON is unable to separately identify the cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets.

### Restatement

During an audit readiness initiative, a Notice of Finding and Recommendation (NFR) was issued where the General PP&E balance on the September 30, 2015 financial statements does not accurately or completely represent expenditures associated with the Construction in Progress in the amount of \$31.3 billion. \$11.6 billion impacted the Gross Cost, Procurement and the Cumulative Results of Operations lines. See Note 23, Restatements for further information.

## NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of \$969.4 million is due to the budget authority of new appropriations being reduced through congressional reductions. The majority of these bookings are related to appropriation 1804, Operations and Maintenance, and are made to budgetary accounts, thus causing the difference.

Other Financing Sources - Other consists primarily of gains and losses associated with General Equipment, Operating Materials & Supplies, and Real Property.

Cumulative Results of Operations represents the net results of operations since inception. Included as a reduction in Cumulative Results of Operations are accruals for which related expenses require funding from future appropriations. These future funding requirements include, among others (a) accrued annual leave earned but not taken, (b) expenses for contingent liabilities and (c) expenses for environmental liabilities.

Unexpended Appropriations represents the amount of spending authorized as of year-end that is unliquidated or unobligated and has not lapsed, been rescinded, or withdrawn.

In accordance with SFFAS No. 43, "Funds form Dedicated Collection: amending SFFAS No. 27, Identifying and Reporting Earmarked Funds," the Department has elected to display a combined presentation of the non-exchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated with all other funds, See Note 20 for additional discussion regarding dedicated collections.

### Restatements

During an audit readiness initiative, a Notice of Finding and Recommendation (NFR) was issued where the General PP&E balance on the September 30, 2015 financial statements does not accurately or completely represent expenditures associated with the Construction in Progress in the amount of \$31.3 billion. \$11.6 billion impacted the Net Cost of Operations line. See Note 23, Restatements for further information

## NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

### Intragovernmental Costs and Exchange Revenue

| As of September 30<br>(Amounts in thousands)                                                       | 2016           | 2015           |
|----------------------------------------------------------------------------------------------------|----------------|----------------|
| <b>Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period</b> | \$ 113,630,478 | \$ 151,436,183 |

The SBR includes intra-entity transactions because the statements are presented as combined.

### Apportionment Categories for Obligations Incurred

The direct and reimbursable obligations under Categories A, B and Exempt from apportionment are reported in the table below. Apportionment categories are determined in accordance with the guidelines provided in Part 4 "Instructions on Budget Execution" of OMB Circular A-11 Preparation, Submission and Execution of the Budget. Category A represents resources apportioned for calendar quarters and Category B represents resources apportioned for other time periods or for activities, projects, objectives or for a combination thereof.

## DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

| As of September 30<br>(Amounts in thousands) | 2016                  |                          |                       |
|----------------------------------------------|-----------------------|--------------------------|-----------------------|
|                                              | Direct Obligations    | Reimbursable Obligations | Total                 |
| <b>Obligations Apportioned Under</b>         |                       |                          |                       |
| Category A                                   | \$ 101,876,981        | \$ -                     | \$ 101,876,981        |
| Category B                                   | 68,560,495            | 7,222,116                | 75,782,611            |
| Exempt                                       | 34,723                | -                        | 34,723                |
| <b>Total</b>                                 | <b>\$ 170,472,199</b> | <b>\$ 7,222,116</b>      | <b>\$ 177,694,315</b> |

| As of September 30<br>(Amounts in thousands) | 2015                  |                          |                       |
|----------------------------------------------|-----------------------|--------------------------|-----------------------|
|                                              | Direct Obligations    | Reimbursable Obligations | Total                 |
| <b>Obligations Apportioned Under</b>         |                       |                          |                       |
| Category A                                   | \$ 100,319,522        | \$ -                     | \$ 100,319,522        |
| Category B                                   | 65,591,633            | 6,628,927                | 72,220,560            |
| Exempt                                       | 20,612                | -                        | 20,612                |
| <b>Total</b>                                 | <b>\$ 165,931,767</b> | <b>\$ 6,628,927</b>      | <b>\$ 172,560,694</b> |

### Permanent, Indefinite Appropriations

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

The Environmental Restoration, Navy (ER, N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. There were 2 transfers from ER, N for \$300.1 million to the Operation and Maintenance, Navy appropriation. There were no transfers into ER, N during this period.

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. See Note 17, Disclosures Related to the Statement of Changes in Net Position, for further information.



## NOTE 19. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

| As of September 30                                                                                                  | 2016            | Restated 2015   |
|---------------------------------------------------------------------------------------------------------------------|-----------------|-----------------|
| <i>(Amounts in thousands)</i>                                                                                       |                 |                 |
| <b>Resources Used to Finance Activities</b>                                                                         |                 |                 |
| Budgetary Resources Obligated:                                                                                      |                 |                 |
| Obligations Incurred                                                                                                | \$ 177,694,315  | \$ 172,560,694  |
| Less: Spending Authority from Offsetting Collections and Recoveries                                                 | (14,294,683)    | (16,082,777)    |
| Obligations Net of Offsetting Collections and Recoveries                                                            | 163,399,632     | 156,477,917     |
| Less: Offsetting Receipts                                                                                           | (97,311)        | (196,776)       |
| Net Obligations                                                                                                     | 163,302,321     | 156,281,141     |
| Other Resources:                                                                                                    |                 |                 |
| Donations and Forfeitures of Property                                                                               | -               | -               |
| Transfers In/Out without Reimbursement                                                                              | (1,187,568)     | (1,012,788)     |
| Imputed Financing from Costs Absorbed by Others                                                                     | 714,199         | 704,140         |
| Other                                                                                                               | (6,162,138)     | 11,343,517      |
| Net Other Resources Used to Finance Activities                                                                      | (6,635,507)     | 11,034,869      |
| <b>Total Resources Used to Finance Activities</b>                                                                   | \$ 156,666,814  | \$ 167,316,010  |
| <b>Resources Used to Finance Items not Part of the Net Cost of Operations</b>                                       |                 |                 |
| Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided:             |                 |                 |
| Undelivered Orders                                                                                                  | \$ 37,805,705   | \$ 5,065,559    |
| Unfilled Customer Orders                                                                                            | 40,775          | 710,695         |
| Resources that Fund Expenses Recognized in Prior Periods                                                            | (1,428,711)     | (1,015,639)     |
| Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations                             | 3,252           | 54,209          |
| Resources that Finance the Acquisition of Assets                                                                    | (39,059,877)    | (11,020,789)    |
| Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations:                |                 |                 |
| Other                                                                                                               | 6,867,588       | (10,438,797)    |
| <b>Total Resources Used to Finance Items not part of the Net Cost of Operations</b>                                 | \$ 4,228,732    | \$ (16,644,762) |
| <b>Total Resources Used to Finance the Net Cost of Operations</b>                                                   | \$ 160,895,546  | \$ 150,671,248  |
| <b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period</b>   |                 |                 |
| Components Requiring or Generating Resources in Future Period:                                                      |                 |                 |
| Increase in Annual Leave Liability                                                                                  | \$ 3,951        | \$ 14,042       |
| Increase in Environmental and Disposal Liability                                                                    | 1,671,469       | 18,297          |
| Increase in Exchange Revenue Receivable from the Public                                                             | 503             | (2,605,386)     |
| Other                                                                                                               | 126,605         | 254,673         |
| Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods                | \$ 1,802,528    | \$ (2,318,374)  |
| Components not Requiring or Generating Resources:                                                                   |                 |                 |
| Depreciation and Amortization                                                                                       | \$ 2,070,844    | \$ 2,846,644    |
| Revaluation of Assets or Liabilities                                                                                | (1,814,524)     | (691,135)       |
| Other                                                                                                               |                 |                 |
| Operating Materials and Supplies Used                                                                               | 2,186,977       | 2,161,169       |
| Other                                                                                                               | (13,042,640)    | (10,364,743)    |
| Total Components of Net Cost of Operations that will not Require or Generate Resources                              | \$ (10,599,343) | \$ (6,048,065)  |
| <b>Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period</b> | \$ (8,796,815)  | \$ (8,366,439)  |
| <b>Net Cost of Operations</b>                                                                                       | \$ 152,098,731  | \$ 142,304,809  |

The Reconciliation of Net Cost of Operations to Budget is designed to reconcile the Net Cost of Operations (reported in the Statement of Net Cost) to the current year obligations (reported in the Statement of Budgetary Resources). This reconciliation is required due to the inherent differences in timing and recognition between the accrual proprietary accounting method used to calculate net cost and the budgetary accounting method used to calculate budgetary resources and obligations.



Due to the DON financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. This difference is a previously identified deficiency.

The absolute value of the adjustments to the Reconciliation of Net Cost of Operations to Budget to bring it into balance with the Statement of Net Costs is \$3 billion. The adjustments were recorded in Components of the Net Cost of Operations Not Requiring or Generating Resources in the Current Period.

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

**Restatements**

During an audit readiness initiative, a Notice of Finding and Recommendation (NFR) was issued where the General PP&E balance on the September 30, 2015 financial statements does not accurately or completely represent expenditures associated with the Construction in Progress in the amount of \$31.3 billion. \$11.6 billion impacted the Net Cost of Operations line. See Note 23, Restatements for further information.

**NOTE 20. FUNDS FROM DEDICATED COLLECTIONS**

| As of September 30<br>(Amounts in thousands) | 2016             | 2015             |
|----------------------------------------------|------------------|------------------|
| <b>Assets</b>                                |                  |                  |
| Fund Balance with Treasury                   | \$ 39,839        | \$ 24,380        |
| Investments                                  | 5,664            | 6,543            |
| Total Assets                                 | <u>\$ 45,503</u> | <u>\$ 30,923</u> |
| <b>Liabilities and Net Position</b>          |                  |                  |
| Other Liabilities                            | \$ 1,275         | \$ 633           |
| Total Liabilities                            | <u>\$ 1,275</u>  | <u>\$ 633</u>    |
| Cumulative Results of Operations             | \$ 44,228        | \$ 30,290        |
| Total Liabilities & Net Position             | <u>\$ 45,503</u> | <u>\$ 30,923</u> |
| <b>Statement of Net Cost</b>                 |                  |                  |
| Program Costs                                | \$ 23,571        | \$ 21,013        |
| Net Cost of Operations                       | <u>\$ 23,571</u> | <u>\$ 21,013</u> |
| <b>Statement of Changes in Net Position</b>  |                  |                  |
| Net Position Beginning of the Period         | \$ 30,290        | \$ 27,545        |
| Net Cost of Operations                       | 23,571           | 21,013           |
| Budgetary Financing Sources                  | 37,509           | 23,758           |
| Other Financing Sources                      | -                | -                |
| Change in Net Position                       | <u>\$ 13,938</u> | <u>\$ 2,745</u>  |
| <b>Net Position End of Period</b>            | <u>\$ 44,228</u> | <u>\$ 30,290</u> |

Funds from Dedicated Collections are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. The DON currently has four funds from dedicated collections, for which a brief

description follows below. There have been no changes in legislation during or subsequent to the reporting period that significantly changes the purpose or that redirects a material portion of the accumulated balances of any of these four funds. Generally, revenues for DON's funds from dedicated collections are inflows of resources to the Government.

### Special Funds from Dedicated Collections

#### *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 DON 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.

### Trust Funds from Dedicated Collections

#### *DON General Gift Fund*

This fund is authorized by 10 United States Code 2601. Under the provisions of this statute, the Secretary of the Navy (SECNAV) may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that it be used for the benefit, or in connection with the establishment, operation, or maintenance of a school, hospital, library, museum, cemetery, or other institution under the jurisdiction of DON.

#### *Ships Stores Profit, Navy*

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

#### *U.S. Naval Academy General Gift Fund*

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

## NOTE 21. FIDUCIARY ACTIVITIES

| As of September 30<br>(Amounts in thousands)    | 2016             | 2015             |
|-------------------------------------------------|------------------|------------------|
| Fiduciary Net Assets, Beginning of Year         | \$ 73,639        | \$ 81,559        |
| Contributions                                   | 83,492           | 88,841           |
| Investment Earnings                             | 262              | 275              |
| Distributions to and on Behalf of Beneficiaries | (68,364)         | (97,036)         |
| Increase/(Decrease) in Fiduciary Net Assets     | 15,390           | (7,920)          |
| <b>Fiduciary Net Assets, End of Period</b>      | <b>\$ 89,029</b> | <b>\$ 73,639</b> |

### FIDUCIARY ASSETS

| As of September 30<br>(Amounts in thousands) | 2016      | 2015      |
|----------------------------------------------|-----------|-----------|
| Cash and Cash Equivalents                    | \$ 89,029 | \$ 73,639 |

Fiduciary activities are the collection or receipt, and management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which Non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

The DON's Fiduciary Activity consists of funds in the Savings Deposit Program. Under 10, USC, §1035, and Department of Defense Financial Management Regulation (FMR), Volume 7A, Chapter 51, service members of both the Navy and Marine Corps who are on a permanent duty assignment outside the United States or its possessions can earn interest at a rate prescribed by the president, not to exceed 10 percent a year, on up to \$10 thousand deposited

into the program. This limitation shall not apply to deposits made on or after September 1, 1966 in the case of those members in a missing status during the Vietnam conflict, the Persian Gulf conflict, or a contingency operation.

A permanent duty assignment is defined as any active duty assignment that contemplates duty in the designated area as a permanent change of station, or more than 30 days on temporary additional duty, temporary duty, or with a deployed ship or unit. This definition of a permanent duty assignment applies specifically to this program, effective as of July 1, 1991. Interest accrual shall terminate 90 days after the member's return to the United States or its possessions. The deposit funds included in the balance are 17X6025 for Navy and 17X6026 for Marine Corps.

## NOTE 22. LEASES

| As of September 30<br>(Amounts in thousands) | 2016               |           |       |            |
|----------------------------------------------|--------------------|-----------|-------|------------|
|                                              | Land and Buildings | Equipment | Other | Total      |
| <b>Entity as Lessee - Operating Leases</b>   |                    |           |       |            |
| Future Payments Due                          |                    |           |       |            |
| Fiscal Year                                  |                    |           |       |            |
| 2017                                         | \$ 149,625         | \$ -      | \$ -  | \$ 149,625 |
| 2018                                         | 152,303            | -         | -     | 152,303    |
| 2019                                         | 155,073            | -         | -     | 155,073    |
| 2020                                         | 157,894            | -         | -     | 157,894    |
| 2021                                         | 160,767            | -         | -     | 160,767    |
| After 5 Years                                | 163,692            | -         | -     | 163,692    |
| Total                                        | \$ 939,354         | \$ -      | \$ -  | \$ 939,354 |

## NOTE 23. RESTATEMENTS

| As of September 30<br>(Amounts in thousands) | FY 2015, as Previously Reported | Adjustment    | FY 2015, as Restated |
|----------------------------------------------|---------------------------------|---------------|----------------------|
| <b>Balance Sheet</b>                         |                                 |               |                      |
| General Property, Plant and Equipment (PP&E) | \$ 292,992,602                  | \$ 31,383,355 | \$ 324,375,957       |
| Cumulative Results of Operations             | 345,149,425                     | 31,383,355    | 376,532,780          |
| <b>Statement of Net Cost</b>                 |                                 |               |                      |
| Gross Cost - Procurement                     | 40,160,576                      | (11,682,123)  | 28,478,453           |
| Net Cost of Operations                       | 153,986,930                     | (11,682,123)  | 142,304,807          |
| <b>Statement of Changes in Net Position</b>  |                                 |               |                      |
| Net Cost of Operations                       | 153,986,930                     | (11,682,123)  | 142,304,807          |

A Notice of Finding and Recommendation (NFR) was issued during an FY 2015 audit initiative stating that “the General PP&E balances on the September 30, 2015 financial statements does not accurately or completely represent expenditures associated with the CIP of general PP&E assets.” Due to limitations of financial and nonfinancial management processes and systems that support the financial statements, the DON is unable to fully implement all elements of USGAAP and OMB Circular No. A-136. Therefore, the DON's PP&E balances as of September 30, 2015 were under stated in the amount of \$31.3 billion. This understatement impacted the Balance Sheet, the Statement of Net Cost and the Statement of Changes in Net Position. For the Balance Sheet, the General Property, Plant and Equipment line was under stated by \$31.3 billion. The Cumulative Results of Operations line was also under stated by \$31.3 billion. For the Statement of Net Cost, the Gross Costs, Procurement line was overstated by \$11.6 billion. The Net Cost of Operations line was also overstated by \$11.6 billion. For the Statement of Changes in Net Position, the Net Cost of Operations line was overstated by \$11.6 billion.

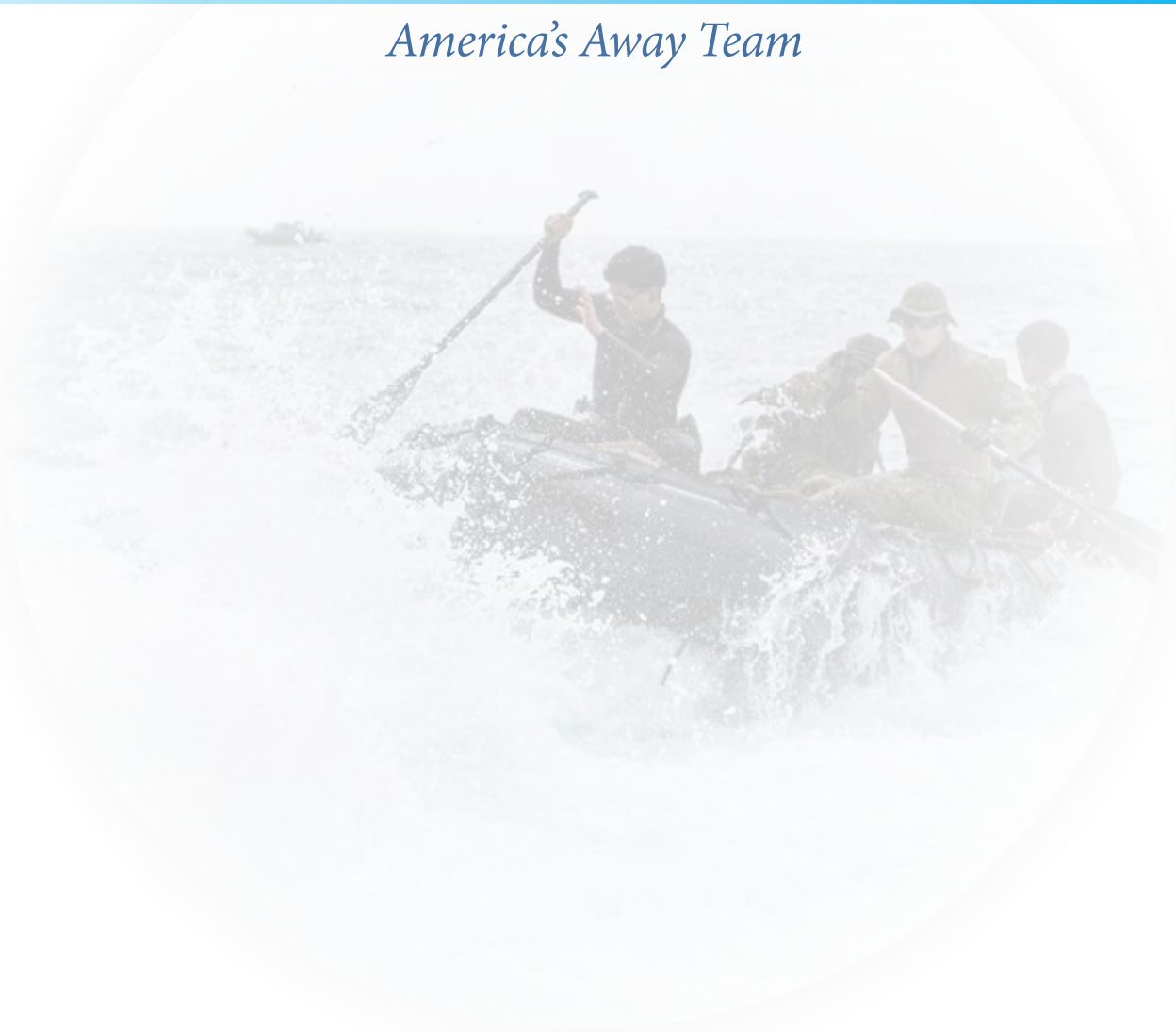
To address the understated General PP&E amount, DON management corrected the known error and is developing and implementing an automated standardized CIP business process to identify, track, review and properly record CIP activity directly into DON's financial accounting systems in accordance with SFFAS No. 6 as a long term solution. The long term solution will include support from DON's Stakeholders and as well as enhance and strengthen internal control to ensure existence, completeness, accuracy, and proper recording of CIP activity in a timely.

2016



**REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION**

*America's Away Team*





## INVESTMENTS IN RESEARCH AND DEVELOPMENT

Yearly Investment in Research and Development  
For Fiscal Years 2012 through 2016 (\$ in millions)

| Categories                                    | FY16             | FY15             | FY14             | FY13             | FY12             |
|-----------------------------------------------|------------------|------------------|------------------|------------------|------------------|
| Basic Research                                | \$ 566           | \$ 572           | \$ 552           | \$ 556           | \$ 554           |
| Applied Research                              | 884              | 804              | 792              | 776              | 738              |
| Development                                   |                  |                  |                  |                  |                  |
| Advanced Technology Development               | 629              | 613              | 631              | 653              | 761              |
| Advanced Component Development and Prototypes | 4,508            | 4,522            | 3,006            | 3,956            | 3,950            |
| System Development and Demonstration          | 5,409            | 4,934            | 4,811            | 4,655            | 5,382            |
| Research, Development, Test, and Evaluation   |                  |                  |                  |                  |                  |
| Management Support                            | 1,177            | 1,144            | 1,142            | 1,061            | 1,298            |
| Operational Systems Development               | 3,706            | 3,581            | 3,403            | 3,863            | 4,137            |
| Undistributed Disbursements*                  | (133)            | -                | -                | -                | -                |
| <b>Totals</b>                                 | <b>\$ 16,746</b> | <b>\$ 16,170</b> | <b>\$ 14,337</b> | <b>\$ 15,520</b> | <b>\$ 16,820</b> |

\*Undistributed Disbursements represent disbursements which are unable to be properly identified and allocated to a research category. Remediation efforts are on-going.

The Office of Naval Research is celebrating 70 years of developing cutting-edge science and technology (S&T) for U.S. naval forces in 2016. It was in August 1946, just after the Second World War, that Congress mandated a new military command to identify and cultivate forward-looking science and technology capabilities, to ensure the superiority of U.S. warfighters.

Long recognized as a leading sponsor of S&T advances through partnerships across government, industry and academia, ONR manages short-, mid-, and long-term scientific research investments, serving as the “venture capital” for America’s technological superiority.

ONR’s establishment in 1946 marked the first time a peacetime organization would use government funds to support civilian science and technology research at universities, laboratories and businesses.

Since that fateful year, the command, along with its Naval Research Enterprise organizations that include ONR Global and the Naval Research Laboratory, has played a leading role in many of the most important discoveries and inventions—from the earliest computer systems and software, to the exploration of the ocean’s depths, to new materials and sensors that have been integrated into everything from household items to warships.

### BASIC RESEARCH EXAMPLES:

#### Brain Research (Microcavitations):

Today’s warfighters are outfitted with body armor strong enough to withstand shrapnel from a bomb or other explosive device. One debilitating threat from a blast, however, is a force they can’t see—the explosive shock wave itself. This wave of energy can cause subtle yet damaging effects on the brain.

ONR research at the University of Texas at Arlington (in partnership with Old Dominion University and Purdue

University), centers on the idea that explosive shock waves cause microcavitations, or tiny bubbles, to form and collapse in the brain. These energy-packed bubbles are so miniscule (less than a millimeter across) and appear, pop and disappear so quickly that they can’t be detected by MRIs or other brain-imaging technology. Consequently, this kind of injury often goes untreated.

When brain microcavitations collapse, they can potentially damage surrounding cells and tissue. This collapse also compromises and causes leakage through the blood-brain barrier—a tightly packed network of blood vessels in the brain that allows healthy molecules to enter the brain from the bloodstream and prevents the entry of harmful ones.

In addition to offering a way to treat the thousands of warfighters who have returned from Iraq and Afghanistan with traumatic brain injuries, this research also can potentially help civilians suffering from trauma related to car accidents and contact sports.

#### *What this research will accomplish:*

- Improved understanding shock waves and microcavitation on brain health
- Create tissue-based models mirroring the properties of tissue and fluids found in the brain and blood-brain barrier
- Prevention methods and treatments

#### Synthetic Biology (Microbes):

An exciting new scientific frontier—synthetic biology—holds many promises for applications to the naval warfighter. ONR research at Massachusetts Institute of Technology (MIT) is exploring the revolutionary potential of creating or re-engineering microbes or other organisms to perform specific tasks like monitoring

chemical threats, creating biofuels and even improving the health and physical performance of warfighters.

Concepts and techniques from electrical engineering are used to manipulate and program a cell's circuitry. With these tools, scientists can engineer bacteria like *Escherichia coli* to carry out functions such as detecting specific light wavelengths or toxic chemicals.

Scientists use “programming language” developed by this research to allow them to program a cell's circuitry much like you would a computer or robot.

Promising research areas include:

- **Gut microbiology:** This area focuses on how gut microbes respond to stressors common to warfighters—changes in diet, fearful situations, sleep loss or disrupted circadian rhythms from living in submarines.
- **Threat detection:** This involves designing highly sensitive microbes (which could be placed on a silicon chip and attached to unmanned vehicles) that could potentially sense the presence of pollutants, toxic chemicals or explosives like trinitrotoluene (TNT). Recent successes include creating a “smart” plant that turns white when it detects TNT.
- **Biofuels:** Specially engineered microbes with carbon dioxide-based metabolisms can use electrical currents to produce butanol, an alternative fuel. This same process might be able to make certain types of medicines or foods in remote locations.

***What this research will accomplish:***

- Reduce susceptibility to stressors such as jet lag, noise and changes in altitude and temperature
- Enhance warfighter performance
- Alternative energy

## APPLIED RESEARCH EXAMPLES:

### Fleet Integrated Simulation Technology Testing Facility:

Lookouts on the bridge of the USS Michael Murphy (DDG-112) scanned the surrounding ocean. All seemed well—clear skies, peaceful waters, busy merchant ship traffic.

Suddenly, a swarm of small fast-attack boats buzzed toward the destroyer. Within moments, a machine gunner shot withering streams of 50-caliber bullets at the approaching enemies, forcing their retreat.

This wasn't a real attack on an American ship, but a tribute to the realism of the Fleet Integrated Simulation Technology Testing Facility (FIST2FAC)—which develops, tests and demonstrates simulator training technology blending live-action exercises with virtual assets and adversaries.

This is the future of training for the Navy. With simulation, you can explore endless possibilities without the expense and logistical challenges of putting hundreds of ships at sea and aircraft in the sky.

The new and improved training technology at FIST2FAC, located on Ford Island, Hawaii, combines a hassle-free setup, software and gaming technology to help naval forces develop strategies for diverse missions and operations. It allows Sailors to interact with artificially intelligent forces in countless virtual settings—and train for multiple missions simultaneously. The system can replicate situations involving aircraft carriers, helicopters (in this case, a squadron from Marine Corps Base Hawaii), lethal and nonlethal weapons, and more.

FIST2FAC, which was developed with support from the Naval Undersea Warfare Center Keyport Division, has demonstrated simulator technology since 2010.

The software is reusable and can be modified for different environments. By comparison, it costs about \$250,000 just to get an aircraft carrier out for live training—and approximately \$6 million to fuel a strike group for a week. A live event lasting six to 10 hours may cost a million dollars.

The ability to recreate so many combat scenarios anywhere also is useful in training for any challenge a ship might face worldwide—from vessel maintenance to landing a fighter jet to navigating hostile waters.

***What this research will accomplish:***

- Enhanced warfighter readiness
- Advanced training technologies
- Cost reductions in readiness training

### New Research Vessel Neil Armstrong:

ONR's new research vessel (R/V) Neil Armstrong was recently put into service at its new home at the Woods Hole Oceanographic Institution in Massachusetts.

The Navy and ONR research partners who use the ship gain great value from what the ship enables. Neil Armstrong will enable tens of thousands of scientific journal articles, generations of scientists will gain at-sea training while performing work for their graduate degrees, and ocean engineering development for new

sensors and devices, will continue to permit Navy oceanographers to lead the world in understanding the oceans.

The Navy and other federal agencies fund the construction of oceanographic research ships, and provide them to U.S. academic institutions for operational management and use. This allows contributing agencies to take advantage of research opportunities using the entire U.S. academic research fleet—providing a range of ship sizes and capabilities, cooperative missions and significant cost savings.

Named after the first person to walk on the moon, the Neil Armstrong replaces the R/V Knorr, which Woods Hole operated from 1970 to 2014. The Knorr was a celebrated vessel, serving as the command ship during the discovery of deep ocean thermal vents (nicknamed “black smokers”) in 1977 and the wreck of the RMS Titanic in 1985.

The Neil Armstrong is a deep-ocean, general-purpose research vessel that will be used for a wide range of scientific and applied science studies—including ocean chemistry and geology, underwater acoustics, marine biology and ecosystem management, and marine technology.

The 238-foot Neil Armstrong can sail on cruises as long as 40 days and accommodate 24 scientists in addition to the 20-person crew. The vessel has advanced sonar to map the ocean bottom in greater detail and state-of-the-art meteorological sensors.

***What this research will accomplish:***

- Long-term U.S. Navy leadership in ocean sensing
- Advanced autonomous systems development for underwater vehicles
- Accurate data and ocean models improve capability in the undersea domain

**DEVELOPMENTAL RESEARCH EXAMPLES:**

**Computer Security:**

Software bloat is a condition where updated software runs slower because of repetitive code, requiring more memory—and becoming more vulnerable to cyber attacks since the additional code could offer hackers more entry points into a software program.

Security is especially important given ONR’s current efforts to design the Naval Tactical Cloud—a multiyear initiative to harness the power of cloud computing and bring big data capabilities to the warfighting environment.

Software bloat is a big problem today because of how code is written and compiled. Past generations of coders wrote new, individualized code for each program upgrade, adding only what was needed to improve performance.

Code libraries contain both the new code and the repetitive code from previous software versions. Downloading the libraries actually installs both sets of code in an upgrade—creating layers of redundant, unused and outdated functions that slow down computer running time.

Hence the security issue: a bloated software system contains a larger code base that could lead to more vulnerabilities and greater entry platforms for hackers and cyber terrorists. After gaining access to a system, a hacker can use the code—even unused, older code—for malicious purposes.

The ONR solution creates “shadow libraries” that can update existing software by pinpointing areas of bloat and adding only the necessary code and data needed for upgrade—skipping the repetitive code. The shadow library then is disabled through an automatic switch mechanism, eliminating the risk of repetition or cyber attack. This method trims software bloat significantly and improves run time speed by more than 70 percent.

Military-focused software plays such a large role in the warfighting environment—from carrying out mission-critical tasks to managing confidential data—and must be even more resistant to cyber attacks than software available to the public.

***What this research will accomplish:***

- Improves computer security
- Enhances computer performance
- Reduces vulnerabilities

**Battlespace Exploitation of Mixed Reality:**

New virtual-reality capabilities emerging at the Battlespace Exploitation of Mixed Reality (BEMR) Lab, in San Diego, California, will make dramatic impacts across the Navy and Marine Corps, including advancements in affordable virtual training, data assessment, firing of weapons and even basic concepts of operations.

The research is sponsored by the ONR and developed at the Space and Naval Warfare Systems Center, Pacific (SSC Pacific).

The BEMR Lab is a constellation of technologies in augmented and virtual reality.

Virtual reality (VR) describes a scenario where a participant is completely immersed in a simulated/virtual world. Augmented reality (AR), by contrast, is used to describe a state where virtual objects are imposed onto real-world vision, like the yellow lines superimposed on televised sports.

When these technologies are merged, and one can easily jump between states of virtuality, it's called Mixed Reality, or MxR. What mixed reality is all about is immersion, feeling like you are really there. Virtual technologies could result in significant cost savings:

- **Training:** Where the warfighter might currently need to fly to a specific spot for training, he or she could don the MxR gear and “be there” virtually, completing training at a fraction of the cost.
- **Maintenance:** MxR technologies can have a subject matter expert “standing” next to Sailors or Marines as they troubleshoot a difficult problem—even if the expert is on the other side of the world.
- **Operations:** MxR technologies will give operators views never before seen, with striking fidelity, to execute missions to exacting standards.

***What this research will accomplish:***

- Advance the state-of-the-art of virtual and mixed reality technologies
- Improve readiness through innovative application to training, maintenance and operations
- Reduce costs by improving readiness and enhancing warfighter skills

**USMC EXAMPLES:**

**Augmented Immersive Team Trainer:**

Marines participated in the fifth and final demonstration of the ONR-developed Augmented Immersive Team Trainer (AITT) system, an augmented reality technology—one of the last steps before the AITT system transitioned from ONR to the Marine Corps for further testing and development.

The AITT comprises of a laptop, software and battery pack, and a helmet-mounted display—and can support a wide range of live, virtual and cutting-edge training scenarios. It uses augmented reality, which means virtual objects are superimposed onto a real environment—like the yellow first-down lines added to television broadcasts of football games for the benefit of viewers at home. This differs from virtual reality, which is a wholly computer-generated environment in which users immerse themselves. During the Oct. 15 demonstration, Marines

using the AITT display saw realistic battlefield effects such as aircraft, ground vehicles, opposing forces and explosions from mortar shells and similar munitions.

The AITT system will be an enormous assist to our Marines, giving them the ability to train more often, and in more places, than ever before. New technologies like this increase warfighter preparation for different scenarios, and reduce training costs at the same time.

The AITT represents a major breakthrough in Marine Corps combat training. Traditionally, the field portion of “call-for-fire” exercises includes aircraft and munitions—which are costly and time-consuming to set up, staff and equip, but an important part of the training experience. The wait time for a test range can be lengthy, rain can cancel the testing and it can be difficult to get assets in place, since equipment can break down.

The AITT completely bypasses these obstacles by using virtual ground vehicles, aircraft and munitions. It also enables Marines to train anywhere, on demand, and eliminates the maintenance issues or weather-related restrictions that can hamper or cancel training.

For the past five years, the AITT system has been part of the ONR Capable Manpower Future Naval Capability—a science and technology program aimed at developing and transitioning cutting-edge technology products to Navy and Marine Corps acquisition managers within a three-to-five-year timeframe.

***What this research will accomplish:***

- Affordable lightweight, virtual training system
- Can support a wide array of live, virtual and cutting-edge training scenarios
- Prepare Marines for real-world situations and environments they will face

**Ground-Based Air Defense:**

Ground-Based Air Defense (GBAD) is ground-based laser systems. It consists of a vehicle-mounted, high-energy laser (HEL) as well as command, control, and communications (C3) and a volumetric surveillance radar.

The volumetric search RADAR locates unmanned aerial system (UAS) targets of interest and passes the information to the C3 platform. The C3 platform performs an analysis of the threat and passes the radar information to the laser platform, which then locates and begins tracking the UAS utilizing a day/night capable sensor system. This then allows the C3 platform to perform visual confirmation and aim point selection. If a kill decision is made, the threat is lased until destruction.



GBAD is a rugged, expeditionary HEL system that can be cued by a radar capable of detecting low radar cross-section threats. It will be able to perform hard kills of UASs to prevent reconnaissance, surveillance, targeting and acquisition of expeditionary forces. It also will demonstrate a C2 interface that is optimized for operational use.

Significant laser and vehicle modeling and simulation, coupled with a detailed trade-off analysis, led to a sophisticated design strategy. This led to the selection of a palletized laser weapon system design using a planar

wave guide laser for 30 kW nominal power; a lightweight reflective beam director; on-board vehicle power enhancements; lithium Ion batteries for power storage; and phase-change material cooling systems that conform to the size, weight and power constraints of using a tactical vehicle platform.

***What this research will accomplish:***

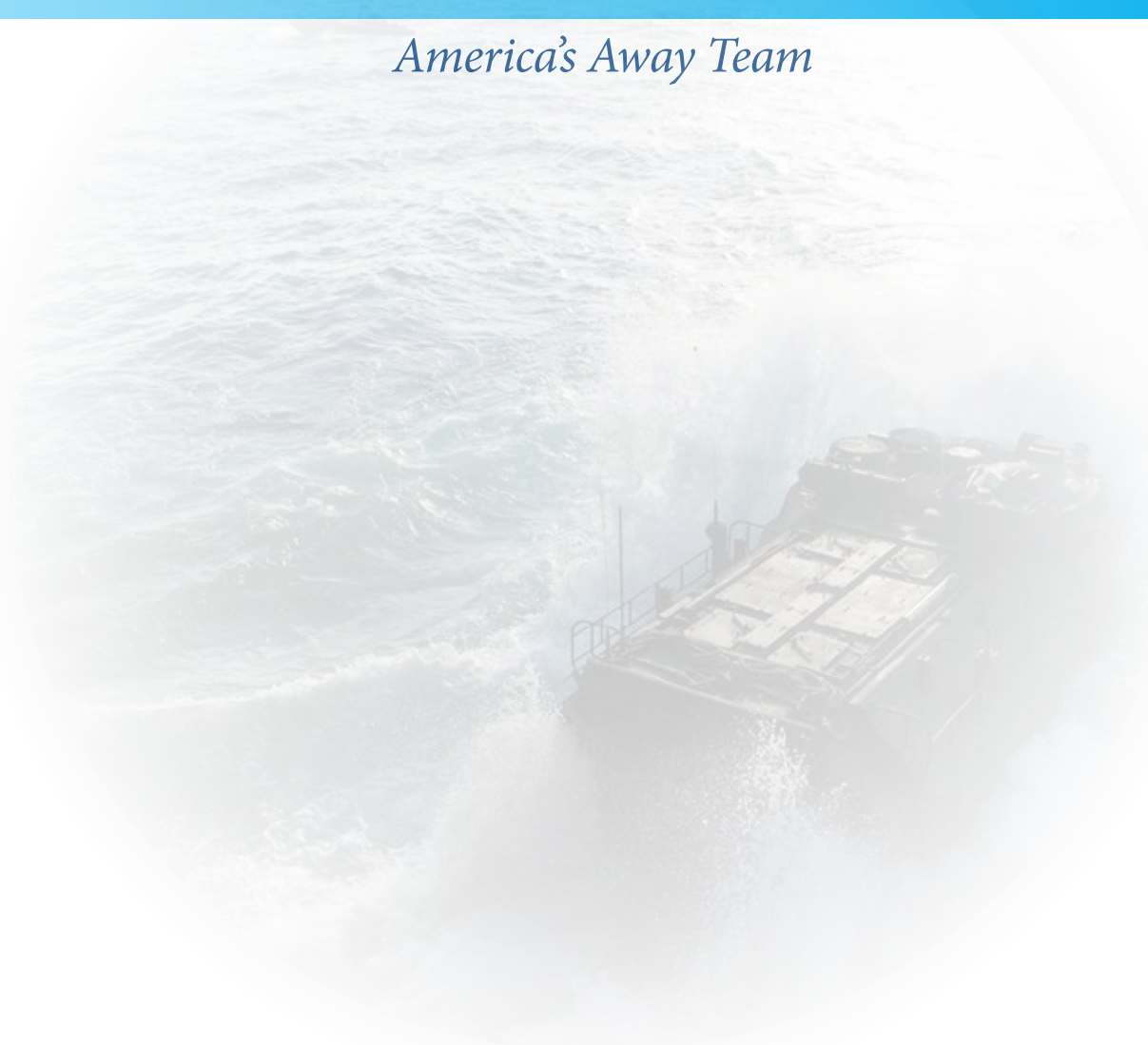
- Completely stationary end-to-end engagement
- Single engagement, with mobile cueing / tracking
- Full mobility between multiple engagements

2016



**REQUIRED SUPPLEMENTARY INFORMATION**

*America's Away Team*



Department of the Navy  
**GENERAL PROPERTY, PLANT, AND EQUIPMENT**

**REAL PROPERTY DEFERRED MAINTENANCE AND REPAIR**

For Fiscal Years Ended September 30, 2016 and 2015 (\$ in thousands)

| Property Type                                                   | FY 2016                    |                                                    |               | FY 2015                    |                                                    |               |
|-----------------------------------------------------------------|----------------------------|----------------------------------------------------|---------------|----------------------------|----------------------------------------------------|---------------|
|                                                                 | 1. Plant Replacement Value | 2. Required Work (Deferred Maintenance and Repair) | 3. Percentage | 1. Plant Replacement Value | 2. Required Work (Deferred Maintenance and Repair) | 3. Percentage |
| <b>Category 1: Enduring Facilities</b>                          |                            |                                                    |               |                            |                                                    |               |
| Navy                                                            | \$ 133,196,730             | 27,297,590                                         | 20.49%        | \$ 168,216,220             | 40,384,450                                         | 24.01%        |
| Marine Corps                                                    | \$ 53,930,898              | 8,669,381                                          | 16.07%        | \$ 53,188,865              | 8,603,642                                          | 16.18%        |
| <b>Category 2: Heritage Assets</b>                              |                            |                                                    |               |                            |                                                    |               |
| Navy                                                            | \$ 34,572,070              | 9,417,820                                          | 27.24%        | \$ 168,350                 | 47,510                                             | 28.22%        |
| Marine Corps                                                    | \$ 3,743,423               | 837,754                                            | 22.38%        | \$ 2,787,887               | 390,862                                            | 14.02%        |
| <b>Category 3: Excess Facilities or Planned for Replacement</b> |                            |                                                    |               |                            |                                                    |               |
| Navy                                                            | \$ 4,623,020               | 1,355,090                                          | 29.31%        | \$ 4,244,940               | 1,401,450                                          | 33.01%        |
| Marine Corps                                                    | \$ 56,488                  | -                                                  | 0.00%         | \$ 72,347                  | -                                                  | 0.00%         |

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

**Description of Property Type categories:**

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

$$FCI = \frac{1 - (\text{Requirements})}{PRV} \times 100$$

The Navy models the “Requirements” value from the condition rating and configuration rating.

The method used to assess facilities conditions is two-fold. All buildings, paving, bridges, dams and rail assets are inspected using the SMS methodology developed by the U.S. Army Corps of Engineers Civil Engineering (USACOE) Research Laboratory (CERL) which provides a FCI for these assets. Other assets are assessed via local facilities inspections to address the adequacy of the facilities to meet its intended purpose. Assets inspected using both methods take the FCI to determine the asset’s Quality rating (Q-rating) as follows: FCI of 100%-90% Q1 (Good); 90%-80% Q2 (Fair); 80%-60% Q3 (Poor); and less than 60% Q4 (Failing).

Generally, the Navy considers an asset acceptable when it is in good condition with an assigned FCI of 90% or above. The DON considers mission, health and safety, and quality of life when assigning priority to maintenance needs.

The deferred maintenance and repair information presented relates to all DoD facilities and is not restricted to capitalized assets. The deferred maintenance and repair information excludes assets on Navy installations where a Defense Agency is responsible for maintenance and repair. For these assets, defense agencies are responsible for funding the condition assessment of facilities and reporting a facility condition index.

1. The Navy is migrating and will utilize the Sustainment Management System (SMS), where applicable, to perform a cyclical assessment of real property facilities and assign a facility condition index, which considers an asset’s key life-cycle attributes such as age and material. The Navy’s Facility Condition Index (FCI) is calculated using the below formula:

2. The Condition Rating is a measure (0 - 100) of an asset’s physical condition at a particular point in time. The Navy’s condition rating is updated using the SMS process, which combines the results of on-site assessments with modeling software to establish system/component condition ratings. The condition assessment

is an 'eyes-on' field assessment that confirms facility component inventory and assesses material condition.

3. The Configuration Rating is a measure (0 - 100) of the asset's capability to support the current occupant or mission with respect to functionality. The Configuration Rating is calculated in the internet Navy Facility Assets Data Store (iNFADS) from an algorithm that weights configuration deficiency codes (code compliance, functional/space criteria, location/siting criteria or inadequate capacity/coverage) collected during Asset Evaluations. Deficiency codes identify impacts to the suitability of spaces for their intended use, including obsolescence of facility components that do not meet new standards.
4. OUSD (AT&L) Facility Sustainment and Recapitalization Memo of 29 April 2014, sets an average of 80 as a minimum inventory-wide FCI goal. With deferred maintenance for the Navy valued at 20.49%, 27.2% and 29.31% of PRV for categories 1 through 3, respectively. The deferred maintenance and repair estimates are based on the facility condition and configuration ratings.

The USMC follows the Office of the Secretary of Defense Installation Strategic Plan goal of having facilities at a Q2 level on average as an acceptable rating. This represents an average level of 20% of Plant Replacement Value (PRV) as an acceptable level of deferred maintenance. The table above shows that deferred maintenance is valued at approximately 16.07% and 22.38% of PRV for categories 1 and 2, respectively. Category 3 is zero because we do not hold deferred maintenance backlogs on facilities to be demolished.

5. The updated Deferred Maintenance and Repair (DM&R) guidance for FY 2015 resulted in changes to the factors used to determine DM&R. For instance, the updated guidance required that the DM&R report should only include facilities where the Asset Allocation Sustainment Fund Code equated to a DoD appropriation. The FY 2014 report included Nonappropriated Funds (NAF) and contractor-operated facilities, which were excluded from the FY 2015 report. The Navy's FY 2015 report includes facilities assigned Operational Status Codes Excess,

Surplus, Caretaker, or Closed, as required by the current guidance. The FY 2014 report did not include facilities assigned these Operational Status Codes.

In addition, in the past, the Navy considered all Heritage Assets to be multi-use. Although the vast majority of Navy Heritage Assets are multi-use, the Navy's current stance is that museums, cemeteries, and monuments/memorials are considered single-use Heritage Assets, and these are now included in Category 2.

From end of FY 2015 to end of FY 2016, the Navy's total deferred maintenance and repair for categories 1 through 3 decreased by 9% from \$41.8 billion to \$38.1 billion. The Navy's end of FY 2015 DM&R of \$41.8 billion included restoration and modernization costs. Of this amount, \$25.0 billion was restoration. The Navy's end of FY 2016 DM&R only includes restoration costs. Modernization costs were excluded to follow guidance in ODUSD(ATL) memorandum, "Standardizing Facility Condition Assessments," dated September 10, 2013, which does not include modernization costs in the determination of deferred maintenance and repair. A comparison of only the restoration portion of the end of FY 2015 DM&R (\$25.0 billion) to the end of FY 2016 DM&R (\$38.1 billion), results in an increase of 52% in deferred maintenance and repair backlog.

The Marine Corps' FY 2016 and 2015 Deferred Maintenance and Repair Report include all Marine Corps Activity Unit Identification Codes (UICs) and all capitalized assets in accordance with Paragraph 1a Section 602 supplemental guidance to DoD Financial Management Regulations (FMR), Volume 6B, Chapter 12.

6. In addition, Category 1 only includes assets assigned a Real Property Asset (RPA) Operational Status Code of "Active," "Outgranted," "Semi-Active," or "Non-Functional." Category 2 only includes assets assigned an RPA Operational Status Code of "Excess" or "Surplus." Category 1 excludes assets identified in Categories 2 and 3. The Navy's FY 2014 Real Property Inventory did not identify any Navy assets as single-use Heritage Assets; therefore, the amounts recorded for this category are zero.



# EQUIPMENT DEFERRED MAINTENANCE AND REPAIR

For Fiscal Year Ended September 30, 2016 (\$ in thousands)

| Major Category*                           | "PY DM&R<br>(End of Year Actuals)" | CY OP-30/PB-45/<br>PB-61 Amounts | Adjustments      | Totals           |
|-------------------------------------------|------------------------------------|----------------------------------|------------------|------------------|
| 1. Aircraft                               | \$199,805                          | \$199,805                        | \$38,894         | \$238,699        |
| 2. Automotive Equipment                   | 47,771                             | 47,771                           | (6,408)          | 41,363           |
| 3. Combat Vehicles                        | -                                  | -                                | 3,154            | 3,154            |
| 4. Construction Equipment                 | -                                  | -                                | (7,180)          | (7,180)          |
| 5. Electronics and Communications Systems | 5,476                              | 5,476                            | (806)            | 4,670            |
| 6. Missiles                               | 80,051                             | 80,051                           | 2,200            | 82,251           |
| 7. Ships                                  | -                                  | -                                | 236,327          | 236,327          |
| 8. Ordnance Weapons and Munitions         | 30,995                             | 30,995                           | 3,746            | 34,741           |
| 9. All Other Items Not Identified Above   | -                                  | -                                | 9,394            | 9,394            |
| <b>Total</b>                              | <b>\$364,098</b>                   | <b>\$364,098</b>                 | <b>\$279,321</b> | <b>\$643,419</b> |

Note: The deferred maintenance amounts reported in the Budget Exhibit Operations (OP) Depot Maintenance (30) that accompanied the most recent President's Budget was used as the basis to identify and report amounts in the Equipment Deferred Maintenance. Material amounts of deferred maintenance beyond the scope of the OP-30 Budget Exhibit, that warrant reporting are in the "Adjustments" column.

\*Amounts include Overseas Contingency Operations (OCO) funding.

Deferred Maintenance and Repair (DM&R) is "maintenance and repairs not performed when they should have been or was scheduled to be and which, therefore, is put off or delayed for a future period." The information applies to both capitalized equipment, such as ships and aircraft, and non-capitalized equipment such as ordnance, weapons types, and targets. All items requiring maintenance in FY 2016 are included in the data for maintenance that was planned or executed by depot maintenance activities. The Department of the Navy has not changed prior year policies. Deferred maintenance increased 76% during FY 2016. Information for each category is below.

## Aircraft

Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), component repair, and software maintenance. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircraft that have reached their Fixed Induction Date (FID) or that have failed an Aircraft Service Period Adjustment (ASPA) inspection at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance is the difference between validated requirements and funding received.

Airframe rework and maintenance (active and reserve) is performed under the Integrated Maintenance Concept (IMC) program. 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 necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR partners with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance. Fifteen F/A-18 A-D Legacy Hornet aircraft were not inducted in FY 2016 due to insufficient capacity at the FRCs to accomplish the work, as well as due to revised workload standards.

## Automotive

Automotive equipment deferred maintenance is attributed to the planned workload for commercial repair. The decrease is due to a reduction in Medium Tactical Vehicle Recovery (MTVR) vehicles scheduled for Reset. The difference is a reduction of 25 vehicles.

## 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 M1A1 Tanks, Amphibious Assault Vehicles (AAVs), Hercules Recovery Vehicles, and Light Armored Vehicles. The total requirement is the planned quantity of combat vehicles that require depot level maintenance in a year as determined by program managers and the operating forces with requirements validated by a modeling process. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

The increase is due to 5 more AAV-P7s being worked to begin the Survivability Upgrade Program (SUP) in FY 2016.

### **Construction Equipment**

The construction equipment category refers to deferred equipment maintenance for active and reserve Marine Corps assets. This category consists of maintenance performed on a variety of tractors and earth moving equipment. In part, the equipment includes the Aardvark Tactical, the 277C Multi-Terrain Loader, the Medium Crawler Tractor, the Armored Excavator with Brush Hog, and Bridge Erection equipment. The total requirement is the planned quantity of equipment that requires depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year. The decrease is due to multiple small requirement changes. The largest change is a reduction of 2 M9 ACE. Examples of other smaller reductions in execution include the following which are each under \$1 million are:

- Clearance launcher
- Fuel Pump, 600. GPM
- EOD PACBOT
- Flood Light Set
- Water Tank Distributor
- Mine Clearing Blade

### **Electronics and Communications Systems**

The electronics and communications systems category refers to deferred systems maintenance for active and reserve Navy and Marine Corps assets. This category consists of maintenance performed on a variety of radar, radio, and wire and communications equipment. In part, the systems include or are associated with the Surveillance Towed-Array Sensor System (SURTASS), P-3 Beartrap, satellite subsystems, the Multi-Band Deployable Antenna, the Multi-Mode Inter/Intra Team Radio, and a variety of radio and radar sets used within the Department of the Navy. The total requirement is the planned quantity of systems and their components that require depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is then the difference between the validated requirements and funding received for that fiscal year. The USMC decrease is due to a reduction of one AN/TPS-59 radar.

### **Missiles**

Four categories are used to determine missile maintenance: missiles, tactical missiles, software maintenance, and other. Deferred maintenance is defined

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

### **Ships**

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 ships. Only depot level 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. One submarine, USS BOISE, scheduled for induction into a CNO maintenance availability in FY 2016 was deferred to future years due to insufficient capacity at the naval shipyards to accomplish the work.

### **Ordnance Weapons and Munitions**

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

### **All Other Items Not Identified Above**

This category comprises deferred maintenance for software, arresting gear, lighting and surfacing equipment, and EFTM (external fuel transfer module). The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year. Software maintenance includes the operational and system test software that runs in the airborne avionics systems (e.g., mission computer, display computer, radar) and the software that runs the ground-based support labs used to perform software sustainment (e.g., compilers, editors, simulation, configuration management).

Department of Defense  
**DEPARTMENT OF THE NAVY**

## STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

*For the Years Ended September 30, 2016 and 2015 (\$ in Thousands)*

|                                                           | Research, Development,<br>Test & Evaluation | Procurement          | Military Personnel   | Family Housing & Military<br>Construction |
|-----------------------------------------------------------|---------------------------------------------|----------------------|----------------------|-------------------------------------------|
| <b>Budgetary Resources:</b>                               |                                             |                      |                      |                                           |
| Unobligated Balance, Brought Forward,<br>October 1        | \$ 2,322,863                                | \$ 23,121,248        | \$ 1,754,152         | \$ 2,498,366                              |
| Recoveries of Prior Year Unpaid Obligations               | 502,033                                     | 2,252,536            | 818,680              | 920,425                                   |
| Other Changes in Unobligated Balance                      | (166,002)                                   | (523,516)            | (283,347)            | (8,453)                                   |
| Unobligated Balance from Prior Year                       |                                             |                      |                      |                                           |
| Budget Authority, Net                                     | 2,658,894                                   | 24,850,268           | 2,289,485            | 3,410,338                                 |
| Appropriations                                            | 18,042,454                                  | 48,129,320           | 45,837,132           | 1,763,357                                 |
| Spending Authority from Offsetting<br>Collections         | 118,634                                     | 850,314              | 416,386              | 813,628                                   |
| <b>Total Budgetary Resources</b>                          | <b>\$ 20,819,982</b>                        | <b>\$ 73,829,902</b> | <b>\$ 48,543,003</b> | <b>\$ 5,987,323</b>                       |
| <b>Status of Budgetary Resources:</b>                     |                                             |                      |                      |                                           |
| Obligations Incurred                                      | \$ 18,564,836                               | \$ 46,520,640        | \$ 46,828,273        | \$ 3,240,773                              |
| Unobligated Balance, End of Year                          |                                             |                      |                      |                                           |
| Apportioned, Unexpired Accounts                           | 1,914,077                                   | 26,334,834           | 141,770              | 2,583,409                                 |
| Exempt from Apportionment, Unexpired<br>Accounts          | -                                           | -                    | -                    | -                                         |
| Unapportioned, Unexpired Accounts                         |                                             |                      |                      |                                           |
| Unexpired unobligated balance, end<br>of year             | 1,914,077                                   | 26,334,834           | 141,770              | 2,583,409                                 |
| Expired unobligated balance, end<br>of year               | 341,069                                     | 974,428              | 1,572,960            | 163,141                                   |
| Total Unobligated Balance, End of Year                    | 2,255,146                                   | 27,309,262           | 1,714,730            | 2,746,550                                 |
| <b>Total Budgetary Resources</b>                          | <b>\$ 20,819,982</b>                        | <b>\$ 73,829,902</b> | <b>\$ 48,543,003</b> | <b>\$ 5,987,323</b>                       |
| <b>Change in Obligated Balance:</b>                       |                                             |                      |                      |                                           |
| Unpaid Obligations                                        |                                             |                      |                      |                                           |
| Unpaid Obligations, Brought Forward,<br>October 1         | \$ 9,068,516                                | \$ 67,425,949        | \$ 3,046,739         | \$ 3,329,354                              |
| Obligations Incurred                                      | 18,564,836                                  | 46,520,640           | 46,828,273           | 3,240,773                                 |
| Outlays, Gross                                            | (16,884,130)                                | (42,782,802)         | (47,405,671)         | (2,209,654)                               |
| Recoveries of Prior Year Unpaid<br>Obligations            | (502,033)                                   | (2,252,536)          | (818,680)            | (920,425)                                 |
| Unpaid Obligations, End of Year, Gross                    | 10,247,189                                  | 68,911,251           | 1,650,661            | 3,440,048                                 |
| Uncollected Payments Brought Forward,<br>October 1        | (146,038)                                   | (189,414)            | (33,150)             | (689,506)                                 |
| Change in Uncollected Payments from<br>Federal Sources    | 10,278                                      | 27,893               | (12,838)             | (125,148)                                 |
| Uncollected Payments from Federal<br>Sources, End of Year | (135,760)                                   | (161,521)            | (45,988)             | (814,654)                                 |
| Obligated Balance, Start of Year                          | 8,922,478                                   | 67,236,535           | 3,013,589            | 2,639,848                                 |
| <b>Obligated Balance, End of Year</b>                     | <b>\$ 10,111,429</b>                        | <b>\$ 68,749,730</b> | <b>\$ 1,604,673</b>  | <b>\$ 2,625,394</b>                       |
| <b>Budget Authority and Outlays, Net:</b>                 |                                             |                      |                      |                                           |
| Budget Authority, Gross                                   | \$ 18,161,088                               | \$ 48,979,634        | \$ 46,253,518        | \$ 2,576,985                              |
| Actual Offsetting Collections                             | (128,912)                                   | (878,320)            | (404,482)            | (691,190)                                 |
| Change in Uncollected Payments from<br>Federal Sources    | 10,278                                      | 27,893               | (12,838)             | (125,148)                                 |
| Recoveries of Prior Year Paid Obligations                 | -                                           | 113                  | 934                  | 2,710                                     |
| Budget Authority, Net                                     | <b>\$ 18,042,454</b>                        | <b>\$ 48,129,320</b> | <b>\$ 45,837,132</b> | <b>\$ 1,763,357</b>                       |
| Outlays, Gross                                            | \$ 16,884,130                               | \$ 42,782,802        | \$ 47,405,671        | \$ 2,209,654                              |
| Actual Offsetting Collections                             | (128,912)                                   | (878,320)            | (404,482)            | (691,190)                                 |
| Outlays, Net                                              | 16,755,218                                  | 41,904,482           | 47,001,189           | 1,518,464                                 |
| Distributed Offsetting Receipts                           | -                                           | -                    | -                    | -                                         |
| <b>Agency Outlays, Net</b>                                | <b>\$ 16,755,218</b>                        | <b>\$ 41,904,482</b> | <b>\$ 47,001,189</b> | <b>\$ 1,518,464</b>                       |

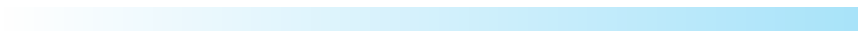
Department of Defense  
**DEPARTMENT OF THE NAVY**

# STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

*For the Years Ended September 30, 2016 and 2015 (\$ in Thousands)*

|                                                        | Operations, Readiness<br>& Support | 2016 Combined         | 2015 Combined         |
|--------------------------------------------------------|------------------------------------|-----------------------|-----------------------|
| <b>Budgetary Resources:</b>                            |                                    |                       |                       |
| Unobligated Balance, Brought Forward, October 1        | \$ 6,578,506                       | \$ 36,275,135         | \$ 35,245,619         |
| Recoveries of Prior Year Unpaid Obligations            | 3,566,353                          | 8,060,027             | 9,719,355             |
| Other Changes in Unobligated Balance                   | (1,274,744)                        | (2,256,062)           | (2,443,706)           |
| Unobligated Balance from Prior Year                    |                                    |                       |                       |
| Budget Authority, Net                                  | 8,870,115                          | 42,079,100            | 42,521,268            |
| Appropriations                                         | 55,352,997                         | 169,125,260           | 159,724,368           |
| Spending Authority from Offsetting Collections         | 4,605,282                          | 6,804,244             | 6,590,193             |
| <b>Total Budgetary Resources</b>                       | <b>\$ 68,828,394</b>               | <b>\$ 218,008,604</b> | <b>\$ 208,835,829</b> |
| <b>Status of Budgetary Resources:</b>                  |                                    |                       |                       |
| Obligations Incurred                                   | \$ 62,539,794                      | \$ 177,694,316        | \$ 172,560,694        |
| Unobligated Balance, End of Year                       |                                    |                       |                       |
| Apportioned, Unexpired Accounts                        | 1,462,365                          | 32,436,455            | 30,084,039            |
| Exempt from Apportionment, Unexpired Accounts          | 1,671,491                          | 1,671,491             | 25,813                |
| Unapportioned, Unexpired Accounts                      |                                    |                       | -                     |
| Unexpired unobligated balance, end of year             | 3,133,856                          | 34,107,946            | 30,109,852            |
| Expired unobligated balance, end of year               | 3,154,744                          | 6,206,342             | 6,165,283             |
| Total Unobligated Balance, End of Year                 | 6,288,600                          | 40,314,288            | 36,275,135            |
| <b>Total Budgetary Resources</b>                       | <b>\$ 68,828,394</b>               | <b>\$ 218,008,604</b> | <b>\$ 208,835,829</b> |
| <b>Change in Obligated Balance:</b>                    |                                    |                       |                       |
| Unpaid Obligations                                     |                                    |                       |                       |
| Unpaid Obligations, Brought Forward, October 1         | \$ 24,500,064                      | \$ 107,370,622        | \$ 110,665,931        |
| Obligations Incurred                                   | 62,539,794                         | 177,694,316           | 172,560,694           |
| Outlays, Gross                                         | (59,567,422)                       | (168,849,679)         | (166,136,648)         |
| Recoveries of Prior Year Unpaid Obligations            | (3,566,353)                        | (8,060,027)           | (9,719,355)           |
| Unpaid Obligations, End of Year, Gross                 | 23,906,083                         | 108,155,232           | 107,370,622           |
| Uncollected Payments Brought Forward, October 1        | (2,379,758)                        | (3,437,866)           | (3,274,255)           |
| Change in Uncollected Payments from Federal Sources    | 12,298                             | (87,517)              | (163,611)             |
| Uncollected Payments from Federal Sources, End of Year | (2,367,460)                        | (3,525,383)           | (3,437,866)           |
| Obligated Balance, Start of Year                       | 22,120,306                         | 103,932,756           | 107,391,676           |
| <b>Obligated Balance, End of Year</b>                  | <b>\$ 21,538,623</b>               | <b>\$ 104,629,849</b> | <b>\$ 103,932,756</b> |
| <b>Budget Authority and Outlays, Net:</b>              |                                    |                       |                       |
| Budget Authority, Gross                                | \$ 59,958,279                      | \$ 175,929,504        | \$ 166,314,561        |
| Actual Offsetting Collections                          | (4,620,411)                        | (6,723,315)           | (6,450,446)           |
| Change in Uncollected Payments from Federal Sources    | 12,298                             | (87,517)              | (163,611)             |
| Recoveries of Prior Year Paid Obligations              | 2,831                              | 6,588                 | 23,864                |
| Budget Authority, Net                                  | \$ 55,352,997                      | \$ 169,125,260        | \$ 159,724,368        |
| Outlays, Gross                                         | \$ 59,567,422                      | \$ 168,849,679        | \$ 166,136,648        |
| Actual Offsetting Collections                          | (4,620,411)                        | (6,723,315)           | (6,450,446)           |
| Outlays, Net                                           | 54,947,011                         | 162,126,364           | 159,686,202           |
| Distributed Offsetting Receipts                        | (97,310)                           | (97,310)              | (196,776)             |
| <b>Agency Outlays, Net</b>                             | <b>\$ 54,849,701</b>               | <b>\$ 162,029,054</b> | <b>\$ 159,489,426</b> |





2016



**OTHER INFORMATION**

*America's Away Team*



**TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT**

*Audit Opinion: Disclaimer*

Restatement: No

| <b>Areas of Material Weaknesses</b>                                               | <b>Beginning Balance</b> | <b>New</b> | <b>Resolved</b> | <b>Consolidated</b> | <b>Ending Balance</b> |
|-----------------------------------------------------------------------------------|--------------------------|------------|-----------------|---------------------|-----------------------|
| Fund Balance with Treasury                                                        |                          | 1          |                 |                     | 1                     |
| Financial Reporting Compilation                                                   | 1                        | 2          |                 | 4                   | 7                     |
| Military Pay                                                                      |                          |            |                 | 1                   | 1                     |
| Contract/ Vendor Pay                                                              |                          |            |                 | 2                   | 2                     |
| Reimbursable Work Orders (Budgetary)                                              | 5                        |            |                 | (3)                 | 2                     |
| Transportation of Things                                                          | 3                        |            |                 | (1)                 | 2                     |
| Equipment Assets                                                                  | 2                        |            |                 | (1)                 | 1                     |
| Real Property Assets                                                              | 1                        |            |                 |                     | 1                     |
| Inventory                                                                         |                          |            |                 | 1                   | 1                     |
| Operating Materials and Supplies                                                  | 1                        |            |                 |                     | 1                     |
| Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures) | 3                        |            |                 | 1                   | 4                     |
| Financial Management Systems                                                      | 3                        |            |                 | (3)                 | 0                     |
| Order to Cash                                                                     | 5                        |            |                 | (5)                 | 0                     |
| <b>Total Material Weaknesses</b>                                                  | <b>24</b>                | <b>3</b>   | <b>0</b>        | <b>(4)</b>          | <b>23</b>             |



## TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES

### *The DON Financial Reporting Material Weaknesses and Corrective Actions*

Effectiveness of Internal Controls over Financial Reporting (FMFIA § 2)  
**Statement of Assurance: Modified Assurance**

| End-to-End Process                                   | Areas of Material Weaknesses                                                      | Beginning Balance | New      | Resolved | Consolidated | Reassessed | Ending Balance |
|------------------------------------------------------|-----------------------------------------------------------------------------------|-------------------|----------|----------|--------------|------------|----------------|
| Budget-to-Report                                     | Fund Balance with Treasury Financial Reporting                                    |                   | 1        |          |              |            | 1              |
|                                                      | Compilation                                                                       | 5                 | 2        |          |              |            | 7              |
| Hire-to-Retire                                       | Military Pay                                                                      | 1                 |          |          |              |            | 1              |
| Order-to-Cash                                        | Accounts Receivable                                                               | 4                 |          |          | (4)          |            | 0              |
| Procure-to-Pay                                       | Contract/ Vendor Pay                                                              | 3                 |          |          |              | (1)*       | 2              |
|                                                      | Reimbursable Work Orders (Budgetary)                                              | 7                 |          |          | (5)          |            | 2              |
|                                                      | Transportation of Things                                                          | 3                 |          |          | (1)          |            | 2              |
| Acquire-to-Retire                                    | Equipment Assets                                                                  | 3                 |          |          | (2)          |            | 1              |
|                                                      | Real Property Assets                                                              | 2                 |          |          | (1)          |            | 1              |
| Plan-to-Stock                                        | Inventory                                                                         | 1                 |          |          |              |            | 1              |
|                                                      | Operating Materials and Supplies                                                  | 1                 |          |          |              |            | 1              |
|                                                      | Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures) | 4                 |          |          |              |            | 4              |
| <b>Total Financial Reporting Material Weaknesses</b> |                                                                                   | <b>34</b>         | <b>3</b> | <b>0</b> | <b>(13)</b>  | <b>(1)</b> | <b>23</b>      |

\* Improper Payments was reported in the prior year as an Internal Control over Financial Reporting (ICOFR) material weakness and reclassified as an Internal Control over Non-Financial Operations (ICONO) material weakness for FY 2016.

### *The DON Operational Material Weaknesses*

Effectiveness of Internal Controls over Non-Financial Operations (FMFIA § 2)  
**Statement of Assurance: Modified Assurance**

| Areas of Material Weaknesses            | Beginning Balance | New      | Resolved | Reassessed | Ending Balance |
|-----------------------------------------|-------------------|----------|----------|------------|----------------|
| Comptroller and Resource Management     |                   |          |          | 1*         | 1              |
| Contract Administration                 | 2                 |          |          |            | 2              |
| Security                                | 1                 |          |          |            | 1              |
| Acquisition                             | 2                 |          |          | (1)**      | 1              |
| Communications                          | 1                 |          |          | (1)**      | 0              |
| Manufacturing, Maintenance, and Repair  |                   | 1        |          |            | 1              |
| Personnel and Organizational Management |                   | 1        |          |            | 1              |
| <b>Total Material Weaknesses</b>        | <b>6</b>          | <b>2</b> | <b>0</b> | <b>(1)</b> | <b>7</b>       |

\* Improper Payments was reported in the prior year as an Internal Control over Financial Reporting (ICOFR) material weakness and reclassified as Internal Control over Non-Financial Operations (ICONO) material weakness for FY 2016.

\*\* Earned Value Management and Communications Security were reclassified by the Senior Management Council (SMC) as reportable conditions. These reportable conditions will be monitored by the SMC in FY 2017 as pending independent validation.

### *Financial Management Systems Material Weakness/Nonconformances and Corrective Actions*

Effectiveness of Internal Controls over Financial Systems (FMFIA § 4)  
**Statement of Assurance: Modified Assurance**

| Nonconformances                                     | Beginning Balance | New      | Resolved | Consolidated | Reassessed | Ending Balance |
|-----------------------------------------------------|-------------------|----------|----------|--------------|------------|----------------|
| Financial Management Systems                        | 20                | 0        | 0        | (11)         | 0          | 9              |
| <b>Total System Conformance Material Weaknesses</b> | <b>20</b>         | <b>0</b> | <b>0</b> | <b>(11)</b>  | <b>0</b>   | <b>9</b>       |



# APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE PRINCIPAL STATEMENTS

## ENTITY ACCOUNTS

### General Funds

017X0380 Coastal Defense Augmentation, Navy  
 017 0513 Ship Modernization, Operations and Sustainment Fund, Navy  
 017 0703 Family Housing, Navy and Marine Corps  
 017X0730 Family Housing Construction, Navy and Marine Corps  
 017 0730 Family Housing Construction, Navy and Marine Corps  
 017 0735 Family Housing Operation and Maintenance, Navy and Marine Corps  
 017X0810 Environmental Restoration, Navy  
 017 1000 Medicare-Eligible Retiree Health Fund Contribution, Navy  
 017 1001 Medicare-Eligible Retiree Health Fund Contribution, Marine Corps  
 017 1002 Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy  
 017 1003 Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps  
 017X1105 Military Personnel, Marine Corps  
 017 1105 Military Personnel, Marine Corps  
 017X1106 Operation and Maintenance, Marine Corps  
 017 1106 Operation and Maintenance, Marine Corps  
 017 1107 Operation and Maintenance, Marine Corps Reserve  
 017 1108 Reserve Personnel, Marine Corps  
 017X1109 Procurement, Marine Corps  
 017 1109 Procurement, Marine Corps  
 017 1116 Operation and Maintenance - Recovery Act, Marine Corps  
 017 1117 Operation and Maintenance - Recovery Act, Marine Corps Reserve  
 017X1205 Military Construction, Navy and Marine Corps  
 017 1205 Military Construction, Navy and Marine Corps  
 017 1206 Military Construction - Recovery Act, Navy and Marine Corps  
 017 1235 Military Construction, Naval Reserve  
 017X1236 Payments to Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy  
 017X1319 Research, Development, Test, and Evaluation, Navy  
 017 1319 Research, Development, Test, and Evaluation, Navy  
 017 1320 Research, Development, Test and Evaluation - Recovery Act, Navy  
 017 1405 Reserve Personnel, Navy  
 017X1453 Military Personnel, Navy  
 017 1453 Military Personnel, Navy  
 017X1506 Aircraft Procurement, Navy

017 1506 Aircraft Procurement, Navy  
 017X1507 Weapons Procurement, Navy  
 017 1507 Weapons Procurement, Navy  
 017 1508 Procurement of Ammunition, Navy and Marine Corps  
 017X1611 Shipbuilding and Conversion, Navy  
 017 1611 Shipbuilding and Conversion, Navy  
 017X1804 Operation and Maintenance, Navy  
 017 1804 Operation and Maintenance, Navy  
 017 1805 Operation and Maintenance - Recovery Act, Navy  
 017X1806 Operations and Maintenance, Navy Reserve  
 017 1806 Operation and Maintenance, Navy Reserve  
 017 1807 Operation and Maintenance - Recovery Act, Navy Reserve  
 017X1810 Other Procurement, Navy  
 017 1810 Other Procurement, Navy

### Revolving Funds

017X4557 National Defense Sealift Fund, Navy  
 017 4557 National Defense Sealift Fund, Navy

### Special Funds

017X5095 Wildlife Conservation, etc., Military Reservations, Navy  
 017X5185 Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy  
 017X5562 Ford Island Improvement Account

### Deposit Funds

017X6001 Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)  
 017X6002 Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)  
 017X6025 Pay of the Navy, Deposit Fund (T)  
 017X6026 Pay of the Marine Corps, Deposit Fund (T)  
 017X6434 Servicemen's Group Life Insurance Fund, Suspense, Navy  
 017X6705 Civilian Employees Allotment Account, Navy  
 017X6706 Commercial Communication Service, Navy  
 017 6763 Gains and Deficiencies on Exchange Transactions, Navy  
 017X6850 Housing Rentals, Navy  
 017X6999 Accounts Payable, Check Issue Underdrafts, Navy

### Trust Funds

017X8716 Department of the Navy General Gift Fund  
 017X8723 Ships Stores Profits, Navy  
 017X8733 United States Naval Academy General Gift Fund



**INSPECTOR GENERAL**  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500

November 7, 2016

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL  
MANAGEMENT AND COMPTROLLER)

SUBJECT: Independent Auditor's Report on the Department of the Navy Working  
Capital Fund FY 2016 and FY 2015 Basic Financial Statements  
(Project No. D2016-D000FS-0124.000, Report No. DODIG-2016-007)

***Report on the Basic Financial Statements***

Public Law 101-576, "Chief Financial Officers Act of 1990," as amended, requires the DoD Inspector General to audit the accompanying Department of the Navy Working Capital Fund consolidated balance sheet as of September 30, 2016, and 2015, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the basic statements (basic financial statements).

***Management's Responsibility for the Annual  
Financial Statements***

The Department of the Navy management is responsible for the annual financial statements. Management is responsible for: (1) preparing financial statements that conform with U.S. generally accepted accounting principles (U.S. GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that they met broad control objectives of Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982" (FMFIA); (3) ensuring that the Department of the Navy's financial management systems substantially comply with Public-Law-104-208, "Federal Financial Management Improvement Act of 1996" (FFMIA) requirements; and (4) complying with applicable laws and regulations.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the basic financial statements based on conducting the audit in accordance with generally accepted government auditing standards and the Office of Management and Budget (OMB) Bulletin No. 15-02, "Audit Requirements for Federal Financial Statements," August 4, 2015. However, based on the matters described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### ***Basis for Disclaimer of Opinion***

Section 1008(d) of the FY 2002 National Defense Authorization Act limits the DoD Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. The Department of the Navy management asserted to us that the Department of the Navy Working Capital Fund FY 2016 and FY 2015 Basic Financial Statements would not substantially conform to U.S. GAAP and that the Department of the Navy Working Capital Fund financial management and feeder systems were unable to adequately support material amounts on the basic financial statements as of September 30, 2016. Accordingly, we did not perform all the auditing procedures required by generally accepted government auditing standards and OMB Bulletin No. 15-02 to determine whether material amounts on the basic financial statements were presented fairly. We considered the scope limitation in forming our conclusions on the basic financial statements.

### ***Disclaimer of Opinion***

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we could not obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Department of the Navy Working Capital Fund FY 2016 and FY 2015 Basic Financial Statements. Thus, the basic financial statements may have undetected misstatements that are both material and pervasive.

### ***Other Information in the Annual Financial Statements***

We performed our audit to form an opinion on the basic financial statements as a whole. The Department of the Navy management presented the Management's Discussion and Analysis, Required Supplementary Information, and Other Information for additional analysis as part of the annual financial statements. These elements are not required parts of the basic financial statements. Therefore, we do not express an opinion or



provide any assurance on the information. We reviewed the other information for inconsistencies with the audited basic financial statements. Based on our limited review, we did not find any material inconsistencies between the information and the basic financial statements and applicable sections of OMB Circular No. A-136 (Revised), "Financial Reporting Requirements," October 7, 2016, and DoD Regulation 7000.14-R, "Financial Management Regulation," volume 6b, "Form and Content of the Department of Defense Audited Financial Statements."

### ***Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements***

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have a direct and material effect on the basic financial statements, and compliance with OMB regulations and audit requirements for financial reporting because management represented that instances of noncompliance identified in prior audits continue to exist. Therefore, we did not determine whether the Department of the Navy Working Capital Fund complied with all applicable laws and regulations, contracts, and grant agreements related to financial reporting. It was not our objective to provide an opinion on compliance with certain provisions of laws and regulations, contracts, and grant agreements, and accordingly, we do not express such an opinion.

See Attachment 1 for additional details on internal control and compliance with legal and other regulatory requirements

### ***Agency Comments and Our Evaluation***

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management and Comptroller). The Department of the Navy officials expressed their continuing commitment to address the problems this report outlines.

This report will be made publicly available pursuant to section 8M, paragraph (b)(1)(A) of the Inspector General Act of 1978, as amended. However, this report is intended solely for the information and use of Congress, the OMB, the U.S. Government Accountability Office, the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, the Department of the Navy management, and the DoD Office of Inspector General. It is not intended to be used and should not be used by anyone else.



We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 or (DSN) 329-5945.



Lorin T. Venable, CPA

Assistant Inspector General

Financial Management and Reporting

Attachment: As stated

# Report on Internal Control Over Financial Reporting

## ***Internal Control Compliance***

In planning our audit, we considered the Department of the Navy Working Capital Fund internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances, for the purposes of expressing our opinion on the basic financial statements, but not appropriate to the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on internal control over financial reporting.

## ***Management Responsibilities***

Management is responsible for implementing and maintaining effective internal controls to include providing reasonable assurance that the Department of the Navy personnel recorded, processed, and summarized accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

## ***Auditor's Responsibilities***

Our purpose was not to express an opinion on internal controls over financial reporting, and we do not do so. However, the following material weaknesses continue to exist that could adversely affect the Department of the Navy Working Capital Fund financial operations.

## ***Previously Identified Material Weaknesses***

Management acknowledged that previously identified material weaknesses continued to exist. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Department of the Navy Working Capital Fund financial statements will not be prevented, or detected and corrected, on a timely basis. The following material weaknesses continue to exist.

**Fund Balance with Treasury.** The Department of the Navy Fund Balance with Treasury reconciliation does not effectively reconcile field-level general ledger balances to reported amounts on budgetary reports and the financial statements. The Department of the Navy does not perform effective oversight of the Fund Balance with Treasury process performed by the Defense Finance and Accounting Service.

**Financial Statement Compilation and Reporting.** The Department of the Navy management identified the following material weaknesses.

- The Department of the Navy has not established sufficient procedures to provide oversight of the third-party shared service providers that process, store, or transmit the Department of the Navy financial data. The Department of the Navy does not have a comprehensive set of governance and oversight agreements. It lacks service-level agreements, memorandums of understanding, or other documents to clearly outline roles and responsibilities of the Department of the Navy and its service providers with respect to controls over processes performed. Controls over financial information technology systems are insufficient.
- The Department of the Navy is unable to provide detailed transaction data to support the history of cumulative transactions. The Department of the Navy's beginning balances are unsupported.
- General ledger accounting system posting logic does not produce expected financial and budgetary accounting relationships.
- Transactions resident in the business transaction systems cannot be reconciled to the Department of the Navy general ledger accounting systems. Process variances, system interface and configuration management issues present a risk that the Department of the Navy could overstate or understate obligations, accounts receivable, accounts payable, and disbursements.

**Transportation of Things.** Effective controls are not in place to prevent unauthorized use of transportation account codes or prevent unauthorized shipments from occurring. Transportation officers across the DoD do not have the capability to determine if the shipping requestor is authorized to use the transportation account codes cited on the shipping document or validate sufficient funds are available prior to releasing for shipment. Additionally, interfaces among transportation and financial systems do not support exchange of all required transactional data. The Department of the Navy standard document numbers may be altered as transportation transactions enter other services' financial and transportation systems. The majority of Transportation of Things systems are owned by transportation service providers and other services. These differences in system requirements result in lost or corrupted transference of data, increased risk of incorrect financial reporting, and extreme difficulty and inability to trace transactions from general ledger to source documentation. This results in

transportation services being charged to the wrong organization, which may lead to potential Antideficiency Act violations and overstatement or understatement in the lines of accounting.

In addition, the DoD does not have a centralized process to maintain, store, and retrieve transportation documentation which is required to support Transportation of Things transactions, management evaluation, and future examination/audits.

**Inventory.** The Department of the Navy has identified problems with the Moving Average Cost inventory value calculations in Navy Enterprise Resource Planning. Business processes currently in existence do not support accurate valuation of inventory, and Navy Enterprise Resource Planning is not designed to support the Department of the Navy's existing business practices that involve the use of estimated prices in funding documents/commercial contracts.

Inventory reported in the financial statements is not valued correctly in accordance with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property." These issues prevent the tracing of transactions from source documentation to dollar values on the Department of the Navy's financial statements.

**General Equipment.** The Department of the Navy cannot establish or support ownership and valuation of General Equipment due to lack of supporting documentation, improper interpretation of guidance, underutilization of the Accountable Property System of Record, and system limitations. In addition, the Department of the Navy cannot substantiate that the Accountable Property System of Record represents a complete inventory of General Equipment assets. The inability to reconcile property accountability systems with financial systems equates to inaccurate asset disclosure and presentation.

**Reimbursable Work Order.** Military Sealift Command liquidations and payments lack supporting receipt and acceptance documentation for the Marine Corps. Delivery confirmation documentation is not received from the Defense Contract Management Agency as required.

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



these deficiencies. Internal control work we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies. We did not identify material weaknesses that were not reported as such in the Department of the Navy's FMFIA report.

## **Report on Compliance with Applicable Provisions of Law, Regulations, Contracts, and Grant Agreements**

U.S. generally accepted government auditing standards and OMB guidance require auditors to report on entities' compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for compliance with existing laws and regulations, contracts, and grant agreements related to financial reporting. Management has also acknowledged to us that previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether the Department of the Navy Working Capital Fund complied with selected provisions of all applicable laws and regulations, contracts, and grant agreements related to financial reporting. We caution that other noncompliance may have occurred and not been detected. Furthermore, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Because of other scope limitations discussed in this report, we limited our work to determining compliance with selected provisions of the applicable laws and regulations.

### ***Antideficiency Act***

Section 1341, title 31, United States Code (31 U.S.C. § 1341 [1990]), limits the Department of the Navy and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Department of the Navy or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As stated in 31 U.S.C. § 1517 (2004), the Department of the Navy and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act, the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. During FY 2016, the Department of the Navy Working Capital Fund reported no Antideficiency Act violations.

## ***Compliance With FFMIA Requirements***

The FFMIA requires the Department of the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For areas in which an agency is not in compliance, OMB Circular No. A-136 requires the agency to identify remediation activities planned or underway to bring the systems into substantial compliance with the FFMIA. The Office of the Assistant Secretary of the Navy (Financial Management and Comptroller), the Department of the Navy Chief Information Officer, the Department of the Navy commands, the Department of the Navy activities, and the Defense Finance and Accounting Service are jointly responsible for implementing and maintaining financial management systems that comply substantially with the Federal financial management system requirements in OMB Circular No. A-127, "Financial Management Systems," June 9, 2009, applicable U.S. generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. The Department of the Navy management states the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to comply substantially with the Federal financial management systems requirements, U.S. generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. The Department of the Navy has based its assessment on system requirements promulgated by OMB in Circular No. A-127 and by the Office of the Secretary of Defense through the DoD Business Enterprise Architecture laws, regulations, and policies. The Department of the Navy staff recognizes that legacy systems were, in some cases, substantively not compliant and therefore did not perform system reviews for selected legacy systems.

For FY 2016, the Department of the Navy Working Capital Fund did not substantially comply with the FFMIA. The Department of the Navy acknowledged to us that the Department of the Navy Working Capital Fund financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements and that previously identified material weaknesses continue. The financial management and feeder systems did not substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2016. Therefore, based on the representation of the Department of the Navy, we did not substantiate whether the Department of the Navy Working Capital Fund complied with FFMIA and OMB implementation guidance.

## **Recommendations**

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



U.S. Marines prepare to dismount a rotor of an MV-22 Osprey. Photo by Cpl Kyle N. Runnels.

## PRINCIPAL STATEMENTS

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### NAVY WORKING CAPITAL FUND

The fiscal year 2016 Navy Working Capital Fund (NWCF) principal statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the NWCF for the fiscal year ending September 30, 2016, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2015.

The following statements comprise the NWCF principal statements:

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

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

\*Note that amounts may vary slightly due to rounding.



Department of Defense  
**DEPARTMENT OF THE NAVY WORKING CAPITAL FUND**

## CONSOLIDATED BALANCE SHEET

*As of September 30, 2016 and 2015 (\$ in Thousands)*

|                                                     | 2016 Consolidated | 2015 Consolidated |
|-----------------------------------------------------|-------------------|-------------------|
| <b>ASSETS</b>                                       |                   |                   |
| Intragovernmental:                                  |                   |                   |
| Fund Balance with Treasury (Note 3)                 | \$ 1,419,711      | \$ 879,569        |
| Accounts Receivable (Note 4)                        | 860,622           | 848,832           |
| Other Assets (Note 5)                               | -                 | 46                |
| <b>Total Intragovernmental Assets</b>               | 2,280,333         | 1,728,447         |
| Cash and Other Monetary Assets (Note 6)             | 901               | 3,778             |
| Accounts Receivable, Net (Note 4)                   | 111,399           | 100,286           |
| Inventory and Related Property, Net (Note 7)        | 33,653,421        | 31,932,757        |
| General Property, Plant and Equipment, Net (Note 8) | 1,987,136         | 2,022,148         |
| Other Assets (Note 5)                               | 3,003,061         | 2,545,095         |
| <b>TOTAL ASSETS</b>                                 | \$ 41,036,251     | \$ 38,332,511     |
| <b>LIABILITIES</b>                                  |                   |                   |
| Intragovernmental:                                  |                   |                   |
| Accounts Payable (Note 10)                          | \$ 226,654        | \$ 323,831        |
| Other Liabilities (Note 11 & Note 12)               | 316,474           | 325,261           |
| <b>Total Intragovernmental Liabilities</b>          | 543,128           | 649,092           |
| Accounts Payable (Note 10)                          | 4,521,759         | 4,290,247         |
| Federal Employee and Veteran Benefits (Note 14)     | 681,273           | 681,052           |
| Other Liabilities (Note 11 & Note 12)               | 1,340,726         | 1,179,461         |
| <b>TOTAL LIABILITIES</b>                            | \$ 7,086,886      | \$ 6,799,852      |
| <b>Commitments and Contingencies (Note 13)</b>      |                   |                   |
| <b>NET POSITION</b>                                 |                   |                   |
| Unexpended Appropriations - Other Funds             | \$ 1,531          | \$ 1,531          |
| Cumulative Results of Operations - Other Funds      | 33,947,834        | 31,531,128        |
| <b>TOTAL NET POSITION</b>                           | \$ 33,949,365     | \$ 31,532,659     |
| <b>TOTAL LIABILITIES AND NET POSITION</b>           | \$ 41,036,251     | \$ 38,332,511     |

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

Department of Defense  
**DEPARTMENT OF THE NAVY WORKING CAPITAL FUND**

**CONSOLIDATED STATEMENT OF NET COST**

*For the Years Ended September 30, 2016 and 2015 (\$ in Thousands)*

|                                  | 2016 Consolidated | 2015 Consolidated   |
|----------------------------------|-------------------|---------------------|
| <b>Program Costs</b>             |                   |                     |
| Gross Costs                      |                   |                     |
| Operations, Readiness, & Support | \$ 29,788,970     | \$ 29,508,310       |
| Less: Earned Revenue             | (28,956,775)      | (26,867,111)        |
| <b>Net Cost of Operations</b>    | <u>\$ 832,195</u> | <u>\$ 2,641,199</u> |

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

Department of Defense  
**DEPARTMENT OF THE NAVY WORKING CAPITAL FUND**

## CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

*For the Years Ended September 30, 2016 and 2015 (\$ in Thousands)*

|                                          | 2016 Consolidated | 2015 Consolidated |
|------------------------------------------|-------------------|-------------------|
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>  |                   |                   |
| <b>Beginning Balance</b>                 | \$ 31,531,128     | \$ 31,303,847     |
| <b>Budgetary Financing Sources:</b>      |                   |                   |
| Appropriations Used                      | -                 | 18,082            |
| Nonexchange Revenue                      | 12,576            | 122,083           |
| Transfers In/Out without Reimbursement   | -                 | -                 |
| Other Budgetary Financing Sources        | -                 | (138)             |
| <b>Other Financing Sources:</b>          |                   |                   |
| Transfers In/Out without Reimbursement   | 1,447,610         | 1,202,731         |
| Imputed Financing                        | 522,859           | 493,567           |
| Other                                    | 1,265,856         | 1,032,155         |
| <b>Total Financing Sources</b>           | 3,248,901         | 2,868,480         |
| <b>Net Cost of Operations</b>            | 832,195           | 2,641,199         |
| <b>Net Change</b>                        | 2,416,706         | 227,281           |
| <b>Cumulative Results of Operations</b>  | \$ 33,947,834     | \$ 31,531,128     |
| <b>UNEXPENDED APPROPRIATIONS</b>         |                   |                   |
| <b>Beginning Balance</b>                 | \$ 1,531          | \$ 19,613         |
| <b>Budgetary Financing Sources:</b>      |                   |                   |
| Appropriations Received                  | -                 | -                 |
| Appropriations Used                      | -                 | (18,082)          |
| <b>Total Budgetary Financing Sources</b> | -                 | (18,082)          |
| <b>Unexpended Appropriations</b>         | 1,531             | 1,531             |
| <b>Net Position</b>                      | \$ 33,949,365     | \$ 31,532,659     |

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

## DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

## COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2016 and 2015 (\$ in Thousands)

|                                                                       | 2016 Combined        | 2015 Combined        |
|-----------------------------------------------------------------------|----------------------|----------------------|
| <b>Budgetary Resources:</b>                                           |                      |                      |
| Unobligated Balance, Brought Forward, October 1                       | \$ 2,280,484         | \$ 3,265,931         |
| Recoveries of Prior Year Unpaid Obligations                           | 2,292,461            | 2,039,359            |
| Other Changes in Unobligated Balance                                  | (1,738,513)          | (1,477,091)          |
| Unobligated Balance from Prior Year Budget Authority, Net             | 2,834,432            | 3,828,199            |
| Appropriations                                                        | -                    | -                    |
| Contract Authority                                                    | 9,351,097            | 8,007,408            |
| Spending Authority from Offsetting Collections                        | 21,361,072           | 20,270,660           |
| <b>Total Budgetary Resources</b>                                      | <b>\$ 33,546,601</b> | <b>\$ 32,106,267</b> |
| <b>Status of Budgetary Resources:</b>                                 |                      |                      |
| New obligations and upward adjustments                                | \$ 31,228,909        | \$ 29,825,783        |
| Unobligated Balance, End of Year                                      |                      |                      |
| Apportioned                                                           | 2,204,422            | 2,186,221            |
| Unapportioned                                                         | 113,270              | 94,263               |
| Unexpired unobligated balance, end of year                            | 2,317,692            | 2,280,484            |
| Expired unobligated balance, end of year                              | -                    | -                    |
| Unobligated Balance Brought Forward, End of Year                      | 2,317,692            | 2,280,484            |
| <b>Total Budgetary Resources</b>                                      | <b>\$ 33,546,601</b> | <b>\$ 32,106,267</b> |
| <b>Change in Obligated Balance:</b>                                   |                      |                      |
| Unpaid Obligations                                                    |                      |                      |
| Unpaid Obligations, Brought Forward, October 1                        | \$ 12,968,335        | \$ 12,574,832        |
| New obligations and upward adjustments                                | 31,228,909           | 29,825,783           |
| Outlays, Gross                                                        | (27,937,506)         | (27,392,921)         |
| Recoveries of Prior Year Unpaid Obligations                           | (2,292,461)          | (2,039,359)          |
| Unpaid Obligations, End of Year, Gross                                | 13,967,277           | 12,968,335           |
| Uncollected Payments                                                  |                      |                      |
| Uncollected Payments from Federal Sources, Brought Forward, October 1 | (12,115,334)         | (12,754,427)         |
| Change in Uncollected Payments from Federal Sources                   | 124,320              | 639,093              |
| Uncollected payments from Federal Sources, End of Year                | (11,991,014)         | (12,115,334)         |
| Obligated Balance, Start of Year                                      | 853,001              | (179,595)            |
| <b>Obligated Balance, End of Year</b>                                 | <b>\$ 1,976,263</b>  | <b>\$ 853,001</b>    |
| <b>Budget Authority and Outlays, Net:</b>                             |                      |                      |
| Budget Authority, Gross                                               | \$ 30,712,169        | \$ 28,278,068        |
| Actual Offsetting Collections                                         | (28,477,649)         | (27,515,162)         |
| Change in Uncollected Payments from Federal Sources                   | 124,320              | 639,093              |
| Budget Authority, Net                                                 | <b>\$ 2,358,840</b>  | <b>\$ 1,401,999</b>  |
| Outlays, Gross                                                        | \$ 27,937,506        | \$ 27,392,921        |
| Actual Offsetting Collections                                         | (28,477,649)         | (27,515,162)         |
| Outlays, Net                                                          | (540,143)            | (122,241)            |
| <b>Agency Outlays, Net</b>                                            | <b>\$ (540,143)</b>  | <b>\$ (122,241)</b>  |

The accompanying notes are an integral part of the statements.



## 1.A. BASIS OF PRESENTATION

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These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON), Navy Working Capital Fund (NWCF), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act (GMRA) of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the NWCF in accordance with, and to the extent possible, U.S. generally accepted accounting principles (USGAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB); the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements"; and the Department of Defense (DoD), Financial Management Regulation (FMR). The accompanying financial statements account for all resources for which the NWCF is responsible unless otherwise noted.

The NWCF is unable to fully implement all elements of USGAAP and OMB Circular No. A-136, due to limitations of financial and nonfinancial management processes and systems that support the financial statements. The NWCF derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with USGAAP. The NWCF continues to implement process and system improvements addressing these limitations.

The NWCF currently has 6 auditor-identified financial statement areas with material weaknesses: (1) Fund Balance with Treasury; (2) Financial Statement Compilation and Reporting; (3) Transportation of Things; (4) General Equipment; (5) Inventory; (6) Reimbursable Work Orders.

## 1.B. MISSION OF THE REPORTING ENTITY

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The DON was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The overall mission of the 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 the DON and other DoD customers to help ensure our military forces are mobile, ready, and have the most advanced technology.

The NWCF is a revolving fund that finances the DON activities providing products and services on a reimbursable basis, based on a relationship between

operating units and NWCF support organizations. Customers send funded orders to the NWCF providers who furnish the services or products, pay for incurred expenses, and bill the customers, who in turn authorize payment. NWCF activities strive to break even over the budget cycle. NWCF has five programs: Depot Maintenance, Supply Management, Research and Development, Base Support, and Transportation.

## 1.C. APPROPRIATIONS AND FUNDS

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

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

## 1.D. BASIS OF ACCOUNTING

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The NWCF's financial management systems are unable to meet all full accrual accounting requirements. This is primarily because many of the NWCF's financial and nonfinancial feeder systems and processes were designed and implemented prior to the legislative mandate to produce financial statements in accordance with USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis but were designed to record information on a budgetary basis.

Due to differences in recording under the accrual method and budgetary basis, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

The NWCF financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of NWCF sub-entities. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, Federal Employees' Compensation Act (FECA) liabilities and environmental liabilities. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At

the consolidated NWCF level, these abnormal balances may not be evident. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

The DoD is continuing the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the current revision of accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). NWCF activities currently use USGAAP compliant and non-compliant systems. Until all NWCF financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by USGAAP, there will be instances when the NWCF's financial data will be derived from budgetary transactions or data from nonfinancial feeder systems.

The preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

### **1.E. REVENUES AND OTHER FINANCING SOURCES**

Depot Maintenance NWCF activities recognize revenue according to the percentage of completion method. Supply Management NWCF activities recognize revenue from the sale of inventory items. Research and Development NWCF activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Base Support NWCF activities recognize revenue at the time service is rendered. Transportation NWCF activities recognize revenue on either a reimbursable or per diem basis. The majority of per diem projects are billed and collected in the month services are rendered. The remaining per diem projects accrue revenue in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered.

The NWCF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 18, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost-sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

### **1.F. RECOGNITION OF EXPENSES**

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred.

Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis. Estimates are made for major items, such as payroll expenses, accounts payable, FECA liabilities, environmental liabilities, and unbilled revenue. In the case of Operating Material & Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses. Under the consumption method, OM&S would be expensed when consumed. Due to system limitations, some expenditures for capital and other long-term assets may be recognized as operating expenses. The NWCF continues to implement process and system improvements to address these limitations.

### **1.G. ACCOUNTING FOR INTRAGOVERNMENTAL ACTIVITIES**

Accounting standards require an entity to eliminate intra-entity activity and balances from consolidated financial statements to prevent overstatement for business with itself. However, NWCF cannot accurately identify intragovernmental transactions by customer because NWCF's systems do not track buyer and seller data at the transaction level. Generally, seller entities within the DoD provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances and are then eliminated. The DoD is implementing replacement systems and a standard financial information structure incorporating the necessary elements to enable DoD to correctly report, reconcile, and eliminate intragovernmental balances.

The Treasury Financial Manual (TFM) Part 2 – Chapter 4700, “Agency Reporting Requirements for the Financial Report of the United States Government,” provides guidance for reporting and reconciling intragovernmental balances. While NWCF is unable to fully reconcile intragovernmental transactions with all Federal agencies, NWCF is able to reconcile balances pertaining to FECA transactions with the Department of Labor (DOL) and benefit program transactions with the Office of Personnel Management.

Imputed financing represents the costs paid on behalf of the NWCF by another Federal entity. The NWCF recognizes imputed costs for (1) employee pension, post-retirement health, and life insurance benefits; (2) post-employment benefits for terminated and inactive employees to include unemployment and workers compensation under FECA; and (3) losses in litigation proceedings.

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

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

## **1.H. TRANSACTIONS WITH FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS**

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

### **1.I. FUNDS WITH THE U.S. TREASURY**

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

In addition, DFAS and the USACE Finance Center submit reports to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis, NWCF's FBWT is reviewed and adjusted, as required to agree with the U.S. Treasury accounts.

### **1.J. CASH AND OTHER MONETARY ASSETS**

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Cash is the total of cash resources under the control of NWCF including coin, paper currency, negotiable instruments, and amounts held for deposit in banks and

other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

## **1.K. ACCOUNTS RECEIVABLE**

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Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience. The NWCF does not recognize an allowance for estimated uncollectible amounts from other federal agencies as receivables from other federal agencies are considered to be inherently collectible. Claims for accounts receivable from other federal agencies are resolved between the agencies in accordance with the Intragovernmental Business Rules published in the TFM.

## **1.L. INVENTORIES AND RELATED PROPERTY**

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Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property" defines "Inventory" as tangible personal property that is held for sale, in the process of production for sale, or to be consumed in the production of goods for sale or in the provision of services for a fee. The term "held for sale" is interpreted to include items for sale or transfer to entities outside the Federal Government, or other federal entities. The NWCF inventory is recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity.

Inventory categories include inventory purchased and available for resale, held for repair, inventory determined. The NWCF values approximately 98% of its resale inventory using the Moving Average Cost (MAC) method. The NWCF reports the remaining 2% of resale inventories at an approximation of historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The LAC method is used because legacy inventory systems were designed for material management rather than accounting. Inventory Held for Repair is valued at the price of a serviceable item less estimated repair costs using the "direct method." When repair is executed, the cost of the repair is capitalized in the inventory account up to the value of a serviceable item. NWCF excess, obsolete, and unserviceable inventory is valued at MAC. The NWCF recognizes excess, obsolete, and unserviceable inventory at a net realizable value of zero pending development of an effective means of valuing such material.

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). The NWCF is continuing to transition the balance of the inventories to MAC method. Most transitioned balances, however, were not base-lined to auditable historical cost and remain noncompliant with SFFAS No. 3.

The NWCF manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in NWCF's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The NWCF holds materiel based on military need and support for contingencies. The DoD is currently developing a methodology to be used to account for "inventory held for resale" and "inventory held in reserve for future resale" under the provisions of SFFAS No. 3, "Accounting for Inventory and Related Property."

Related property includes OM&S. The NWCF OM&S is categorized as operating material and supplies held for use and held for repair. The OM&S is valued at MAC and LAC. The NWCF uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, NWCF uses the purchase method. Under this method, material and supplies are expensed when purchased. During FY 2016 and 2015, the NWCF expensed significant amounts of OM&S using the purchase method because legacy systems could not support the consumption method. The NWCF currently performs an entry to record previously expensed OM&S as an asset on the Balance Sheet based on amounts obtained via data call. This is a material weakness for DoD and long-term system corrections are in the process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

Many high-dollar items, such as aircraft engines, are categorized as OM&S rather than general equipment. The NWCF determined the recurring high dollar-value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. The NWCF OM&S includes the related spares and repair parts for materiel.

The NWCF recognizes excess, obsolete, and unserviceable OM&S at a net realizable value of zero pending development of an effective means of valuing such material.

Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by NWCF. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make it suitable for sale. Often, it is more economical to repair these items rather than to procure them. The NWCF often relies on weapon systems and machinery no longer in production. As a result, 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 (1) costs related to the production or servicing of items, including direct material, labor, applied overhead; (2) the value of finished products or completed services that are yet to be placed in service; and (3) munitions in production and depot maintenance work with its associated costs incurred in the delivery of maintenance services.

### **1.M. GENERAL PROPERTY, PLANT AND EQUIPMENT**

NWCF General Property, Plant and Equipment (PP&E) assets are capitalized in accordance with SFFAS No. 6, "Accounting for Property, Plant and Equipment," as amended by SFFAS Nos. 10, 23, and 35, when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds NWCF's capitalization threshold. The NWCF capitalizes improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The NWCF depreciates all General PP&E, other than land, on a straight-line basis. In accordance with SFFAS No. 6, land is not depreciated. The NWCF's General PP&E and real property capitalization threshold is \$250 thousand. The capitalization threshold applies to asset acquisitions and modifications/improvements placed into service after September 30, 2013. PP&E assets acquired prior to October 1, 2013 were capitalized at prior threshold levels (\$100 thousand for equipment and \$20 thousand for real property) and are carried at the remaining net book value.

NWCF capitalizes all PP&E used in the performance of its mission. These assets are capitalized as General PP&E whether or not they meet the definition of any other PP&E category. Due to long standing financial system deficiencies, NWCF uses a combination of actual expenditure data, cost factors, and program funding to estimate the value for General PP&E, in accordance with SFFAS No. 35, "Estimating the Historical Cost of General



Property, Plant, and Equipment.” For Real Property, NWCF used plant replacement value (PRV). The NWCF is developing a process to track and record actual General PP&E costs in accordance with SFFAS No. 6.

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

The DoD developed policy and a reporting process for contractors with government furnished equipment that provides appropriate General PP&E information for financial statement reporting. The Federal Acquisition Regulations (FAR) requires NWCF maintain, in their property systems, information on all property furnished to contractors. These actions are structured to capture and report the information necessary for compliance with Federal accounting standards. The NWCF has not fully implemented this policy primarily due to system limitations. The DON is currently in the process of developing processes to record all contractor held property in NWCF accountable process systems of record (APSR).

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### **1.N. ADVANCES AND PREPAYMENTS**

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

Due to inconsistencies in the posting logic for nonfederal advances and prepayments, NWCF is noncompliant with the Federal Financial Management Improvement Act of 1996 (FFMIA), which requires agencies to comply with the Federal financial management systems requirements, standards promulgated by the FASAB, and USSGL at the transaction level.

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### **1.O. LEASES**

In accordance with SFFAS No. 5, “Accounting for Liabilities of the Federal Government,” lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or

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

Office space leases entered into by NWCF are the largest component of operating leases and are based on costs gathered from existing leases, General Services Administration (GSA) bills, and interservice support agreements. Future year projections use the Consumer Price Index.

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### **1.P. OTHER ASSETS**

Other assets include nonfederal advances and prepayments, military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on NWCF’s Balance Sheet.

The NWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, NWCF may provide financing payments. Contract financing payments are defined in the FAR, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost reimbursement contracts. It is DoD policy to record certain contract financing payments as other assets. The NWCF has not fully implemented this policy primarily due to system limitations.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion. The Defense Federal Acquisition Regulation Supplement authorizes progress payments based on a percentage or stage of completion only for

construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments based on percentage or stage of completion are reported as Construction in Progress.

### **1.Q. CONTINGENCIES AND OTHER LIABILITIES**

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The DON is party to various administrative proceedings, legal actions, and claims. Under SFFAS No. 5, “Accounting for Liabilities of the Federal Government,” as amended by SFFAS No. 12, “Recognition of Contingent Liabilities Arising from Litigation,” the Balance Sheet should include estimated liabilities for these items, when an adverse decision is probable, reasonably possible, and estimable. When the amount of the potential loss cannot be estimated, or the likelihood of an unfavorable outcome is remote, the contingency is not disclosed.

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

Other liabilities also arise as a result of anticipated disposal costs for NWCF assets. Consistent with SFFAS No. 6, “Accounting for Property, Plant and Equipment,” recognition of an anticipated environmental liability begins when the asset is placed into service. Based on DoD’s policy, which is consistent with SFFAS No. 5, nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. In addition DoD recognizes nonenvironmental disposal liabilities for nuclear-powered military equipment when placed into service. The amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs. The NWCF Environmental Liabilities are reported under DON General Fund (GF).

### **1.R. ACCRUED LEAVE**

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The NWCF reports military leave, compensatory leave, and annual leave earned by civilians, but not yet used as accrued liabilities. The accrued balance is adjusted annually to reflect current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

### **1.S. NET POSITION**

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

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

Cumulative results of operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

### **1.T. UNDISTRIBUTED DISBURSEMENTS AND COLLECTIONS**

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Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury. Supported undistributed disbursements and collections have corroborating documentation for the summary level adjustments made to accounts payable and receivable. Unsupported undistributed disbursements and collections do not have supporting documentation for the transactions and most likely would not meet audit scrutiny. However, both supported and unsupported adjustments may have been made to NWCF accounts payable and receivable trial balances prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, DoD generally cannot determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements and collections are also applied to reduce accounts payable and receivable accordingly.

### **1.U. MILITARY RETIREMENT AND FEDERAL EMPLOYMENT BENEFITS**

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For financial reporting purposes, the DON’s actuarial liability for workers’ compensation benefits is developed by DOL and provided to the DON at the end of each fiscal year. Military retirement is accounted for in the audited financial statements of the Military Retirement fund; as such, NWCF does not record any liabilities or obligations for pensions or healthcare retirement benefits.

## NOTE 2. NONENTITY ASSETS

| As of September 30<br>(Amounts in thousands) | 2016          | 2015          |
|----------------------------------------------|---------------|---------------|
| <b>Accounts Receivable with the Public</b>   | \$ 35,294     | \$ 25,818     |
| <b>Total Entity Assets</b>                   | \$ 41,000,957 | \$ 38,306,693 |
| <b>Total Assets</b>                          | \$ 41,036,251 | \$ 38,332,511 |

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

### Nonentity Nonfederal Accounts Receivable (Public)

The nonentity non-Federal accounts receivable amount represents interest, penalties, fines and administrative fees that will be remitted to the U.S. Treasury.

## NOTE 3. FUND BALANCE WITH TREASURY

| As of September 30<br>(Amounts in thousands) | 2016         | 2015       |
|----------------------------------------------|--------------|------------|
| <b>Fund Balances</b>                         |              |            |
| Revolving Funds                              | \$ 1,419,711 | \$ 879,569 |

### STATUS OF FUND BALANCE WITH TREASURY

| As of September 30<br>(Amounts in thousands) | 2016         | 2015         |
|----------------------------------------------|--------------|--------------|
| <b>Unobligated Balance</b>                   |              |              |
| Available                                    | \$ 2,204,421 | \$ 2,186,219 |
| Unavailable                                  | 113,270      | 94,263       |
| <b>Obligated Balance not yet Disbursed</b>   | 13,967,278   | 12,968,336   |
| <b>Non-FBWT Budgetary Accounts</b>           | (14,865,258) | (14,369,249) |
| <b>Total</b>                                 | \$ 1,419,711 | \$ 879,569   |

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

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. The unavailable amount primarily relates to Research and Development funding. Certain unobligated balances are restricted for future use and are not apportioned for current use.

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

Non-FBWT Budgetary Accounts reduces the Status of FBWT. This amount is comprised of contract authority, accounts receivable, and unfilled orders without advance from customers for the NWCF. Due to the DON systems inability to segregate Budgetary FBWT balances, Non-FBWT Budgetary Accounts are used to reconcile the Status of FBWT.

## OTHER

| As of September 30<br>(Amounts in thousands)    | 2016         | 2015       |
|-------------------------------------------------|--------------|------------|
| <b>Fund Balances Per Treasury Versus Agency</b> |              |            |
| Fund Balance per Treasury                       | \$ 1,419,711 | \$ 879,569 |
| Fund Balance per DON                            | 1,419,711    | 879,569    |
| <b>Reconciling Amount</b>                       | \$ -         | \$ -       |

## NOTE 4. ACCOUNTS RECEIVABLE

| As of September 30<br>(Amounts in thousands)    | 2016             |                                        |                          |
|-------------------------------------------------|------------------|----------------------------------------|--------------------------|
|                                                 | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net |
| <b>Intragovernmental Receivables</b>            | \$ 860,622       | \$ -                                   | \$ 860,622               |
| <b>Nonfederal Receivables (From the Public)</b> | 116,495          | (5,096)                                | 111,399                  |
| <b>Total</b>                                    | \$ 977,117       | \$ (5,096)                             | \$ 972,021               |

| As of September 30<br>(Amounts in thousands)    | 2015             |                                        |                          |
|-------------------------------------------------|------------------|----------------------------------------|--------------------------|
|                                                 | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net |
| <b>Intragovernmental Receivables</b>            | \$ 848,832       | \$ -                                   | \$ 848,832               |
| <b>Nonfederal Receivables (From the Public)</b> | 106,016          | (5,730)                                | 100,286                  |
| <b>Total</b>                                    | \$ 954,848       | \$ (5,730)                             | \$ 949,118               |

Accounts Receivable represents the NWCF's claim for payment from other entities. Intragovernmental Receivables primarily represents amounts due from other Federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Claims with other Federal agencies are resolved in accordance with the Intragovernmental Business Rules. Non-Federal Accounts Receivable is mainly held with Naval Facilities Engineering Command and Naval Supply Systems Command. The NWCF only recognizes an allowance for uncollectible amounts from the public. The methodology used in determining the allowance amount is discussed in Note 1.K, Accounts Receivable.

## NOTE 5. OTHER ASSETS

| As of September 30<br>(Amounts in thousands)   | 2016         | 2015         |
|------------------------------------------------|--------------|--------------|
| <b>Intragovernmental Other Assets</b>          |              |              |
| Advances and Prepayments                       | \$ -         | \$ 46        |
| <b>Outstanding Contract Financing Payments</b> | 864,534      | 654,265      |
| <b>Advances and Prepayments</b>                | 2,135,231    | 1,890,004    |
| <b>Other Assets (With the Public)</b>          | 3,296        | 826          |
| <b>Total Nonfederal Other Assets</b>           | 3,003,061    | 2,545,095    |
| <b>Total</b>                                   | \$ 3,003,061 | \$ 2,545,141 |

Non-Federal Other Assets - Outstanding Contract Financing Payments consist of contract terms and conditions for certain types of contract financing payments convey certain rights to the NWCF protecting 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 NWCF. The NWCF does not have the right to take the work, except as provided in contract clauses related to termination or acceptance. The NWCF is not obligated to make payment to the contractor until delivery and acceptance. As a result, cash outlays and payments are made by the NWCF to contractors, grantees, or others to cover the recipients' anticipated and periodic expenses before those expenses are incurred. Outstanding Contract Financing Payments are reduced when goods and services are received, contract terms are met, progress is made on a contract, or prepaid expenses expire.



Outstanding Contract Financing Payments includes \$795.4 million in contract financing payments and an additional \$69.1 million in estimated future funded payments to contractors upon delivery and Government acceptance of a satisfactory product. Refer to Note 12, Other Liabilities, for further information.

Due to reclassification of intragovernmental activity and inaccurate posting logic, non-Federal Advances and Prepayments are recognized within the NWCF.

Non-Federal Other Assets - Advances and Prepayments increased primarily due to Navy Supply Management reclassification of Federal Advances and Prepayments to non-Federal Advances and Prepayments in order to reconcile seller side trading partner data.

Non-Federal Other Assets consists of prepayments made to vendors and travel advances made to employees.

## NOTE 6. CASH AND OTHER MONETARY ASSETS

| As of September 30<br>(Amounts in thousands) | 2016   | 2015     |
|----------------------------------------------|--------|----------|
| Cash                                         | \$ 901 | \$ 3,778 |

NWCF Cash consists of coins, paper currency and readily negotiable instruments; such as money orders, checks, and bank drafts on hand or in transit for deposit.

There are no restrictions on cash, or the use, or conversion of foreign currencies.

## NOTE 7. INVENTORY AND RELATED PROPERTY

| As of September 30<br>(Amounts in thousands)   | 2016          | 2015          |
|------------------------------------------------|---------------|---------------|
| <b>Inventory, Net</b>                          | \$ 33,469,449 | \$ 31,765,896 |
| <b>Operating Materials &amp; Supplies, Net</b> | 183,972       | 166,861       |
| <b>Total</b>                                   | \$ 33,653,421 | \$ 31,932,757 |



## INVENTORY AND RELATED PROPERTY

| As of September 30                  | 2016                  |                       |                      | Valuation Method |
|-------------------------------------|-----------------------|-----------------------|----------------------|------------------|
|                                     | Inventory Gross Value | Revaluation Allowance | Inventory, Net       |                  |
| <i>(Amounts in thousands)</i>       |                       |                       |                      |                  |
| <b>Inventory, Net</b>               |                       |                       |                      |                  |
| <b>Inventory Categories</b>         |                       |                       |                      |                  |
| Available and Purchased for Resale  | \$ 19,201,669         | \$ 53,240             | \$ 19,254,909        | MAC, LAC         |
| Held for Repair                     | 14,239,432            | (61,988)              | 14,177,444           | MAC, LAC         |
| Excess, Obsolete, and Unserviceable | 19,899                | (19,899)              | -                    | NRV              |
| Work in Process                     | 37,096                | -                     | 37,096               | AC               |
| <b>Total</b>                        | <b>\$ 33,498,096</b>  | <b>\$ (28,647)</b>    | <b>\$ 33,469,449</b> |                  |
| As of September 30                  | 2015                  |                       |                      |                  |
| <i>(Amounts in thousands)</i>       |                       |                       |                      |                  |
| <b>Inventory, Net</b>               |                       |                       |                      |                  |
| <b>Inventory Categories</b>         |                       |                       |                      |                  |
| Available and Purchased for Resale  | \$ 18,662,262         | \$ 54,700             | \$ 18,716,962        | MAC, LAC         |
| Held for Repair                     | 13,074,070            | (49,999)              | 13,024,071           | MAC, LAC         |
| Excess, Obsolete, and Unserviceable | 19,996                | (19,996)              | -                    | NRV              |
| Work in Process                     | 24,863                | -                     | 24,863               | AC               |
| <b>Total</b>                        | <b>\$ 31,781,191</b>  | <b>\$ (15,295)</b>    | <b>\$ 31,765,896</b> |                  |

### Legend for Valuation Methods:

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

SFFAS No. 3 defines “Inventory” as tangible personal property that is Held for Sale, in the process of production for sale, or to be consumed in the production of goods for sale or in the provision of services for a fee. The term “held for sale” is interpreted to include items for sale or transfer to entities outside the Federal Government, or other federal entities. All DON inventory is funded under the Navy Working Capital Fund NWCF.

NWCF inventory is segmented into consumable and repairable and inventory is recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity.

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

- 1) Distributions without reimbursement are made when authorized by Department of Defense (DoD) directives;
- 2) War reserve materiel includes repair items that are considered restricted; and
- 3) Inventory, with the exception of safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

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

DON Inventory is disposed of in accordance with the Resource Conservation and Recovery Act (RCRA) of 1979 and Federal Facility Compliance Act (FFCA) of 1992, which requires that munitions be reviewed periodically and a determination be made as to suitability for use and potential to be deemed hazardous waste.

Inventory available and purchased for resale includes consumable and repairable items owned and managed by the NWCF. Inventory is assigned to categories based upon condition of the inventory items, or in the case of raw material and work-in-process, based upon stage of fabrication. Inventory Held for Repair consists of damaged materiel that requires repair to make it usable. Excess inventory includes scrap materials or items that are uneconomical to repair and are awaiting disposal. Work in process includes costs related to the production or servicing of items, including direct 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.

## OPERATING MATERIALS AND SUPPLIES, NET

| As of September 30            | 2016              |                       |                   |                  |
|-------------------------------|-------------------|-----------------------|-------------------|------------------|
|                               | OM&S Gross Value  | Revaluation Allowance | OM&S, Net         | Valuation Method |
| <i>(Amounts in thousands)</i> |                   |                       |                   |                  |
| <b>OM&amp;S Categories</b>    |                   |                       |                   |                  |
| Held for Use                  | \$ 183,964        | \$ -                  | \$ 183,964        | LAC, MAC         |
| Held for Repair               | 8                 | -                     | 8                 | LAC, MAC         |
| <b>Total</b>                  | <b>\$ 183,972</b> | <b>\$ -</b>           | <b>\$ 183,972</b> |                  |
| <br>                          |                   |                       |                   |                  |
| As of September 30            | 2015              |                       |                   |                  |
|                               | OM&S Gross Value  | Revaluation Allowance | OM&S, Net         | Valuation Method |
| <i>(Amounts in thousands)</i> |                   |                       |                   |                  |
| <b>OM&amp;S Categories</b>    |                   |                       |                   |                  |
| Held for Use                  | \$ 166,853        | \$ -                  | \$ 166,853        | LAC, MAC         |
| Held for Repair               | 8                 | -                     | 8                 | LAC, MAC         |
| <b>Total</b>                  | <b>\$ 166,861</b> | <b>\$ -</b>           | <b>\$ 166,861</b> |                  |

### Legend for Valuation Methods:

LAC = Latest Acquisition Cost    MAC = Moving Average Cost

In accordance with SFFAS No. 3, "Accounting for Inventory and Related Property" the DON categorizes its OM&S as Held for Use and Held for Repair. The DON assigns OM&S to a category based upon the type and condition of the asset. OM&S Held for Use includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal.

OM&S includes the related spares and repair parts for materiel. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, support equipment, etc. The DON categorizes its OM&S as ordinance, uninstalled engines, and OM&S – Remainder. OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines.

Federal Accounting Standards require disclosure of the amount of OM&S Held for "Future Use." The NWCFC reports that \$0.3 million and \$0.4 million of OM&S is Held for Future Use and is included in the "Held for Use" category as of September 30, 2016 and September 30, 2015, respectively. These items are not readily available in the market and there is a more than a remote chance that they will eventually be needed.

The DON uses a combination of the Consumption Method and Purchase Method to account for OM&S. DON Budget Submitting Offices (BSOs) use the Consumption Method unless use of the Purchase Method is approved. The use of the Purchase Method is only available to DON BSOs when OM&S they maintain is (1) not material, (2) in the hands of the end user, or (3) it is not cost-beneficial to apply the Consumption Method.

## NOTE 8. GENERAL PP&E, NET

| As of September 30                    | 2016                                    |              |                     |                                                |                     |
|---------------------------------------|-----------------------------------------|--------------|---------------------|------------------------------------------------|---------------------|
|                                       | Depreciation/<br>Amortization<br>Method | Service Life | Acquisition Value   | (Accumulated<br>Depreciation/<br>Amortization) | Net Book Value      |
| <i>(Amounts in thousands)</i>         |                                         |              |                     |                                                |                     |
| <b>Major Asset Classes</b>            |                                         |              |                     |                                                |                     |
| Land                                  | N/A                                     | N/A          | \$ 3,231            | \$ -                                           | \$ 3,231            |
| Buildings, Structures, and Facilities | S/L                                     | 20 or 40     | 6,150,010           | (5,014,376)                                    | 1,135,634           |
| Software                              | S/L                                     | 2-5 or 10    | 254,538             | (209,233)                                      | 45,305              |
| General Equipment                     | S/L                                     | 5 or 10      | 3,000,435           | (2,458,326)                                    | 542,109             |
| Construction-in-Progress              | N/A                                     | N/A          | 260,847             | -                                              | 260,847             |
| Other                                 | N/A                                     | N/A          | 10                  | -                                              | 10                  |
| <b>Total General PP&amp;E</b>         |                                         |              | <b>\$ 9,669,071</b> | <b>\$ (7,681,935)</b>                          | <b>\$ 1,987,136</b> |
| <br>                                  |                                         |              |                     |                                                |                     |
| As of September 30                    | 2015                                    |              |                     |                                                |                     |
|                                       | Depreciation/<br>Amortization<br>Method | Service Life | Acquisition Value   | (Accumulated<br>Depreciation/<br>Amortization) | Net Book Value      |
| <i>(Amounts in thousands)</i>         |                                         |              |                     |                                                |                     |
| <b>Major Asset Classes</b>            |                                         |              |                     |                                                |                     |
| Land                                  | N/A                                     | N/A          | \$ 3,231            | \$ -                                           | \$ 3,231            |
| Buildings, Structures, and Facilities | S/L                                     | 20 or 40     | 6,195,251           | (4,997,090)                                    | 1,198,161           |
| Software                              | S/L                                     | 2-5 or 10    | 295,679             | (247,439)                                      | 48,240              |
| General Equipment                     | S/L                                     | 5 or 10      | 2,866,149           | (2,329,667)                                    | 536,482             |
| Construction-in-Progress              | N/A                                     | N/A          | 236,034             | -                                              | 236,034             |
| Other                                 | N/A                                     | N/A          | -                   | -                                              | -                   |
| <b>Total General PP&amp;E</b>         |                                         |              | <b>\$ 9,596,344</b> | <b>\$ (7,574,196)</b>                          | <b>\$ 2,022,148</b> |

### Legend for Valuation Methods:

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

### General Composition of General Property, Plant and Equipment

The NWCF General PP&E consists of land, buildings and structures, lease hold improvements, software, general equipment and Construction-in-Progress. General PP&E, Other consists of assets awaiting disposal.

### General Property, Plant and Equipment Valuation

The acquisition cost for General PP&E is captured and maintained in the applicable accountable property systems of record. The capitalizing methodology for General PP&E assets is discussed in Note 1.M, General Property, Plant, and Equipment.

### Restrictions on Use of Property, Plant and Equipment

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

As a result of audit readiness efforts, adjustments had to be made to mission critical asset balances that resulted from events that could not be identified to specific accounting periods, and that those adjustments were made against current year gain/loss accounts. Significant accounting adjustments have been made to the DON's mission critical assets as a result of the Department's ongoing audit readiness efforts. These accounting adjustments were recognized in current year gain/loss accounts when auditable data was not available to support restatement of prior period financial statements.



## NOTE 9. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

| As of September 30<br>(Amounts in thousands)                | 2016 |           | 2015 |           |
|-------------------------------------------------------------|------|-----------|------|-----------|
| <b>Intragovernmental Liabilities</b>                        |      |           |      |           |
| Other                                                       | \$   | 145,574   | \$   | 145,686   |
| <b>Federal Employee and Veteran Benefits</b>                |      | 686,473   |      | 681,052   |
| <b>Total Liabilities Not Covered by Budgetary Resources</b> | \$   | 832,047   | \$   | 826,738   |
| <b>Total Liabilities Covered by Budgetary Resources</b>     | \$   | 6,254,839 | \$   | 5,973,114 |
| <b>Total Liabilities</b>                                    | \$   | 7,086,886 | \$   | 6,799,852 |

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through Congressional appropriations or earnings of the entity.

Intragovernmental Liabilities – Other consists of the unfunded portion of FECA liability due to the Department of Labor and unemployment compensation due to applicable States. These liabilities will be funded by future year’s budgetary resources.

Military Retirement and Other Federal Employment Benefits consist of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities represent the FECA Actuarial liabilities that will be funded in future periods. Refer to Note 14, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Nonfederal Liabilities - Other Liabilities includes estimated legal contingent liabilities that are not currently budgeted for but will become funded as future events occur.

## NOTE 10. ACCOUNTS PAYABLE

| As of September 30<br>(Amounts in thousands) | 2016             |                                              |              |
|----------------------------------------------|------------------|----------------------------------------------|--------------|
|                                              | Accounts Payable | Interest, Penalties, and Administrative Fees | Total        |
| <b>Intragovernmental Payables</b>            | \$ 226,654       | \$ -                                         | \$ 226,654   |
| <b>Nonfederal Payables (to the Public)</b>   | 4,521,759        | -                                            | 4,521,759    |
| <b>Total</b>                                 | \$ 4,748,413     | \$ -                                         | \$ 4,748,413 |

| As of September 30<br>(Amounts in thousands) | 2015             |                                              |              |
|----------------------------------------------|------------------|----------------------------------------------|--------------|
|                                              | Accounts Payable | Interest, Penalties, and Administrative Fees | Total        |
| <b>Intragovernmental Payables</b>            | \$ 323,831       | \$ -                                         | \$ 323,831   |
| <b>Nonfederal Payables (to the Public)</b>   | 4,290,247        | -                                            | 4,290,247    |
| <b>Total</b>                                 | \$ 4,614,078     | \$ -                                         | \$ 4,614,078 |

Accounts Payable includes amounts owed to Federal and non-Federal entities for goods and services received by the NWCF. The NWCF’s systems do not track intragovernmental accounts payable transactions by customer. As a result, in the intragovernmental eliminations process, buyer-side accounts payable are adjusted to agree with supportable inter/intra-agency seller-side accounts receivable. The NWCF’s methodology for adjusting accounts payables consist of (1) reclassifying amounts between federal and nonfederal accounts payable; (2) accruing additional accounts payable and expenses; and (3) applying both supported and unsupported undistributed disbursements at the reporting entity level.

## NOTE 11. ENVIRONMENTAL LIABILITIES AND DISPOSAL LIABILITIES

The NWCF Environmental Liabilities are reported under the DON GF financial statements and accompanying Note 12, Environmental Liabilities and Disposal Liabilities.

## NOTE 12. OTHER LIABILITIES

| As of September 30<br>(Amounts in thousands)           | 2016                |                      |                     |
|--------------------------------------------------------|---------------------|----------------------|---------------------|
|                                                        | Current Liability   | Noncurrent Liability | Total               |
| <b>Intragovernmental</b>                               |                     |                      |                     |
| Advances from Others                                   | \$ 77,989           | \$ -                 | \$ 77,989           |
| FECA Reimbursement to the Dept of Labor                | 65,593              | 79,981               | 145,574             |
| Custodial Liabilities                                  | 35,294              | -                    | 35,294              |
| Employer Contribution and Payroll Taxes Payable        | 57,617              | -                    | 57,617              |
| <b>Total Intragovernmental</b>                         | <b>236,493</b>      | <b>79,981</b>        | <b>316,474</b>      |
| <b>Accrued Funded Payroll and Benefits</b>             | <b>986,670</b>      | <b>-</b>             | <b>986,670</b>      |
| <b>Advances from Others</b>                            | <b>251,047</b>      | <b>-</b>             | <b>251,047</b>      |
| <b>Deposit Funds and Suspense Accounts</b>             | <b>47</b>           | <b>-</b>             | <b>47</b>           |
| <b>Contract Holdbacks</b>                              | <b>2,442</b>        | <b>-</b>             | <b>2,442</b>        |
| <b>Employer Contribution and Payroll Taxes Payable</b> | <b>5,278</b>        | <b>-</b>             | <b>5,278</b>        |
| <b>Contingent Liabilities</b>                          | <b>-</b>            | <b>74,296</b>        | <b>74,296</b>       |
| <b>Other Liabilities</b>                               | <b>20,946</b>       | <b>-</b>             | <b>20,946</b>       |
| <b>Total Other Liabilities</b>                         | <b>\$ 1,502,923</b> | <b>\$ 154,277</b>    | <b>\$ 1,657,200</b> |
| <br>                                                   |                     |                      |                     |
| As of September 30<br>(Amounts in thousands)           | 2015                |                      |                     |
|                                                        | Current Liability   | Noncurrent Liability | Total               |
| <b>Intragovernmental</b>                               |                     |                      |                     |
| Advances from Others                                   | \$ 111,821          | \$ -                 | \$ 111,821          |
| FECA Reimbursement to the Dept of Labor                | 65,549              | 80,137               | 145,686             |
| Custodial Liabilities                                  | 25,818              | -                    | 25,818              |
| Employer Contribution and Payroll Taxes Payable        | 41,936              | -                    | 41,936              |
| <b>Total Intragovernmental</b>                         | <b>245,124</b>      | <b>80,137</b>        | <b>325,261</b>      |
| <b>Accrued Funded Payroll and Benefits</b>             | <b>873,542</b>      | <b>-</b>             | <b>873,542</b>      |
| <b>Advances from Others</b>                            | <b>250,688</b>      | <b>-</b>             | <b>250,688</b>      |
| <b>Deposit Funds and Suspense Accounts</b>             | <b>40</b>           | <b>-</b>             | <b>40</b>           |
| <b>Contract Holdbacks</b>                              | <b>1,207</b>        | <b>-</b>             | <b>1,207</b>        |
| <b>Employer Contribution and Payroll Taxes Payable</b> | <b>2,604</b>        | <b>-</b>             | <b>2,604</b>        |
| <b>Contingent Liabilities</b>                          | <b>-</b>            | <b>49,908</b>        | <b>49,908</b>       |
| <b>Other Liabilities</b>                               | <b>1,472</b>        | <b>-</b>             | <b>1,472</b>        |
| <b>Total Other Liabilities</b>                         | <b>\$ 1,374,677</b> | <b>\$ 130,045</b>    | <b>\$ 1,504,722</b> |

Advances from Others represent liabilities for collections received to cover future expenses or acquisition of assets. Custodial Liabilities represents liabilities for collections reported as non-exchange revenues where the NWCF is acting on behalf of another Federal entity.

Non-federal Other Liabilities is attributed to improperly recorded unfunded liability transactions in the field accounting system. The posting issues creating this condition have been documented in a Navy ERP management tracking database to support identification and prioritization of corrective action.

Contingent Liabilities includes \$69.1 million related to contracts authorizing progress payments based on cost as defined in the FAR. In accordance with contract terms, specific rights to the contractor's work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The NWCF is under no obligation to pay the contractor for amounts in excess of progress payments authorized in the contract until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid are estimable, the NWCF has

recognized a contingent liability for the estimated unpaid costs considered conditional for payment pending delivery and government acceptance.

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

## NOTE 13. COMMITMENTS AND CONTINGENCIES

The NWCF is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The NWCF has accrued contingent legal liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The NWCF records contingent liabilities in Note 12, Other Liabilities.

For FY 2016, NWCF materiality threshold for reporting litigation, claims, or assessments is \$5.5 million. The NWCF OGC conducts a review of litigation and claims threatened or asserted involving NWCF to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The NWCF currently has 2 cases that meet the existing FY 2016 materiality threshold. The NWCF legal counsel was able to express an opinion concerning the likely outcome of these cases. One of these cases is assessed as probable for an adverse decision against the DON with an estimated loss of \$5.2 million and is recorded as a Contingent Liability. This case will be paid out of the DON working capital fund if an adverse decision should occur. The other assessed case is indicated as remote with no financial impact noted.

The DON is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the DON's automated system processes have limited capability to capture these potential liabilities; therefore, the amounts reported may not fairly present DON's commitments and contingencies.

## NOTE 14. MILITARY RETIREMENT AND OTHER FEDERAL EMPLOYMENT BENEFITS

| As of September 30              | 2016        |                                          |                      |
|---------------------------------|-------------|------------------------------------------|----------------------|
|                                 | Liabilities | (Less: Assets Available to Pay Benefits) | Unfunded Liabilities |
| <i>(Amounts in thousands)</i>   |             |                                          |                      |
| <b>Other Actuarial Benefits</b> |             |                                          |                      |
| FECA                            | \$ 681,273  | \$ -                                     | \$ 681,273           |
| As of September 30              | 2015        |                                          |                      |
| <i>(Amounts in thousands)</i>   |             |                                          |                      |
| <b>Other Actuarial Benefits</b> |             |                                          |                      |
| FECA                            | \$ 681,052  | \$ -                                     | \$ 681,052           |

The NWCF reports an actuarial liability for the FECA. The FECA provides Federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. The FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. The FECA is administered by the Office of Workers' Compensation Programs. The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

### Actuarial Cost Method Used

The NWCF's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to NWCF only at the end of each fiscal year.

The estimate 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.

## NOTE 15. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF NET COST

| Intragovernmental Costs and Exchange Revenue |                        |                        |
|----------------------------------------------|------------------------|------------------------|
| As of September 30                           | 2016                   | 2015                   |
| <i>(Amounts in thousands)</i>                |                        |                        |
| <b>Intragovernmental Costs</b>               | \$ 4,882,783           | \$ 5,019,198           |
| <b>Nonfederal Costs</b>                      | 24,906,187             | 24,489,112             |
| <b>Total Costs</b>                           | <u>\$ 29,788,970</u>   | <u>\$ 29,508,310</u>   |
| <b>Intragovernmental Earned Revenue</b>      | \$ (26,407,600)        | \$ (25,150,622)        |
| <b>Nonfederal Revenue</b>                    | (2,549,175)            | (1,716,489)            |
| <b>Total Revenue</b>                         | <u>\$ (28,956,775)</u> | <u>\$ (26,867,111)</u> |
| <b>Total Net Cost</b>                        | <u>\$ 832,195</u>      | <u>\$ 2,641,199</u>    |

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government that are supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The DoD's current processes and systems do not capture and report accumulated cost for major programs based upon the performance measures as required by the Government Performance and Results Act. The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 30, "Inter-entity Cost Implementation."

Intragovernmental costs and revenue represent transactions made between two reporting entities within the Federal Government.

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

Large balances in the public costs and revenue lines are a result of the current process in Navy Enterprise Resource Planning. The process produces inflated gains and offsetting losses on separate financial statement and note schedule lines, however, the impact on Net Cost is reduced when the gains and losses are combined. The Navy is currently working to resolve the business process that results in daily postings to the gain and loss accounts for in-transit inventory.

The NWCF's financial management systems do not track intragovernmental transactions by customer. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between Federal and non-Federal expenses. Intradepartment revenues and expenses are then eliminated.

## NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

The Statement of Changes in Net Position (SCNP) reports the change in net position during the reporting period. Net position is affected by changes to its two components: Cumulative Results of Operations and Unexpended Appropriations.



## NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

|                                                                                                    | 2016          | 2015         |
|----------------------------------------------------------------------------------------------------|---------------|--------------|
| As of September 30<br>(Amounts in thousands)                                                       |               |              |
| <b>Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period</b> | \$ 10,695,603 | \$ 9,755,190 |

### DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

|                                                     | 2016               |                          |                      |
|-----------------------------------------------------|--------------------|--------------------------|----------------------|
|                                                     | Direct Obligations | Reimbursable Obligations | Total                |
| <b>As of September 30</b><br>(Amounts in thousands) |                    |                          |                      |
| <b>Obligations Apportioned Under</b>                |                    |                          |                      |
| Category A                                          | \$ -               | \$ -                     | \$ -                 |
| Category B                                          | -                  | 31,228,909               | 31,228,909           |
| Exempt                                              | -                  | -                        | -                    |
| <b>Total</b>                                        | <b>\$ -</b>        | <b>\$ 31,228,909</b>     | <b>\$ 31,228,909</b> |

|                                                     | 2015               |                          |                      |
|-----------------------------------------------------|--------------------|--------------------------|----------------------|
|                                                     | Direct Obligations | Reimbursable Obligations | Total                |
| <b>As of September 30</b><br>(Amounts in thousands) |                    |                          |                      |
| <b>Obligations Apportioned Under</b>                |                    |                          |                      |
| Category A                                          | \$ -               | \$ -                     | \$ -                 |
| Category B                                          | -                  | 29,825,783               | 29,825,783           |
| Exempt                                              | -                  | -                        | -                    |
| <b>Total</b>                                        | <b>\$ -</b>        | <b>\$ 29,825,783</b>     | <b>\$ 29,825,783</b> |

The table above discloses apportionment categories for obligations incurred for direct and reimbursable obligations in the apportionment category they are under (Category A, B and Exempt from apportionment).

#### **Other Disclosures**

The Statement of Budgetary Resources includes intra-entity transactions because the statements are presented as combined.



## NOTE 18. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

| As of September 30                                                                                                  | 2016                   | 2015                  |
|---------------------------------------------------------------------------------------------------------------------|------------------------|-----------------------|
| <i>(Amounts in thousands)</i>                                                                                       |                        |                       |
| <b>Resources Used to Finance Activities</b>                                                                         |                        |                       |
| Budgetary Resources Obligated:                                                                                      |                        |                       |
| Obligations Incurred                                                                                                | \$ 31,228,909          | \$ 29,825,783         |
| Less: Spending Authority from Offsetting Collections and Recoveries                                                 | (30,645,792)           | (28,915,431)          |
| Net Obligations                                                                                                     | 583,117                | 910,352               |
| Other Resources:                                                                                                    |                        |                       |
| Transfers In/Out without Reimbursement                                                                              | 1,447,610              | 1,202,731             |
| Imputed Financing from Costs Absorbed by Others                                                                     | 522,859                | 493,567               |
| Other                                                                                                               | 1,265,856              | 1,032,155             |
| Net Other Resources Used to Finance Activities                                                                      | 3,236,325              | 2,728,453             |
| <b>Total Resources Used to Finance Activities</b>                                                                   | <b>\$ 3,819,442</b>    | <b>\$ 3,638,805</b>   |
| <b>Resources Used to Finance Items not Part of the Net Cost of Operations</b>                                       |                        |                       |
| Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided:             |                        |                       |
| Undelivered Orders                                                                                                  | \$ (940,414)           | \$ (190,534)          |
| Unfilled Customer Orders                                                                                            | (285,591)              | (395,003)             |
| Resources that Fund Expenses Recognized in Prior Periods                                                            | (812)                  | (65,175)              |
| Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations                             | -                      | -                     |
| Resources that Finance the Acquisition of Assets                                                                    | (6,211,257)            | (5,406,684)           |
| Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations:                |                        |                       |
| Other                                                                                                               | (2,713,466)            | (2,234,886)           |
| <b>Total Resources Used to Finance Items not part of the Net Cost of Operations</b>                                 | <b>\$ (10,151,540)</b> | <b>\$ (8,292,282)</b> |
| <b>Total Resources Used to Finance the Net Cost of Operations</b>                                                   | <b>\$ (6,332,098)</b>  | <b>\$ (4,653,477)</b> |
| <b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period</b>   |                        |                       |
| Components Requiring or Generating Resources in Future Period:                                                      |                        |                       |
| Other                                                                                                               | \$ 6,122               | \$ -                  |
| Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods                | \$ 6,122               | \$ -                  |
| Components not Requiring or Generating Resources:                                                                   |                        |                       |
| Depreciation and Amortization                                                                                       | \$ 226,200             | \$ 352,464            |
| Revaluation of Assets or Liabilities                                                                                | 1,445,027              | 1,712,800             |
| Other                                                                                                               |                        |                       |
| Cost of Goods Sold                                                                                                  | 8,887,804              | 8,680,395             |
| Operating Materials and Supplies Used                                                                               | -                      | 213                   |
| Other                                                                                                               | (3,400,859)            | (3,451,196)           |
| <b>Total Components of Net Cost of Operations that will not Require or Generate Resources</b>                       | <b>7,158,172</b>       | <b>7,294,676</b>      |
| <b>Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period</b> | <b>\$ 7,164,294</b>    | <b>\$ 7,294,676</b>   |
| <b>Net Cost of Operations</b>                                                                                       | <b>\$ 832,196</b>      | <b>\$ 2,641,199</b>   |

Due to the NWCF financial system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. This difference is a previously identified deficiency. As a result of these system limitations, resources that finance the acquisition of assets on the reconciliation of Net Cost of Operations to Budget were adjusted upward by \$6.2 billion (absolute amount) as of September 30, 2016 to bring it into balance with the SNC.

The following Reconciliation of Net Cost of Operations to Budget lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries

- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Resources Used to Finance Activities - Other, is presented as the net increase to inventory for the period. The DON is working to resolve the business postings for in-transit inventory that are creating distortions in the reported revenues and expenses.

Resources Used to Finance Items Not Part of Net Cost of Operations - Other, are amounts related to supply management of inventory available and purchased for resale including consumable spare and repair parts and reparable items as well as goods transferred for reissue from inventory.

Components Requiring or Generating Resources - Other, consists of Contingent Legal Liabilities and changes in the FECA liabilities based on data received from the Department of Labor.

Components Not Requiring or Generating Resources - Other, consists of Applied Overhead and Cost Capitalization Offset. These balances represent overhead costs distributed to work in process and costs transferred to an "in-process" asset accounts such as construction in progress.

## NOTE 19. DISCLOSURES RELATED TO INCIDENTAL CUSTODIAL COLLECTIONS

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The NWCF collected \$47.9 million of incidental custodial revenues generated primarily from surcharges, interest, penalties, fines and administrative fees. These funds are not available for use by the NWCF. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.

2016



**REQUIRED SUPPLEMENTARY INFORMATION**

*America's Away Team*





Navy Working Capital Fund  
**GENERAL PROPERTY, PLANT, AND EQUIPMENT**

**REAL PROPERTY DEFERRED MAINTENANCE AND REPAIR**

*For Fiscal Year Ended September 30, 2016*

The Navy Working Capital Fund real property deferred maintenance and repair information for fiscal year ended September 30, 2016 is reported with the Department of the Navy deferred maintenance and repair. See Department of the Navy General Fund Required Supplementary Information.

2016



## OTHER INFORMATION

### *America's Away Team*



# APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE PRINCIPAL STATEMENTS

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## ENTITY ACCOUNTS

### 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<sup>a</sup>  
97X4930.NA2\* Depot Maintenance – Aviation  
97X4930.NA4A\* Depot Maintenance – Other, Marine Corps  
97X4930.ND\* Transportation  
97X4930.NE\* Base Support  
97X4930.NH\* Research and Development  
97X4930.NC\* Supply Management  
97X4930.NC3\* Supply Management, Marine Corps

### Notes:

- \* The “\*” represents alpha or numeric characters which identify an activity or reporting segment of the activity group.
- a Depot Maintenance, Shipyards became a part of the DON in FY 2007. The Depot Maintenance, Shipyards information included in this report represents residual NWCF accounting.

2016



## APPENDIX

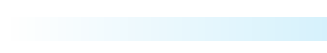
### *America's Away Team*





| ACRONYM               | DEFINITION                                                            | ACRONYM            | DEFINITION                                          |
|-----------------------|-----------------------------------------------------------------------|--------------------|-----------------------------------------------------|
| <b>AC</b>             | Active Component                                                      | <b>DON/AA</b>      | Department of the Navy Assistant for Administration |
| <b>AFCYBER</b>        | Air Force Cyber Command                                               | <b>E2O</b>         | Marine Corps Expeditionary Energy Office            |
| <b>AFR</b>            | Annual Financial Report                                               | <b>EAP</b>         | Employee Assistance Program                         |
| <b>AFRICOM</b>        | Africa Command                                                        | <b>EFTM</b>        | External Fuel Transfer Module                       |
| <b>AITT</b>           | Augmented Immersive Team Trainer                                      | <b>EHR</b>         | Electronic Health Record                            |
| <b>APSR</b>           | Accountable Property System of Record                                 | <b>EOP</b>         | Executive Office of the President                   |
| <b>ARCYBER</b>        | Army Cyber Command                                                    | <b>EPR</b>         | Evaluation, Prioritization, and Remediation         |
| <b>ASN FM&amp;C</b>   | Assistant Secretary of the Navy, Financial Management & Comptroller   | <b>ER, N</b>       | Environmental Restoration, Navy                     |
| <b>ASN RD&amp;A</b>   | Assistant Secretary of the Navy, Research, Development, & Acquisition | <b>ERP</b>         | Enterprise Resource Planning                        |
| <b>ASPA</b>           | Aircraft Service Period Adjustment                                    | <b>FAR</b>         | Federal Acquisition Regulations                     |
| <b>ATFP</b>           | Anti-Terrorism/Force Protection                                       | <b>FASAB</b>       | Federal Accounting Standards Advisory Board         |
| <b>AWF</b>            | Acquisition Workforce                                                 | <b>FAST Book</b>   | Federal Account Symbols and Titles Book             |
| <b>BIG</b>            | Business Intelligence Group                                           | <b>FBWT</b>        | Fund Balance with Treasury                          |
| <b>BPI</b>            | Business Process Improvement                                          | <b>FCI</b>         | Facility Condition Index                            |
| <b>BRAC</b>           | Base Closure and Realignment Commission                               | <b>FECA</b>        | Federal Employees' Compensation Act                 |
| <b>BSO</b>            | Budget Submitting Office                                              | <b>FFMIA</b>       | Federal Financial Management Improvement Act        |
| <b>BUMED</b>          | Bureau of Medicine and Surgery                                        | <b>FIAR</b>        | Financial Improvement and Audit Readiness           |
| <b>BUPERS</b>         | Bureau of Naval Personnel                                             | <b>FID</b>         | Fixed Induction Date                                |
| <b>CCDR</b>           | Combatant Commander                                                   | <b>FIP</b>         | Financial Improvement Program                       |
| <b>CFO</b>            | Chief Financial Officer                                               | <b>FLTCYBER</b>    | Fleet Cyber Command                                 |
| <b>CG FMFLANT</b>     | Commanding General, Fleet Marine Forces Atlantic                      | <b>FMFIA</b>       | Federal Managers' Financial Integrity Act           |
| <b>CIP</b>            | Construction in Progress                                              | <b>FSA</b>         | Field Support Activity                              |
| <b>CMC</b>            | Commandant of the Marine Corps                                        | <b>FTE</b>         | Full Time Equivalent                                |
| <b>CNIC</b>           | Commander, Navy Installations Command                                 | <b>FY</b>          | Fiscal Year                                         |
| <b>CNO</b>            | Chief of Naval Operations                                             | <b>GAO</b>         | Government Accountability Office                    |
| <b>CNRF</b>           | Commander, Navy Reserve Force                                         | <b>GF</b>          | General Fund                                        |
| <b>COMMARFORCOM</b>   | United States Marine Corps Forces Command                             | <b>GMRA</b>        | Government Management Reform Act of 1994            |
| <b>COMPACFLT</b>      | Commander U.S. Pacific Fleet                                          | <b>GPRA</b>        | Government Performance and Results Act              |
| <b>COMUSFLTFORCOM</b> | U.S. Fleet Forces Command                                             | <b>GSA</b>         | General Services Administration                     |
| <b>CSMP</b>           | Current Ships' Maintenance Plan                                       | <b>GW</b>          | Gigawatt                                            |
| <b>CTC</b>            | Cost to Complete                                                      | <b>HQMC</b>        | Headquarter, U.S. Marine Corps                      |
| <b>CYBERCOM</b>       | U.S. Cyber Command                                                    | <b>IA</b>          | Individual Augmentees                               |
| <b>DASN (FO)</b>      | Deputy Assistant Secretary of the Navy (Financial Operations)         | <b>ICOFR</b>       | Internal Controls Over Financial Reporting          |
| <b>DCO</b>            | Defensive Cyber Operations                                            | <b>ICOFS</b>       | Internal Controls Over Financial Systems            |
| <b>DDNI</b>           | Deputy Director of Naval Intelligence                                 | <b>ICONO</b>       | Internal Controls Over Non-Financial Operations     |
| <b>DDRS-DCM</b>       | Defense Departmental Reporting System Data Collection Module          | <b>IMC</b>         | Integrated Maintenance Concept                      |
| <b>DERP</b>           | Defense Environmental Restoration Program                             | <b>iNFADS</b>      | internet Navy Facility Assets Data Store            |
| <b>DFAS</b>           | Defense Finance and Accounting Service                                | <b>IPA</b>         | Independent Public Accounting                       |
| <b>DFAS-CL</b>        | Defense Finance and Accounting Service - Cleveland                    | <b>IRP</b>         | Installation Restoration Program                    |
| <b>DHMSM</b>          | Defense Healthcare Management System Modernization                    | <b>IT</b>          | Information Technology                              |
| <b>DM&amp;R</b>       | Deferred Maintenance and Repair                                       | <b>IV&amp;V</b>    | Independent Verification and Validation             |
| <b>DNI</b>            | Director of Naval Intelligence                                        | <b>JCS CSG</b>     | USS John C. Stennis Carrier Strike Group            |
| <b>DNS</b>            | Director, Navy Staff                                                  | <b>JIC-P</b>       | Joint Infantry Company Prototype                    |
| <b>DoD</b>            | Department of Defense                                                 | <b>LAC</b>         | Latest Acquisition Cost                             |
| <b>DoD FMR</b>        | Department of Defense Financial Management Regulation                 | <b>LCS</b>         | Littoral Combat Ship                                |
| <b>DoDIG</b>          | Department of Defense Inspector General                               | <b>LOGCOM</b>      | Marine Corps Logistics Command                      |
| <b>DOL</b>            | Department of Labor                                                   | <b>MAC</b>         | Moving Average Cost                                 |
| <b>DON</b>            | Department of the Navy                                                | <b>MARFORCOM</b>   | U.S. Marine Corps Forces Command                    |
|                       |                                                                       | <b>MARFORCYBER</b> | U.S. Marine Corps Forces, Cyberspace Command        |

| ACRONYM              | DEFINITION                                                                       | ACRONYM              | DEFINITION                                                         |
|----------------------|----------------------------------------------------------------------------------|----------------------|--------------------------------------------------------------------|
| <b>MARFORNORTH</b>   | Marine Forces Northern Command                                                   | <b>PCBs</b>          | Polychlorinated Biphenyls                                          |
| <b>MARFORPAC</b>     | U.S. Marine Corps Forces, Pacific                                                | <b>PII</b>           | Personally Identifiable Information                                |
| <b>MARFORRES</b>     | U.S. Marine Corps Forces Reserve                                                 | <b>PMI</b>           | Planned Maintenance Intervals                                      |
| <b>MARFORSOC</b>     | U.S. Marine Corps Forces, Special Operations Command                             | <b>PP&amp;E</b>      | Property Plant & Equipment                                         |
| <b>MAU</b>           | Major Assessable Unit                                                            | <b>PRV</b>           | Plant Replacement Value                                            |
| <b>MCEN</b>          | Marine Corps Enterprise Network                                                  | <b>Q-rating</b>      | Quality Rating                                                     |
| <b>MCICOM</b>        | Marine Corps Installations Command                                               | <b>R&amp;D</b>       | Research and Development                                           |
| <b>MICP</b>          | Managers' Internal Control Program                                               | <b>RCRA</b>          | Resource Conservation and Recovery Act                             |
| <b>MMRP</b>          | Military Munitions Response Program                                              | <b>REPO</b>          | Renewable Energy Program Office                                    |
| <b>MRR</b>           | Marine Raider Regiment                                                           | <b>RHIMES</b>        | Resilient Hull, Mechanical, and Electrical Security                |
| <b>MRSG</b>          | Marine Raider Support Group                                                      | <b>RIMPAC</b>        | Rim of the Pacific Exercise                                        |
| <b>MSC</b>           | Military Sealift Command                                                         | <b>RPA</b>           | Real Property Asset                                                |
| <b>MSOS</b>          | Marine Special Operations School                                                 | <b>S&amp;T</b>       | Science and Technology                                             |
| <b>MW</b>            | Megawatt                                                                         | <b>S/L</b>           | Straight Line                                                      |
| <b>NAF</b>           | Nonappropriated Funds                                                            | <b>SAPR</b>          | Sexual Assault Prevention & Response                               |
| <b>NAVAIR</b>        | Naval Air Systems Command                                                        | <b>SAT</b>           | Senior Assessment Team                                             |
| <b>NAVAUDSVC</b>     | Naval Audit Service                                                              | <b>SBA</b>           | Schedule of Budgetary Activity                                     |
| <b>NAVFAC</b>        | Naval Facilities Engineering Command                                             | <b>SBR</b>           | Statement of Budgetary Resources                                   |
| <b>NAVINGEN</b>      | Naval Inspector General                                                          | <b>SCNP</b>          | Statement of Changes in Net Position                               |
| <b>NAVSEA</b>        | Naval Sea Systems Command                                                        | <b>SEAL</b>          | Special Warfare Operators                                          |
| <b>NAVSUP</b>        | Naval Supply Systems Command                                                     | <b>SECNAV</b>        | Secretary of the Navy                                              |
| <b>NCBC</b>          | Naval Construction Battalion Center                                              | <b>SES</b>           | Senior Executive Service                                           |
| <b>NDSF</b>          | National Defense Sealift Fund                                                    | <b>SFFAS</b>         | Statement of Federal Financial Accounting Standards                |
| <b>NEPTUNE</b>       | Naval Enterprise Partnership Teaming with Universities for National Excellence   | <b>SMC</b>           | Senior Management Council                                          |
| <b>NETC</b>          | Naval Education Training Command                                                 | <b>SMS</b>           | Sustainment Management System                                      |
| <b>NIA</b>           | Naval Intelligence Activity                                                      | <b>SNC</b>           | Statement of Net Cost                                              |
| <b>NORM</b>          | Normalization of Data System                                                     | <b>SOA</b>           | Statement of Assurance                                             |
| <b>NORTHCOM</b>      | Northern Command                                                                 | <b>SOF</b>           | Special Operations Forces                                          |
| <b>NPC</b>           | Navy Personnel Command                                                           | <b>SP</b>            | Standard Price                                                     |
| <b>NPS</b>           | Naval Postgraduate School                                                        | <b>SPAWAR</b>        | Space and Naval Warfare Systems Command                            |
| <b>NRC</b>           | Navy Recruiting Command                                                          | <b>SSBN</b>          | Ballistic Missile Submarines                                       |
| <b>NRV</b>           | Net Realizable Value                                                             | <b>SSGN</b>          | Guided Missile Submarine                                           |
| <b>NSW</b>           | Naval Special Warfare                                                            | <b>SSP</b>           | Strategic Systems Program                                          |
| <b>NSWC</b>          | Naval Special Warfare Command                                                    | <b>STEM</b>          | Science, Technology, Engineering, and Mathematics                  |
| <b>NSWC</b>          | Naval Surface Warfare Center                                                     | <b>SURTASS</b>       | Surveillance Towed-Array Sensor System                             |
| <b>NWC</b>           | Naval War College                                                                | <b>TFM</b>           | Treasury Financial Manual                                          |
| <b>NWCF</b>          | Navy Working Capital Fund                                                        | <b>U.S.</b>          | United States of America                                           |
| <b>OCFP</b>          | Outstanding Contract Financing Payments                                          | <b>UAV</b>           | Unmanned Aerial Vehicle                                            |
| <b>OCO</b>           | Offensive Cyberspace Operations                                                  | <b>UIC</b>           | Unit Identification Code                                           |
| <b>OCONUS</b>        | Outside Contiguous United States                                                 | <b>USACE</b>         | U.S. Army Corps of Engineers                                       |
| <b>OFRP</b>          | Optimized Fleet Response Plan                                                    | <b>USACOE - CERL</b> | U.S. Army Corps of Engineers Civil Engineering Research Laboratory |
| <b>OGC</b>           | Office of General Counsel                                                        | <b>USCYBERCOM</b>    | United States Cyber Command                                        |
| <b>OM&amp;S</b>      | Operating Materials & Supplies                                                   | <b>USFF</b>          | United States Fleet Forces Command                                 |
| <b>OMB</b>           | Office of Management and Budget                                                  | <b>USFK</b>          | U.S. Forces Korea                                                  |
| <b>ONI</b>           | Office of Naval Intelligence                                                     | <b>USGAAP</b>        | U.S. Generally Accepted Accounting Principles                      |
| <b>ONR</b>           | Office of Naval Research                                                         | <b>USMC</b>          | United States Marine Corps                                         |
| <b>OPR</b>           | Office of Primary Responsibility                                                 | <b>USNA</b>          | United States Naval Academy                                        |
| <b>OSC</b>           | Operational Stress Control                                                       | <b>USPACOM</b>       | U.S. Pacific Command                                               |
| <b>OSD</b>           | Office of Secretary of Defense                                                   | <b>USSGL</b>         | United States Standard General Ledger                              |
| <b>OUSD AT&amp;L</b> | Office of the Under Secretary of Defense, Acquisition, Technology, and Logistics | <b>USSOCOM</b>       | U.S. Special Operations Command                                    |
| <b>OUSD(C)</b>       | Office of Under Secretary of Defense, Comptroller                                | <b>USSTRATCOM</b>    | United States Strategic Command                                    |
| <b>PAO</b>           | Principal Administering Office                                                   |                      |                                                                    |





### Cover Credits

- 1.** Marines board a CH-53E Super Stallion helicopter during flight operations aboard an amphibious transport dock ship (U.S. Navy photo by Mass Communication Specialist 2nd Class Adam Austin/Released)
- 2.** Stars and a lone light illuminate the USS Ronald Reagan (U.S. Navy photo by Mass Communication Specialist 3rd Class Ryan McFarlane/Released)
- 3.** Departing Souda Bay, Greece. The guided-missile destroyer is conducting a routine patrol in support of U.S. national security interests in Europe. (U.S. Navy Photo by Mass Communication Specialist 3rd Class Robert S. Price/Released)

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## FOR MORE INFORMATION

Assistant Secretary of the Navy Financial Management and Comptroller  
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