ACCOUNTABILITY TO AMERICA

DEPARTMENT OF THE NAVY

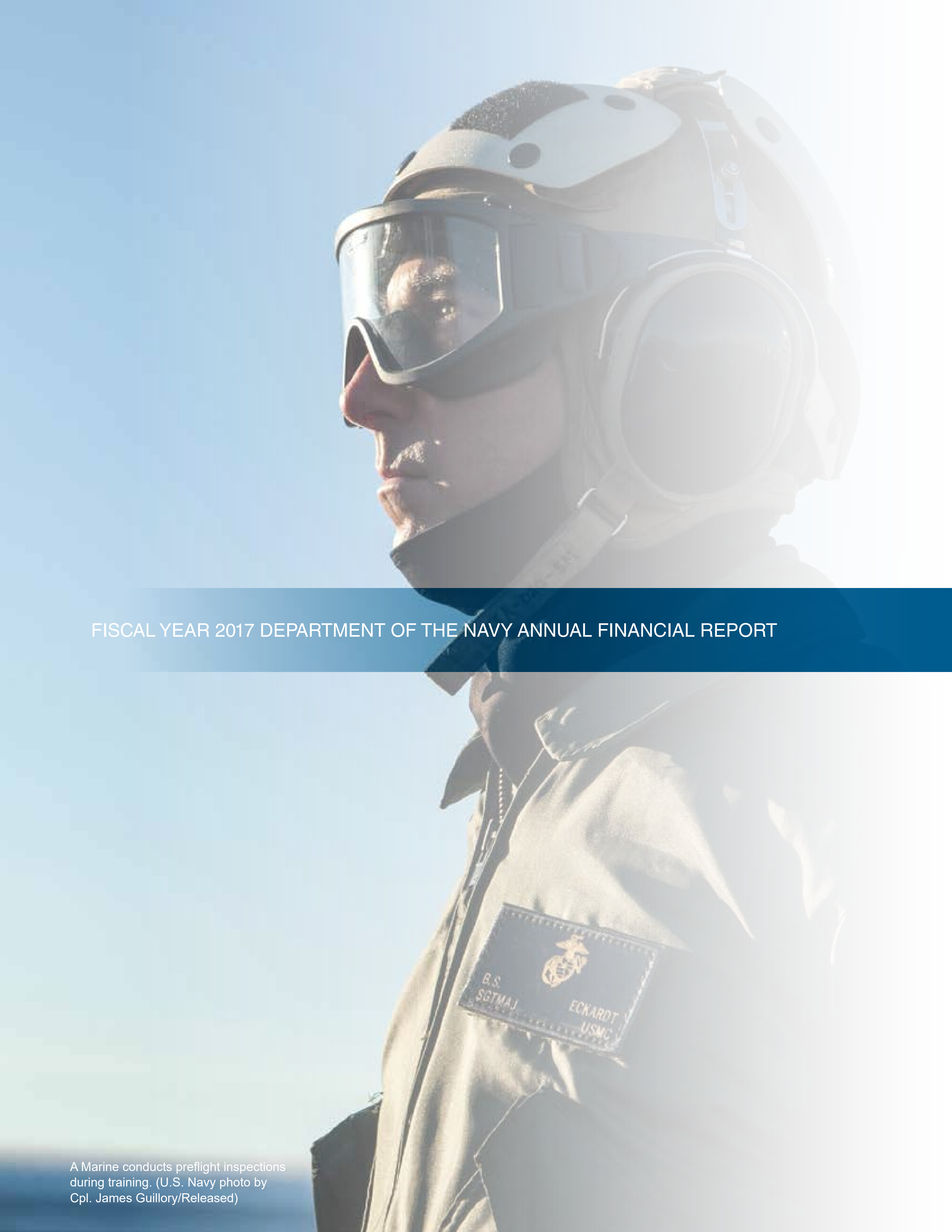
FISCAL YEAR 2017 ANNUAL FINANCIAL REPORT

People

Processes

Capabilities

FISCAL YEAR 2017 DEPARTMENT OF THE NAVY ANNUAL FINANCIAL REPORT



A Marine conducts preflight inspections during training. (U.S. Navy photo by Cpl. James Guillory/Released)

An Airman reattaches fasteners on the tail rotor of an MH-60R Sea Hawk helicopter. (U.S. Navy photo by Mass Communication Specialist 2nd Class Andrew J. Sneeringer/Released)

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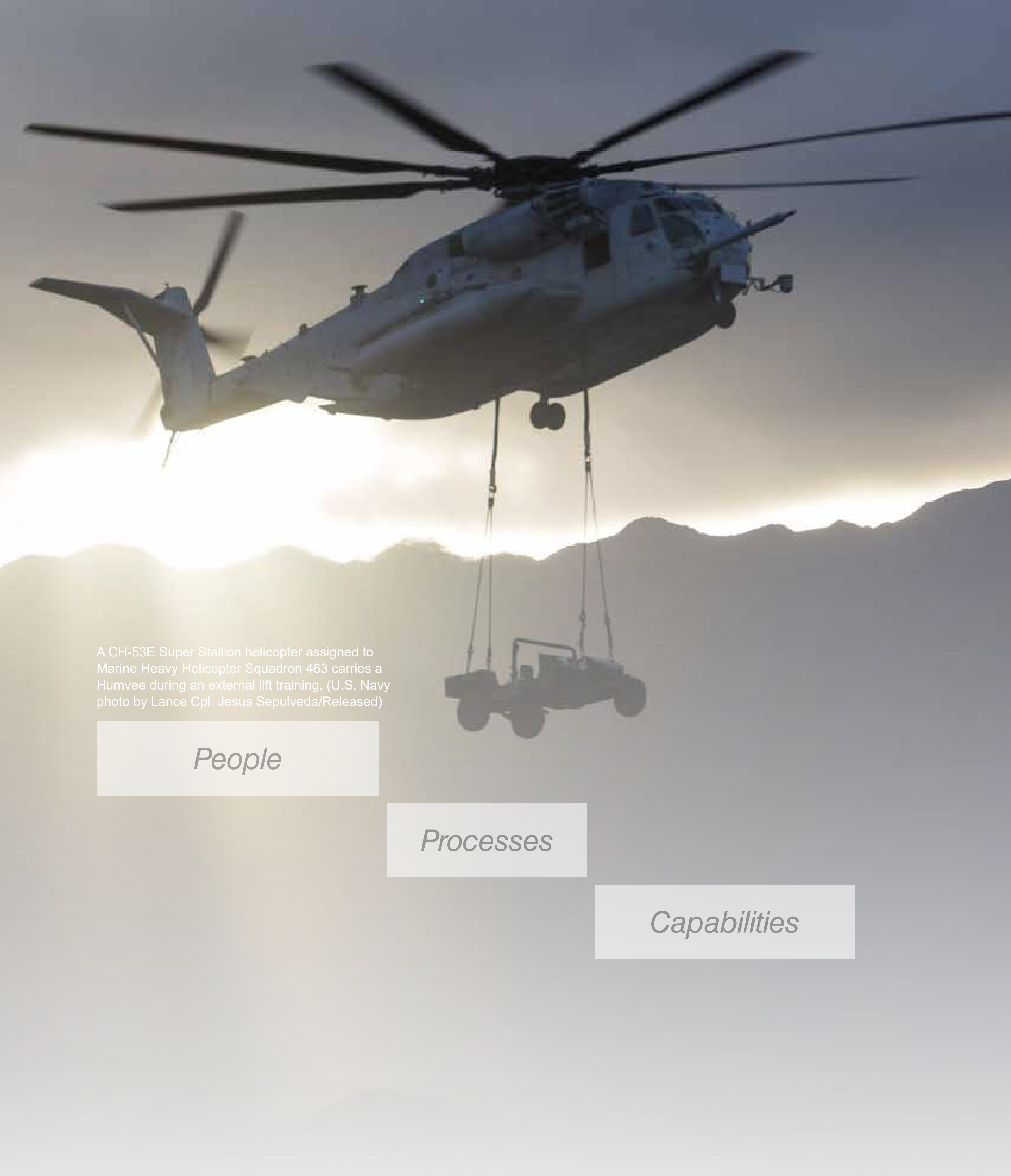

A CH-53E Super Stallion helicopter assigned to Marine Heavy Helicopter Squadron 463 carries a Humvee during an external lift training. (U.S. Navy photo by Lance Cpl. Jesus Sepulveda/Released)

People

Processes

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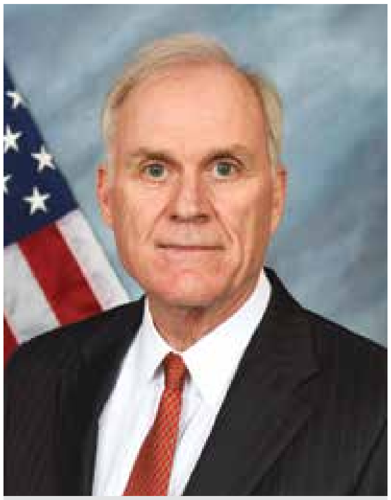
RICHARD V. SPENCER



"Going forward, we will make significant investments in improving readiness and modernization for both the Navy and Marine Corps."

NOVEMBER 2017

As the nation's forward global force, the Navy and Marine Corps are fully deployed, continuously present afloat and ashore, promoting and protecting the national interests of the United States. We must always be ready to deliver the fight in a moment's notice. To accomplish this, we must ensure our people are highly trained and well equipped, and we must improve and modernize our capabilities and streamline our processes. The technological and operational advantage we have had over our adversaries is shrinking. It is imperative that we increase the level of urgency in every way we operate as an enterprise. Going forward, we will make significant investments in improving readiness and modernization for both the Navy and Marine Corps.

Our priorities center on People, Capabilities, and Processes, and will be achieved by our focus on speed, value, results, and partnerships. Readiness, lethality, and modernization are the requirement driving these priorities.

***People* – Our military and civilian workforce is our greatest resource.**

- We will enhance the performance of our force by improving policies, programs, and training.
- The organization will capitalize on its best talent today, retain that talent over the long term, and find ways to continue to recruit the best people for the mission of the future.
- Our military and civilian team will be measured against the highest ethical standards for every task and mission.

***Capabilities* – We will be capable of providing maritime dominance and power projection required by the Nation.**

- The organization will focus on training, modernization, and maintenance in order to achieve a high state of readiness and enhanced lethality, now and in the future.

***Processes* – We must improve our processes in order for our people to meet future challenges.**

- We will drive efficiency, adopt and implement new ideas, and leverage leading practices from industry and academia to positively impact and support acquisition, manpower, research, and operational processes.

Auditability of the Department of the Navy (DON) is a priority for every member in the Department and leadership is fully engaged and aware of their responsibilities in moving toward this goal. As presented in the DON's Fiscal Year 2017 Annual Financial Report, "*Accountability to America*," the Department has made great strides toward a full financial statement audit. Leadership is focused on attaining a clean audit opinion, which will demonstrate accountability and enhance enterprise credibility. 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.

People. Capabilities. Processes. The inherent excellence and value of all three of these are integral to the Navy of today— and tomorrow. As Secretary of the Navy, I am making excellence in our People, Capabilities, and Processes my priority, and I aim to bring our focus back onto readiness and lethality.

Richard V. Spencer
Secretary of the Navy


Showing a Seaman how to use an alidade compass aboard a guided missile cruiser. (U.S. Navy photo by Mass Communication Specialist 2nd Class Sonja Wickard/Released)

OVERVIEW

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 deploy, shape, train, deter, and respond 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 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 and is reimbursed for the goods, services, and infrastructure provided to the DON and other DoD customers, 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 continues to move forward and make significant progress toward a full financial statement audit and overall financial improvement. The FY 2015 and FY 2016 Schedules of Budgetary Activity (SBA) audits yielded numerous Notices of Findings and Recommendation, with a Flag Officer or Senior Executive assigned to direct the remediation of each finding. In raising the level of responsibility for correcting deficiencies, the Navy is widening the circle of accountability for making improvements in its culture. The DON is meeting hurdles head-on with full awareness that financial audit readiness will not be a one-time achievement – rather, it will be marked by a progressively changing business environment in which improvements will be incorporated into permanent work processes. The result will be a strengthened stewardship for public funds, institutionalized by performing effective internal controls over business processes and systems and by making business policies and procedures more precise and compliant with accounting standards. The DON is committed to promoting a business culture in which all participants understand their respective roles in achieving and sustaining financial auditability, from senior leaders down to the business managers who support the warfighting forces each day.

The DON FY 2017 objectives and goals focused 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 that support the DON's objectives and goals.

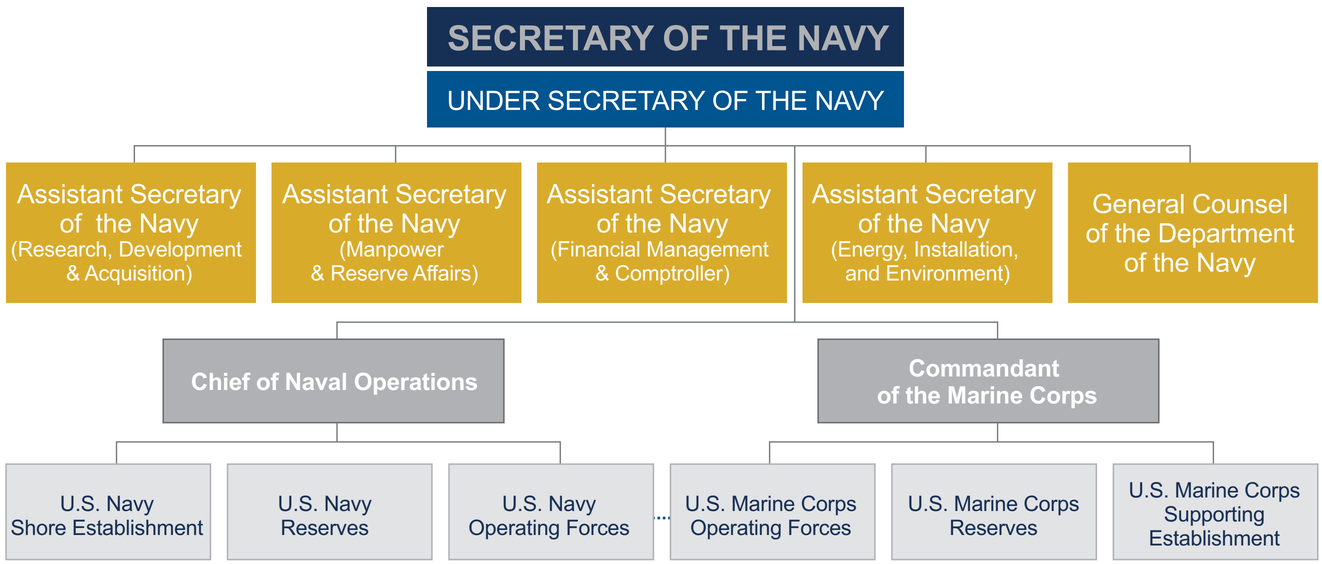
Ships in a simulated strait transit. (U.S. Navy photo by Mass Communication Specialist 2nd Class Paul L. Archer/Released)

A Naval Aircrewman makes preparations to take off in an MH-60S Sea Hawk helicopter. (U.S. Navy photo by Mass Communication Specialist 2nd Class Sean M. Castellano/Released)

TO MAINTAIN, TRAIN, AND EQUIP COMBAT-READY NAVAL FORCES CAPABLE OF WINNING WARS, DETERRING AGGRESSION, AND MAINTAINING FREEDOM OF THE SEAS.

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 DON, 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 (CNO), 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.

U.S. NAVY

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. The CNO is also the principal advisor to the Secretary of Defense (SECDEF) 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 CNO and provide, train, and equip naval forces. Operationally, they provide naval forces and report to the appropriate Unified Combatant Commanders. The Commander of the U.S. Fleet Forces Command controls fleet assets on both the Atlantic and Pacific coasts for inter-deployment 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 ships, 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 approximately 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 approximately 9,500 authorized full time equivalent (FTE) civilian employees. BUPERS is headquartered in Arlington, VA.

COMMANDER, NAVY INSTALLATIONS COMMAND

Commander, Navy Installations Command (CNIC), headquartered at the Washington Navy Yard in Washington, DC, is responsible for worldwide U.S. Navy shore installation management as the Navy's shore integrator, designing and developing integrated solutions for sustainment and development of Navy shore infrastructure. With more than 53,000 military and civilian personnel worldwide across 11 regions, 71 installations, and 123 Naval Operations Support Centers, CNIC is responsible for the operations, maintenance and quality of life programs to support the Navy's Fleet, Fighter, and Family. "Fleet" represents the operating forces of the Navy. CNIC ensures all installation requirements necessary to train and operate the Fleets (Ports, Airfields, Training Ranges, etc.) are maintained and ready regardless of tempo. "Fighter" represents the men and women in the operating forces. CNIC ensures the installation's ability to facilitate the manning, training, and equipping of the Navy's fighting force never skips a beat. "Family" represents the men and women of the armed forces and their families. To ensure our fighting force is supported on all fronts, our Family and Community Services, Housing and Safety efforts provide the peace of mind to allow the Navy to operate effectively. 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.

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 approximately 58,000 personnel of the Navy Reserve represent approximately 15% of the Navy Total Force. The Navy Reserve, which provides essential warfighting capabilities and expertise, is 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.

COMMANDER, 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 130,000 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 $13 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 in Pearl Harbor, HI.

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 Secretary of the Navy (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 approximately 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 Budget Submitting Office (BSO) and Principal Administering Office (PAO) for Navy's assigned unified command, 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 46 personnel and is headquartered at the Washington Navy Yard in Washington, DC, with some staff located at U.S. Pacific Command (USPACOM) Headquarters in Hawaii. Additionally, FSA plans and programs for current and future resource requirements for activities within the Director, Navy Staff (DNS) sponsorship and provides contract support for DNS/CNO activities.

NAVAL AIR SYSTEMS COMMAND

The Naval Air Systems Command (NAVAIR) has a force of approximately 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 $13 billion. NAVFAC has approximately 17,400 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) is the largest of the Navy's five systems commands and is responsible to design, build, deliver, and maintain ships and systems on-time and on-cost for the Navy. The NAVSEA workforce is comprised of more than 74,000 military and civilian personnel in 37 activities located across the United States and around the world. Included are 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, submersibles, and other sea platforms; shipboard combat systems and components; other surface and undersea warfare and weapons systems including ship and aviation interface systems; and surface and submarine expendable ordnance. NAVSEA exercises technical and certification authority for ship, submarine, diving, and weapon systems. NAVSEA reports to the CNO and the Commandant of the Marine Corps, as appropriate, for the execution of logistics sustainment and operating forces responsibilities. NAVSEA acts for, and exercises 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. NAVSEA is comprised of headquarters staff and 5 affiliated Program Executive Offices (PEOs), located at the Washington Navy Yard in Washington, DC, 10 working capital fund divisions of the Naval Surface and Undersea Warfare Centers, 11 general fund field activities that includes 4 Supervisors of Shipbuilding who administer contracts with private sector shipbuilders, and numerous detachments across the United States and around the world.

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 Operator (SEAL) Teams and Special Boat Teams), logistics commands, training commands and detachments, mobile communications teams, NSW Units (Outside Continental United States (OCONUS)), and a National Mission Force.

NSWC is currently comprised of approximately 11,200 total funded billets (Active Duty, Reserve, Government Civilian, and Contractors), including 2,871 active-duty SEAL billets, 824 Special Warfare Boat Operator billets, 4,427 support billets, 1,045 reserve billets, 1,283 Government civilian FTEs and 760 contractor FTEs. The NSW Force is organized around eight SEAL teams, one SEAL Delivery Vehicle Team, three Special Boat Teams, and supporting commands that 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. The ONR organization employs approximately 1,050 people, comprised of 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 more than 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 DON'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 Program (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, the Director of SSP has been assigned the responsibility and authority as Nuclear Weapons Regulator via Secretary of the Navy Instruction (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 (USFLTFORCOM) supports both the CNO and Combatant Commanders worldwide by providing responsive, relevant, sustainable Naval forces ready-for-tasking. USFLTFORCOM 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. USFLTFORCOM is headquartered in Norfolk, VA.

The Military Sealift Command (MSC), under USFLTFORCOM, 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.

U.S. MARINE CORPS

The Marine Corps, established on November 10, 1775, has an FY 2017 end-strength of approximately 184,500 Active Duty Marines and 38,700 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, DC 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 and higher authority. This includes the administration, discipline, internal organization, training requirements, efficiency, and readiness of the service. The Commandant is also a member of the Joint Chiefs of Staff, and HQMC supports him in his interaction with the Joint Staff. HQMC is spread throughout the Washington, DC metro area, including locations at the Pentagon, Marine Barracks Washington, DC, Marine Corps Base Quantico, and the Washington Navy Yard.

U.S. MARINE CORPS FORCES COMMAND

Located in Norfolk, VA, U.S. Marine Corps Forces Command (MARFORCOM) is tasked with commanding the Active Component operating forces; executing force sourcing and synchronization to provide joint commanders with the Marine Corps forces they require; directing deployment planning and execution in support of combatant commander and service requirements; serving as Commanding General, Fleet Marine Forces Atlantic, and commanding embarked Marine Corps forces; coordinating Marine Corps-Navy integration of operational initiatives and advising the Commander, U.S. Fleet Forces Command, on Navy support to Marine Corps forces assigned to naval ships, bases, and installations; and serving as Commander, Marine Forces Europe.

U.S. MARINE CORPS FORCES, CYBERSPACE COMMAND

Recognizing the significance of the cyberspace domain to national security, the Secretary of Defense directed the establishment of Cyberspace Command (CYBERCOM) as a sub-unified command under the U.S. Strategic Command. The primary objective of CYBERCOM is to integrate the computer network operations capabilities of the services and agencies in support of the National Strategy to Secure Cyberspace. In response, the Marine Corps established U.S. Marine Corps Forces, Cyberspace Command (MARFORCYBER) in October 2009. MARFORCYBER's mission is to plan, coordinate, integrate, synchronize, and direct full spectrum Marine Corps cyberspace operations. This includes DoD Global Information Grid operations, defensive cyber operations, and when directed, planning and executing offensive cyberspace operations. These operations support the Marine Air Ground Task Force, joint, and combined cyberspace requirements that 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 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. The 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. The Commander, MARFORPAC supports national and theater strategic objectives, and exercises Marine Corps component responsibilities in support of operational and concept plans, theater security cooperation, foreign humanitarian assistance, homeland defense, and force posture.

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. MARFORRES has units located all over the United States and in Puerto Rico.

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, MARFORSOC 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 (MRSG); and the Marine Special Operations School (MSOS) located at Camp Lejeune, NC. Led by a Marine Corps Major General, MARFORSOC headquarters is responsible for identifying Marine special operations-unique requirements; developing Marine SOF tactics, techniques, procedures and doctrine; and executing assigned missions in accordance with designated conditions and standards. MARFORSOC's primary focus has been the support of operations in Afghanistan, and in addition, units have been involved in many other missions that span the globe, the majority of which focus on training partner nation forces, assisting in counter-narcoterrorism efforts and providing other subject matter expert guidance to countries in component commands such as U.S. Africa Command, U.S. Pacific Command, U.S. Southern Command and U.S. Central Command.

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 (MCLC) 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 MCLC maximize supported unit readiness, synchronize distribution processes, and support Marine Corps enterprise and program-level total lifecycle management. MCLC is structured to execute its core competencies via its four subordinate commands, its Marine Expeditionary Force (MEF) Support Teams co-located with each MEF and Marine Forces Reserve Headquarters, and its liaison officers in the National Capital Region, at Marine Corps Systems Command, and the Program Executive Office-Land Systems.

Marines and Sailors assigned a carrier strike group stand at attention before manning the rails. (U.S. Navy photo by Mass Communication Specialist 3rd Class Oliver Cole/Released)

DEPARTMENT OF THE NAVY PERSONNEL COUNT

U.S. NAVY CIVILIANS: 185,719
(Full-time Equivalents)

U.S. MARINE CORPS CIVILIANS: 19,862
(Full-time Equivalents)

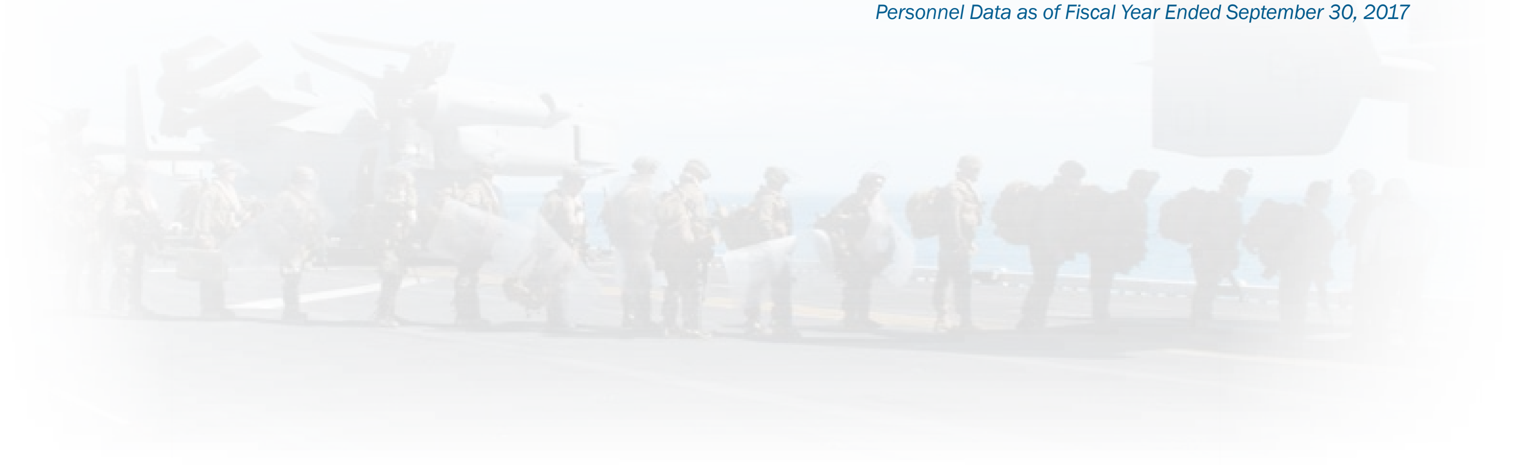
U.S. NAVY ACTIVE: 323,944
(Officers, Enlisted, and Midshipmen)

U.S. MARINE CORPS ACTIVE: 184,514
(Officers and Enlisted)

U.S. NAVY RESERVE: 57,824
(Drilling Reserve and Full-time Support)

U.S. MARINE CORPS RESERVE: 38,682
(Drilling Reserve and Full-time Support)

Personnel Data as of Fiscal Year Ended September 30, 2017



Sailors remove chocks and chains from an SA-330 Puma helicopter on the flight deck of a guided-missile destroyer. (U.S. Navy photo by Mass Communication Specialist 2nd Class Tyler Preston/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.

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 cooperative strategy was developed to be a unified and enduring approach applying maritime power to the critical 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 safeguard maritime interests at home and abroad.

The following DON goals and objectives for FY 2017 focused 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 maintain 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

The men and women of the DON provide the nation with an asymmetric advantage. No quantity of next generation ships or aircraft will bring success without the skilled, dedicated, and talented Sailors, Marines, and civilians who build, maintain, and operate the Navy and Marine Corps. Today's force is the most talented and high performing in history. However, just as the American technological advantage in warfare is not something to take for granted, it cannot simply be assumed that the Navy will always attract America's best and brightest to serve in an all-volunteer military and civilian workforce. Providing the incentives to attract top talent and an environment to thrive remains a top priority for the Department. The desire to serve remains strong in America, thus aiding the Navy and the Marine Corps in achieving overall recruiting objectives.

The Department remains dedicated to strengthening its investment in the ethical development of Sailors, Marines, and civilian employees to further their competence, confidence, character, and integrity such that their day-to-day actions and decisions are motivated by and aligned with the Department's core values of Honor, Courage, and Commitment. The DON has given priority to analyzing and updating training curricula and educational programs across the Department to emphasize the importance of ethical behavior and to diminish instances of destructive behavior. People are the DON's competitive advantage and there is no higher priority than to provide the tangible and intangible incentives that will allow the Navy to continue to recruit and retain the nation's elite.

Support Health and Quality of Life for Military and Civilians

The DON is focused on helping Sailors and Marines maximize their personal and professional readiness by assisting them and their families in dealing with the mental, physical and emotional challenges of military service. Providing a holistic approach to maintaining the health and resilience of the force, the Navy has made improvements to physical fitness and nutrition programs, enriched family support programs, developed financial literacy training, and prioritized mental wellness. The Morale, Welfare, and Recreation (MWR) program provides a variety of services promoting physical activity and a healthy lifestyle. MWR has extended fitness center hours of operation and are piloting 24/7 centers in many locations. MilitaryChildCare.com, an innovative online childcare information, request, and reservation system, which became fully operational in FY 2017, will allow families to secure critical child care services anywhere in the world before they execute a Permanent Change of Station (PCS) move. The Marine Corps and Navy expanded financial literacy training throughout the military lifecycle with topics relevant to life and career touch points. Earlier this year, the Navy released a financial literacy mobile application to enhance access to training, references, guides, and other resources for the transition to the Blended Retirement System (BRS). The BRS is a new military retirement system for service members signed into law as part of the National Defense Authorization Act of 2016.

Promote and Enforce a Culture Free of Sexual Assault

An environment that allows Sailors, Marines, and civilians to thrive is one that is respectful to all, free of harassment, bullying, and assault. Sexual assault is a crime that is not tolerated within the naval service. Those who report a sexual assault are supported by over 240 sexual assault response coordinators, 8,000 full and part-time victim advocates, 250 legal personnel, 160 criminal investigators, and 210 medical forensic examiners. The DON has a robust and effective Sexual Assault Prevention and Response (SAPR) program and Victims' Legal Counsel that together encourages increased reporting and provides critical support to those who come forward. The Department is also taking steps to prevent and respond to perceptions of retaliation or ostracism on the part of the courageous individuals who report these crimes – whether by the chain of command or peers. While there is still much work to be done, reporting across the Department has increased twofold since 2012 and, based on surveys, the estimated number of assaults on Service members has almost halved during that same time. Leaders at all levels are held accountable to ensure every member of the Navy-Marine Corps team can excel in an environment that maximizes their talents and rejects those who would degrade or diminish another service member.

During FY 2017, the DON's Sexual Assault Prevention and Response Office (SAPRO) focused on four key initiatives:

- Retaliation Prevention Training - engaged with Sailors and Marines in live, audience-participation "Pure Praxis" training programs conducted worldwide;
- Navy "A" School Sexual Assault Surveys - engaged with Sailors graduating from any Navy "A" School vocational training program to complete an anonymous online sexual assault survey;
- Naval Support Activity (NSA) Bahrain Sexual Assault Survey - developed and implemented customized sexual assault survey at NSA Bahrain to assess trends in key factors; and
- Junior Leader SAPR Training Tool - developed short training scenarios in a collection intended to develop SAPR skills in junior leadership development programs. The SAPRO is exploring follow-on products for more senior enlisted leadership because of the success of this training tool.

Participation in each of these four initiatives exceeded the planned targets.

Also during FY 2017, Commander, Naval Legal Service Command (CNLSC) revised procedures within prosecution commands to ensure timely and effective processing of sexual assault cases. Through the Trial Counsel Assistance Program (TCAP), CNLSC implemented new guidelines for review of sexual assault cases, providing commanders with quality legal advice sooner. Additionally, TCAP updated procedures for certifying Trial Counsel Prosecutors as Special Victims Investigation and Prosecution (SVIP)-qualified; ensuring counsel prosecuting said cases have met training and experiential requirements before serving as lead counsel.

A Gunner's Mate Seaman installs a gunbelt feed on a M38 25mm Anti-surface gun. (U.S. Navy photo by Mass Communication Specialist 2nd Class William McCann/Released)

Organize, Train, Equip, and Maintain Resilient Combat-ready Forces

The Navy is challenged by persistently low readiness levels as a result of increased lengths of deployments, which leads to maintenance challenges. Even as the number of Navy ships has decreased, the number of ships deployed overseas has remained roughly constant at about 100 ships. Each ship is being deployed more to maintain the same level of presence. The Navy has had to shorten, eliminate, or defer training and maintenance periods to support the high deployment rates. The DON continues to see the benefits of Optimized Fleet Response Plan (OFRP). The OFRP seeks to maximize employability while preserving maintenance and training with continuity in ship leadership and carrier strike group assignments, and restoring operational and personnel tempos to acceptable levels. The new schedule is designed to achieve a number of benefits, including increasing readiness and maximizing employability to combatant commanders. The Navy also anticipates that better scheduling will result in increased predictability for sailors, public shipyards, and private ship repair companies that maintain the fleet.

In FY 2017, the DON launched Sailor 2025, the Navy's program to improve and modernize personnel management and training systems to more effectively recruit, develop, manage, reward, and retain the force of tomorrow. Sailor 2025 is a set of approximately 45 initiatives built on a framework of three pillars: a modern personnel system, a career learning continuum, and career readiness. It focuses on empowering Sailors, updating policies, procedures, and operating systems, and providing the right training at the right time in the right way to ensure Sailors are ready for the Fleet. While the Navy is in a good position today with respect to recruiting, retention and manning, the DON is at a strategic crossroad where it needs to think about how it will conduct business for the Sailors of the future.

U.S. Naval Academy midshipmen from the Class of 2017 toss their covers in the air during the graduation and commissioning ceremony at Navy/Marine Corps Memorial Stadium. (U.S. Navy photo by Chief Mass Communication Specialist Anthony Koch/Released)

The Department's civilian workforce is an irreplaceable partner to the warfighters and is one of the most technologically advanced and innovative workforces in the world. More than half of the civilians are scientists, engineers, mathematicians, and logisticians and to sustain that workforce into the future, the Department continues to leverage strategic partnerships with science, technology, engineering, and math (STEM)-related groups and educational institutions to highlight naval service as a rewarding career option.

The Department is also working to ensure personnel policies and programs are keeping pace with the innovative human resources environment of the private sector. The Fleet Scholar Education Program (FSEP) allows the best and brightest officers to learn at America's most prestigious universities. The FSEP provides a total of 30 fully funded full-time graduate education opportunities with participant selection from the highest performing officers from each community. Career broadening programs improve the intellectual capital of the officer corps, providing sought after opportunities for the best and brightest.

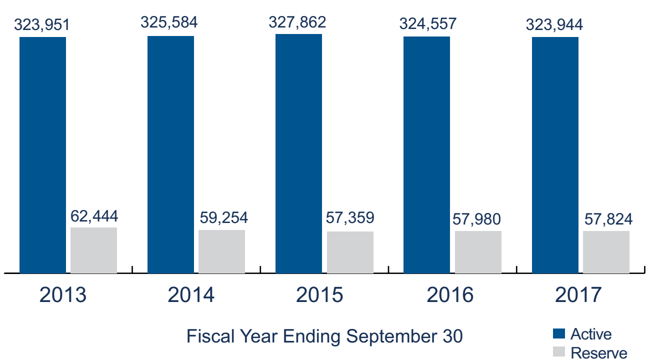
Despite the DON's commitment to providing the highest quality of life to Sailors and Marines, the tragedy of suicide continues to plague the Department as it does society as a whole. The DON has made strides in arresting the incidence of suicide and continues to seek promising paths to prevention. During the past year, the Navy launched the Sailor Assistance and Intercept for Life (SAIL) program, a research-based non-clinical intervention strategy, modeled after the successful Marine Corps Intercept Program. The SAIL program provides rapid assistance, on-going risk assessment and support for Sailors who have exhibited suicide-related behaviors. The Marine Corps has initiated Death by Suicide Review

Boards to gain in depth understanding of all Marine deaths by suicide. Although the Marine Corps and Navy have reduced military suicides from the peak numbers seen a few years ago, the Department must continue our efforts to increase resiliency, promote help seeking and provide treatment, and support for those in need.

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 change in the Navy's active component remained flat, while the reserves decreased by 7%. The Navy has been able to accomplish all assigned missions at this level because of force structure changes, efficiencies gained through technology, modification in workforce mix, and new manning practices.

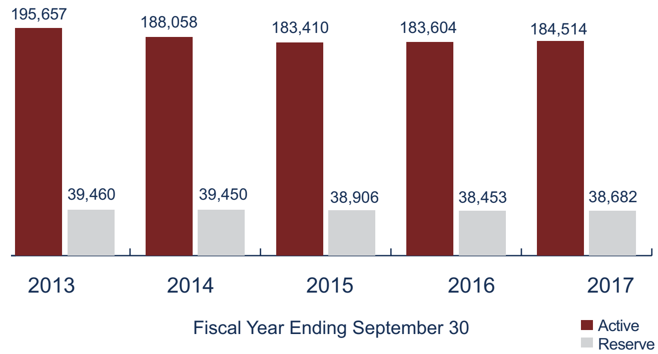
U.S. NAVY END STRENGTH



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 has decreased its active and reserve components by 6% and 2%, respectively.

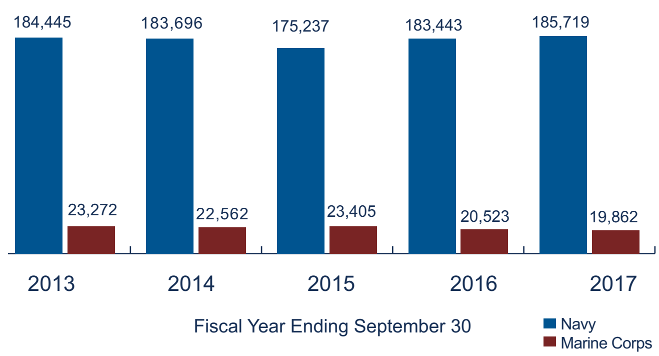
U.S. MARINE CORPS END STRENGTH



Navy and Marine Corps Civilian Personnel

The size of the civilian workforce, which has increased by 1% for the Navy and decreased by 15% for the Marine Corps 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, financial management, and budgeting.

CIVILIAN PERSONNEL (FULL-TIME EQUIVALENTS*)



** Full-time equivalents are the total number of regular straight-time hours (i.e., excluding overtime and holiday hours) worked by employees divided by the number of compensable hours applicable to each fiscal year.*

Goal 2: Platforms

The DON's responsibility of protecting the country and responding to international obligations requires platforms and ships for Sailors and Marines to complete their missions successfully. Sustaining the correct number of vessels to have an adequate and efficient fleet enables the DON to uphold national security and maintain an active international presence. The commitment to have an efficient and precise fleet comprised of the proper mix of platforms is a high priority for the DON. Additionally, focusing on cyber security, financial management, and unmanned systems helps the DON ensure its ability to execute its mission in a more effective and efficient manner.

Ships

During FY 2017, the DON conducted a Force Structure Assessment to determine the right balance of existing forces, ships currently under construction, and future procurement plans needed to address the ever-evolving and increasingly complex threats the Navy encounters in the global maritime commons. The Assessment called for achieving and maintaining a fleet of 355 ships and revalidating the warfighting requirement of 52 small surface combatants, including the Littoral Combat Ship (LCS) and a future Frigate. To date, nine LCS ships have been delivered, 17 are in construction or under contract, and all are on track to deliver within the cost cap. Three additional ships were authorized and appropriated in FY 2017, which ensures continued production while the Navy refines the requirements and acquisition strategy for the future Frigate. The LCS program continues to field its mission systems incrementally. LCS 4 is currently deployed with the first instantiation of an over-the-horizon missile capability. The LCS Surface-to-Surface Missile Module with Longbow Hellfire is currently in testing and on track for introduction in 2018. The Mine Countermeasure and Anti-Submarine Warfare mission modules are in testing, with expected delivery in FY 2019 and 2021, respectively.

Also in FY 2017, the DON commissioned the USS Gerald R Ford (CVN 78), the first of a new class of nuclear-powered aircraft carriers in over 40 years. The *Ford*-class incorporates advancements in technology that make the carrier more capable and efficient, while also providing it with the ability to implement future advancements in technology with relative ease. With increased capability and reduced total-ownership costs – through manpower reductions and innovations, such as greater electrical production from the nuclear power plant, the use of fiber-optic networks, improved corrosion control, and the use of new, lightweight materials – CVN 78 and future *Ford*-class carriers package increased warfighting capability and enhanced survivability. With a length of 1,106-feet, the USS Ford is comparable to the size of three football fields, allowing for an expanded flight deck that is easier for aircraft to maneuver and launch faster. Additionally, it features a better-positioned island structure, giving the Captain improved visibility. With more than double the electrical capacity and automated equipment, the ship can sail more efficiently with at least 600 less crewmembers, which will save an estimated $4 billion over the ship's 50-year lifespan.

The DON Financial Management and Audit Readiness Program

The DON Financial Improvement and Audit Readiness (FIAR) Program and the Marine Corps Financial Improvement and Audit Readiness Initiatives are ongoing efforts that made great strides in FY 2017 towards DON's financial statement auditability. With the mindset of fully embracing the audit, the DON established an Audit Committee to enhance senior leadership engagement and formalize a governance structure over the resolution of enterprise-wide deficiencies. Some of the key wins achieved in FY 2017 include:

- Navy produced quarterly Full Financial statement packages for Navy-only GF to include pro-forma footnotes
- Navy completed the DoD IG Assertion paper for Real Property stating that Navy is ready for FY 2017 DoD IG Existence & Completeness (E&C) audit of facilities, buildings, & structures
- Navy achieved E&C baseline valuation over most material asset segments representing 67% of total GF Property, Plant & Equipment (PP&E)

Through these accomplishments, the DON continues to progress towards the ultimate objective of receiving a clean audit opinion.

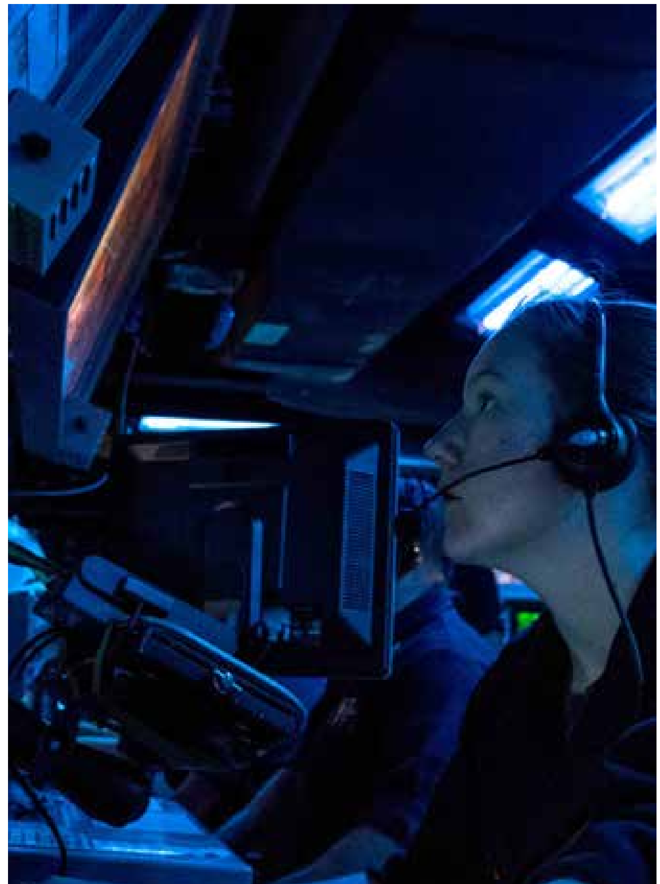
The FIAR efforts align with the priorities and associated strategy established by the Under Secretary of Defense (Comptroller) for bringing the DoD into a state of financial audit readiness and in compliance with the Chief Financial Officers Act of 1990 (as amended). These priorities focus on improving 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 PP&E and real property, as reported on the Balance Sheet.

These priorities demonstrate the value of these financial statements to the daily business operations, particularly for funds control and resource utilization.

In FY 2017, the Navy entered into a Balance Sheet audit with an Independent Public Accounting (IPA) firm. The Navy is working closely with the auditors to provide a complete picture of the Navy and its processes. Undergoing an audit allows the Navy to utilize the feedback to further strengthen areas of weakness and focus on improving business discipline and the quality of financial information. In addition to the current FY 2017 audit, the DON is working to broaden audit readiness efforts in preparation for the full scope FY 2018 audit. These efforts will include preparing key supporting documentation and performing business process reviews. The DON is confident these efforts will continue to improve audit posture.

Also during FY 2017, the DoD IG engaged an IPA to initiate an audit of the Marine Corps FY 2017 General Fund financial statements. Like previous SBA and SBR audits, the Marine Corps is leading the way for the DoD on a multi-year mission to achieve U.S. GAAP compliance. While under audit, the Marine Corps was able to demonstrate the tie out of the U.S. Standard General Ledger (USSGL) trial balances to the universe of transactions that supports the financial statements. This was a critical step in obtaining an audit opinion. Achieving full financial statement auditability is a tremendous undertaking and success requires patience and consistent focus on corrective actions. This mission has been, and will continue to be, a challenge. The Marine Corps anticipates multiple audit findings from the FY 2017 financial statement audit. 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.

Throughout FY 2017, the DON has embraced the increased audit tempo as an opportunity to improve organizational business rigor. By working with IPAs, the DON will charge forward embarking upon a new state of financial audit readiness and compliance. While good progress has been made to date, the DON's audit



Standing watch at a console in a combat information center. (U.S. Navy photo by Mass Communication Specialist 3rd Class J. R. DiNiro/Released)

journey must build upon its multi-year efforts through strengthening core business capabilities necessary to obtain an opinion on all financial statements. The Department will continue to build the capabilities for audit, and success in the later years will accelerate, as the DON gains new insight from early audit findings and continues to remediate the causes of weaknesses. The DON is confident in the planned course yet remains flexible to tackle obstacles that lay ahead.

Cybersecurity and Agile Systems

Building the force is not limited to new platforms that operate in the traditional domains of sea, undersea, air and space, but also in the newest warfighting domain: cyberspace. With the exponential growth and ubiquitous availability of advanced computing methods and information technology in today's highly networked environment, the Navy and Marine Corps must operate effectively in cyberspace. The DON must lead in both offensive and defensive use of this new domain and building cyber resiliency into networks to allow the "fight through" of a cyber attack. Cyber resiliency ensures that when an attacker gets through defenses, the DON rapidly detects and reacts to the anomalous cyber activity in a way that allows the continuation of critical operations while the integrity of that portion of the network is restored. Cyber defense-in-depth is achieved by surveillance and reconnaissance within networks to detect malicious activity. Navy and Marine Corps Cyber Commands leverage layers of sensors, analysts, and cyber specialists to assure continuity of maritime missions and protect data. In addition to defense and assured access, the Navy and Marine Corps are prepared to deliver cyber effects at a time and place of their choosing across the full range of military operations in support of Naval and joint commanders' objectives.

In FY 2017, the DON worked to cyber harden and protect cyber investments. The DON moved toward cyber detection, response, and recovery phases for cybersecurity and developed a Risk Management Framework Process Guide as well as Defense in Depth Functional Implementation Architecture to better identify and prevent cyber-attacks. The DON conducted a pilot execution of a model to track cyber security return on investments and developed a comprehensive cybersecurity cost model to inform the Program Objective Memorandum process.

Unmanned Systems

The DON participated in numerous activities to integrate unmanned systems (UxS) into DON culture. Whether it's performing military activities and training exercises or collecting data on oceans and waterways, the DON increased the use of unmanned systems to accomplish their mission. U.S. and allied combat operations continue to highlight the value of unmanned systems in the modern combat environment. Combatant Commanders and warfighters value the inherent features of unmanned systems, especially their persistence, versatility, and reduced risk to human life.

The DON participated in a series of workshops in FY 2017 that had wide spread participation across the organization. The "DON Strategic Roadmap for Unmanned Systems" lays out the DON's vision for the continuing development, fielding, and employment of unmanned systems technologies. The Deputy Assistant Secretary of the Navy (DASN) (UxS) participated in numerous speaking engagements to build a diverse and enthusiastic community between the DON, industry, and educational partners. In collaboration with the Naval Postgraduate School, DASN (UxS) began developing a stakeholder tool to facilitate executing the actions called for in the Strategic Roadmap amongst the emerging unmanned community.

To optimize department structure to support and facilitate development and integration of unmanned systems, the CNO Warfare Systems Directorate reorganized in FY 2017 as part of the Navy's ongoing process to mainstream the complementary warfighting effects of manned and unmanned warfare systems. This reorganization will help leverage the capabilities and communication between ships, submarines and aircraft, as well as create a leaner, more agile, effective, and efficient organization.

In FY 2017, the DON designated the Snakehead Large Displacement Unmanned Undersea Vehicle (LDUUV) for accelerated acquisition as a Maritime Accelerated Capability Office (MACO) program. These programs have the necessary requirements, funding, and acquisition authority to implement these mature systems rapidly. The Navy is leveraging proven technologies to quickly move on the LDUUV program and get it in the water as soon as FY 2019. This will get it into the hands of Sailors and allow for feedback that will feed future LDUUV programs. Once approved for accelerated acquisition, the Snakehead LDUUV program approvals will be streamlined and program heads will have a direct line to top officials. Program of record requirements will still be followed, but progression will be faster. The Snakehead LDUUV is intended to have long-range, high endurance capacity and designed for surface or submarine launch. It can be recovered and stored on LCSs, *Virginia*-class submarines, and *Ohio*-class submarines.

Goal 3: Power

Energy is critical to the DON's ability to provide the global presence necessary to ensure stability, deter potential adversaries, and present options in times of crisis – wherever and whenever they might arise. The Navy's energy strategy is centered on energy security, energy efficiency and sustainability while remaining the pre-eminent maritime power. The key elements of the strategy include:

- Maintain Presence – Energy-efficient operations and diverse energy supplies strengthen the ability to provide the presence necessary to ensure stability, deter potential adversaries, and provide options in times of crisis.
- Provide Strategic Flexibility – Diversifying energy sources helps shield the DON from volatile energy prices and supplies and arms the Navy with operational flexibility.
- Boost Combat Capability – Optimizing energy use is a force multiplier that can increase range, endurance, and payload, and is essential for the effective deployment of next-generation weapons including the directed energy weapons and the rail gun.
- Protect Sailors and Marines – Using energy efficiently takes fuel convoys off the road and reduces the amount of time ships are tied to oilers at sea, saving lives, time, and money.
- Ensure Mission Success – Shore installations play a critical role in promoting readiness and generating the force structure necessary for mission success. Improving energy efficiency and increasing the use of alternative energy promotes more secure and resilient installation operations.
- Promote Sustainability – Increasing the use of environmentally responsible technologies afloat and ashore reduces greenhouse gas emissions and lessens dependence on fossil fuels, creating a sustainable model for national defense.

Increase Alternative Energy Sources

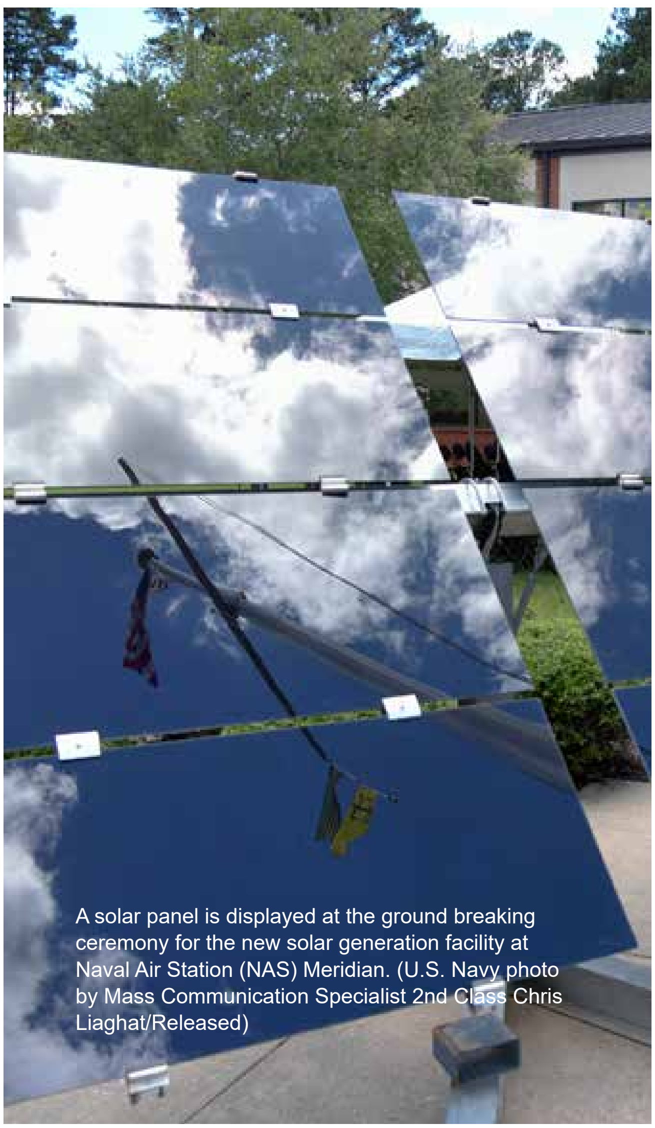
The Renewable Energy Program Office (REPO) led energy efficient acquisitions to achieve the DON's goal of producing one gigawatt of renewable energy generation capacity by the end of 2015—an important milestone towards meeting the Navy's overall goal of 50% of total energy consumption coming from alternative 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.

To leverage one gigawatt execution and improve energy security, the DON achieved 440 megawatts of renewable energy capacity online at DON installations as well as hundreds of additional megawatts under construction, awarded, and in procurement. Renewable and alternative energy adds to the sustainability of the commercial grid that naval installations rely on and, at select locations, offers an alternative power supply to continue operations in the event of a disruption to the commercial grid. The in-kind considerations received from third-party financiers of these projects include microgrid controls, battery storage, feeder lines, substations and other electrical infrastructure upgrades, further enhancing installation energy security.

In FY 2017, the DON continued to increase the use of alternative energy across the enterprise. By commissioning the USS Gerald R. Ford, the DON created the most advanced next generation aircraft carrier powered by nuclear power. The USS Ford is able to generate 13,800 volts of electrical power, more than three times that of the *Nimitz*-class carrier that it replaces. The Electromagnetic Aircraft Launch System (EMALS) replaced the traditional steam-powered catapults of the *Nimitz*-class. Using stored kinetic energy and solid-state electrical power conversion, EMALS provides greater control and precision when launching aircraft, expanding the ship's operational capability to launch more types of planes, from heavy strike fighter jets to light unmanned aircraft. The aircraft carrier's lighting system is improved as 44,000 high-efficiency fluorescent T-8 light bulbs produce more light and last nearly twice as long as the lighting it replaces. These energy improvements result in higher efficiency and offer crew quality of life improvements. The second ship of the Ford-class, the future USS John F. Kennedy, is well along in construction, keeping America's Navy on the forefront of today's rapidly-evolving energy innovation.

Sail The Great Green Fleet

The DON wrapped up the year-long Great Green Fleet (GGF) initiative in FY 2017. The purpose of the GGF was to make the DON's Sailors and Marines stronger warfighters: able to go farther, stay longer, and deliver more firepower. The GGF helped usher in the next era of DON energy innovation by demonstrating that energy efficient technology and operating procedures can increase mission capability through energy savings. The DON will use this information to continue training and educating DON personnel on the importance of energy efficiency.



A solar panel is displayed at the ground breaking ceremony for the new solar generation facility at Naval Air Station (NAS) Meridian. (U.S. Navy photo by Mass Communication Specialist 2nd Class Chris Liaghat/Released)

Highlights for the GGF during FY 2017 include the Marine Corps Expeditionary Energy Office hosting a Capability Exercise at Marine Corps Air Ground Combat Center Twentynine Palms during which Marines, amid an exercise, demonstrated how energy efficiency technology and renewable energy assets increased their mission capability. Another highlight included the Eisenhower Carrier Strike Group completing its deployment as the GGF's East Coast Carrier Strike Group (CSG). During its tour, the Eisenhower CSG took on synthetic fuel from an Italian Navy oiler and visited multiple ports throughout Italy and the Mediterranean showcasing energy efficiency technology and synthetic fuels in normal operations. The GGF reported the Fleet saving over 18,000 underway steaming hours' worth of fuel through the use of energy conservation measures.

Increase Energy Innovation and Efficiency

Mission success depends on ships, aircraft, and installations operating reliably and effectively. A culture of energy efficiency is foundational to the Navy and Marine Corps' mission of ensuring stability, deterring potential adversaries, and presenting options in times of crisis. The DON depends on access to secure sources of energy. The Department is leveraging technologies and platforms, along with pragmatic fuel and energy practices, to boost combat effectiveness, maximize strategic options, and better protect Sailors and Marines.

The DON strives to institutionalize resource and energy efficiency throughout the enterprise. This was witnessed as the DON received results of the 2017 Navy energy survey, showing 55% of high level officers believe the primary purpose of the Navy Energy Program is to enhance operational capability, and 62% of active duty Sailors agree that optimizing energy use increases range, endurance, and payload.

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.

Integrative Energy Security and Resiliency Strategy

In order to develop an integrative energy security and resiliency strategy, the DON established an energy security framework. The framework will be used as guidance for improving energy security posture across all DON installations. The DON provided the framework to establish minimum performance goals for energy management that pertain to reliability, resiliency, and efficiency. It is intended as a primer for additional assessment tools and strategies that are intended to improve an installation's holistic energy plan. DON leadership developed an energy security benchmarking document and draft assessment tool.

Goal 4: Partnerships

The DON worked extensively to build and maintain cooperative relationships and alliances that are critical to ensuring global security. These relationships are essential to diffuse tensions, provide disaster relief, reduce misunderstandings, establish security, and limit conflict in the global environment. This assures that 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

In FY 2017, the DON invested heavily in promoting, maintaining, and advancing itself as the "Security Partner of Choice" to strengthen key alliances. Interoperability efforts at the senior level have ensured the continuation of support to building partner capacity and alliance activities across the globe. In May 2017, the DON took part in the 23rd annual Cooperation Afloat Readiness and Training (CARAT) exercise series between the Royal Thai Navy and the U.S. Navy and Marine Corps in Thailand. As the premier naval engagement in South and Southeast Asia, CARAT provides a regional venue to address shared maritime security priorities, enhance interoperability among participating forces, and develop sustained naval partnerships with nations across South and Southeast Asia. Engagement through CARAT provides the U.S. and Thailand an opportunity to strengthen alliance and maritime partnership. The complexity of the training and the diverse cadre of Sailors and Marines allow the DON to deepen relationships at all levels and create bonds of trust that span generations within our forces. CARAT Thailand 2017 consisted of eight days of shore-based and at-sea training events in multiple warfare areas. The exercise features a robust sea phase with surface warfare maneuvering tactics, small-boat operations, manned and unmanned helicopter flight operations, communication exercises and more.

Additionally, the DON Office of Small Business Programs (OSBP) co-hosted the 29th annual DON Gold Coast Small Business Procurement event. The purpose of the event is to provide a forum to educate, guide, and assist businesses, especially small businesses, in working with the government. The responsibility to efficiently maintain a fleet of nearly 300 ships, systems and their support infrastructure is a huge undertaking, and success is only possible through ongoing partnerships between the DON and its large and small business partners in industry. OSBP's mission is to ensure that every small business that wishes to do business with the DON has the necessary knowledge about the program and tools to successfully participate as either a prime contractor or a subcontractor. Special emphasis is placed on assisting small businesses that have been historically underutilized or have had difficulty participating in the procurement process. Their goal is to bring faster, more efficient information on the DON forecasted procurement opportunities, thereby providing the business community adequate time to develop business strategies. DON buying activities are working diligently to accomplish small business program goals.

Implement the DON Innovation Vision and Transformation Initiatives

In June 2017, DON leadership conducted the Annual SECNAV Innovation Award Ceremony. Across the DON, talented Sailors, Marines and civilians are continually creating innovative solutions to the most complex problems. The Annual SECNAV Innovation Awards Program acknowledges top Naval Innovators in the workforce today and inspires the problem solvers of the future. The awards program recognizes top DON individuals or teams making significant problem-solving contributions in the following areas: Innovation Leadership, Data Analytics, Innovation Catalyst, Technology Development, Innovation Scholarship, Automated Process Development, Enlisted Innovator, and Outside the Box Thinking. FY 2017's Data Analytics winner was CTN1 Forrest Perez. Off-the-shelf systems proved inadequate for the needs of Cyber Protection Teams (CPTs), operating under U.S. Cyber Command to identify advanced threats on the DoD Information Network. CTN1 Perez's development of the Cyber Tactical Assessment Kit (C-TAK) resulted in an advanced analytic capability, empowering Navy CPTs to effectively monitor high-throughput networks. C-TAK uses custom scripts and graphical dashboards to aggregate network data streams, carve out critical information, and visualize high volume, rapidly changing threats in real time. The Navy adopted C-TAK as its standard network analysis system and all CPTs have been equipped with this innovative warfighting capability. Its real-time network data analytics reduced the time needed to train new analysts from an average of four months to less than one. Furthermore, analysts using C-TAK are able to detect more covert malicious activity than was possible using earlier systems. This is just one of the many innovations the DON workforce is continuously accomplishing.

Foster an Innovative Culture that Advances Diversity and Inclusion in the Workforce

In FY 2017, the DON made significant progress in executing the Diversity and Inclusion (D&I) Implementation Plan. The roadmap was completed along with recommended goals and actions. The roadmap is used to harness diversity as a force multiplier and to foster a culture of inclusion. Three strategic imperatives are outlined to guide efforts to maximize and improve diversity and inclusion programs. These strategic imperatives serve as the cornerstone for improving warfighting presence at the right time, with the most skilled team, ready for decisive operations and combat. The first strategic imperative is a promise to recruit and access from a diverse group of applicants to secure a high-performing, innovative workforce that reflects all segments of society. The second is a promise to cultivate an inclusive culture that accelerates opportunities to empower each individual's maximum impact, encourages innovation and collaboration, enhances developmental opportunities, and retains the best talent to enable uniformed and civilian personnel to contribute to their full potential. The third imperative promises to develop strategies to equip leaders with the ability to effectively manage diversity, be accountable, measure results, and refine approaches to engender a sustainable culture of inclusion. Also as part of the D&I Implementation plan, the Employee Resource Groups expanded across the DON and D&I skill capacity was strengthened through formalized training in six competencies: business acumen, strategic leadership, strategic communications, building coalitions, change management, and D&I measurement.

Also in FY 2017, the DON developed the Navy Civilian Workforce Framework. This Framework is the first step toward identifying what the Navy can do to strengthen the civilian workforce, and by extension the Navy team as a whole. Navy civilians offer unique technical expertise, continuity of knowledge and experience, and diversity of thought and perspective. The Department must fully leverage those contributions to succeed in its mission. The full plan to strengthen the civilian workforce is outlined in the Framework, and will be further developed by more specific strategies that specify the actions each command within the Navy will take to meet the objectives. These efforts will be overseen by a Civilian Workforce Advisory Board to drive alignment and accountability, and to ensure the DON learns rapidly as it takes a more deliberate approach to strengthening this key element of the DON team.

Seamen paint the hull of a ship. (U.S. Navy photo by Mass Communication Specialist Seaman Patrick Semales/Released)

Signaling to the crane operator aboard a fleet replenishment oiler. (U.S. Navy photo by Mass Communication Specialist 3rd Class Ian Kinkead/Released)

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

The DON Commanders, senior leaders, and managers are obligated to safeguard the integrity of its 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 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:

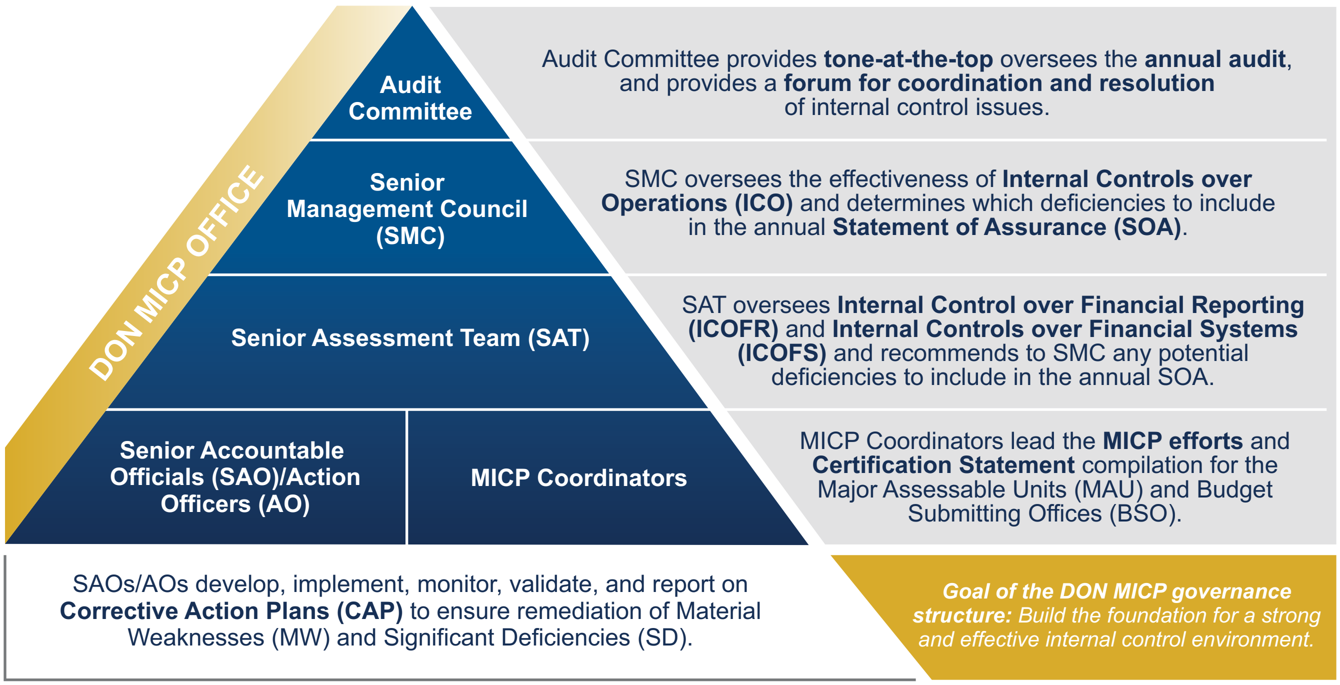
- Effectiveness and efficiency of operations;
- Reliability of financial and non-financial reporting;
- Compliance with applicable laws and regulations; and

- Financial information systems are compliant with the FFMIA of 1996 (Public Law 104-208).

Internal Controls Governance

This year, the DON continued building upon the DON's Managers' Internal Control Program (MICP) governance structure to align with the FMFIA and the Office of Management and Budget (OMB) Circular No. A-123 requirements. The DON implemented a comprehensive internal control governance structure to monitor risks, effectiveness of internal controls, remediation of deficiencies, and report progress in the annual SOA. The governance structure and the roles and responsibilities of each governing body are illustrated in Figure 1.

FIGURE 1: DON MICP GOVERNANCE STRUCTURE



The DON Audit Committee oversees the annual audit of the financial statements and assists with enterprise resolution of obstacles to a clean audit opinion. The Audit Committee, tri-chaired by the Under Secretary of the Navy, Vice Chief of Naval Operations, and the Assistant Commandant of the Marine Corps, broadly represents the DON's senior-level functional expertise, providing comprehensive and dedicated oversight of the financial statement audit and a forum to discuss and resolve business process issues that impact financial reporting, accounting, and audit.

A Senior Executive Service (SES) or Flag Officer from each of the 17 Major Assessable Units (MAUs), which include 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, comprise the DON's Senior Management Council. The SMC, chaired by the Deputy Assistant Secretary of the Navy (Financial Operations (DASN (FO)) oversees the DON MICP and advises the Secretary of the Navy and the Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN (FM&C)) on program implementation, effectiveness, and reporting.

The Senior Assessment Team (SAT) is the governing body that oversees FFMIA compliance activities associated with assessing Internal Control over Financial Reporting (ICOFR) and Internal Controls over Financial Systems (ICOFS). It is comprised of Comptrollers for DON BSOs. The SAT is co-chaired by the Deputy Assistant Secretary of the Navy (Financial Operations) and the Deputy Assistant Secretary of the Navy (Financial Policy and Systems). The SAT provides similar oversight functions to the BSOs as the Senior Management Council (SMC) provides to the MAUs; however, the focus of the SAT is ICOFR and ICOFS.

Both the SMC and SAT meet at least quarterly to discuss Corrective Action Plan (CAP) remediation status, results of risk assessments and internal control testing, and to deliberate as to whether newly identified deficiencies warrant designation as Material Weaknesses (MWs) or Significant Deficiencies (SDs). While the SAT can recommend the approval or closure of a new or existing weakness or deficiency, the SMC is responsible for final approval.

Senior Accountable Officials (SAOs) are DON Senior Executives or Flag Officers that have been assigned a specific weakness or deficiency, and are responsible for remediating the deficiency and for reporting remediation status to the SMC and SAT. The SMC and SAT MICP Coordinators are the working-level internal control representatives for their activity, ensuring risk assessments are completed, controls are operating effectively, deficiencies are identified and reported, corrective actions are developed and executed, and a Certification Statement is prepared.

The DON MICP provides the required framework and guidance for MAUs and BSOs to effectively implement a system of internal controls, complete assessments, and provide accurate and timely reporting. The MAUs and BSOs identify the organizational objectives and the business processes used to achieve their mission. They identify the risks inherent in these business processes and the controls in effect to mitigate them. The MAUs and BSOs 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 operations and processes.

Internal Control over Operations

The DON MICP is the administrative vehicle for monitoring Internal Controls over Operations (ICO). 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 the network of 17 MAUs.

In FY 2017, the DON resolved two MWs, reassessed one MW, and identified one new MW. There were five uncorrected ICO MWs in the following internal control reporting categories: (1) comptroller and resource management, (2) contract administration, (3) security, (4) manufacturing, maintenance, and repair, and (5) personnel and organizational management.

In addition to ICO assessments described above, the DON MICP encompasses ICOFR and ICOFS into the Department's annual SOA to support the OSD report to Congress and the President.

Internal Control over Financial Reporting

In FY 2017, the DON continued to build upon prior year progress in improving ICOFR, maintaining focus on its audit objectives and on a robust internal control program critical to success and sustainability. Internal controls are a cornerstone of the DON's audit readiness program and a key input to its many audit related initiatives.

The DON's 19 BSOs define the Assessable Units (AUs) within their organization based on those most critical to the BSO's mission and strategic objectives. The BSOs executed their internal control process, which includes risk assessment, control testing, deficiency identification and subsequent corrective actions, and reporting results in their certification statement. These certification statements and their supporting enclosures are the primary source documents for the Secretary of the Navy's determination of reasonable assurance over the effectiveness of the DON's financial operations and processes.

The DON continues to maintain and enhance its standard business processes. Further, the DON worked with its service providers to ensure its business process documentation stays in alignment with the services they provide; documentation is being updated to reflect the alignment of Navy control points to Complementary User Entity Controls. The DON's BSOs participate in monthly change control board meetings designed to obtain concurrence on all recommended process changes. The DON's standard business processes serve as the foundation for BSO internal control testing, and they help to improve the overall control environment.

The DON tests key internal controls within various business processes, using a variety of testing methodologies, and maintains documentation to support its evaluation and level of assurance.

In FY 2017, the DON resolved one ICOFR MW and identified two new MWs, for a total of 24 MWs in Fund Balance with Treasury, Financial Reporting Compilation, Military Pay, Accounts Payable, Contract/Vendor Pay, Reimbursable Work Orders, Transportation of Things, Equipment Assets, Real Property Assets, 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 2017 reporting period towards improving ICOFS. In conjunction with the Office of the Secretary of Defense and service providers, the DON continues to assess relevant financial system controls to ensure compliance with the OMB Circular No. A-123, Federal Information System Controls Audit Manual (FISCAM), FIAR, National Institute of Standards and Technology (NIST) Risk Management Framework (RMF), and financial information systems compliance with the Federal Financial Management Improvement Act of 1996. ICOFS is the foundation of auditability for financial systems. Consequently, the following ICOFS efforts to facilitate an auditable financial systems environment are underway.

The DON maintains several initiatives, specifically concerning providing Information Technology (IT) control governance in the form of publishing Enterprise IT Control Guidance and maintaining an inventory of IT systems and their financial significance. The DON continued the work of the Financial Information Systems Working Group (FISWG), co-chaired by designees from the ASN (FM&C) and the DON Chief Information Officer. The FISWG addressed enterprise IT control guidance for NIST Control Families, funding for IT controls/audit requirements, and the RMF transition. Additionally, the DON established an inventory of DON IT systems relevant to its financial statements, including key service provider-owned systems to document the flow of financial data through its IT systems. The DON continues to refine this inventory by developing clearly defined scoping criteria and closely examining the systems environment.

In FY 2017, the DON resolved one nonconformance, for an ending balance of eight nonconformances in IT controls across key and ancillary IT systems. The DON noted the following:

- Issues for separation of duties within Enterprise Resource Planning (ERP) system,
- Noncompliance 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, and
- Lack of standardized and specific control criteria guidance.

Financial system MWs are assigned to the Office of Financial Policy and Systems (FMP) and DON Chief Information Officer, with similar remediation and validation process as ICOFR MWs.

The following page is the management assurance letter for FY 2017.

THE SECRETARY OF THE NAVY
WASHINGTON DC 20350-1000

August 28, 2017

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2017

As Secretary of the Navy, I recognize that the Department of the Navy (DON) is responsible for managing risks and maintaining effective internal controls to meet the objectives of Sections 2 and 4 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The DON conducted its assessment of risk and internal control in accordance with the Office of Management and Budget (OMB) Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control. Based on the results of the assessment, as of the date of this memorandum, the DON can provide reasonable assurance, except for the 37 Material Weaknesses (MW) reported in the "Material Weaknesses and Corrective Action Plans" section, that internal controls over operations, reporting, and compliance were operating effectively. In the event a material change occurs in the internal control environment between the date of this memorandum and 30 September 2017, a supplemental statement will be issued to update the resulting assurance level. The annex of classified and Special Access Programs' (SAP) MWs has been forwarded through proper access to the Office of the Secretary of Defense SAP Central Office.

The "Internal Control Evaluation" section provides specific information on how the DON conducted the assessment of Internal Controls over Operations. Based on the results of the assessment, as of the date of this memorandum, the DON can provide reasonable assurance, except for the five MWs reported in the "Operational Material Weaknesses" section (beginning on page 25), that internal controls over operations and compliance were operating effectively. In the event a material change occurs in the internal control environment between the date of this memorandum and 30 September 2017, a supplemental statement will be issued to update the resulting assurance level.

The "Internal Control Evaluation" section provides specific information on how the DON conducted the assessment of Internal Control over Financial Reporting. Based on the results of the assessment, the DON can provide reasonable assurance, except for the 24 MWs reported in the "Financial Reporting Material Weaknesses" section (beginning on page 40), that internal controls over reporting (including external financial

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2017

reporting) and compliance were operating effectively as of 30 June 2017 in accordance with OMB Circular No. A-123, Appendix A.

The DON also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with Federal Financial Management Improvement Act (FFMIA) of 1996 (Public Law 104-208) and OMB Circular No. A-123, Appendix D. The "Internal Control Evaluation" section provides specific information on how the DON conducted the assessment of Internal Controls over Financial Systems. Based on the results of this assessment, the DON can provide reasonable assurance, except for the eight nonconformance items reported in the "Financial Management Systems Material Weaknesses/Nonconformances" section (beginning on page 82), that the internal controls over the financial systems comply with the FFMIA and OMB Circular No. A-123, Appendix D, as of 30 June 2017.

My point of contact is Captain Milton W. Troy, III, who may be reached at milton.troy@navy.mil or (202) 433-9228.

Richard V. Spencer

Attachments:
As stated

A fleet replenishment oiler transits alongside an amphibious assault ship. (U.S. Navy photo by Mass Communication Specialist 2nd Class Jeanette Mullinax/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 nonfinancial 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 2017 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 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.

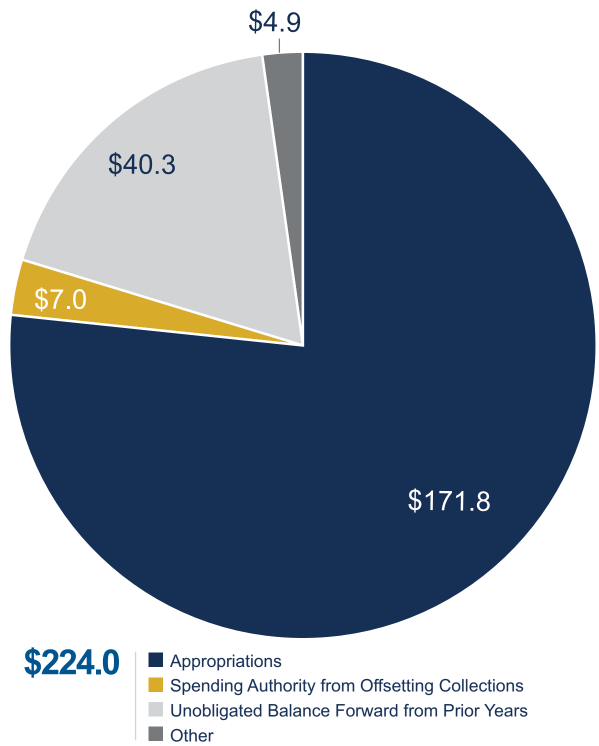
Enacted appropriations flow through OMB and the Office of the Secretary of Defense to the Office of the Secretary of the Navy, where they are allocated to administering offices and commands. The administering offices and commands, which obligate the appropriations to fund operational expenses and capital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

Results of Operations

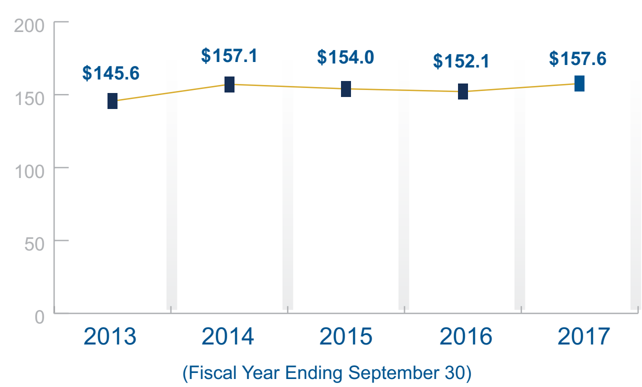
The Combined Statement of Budgetary Resources (SBR) presents total budgetary resources of $224 billion that were available to the DON during FY 2017 and the status of those resources at fiscal year-end. Total budgetary resources were up $6 billion, a 2.8% increase in FY 2017 compared to FY 2016. The enacted appropriations of $171.8 billion represent 76.7% of total budgetary resources and increase of $2.7 billion from FY 2016. The increase in total budgetary resources is attributable to the 1.6% appropriations increase. The DON obligated $185.3billion of the $224 billion total resources in FY 2017, which is an increase of $7.6 billion or 4.3% compared to FY 2016.

The Consolidated Statement of Net Cost (SNC) presents net cost of operations of $157.6 during FY 2017. Net cost of operations represents gross costs incurred by the DON less earned revenue. Net cost of operations increased $5.5 billion, which represents a 3.6% increase over FY 2016.

FY 2017 DON GF SOURCES OF FUNDS
($ in Billions)



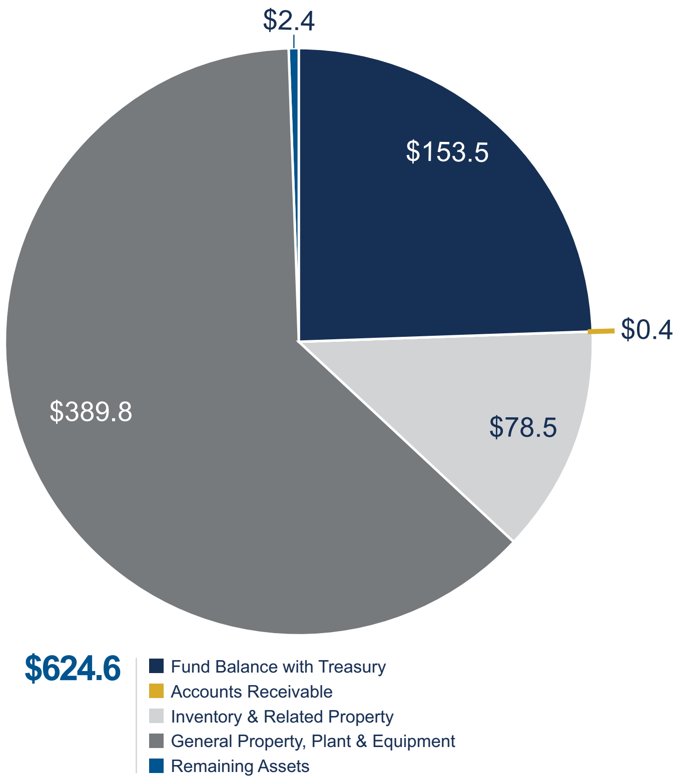
FY 2013 – 2017 DON GF NET COST OF OPERATIONS
($ in Billions)



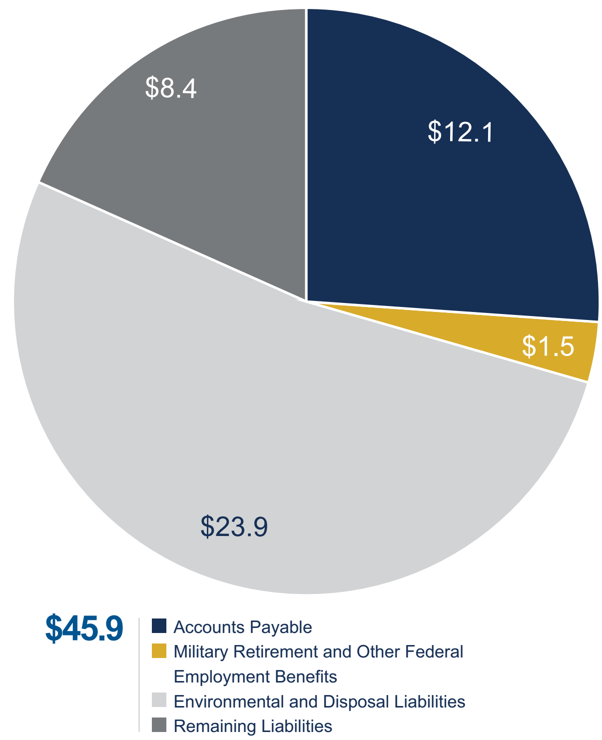
Financial Position

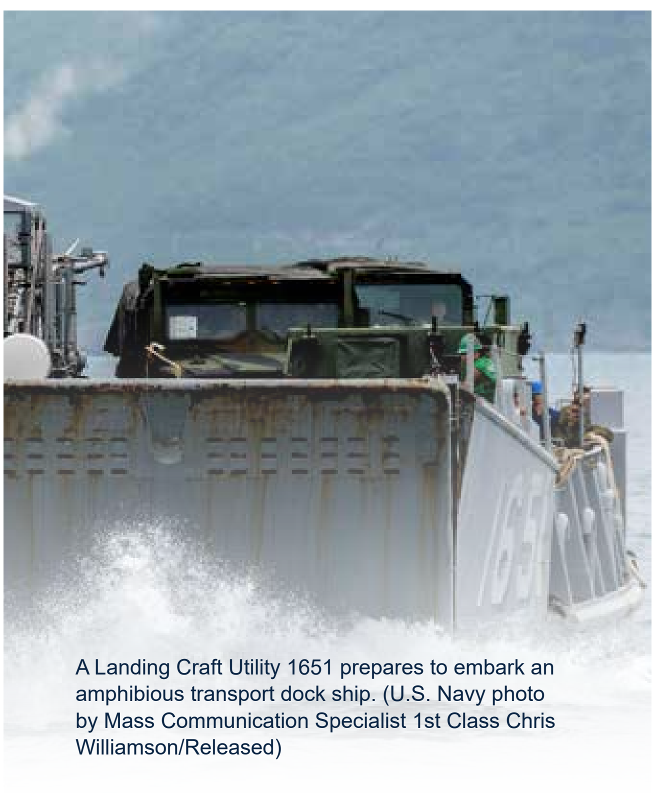
The DON continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets and total liabilities. As of September 30, 2017, net position totaled $578.7 billion compared to the September 30, 2016 net position of $565.3 billion. This represents a $13.4 billion or 2.4% increase from FY 2016.

FY 2017 DON GF TOTAL ASSETS
($ in Billions)



FY 2017 DON GF TOTAL LIABILITIES
($ in Billions)




A Landing Craft Utility 1651 prepares to embark an amphibious transport dock ship. (U.S. Navy photo by Mass Communication Specialist 1st Class Chris Williamson/Released)

Navy Working Capital Fund

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

NAVY WORKING CAPITAL FUND BUSINESS ACTIVITIES BY BUSINESS AREA

Supply Management
Supply Management, Navy
(https://www.navsup.navy.mil)

Supply Management, Marine Corps
(http://www.logcom.usmc.mil)

Depot Maintenance
Depot Maintenance, Aviation
(http://www.navair.navy.mil)

Depot Maintenance, Marine Corps
(http://www.logcom.usmc.mil)

Fleet Readiness Centers
(http://www.navair.navy.mil)

Base Support
Facilities Engineering Commands
(https://portal.navfac.navy.mil)

Naval Facilities Engineering Service Center
(https://portal.navfac.navy.mil)

Transportation
Military Sealift Command
(http://www.msc.navy.mil)

Research and Development
Naval Research Laboratory*
(http://www.nrl.navy.mil)

Naval Surface Warfare Center
(http://www.navsea.navy.mil)

Naval Undersea Warfare Center
(http://www.navsea.navy.mil)

Naval Air Warfare Center
(http://www.navair.navy.mil)

Space and Naval Warfare Systems Centers
(http://spawar.navy.mil)

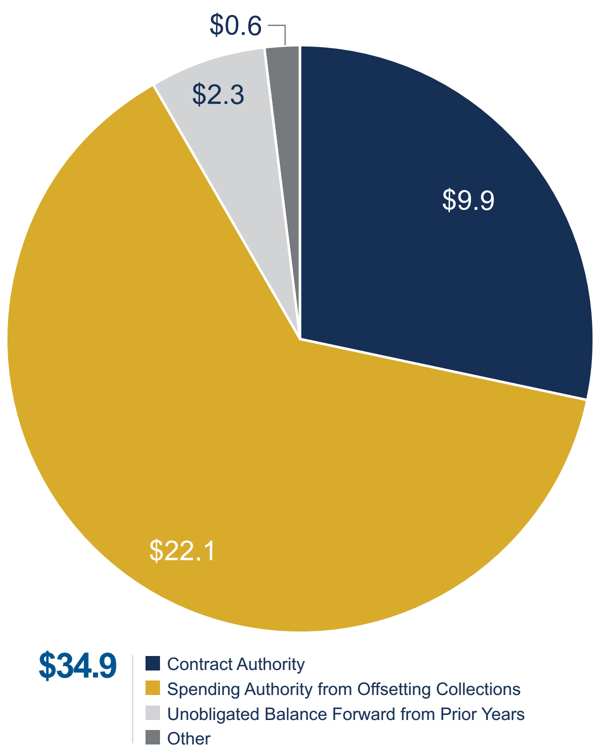
**Also see Office of Naval Research (http://www.onr.navy.mil)*

Results of Operations

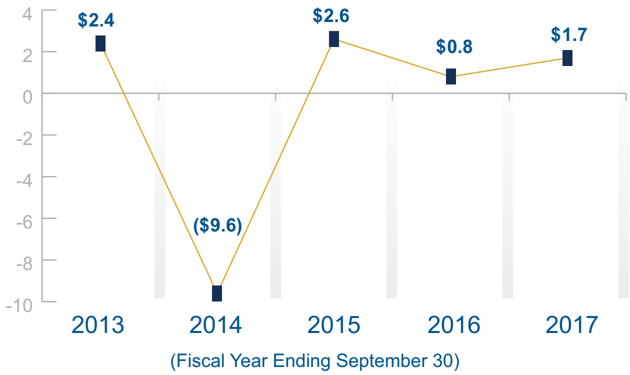
The Combined SBR presents total budgetary resources of $34.9 billion that were available to NWCF during FY 2017 and the status of those resources at fiscal year-end. Total budgetary resources increased $1.4 billion, which was a 4.2% increase over FY 2016. NWCF budget authority is comprised of contract authority and spending authority from offsetting collections of which the latter accounts for 63.3% of total budgetary resources. The majority of the increase in overall budget authority is due to a $0.5 billion increase in Contract Authority and $0.8 billion increase in spending authority from offsetting collections in FY 2017. NWCF business activities obligated $32 billion total resources in FY 2017, which represents an increase of $0.8 billion or 2.6% over FY 2016.

The Consolidated SNC presents net cost of operations of $1.7 billion during FY 2017. Net cost of operations represents gross costs incurred by the 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 $61.2 billion in net costs and $59.5 billion in earned revenue in FY 2017, which results in a positive net cost of operations.

FY 2017 NWCF SOURCES OF FUNDS
($ in Billions)



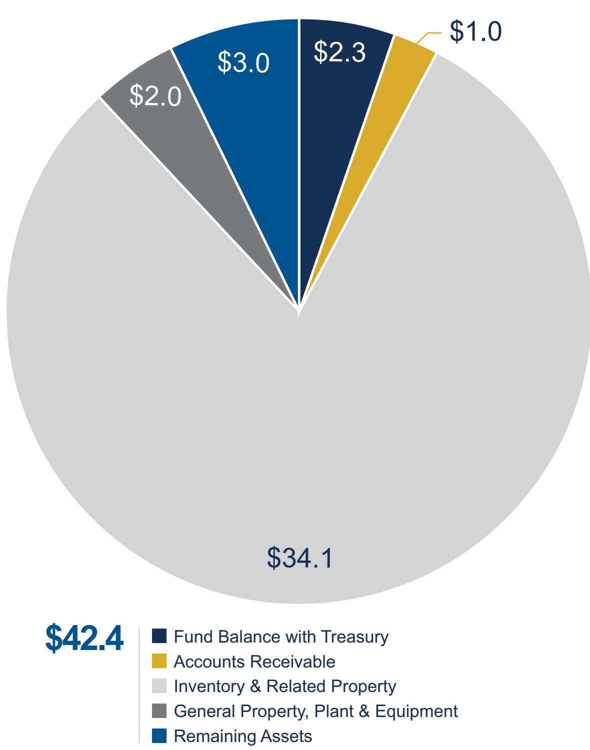
NWCF NET COST OF OPERATIONS, FY 2013 – 2017
($ in Billions)



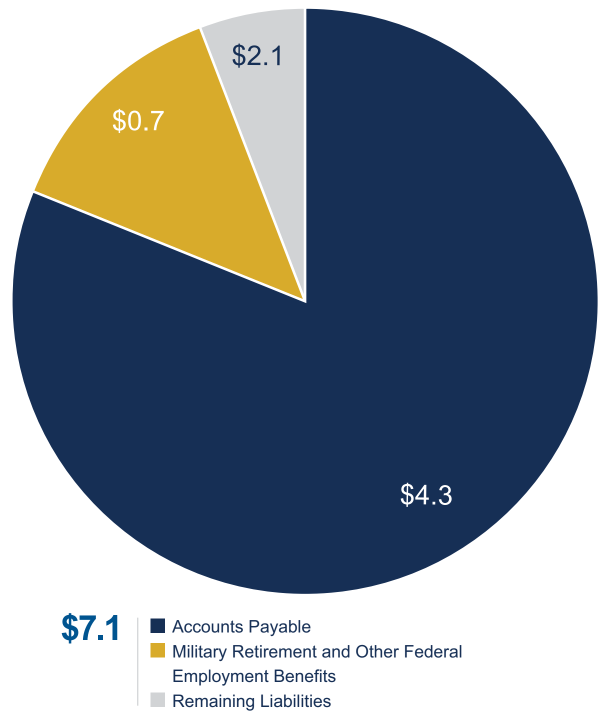
Financial Position

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, 2017, net position totaled $35.3 billion, which represents an increase of $1.4 billion and a 4.1% increase from FY 2016. An increase of $1.4 billion in total assets and no change in total liabilities contributed to the overall increase in net position.

FY 2017 NWCF TOTAL ASSETS
($ in Billions)



FY 2017 NWCF TOTAL LIABILITIES
($ in Millions)

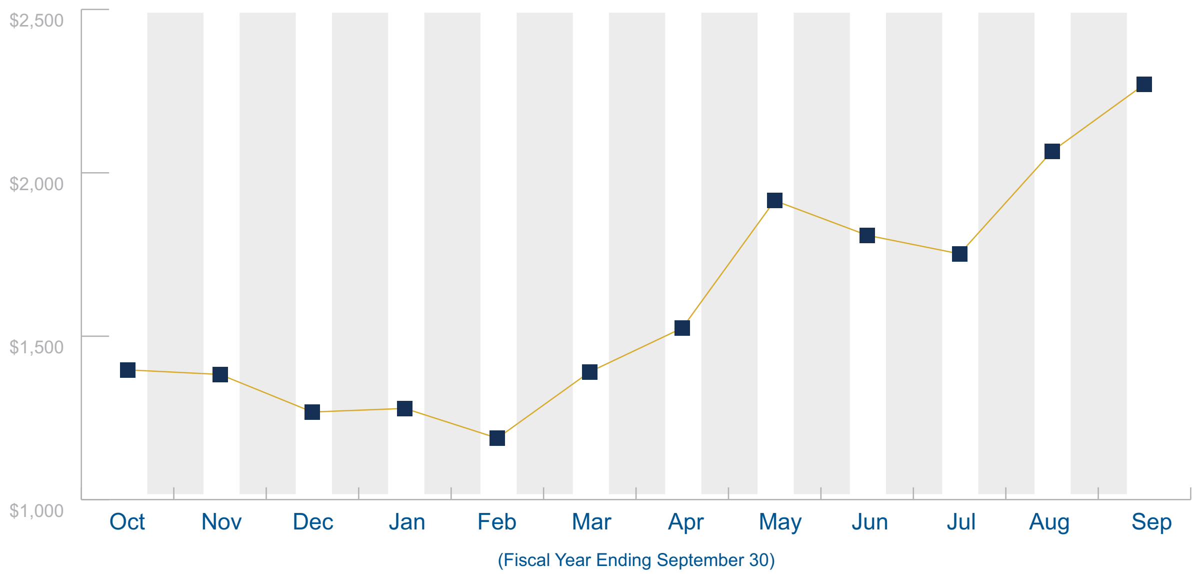


Cash Management

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 2017, the high cash requirement was $2.2 billion and the low cash requirement was $1.3 billion.

NWCF CASH BALANCES
OCTOBER 1, 2016 TO SEPTEMBER 30, 2017
($ in Millions)



Preparing to install a concrete column for a multipurpose building project (U.S. Navy photo by Construction Electrician 3rd Class Tyler Benvie/Released)

Sailors conduct flight operations aboard an aircraft carrier. (U.S. Navy photo by Mass Communication Specialist 2nd Class Rebecca Sunderland/Released)

LOOKING FORWARD

The DON's priorities in FY 2018 will focus on its workforce, continuing to improve war fighter readiness, and reforming processes to meet future challenges. 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

The DON's military personnel are the cornerstone of the Navy. The Navy will continue improving the quality of life for Sailors and Marines based on initiatives begun in prior years. In FY 2018, the DON will further invest in the Navy Sailor 2025 program which is comprised of three main efforts: 1) modernize personnel systems enabling more choices and transparency; 2) create a ready, relevant learning system that supports modern teaching initiatives; and 3) enhance career readiness initiatives that fosters and support empowerment and trust, resilience and health, and a work life balance that is inclusive and respectful of the diverse Navy. The DON offers a comprehensive package of pay and benefits that rewards personnel assigned to deployable units by providing increased sea pay, special and incentive pays for critical skill-sets, and compensation for Sailors and Marines underway for extended deployments. 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 achieve and maintain high standards to be ready for decisive operations and combat. DON civilian employees are essential to mission success. A key to readiness recovery and sustainment is the ability to grow the force as needed. In FY 2018, the DON will continue to increase engineering support at warfare centers for continued growth on platforms including the Joint Strike Fighter, *Columbia* Class Program, and unmanned systems. To invest in the workforce of the future, the DON has added FTEs for Science, Technology, Engineering, and Mathematics per Congressional direction. Additionally, the Department has increased personnel for cyber and tactical support at systems centers to confront the challenges of today's cyber warfare.

Readiness

In FY 2018, the DON will continue to build on its efforts to increase operational readiness and enable deployed forces to steam ships and fly aircraft. This includes maintaining support for Carrier Strike Groups, Amphibious Ready Groups, and Marine Expeditionary Forces to respond to persistent and emerging threats.

Observing well deck operations aboard an amphibious dock landing ship. (U.S. Navy photo by Mass Communication Specialist 2nd Class Kaleb R. Staples/Released)

These endeavors will enhance warfighter readiness, address pressing shortfalls, and increase lethality by mitigating gaps in combat power. The DON's continued investment in Facility Sustainment, Restoration, and Modernization (FSRM) is necessary to maintain shore installations supporting required capabilities in the Defense Strategic Guidance. The FSRM program maintains the working order of facilities inventory and prevents premature condition degradation of mission critical facilities. Additionally, by early FY 2018, the Vice Chief of Naval Operations will complete a comprehensive review of training, operational performance, mission standards, material readiness, and utility of current navigation equipment and combat systems. This comprehensive review aims to identify the root cause of the recent increase in surface fleet incidents and will include recommendations on corrective actions. These efforts all contribute to a ready Navy and Marine Corps that are forward postured to defeat and deter adversaries, support partners, and create decision space for national leaders.

Procurement

The DON will continue aggressive efforts to reduce acquisition costs, improve capability, and support the industrial base. The Navy's shipbuilding budget for FY 2018 procures eight battle force ships, including one *Ford* Class aircraft carrier; two *Virginia* Class submarines; two DDG 51 *Arleigh Burke* destroyers; one Littoral Combat Ship; one T-AO 205 oiler; and one T-ATS towing, salvage, and rescue ship. The FY 2018 budget includes key warfighting modernization efforts for manned and unmanned aircraft, Ground Combat Tactical Vehicles, Command and Control/Situational Awareness, Ground Radars, Digital Fires Support, and Training Systems. Modernization is essential to develop warfighting functions and is key to ensuring tomorrow's Sailors and Marines are equipped to outmatch anticipated future challenges.

Development

The DON's Research, Development, Test, and Evaluation program supports DON missions by providing 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 continues to be fundamental in areas such as the *Columbia* class submarine program, *Virginia* Payload Module, Electronic Development Model aircraft, unmanned systems, and electromagnetic warfare. In response to the accelerating rate of change in the global environment and landscape of potential threats, there is a critical need to improve agility in the development and delivery of warfighting capabilities to the Fleet. The FY 2018 budget provides for rapid prototyping in support of acquisition agility. Prototyping includes fast-tracked technology insertion initiatives and incremental prototype campaigns that deliver game-changing technology solutions to high priority warfighting needs and associated complex problems. Ongoing research and development efforts for the *Columbia* class submarine program will focus on the propulsion plant, common missile compartment development, and platform development technologies like the propulsor, Strategic Weapons System, and maneuvering/ship control. The Engineering and Manufacturing Development Phase of the VH-92A Presidential Helicopter continues in FY 2018 to include the integration of systems, production, qualification, and support of test articles; logistics products development; and demonstration of system integration, interoperability, safety, and utility. FY 2018 includes finalization of modification and delivery of two Electronic Development Model aircraft.


A guided-missile destroyer sits pierside. (U.S. Navy photo by Mass Communication Specialist 3rd Class Robert S. Price/Released)

Infrastructure

The mission of the Department could not be achieved without high quality facilities that support Sailors, Marines, and their families. The ability to rapidly deploy around the globe is directly connected to an effective shore infrastructure. In support of this, the Department's critical goals in FY 2018 include the financing of 35 military construction projects. Key tenets in the Department's facilities investment strategy for FY 2018 are as follows: Shipyard Improvements, Ordnance Recapitalization, Supporting New Systems, Depot Maintenance Recapitalization, Replacing Aging Infrastructure, and Force Relocations and Consolidations. The family housing budget includes the operation, maintenance, recapitalization, leasing, and privatization oversight of the Department's family housing worldwide and delivers the funding level necessary to provide safe and adequate housing either through the community or in government quarters.

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 support operations in Afghanistan, the Horn of Africa, and other locations in theater, as well the European Reassurance Initiative. Priorities for FY 2018 include sustaining operations and manpower, providing 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

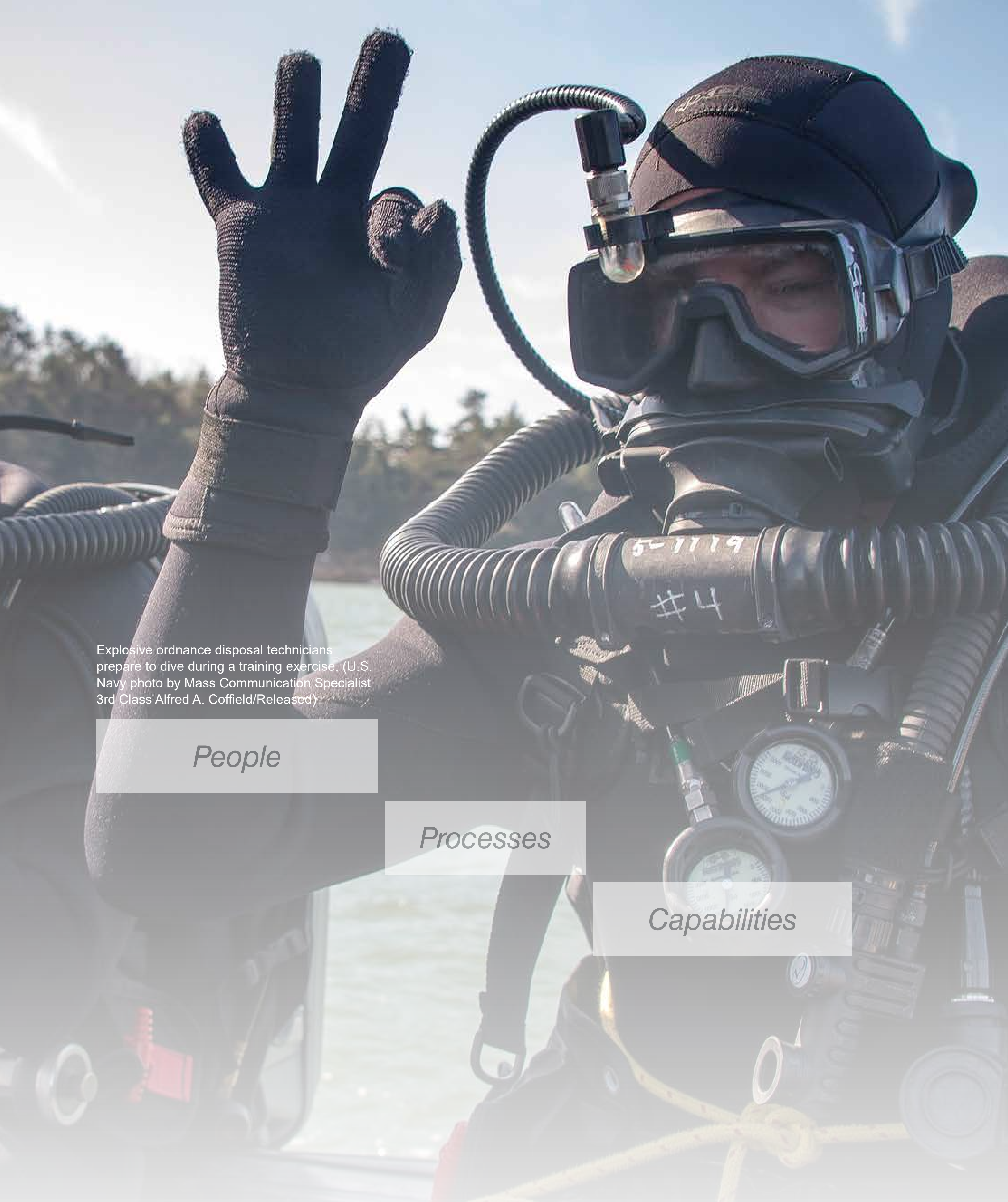
The DON will continue to realize savings in FY 2018. Some examples of these key saving initiatives include: Better Buying Power that provides acquisition cost savings for DDG-51, *Virginia* Class, and F-35s; Business Operations which delivers general and administrative overhead reductions at working capital fund activities; and personnel reductions which represent a continuation of management headquarters activity adjustments. The Department will continue to aggressively pursue opportunities to drive down the cost of doing business and is continually assessing existing business systems, evaluating dated organization structures, optimizing the force mix, and seeking bold ideas to maximize the use of taxpayer dollars. The goal is to drive innovative enterprise transformation to reduce spending on unnecessary overhead to preserve critical naval capabilities. These savings reflect better buying power through reevaluating modernization programs and enhancing contract competition, changes to business practices by organizational consolidations and eliminating duplication, information technology improvements through help desk consolidations and enterprises licenses, termination of underperforming or unneeded programs, tightening personnel costs, and reducing travel. The DON is increasing its momentum toward full auditability and achieving the Congressionally-established goal of undergoing an FY 2018 audit on all four of its financial statements. The Navy is using as a springboard the results of its FY 2015 and FY 2016 Schedules of Budgetary Activity audits and correcting the deficiencies identified. Presently, the Marine Corps is undergoing a full audit in advance of the FY 2018 deadline and is providing lessons learned to the Navy. Establishing an annual audit cycle is an essential step toward achieving a favorable audit opinion. Continual audit presence helps instill the corporate rigor and focus required to support the demanding audit pace while providing valuable insight for future business improvements.

Preparing to land aboard a guided-missile cruiser. (U.S. Navy photo by Mass Communication Specialist 2nd Class Kayla Cosby/Released)

An amphibious assault ship transits the Mediterranean Sea as seen from an MV-22B Osprey. (U.S. Navy photo by Lt. Sherrie Flippin/Released)

LIMITATIONS TO THE FINANCIAL STATEMENTS

The principal financial statements are prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). The statements are prepared from the books and records of the entity in accordance with federal generally accepted accounting principles and formats prescribed by the Office of Management and Budget. Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. Government.



Explosive ordnance disposal technicians prepare to dive during a training exercise. (U.S. Navy photo by Mass Communication Specialist 3rd Class Alfred A. Coffield/Released)

> *“A Department priority this year is to strengthen readiness and lay the foundation for future growth of the force.”*

JOSEPH B. MARSHALL, JR.

NOVEMBER 2017

I am pleased to present the Department of the Navy’s Annual Financial Report, *Accountability to America*, for fiscal year 2017. A Department priority this year is to strengthen readiness and lay the foundation for future growth of the force. The past few years have been challenging, with inconsistent and delayed funding, as well as a growing imbalance between operational demands placed on the force and the funding available to operate and sustain the force. Despite these challenges, the Navy has continued to maintain a strong global presence and deliver on its mission.

The Department continues to place high priority on financial improvement and audit readiness. A critical step in demonstrating sound stewardship of the funds we are entrusted with is to undergo a Full Financial Statement Audit in fiscal year 2018. Over the past few years, the Department has made significant progress in establishing the foundational competencies necessary to begin the audit. The establishment of these critical capabilities is the result of the hard work, dedication, and collaboration across the entire Navy.

Given the complexity and size of our operations, we anticipate that an unmodified audit opinion will be several years away. Although there is still work to be done, being under audit is the best tool. The audit will provide actionable feedback to continue transforming business processes, improving operations, and positively changing the way we do business. Standardizing our business processes and strengthening internal controls will help ensure financial data accurately reflects our business activities and minimize opportunities for the misuse of funds. It will also improve the visibility into the management of the billions of dollars that it takes to build, operate and maintain our naval forces. This transparency will allow us to better direct those funds consistent with the nation’s priorities.

It is imperative we know where every dollar is spent and incorporate innovative business practices to maximize the value of our investment. We cannot just spend more; we must spend wisely. The Department is committed to being excellent stewards of resources to ensure we deliver the maximum warfighting capability for every dollar provided by the American people.

Joseph B. Marshall, Jr.
Acting Assistant Secretary of the Navy
(Financial Management and Comptroller)

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

November 7, 2017

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 2017 and FY 2016 Basic Financial Statements (Project No. D2017-D000FS-0105.000, Report No. DODIG-2018-009)

Report on the Basic Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990," requires the DoD Inspector General to audit the accompanying Department of the Navy General Fund consolidated balance sheet as of September 30, 2017, and September 30, 2016, 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 accounting principles generally accepted in the United States of America (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 (GAGAS) and the Office of Management and Budget (OMB) Bulletin No. 17-03, "Audit Requirements for Federal Financial Statements," September 29, 2017. 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 GAGAS 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 2017 and FY 2016 Basic Financial Statements would not substantially conform to 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, 2017. We considered the scope limitation in forming our conclusions on the basic financial statements. Accordingly, we did not perform all the auditing procedures required by GAGAS and OMB Bulletin No. 17-03 to determine whether material amounts on the basic financial statements were presented fairly.

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 2017 and FY 2016 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 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," August 15, 2017, 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. The Department of the Navy 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 Assistant Secretary of the Navy (Financial Management and Comptroller) did not provide comments to the draft report.

This report will be made publicly available under section 8M, paragraph (b)(1)(A) of the Inspector General Act of 1978. 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. This report is not intended for, nor should it be used by, any other audience.

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

Lorin T. Venable

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's internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances and for expressing our opinion on the basic financial statements, but not for 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 and 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's 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 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.

- 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. The Department of the Navy standard document numbers may be altered as transportation transactions enter other Military Services' financial and transportation systems.

Transportation service providers and other Military 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 in tracing 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 required to support Transportation of Things transactions, management evaluations, and future examinations 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 year-end accruals, which could result in invalid or unauthorized transactions.

The Department of the Navy's financial management controls over the Statement of Budgetary Resources are not designed or operating effectively to provide reasonable assurance that balances related to commitments, obligations, de-obligations, undelivered orders, and unfilled customer orders are valid and recorded accurately.

Military Standard Requisitioning and Issue Procedures. The Department of the Navy's control environment is not designed 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 (valid) 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 U.S. 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.

The Department of the Navy is not able to generate a transactional level population to support the reported accounts payable balance at fiscal year-end. Additionally, the Department of the Navy does not have a process to record an estimated liability for goods and services incurred, but not yet invoiced by the vendor. Analysis indicates accounts payable may be materially understated.

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 problems 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 in the Department of the Navy's FMFIA report.

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

GAGAS 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 limited our work to determining compliance with selected provisions of the applicable laws, regulations, contracts, and grant agreements. Other noncompliance may have occurred and not been detected, and 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.

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 (ADA), the head of the agency must immediately report to the President and Congress all relevant facts and a statement of actions taken. During FY 2017, the Department of the Navy reported no ADA violations.

DoD Regulation 7000.14-R, "Financial Management Regulation," volume 14, chapter 7, "Antideficiency Act Report," establishes time frames for identifying and reporting ADA violations. The regulation states that the formal investigation and reporting on ADA violations should take no more than 15 months. Two investigations of potential ADA violations are open and one has been open for more than 15 months.

Compliance With FFMIA Requirements

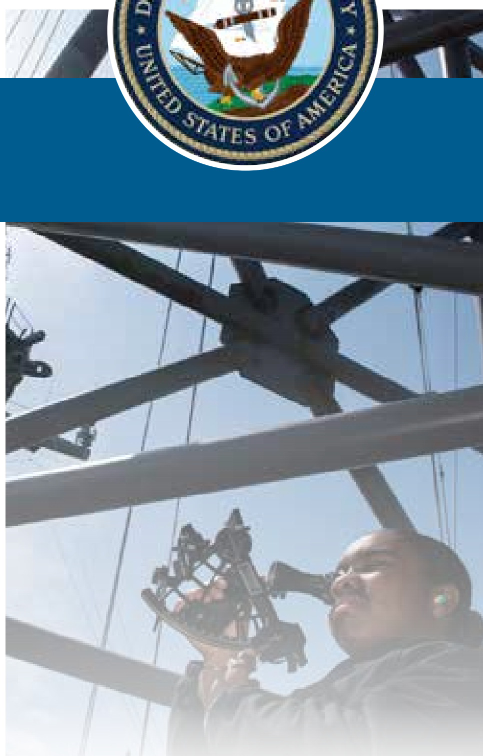
The FFMIA requires the Department of the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. For areas 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. Standard General Ledger at the transaction level.

Department of the Navy management states that the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to substantially comply with the Federal financial management systems requirements, U.S. generally accepted accounting principles, and the U.S. Standard General Ledger at the transaction level. The Department of the Navy has based its assessment on system requirements issued 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 2017, 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, or the U.S. Standard General Ledger at the transaction level as of September 30, 2017. 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 the 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.



A Quartermaster uses a sextant to determine the global position of an amphibious assault ship. (U.S. Navy photo by Mass Communication Specialist Seaman Apprentice Jesse Marquez Magallanes/Released)

PRINCIPAL STATEMENTS

DEPARTMENT OF THE NAVY GENERAL FUND

The fiscal year 2017 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, 2017, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2016.

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, 2017 and 2016
($ in Thousands)

	2017 Consolidated	2016 Consolidated
ASSETS:		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 153,450,180	$ 145,212,868
Investments (Note 4)	6,784	5,664
Accounts Receivable (Note 5)	330,582	181,481
Other Assets (Note 6)	695,255	580,268
Total Intragovernmental Assets	154,482,801	145,980,281
Cash and Other Monetary Assets (Note 7)	93,674	93,929
Accounts Receivable, Net (Note 5)	96,767	631,548
Inventory and Related Property, Net (Note 8)	78,527,486	81,577,809
General Property, Plant and Equipment, Net (Note 9)	389,805,674	362,367,317
Other Assets (Note 6)	1,623,411	8,675,162
TOTAL ASSETS	$ 624,629,813	$ 599,326,046
Stewardship Property, Plant and Equipment (Note 9) *		
LIABILITIES		
Intragovernmental:		
Accounts Payable (Note 11)	$ 1,246,970	$ 1,387,186
Other Liabilities (Note 13)	633,344	1,122,166
Total Intragovernmental Liabilities	1,880,314	2,509,352
Accounts Payable (Note 11)	10,819,851	348,127
Federal Employee and Veteran Benefits (Note 15)	1,478,171	1,460,768
Environmental and Disposal Liabilities (Note 12)	23,910,695	22,717,646
Other Liabilities (Note 13 & Note 14)	7,791,283	7,023,849
TOTAL LIABILITIES	45,880,314	34,059,742
Commitments and Contingencies (Note 14) *		
NET POSITION		
Unexpended Appropriations - Other Funds	$ 139,145,473	$ 148,179,076
Cumulative Results of Operations - Dedicated Collections	47,521	44,228
Cumulative Results of Operations - Other Funds	439,556,505	417,043,000
Net Position - Dedicated Collections	47,521	44,228
Net Position - Other Funds	578,701,978	565,222,076
TOTAL NET POSITION	$ 578,749,499	$ 565,266,304
TOTAL LIABILITIES AND NET POSITION	$ 624,629,813	$ 599,326,046

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, 2017 and 2016

($ in Thousands)

	2017 Consolidated	2016 Consolidated
Program Costs		
Gross Costs		
Military Personnel	$ 46,332,648	$ 45,970,073
Operations, Readiness, & Support	65,691,547	60,487,437
Procurement	31,483,301	35,141,110
Research, Development, Test, & Evaluation	17,463,644	16,456,987
Family Housing & Military Construction	1,834,311	1,570,367
Less: Earned Revenue	(5,203,815)	(7,527,243)
Net Cost of Operations	$ 157,601,636	$ 152,098,731

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Year Ended September 30, 2017
($ in Thousands)

	2017 Dedicated Collections	2017 Other Funds	2017 Eliminations	2017 Consolidated
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances	$ 44,228	$ 417,043,000	$ -	$ 417,087,228
Prior Period Adjustments:				
Changes in Accounting Principles	-	-	-	-
Corrections of Errors	-	-	-	-
Beginning Balances, as adjusted	44,228	417,043,000	-	417,087,228
Budgetary Financing Sources:				
Other Adjustments (Rescissions, etc.)	-	27,323	-	27,323
Appropriations Used	-	178,034,927	-	178,034,927
Non-exchange Revenue	188	-	-	188
Donations & Forfeitures of Cash & Cash Equivalents	38,158	753	-	38,911
Transfers-In/Out without Reimbursement	-	(1,929)	1,929	-
Other Financing Sources:				
Donations and Forfeitures of Property	-	-	-	-
Transfers-In/Out without Reimbursement	-	1,552,970	(1,929)	1,551,041
Imputed Financing from Costs Absorbed by Others	-	575,130	-	575,130
Other	-	(109,086)	-	(109,086)
Total Financing Sources	38,346	180,080,088	-	180,118,434
Net Cost of Operations	35,053	157,566,583	-	157,601,636
Net Change	3,293	22,513,505	-	22,516,798
Cumulative Results of Operations	$ 47,521	$ 439,556,505	$ -	$ 439,604,026
UNEXPENDED APPROPRIATIONS				
Beginning Balances	$ -	$ 148,179,076	$ -	$ 148,179,076
Budgetary Financing Sources:				
Appropriations Received	-	173,153,216	-	173,153,216
Appropriations Transferred-In/Out	-	615,393	-	615,393
Other Adjustments (Rescissions, etc.)	-	(4,767,285)	-	(4,767,285)
Appropriations Used	-	(178,034,927)	-	(178,034,927)
Total Budgetary Financing Sources	-	(9,033,603)	-	(9,033,603)
Unexpended Appropriations	-	139,145,473	-	139,145,473
Net Position	$ 47,521	$ 578,701,978	$ -	$ 578,749,499

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
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balances	$ 30,290	$ 345,149,425	$ -	$ 345,179,715
Prior Period Adjustments:				
Changes in Accounting Principles	-	(1,855,470)	-	(1,855,470)
Corrections of Errors	-	31,383,355	-	31,383,355
Beginning Balances, as adjusted	30,290	374,677,310	-	374,707,600
Budgetary Financing Sources:				
Other Adjustments (Rescissions, etc.)	-	-	-	-
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
Other Financing Sources:				
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)
Total Financing Sources	37,509	194,440,850	-	194,478,359
Net Cost of Operations	23,571	152,075,160	-	152,098,731
Net Change	13,938	42,365,690	-	42,379,628
Cumulative Results of Operations	$ 44,228	$ 417,043,000	$ -	$ 417,087,228
UNEXPENDED APPROPRIATIONS				
Beginning Balances	$ -	$ 182,429,593	$ -	$ 182,429,593
Budgetary Financing Sources:				
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)
Total Budgetary Financing Sources	-	(34,250,517)	-	(34,250,517)
Unexpended Appropriations	-	148,179,076	-	148,179,076
Net Position	$ 44,228	$ 565,222,076	$ -	$ 565,266,304

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2017 and 2016
($ in Thousands)

	2017 Combined	2016 Combined
Budgetary Resources:		
Unobligated Balance, Brought Forward, October 1	$ 40,314,288	$ 36,275,135
Recoveries of Prior Year Unpaid Obligations	7,595,616	8,060,027
Other Changes in Unobligated Balance	(2,745,369)	(2,256,062)
Unobligated Balance from Prior Year		
Budget Authority, Net	45,164,535	42,079,100
Appropriations	171,813,718	169,125,260
Spending Authority from Offsetting Collections	6,996,220	6,804,244
Total Budgetary Resources	$ 223,974,473	$ 218,008,604
Status of Budgetary Resources:		
New Obligations and Upward Adjustments (total)	$ 185,323,197	$ 177,694,316
Unobligated Balance, End of Year		
Apportioned, Unexpired Accounts	32,861,988	32,436,455
Exempt from Apportionment, Unexpired Accounts	29,203	1,671,491
Unapportioned, Unexpired Accounts	-	-
Unexpired Unobligated Balance, End of Year	32,891,191	34,107,946
Expired Unobligated Balances, End of Year	5,760,085	6,206,342
Total Unobligated Balance, End of Year	38,651,276	40,314,288
Total Status of Budgetary Resources	$ 223,974,473	$ 218,008,604
Change in Obligated Balance:		
Unpaid Obligations		
Unpaid Obligations, Brought Forward, October 1	$ 108,155,232	$ 107,370,622
New Obligations and Upward Adjustments (total)	185,323,197	177,694,316
Outlays, Gross	(167,627,469)	(168,849,679)
Recoveries of Prior Year Unpaid Obligations	(7,595,616)	(8,060,027)
Unpaid Obligations, End of Year, Gross	118,255,344	108,155,232
Uncollected Payments		
Uncollected Payments from Federal Sources, Brought Forward, October 1	(3,525,383)	(3,437,866)
Change in Uncollected Payments from Federal Sources	(281,921)	(87,517)
Uncollected Payments from Federal Sources, End of Year	(3,807,304)	(3,525,383)
Obligated Balance, Start of Year	104,629,849	103,932,756
Obligated Balance, End of Year	$ 114,448,040	$ 104,629,849
Budget Authority and Outlays, Net:		
Budget Authority, Gross	$ 178,809,938	$ 175,929,504
Actual Offsetting Collections	(6,717,712)	(6,723,315)
Change in Uncollected Payments from Federal Sources	(281,921)	(87,517)
Recoveries of Prior Year Paid Obligations	3,413	6,588
Budget Authority, Net	$ 171,813,718	$ 169,125,260
Outlays, Gross	$ 167,627,469	$ 168,849,679
Actual Offsetting Collections	(6,717,712)	(6,723,315)
Outlays, Net	160,909,757	162,126,364
Distributed Offsetting Receipts	(183,240)	(97,310)
Agency Outlays, Net	$ 160,726,517	$ 162,029,054

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) General Fund (GF), as required by the Chief Financial Officers 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 (U.S. GAAP) 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 related to classified assets, programs, and operations is 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 collects information from the financial systems 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 for incorporation into the financial statements. DFAS collects and incorporates additional financial information from multiple sources, such as intragovernmental trading partner data. The Defense Departmental Reporting System Data Collection Module (DDRS-DCM) captures certain required financial information from nonintegrated systems for the DON financial statements.

The DON is unable to fully implement all elements of U.S. GAAP 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 from both financial and nonfinancial systems. The nonfinancial systems were designed primarily to support reporting requirements for maintaining accountability over assets rather than preparing financial statements in accordance with U.S. GAAP. The DON continues to implement process and system improvements to address these limitations.

The DON GF currently has 11 financial statement areas with material weaknesses: (1) Fund Balance with Treasury, (2) Financial Reporting Compilation, (3) Military Pay, (4) Accounts Payable, (5) Contract/Vendor Pay, (6) Reimbursable Work Orders, (7) Transportation of Things, (8) Equipment Assets, (9) Real Property Assets, (10) Operating Materials and Supplies, and (11) Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures).

1.B. Mission of the Reporting Entity

The DON was established 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.

1.C. Appropriations and Funds

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

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

Revolving fund accounts are funds authorized by specific provisions of law financed by a corpus through an appropriation or a transfer to perform a continuing cycle of operations through the sales of goods and services without fiscal year limitations.

The National Defense Sealift Fund is the DON General Fund's only revolving fund. This unique fund receives annual appropriations expiring after 5 years and the revenues generated from the sales of goods and services do not expire.

Trust fund accounts 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 receipts reserved for a specific purpose, such 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 fund accounts are used to record monies held temporarily where the DON is acting as an agent or a custodian for funds awaiting distribution 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 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; activities for these funds are reported separately from the DON financial statements and reported to the parent.

Additionally, the DON receives allocation transfers from the following Security Assistance programs: Foreign Military Financing Program and the International Military Education and Training Program. While these funds meet the OMB exception for EOP funds, they are reported separately from the DON's financial statements based on an agreement with OMB.

As the parent, the DON provides allocation transfers to the Federal Highway Administration and all related activity is reported in the DON's financial statements.

1.D. Basis of Accounting

The DON's financial management systems are unable to meet 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 U.S. GAAP. 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 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 U.S. GAAP. 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's financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by U.S. GAAP, 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.

1.E. Revenues and Other Financing Sources

The DON receives congressional appropriations as financing sources for general funds, and on occasion, receives congressional appropriations for Working Capital Funds. These funds are available for one year, multiple years, or indefinitely. When authorized by legislation, these appropriations are supplemented with 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 receive value in return.

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, environmental liabilities, FECA liabilities, environmental liabilities, and unbilled revenue. 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, some 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

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, as 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 that will incorporate 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 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; and (3) losses in litigation proceedings.

The DoD's proportionate share of public debt and related expenses of the federal government is not included within the DoD's financial statements. The federal government does not apportion debt and its related costs to federal agencies. 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, as the U.S. Treasury does not allocate such costs to DoD. Accordingly, 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.

1.H. Transactions with Foreign Governments and International Organizations

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, the 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

The DON's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of 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 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, the DON's FBWT is reviewed and adjusted, as required, to agree with the U.S. Treasury accounts. Refer to Note 3, "Fund Balance with Treasury," for additional information.

1.J. Cash and Other Monetary Assets

Cash resources under the control of the DoD include 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 its 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 and 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 uncollectible amounts are based on an individual account analysis and group analysis. The analysis is based on three years of receivable data. The DON uses non-intragovernmental data to determine the historical percentage of collections in each age category of public receivables.

The DON does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims for accounts receivable against other federal agencies are resolved 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. 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. In accordance with SFFAS No. 3, under the consumption method, the DON capitalizes OM&S upon purchase and expenses it when it is used. Under the purchase method, materiel and supplies are expensed when purchased. DON Budget Submitting Offices (BSO) use the Consumption Method unless the 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 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), Standard Price (SP), Historical Cost (HC), 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.

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

The DON reports investments in accordance with SSFAS 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 the Fiscal Service. 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

The DON 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." The DON capitalizes assets when it has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization thresholds. The DON capitalizes improvements to existing general PP&E assets if the improvement equals or exceeds the capitalization threshold, extends the useful life of the underlying asset or increases the size, efficiency, or capacity of the asset. The DON depreciates all general PP&E, other than land, on a straight-line basis in accordance with SFFAS No. 6.

The DON uses several capitalization thresholds for its general PP&E. For all general fund assets acquired or developed after October 1, 2013, the DON uses a $1 million threshold for General Equipment (with the exception of the USMC, who uses $100 thousand) and $250 thousand for Real Property and Internal Use Software. For general fund assets acquired prior to October 1, 2013, the DON used a threshold of $100 thousand for General Equipment and $20 thousand for Real Property.

Due to long standing financial system deficiencies, the DON uses a combination of actual expenditure data, program funding, and cost factors to estimate the value of general PP&E in accordance with SFFAS No. 35, "Estimating the Historical Cost of General Property, Plant and Equipment." The DON is developing a process to track and record actual general PP&E costs in accordance with SFFAS Nos. 6 and 10. 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.

When it is in the best interest of the government, the DON provides government property to contractors to complete contract work. The DON owns such property and provides it to the contractor, or it is purchased directly by the contractor for the government. The Federal Acquisition Regulations (FAR) requires the DON to maintain information on all property furnished to contractors in its property systems. In addition, the DON is not fully compliant with these requirements and is in the process of developing a business process to record and track all contractor held property in DON accountable property systems of records (APSR).

1.O. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy as prescribed in SSFAS No. 1 is to record advances or prepayments in accordance with U.S. GAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense or properly classify assets when the related goods and services are received. The DON has not fully 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 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 the USSGL at the transaction level.

1.P. Leases

In accordance with SSFAS 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. As the lessee, the DON receives the use and possession of leased property, such as 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 are the largest component of operating leases, and pricing is based on costs gathered from existing leases, General Services Administration (GSA) bills, and interservice support agreements. Future year lease payment projections are based on the Consumer Price Index.

1.Q. Other Assets

Other assets include military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on the DON's Balance Sheet. The DON maintains this classification in accordance with SSFAS 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 oversea 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. The Defense FAR 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

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

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. 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. Nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. Additionally, the

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

The DON reports unused military, compensatory, and civilian annual leaves 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

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

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

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 the DON's accounts payable and receivable trial balances prior to validating 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 or 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

Fiduciary cash and other assets are not assets of the DON and are not recognized in the financial statements; however, they are reported on Note 21, "Fiduciary Activities."

1.X. Federal Employee and Veterans' Benefits

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 such, the DON does not record any liabilities or obligations for pensions or healthcare retirement benefits.

NOTE 2. NONENTITY ASSETS

As of September 30	2017	2016
(Amounts in thousands)		
Intragovernmental Assets		
Fund Balance with Treasury	$ 345,287	$ 253,241
Nonfederal Assets		
Cash and Other Monetary Assets	93,675	93,929
Accounts Receivable	100,676	528,056
Total Nonentity Assets	539,638	875,226
Total Entity Assets	624,090,175	598,450,820
Total Assets	$ 624,629,813	$ 599,326,046

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

Intragovernmental Assets - Fund Balance with Treasury
This nonentity asset category primarily represents amounts in the DON's Civilian Employee Allotments Account, Thrift Savings Plan, and Withheld State and Local Taxes Fund.

Nonfederal Assets - 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 the DON disbursing officers on behalf of other agencies and are not available for the DON's use in normal operations.

Nonfederal Assets - Accounts Receivable (Public)
The primary component of nonentity accounts receivable is contractor debts owed to cancelled general fund accounts. The balance also includes out-of-service employee debts owed to cancelled general fund accounts, and interest, penalty, and administrative charges for all other public debts. As debts are repaid, they are deposited to Treasury Miscellaneous Receipts.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30	2017	2016
(Amounts in thousands)		
Fund Balances		
Appropriated Funds	$ 152,993,284	$ 144,758,375
Revolving Funds	58,046	140,877
Trust Funds	39,972	37,854
Special Funds	2,350	2,360
Other Fund Types	356,528	273,402
Total	$ 153,450,180	$ 145,212,868

Other

As of September 30	2017	2016
(Amounts in thousands)		
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	$ 153,445,085	$ 145,279,120
Fund Balance per DON	153,450,180	145,212,868
Reconciling Amount	$ (5,095)	$ 66,252

The DON Fund Balance above consists of Appropriated Funds, Revolving Funds, Trust Funds, Special Funds, and Other Fund Types. Other Fund Types is comprised of receipt accounts and deposit funds, which temporarily hold funds for distribution to another fund or entity or represent funds held by the DON as an agent for others. Additionally, Other

Fund Types includes budget clearing (suspense) accounts, which are used to temporarily hold unidentifiable general, special, or trust fund expenditures or collections that belong to the federal government.

The total reconciling amount of $5.1 million in FBWT is due to saving deposit program accounts and parent-child transactions. The Fund Balance with Treasury line does not include amounts in the DON's savings deposit accounts. Additionally, the DON adjusts to recognize allocation amounts in instances where funds are not included in Treasury (i.e., the DON is the parent) or instances where funds are not included in the DON Fund Balance (i.e., where the DON is the child). See Note 21, "Fiduciary Activities," for additional information regarding the deposit funds.

The Fund Balance per DON includes undistributed disbursements and collections. The DON field-level GL accounting systems may not include all Treasury collection and disbursement activity due to timing differences and disbursements made by other DoD agencies on behalf of the DON. The DON recorded adjustments totaling $1.2 billion in FY 2017 to compensate for these differences. Due to financial system limitations, the DON performs manual reconciliations after the period-end close to categorize these adjustments as supported and unsupported.

Status of Fund Balance with Treasury

As of September 30	2017	2016
(Amounts in thousands)		
Unobligated Balance		
Available	$ 32,891,192	$ 34,107,946
Unavailable	5,761,195	6,207,329
Obligated Balance not yet Disbursed	118,255,343	108,155,231
Non-Budgetary FBWT	356,528	273,402
Non-FBWT Budgetary Accounts	(3,814,078)	(3,531,040)
Total	$ 153,450,180	$ 145,212,868

The Status of 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 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. Separately, Non-FBWT Budgetary Accounts reduce 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.

Deposit & Clearing (Suspense) Accounts

As of September 30	2017	2016
(Amounts in thousands)		
Fund Balances Per Treasury Versus Agency		
17F3875.001 Budget Clearing Account	$ 3,284	$ 13,970
17F3875.002 Budget Clearing Account	49,283	45,912
17F3875.004 Treasury Suspense Account	(1,517)	(43,367)
17F3880.000 Unavailable Check Cancellations and Overpayments	4,096	2,314
17F3882 Thrift Savings Plan	(930)	53,604
17F3885.000 Intragovernmental Payment and Collection -Interfund	(2,216)	(246)
17F3885.007 Intragovernmental Payment and Collection -IPAC	(41,689)	1,578
17F3886 Thrift Savings Plan	(1)	-
Total	$ 10,310	$ 73,765

The table above reflects budget clearing (suspense) accounts that are assigned to the DON.

NOTE 4. INVESTMENTS AND RELATED INTEREST

As of September 30	2017			
(Amounts in thousands)	Cost	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	$ 6,771	$ 2	$ 6,773	$ 6,770
Accrued interest	11	-	11	11
Total	$ 6,782	$ 2	$ 6,784	$ 6,781

As of September 30	2016			
(Amounts in thousands)	Cost	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	$ 5,656	$ 3	$ 5,659	$ 5,662
Accrued Interest	5	-	5	5
Total	$ 5,661	$ 3	$ 5,664	$ 5,667

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	2017		
(Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 330,582	$ -	$ 330,582
Nonfederal Receivables (From the Public)	122,997	(26,230)	96,767
Total	$ 453,579	$ (26,230)	$ 427,349

As of September 30	2016		
(Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 181,481	-	$ 181,481
Nonfederal Receivables (From the Public)	637,927	(6,379)	631,548
Total	$ 819,408	$ (6,379)	$ 813,029

Accounts Receivable represents the DON'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. 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." The decrease in Accounts Receivable, Net from FY 2016 to FY 2017 was primarily driven by the settlement of the A-12 Avenger II aircraft program claims. Refer to Note 2, "Nonentity Assets," for additional information on Nonfederal Accounts Receivable.

NOTE 6. OTHER ASSETS

As of September 30	2017	2016
(Amounts in thousands)		
Intragovernmental Other Assets		
Advances and Prepayments	$ 695,255	$ 580,268
Outstanding Contract Financing Payments	1,452,375	8,436,660
Advances and Prepayments	162,745	232,036
Other Assets (With the Public)	8,291	6,466
Total Nonfederal Other Assets	1,623,411	8,675,162
Total	$ 2,318,666	$ 9,255,430

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)

Nonfederal Other Assets - OCFP consist of 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 do not 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, the DON is unable to identify these payments due to system limitations, thus all amounts are reported as OCFP.

During FY 2017, as a result of efforts to improve the financial reporting of other asset balances, the DON recorded a reclassification of the OCFP balance to CIP and expenses, which reduced the OCFP balance by $7.7 billion as compared to FY 2016. 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 of $1.1 billion were recorded during FY 2017 to reclassify Advances and Prepayments to CIP related to Shipbuilding and Conversion. Accounting processes were changed to record future Shipbuilding and Conversion costs to CIP. OCFP of $1.5 billion represents estimated future contract financing payments payable to contractors upon future delivery and government acceptance.

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	2017	2016
(Amounts in thousands)		
Cash	$ 60,104	$ 64,929
Foreign Currency	33,570	29,000
Total	$ 93,674	$ 93,929

Cash and Foreign Currency consist primarily of cash held by the 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 the 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	2017	2016
(Amounts in thousands)		
Inventory, Net	$ -	$ -
Operating Material & Supplies, Net	78,527,486	81,577,809
Total	$ 78,527,486	$ 81,577,809

Inventory and Related Property

As of September 30 — **2017**

(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use	$ 62,255,918	$ -	$ 62,255,918	SP, LAC, MAC
Held for Repair	16,271,568	-	16,271,568	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,010,154	(1,010,154)	-	NRV
Total	$ 79,537,640	$ (1,010,154)	$ 78,527,486	

As of September 30 — **2016**

(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
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
Total	$ 82,557,198	$ (979,389)	$ 81,577,809	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost NRV = Net Realizable Value SP = Standard Price MAC = Moving Average Cost

Inventory and Related Property

As of September 30 — **2017**

(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use				
Ordinance	$ 31,680,038	$ -	$ 31,680,038	MAC
Uninstalled Aircraft Engines	2,309,620	-	2,309,620	LAC, HC
Remainder	28,266,260	-	28,266,260	LAC, MAC
Total Held for Use	62,255,918	-	62,255,918	
Held For Repair				
Ordinance	6,705,178	-	6,705,178	MAC
Uninstalled Aircraft Engines	4,035,441	-	4,035,441	LAC, HC
Remainder	5,530,949	-	5,530,949	LAC, MAC
Total Held for Repair	16,271,568	-	16,271,568	
Excess, Obsolete, and Unserviceable				
Ordinance	811,607	(811,607)	-	NRV
Uninstalled Aircraft Engines	149,245	(149,245)	-	NRV
Remainder	49,302	(49,302)	-	NRV
Total Excess, Obsolete, and Unserviceable	1,010,154	(1,010,154)	-	
Total	$ 79,537,640	$ (1,010,154)	$ 78,527,486	

As of September 30 — **2016**

(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use				
Ordinance	$ 30,839,841	$ -	$ 30,839,841	MAC
Uninstalled Aircraft Engines	2,855,753	-	2,855,753	LAC, HC
Remainder	31,886,624	25,286	31,911,910	LAC, MAC
Total Held for Use	65,582,218	25,286	65,607,504	
Held For Repair				
Ordinance	6,604,735	-	6,604,735	MAC
Uninstalled Aircraft Engines	3,679,409	-	3,679,409	LAC, HC
Remainder	5,686,161	-	5,686,161	LAC, MAC
Total Held for Repair	15,970,305	-	15,970,305	
Excess, Obsolete, and Unserviceable				
Ordinance	784,967	(784,967)	-	NRV
Uninstalled Aircraft Engines	146,827	(146,827)	-	NRV
Remainder	72,881	(72,881)	-	NRV
Total Excess, Obsolete, and Unserviceable	1,004,675	(1,004,675)	-	
Total	$ 82,557,198	$ (979,389)	$ 81,577,809	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost   NRV = Net Realizable Value   HC = Historical Cost   MAC = Moving Average Cost

All DON inventory is funded and reported under the Navy Working Capital Fund (NWCF). Refer to NWCF Note 7, "Inventory and Related Property," for additional information.

OM&S includes assets to be consumed in the normal course of operations or as part of a larger asset assembly. The DON classifies its OM&S in three categories: Ordnance (such as ammunition, conventional missiles, torpedoes), centrally managed Uninstalled Aircraft Engines, and all other OM&S ("Other"). The "Other" OM&S includes sponsor funded uninstalled modification kits, spares and repair parts for major end items (ships, aircraft, tanks), and clothing, textiles, and petroleum products.

The DON assigns OM&S to categories based upon the type and condition of the asset in accordance with SFFAS No. 3, "Accounting for Inventory and Related Property." The DON categorizes its OM&S as Held for Use, Held for Repair, and Excess, Obsolete, and Unserviceable. 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. All other OM&S is classified as Held for Use.

SFFAS No. 3 requires disclosure of the amount of OM&S Held for "Future Use." The DON held $7.2 billion and $6.7 billion of OM&S for future use, which is included in the "Held for Use" category as of September 30, 2017 and September 30, 2016, 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.

There are no restrictions on the use of OM&S.

NOTE 9. GENERAL PROPERTY, PLANT AND EQUIPMENT (PP&E), NET

As of September 30 — **2017**

(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 531,931	$ -	$ 531,931
Buildings, Structures, and Facilities	S/L	20 or 40	157,426,745	(119,599,723)	37,827,022
Leasehold Improvements	S/L	lease term	6,530	(6,530)	-
Software	S/L	2-5 or 10	20,285	(6,800)	13,485
General Equipment:					
Vessels	S/L	20-50	305,356,609	(138,872,388)	166,484,221
Aircraft	S/L	15-30	150,647,315	(70,854,314)	79,793,001
Satellites	S/L	10-15	12,332,990	(9,383,478)	2,949,512
Trident Missiles	S/L	25	4,658,764	(2,661,592)	1,997,172
General Equipment-Remainder	S/L	Various	40,544,842	(30,926,778)	9,618,064
Total General PP&E			513,540,520	(252,698,550)	260,841,970
Construction-in-Progress	N/A	N/A	79,287,908	-	79,287,908
Other	N/A	N/A	11,303,358	-	11,303,358
Total General PP&E			$ 762,117,277	$ (372,311,603)	$ 389,805,674

As of September 30 — **2016**

(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
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:					
Vessels	S/L	20-50	281,447,297	(143,132,472)	138,314,825
Aircraft	S/L	15-30	145,058,774	(69,436,960)	75,621,814
Satellites	S/L	10-15	13,365,679	(9,494,191)	3,871,488
Trident Missiles	S/L	25	4,659,968	(2,447,907)	2,212,061
General Equipment-Remainder	S/L	Various	38,211,889	(29,157,847)	9,054,042
Total General PP&E			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
Total General PP&E			$ 727,184,400	$ (364,817,083)	$ 362,367,317

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

The DON General PP&E is comprised of General Equipment, Real Property (Land and Buildings, Structures, and Facilities), Improvements to Assets Under Leasehold Improvements, Internal Use Software, and Construction in Progress (both Real Property and General Equipment). The DON further segments its General Equipment into Vessels, Aircraft, Trident Missiles, Satellites, and Other Long-lived Tangible Equipment ("Other").

"Other" General PP&E consists of Real Property held in Caretaker Status. Caretaker is defined as those properties that DON still owns but are 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 the DON continued use of these properties until the treaties expire. There are no other known restrictions on general PP&E.

Significant accounting adjustments have been made to the DON's mission critical assets PP&E 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.

Specifically, in FY 2017, the DON revalued its historical Vessels and Real Property balances. For Vessels, the DON utilized a combination of historical budgetary information and "like-kind" purchases to revalue its recorded vessels balances. The use of these valuation methods resulted in an increase of the net book value of Vessels by $20.4 billion. Also, during this revaluation review, the DON wrote off net book value of $4.6 billion due to correction of errors in the prior year related to balances which could not be properly associated to specific vessels. The DON also placed in service new Vessels with a net book value of $16.1 billion during FY 2017.

For Real Property, the DON utilized the Plant Replacement Value (PRV) methodology to estimate the value of its financially reportable Real Property assets. PRV resulted in a net book value of Buildings and Structures of $37.8 billion. Adjustments to Construction in Progress included $6.8 billion from accrued Accounts Payable, which represents goods, services, and costs incurred but not invoiced.

Heritage Assets

As of September 30	Measure Quantity	As of September 30, 2016	Additions	Deletions	As of September 30, 2017
Building and Structures	Each	10,035	384	-	10,419
Archaeological Sites	Each	18,534	-	-	18,534
Museum Collection Items (Objects, Not Including Fine Art)	Each	536,157	9,109	11,780	533,486
Museum Collection Items (Objects, Fine Art)	Each	43,707	160	198	43,669

As of September 30		As of September 30, 2016	Additions	Deletions	As of September 30, 2017
Stewardship Land (Acres in thousands)					
Facility Code	**Facility Title**				
9110	Government Owned Land	1	-	1	-
9111	State Owned Land	1	-	1	-
9120	Withdrawn Public Land	2,779	1	227	2,553
9130	Licensed and Permitted Land	23	-	-	23
9140	Public Land	5	-	-	5
				Grand Total	2,581
				TOTAL - All Other Lands	(23)
				TOTAL - Stewardship Lands	2,558

Heritage Assets and Stewardship Land

SFFAS No. 29, "Heritage Assets and Stewardship Land," requires note disclosures for these types of assets. The 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, historical artifacts, art, ships, aircraft, installation and stewardship land, and other cultural resources. 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 heritage asset and cultural resources stewardship.

Heritage assets provide an invaluable window into, and often irreplaceable evidence for, the history and material culture of the Navy and Marine Corps.

Heritage assets within the DON consist of buildings and structures, and museum-type 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. This also includes sunken military craft (as defined by the Sunken Military Craft Act), which are managed as 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-type Collection Items. Art and artifacts that have been formally accessioned into a DON collection for the purpose of display or exhibition.

Heritage assets receive such designation, and have such designation withdrawn, through the accessioning and deaccessioning procedures for DON collections, or through evaluation in compliance with the National Historic Preservation Act. Designation is in accordance with the standards articulated with the collection scopes and collecting plans, or by application of the criteria of the National Register of Historic Places.

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, 2017.

For additional information on heritage assets deferred maintenance and repairs, refer to the Required Supplementary Information (RSI) section.

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30	2017	2016
(Amounts in thousands)		
Intragovernmental Other Liabilities	$ 346,120	$ 370,197
Nonfederal Liabilities		
Accounts Payable	(216,161)	(113,241)
Federal Employee and Veteran Benefits	1,476,831	1,459,377
Environmental and Disposal Liabilities	23,910,695	22,717,646
Other Liabilities	4,176,454	3,474,702
Total Liabilities Not Covered by Budgetary Resources	29,693,939	27,908,681
Total Liabilities Covered by Budgetary Resources	16,186,375	6,151,061
Total Liabilities	$ 45,880,314	$ 34,059,742

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.

Federal Liabilities
Intragovernmental Liabilities consist of unfunded 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 DON'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, "Federal Employee and Veterans' Benefits," for additional information.

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

Other Nonfederal Liabilities includes 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 — **2017**

(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 1,246,970	$ -	$ 1,246,970
Nonfederal Payables (to the Public)	10,819,851	-	10,819,851
Total	$ 12,066,821	$ -	$ 12,066,821

As of September 30 — **2016**

(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 1,387,186	$ -	$ 1,387,186
Nonfederal Payables (to the Public)	348,082	45	348,127
Total	$ 1,735,268	$ 45	$ 1,735,313

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. During FY 2017, the DON changed its methodology to account for the seller-side accounts receivable. The accounts payable entry was previously recorded as a reclassification between federal and nonfederal accounts payable and is now recorded as an accrual entry to federal accounts payable.

Additionally, the DON implemented an accrual estimation methodology that led to an adjustment to nonfederal accounts payable of $9.2 billion. This adjustment was completed to record the estimated amount of cost incurred and goods or services received but not invoiced.

NOTE 12. ENVIRONMENTAL AND DISPOSAL LIABILITIES

As of September 30	2017	2016
(Amounts in thousands)		
Environmental Liabilities–Nonfederal		
Accrued Environmental Restoration Liabilities		
Active Installations - Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 3,494,926	$ 3,429,145
Active Installations - Military Munitions Response Program (MMRP)	2,129,180	2,185,945
Other Accrued Environmental Liabilities - Non-BRAC		
Environmental Corrective Action	142	520
Environmental Closure Requirements	290,457	480,455
Asbestos	249,472	305,214
Non-Military Equipment	3,740	-
Base Realignment and Closure Installations		
Installation Restoration Program	1,464,280	1,464,018
Military Munitions Response Program	128,880	95,886
Environmental Corrective Action / Closure Requirements	4,240	7,223
Environmental Disposal for Military Equipment / Weapons Programs		
Nuclear Powered Military Equipment / Spent Nuclear Fuel	15,790,822	14,546,847
Other Weapons Systems	354,556	202,393
Total	$ 23,910,695	$ 22,717,646

The DON EDL reports the estimated environmental clean-up or disposal costs for hazardous waste associated with future closure of general PP&E assets. Such costs are categorized as operational range contamination, asbestos abatement, and disposal of nonmilitary equipment. However, the Navy does not have active ranges with off-site migration therefore does not have a liability for Environmental Response at Operational Ranges.

Applicable Laws and Regulations for Cleanup Requirements

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

- The Resource Conservation and Recovery Act of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984
- 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 of 1980
- Medical Waste Tracking Act of 1988
- Toxic Substances Control Act of 1976
- Resource Conversation and Recovery Act of 1976

Description of the Types of Environmental Liabilities and Disposal Liabilities

Accrued Environmental Restoration Liabilities

The DON environmental cleanup cost estimate was based on 4,051 Installation Restoration Program (IRP) and 401 Military Munitions Response Program (MMRP) sites at 207 active installations. As of September 30, 2017, the DON estimated and reported $5.6 billion for environmental restoration liabilities. This amount is comprised of $3.5 billion in Active Installations-IRP liabilities and $2.1 billion in Active Installations-MMRP liabilities.

Other Accrued Environmental Liabilities – Non-BRAC

The DON's estimated environmental cleanup cost was based on general PP&E assets and totaled $543.8 million for FY 2017. The amount is comprised of $331.7 million for the Navy and $212.1 million for the U.S. Marine Corps. 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 (if fully remediated within the current fiscal year).

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, 2017, the 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 $4 million for environmental corrective action and closure requirements.

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. The DON and the Department of Energy share estimated future costs of disposing of high-level waste and Spent Nuclear Fuel (SNF). The portion of SNF reflected on the DON's balance sheet represents the DON's portion of the estimated future cost based on historical cost factors.

Nature of Estimates and the Disclosure of Additional Information

Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. As of September 30, 2017, 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.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

<u>Active Installations - Defense Environmental Restoration Program (DERP) Funded</u>: 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 Other 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.

The above table excludes estimated total cleanup costs associated with general PP&E of $3.9 billion for FY 2017 and $2.6 billion for FY 2016. 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.

For FY 2017, Working Capital Fund Environmental Liabilities associated with Other Accrued Environmental Liabilities will be reported on the Navy Working Capital Fund Financial Statement.

NOTE 13. OTHER LIABILITIES

As of September 30	2017		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	$ 17,177	$ -	$ 17,177
Disbursing Officer Cash	95,045	-	- 95,045
Judgment Fund Liabilities	4,824	-	4,824
FECA Reimbursement to the Dept. of Labor	135,439	164,854	300,293
Custodial Liabilities	99,304	-	99,304
Employer Contribution and Payroll Taxes Payable	75,657	-	75,657
Other Liabilities	41,044	-	41,044
Total Intragovernmental	468,490	164,854	633,344
Accrued Funded Payroll and Benefits	344,831	-	344,831
Advances from Others	1,145,753	-	1,145,753
Deposit Funds and Suspense Accounts	356,529	-	356,529
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	1,136,720	58,516	1,195,236
Accrued Unfunded Annual Leave	2,894,929	-	2,894,929
Contract Holdbacks	110,288	3,835	114,123
Employer Contribution and Payroll Taxes Payable	158,644	-	158,644
Contingent Liabilities	589	1,538,074	1,538,663
Other Liabilities	42,575	-	42,575
Total Other Liabilities	$ 6,659,348	$ 1,765,279	$ 8,424,627

As of September 30	2016		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
Intragovernmental			
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
Total Intragovernmental	951,031	171,135	1,122,166
Accrued Funded Payroll and Benefits	387,614	-	387,614
Advances from Others	976,883	-	976,883
Deposit Funds and Suspense Accounts	273,402	-	273,402
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	154,732	46,979	201,711
Accrued Unfunded Annual Leave	2,853,010	-	2,853,010
Contract Holdbacks	220,551	543	221,094
Employer Contribution and Payroll Taxes Payable	34,839	-	34,839
Contingent Liabilities	22,540	2,028,208	2,050,748
Other Liabilities	24,548	-	24,548
Total Other Liabilities	$ 5,899,150	$ 2,246,865	$ 8,146,015

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 by the DON as an agent for others and paid at the direction of the owner or held in suspense temporarily for distribution to another fund or entity.

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, and other related liabilities.

Custodial Liabilities represent liabilities for collections reported as nonexchange revenues where the DON is acting on behalf of another federal entity. Based on guidance in SFFAS No. 31, "Accounting for Fiduciary Activities," the Statement of Custodial Activity is not required as part of the DON's financial statements, as balances that would be reported on the Statement of Custodial Activity are reflected on the DON's Balance Sheet.

Intragovernmental Other Liabilities consists primarily of Unemployment Compensation liabilities.

Nonfederal 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 $1.5 billion related to contracts authorizing progress payments based on cost as defined in the 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 that 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.

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.

Contingent Liabilities also includes accrued contingent legal liabilities pertaining to pending legal cases where the Office of General Counsel (OGC) and the Office of the Judge Advocate General (OJAG) consider an adverse decision probable and the amount of the loss 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. Refer to Note 16, “Commitments and Contingencies,” for additional information.

NOTE 14. COMMITMENTS AND CONTINGENCIES

The DON is a party in various administrative proceedings, legal actions, and 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 DON OGC and 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. For each claim above the annual assessment materiality threshold, OGC and OJAG assess the likelihood of an unfavorable outcome, as follows: probable, remote, and unable to express an opinion. For FY 2017, the DON materiality threshold for reporting litigation, claims, or assessments is $68.0 million.

As of September 30, 2017, the DON has 20 cases exceeding the materiality threshold. Four cases totaling $69.7 million are assessed as probable for an adverse decision. One of the four cases ($16 million estimated) will potentially be paid from the DON’s general fund. The other three cases (totaling $69.7 million estimated) will potentially be paid out of the U.S. Treasury Judgment Fund without reimbursement from the DON. Eight cases are assessed as remote with no financial impact noted. The DON legal counsel is unable to express an opinion concerning the outcome on the eight remaining cases ($3 billion estimated). DON management elects to disclose these eight cases as reasonably possible in accordance with the U.S. Government Accountability Office (GAO) Financial Audit Manual (FAM) Section 1002.31, "Inquiries of Legal Counsel." Additionally, OGC and OJAG review pending claims below the materiality threshold, which are classified as reasonably possible. In the aggregate, the total claim value for these cases is $1.2 billion.

In addition to legal cases managed by the OGC and OJAG, DON's Office of Civilian Human Resources (OCHR) manages U.S. Equal Employment Opportunity Commission (EEOC) cases presented against the DON. As of September 30, 2017, OCHR is managing 803 Complaints that are in hearing and 45 complaints pending a final agency action. EEOC case liability is not included in the contingent legal liability calculation amount, as the maximum exposure of these cases, individually and collectively, is not material to the DON financial statements. The maximum potential liability of any individual EEOC case is $0.3 million.

In addition to formal litigation and claims related to EEOC cases, the DON is also party to contract award disputes that have resulted in claims that are awaiting Contracting Officers Final Decision (COFD). Claims related to bid protest are not in formal litigation but do present a reasonable possibility of future loss to the DON. As of September 30, 2017, the DON has 118 claims awaiting COFD and the potential loss related to those claims is $344 million.

The DON is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, which 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. Additional system limitations prevent the DON from properly estimating the amount of obligations related to canceled appropriations in which the Navy has a contractual commitment for payment. An analysis of underlying transactions will be needed to determine the amount of accounts payable related to canceled funds.

The DON does not have any contractual arrangements that may require future obligations.

NOTE 15. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30 — **2017**

(Amounts in thousands)	Liability	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	$ 1,476,831	$ -	$ 1,476,831
Other	1,340	(1,340)	-
Total Other Benefits	$ 1,478,171	$ (1,340)	$ 1,476,831

As of September 30 — **2016**

(Amounts in thousands)	Liability	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
FECA	$ 1,459,377	$ -	$ 1,459,377
Other	1,391	(1,391)	-
Total Other Benefits	$ 1,460,768	$ (1,391)	$ 1,459,377

The DON 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 of Defense level.

Actuarial Cost Method Used and Assumptions:
The DON's actuarial liability for workers' compensation benefits is developed by the DOL 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 DOL calculates the future workers' compensation liability using wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIM). The actual rates for these factors for charge back year (CBY) 2017 were also used to adjust the methodology's historical payments to current year constant dollars.

To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Year over year changes in the liability were also examined, with any significant agency-level differences inspected in greater detail. The DOL concluded that the model has been stable and has projected each agency's actual payments well.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the U.S. Treasury Nominal Coupon Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.7% was assumed for year one, year two, and thereafter. An interest rate for medical benefits of 2.2% was assumed for year one, year two, and thereafter.

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 FECA liability, and the current portion of veterans' disability compensation benefits.

NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

As of September 30	2017	2016
(Amounts in thousands)		
Intragovernmental Costs	$ 44,665,828	$ 46,286,419
Nonfederal Cost	118,139,623	113,339,555
Total Cost	162,805,451	159,625,974
Intragovernmental Revenue	(3,510,263)	(2,381,355)
Nonfederal Revenue	(1,693,552)	(5,145,888)
Total Revenue	(5,203,815)	(7,527,243)
Total Net Cost	$ 157,601,636	$ 152,098,731

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 DoD's current processes and systems capture costs based on appropriations groups. The lower level costs for major programs are not presented 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."

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.

The DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of U.S. GAAP for federal agencies. Most of the DON's legacy systems were designed to record information on a budgetary basis and do not track intragovernmental transactions by customer at the transaction level. Considering these systems limitations, the DON is unable to accurately compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental 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. Intradepartmental revenues and expenses are then eliminated.

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

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.

NOTE 17. 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. Appropriations Received on the 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 $1.3 billion is due to the budget authority of new appropriations being reduced through congressional reductions. The majority of these bookings are related to appropriations 0513, Ship Modernization, Operations, and Sustainment Fund, 1804, Operation and Maintenance, and 1611, Procurement, Shipbuilding 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," as amended by SFFAS No. 27, the Department has elected to display a combined presentation of the nonexchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated with all other funds. Refer to Note 20, "Funds from Dedicated Collections," for additional information.

NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

Intragovernmental Costs and Exchange Revenue

As of September 30	2017	2016
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 106,681,797	$ 113,630,478

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	2017		
(Amounts in thousands)	Direct Obligations	Reimbursable Obligations	Total
Obligations Apportioned Under			
Category A	$ 103,715,535	$ -	$ 103,715,535
Category B	74,214,316	7,355,676	81,569,992
Exempt	37,670	-	37,670
Total	$ 177,967,521	$ 7,355,676	$ 185,323,197

As of September 30	2016		
(Amounts in thousands)	Direct Obligations	Reimbursable Obligations	Total
Obligations Apportioned Under			
Category A	$ 101,876,981	$ -	$ 101,876,981
Category B	68,560,495	7,222,117	75,782,612
Exempt	34,723	-	34,723
Total	$ 170,472,199	$ 7,222,117	$ 177,694,316

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 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 the fiscal year.

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 three transfers from ER, N for $289.3 million to the Operation and Maintenance, Navy appropriation.

Appropriations Received on the SCNP does not agree with Appropriations Received on the SBR due to differences between proprietary and budgetary accounting concepts and reporting requirements. Refer to Note 17, "Disclosures Related to the Statement of Changes in Net Position," for additional information.

NOTE 19. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30	2017	2016
(Amounts in thousands)		
Resources Used to Finance Activities		
Budgetary Resources Obligated:		
Obligations Incurred	$ 185,323,197	$ 177,694,316
Less: Spending Authority from Offsetting Collections and Recoveries	(14,595,249)	(14,294,685)
Obligations Net of Offsetting Collections and Recoveries	170,727,948	163,399,631
Less: Offsetting Receipts	(183,240)	(97,310)
Net Obligations	170,544,708	163,302,321
Other Resources:		
Donations and Forfeitures of Property	-	-
Transfers In/Out without Reimbursement	1,551,041	(1,187,568)
Imputed Financing from Costs Absorbed by Others	575,130	714,199
Other	(109,086)	(6,162,138)
Net Other Resources Used to Finance Activities	2,017,085	(6,635,507)
Total Resources Used to Finance Activities	172,561,793	156,666,814
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided:		
Undelivered Orders	6,948,681	37,805,705
Unfilled Customer Orders	829,547	40,775
Resources that Fund Expenses Recognized in Prior Periods	(347,049)	(1,428,711)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	29,378	3,252
Resources that Finance the Acquisition of Assets	(3,310,310)	(39,059,877)
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations:	-	-
Other	(1,757,432)	6,867,588
Total Resources Used to Finance Items not part of the Net Cost of Operations	2,392,815	4,228,732
Total Resources Used to Finance the Net Cost of Operations	174,954,608	160,895,546
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Period:		
Increase in Annual Leave Liability	56,696	3,951
Increase in Environmental and Disposal Liability	1,193,049	1,671,469
Increase in Exchange Revenue Receivable from the Public	30,259	503
Other	882,563	126,605

As of September 30	2017	2016
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	2,162,567	1,802,528
Components not Requiring or Generating Resources:		
Depreciation and Amortization	11,256,830	2,070,844
Revaluation of Assets or Liabilities	2,621,187	(1,814,524)
Other		
Cost of Goods Sold	984,978	-
Operating Materials and Supplies Used	1,698,452	2,186,977
Other	(36,076,986)	(13,042,640)
Total Components of Net Cost of Operations that will not Require or Generate Resources	(19,515,539)	(10,599,343)
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	(17,352,972)	(8,796,815)
Net Cost of Operations	$ 157,601,636	$ 152,098,731

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. 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 $2.7 billion as of September 30, 2017 to bring it into balance with the SNC.

The adjustments were recorded in Components of the Net Cost of Operations Not Requiring or Generating Resources in the Current Period. The majority of the $36.1 billion reported is related to cost capitalization offsets for ships and aircraft expensed in FY 2017.

Resources Used to Finance Activities- Other primarily consists of other gains and other losses.

Resources Used to Finance Items not Part of Net Cost of Operations- Other primarily consists of other gains and other losses.

The Reconciliation of Net Cost of Operations to Budget is presented as a consolidated statement. However, the following lines are presented as combined (i.e., not consolidated), as intra-entity 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

NOTE 20. FUNDS FROM DEDICATED COLLECTIONS

As of September 30	2017	2016
(Amounts in thousands)		
Assets		
Fund Balance with Treasury	$ 41,948	$ 39,839
Investments	6,785	5,664
Total Assets	$ 48,733	$ 45,503
Liabilities and Net Position		
Other Liabilities	$ 1,212	$ 1,275
Total Liabilities	1,212	1,275
Cumulative Results of Operations	47,521	44,228
Total Liabilities & Net Position	$ 48,733	$ 45,503
Statement of Net Cost		
Program Costs	$ 35,053	$ 23,571
Net Cost of Operations	$ 35,053	$ 23,571
Statement of Changes in Net Position		
Net Position Beginning of the Period	$ 44,228	$ 30,290
Net Cost of Operations	35,053	23,571
Budgetary Financing Sources	38,346	37,509
Other Financing Sources	-	-
Change in Net Position	3,293	13,938
Net Position End of Period	$ 47,521	$ 44,228

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 U.S.C. §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 U.S.C. §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 U.S.C. §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 U.S.C. §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	2017	2016
(Amounts in thousands)		
Fiduciary Net Assets, Beginning of Year	$ 89,029	$ 73,639
Contributions	71,230	83,492
Investment Earnings	289	262
Distributions to and on Behalf of Beneficiaries	(90,136)	(68,364)
Increase/(Decrease) in Fiduciary Net Assets	(18,617)	15,390
Fiduciary Net Assets, End of Period	$ 70,412	$ 89,029

Fiduciary Assets

As of September 30	2017	2016
(Amounts in thousands)		
Cash and Cash Equivalents	$ 70,412	$ 89,029

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 Nonfederal 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, U.S.C. §1035, and DoD 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% 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 the Savings Desposit 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	2017			
(Amounts in thousands)	Land and Buildings	Equipment	Other	Total
Entity as Lessee - Operating Leases				
Future Payments Due				
Fiscal Year				
2018	$ 150,532	$ 594	$ 82	$ 151,208
2019	153,454	605	84	154,143
2020	156,472	617	85	157,174
2021	159,548	628	87	160,263
2022	162,685	640	89	163,414
After 5 Years	165,883	652	90	166,625
Total	$ 948,574	$ 3,736	$ 517	$ 952,827

A littoral combat ship moors. (U.S. Navy photo by Mass Communication Specialist 3rd Class Deven Leigh Ellis/Released)

DEPARTMENT OF THE NAVY
REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

YEARLY INVESTMENT IN RESEARCH AND DEVELOPMENT

For Fiscal Years 2013 through 2017
($ in millions)

Categories	FY17	FY16	FY15	FY14	FY13
Basic Research	$ 610	$ 566	$ 572	$ 552	$ 556
Applied Research	865	884	804	792	776
Development					
Advanced Technology Development	715	629	613	631	653
Advanced Component Development and Prototypes	4,578	4,508	4,522	3,006	3,956
System Development and Demonstration	5,712	5,409	4,934	4,811	4,655
Research, Development, Test, and Evaluation Management Support	1,173	1,177	1,144	1,142	1,061
Operational Systems Development	3,720	3,706	3,581	3,403	3,863
Undistributed Disbursements*	-	(133)	-	-	-
Totals	**$ 17,373**	**$ 16,746**	**$ 16,170**	**$ 14,337**	**$ 15,520**

** 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 (ONR) has been developing cutting-edge science and technology (S&T) for U.S. naval forces for more than 70 years. In August 1946, after the Second World War, Congress mandated a new military command to identify and cultivate forward-looking S&T research, to ensure the maritime superiority of U.S. naval warfighters.

Long recognized as a leading sponsor of S&T research through partnerships across government, industry and academia, ONR manages short-, mid-, and long-term S&T, serving as the “venture capital” for the Department of the Navy.

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.

Today, ONR leads the Naval Research Enterprise comprised of ONR Headquarters, the Naval Research Laboratory, the Office of Naval Research Global, and PMR-51 (office of special projects). ONR is constantly changing to keep pace with technology innovation and to accelerate results. Under the direction of Rear Admiral David Hahn, Chief of Naval Research, his strategic guidance is aligning investments to support new priorities and restructuring the business of naval science to support six core research portfolios.

Together, the naval scientific and engineering community must be the first-to-field with decisive capabilities.

Basic Research Examples

<u>Aerodynamics Models for Designs of Bio-Inspired Robots and Unmanned Aerial Vehicles:</u>
Resembling a feathered flying ace with his miniature protective goggles and chinstrap, the parrotlet named Obie stood ready to take off. On signal, Obie propelled into the air, flapped through a laser field infused with microparticles and landed on another perch three feet away. The journey only lasted three seconds, but it challenged the accuracy of three aerodynamics models long used to predict animal flight. It also might impact the future designs of bio-inspired drones, robots, and unmanned aerial vehicles (UAVs), a topic of interest to the Navy and Marine Corps.

Sponsored by ONR, researchers at Stanford University found a new way to precisely measure the vortices, or the circular patterns of rotating air, created by birds’ wings during flight. The results shed greater light on how these creatures produce enough lift to fly. First, they had Obie and other parrotlets fly several times through a laser field flashing 1,000 times per second, lighting up nontoxic aerosol particles the size of a micron (one thousandth of a millimeter). As Obie flapped through the field, thin mist particles moved around his wingtips and were photographed by super-high-speed cameras, creating a new picture of the vortices in the wake of a flying animal. The Stanford researchers took this data and combined it with measurements gathered from an aerodynamic force platform.

The researchers then applied each of the three prevailing models to these new measurements multiple times. In each case, the existing models failed to forecast the actual lift of the parrotlets. The problem was that long-standing models are based on historical measurements taken a few wingbeats behind a flying animal, resulting in predictions that wing vortices stay relatively frozen over time, similar to the puffy clouds that form and dissipate slowly in an airplane's wake. This research demonstrated that birds' wing vortices actually break up suddenly and violently, within two to three beats.

Future stages of research will involve applying this new model to studies of how winged drones and UAVs can perform missions in environments that are difficult to navigate, such as dense woodland. This work is sponsored by an ONR Multidisciplinary University Research Initiative focusing on unmanned, autonomous flight.

What this research will accomplish:

- New technologies to collect data in free-flight conditions
- Knowledge to improve accuracy of design models for lift
- Future UAVs capable of navigating challenging environments like under a thick forest canopy or through urban canyons.

Finding a Better Way to Forecast Hurricane Strength:
As Hurricane Irma approached U.S. shores, researchers sponsored by ONR used air-dropped autonomous sensors to compile real-time ocean observations to help forecasters predict the strength of future tropical storms. This marks the first time a new, specialized version of the sensors—called ALAMO (Air-Launched Autonomous Micro Observer) sensors—was used in hurricane-prediction research. While standard computerized prediction models rely on atmospheric data like air temperature, humidity, altitude, and wind speed and direction, the ALAMO sensors use sophisticated instruments to gauge water temperature, salinity and pressure beneath the sea surface.

Fully developed tropical cyclones—called hurricanes or typhoons, depending on their region—can grow as wide as several hundred miles and sustain winds greater than 150 miles per hour. With historically high winds, Hurricane Irma is one of the strongest storms ever recorded in the Atlantic Ocean.

Such storms are notoriously difficult to predict, presenting a volatile meteorological cocktail in that can change direction, speed, and strength quickly and unexpectedly. One reason is that current forecasting models focus on the atmosphere instead of the underwater properties that contribute to the creation of hurricanes, but are difficult to observe.

In addition to the potential catastrophic damage to coastal communities, hurricanes also pose a severe threat to U.S. Navy fleet operations. Accurate forecasting is critical for protecting ships at sea, evacuating vulnerable bases, and providing humanitarian assistance and disaster relief.

The ONR-sponsored research team, composed of U.S. Naval Academy midshipmen and scientists from Woods Hole Oceanographic Institution, dropped ten ALAMO sensors from an Air Force C-130 "Hurricane Hunter" aircraft into Caribbean waters, ahead of the storm.

Short, metal tubes crammed with sensors and scientific instruments, each ALAMO sensor sank nearly 1,000 feet underwater and then rose again. They tracked ocean temperature, salinity, and pressure, and transmitted this data via satellite for use by the Naval Research Laboratory to update the Navy's coupled ocean-atmosphere forecasting models.

The information accumulated will be used to improve the Navy's Coupled Ocean/Atmosphere Mesoscale Prediction System-Tropical Cyclone (COAMPS-TC). COAMPS-TC, developed with ONR support, uses complex algorithms to predict hurricane intensity by processing real-time and historical meteorological data, fed by information from satellites. ONR's sponsored hurricane research is part of the Task Force Ocean initiative, which seeks to strengthen the Navy's oceanographic capabilities in ocean sensing and modeling technology.

What this research will accomplish:

- Improve ocean and atmosphere modeling and prediction for fleet operations
- Enable an accurate picture of conditions in the ocean water before, during, and after a hurricane
- Help the Navy issue operational guidance for fleet safety and improve understanding of the complex air-sea interaction processes that drive the intensity of tropical hurricanes

Applied Research Examples

Blast Load Assessment Sense and Test—BLAST:
Modern body armor protects warfighters against shrapnel from explosive blasts. However, they still face a hidden threat from the resulting blast pressure and shock wave that could cause traumatic brain injury (TBI). To fight this invisible, insidious adversary, the ONR is sponsoring the development of a portable, three-part system that can measure blast pressure, establish injury thresholds for the brain, and analyze potential TBI symptoms. It's called Blast Load Assessment Sense and Test, or BLAST, for short.

BLAST is part of ONR's Future Naval Capability, which is 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. It uses coin-sized sensors that are tough enough to survive an explosion, can be worn on helmets and body armor, and are able to record blast pressure. Pressure measurements can be downloaded with a specialized scanner. Current design possibilities include a handheld barcode-style scanner and a stationary scanner modeled after airport metal detectors. By using a special algorithm to convert data into a "go or no-go" injury threshold, BLAST indicates if exposed warfighters can stay in the fight or need a TBI-focused medical exam.

BLAST sensors are currently being tested in laboratories using electrical shocks to simulate blasts of varying size and intensity. By the end of FY 2019, the system is expected to be tested on field mannequins and then by Marines completing *breacher* training where they overcome obstacles such as walls and doors using explosives.

What this research will accomplish:

- Recognize the signs of TBI early and tell warfighters they might need medical attention
- Reduces the likelihood of someone enduring multiple blasts and suffering more serious brain injury
- Provide valuable blast pressure data that can be used to assess the possibility of TBI

Digital Flight Deck Ouija Boards:
The flight decks of aviation-capable vessels like aircraft carriers bustle with noise and danger including screaming jets, snapping steel cables, and powerful tractors and forklifts. Planning and orchestrating this high-octane dance requires precision and accuracy from those responsible for directing deck traffic.

To make the jobs of aircraft handlers easier, the ONR TechSolutions program has sponsored the development of the Deployable Ship Integration Multitouch System (DSIMS). DSIMS is a mobile software package that features a digital, touchscreen image of a ship's flight deck or hangar bay, and can be used on a laptop or desktop computer. It enables aircraft handlers to change flight deck configurations from anywhere on the ship, plan operations before deployment, and share information digitally with other DSIMS users for improved collaboration.

To track the movements of aircraft and equipment on the flight deck, handlers currently use a tool informally called a "Ouija Board," which is a waist-high, six-foot-long physical replica of the deck. Located in the ship's flight deck control center, the board is covered with toy-like plastic models of aircraft, each marked with colored thumbtacks to designate maintenance, fuel, and flight status. The Ouija Board's design has barely changed since World War II. Despite its effectiveness, however, it does have limitations. For example, if aircraft handlers need to plan for upcoming or unexpected scenarios such as bad weather or a surprise VIP visit, they must do so while underway, and change the Ouija Board back to its original layout after completing the planning session.

By contrast, DSIMS can help plan such situations months before a ship leaves port. When playing out various flight deck situations, or "evolutions," on the DSIMS touchscreen, participants can use their fingertips or a computer mouse to move around digital aircraft, to show which aircraft need to be where and how crates and other equipment should be positioned.

In contrast to the thumbtacks, there are special screen modules denoting aircraft fueling needs, maintenance requests, and availability for flight. Each evolution can be saved and recalled during operations or used for briefings and training.

During FY 2018, TechSolutions will deliver a prototype DSIMS for testing and evaluation on several ships, including the Iwo Jima vessels. The team hopes to see the system issued throughout the fleet soon thereafter.

What this research will accomplish:

- Enables aircraft handlers to change flight deck configurations anywhere on the ship
- Plan operations before deployment
- Share information digitally with other DSIMS users for improved collaboration

Developmental Research Examples

New Submarine Steam Suits:
Two Sailors attended a recent demonstration of the prototype steam suit at Naval Submarine Base New London. One was testing the newest suit designed to protect Sailors from steam leaks on nuclear-powered submarines. He pulled on thick gloves and boots, and donned a face shield for a self-contained breathing apparatus. Then he slid into the sleek, silver prototype steam suit, hoisted an air tank onto his back and connected a regulator to the breathing apparatus. Total time: a little more than two minutes. Meanwhile, the other Sailor wrestled with the current, older steam suit used Navy-wide. First, he put on boots and a set of firefighters' coveralls, followed by the air tank and breathing apparatus. Finally, he wriggled into a bulky, HAZMAT-style chemical suit. His time: more than double first Sailor.

Sponsored by the ONR TechSolutions Program, the new suit was developed by the Naval Sea Systems Command (NAVSEA) and Navy Clothing and Textile Research Facility (NCTRF), and currently is being tested at sea. If pressurized steam lines aboard a submarine rupture, they can leak steam at extremely high temperatures, potentially resulting in severe injury or death. To make emergency repairs or rescue crewmates, Sailors must wear protective suits.

Although the current steam suits used Navy-wide have performed well since being introduced a decade ago, NAVSEA regularly receives suggestions from Sailors on how to improve them—so the command contacted TechSolutions about designing a better suit. TechSolutions is ONR's rapid-response science and technology program that develops prototype technologies to address problems voiced by Sailors and Marines, usually within 12-18 months.

With TechSolutions' guidance, NAVSEA partnered with NCTRF to implement several key suit improvements. It's one piece and nine pounds lighter—cutting donning time while still maintaining protective strength. Then there's the unique style of gloves. While the current steam suit has mittens, the new prototype features "lobster claws" with thumbs and two fingers, making it easier to grasp tools, climb ladders and navigate the close confines of a submarine. They also have leathery fabric for wiping the face shield if steam fogs it up.

The prototype suits will be tested during at-sea drills aboard the Toledo and two other submarines. Afterward, NAVSEA will make suggested improvements and, hopefully, see the suit issued throughout the fleet in the next couple of years.

What this research will accomplish:

- Provides enhanced flexibility, maneuverability and ease of donning protective suits during an emergency
- A lighter suit that enables users to get around better, quicker and easier

- Improved air tank and hose for the breathing apparatus worn on the outside, instead of under a chemical suit, allowing better access to oxygen

New Operating System Will Improve Navy Computing Power:
ONR has designed a system that could revolutionize how military and commercial computing systems perform. *Popcorn Linux* is an operating system that can compile different programming languages into a single cyber tongue. By applying Popcorn Linux to longtime, legacy Navy and Marine Corps computer systems, the DON can improve software without requiring thousands of man-hours to rewrite millions of lines of code.

Crunching huge amounts of data for complex applications like battlespace awareness and artificial intelligence requires extremely powerful processing. Unfortunately, many of the processors capable of this speak their own specialized software programming languages and must be programmed to interact with each other. To increase computing speed, microchip manufacturers in recent years have placed multiple processing units on individual chips. The iPhone 7, for example, has four processors: two high-power (think of a Ford Mustang) and two low-power (think of a Toyota Prius). They work in conjunction to simultaneously dial phone numbers, open web pages, check text messages, and take photos and videos.

That involves designating specialized "heterogeneous" processors to carry out specific tasks, like displaying graphics or web browsing. Each processor can be devoted to one specialty rather than divided among several functions, resulting in much faster performance. Each processor has its own set of instructions that only it understands. To address this, software developers must manually adjust code to determine which tasks should run on which processors. This is a tedious process because extra features and updates are added regularly.

Popcorn Linux can be used with any computer or device, serving as a translation tool by taking generic coding language and transforming it into multiple specialized program languages. From there, Popcorn Linux automatically figures out what pieces of the programming code are needed to perform particular tasks and transfers these instruction "kernels" (the "popcorn" part) to the appropriate function.

In FY 2018, ONR will work with industry partners to create a version of Popcorn Linux that can meet the strenuous industrial standards required by the Navy and Marine Corps.

What this research will accomplish:

- Significant savings in software development and maintenance costs
- Takes generic coding language and translates it into multiple specialized program languages
- Simplifies working with legacy systems with numerous security patches and millions of lines of code

USMC Examples

The Mind as a Weapon: Helping Marines Make Faster, Better Combat Decisions:
Battlefield commanders face many scenarios requiring fast decisions such as attacking an enemy position, evacuating injured warfighters, and navigating unfamiliar terrain. Each situation pushes leaders to make quick and informed choices.

To enhance these decision-making capabilities, especially for small-unit leaders, the 2nd Battalion, 6th Marines, better known as "The Spartans," held a weeklong exercise called Spartan Emerging Technology and Innovation Week at Camp Lejeune, North Carolina. The event, also called Spartan Week, featured various training technologies, from quadcopters to augmented reality, that were developed with support from the ONR to accelerate the development of decision-making skills.

During Spartan Week, Marines used several ONR-sponsored technologies. These included the Interactive Tactical Decision Game (I-TDG) with an associated augmented-reality headset, the Augmented Immersive Team Trainer (AITT), and a quadcopter-based system for surveying and modeling terrain quickly. I-TDG is a web technology-based application that allows Marines to plan missions and conduct "what if" tactical-decision games or simulation-based exercises. It supports maps and multimedia tools and links to ONR's HoloLens augmented-reality headset. AITT is comprised of a laptop, software, battery pack, and helmet-mounted display that can support forward-observer training in live field environments. It employs augmented reality technology, which inserts virtual objects into a real environment, to create realistic tactical scenarios, including friendly and opposing ground vehicles as well as aircraft and battlefield effects, such as explosions from mortar shells and artillery.

What this research will accomplish:

- Develop a suite of new training tools that are easy to implement, tailorable to Marines' needs, and include the ability to assess decision-making skills
- Enable Marines to perform simulated missions in a safe classroom environment, carry out multiple missions, and use I-TDG as an after-action review tool.
- Enable Marines, from squad leaders to riflemen, to evaluate their ability to make fast decisions

<u>New Unmanned Mine-Detection System:</u>
During a recent technology demonstration at Marine Corps Base Camp Pendleton in Oceanside, CA, the ONR TechSolutions program unveiled a new way to detect buried and submerged mines. The Mine Warfare Rapid Assessment Capability (MIW RAC) system consists of a one-pound quadcopter outfitted with an ultra-sensitive magnetometer sensor system to detect mines and provide real-time search data to a handheld Android device.

MIW RAC is a portable, remote-controlled system that can detect buried or underwater mines during amphibious beach landings. It's designed to help explosive ordnance disposal teams quickly find mines and dangerous metal obstacles within coastal surf zones and very-shallow-water zones. MIW RAC would provide a new, real-time aerial complement to existing underwater mine-detection capabilities.

While the quadcopter and tablet device are available commercially, the heart of MIW RAC is its proprietary magnetometer sensor suite that has an extensive detection range and uses complex algorithms to differentiate between various types of objects.

MIW RAC originated in 2015 when the Navy Expeditionary Combat Command (NECC) sent a request to ONR's TechSolutions program for a portable system that could detect potential hazards in surf zones, be easy for warfighters to use, and fit diverse platforms. With TechSolutions guidance, NECC partnered with Naval Surface Warfare Center, Carderock, Combat Direction Systems Activity Dam Neck, and two commercial companies (BDS and Physical Sciences, Inc.) to develop the components of MIW RAC.

TechSolutions will deliver prototype MIW RACs to NECC's Explosive Ordnance Disposal Group for further testing and evaluation. The team hopes to see the system issued throughout the fleet next year.

What this research will accomplish:

- Localize mines quickly and accurately
- Detect buried and underwater mines during amphibious beach landings
- Survey an area before troops arrive or attempt bring a vessel ashore

Inside the Combined Arms Virtual Environment (CAVE) trainer during the Tactical Air Control Party (TACP) course. (U.S. Marine Corps photo by Brandon E. Holmes/Released)

DEPARTMENT OF THE NAVY REQUIRED SUPPLEMENTARY INFORMATION

REAL PROPERTY DEFERRED MAINTENANCE AND REPAIR

For Fiscal Year Ended September 30, 2017
($ in thousands)

Property Type	FY 2017: 1. Plant Replacement Value	FY 2017: 2. Required Work (Deferred Maintenance and Repair)	FY 2017: 3. Percentage	FY 2016: 1. Plant Replacement Value	FY 2016: 2. Required Work (Deferred Maintenance and Repair)	FY 2016: 3. Percentage
Category 1: Enduring Facilities						
Navy	$ 187,263,750	13,943,710	7.45%	$ 133,196,730	27,297,590	20.49%
Marine Corps	$ 61,997,018	9,434,682	15.22%	$ 53,930,898	8,669,381	16.07%
Category 2: Heritage Assets						
Navy	$ 197	-	0.00%	$ 34,572,070	9,417,820	27.24%
Marine Corps	$ 4,088,585	914,685	22.37%	$ 3,743,423	837,754	22.38%
Category 3: Excess Facilities or Planned for Replacement						
Navy	$ 4,957,410	340,350	6.87%	$ 4,623,020	1,355,090	29.31%
Marine Corps	$ 105,277	-	0.00%	$ 56,488	-	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 (NWCF). Similarly, Marine Corps real property deferred maintenance and repair data represent both the United States Marine Corps General Fund and NWCF-Marine Corps.

Description of Property Type categories:

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

The deferred maintenance and repair information presented relates to all DON facilities and is not restricted to capitalized assets. The deferred maintenance and repair information excludes assets on DON 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 (FCI).

1. M&R Policies

The DON has migrated and will utilize the Sustainment Management System (SMS), where applicable, to perform a cyclical assessment of real property facilities and assign a FCI, which considers an asset's key life-cycle attributes, such as age and composition material. The Navy's FCI is calculated using the below formula:

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

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 US Army Corps of Engineers (USACE) Civil Engineering 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).

The Marine Corps' Deferred Maintenance and Repair Report includes 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.

2. M&R Prioritization

The DON considers mission, health and safety, and quality of life when assigning priority to maintenance needs. The top priority is emergency maintenance and repair to any facility or asset deficiency that immediately endangers life, safety, compliance, or inhibits the installation from performing mission critical functions. The next priority is a deficiency to the life, health, safety or compliance of a facility or asset that does not immediately endanger personnel or government property, but for which delays in repair could result in an emergency. Lastly is the facilities maintenance and repair required to restore a Tier One (high Mission Dependency Index (MDI)) facility to a condition substantially equivalent to its original intended and designed capability or agreed condition. This is followed by Tier 2 (medium MDI) and then Tier 3 (low MDI)

3. Acceptable Condition Standards

Generally, the Navy considers an asset acceptable when it is in good condition with an assigned FCI of 90% or above. The primary factors considered by the USMC in determining acceptable condition align to restoring a real property facility, system, or component to such a condition that it may effectively be used for its designated functional purpose.

4. Capitalization of DM&R

The deferred maintenance and repair information presented relates to all facilities and is not restricted to capitalized assets.

The Navy's FY 2017 deferred maintenance was valued at 7.45% and 6.87% of PRV for categories 1 and 3, respectively. Beginning in FY 2017, the Navy updated the deferred maintenance and repair (DM&R) calculation approach to apply the guidance in the ODUSD(ATL) memorandum, "*Standardizing Facility Condition Assessments*," dated September 10, 2013. The memorandum requires the use of a FCI for DM&R calculations.

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 PRV as an acceptable level of deferred maintenance. The table above shows that deferred maintenance is valued at approximately 15.22% and 23.37% of PRV for categories 1 and 2, respectively. Category 3 is zero because the USMC does not hold deferred maintenance backlogs on facilities to be demolished.

5. Asset Exclusions

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.

6. DM&R Variance

From the end of FY 2016 to the end of FY 2017, the Navy's total deferred maintenance and repair for categories 1 through 3 decreased from $38.1 billion to $14.3 billion. Because FY 2017 is the first year that SMS-generated DM&R was used to calculate the Navy's FCI values, a valid comparison of the FY 2016 to FY 2017 DM&R cannot be made.

In addition, during FY 2017, the Navy performed an analysis of all Heritage Assets to validate the classification between single-use and multi-use. Based on this assessment, the vast majority of Navy Heritage Assets are multi-use, as the predominant use of the asset is for general government operations.

EQUIPMENT DEFERRED MAINTENANCE AND REPAIR

For Fiscal Year Ended September 30, 2017
($ in thousands)

Major Category*	"PY DM&R (End of Year Actuals)"	CY OP-30/PB-45/ PB-61 Amounts	Adjustments	Totals
1. Aircraft	$238,699	$238,699	$(51,633)	$187,066
2. Automotive Equipment	41,363	6,408	56,036	62,444
3. Combat Vehicles	3,154	-	15,110	15,110
4. Construction Equipment	(7,180)	7,180	(7,180)	-
5. Electronics and Communications Systems	4,670	12,964	(5,046)	7,918
6. Missiles	82,251	82,269	(14,910)	67,359
7. Ships	236,327	236,327	-	236,327
8. Ordnance Weapons and Munitions	34,741	43,561	(30,959)	12,602
9. All Other Items Not Identified Above	9,394	9,394	2,984	12,378
Total	**$643,419**	**$636,802**	**$(35,598)**	**$601,204**

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 were scheduled to be; therefore, are 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 2017 are included in the data. The Department of Navy has not changed prior year policies. Deferred maintenance decreased 6.6% during FY 2017, primarily due to a reduction of aircraft maintenance. This was driven by improvements to depot capacity, revised aircraft workload standards, and aircraft engine readiness goals being met. This reduction was partially offset by an increase in Marine Corps deferred maintenance, caused by delayed maintenance for Mine-Resistant Ambush Protected (MRAP) vehicles and MRAP All-Terrain Vehicles (M-ATV) until FY 2018. The USS Boise, scheduled for maintenance in FY 2016, remains on the FY 2017 report, as the CNO maintenance availability was moved to FY 2019.

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). 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. Funds were not necessary to induct the deferred engine assets in FY 2017, as current engine readiness goals were met.

Automotive Equipment

Automotive equipment deferred maintenance is attributed to the planned workload for commercial repair.

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, 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 unfunded amount is due to a change on the maintenance rotation plan for Light Armored Vehicles.

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.

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.

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 FY 2019 and remains in the report.

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, 2017 and 2016

($ in Thousands)

	Research, Development, Test & Evaluation	Procurement	Military Personnel	Family Housing & Military Construction
Budgetary Resources:				
Unobligated Balance, Brought Forward, October 1	$ 2,255,146	$ 27,309,262	$ 1,714,730	$ 2,746,550
Recoveries of Prior Year Unpaid Obligations	550,789	2,182,559	744,959	621,917
Other Changes in Unobligated Balance	(134,034)	(549,340)	(528,745)	(64,564)
Unobligated Balance from Prior Year Budget Authority, Net	2,671,901	28,942,481	1,930,944	3,303,903
Appropriations	17,799,321	50,444,408	46,232,536	1,601,729
Spending Authority from Offsetting Collections	98,785	793,276	395,666	659,241
Total Budgetary Resources	$ 20,570,007	$ 80,180,165	$ 48,559,146	$ 5,564,873
Status of Budgetary Resources:				
New Obligations and Upward Adjustments (total)	$ 18,156,706	$ 53,051,253	$ 47,059,714	$ 2,708,366
Unobligated Balance, End of Year				
Apportioned, Unexpired Accounts	2,109,271	26,188,332	81,097	2,752,436
Exempt from Apportionment, Unexpired Accounts	-	-	-	-
Unapportioned, Unexpired Accounts	-	-	-	-
Unexpired Unobligated Balance, End of Year	2,109,271	26,188,332	81,097	2,752,436
Expired Unobligated Balance, End of Year	304,030	940,580	1,418,335	104,071
Total Unobligated Balance, End of Year	2,413,301	27,128,912	- 1,499,432	2,856,507
Total Status of Budgetary Resources	$ 20,570,007	$ 80,180,165	$ 48,559,146	$ 5,564,873
Change in Obligated Balance:				
Unpaid Obligations				
Unpaid Obligations, Brought Forward, October 1	$ 10,247,189	$ 68,911,251	$ 1,650,661	$ 3,440,048
New Obligations and Upward Adjustments (total)	18,156,706	53,051,253	47,059,714	2,708,366
Outlays, Gross	(17,442,246)	(42,046,805)	(46,296,036)	(2,106,866)
Recoveries of Prior Year Unpaid Obligations	(550,789)	(2,182,559)	(744,959)	(621,917)
Unpaid Obligations, End of Year, Gross	10,410,860	77,733,140	1,669,380	3,419,631
Uncollected Payments				
Uncollected Payments from Federal Sources, Brought Forward, October 1	(135,760)	(161,521)	(45,988)	(814,654)
Change in Uncollected Payments from Federal Sources	29,495	9,601	13,983	10,254
Uncollected Payments from Federal Sources, End of Year	(106,265)	(151,920)	(32,005)	(804,400)
Obligated Balance, Start of Year	10,111,429	68,749,730	1,604,673	2,625,394
Obligated Balance, End of Year	$ 10,304,595	$ 77,581,220	$ 1,637,375	$ 2,615,231
Budget Authority and Outlays, Net:				
Budget Authority, Gross	$ 17,898,106	$ 51,237,684	$ 46,628,202	$ 2,260,970
Actual Offsetting Collections	(128,280)	(802,877)	(413,012)	(669,495)
Change in Uncollected Payments from Federal Sources	29,495	9,601	13,983	10,254
Recoveries of Prior Year Paid Obligations	-	-	3,363	-
Budget Authority, Net	$ 17,799,321	$ 50,444,408	$ 46,232,536	$ 1,601,729
Outlays, Gross	$ 17,442,246	$ 42,046,805	$ 46,296,036	$ 2,106,866
Actual Offsetting Collections	(128,280)	(802,877)	(413,012)	(669,495)
Outlays, Net	17,313,966	41,243,928	45,883,024	1,437,371
Distributed Offsetting Receipts	-	-	-	-
Agency Outlays, Net	$ 17,313,966	$ 41,243,928	$ 45,883,024	$ 1,437,371

The accompanying notes are an integral part of the statements.

Department of Defense

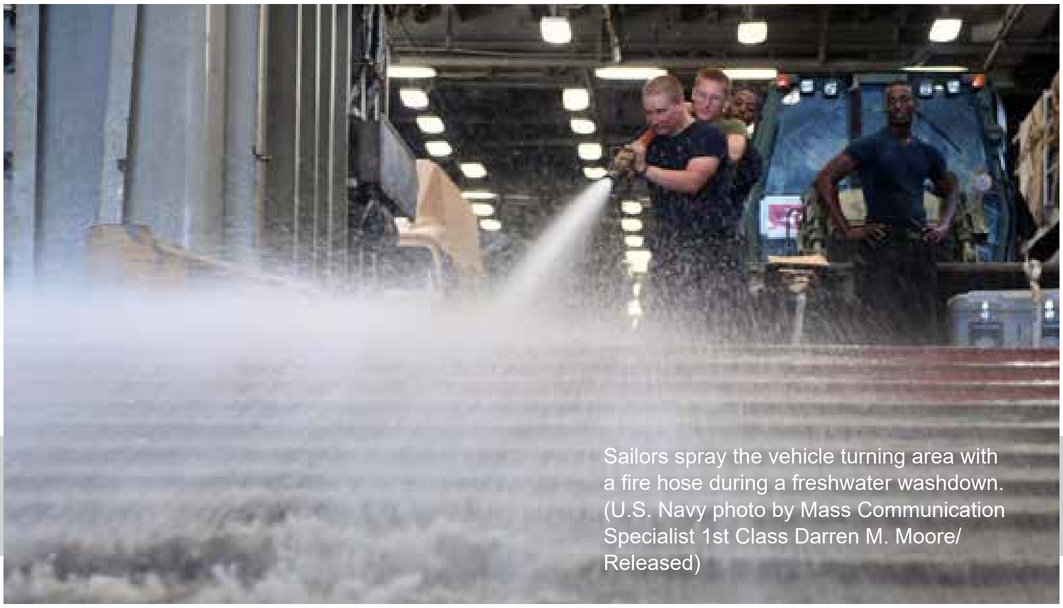
DEPARTMENT OF THE NAVY

STATEMENT OF DISAGGREGATED BUDGETARY RESOURCES

For the Years Ended September 30, 2017 and 2016
($ in Thousands)

	Operations, Readiness & Support	2017 Combined	2016 Combined
Budgetary Resources:			
Unobligated Balance, Brought Forward, October 1	$ 6,288,600	$ 40,314,288	$ 36,275,135
Recoveries of Prior Year Unpaid Obligations	3,495,392	7,595,616	8,060,027
Other Changes in Unobligated Balance	(1,468,686)	(2,745,369)	(2,256,062)
Unobligated Balance from Prior Year Budget Authority, Net	8,315,306	45,164,535	42,079,100
Appropriations	55,735,724	171,813,718	169,125,260
Spending Authority from Offsetting Collections	5,049,252	6,996,220	6,804,244
Total Budgetary Resources	$ 69,100,282	$ 223,974,473	$ 218,008,604
Status of Budgetary Resources:			
New Obligations and Upward Adjustments (total)	$ 64,347,158	$ 185,323,197	$ 177,694,316
Unobligated Balance, End of Year			
Apportioned, Unexpired Accounts	1,730,852	32,861,988	32,436,455
Exempt from Apportionment, Unexpired Accounts	29,203	29,203	1,671,491
Unapportioned, Unexpired Accounts	-	-	-
Unexpired Unobligated Balance, End of Year	1,760,055	32,891,191	34,107,946
Expired Unobligated Balance, End of Year	2,993,069	5,760,085	6,206,342
Total Unobligated Balance, End of Year	4,753,124	38,651,276	40,314,288
Total Status of Budgetary Resources	$ 69,100,282	$ 223,974,473	$ 218,008,604
Change in Obligated Balance:			
Unpaid Obligations			
Unpaid Obligations, Brought Forward, October 1	$ 23,906,083	$ 108,155,232	$ 107,370,622
New Obligations and Upward Adjustments (total)	64,347,158	185,323,197	177,694,316
Outlays, Gross	(59,735,516)	(167,627,469)	(168,849,679)
Recoveries of Prior Year Unpaid Obligations	(3,495,392)	(7,595,616)	(8,060,027)
Unpaid Obligations, End of Year, Gross	25,022,333	118,255,344	108,155,232
Uncollected Payments			
Uncollected Payments from Federal Sources, Brought Forward, October 1	(2,367,460)	(3,525,383)	(3,437,866)
Change in Uncollected Payments from Federal Sources	(345,254)	(281,921)	(87,517)
Uncollected Payments from Federal Sources, End of Year	(2,712,714)	(3,807,304)	(3,525,383)
Obligated Balance, Start of Year	21,538,623	104,629,849	103,932,756
Obligated Balance, End of Year	$ 22,309,619	$ 114,448,040	$ 104,629,849
Budget Authority and Outlays, Net:			
Budget Authority, Gross	$ 60,784,976	$ 178,809,938	$ 175,929,504
Actual Offsetting Collections	(4,704,048)	(6,717,712)	(6,723,315)
Change in Uncollected Payments from Federal Sources	(345,254)	(281,921)	(87,517)
Recoveries of Prior Year Paid Obligations	50	3,413	6,588
Budget Authority, Net	$ 55,735,724	$ 171,813,718	$ 169,125,260
Outlays, Gross	$ 59,735,516	$ 167,627,469	$ 168,849,679
Actual Offsetting Collections	(4,704,048)	(6,717,712)	(6,723,315)
Outlays, Net	55,031,468	160,909,757	162,126,364
Distributed Offsetting Receipts	(183,240)	(183,240)	(97,310)
Agency Outlays, Net	$ 54,848,228	$ 160,726,517	$ 162,029,054

The accompanying notes are an integral part of the statements.



Sailors spray the vehicle turning area with a fire hose during a freshwater washdown. (U.S. Navy photo by Mass Communication Specialist 1st Class Darren M. Moore/ Released)

DEPARTMENT OF THE NAVY OTHER INFORMATION

TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT

Audit Opinion: Disclaimer
Restatement: No

Areas of Material Weaknesses	Beginning Balance	New	Resolved	Ending Balance
Fund Balance with Treasury	1	-	-	1
Financial Statement Reporting and Compilation	7	-	-	7
Military Pay	1	-	-	1
Contract/Vendor Pay	2	1	-	3
Reimbursable Work Orders (Budgetary)	2	1	-	3
Transportation of Things	2	-	-	2
Equipment Assets	1	-	-	1
Real Property Assets	1	-	-	1
Inventory	1	-	-	1
Operating Materials and Supplies	1	-	-	1
Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures)	4	-	(1)	3
Total Material Weaknesses	**23**	**2**	**(1)**	**24**

Looking through a periscope during an exercise. (U.S. Navy photo by Mass Communication Specialist 2nd Class Huey D. Younger Jr./Released)

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	Reassessed	Ending Balance
Budget-to-Report	Fund Balance with Treasury	1	-	-	-	1
	Financial Statement Reporting and Compilation	6	-	-	-	6
Hire-to-Retire	Military Pay	1	-	-	-	1
Procure-to-Pay	Contract/Vendor Pay	2	1	-	-	3
	Reimbursable Work Orders (Budgetary)	1	-	-	-	1
	Transportation of Things	2	-	-	-	2
Acquire-to-Retire	Equipment Assets	1	-	-	-	1
	Real Property Assets	1	-	-	-	1
Plan-to-Stock	Inventory	1	-	-	-	1
	Operating Materials and Supplies	1	-	-	-	1
	Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures)	3	-	(1)	-	2
Multiple End-to-End Processes	Military Standard Requisitioning and Issue Procedures (Requisitioning Procedures)	1	-	-	-	1
	Reimbursable Work Orders (Budgetary)	1	1	-	-	2
	Financial Statement Reporting and Compilation	1	-	-	-	1
Total Financial Reporting Material Weaknesses		**23**	**2**	**(1)**	**0**	**24**

** End-to-End Processes were assessed and re-baselined during FY 2017*

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	-	(1)	-	1
Security	0	1	-	-	1
Acquisition	1	-	-	(1)*	0
Communications	1	-	(1)	-	0
Manufacturing, Maintenance, and Repair	1	-	-	-	1
Personnel and Organizational Management	1	-	-	-	1
Total Material Weaknesses	**7**	**1**	**(2)**	(1)	**5**

**Attenuating Hazardous Noise in Acquisition and Weapons System Design was reclassified by the Senior Management Council (SMC) as a Significant Deficiency (SD). The SMC will continue to monitor progress made on this deficiency.*

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	Reassessed	Ending Balance
Financial Management Systems	9	0	(1)	0	8
Total System Conformance Material Weaknesses	9	0	(1)	0	8

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)

	Agency	Auditor
1. Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
2. Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
3. USSGL at Transaction Level	Lack of compliance noted	Lack of compliance noted

APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE PRINCIPAL STATEMENTS

ENTITY ACCOUNTS

General Funds

017X0380	Coastal Defense Augmentation, Navy
017X0513	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
017 1612	National Sea-Based Deterrence Fund, 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)
017X6025	Pay of the Navy, Deposit Fund (T)
017X6026	Pay of the Marine Corps, Deposit Fund (T)
017X6502	Foreign Cooperative Projects, Navy
017X6228	Thrift Savings Plan, Military
017X6705	Civilian Employees Allotment Account, Navy
017 6763	Gains and Deficiencies on Exchange Transactions, Navy
017X6275	Withhold State and Local Taxes
017X6276	Other Federal Payroll Withholdings, Allotments
017X5000	Advances Without Orders from Non-Federal Sources
017X6501	Small Escrow Amounts

Trust Funds

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

(T) - represents legacy Trust Fund accounts.

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

November 7, 2017

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 2017 and FY 2016 Basic Financial Statements (Project No. D2017-D000FS-0106.000, Report No. DODIG-2018-010)

Report on the Basic Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990," requires the DoD Inspector General to audit the accompanying Department of the Navy Working Capital Fund consolidated balance sheet as of September 30, 2017, and September 30, 2016, 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 accounting principles generally accepted in the United States of America (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 (GAGAS) and the Office of Management and Budget (OMB) Bulletin No. 17-03, “Audit Requirements for Federal Financial Statements,” September 29, 2017. 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 GAGAS 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 2017 and FY 2016 Basic Financial Statements would not substantially conform to 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, 2017. We considered the scope limitation in forming our conclusions on the basic financial statements. Accordingly, we did not perform all the auditing procedures required by GAGAS and OMB Bulletin No. 17-03 to determine whether material amounts on the basic financial statements were presented fairly.

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 2017 and FY 2016 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," August 15, 2017, 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. The Department of the Navy 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 Assistant Secretary of the Navy (Financial Management and Comptroller) did not provide comments to the draft report.

This report will be made publicly available under section 8M, paragraph (b)(1)(A) of the Inspector General Act of 1978. 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. This report is not intended for, nor should it be used by, any other audience.

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

Lorin T. Venable

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's internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances and for expressing our opinion on the basic financial statements, but not for 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 and could adversely affect the Department of the Navy Working Capital Fund's 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 DoD's 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.

- 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 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.

- General ledger accounting system posting logic does not produce expected financial and budgetary accounting relationships.

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. The Department of the Navy standard document numbers may be altered as transportation transactions enter other Military Services' financial and transportation systems.

Attachment 1
Page **2** of **6**

Transportation service providers and other Military 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 in tracing 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 required to support Transportation of Things transactions, management evaluations, and future examinations or audits.

Inventory. The Department of the Navy has identified problems with the Moving Average Cost inventory value calculations in Navy Enterprise Resource Planning system. Business processes currently in existence do not support accurate valuation of inventory, and Navy Enterprise Resource Planning system 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 Orders. Military Sealift Command liquidations and payments lack supporting receipt and acceptance documentation for the U.S. Marine Corps. Delivery confirmation documentation is not received from the Defense Contract Management Agency as required.

The Department of the Navy's financial management controls over the Statement of Budgetary Resources are not designed or operating effectively to provide reasonable assurance that balances related to commitments, obligations, de-obligations, undelivered orders, and unfilled customer orders are valid and recorded accurately.

Contract Vendor Pay. The Department of the Navy is not able to generate a transactional level population to support the reported accounts payable balance at fiscal year-end. Additionally, the Department of the Navy does not have a process to record an estimated liability for goods and services incurred, but not yet invoiced by the vendor. Analysis indicates accounts payable may be materially understated.

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 Laws, Regulations, Contracts, and Grant Agreements

GAGAS 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 limited our work to determining compliance with selected provisions of the applicable laws, regulations, contracts, and grant agreements. Other noncompliance may have occurred and not been detected, and 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.

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 immediately report to the President and Congress all relevant facts and a statement of actions taken. During FY 2017, the Department of the Navy 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. 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. Standard General Ledger at the transaction level.

Department of the Navy management states that the staff is focusing compliance efforts on the Navy Enterprise Resource Planning system and selected legacy environments, which will be tested to substantially comply with the Federal financial management systems requirements, U.S. generally accepted accounting principles, and the U.S. Standard General Ledger at the transaction level. The Department of the Navy has based its assessment on system requirements issued 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 2017, 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, or the U.S. Standard General Ledger at the transaction level as of September 30, 2017. 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 the 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.

Sailors heave line in preparation for departure. (U.S. Navy photo by Mass Communication Specialist Seaman David Claypool/Released)

PRINCIPAL STATEMENTS

NAVY WORKING CAPITAL FUND

The fiscal year 2017 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, 2017, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2016.

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, 2017 and 2016

($ in Thousands)

	2017 Consolidated	2016 Consolidated
ASSETS		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 2,270,703	$ 1,419,711
Accounts Receivable (Note 4)	897,794	860,622
Other Assets (Note 5)	37	-
Total Intragovernmental Assets	3,168,534	2,280,333
Cash and Other Monetary Assets (Note 6)	-	901
Accounts Receivable, Net (Note 4)	112,887	111,399
Inventory and Related Property, Net (Note 7)	34,093,955	33,653,421
General Property, Plant and Equipment, Net (Note 8)	1,976,839	1,987,136
Other Assets (Note 5)	3,087,622	3,003,061
TOTAL ASSETS	$ 42,439,837	$ 41,036,251
LIABILITIES		
Intragovernmental:		
Accounts Payable (Note 10)	$ 231,177	$ 226,654
Other Liabilities (Note 11 & Note 12)	327,986	316,474
Total Intragovernmental Liabilities	559,163	543,128
Accounts Payable (Note 10)	4,098,085	4,521,759
Federal Employee and Veteran Benefits (Note 14)	667,598	681,273
Environmental and Disposal Liabilities (Note 11)	303,463	-
Other Liabilities (Note 11 & Note 12)	1,496,965	1,340,726
TOTAL LIABILITIES	7,125,274	7,086,886
Commitments and Contingencies (Note 13)		
NET POSITION		
Unexpended Appropriations - Other Funds	$ 1,531	$ 1,531
Cumulative Results of Operations - Other Funds	35,313,032	33,947,834
TOTAL NET POSITION	$ 35,314,563	$ 33,949,365
TOTAL LIABILITIES AND NET POSITION	$ 42,439,837	$ 41,036,251

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, 2017 and 2016

($ in Thousands)

	2017 Consolidated	2016 Consolidated
Program Costs		
Gross Costs		
Operations, Readiness, & Support	$ 61,197,080	$ 29,788,970
Less: Earned Revenue	(59,529,324)	(28,956,775)
Net Cost of Operations	$ 1,667,756	$ 832,195

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2017 and 2016
($ in Thousands)

	2017 Consolidated	2016 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balance	$ 33,947,834	$ 31,531,128
Budgetary Financing Sources:		
Nonexchange Revenue	15,051	12,576
Other Financing Sources:		
Transfers In/Out without Reimbursement	1,110,356	1,447,610
Imputed Financing	425,058	522,859
Other	1,482,489	1,265,856
Total Financing Sources	3,032,954	3,248,901
Net Cost of Operations	1,667,756	832,195
Net Change	1,365,198	2,416,706
Cumulative Results of Operations	$ 35,313,032	$ 33,947,834
UNEXPENDED APPROPRIATIONS		
Beginning Balance	$ 1,531	$ 1,531
Budgetary Financing Sources:		
Appropriations Received	-	-
Appropriations Used	-	-
Total Budgetary Financing Sources	-	-
Unexpended Appropriations	1,531	1,531
Net Position	$ 35,314,563	$ 33,949,365

The accompanying notes are an integral part of the statements.

Department of Defense

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2017 and 2016

($ in Thousands)

	2017 Combined	2016 Combined
Budgetary Resources:		
Unobligated Balance, Brought Forward, October 1	$ 2,317,692	$ 2,280,484
Recoveries of Prior Year Unpaid Obligations	2,403,503	2,292,461
Other Changes in Unobligated Balance	(1,791,083)	(1,738,513)
Unobligated Balance from Prior Year Budget Authority, Net	2,930,112	2,834,432
Appropriations	-	-
Contract Authority	9,855,307	9,351,097
Spending Authority from Offsetting Collections	22,134,298	21,361,072
Total Budgetary Resources	$ 34,919,717	$ 33,546,601
Status of Budgetary Resources:		
New Obligations and Upward Adjustments	$ 31,974,214	$ 31,228,909
Unobligated Balance, End of Year		
Apportioned	2,810,321	2,204,422
Exempt from apportionment, unexpired accounts	1,696	-
Unapportioned	133,486	113,270
Unexpired Unobligated Balance, End of Year	2,945,503	2,317,692
Expired Unobligated Balance, End of Year	-	-
Unobligated Balance Brought Forward, End of Year	2,945,503	2,317,692
Total Status of Budgetary Resources	$ 34,919,717	$ 33,546,601
Change in Obligated Balance:		
Unpaid Obligations		
Unpaid Obligations, Brought Forward, October 1	$ 13,967,277	$ 12,968,335
New Obligations and Upward Adjustments	31,974,214	31,228,909
Outlays, Gross	(28,079,594)	(27,937,506)
Recoveries of Prior Year Unpaid Obligations	(2,403,503)	(2,292,461)
Unpaid Obligations, End of Year, Gross	15,458,394	13,967,277
Uncollected Payments		
Uncollected Payments from Federal Sources, Brought Forward, October 1	(11,991,014)	(12,115,334)
Change in Uncollected Payments from Federal Sources	(789,376)	124,320
Uncollected payments from Federal Sources, End of Year	(12,780,390)	(11,991,014)
Obligated Balance, Start of Year	1,976,263	853,001
Obligated Balance, End of Year	$ 2,678,004	$ 1,976,263
Budget Authority and Outlays, Net:		
Budget Authority, Gross	$ 31,989,605	$ 30,712,169
Actual Offsetting Collections	(28,930,586)	(28,477,649)
Change in Uncollected Payments from Federal Sources	(789,376)	124,320
Budget Authority, Net	$ 2,269,643	$ 2,358,840
Outlays, Gross	$ 28,079,594	$ 27,937,506
Actual Offsetting Collections	(28,930,586)	(28,477,649)
Outlays, Net	(850,992)	(540,143)
Agency Outlays, Net	$ (850,992)	$ (540,143)

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) 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 (U.S. GAAP) 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.

Information relative to classified assets, programs, and operations is 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 systems and incorporates it into the financial statements for the NWCF. The NWCF collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL for incorporation into the financial statements.

The NWCF is unable to fully implement all elements of U.S. GAAP 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 U.S. GAAP. The NWCF continues to implement process and system improvements addressing these limitations.

The NWCF currently has seven 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; (7) Contractor Vendor Pay.

1.B. Mission of the Reporting Entity

The DON was established 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 by 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

The 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

The NWCF's financial management systems are unable to meet 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 U.S. GAAP. 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 DON financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of DON 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 DON is continuing the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with U.S. GAAP. 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 U.S. GAAP, 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.

1.E. Revenues and Other Financing Sources

The NWCF Depot Maintenance 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.

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 NWCF recognizes nonexchange revenue from the U.S. Naval Academy General Gift Fund, DON General Gift Fund, and the Military Reservation Wildlife Conservation Fund where the parties that will not receive value in return from the NWCF.

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 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, 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, as 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; 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. 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, as the U.S. Treasury does not allocate such costs to DoD. Accordingly, 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.

1.H. Transactions with Foreign Governments and International Organizations

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

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

The NWCF's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of 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, the NWCF FBWT is reviewed and adjusted, as required, to agree with the U.S. Treasury accounts. Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.J. Cash and Other Monetary Assets

Cash resources include 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 NWCF does not separately identify currency fluctuation transactions.

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 its operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions. 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. The DON does not separately identify currency fluctuation transactions.

1.K. Accounts Receivable

Accounts receivable from other federal entities and 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 uncollectible amounts is based on an individual account analysis and group analysis. The analysis is based on three years of receivable data. The NWCF uses non-intragovernmental data to determine the historical percentage of collections in each age category of public receivables.

The NWCF does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved in accordance with dispute resolution procedures defined in the Treasury Financial Manual (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 NWCF interprets the term "held for sale" to include items for sale or transfer to entities outside the federal government or other federal entities.

NWCF recognizes inventory 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, and inventory that the NWCF determines to be excess, obsolete, or unserviceable. The NWCF values resale inventory using the Moving Average Cost (MAC) method.

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. 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.

The NWCF values Inventory Held for Repair at the price of a serviceable item less estimated repair costs using the “direct method.” When the NWCF complete the repair, the cost of the repair is capitalized in the inventory account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account. NWCF recognizes excess, obsolete, and unserviceable inventory at a net realizable value of zero. Inventory work in process, including production and service costs and the value of finished products or completed services pending submission of bills to customers, is valued at Actual Cost (AC).

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.

Related property includes OM&S. 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 Latest Acquisition Cost (LAC).

The NWCF uses a combination of the Consumption Method and Purchase Method to account for OM&S. In accordance with SFFAS No. 3, under the consumption method, the NWCF capitalized OM&S upon purchase and expensed it when it is consumed. Under the purchase method, material and supplies are expensed when purchased. Individual components in the NWCF use the Consumption Method unless the 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.

The NWCF standard valuation method is MAC. However, some OM&S is valued using Latest Acquisition Cost (LAC). 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.

The NWCF recognizes excess, obsolete, and unserviceable inventory and OM&S at a net realizable value (NRV) 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 the 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; and (2) the value of finished products or completed services that are yet to be placed in service.

1.M. General Property, Plant and Equipment

The NWCF General Property, Plant and Equipment (PP&E) assets are capitalized in accordance with SFFAS No. 6, "Accounting for Property, Plant and Equipment" and SFFAS No. 10, "Accounting for Internal Use Software." The NWCF capitalizes general PP&E assets at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization thresholds. The NWCF capitalizes improvements to existing general PP&E assets if the improvement equals or exceeds the General Fund's capitalization threshold, extends the useful life of the underlying asset or increases 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.

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. The NWCF capitalized PP&E assets acquired prior to October 1, 2013 lower threshold levels ($100 thousand for equipment and $20 thousand for real property).

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. 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, the DON provides government property to contractors to complete contract work. The DON either owns such property, and either provides it to the contractor or it is purchased directly by the contractor for the government. The Federal Acquisition Regulations (FAR) requires the DON maintain, information on all property furnished to contractors in its property systems. The DON has not fully complied with these requirements and is in the process of developing a business process to record and track all contractor held property in DON accountable process systems of records (APSR).

1.N. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy, as prescribed in SSFAS No. 1, is to record advances or prepayments in accordance with U.S. GAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and properly classify assets when the related goods and services are received. The NWCF has not fully 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.

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. As the lessee, the NWCF receives the use and possession of leased property, such as 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 are the largest component of operating leases; pricing is based on costs gathered from existing leases, General Services Administration (GSA) bills, and interservice support agreements. Future year lease payment projections are based on the Consumer Price Index.

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 maintains this classification in accordance with SSFAS No. 1.

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 costs, 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

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

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. 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, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. Additionally, the 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. Prior to FY 2017, the DON reported all Environmental Liabilities on the General Fund Financial Statements. As a result of audit readiness efforts, Environmental Liabilities related to NWCF assets are now reported on the NWCF Financial Statements. See Note 11, "Environmental and Disposal Liabilities," for additional information.

1.R. Accrued Leave

The NWCF reports unused military, compensatory, and civilian annual leaves 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

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

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. Federal Employee and Veterans' Benefits

For financial reporting purposes, the DON's actuarial liability for workers' 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 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	2017	2016
(Amounts in thousands)		
Accounts Receivable with the Public	$ 49,803	$ 35,294
Total Entity Assets	$ 42,390,034	$ 41,000,957
Total Assets	$ 42,439,837	$ 41,036,251

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

Nonfederal accounts receivable with the public represent 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	2017	2016
(Amounts in thousands)		
Fund Balances		
Revolving Funds	$ 2,270,703	$ 1,419,711

Other

As of September 30	2017	2016
(Amounts in thousands)		
Fund Balances Per Treasury Versus Agency		
Fund Balance per Treasury	$ 2,270,703	$ 1,419,711
Fund Balance per DON	2,270,703	1,419,711
Reconciling Amount	$ -	$ -

The NWCF FBWT consists of Revolving Funds, which is a fund that remains available to finance an organization's continuing operations without any fiscal year limitation, as the organization replenishes the fund by repaying money used from the account.

The Fund Balance above includes undistributed disbursements and collections. The NWCF field-level GL accounting systems may not include all Treasury collection and disbursement activity due to timing differences and disbursements made by other DoD agencies on behalf of the DON. The DON recorded adjustments totaling $240 million in FY 2017 to compensate for these differences. Due to financial system limitations, the DON performs manual reconciliations after the period-end close to categorize these adjustments as supported and unsupported.

Status of Fund Balance with Treasury

As of September 30	2017		2016	
(Amounts in thousands)				
Unobligated Balance				
Available	$	2,812,016	$	2,204,421
Unavailable		133,486		113,270
Obligated Balance not yet Disbursed		15,458,395		13,967,278
Non-FBWT Budgetary Accounts		(16,133,194)		(14,865,258)
Total	$	2,270,703	$	1,419,711

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 balance 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 reduce 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.

NOTE 4. ACCOUNTS RECEIVABLE

As of September 30 — **2017**

(Amounts in thousands)	Gross Amount Due		Allowance For Estimated Uncollectibles		Accounts Receivable, Net	
Intragovernmental Receivables	$	897,794	$	-	$	897,794
Nonfederal Receivables (From the Public)		118,294		(5,407)		112,887
Total	$	1,016,088	$	(5,407)	$	1,010,681

As of September 30 — **2016**

(Amounts in thousands)	Gross Amount Due		Allowance For Estimated Uncollectibles		Accounts Receivable, Net	
Intragovernmental Receivables	$	860,622	$	-	$	860,622
Nonfederal Receivables (From the Public)		116,495		(5,096)		111,399
Total	$	977,117	$	(5,096)	$	972,021

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. Nonfederal 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." Refer to Note 2, "Nonentity Assets," for additional information on Nonfederal Accounts.

NOTE 5. OTHER ASSETS

As of September 30	2017	2016
(Amounts in thousands)		
Intragovernmental Other Assets		
Advances and Prepayments	$ 37	$ -
Outstanding Contract Financing Payments	826,019	864,534
Advances and Prepayments	2,260,422	2,135,231
Other Assets (With the Public)	1,181	3,296
Total Nonfederal Other Assets	3,087,622	3,003,061
Total	$ 3,087,659	$ 3,003,061

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 rights to the NWCF, protecting the contract work from state or local taxation, liens or attachment by contractors' creditors, transfer of property, or disposition in bankruptcy. However, these rights do not 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, and 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 is comprised of $759.3 million in contract financing payments and an additional $66.7 million in estimated future funded payments to contractors upon delivery and Government acceptance of a satisfactory product. Refer to Note 12, "Other Liabilities," for additional information.

Nonfederal Other Assets - Other Assets (With the Public)
Nonfederal Other Assets consists of prepayments made to vendors and travel advances made to employees. Fluctuations are primarily due to Navy Supply Management reclassification of Federal Advances and Prepayments to Nonfederal Advances and Prepayments in order to reconcile seller side trading partner data.

NOTE 6. CASH AND OTHER MONETARY ASSETS

As of September 30	2017	2016
(Amounts in thousands)		
Cash	$ -	$ 901

The 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.

NOTE 7. INVENTORY AND RELATED PROPERTY

As of September 30	2017	2016
(Amounts in thousands)		
Inventory, Net	$ 33,896,764	$ 33,469,449
Operating Materials & Supplies, Net	197,191	183,972
Total	$ 34,093,955	$ 33,653,421

Inventory and Related Property

As of September 30 — **2017**

(Amounts in thousands)	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
Inventory, Net				
Inventory Categories				
Available and Purchased for Resale	$ 19,423,885	$ (46,518)	$ 19,377,367	MAC, LAC
Held for Repair	14,540,294	(53,587)	14,486,707	MAC, LAC
Excess, Obsolete, and Unserviceable	11,082	(11,082)	-	NRV
Work in Process	32,690	-	32,690	AC
Total	$ 34,007,951	$ (111,187)	$ 33,896,764	

As of September 30 — **2016**

(Amounts in thousands)	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
Inventory, Net				
Inventory Categories				
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
Total	$ 33,498,096	$ (28,647)	$ 33,469,449	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost NRV = Net Realizable Value MAC = Moving Average Cost AC = Actual Cost

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 or services for a fee. The NWCF interprets “Held for Sale” to include items for sale or transfer to entities outside the DON. All DON inventory is funded and reported under the NWCF.

NWCF inventory is recognized when title passes or the goods are delivered to the purchasing entity. It is then segmented into consumable and repairable inventory.

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 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.

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

Inventory available and purchased for resale includes consumable and reparable 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 **2017**

(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use	$ 197,070	$ -	$ 197,070	LAC, MAC
Held for Repair	121	-	121	LAC, MAC
Excess, Obsolete, and Unserviceable	-	-	-	NRV
Total	$ 197,191	$ -	$ 197,191	

As of September 30 **2016**

(Amounts in thousands)	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
OM&S Categories				
Held for Use	$ 183,964	$ -	$ 183,964	LAC, MAC
Held for Repair	8	-	8	LAC, MAC
Excess, Obsolete, and Unserviceable	-	-	-	NRV
Total	$ 183,972	$ -	$ 183,972	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost MAC = Moving Average Cost NRV = Net Realizable Value

In accordance with SFFAS No. 3, "Accounting for Inventory and Related Property," the NWCF categorizes its Operating Materials & Supplies (OM&S) as Held for Use and Held for Repair. The DON assigns Operating Materials & Supplies OM&S to categories based upon the type and condition of the asset. Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. All other OM&S is classified as Held for Use.

SFFAS No. 3 requires disclosure of the amount of OM&S held for "Future Use." The NWCF includes "Future Use" OM&S within the "Held for Use" category. OM&S held for "Future Use" totaled $0.5 million and $0.3 million as of September 30, 2017 and September 30, 2016, 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. There are no restrictions on the use of OM&S.

NOTE 8. GENERAL PROPERTY, PLANT AND EQUIPMENT (PP&E), NET

As of September 30 **2017**

(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 3,242	$ -	$ 3,242
Buildings, Structures, and Facilities	S/L	20 or 40	5,897,365	(4,784,781)	1,112,584
Software	S/L	2-5 or 10	206,543	(167,807)	38,736
General Equipment	S/L	5 or 10	2,971,665	(2,423,804)	547,861
Construction-in-Progress	N/A	N/A	274,316	-	274,316
Other	N/A	N/A	100	-	100
Total General PP&E			$ 9,353,231	$ (7,376,392)	$ 1,976,839

As of September 30			2016		
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
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
Total General PP&E			$ 9,669,071	$ (7,681,935)	$ 1,987,136

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

The NWCF general PP&E primarily consists of land, buildings, structures, facilities, software, general equipment, and construction in progress. Other general PP&E consists of assets awaiting disposal.

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."

There are no known restrictions on the use or convertibility of general PP&E.

NOTE 9. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30	2017	2016
(Amounts in thousands)		
Intragovernmental Liabilities		
Other	$ 135,800	$ 145,574
Federal Employee and Veteran Benefits	667,598	681,273
Environmental Liabilities	303,463	-
Other Liabilities	-	5,200
Total Nonfederal Liabilities	971,061	686,473
Total Liabilities Not Covered by Budgetary Resources	1,106,861	832,047
Total Liabilities Covered by Budgetary Resources	6,018,413	6,254,839
Total Liabilities	$ 7,125,274	$ 7,086,886

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.

Federal Liabilities
Intragovernmental Liabilities consist of unfunded 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
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.

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

Other Nonfederal Liabilities includes annual leave and the disposal of excess structures that are not currently budgeted for but will become funded as future events occur.

NOTE 10. ACCOUNTS PAYABLE

As of September 30 — **2017**

(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 231,177	$ -	$ 231,177
Nonfederal Payables (to the Public)	4,098,085	-	4,098,085
Total	$ 4,329,262	$ -	$ 4,329,262

As of September 30 — **2016**

(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	$ 226,654	$ -	$ 226,654
Nonfederal Payables (to the Public)	4,521,759	-	4,521,759
Total	$ 4,748,413	$ -	$ 4,748,413

Accounts Payable includes amounts owed to federal and nonfederal 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 AND DISPOSAL LIABILITIES

As of September 30	2017	2016
(Amounts in thousands)		
Environmental Liabilities - Nonfederal		
Other Accrued Environmental Liabilities - Non-BRAC		
Environmental Corrective Action	$ 394	$ -
Environmental Closure Requirements	201,288	-
Asbestos	100,364	-
Non-Military Equipment	1,417	-
Total	$ 303,463	$ -

Prior to FY 2017, the DON reported all Environmental Liabilities on the General Fund (GF) Financial Statements. As a result of audit readiness efforts in FY 2017, $303.5 million of GF Environmental Liabilities are now reported on the NWCF Financial Statements. See the DON GF Financial Statements and accompanying Note 12, "Environmental Liabilities and Disposal Liabilities," for additional information.

This NWCF reports the environmental clean-up or disposal costs for hazardous waste associated with future closure of general PP&E assets. Such costs are categorized as environmental corrective action, closure of facilities, remediation of operational range contamination, asbestos abatement, and disposal of non-military equipment. The remaining Environmental Liabilities are reported under the DON General Fund Financial Statements and accompanying Note 12, "Environmental Liabilities and Disposal Liabilities."

Applicable Laws and Regulations for Cleanup Requirements

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

- The Resource Conservation and Recovery Act of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984
- 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 of 1980
- Medical Waste Tracking Act of 1988
- Toxic Substances Control Act of 1976
- Resource Conversation and Recovery Act of 1976

The NWCF is required to clean up contamination from past waste disposal practices, leaks, spills, and other activity resulting in public health or environmental risk. NWCF accomplishes this effort in coordination with regulatory agencies and, if applicable, other responsible parties and current property owners. The NWCF is also required to recognize closure and post-closure costs for its general PP&E and environmental corrective action costs for current operations. Each of the NWCF major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapon systems, and environmental costs related to Base Closure and Realignment Commission (BRAC) actions.

Description of the Types of Environmental Liabilities and Disposal Liabilities

Other Accrued Environmental Liabilities – Non-BRAC
The NWCF defines Non-BRAC environmental units as non-military equipment in active use and real property sites those sites associated with on-going operations such as solid/hazardous waste management unit cleanup, landfill closure, permitted facilities, asbestos remediation removal, replacement, retro fill, and/or disposal of PCB transformers, underground storage tank remedial investigation and closure.

Nature of Estimates and the Disclosure of Additional Information
Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. As of September 30, 2017, 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.

The above table excludes estimated total cleanup costs associated with general PP&E of $1.4 million for FY 2017.

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

NOTE 12. OTHER LIABILITIES

As of September 30	2017		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	$ 82,319	$ -	$ 82,319
FECA Reimbursement to the Dept of Labor	61,168	74,632	135,800
Custodial Liabilities	49,803	-	49,803
Employer Contribution and Payroll Taxes Payable	60,064	-	60,064
Total Intragovernmental	253,354	74,632	327,986
Accrued Funded Payroll and Benefits	1,032,417	-	1,032,417
Advances from Others	368,182	-	368,182
Deposit Funds and Suspense Accounts	876	-	876
Contract Holdbacks	4,662	-	4,662
Employer Contribution and Payroll Taxes Payable	4,642	-	4,642
Contingent Liabilities	-	66,741	66,741
Other Liabilities	19,445	-	19,445
Total Other Liabilities	$ 1,683,578	$ 141,373	$ 1,824,951

As of September 30	2016		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
Intragovernmental			
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
Total Intragovernmental	236,493	79,981	316,474
Accrued Funded Payroll and Benefits	986,670	-	986,670
Advances from Others	251,047	-	251,047
Deposit Funds and Suspense Accounts	47	-	47
Contract Holdbacks	2,442	-	2,442
Employer Contribution and Payroll Taxes Payable	5,278	-	5,278
Contingent Liabilities	-	74,296	74,296
Other Liabilities	20,946	-	20,946
Total Other Liabilities	$ 1,502,923	$ 154,277	$ 1,657,200

Advances from Others represent liabilities for collections received to cover future expenses or acquisition of assets. Custodial Liabilities represents liabilities for collections reported as nonexchange revenues where the NWCF is acting on behalf of another federal entity.

Nonfederal Other Liabilities is attributed to improperly recorded unfunded liability transactions in the field accounting system. The posting issues creating this condition have been documented to support identification and prioritization of corrective action.

Contingent Liabilities includes $66.7 million 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 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 that 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 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 13. COMMITMENTS AND CONTINGENCIES

The NWCF is a party in various administrative proceedings, legal actions, and 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. Additional information about the NWCF contingent legal liabilities can be found in Note 12, "Other Liabilities."

The DON OGC and 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. For each claim above the annual assessment materiality threshold, OGC and OJAG assess the likelihood of an unfavorable outcome, as follows: probable, remote, and unable to express an opinion. For FY 2017, the DON materiality threshold for reporting litigation, claims, or assessments is $5.8 million.

As of September 30, 2017, the NWCF has three cases that exceed the materiality threshold. The NWCF legal counsel has assessed the outcome of these cases as remote, with no financial impact noted.

The NWCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolutions, 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.

Additional system limitations prevent the NWCF from properly estimating the amount of obligations where the Navy has a contractual commitment for payment. An analysis of underlying transactions will be needed to determine the amount of accounts payable related to cancelled funds.

The NWCF does not have any contractual arrangements which may require future obligations.

NOTE 14. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30		2017	
(Amounts in thousands)	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits			
FECA	$ 667,598	$ -	$ 667,598

As of September 30		2016	
(Amounts in thousands)	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits			
FECA	$ 681,273	$ -	$ 681,273

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 and Assumptions

The NWCF's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the 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 DOL calculates the future workers' compensation liability using wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIM). The actual rates for these factors for charge back year (CBY) 2017 were also used to adjust the methodology's historical payments to current year constant dollars.

To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Changes in the liability from last year's analysis to the year's analysis were also examined by agency, with any significant differences by agency inspected in greater detail. DOL concluded that the model has been stable and has projected the actual payments by agency well.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the U.S. Treasury's Yield Curve for Treasury Nominal Coupon Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.7% was assumed for year one, year two, and thereafter. An interest rate for medical benefits of 2.2% was assumed for year one, year two, and thereafter.

NOTE 15. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Intragovernmental Costs and Exchange Revenue

As of September 30		2017		2016
(Amounts in thousands)				
Intragovernmental Costs	$	5,301,440	$	4,882,783
Nonfederal Costs		55,895,640		24,906,187
Total Costs	$	61,197,080	$	29,788,970
Intragovernmental Earned Revenue	$	(26,714,668)	$	(26,407,600)
Nonfederal Revenue		(32,814,656)		(2,549,175)
Total Revenue	$	(59,529,324)	$	(28,956,775)
Total Net Cost	$	1,667,756	$	832,195

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 capture costs based on appropriations groups as presented above. The lower level costs for major programs are not presented 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."

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 nonfederal expenses. Intradepartmental 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.

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.

NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30	2017	2016
(Amounts in thousands)		
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 12,323,131	$ 10,695,603

DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30 — **2017**

(Amounts in thousands)	Direct Obligations	Reimbursable Obligations	Total
Obligations Apportioned Under			
Category A	$ -	$ -	$ -
Category B	-	31,974,214	31,974,214
Exempt	-	-	-
Total	$ -	$ 31,974,214	$ 31,974,214

As of September 30 — **2016**

(Amounts in thousands)	Direct Obligations	Reimbursable Obligations	Total
Obligations Apportioned Under			
Category A	$ -	$ -	$ -
Category B	-	31,228,909	31,228,909
Exempt	-	-	-
Total	$ -	$ 31,228,909	$ 31,228,909

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.

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	2017	2016
(Amounts in thousands)		
Resources Used to Finance Activities		
Budgetary Resources Obligated:		
Obligations Incurred	$ 31,974,214	$ 31,228,909
Less: Spending Authority from Offsetting Collections and Recoveries	(32,123,467)	(30,645,793)
Net Obligations	(149,253)	583,116
Other Resources:		
Transfers In/Out without Reimbursement	1,110,356	1,447,610
Imputed Financing from Costs Absorbed by Others	425,058	522,859
Other	1,482,489	1,265,856
Net Other Resources Used to Finance Activities	3,017,903	3,236,325
Total Resources Used to Finance Activities	2,868,650	3,819,441
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided:		
Undelivered Orders	(1,627,528)	(940,414)
Unfilled Customer Orders	655,388	(285,591)
Resources that Fund Expenses Recognized in Prior Periods	(23,449)	(812)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	-	-
Resources that Finance the Acquisition of Assets	(4,296,286)	(6,211,257)
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations:		
Other	(2,592,843)	(2,713,466)
Total Resources Used to Finance Items not part of the Net Cost of Operations	(7,884,718)	(10,151,540)
Total Resources Used to Finance the Net Cost of Operations	(5,016,068)	(6,332,099)
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Period:		
Increase in environmental and disposal liability	303,463	-
Other	-	6,122
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	303,463	6,122
Components not Requiring or Generating Resources:		
Depreciation and Amortization	279,128	226,200
Revaluation of Assets or Liabilities	408,473	1,445,027
Other		
Cost of Goods Sold	9,022,740	8,887,804
Operating Materials and Supplies Used	-	-
Other	(3,329,980)	(3,400,859)
Total Components of Net Cost of Operations that will not Require or Generate Resources	6,380,361	7,158,172
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	6,683,824	7,164,294
Net Cost of Operations	$ 1,667,756	$ 832,195

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 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 $5.3 billion (absolute amount) as of September 30, 2017 to bring it into balance with the SNC.

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 lines are presented as combined instead of consolidated as intra-entity 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

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.

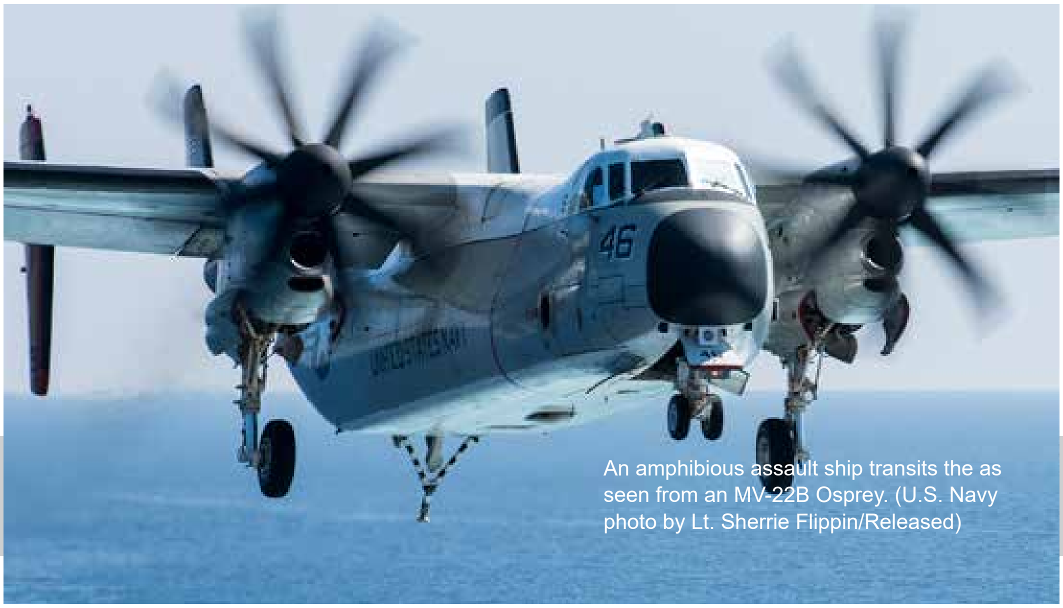
Resources Used to Finance Items Not Part of Net Cost of Operations - Other, are amounts related to supply management of inventory available and purchased for resale including consumable spare and repair parts and reparable items as well as goods transferred for reissue from inventory.

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

The NWCF collected $64.9 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.



An amphibious assault ship transits the as seen from an MV-22B Osprey. (U.S. Navy photo by Lt. Sherrie Flippin/Released)

NAVY WORKING CAPITAL FUND REQUIRED SUPPLEMENTARY INFORMATION

REAL PROPERTY DEFERRED MAINTENANCE AND REPAIR

For Fiscal Year Ended September 30, 2017

The Navy Working Capital Fund real property deferred maintenance and repair information for fiscal year ended September 30, 2017 is reported with the Department of the Navy deferred maintenance and repair. See Department of the Navy General Fund Required Supplementary Information.

Conducting a foreign objects and debris walk down on the flight deck. (U.S. Navy photo by Mass Communication Specialist 3rd Class Zachary Eshleman/Released)

NAVY WORKING CAPITAL FUND OTHER INFORMATION

APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE PRINCIPAL STATEMENTS

ENTITY ACCOUNTS

Navy Working Capital Fund (NWCF)

Fund/Account Treasury Symbol and Title

97X4930.002	Defense Working Capital Fund, Navy

Navy Working Capital Fund Activity Group Treasury Symbol and Title

97X4930.NA2*	Depot Maintenance – Aviation
97X4930.NA4*	Depot Maintenance – Other, Marine Corps
97X4930.NA3*	Ordnance
97X4930.ND*	Transportation
97X4930.NE*	Base Support
97X4930.NH*	Research and Development
97X4930.NC*	Supply Management
97X4930.NC3*	Supply Management, Marine Corps

Notes:

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

Delivering vehicles and equipment from an amphibious dock landing ship. (U.S. Navy photo by Mass Communication Specialist 1st Class Darren M. Moore/Released)

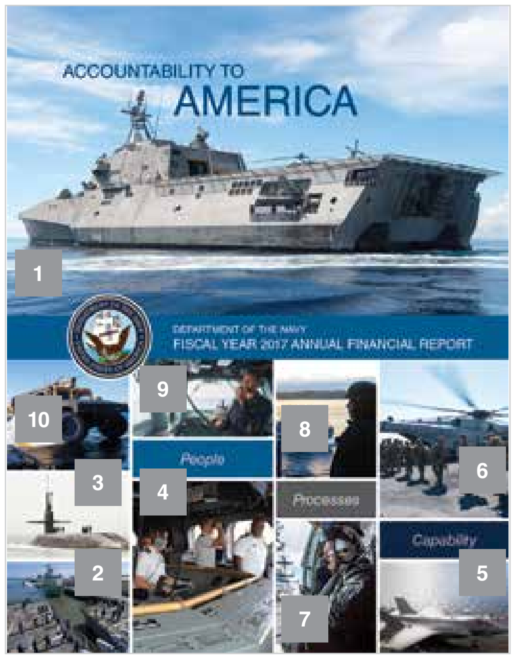
APPENDIX

ACRONYM	DEFINITION
AFR	Annual Financial Report
AITT	Augmented Immersive Team Trainer
ALAMO	Air-Launched Autonomous Micro Observer
AO	Action Officer
APSR	Accountable Property System of Record
ASN (FM&C)	Assistant Secretary of the Navy, Financial Management & Comptroller
ASN (RD&A)	Assistant Secretary of the Navy, Research, Development, & Acquisition
ATFP	Anti-Terrorism/Force Protection
AU	Assessable Unit
BD/DR	Demolition and Debris Removal
BLAST	Blasts Load Assessment Sense and Test
BRAC	Base Closure and Realignment Commission
BRS	Blended Retirement System
BSO	Budget Submitting Office
BUMED	Bureau of Medicine and Surgery
BUPERS	Bureau of Naval Personnel
CAP	Corrective Action Plan
CARAT	Cooperation Afloat Readiness Training
CAVE	Combined Arms Virtual Environment
CBY	Charge Back Year
CFO	Chief Financial Officer
CIP	Construction in Process
CMC	Commandant of the Marine Corps
CNIC	Commander, Navy Installations Command
CNLSC	Commander, Naval Legal Service Command
CNO	Chief of Naval Operations
CNRF	Commander, Navy Reserve Force
COAMPS-TC	Coupled Ocean/Atmosphere Mesoscale Prediction System-Tropical Cyclone
COFD	Contracting Officers Final Decision
COLA	Cost of Living Adjustment
COMPACFLT	Commander, U.S. Pacific Fleet
CPIM	Consumer Price Index Medical
CPT	Cyber Protection Teams
CSG	Carrier Strike Group
CSMP	Current Ships' Maintenance Plan
C-TAK	Cyber Tactical Assessment Kit
CTC	Cost to Complete
CYBERCOM	Cyber Command
D&I	Diversity and Inclusion
DASN (FO)	Deputy Assistant Secretary of the Navy (Financial Operations)
DASN (UxS)	Deputy Assistant Secretary of the Navy (Unmanned Systems)
DDNI	Deputy Director of Naval Intelligence
DDRS-DCM	Defense Departmental Reporting System Data Collection Module
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DFAS-CL	Defense Finance and Accounting Service - Cleveland
DISMS	Deployable Ship Integration Multitouch System
DM&R	Deferred Maintenance and Repair
DNI	Director of Naval Intelligence
DNS	Director, Navy Staff
DoD	Department of Defense
DoD FMR	Department of Defense Financial Management Regulation
DoDIG	Department of Defense Inspector General

ACRONYM	DEFINITION
DOL	Department of Labor
DON	Department of the Navy
DON/AA	Department of the Navy Assistant for Administration
E&C	Existence and Completeness
EEOC	Equal Employment Opportunity Commission
EFTM	External Fuel Transfer Module
EMALS	Electromagnetic Aircraft Launch System
EOP	Executive Office of the President
ER, N	Environmental Restoration, Navy
ERP	Enterprise Resource Planning
FAM	Federal Audit Manual
FAR	Federal Acquisition Regulations
FASAB	Federal Accounting Standards Advisory Board
FAST	Federal Account Symbols and Titles
FBWT	Fund Balance with Treasury
FCI	Facility Condition Index
FECA	Federal Employees' Compensation Act
FFCA	Federal Facility Compliance Act
FFMIA	Federal Financial Management Improvement Act
FIAR	Financial Improvement and Audit Readiness
FID	Fixed Induction Date
FIP	Financial Improvement Program
FISCAM	Federal Information System Controls Audit Manual
FISWG	Financial Information Systems Working Group
FMFIA	Federal Managers' Financial Integrity Act
FMR	Financial Management Regulation
FSA	Field Support Activity
FSEP	Fleet Scholar Education Program
FSRM	Facility Sustainment, Restoration, and Modernization
FTE	Full Time Equivalent
FY	Fiscal Year
GAO	Government Accountability Office
GF	General Fund
GGF	Great Green Fleet
GMRA	Government Management Reform Act of 1994
GPRA	Government Performance and Results Act
GSA	General Services Administration
HC	Historical Cost
HQMC	Headquarter, Marine Corps
IA	Individual Augmentees
ICO	Internal Controls over Operations
ICOFR	Internal Controls Over Financial Reporting
ICOFS	Internal Controls Over Financial Systems
IMC	Integrated Maintenance Concept
IPA	Independent Public Accounting
IRP	Installation Restoration Program
IT	Information Technology
I-TDG	Interactive Tactical Decision Game
LAC	Latest Acquisition Cost
LCS	Littoral Combat Ship
LDUUV	Large Displacement Unmanned Undersea Vehicle
MAC	Moving Average Cost
MACO	Maritime Accelerated Capability Office
MARFORCOM	U.S. Marine Corps Forces Command

ACRONYM	DEFINITION
MARFORCYBER	U.S. Marine Corps Forces, Cyberspace Command
MARFORPAC	U.S. Marine Corps Forces, Pacific
MARFORRES	U.S. Marine Corps Forces Reserve
MARFORSOC	U.S. Marine Corps Forces, Special Operations Command
MAU	Major Assessable Unit
MCICOM	Marine Corps Installations Command
MCLC	Marine Corps Logistics Command
MDI	Mission Dependency Index
MEF	Marine Expeditionary Force
MICP	Managers' Internal Control Program
MIW RAC	Mine Warfare Rapid Assessment Capability
MMRP	Military Munitions Response Program
MRAP	Mine-Resistant Ambush Protected
MRR	Marine Raider Regiment
MRSG	Marine Raider Support Group
MSC	Military Sealift Command
MSOS	Marine Special Operations School
MW	Material Weakness
MWR	Morale, Welfare, and Recreation
NAS	Naval Air Station
NAVAIR	Naval Air Systems Command
NAVFAC	Naval Facilities Engineering Command
NAVSEA	Naval Sea Systems Command
NAVSUP	Naval Supply Systems Command
NCTRF	Navy Clothing and Textile Research Facility
NDSF	National Defense Sealift Fund
NECC	Navy Expeditionary Combat Command
NETC	Naval Education Training Command
NIA	Naval Intelligence Activity
NIST	National Institute of Standards and Technology
NORM	Normalization of Data System
NPC	Navy Personnel Command
NPS	Naval Postgraduate School
NRC	Navy Recruiting Command
NRV	Net Realizable Value
NSA	Naval Support Activity
NSW	Naval Special Warfare
NSWC	Naval Special Warfare Command
NWC	Naval War College
NWCF	Navy Working Capital Fund
OCFP	Outstanding Contract Financing Payments
OCHR	Office of Civilian Human Resources
OCO	Overseas Contigency Operations
OCONUS	Outside Contiguous United States
OFRP	Optimized Fleet Response Plan
OGC	Office of General Counsel
OJAG	Office of the Judge Advocate General
OM&S	Operating Materials & Supplies
OMB	Office of Management and Budget
ONR	Office of Naval Research
OSBP	Office of Small Business Programs
OSD	Office of Secretary of Defense
OUSD(AT&L)	Office of the Under Secretary of Defense for Acquisition, Technology and Logistics
PAO	Principal Administering Office
PCS	Permanent Change of Station
PEO	Program Executive Office

ACRONYM	DEFINITION
PMI	Planned Maintenance Intervals
PP&E	Property, Plant, & Equipment
PRV	Plant Replacement Value
R&D	Research and Development
RCRA	Resource Conservation and Recovery Act
REPO	Renewable Energy Program Office
RMF	Risk Management Framework
RPA	Real Property Asset
RSI	Required Supplementary Information
S&T	Science and Technology
S/L	Straight Line
SAIL	Sailor Assistance and Intercept for Life
SAO	Senior Accountable Officials
SAPR	Sexual Assault Prevention & Response
SAPRO	Sexual Assault Prevention & Response Office
SAT	Senior Assessment Team
SBA	Schedule of Budgetary Activity
SBR	Statement of Budgetary Resources
SCNP	Statement of Changes in Net Position
SD	Significant Deficiencies
SEAL	Special Warfare Operators
SECDEF	Secretary of Defense
SECNAV	Secretary of the Navy
SECNAVINST	Secretary of the Navy Instructions
SES	Senior Executive Service
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Senior Management Council
SMS	Sustainment Management System
SNC	Statement of Net Cost
SNF	Spent Nuclear Fuel
SOA	Statement of Assurance
SOF	Special Operations Forces
SP	Standard Price
SPAWAR	Space and Naval Warfare Systems Command
SSGN	Guided Missile Submarine
SSP	Strategic Systems Program
STEM	Science, Technology, Engineering, and Math
SURTASS	Surveillance Towed-Array Sensor System
SVIP	Special Victims Investigation and Prosecution
TBI	Traumatic Brain Injury
TCAP	Trial Counsel Assitance Program
TFM	Treasury Financial Manual
TNC	Treasury Nominal Coupon
U.S.	United States of America
UAV	Unmanned Aerial Vehicle
UIC	Unit Identification Code
USACE	U.S. Army Corps of Engineers
USACOE - CERL	U.S. Army Corps of Engineers Civil Engineering Research and Development
USFK	U.S. Forces Korea
USFLTFORCOM	U.S. Fleet Forces Command
USGAAP	U.S. Generally Accepted Accounting Principles
USMC	United States Marine Corps
USNA	United States Naval Academy
USPACOM	U.S. Pacific Command
USSGL	U.S. Standard General Ledger
USSOCOM	U.S. Special Operations Command
UxS	Unmanned Systems



1. A littoral combat ship transits the Bohol Sea during an exercise. (U.S. Navy photo by Mass Communication Specialist 3rd Class Deven Leigh Ellis/Released)
2. Sailors assigned to guided-missile destroyers move mooring lines between the ships as they prepare to depart. (U.S. Navy photo by Mass Communication Specialist 1st Class Byron C. Linder/Released)
3. An Ohio-class ballistic-missile submarine transits a canal as it returns to its homeport. (U.S. Navy photo by Mass Communication Specialist 1st Class Amanda R. Gray/Released)
4. A commanding officer of a littoral combat ship discusses ship maneuvers with the bridge team as the ship transits to arrive at the ship's homeport. (U.S. Navy photo by Lt. Miranda Williams/Released)
5. An F35B Lightning II prepares to take off from the flight deck of an amphibious assault ship. (U.S. Marine Corps photo by Lance Cpl. Dana Beesley/Released)
6. Marines assigned embark a CH-53E Super Stallion helicopter on the flight deck of an amphibious assault ship. (U.S. Navy photo by Mass Communication Specialist Seaman Cosmo Walrath/Released)
7. An Aircrewman prepares to take off in a MH-60R Sea Hawk helicopter. (U.S. Navy photo by Mass Communication Specialist Seaman Zachary Wickline/Released)
8. Standing watch on the fantail of an aircraft carrier. (U.S. Navy photo by Mass Communication Specialist 3rd Class Samuel Bacon/Released)
9. A Quartermaster assigned to an amphibious assault ship monitors the ship's course on the bridge. (U.S. Navy photo by Mass Communication Specialist Seaman Vance Hand/Released)
10. A Humvee being directed onto a Landing Craft Utility (LCU) from an amphibious transport dock ship. (U.S. Navy photo by Mass Communication Specialist 3rd Class Jonathan Clay/Released) 170719-N-UX013-340

Preparation of this report cost the Department of the Navy approximately $105,000 in Fiscal Year 2017. Generated on 2017Nov9 RefID: B-BC0FC6B

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www.finance.hq.navy.mil/FMC

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