



Department of the Navy Fiscal Year 2013 Annual Financial Report

Principal Statements





PRINCIPAL STATEMENTS

The Fiscal Year 2013 Department of the Navy (DON) 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, 2013, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2012.

The following statements comprise the DON 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.

The Independent Auditor's Report refers to the Department of the Navy (DON) financial statements as the Department of the Navy General Fund financial statements.

CONSOLIDATED BALANCE SHEET*As of September 30, 2013 and 2012*

(\$ in Thousands)

	2013 Consolidated	2012 Consolidated
ASSETS		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 142,685,856	\$ 143,102,685
Investments (Note 4)	8,326	7,968
Accounts Receivable (Note 5)	280,871	195,181
Other Assets (Note 6)	467,313	346,428
Total Intragovernmental	143,442,366	143,652,262
Cash and Other Monetary Assets (Note 7)	98,977	93,840
Accounts Receivable, Net (Note 5)	3,853,141	3,616,372
Inventory and Related Property, Net (Note 8)	75,063,235	68,340,085
General Property, Plant, and Equipment, Net (Note 9)	269,951,986	228,851,453
Other Assets (Note 6)	50,709,475	46,118,969
TOTAL ASSETS	\$ 543,119,180	\$ 490,672,981
Stewardship Property, Plant, and Equipment (Note 9)		
LIABILITIES		
Intragovernmental:		
Accounts Payable (Note 11)	\$ 1,897,903	\$ 1,587,406
Other Liabilities (Note 13)	4,474,008	4,386,160
Total Intragovernmental Liabilities	6,371,911	5,973,566
Accounts Payable (Note 11)	398,830	232,068
Federal Employee and Veteran Benefits (Note 15)	1,719,183	1,670,760
Environmental and Disposal Liabilities (Note 12)	21,663,602	21,599,934
Other Liabilities (Note 13 & Note 14)	8,614,364	8,172,836
TOTAL LIABILITIES	38,767,890	37,649,164
Commitments and Contingencies (Note 14)		
NET POSITION		
Unexpended Appropriations - Other Funds	187,097,659	184,561,909
Cumulative Results of Operations - Dedicated Collections	27,762	29,532
Cumulative Results of Operations - Other Funds	317,225,869	268,432,376
TOTAL NET POSITION	\$ 504,351,290	\$ 453,023,817
TOTAL LIABILITIES AND NET POSITION	\$ 543,119,180	\$ 490,672,981

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF NET COST*For the Years Ended September 30, 2013 and 2012*

(\$ in Thousands)

	2013 Consolidated	2012 Consolidated
Program Costs		
Gross Costs		
Military Personnel	\$ 45,558,971	\$ 47,405,225
Operations, Readiness, & Support	60,652,956	63,204,636
Procurement	32,722,780	50,485,242
Research, Development, Test, & Evaluation	16,070,203	16,764,357
Family Housing & Military Construction	1,650,910	2,434,831
Less: Earned Revenue	<u>(11,022,888)</u>	<u>(10,599,907)</u>
Net Cost of Operations	\$ <u>145,632,932</u>	\$ <u>169,694,384</u>

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION*For the Year Ended September 30, 2013*

(\$ in Thousands)

	2013 Dedicated Collections	2013 Other Funds	2013 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	\$ 29,532	\$ 268,432,376	\$ 268,461,908
Budgetary Financing Sources:			
Appropriations Used	-	157,318,575	157,318,575
Nonexchange Revenue	210	-	210
Donations & Forfeitures of Cash & Cash Equivalents	22,822	492	23,314
Transfers-In/Out without Reimbursement	-	10,500	10,500
Other Financing Sources:			
Donations and Forfeitures of Property	-	6,897	6,897
Transfers-In/Out without Reimbursement	-	(654,769)	(654,769)
Imputed Financing from Costs Absorbed by Others	-	746,117	746,117
Other	-	36,973,812	36,973,812
Total Financing Sources	23,032	194,401,624	194,424,656
Net Cost of Operations	24,426	145,608,506	145,632,932
Net Change	(1,394)	48,793,118	48,791,724
Cumulative Results of Operations	28,138	317,225,494	317,253,632
UNEXPENDED APPROPRIATIONS			
Beginning Balances	-	184,561,909	184,561,909
Budgetary Financing Sources:			
Appropriations Received	-	174,139,345	174,139,345
Appropriations Transferred-In/Out	-	(666,067)	(666,067)
Other Adjustments (Rescissions, etc.)	-	(13,618,953)	(13,618,953)
Appropriations Used	-	(157,318,575)	(157,318,575)
Total Budgetary Financing Sources	-	2,535,750	2,535,750
Unexpended Appropriations	-	187,097,659	187,097,659
Net Position	28,138	504,323,153	504,351,291

The accompanying notes are an integral part of the statements.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION*For the Year Ended September 30, 2012*

(\$ in Thousands)

	2012 Dedicated Collections	2012 Other Funds	2012 Consolidated
CUMULATIVE RESULTS OF OPERATIONS			
Beginning Balances	\$ 25,545	267,253,020	\$ 267,278,565
Budgetary Financing Sources:			
Appropriations Used	(41)	166,059,179	166,059,138
Nonexchange Revenue	218	-	218
Donations & Forfeitures of Cash & Cash Equivalents	23,734	237	23,971
Transfers-In/Out without Reimbursement	-	-	-
Other Financing Sources:			
Donations and Forfeitures of Property	-	1,742	1,742
Transfers-In/Out without Reimbursement	-	(138,094)	(138,094)
Imputed Financing from Costs Absorbed by Others	-	816,514	816,514
Other	-	4,114,238	4,114,238
Total Financing Sources	23,911	170,853,816	170,877,727
Net Cost of Operations	19,924	169,674,460	169,694,384
Net Change	3,987	1,179,356	1,183,343
Cumulative Results of Operations	29,532	268,432,376	268,461,908
UNEXPENDED APPROPRIATIONS			
Beginning Balances	-	178,477,576	178,477,576
Budgetary Financing Sources:			
Appropriations Received	-	173,531,259	173,531,259
Appropriations Transferred-In/Out	-	1,376,886	1,376,886
Other adjustments (Rescissions, etc.)	(41)	(2,764,633)	(2,764,674)
Appropriations Used	41	(166,059,179)	(166,059,138)
Total Budgetary Financing Sources	-	6,084,333	6,084,333
Unexpended Appropriations	-	184,561,909	184,561,909
Net Position	29,532	452,994,285	453,023,817

The accompanying notes are an integral part of the statements.

COMBINED STATEMENT OF BUDGETARY RESOURCES*For the Years Ended September 30, 2013 and 2012*

(\$ in Thousands)

	2013 Combined	2012 Combined
Budgetary Resources:		
Unobligated Balance, Brought Forward, October 1	\$ 32,549,715	\$ 33,205,881
Recoveries of Prior Year Unpaid Obligations	11,866,228	13,249,015
Other Changes in Unobligated Balance	(1,955,989)	(1,337,751)
Unobligated Balance from Prior Year		
Budget Authority, net	42,459,954	45,117,145
Appropriations	161,841,280	173,505,214
Spending Authority from Offsetting Collections	7,367,629	8,105,260
Total Budgetary Resources	\$ 211,668,863	\$ 226,727,619
Status of Budgetary Resources:		
Obligations Incurred	\$ 178,352,738	\$ 194,177,904
Unobligated Balance, End of Year		
Apportioned	28,231,804	28,451,635
Exempt from Apportionment	20,725	-
Unapportioned	5,063,596	4,098,080
Unobligated Balance Brought Forward, End of Year	33,316,125	32,549,715
Total Budgetary Resources	\$ 211,668,863	\$ 226,727,619
Change in Obligated Balance:		
Unpaid Obligations		
Unpaid Obligations, Brought Forward, October 1	\$ 112,927,456	\$ 107,478,038
Obligations Incurred	178,352,738	194,177,904
Outlays, gross	(166,935,123)	(175,479,471)
Recoveries of Prior Year Unpaid Obligations	(11,866,228)	(13,249,015)
Unpaid Obligations, End of Year, gross	112,478,843	112,927,456
Uncollected payments		
Uncollected Payments from Federal Sources, Brought Forward, October 1	(2,629,802)	(2,509,887)
Change in Uncollected Customer Payments from Federal Sources	(599,692)	(119,916)
Uncollected Payments from Federal Sources, End of Year	(3,229,494)	(2,629,803)
Obligated Balance, Start of Year	\$ 110,297,654	\$ 104,968,151
Obligated Balance, End of Year	\$ 109,249,349	\$ 110,297,653
Budget Authority and Outlays, Net:		
Budget Authority, gross	\$ 169,208,909	\$ 181,610,474
Actual Offsetting Collections	(6,767,937)	(7,985,345)
Change in Uncollected Customer Payments from Federal Sources	(599,692)	(119,916)
Budget Authority, net	\$ 161,841,280	\$ 173,505,213
Outlays, gross	\$ 166,935,123	\$ 175,479,471
Actual Offsetting Collections	(6,767,937)	(7,985,345)
Outlays, net	160,167,186	167,494,126
Distributed Offsetting Receipts	(86,119)	(226,131)
Agency Outlays, Net	\$ 160,081,067	\$ 167,267,995

The accompanying notes are an integral part of the statements.

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

1.A. Basis of Presentation

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

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

The DON financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance and Accounting Service, Cleveland (DFAS-CL) collects information from the financial system and incorporates it into the financial statements for the DON. The DON collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL for incorporation into the financial statements. On behalf of the DON, DFAS-CL also collects information from multiple sources, such as intragovernmental data from the DON's trading partners, which is incorporated into the financial statements. The Defense Departmental Reporting System Data Collection Module (DDRS DCM) captures certain required financial information from non-integrated systems for the DON financial statements. The DDRS DCM identifies the information requirements to the source provider, and integrates data into the financial statement preparation process.

The DON is unable to fully implement all elements of USGAAP and the OMB Circular No. A-136 due to limitations of its financial and nonfinancial management processes and systems that support the financial statements. The DON derives reported values and information for major asset and liability categories largely from nonfinancial systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with USGAAP. The DON continues to implement process and system improvements addressing these limitations. The DON is currently converting legacy systems to Navy Enterprise Resource Planning (ERP) and developing plans to ensure accurate and complete financial records.

The Department of Defense Inspector General (DoDIG) issued an audit report identifying 11 financial statement material weaknesses: (1) Financial Management Systems; (2) Fund Balance With Treasury; (3) Problem Disbursements; (4) Unobligated Balances; (5) Financial Reporting of Plan to Perform/Order to Cash; (6) Financial Reporting of Operating Materials and Supplies; (7) Financial Reporting of General Equipment, Real Property, and Military Equipment; (8) Accounts Payable; (9) Other Assets; (10) Statement of Changes in Net Position; (11) Statement of Net Cost.

The FY 2012 financial statements were reclassified to conform to the FY 2013 financial statement presentation requirements. Changes to the presentation of the Combined and Combining Statements of Budgetary Resources were made, in accordance with guidance provided in OMB Circular No. A-136, Financial Reporting Requirements, and as such, activity and balances reported on the FY 2012 Combined and Combining Statement of Budgetary Resources have been reclassified to conform to the presentation in the current year. Certain other prior year amounts have also been reclassified to conform to the current year presentation. The reclassifications had no material effect on total assets, liabilities, net position, change in net position, or budgetary resources as previously reported.

Subsequent events and transactions occurring after September 30, 2013 through the date of the auditors' opinion should be evaluated for potential recognition or disclosure in the financial statements. However, the DON is not yet able to implement this requirement. The date of the auditors' opinion also represents the date that the financial statements were available to be issued.

1.B. Mission of the Reporting Entity

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

1.C. Appropriations and Funds

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

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

These general funds also include supplemental funds enacted by the American Recovery and Reinvestment Act (Recovery Act) of 2009.

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

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

Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as funds from dedicated collections. Funds from dedicated collections are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The DON is required to separately account for and report on the receipt, use and retention of revenues and other financing sources for funds from dedicated collections.

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

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

Additionally, the DON receives allocation transfers from the EOP for the Foreign Military Financing Program (meeting the OMB exception), the International Military Education and Training Program, U.S. Forest Service, and the Federal Highway Administration. The activities for these funds are reported separately from the DoD financial statements and reported to the parent.

The DON receives allocation transfers for the Security Assistance programs that meet the OMB exception for EOP funds. These funds are reported separately from the DoD financial statements based on an agreement with OMB.

1.D. Basis of Accounting

The DON's financial management systems are unable to meet all full accrual accounting requirements. Many of the DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by USGAAP. Most of the DON's financial and nonfinancial legacy systems were designed to record information on a budgetary basis.

Although the DON has not fully implemented accrual accounting, under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Under the budgetary basis, however, funds availability is recorded based upon legal considerations and constraints. As a result, 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, environmental liabilities, and Federal Employees' Compensation Act (FECA) 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 determining the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with USGAAP. One such action is the conversion of the DON's legacy systems to ERP which is designed to modernize and standardize Navy's business practices. Navy ERP was developed utilizing the USSGL account structure to better comply with applicable financial management requirements. Until all the DON financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by USGAAP, financial data will be derived from proprietary transactions, data from nonfinancial feeder systems, and accruals.

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

1.E. Revenues and Other Financing Sources

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

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

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, 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, and FECA liabilities. In the case of Operating Materials & Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to transition to the consumption method for recognizing OM&S expenses. Under the consumption method, OM&S would be expensed when consumed. Due to system limitations, in some instances expenditures for capital and other long-term assets may be recognized as operating expenses. The DON continues to implement process and system improvements to address these limitations.

1.G. Accounting for Intragovernmental Activities

Accounting standards require that an entity eliminates intra-entity activity and balances from consolidated financial statements in order to prevent overstatement for business with itself. However, the DON cannot accurately identify intragovernmental transactions by customer because the DON's systems do not track buyer and seller data at the transaction level. Generally, seller entities within 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 that will incorporate the necessary elements that will enable DoD to correctly report, reconcile, and eliminate intragovernmental balances.

Treasury Financial Manual Part 2 – Chapter 4700, "Agency Reporting Requirements for the Financial Report of the United States Government" provides guidance for reporting and reconciling intragovernmental balances. While the DON is unable to fully reconcile intragovernmental transactions with all federal agencies, the DON is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing

Bank, FECA transactions with the U.S. Department of Labor, and benefit program transactions with the Office of Personnel Management.

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

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

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

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

1.J. Cash and Other Monetary Assets

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

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

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

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. In accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities, the methodology for losses due to uncollectable amounts are based on an individual account analysis and/or group analysis. The analysis is based on three years of receivable data. This data is used to determine the historical percentage of collections in each age category of receivables. The DON does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute

resolution procedures defined in the Treasury Financial Manual Part 2, Chapter 4700, Appendix 10, “Intragovernmental Business Rules”.

1.L. Inventories and Related Property

The DON 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, support equipment, etc. As it relates to the DON, OM&S includes the related spares and repair parts for materiel. Items commonly used in and available from the commercial sector are not managed in the DON’s materiel management activities. The DON holds materiel based on military need and support for contingencies.

The DON uses both the consumption method and the purchase method of accounting for OM&S. The DON OM&S is categorized as operating materials and supplies held for use, operating materials and supplies held in reserve for future use (held for repair) (including munitions not held for sale) and excess, obsolete and unserviceable operating material and supplies. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the DON uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2013 and 2012, the DON expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for the DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

The DON OM&S assets held for use and held for repair use three cost valuation methods: Standard Price (SP), Latest Acquisition Cost (LAC), and Moving Average Cost (MAC). Excess, obsolete, and unserviceable OM&S are cost valued using Net Realizable Value pending development of an effective means of valuing such material. The LAC method is used because legacy logistics systems were designed for material management rather than accounting purposes. Although these systems provide visibility and accountability over inventory and related property items, they do not maintain historical cost data necessary to comply with SFFAS No. 3. Additionally, these legacy inventory systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (FFMIA). The DON is continuing to transition OM&S to the MAC method. Most transitioned balances, however, were not baselined to auditable historical cost, and remain noncompliant with SFFAS No. 3.

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

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

The DON reports investments in accordance with SFFAS No. 1, Accounting for Selected Assets and Liabilities. The DON reports 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, which are issued to federal agencies by the U.S. Treasury’s Bureau of Public Debt. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

1.N. General Property, Plant and Equipment

General Property, Plant and Equipment (PP&E) assets are capitalized in accordance with SFFAS No. 6, Accounting for Property, Plant and Equipment, as amended by SFFAS Nos. 10, 23, and 35, when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD’s capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DON depreciates all General PP&E, other than land and Military Equipment (ME) classified as aircraft, on a straight-line basis in accordance with FMR Volume 4 Chapter 6. The DoD’s General PP&E capitalization threshold is \$100 thousand except for real property, which is \$20 thousand.

The DON uses a combination of actual expenditure data and program funding to calculate the value for ME in accordance with SFFAS No. 35. The DON is developing a process to track and record actual ME costs. The ME value is updated using expenditure, acquisition, and disposal information.

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

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

1.O. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy as prescribed in SFFAS No. 1, Accounting for Selected Assets and Liabilities is to record advances or prepayments in accordance with USGAAP. As such, payments made prior to the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The DON has not implemented this policy primarily due to system limitations.

Due to inconsistencies in the posting logic for Nonfederal Advances and Prepayments, the DON is noncompliant with the 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 SFFAS No. 5, Accounting for Liabilities of the Federal Government, lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, the DON records the applicable asset as though purchased, with an offsetting liability, and depreciates it. The DON records the asset and the liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The DON, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risk of ownership. Payments for operating leases are expensed over the lease term as they become payable.

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

1.Q. Other Assets

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

Advances are cash outlays made by the DON to its employees, contractors, or others to cover a part or all of the recipients' anticipated expenses. Military pay advances are advance payments authorized for purposes intended to ease hardships imposed by the lack of regular payments when a military member is mobilized, ordered to duty at distant stations, or deployed aboard ships for more than 30 days. Civilian pay advances are payments advanced to full time the 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, the DON may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulation, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. 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.

1.R. Contingencies and Other Liabilities

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

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The 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, Accounting for Property, Plant and Equipment, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. The DON adheres to the DoD's policy, which is consistent with SFFAS No. 5, Accounting for Liabilities of Federal Government, and states that nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. The DoD recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

1.S. Accrued Leave

Military leave, compensatory and annual leave earned by civilians, but not yet used, is reported 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 disbursements and collections may be evidenced by the availability of corroborating documentation that would generally support the summary-level adjustments made to accounts payable and receivable. Both supported and unsupported adjustments may have been made to the DON's Accounts Payable and Receivable trial balances prior to validating that the underlying transactions required to establish the Accounts Payable/Receivable were previously made. As a result, misstatements of reported Accounts Payable and Receivables are likely present in the DON's financial statements.

Due to noted material weaknesses in current accounting and financial feeder systems, the DoD is generally unable to determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, the DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Both supported and unsupported undistributed disbursements and collections are then 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 on the balance sheet. Fiduciary activities are reported on the financial statement note schedules in accordance with SFFAS No. 31, Accounting for Fiduciary Activities.

1.X. Federal Employee and Veteran Benefits

For financial reporting purposes, the DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON at the end of each fiscal year. 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

<i>As of September 30</i>		
(Amounts in thousands)		
	2013	2012
Intragovernmental		
Fund Balance with Treasury	\$ 198,608	\$ 288,275
Cash and Other Monetary Assets	98,977	93,840
Accounts Receivable	3,710,658	3,528,238
Total Nonentity Assets	4,008,243	3,910,353
Total Entity Assets	539,110,937	486,762,628
Total Assets	\$ 543,119,180	\$ 490,672,981

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

Intragovernmental Fund Balance with Treasury

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

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.

Nonentity Nonfederal Accounts Receivable (Public)

The primary component of nonentity accounts receivable is an advance payment made to a contractor for the A-12 aircraft procurement program, which remains in litigation and includes associated accrued interest. These receivable balances are being reported in nonentity accounts receivable since the original appropriation year has been cancelled, and any funds collected as a result of this litigation would be remitted to the U.S. Treasury.

NOTE 3. FUND BALANCE WITH TREASURY

<i>As of September 30</i>		
(Amounts in thousands)		
	2013	2012
Fund Balances		
Appropriated Funds	\$ 141,795,951	\$ 141,644,490
Revolving Funds	667,591	1,147,198
Trust Funds	21,535	20,588
Special Funds	2,171	2,134
Other Fund Types	198,608	288,275
Total	\$ 142,685,856	\$ 143,102,685

Other Fund Types consists primarily of amounts in the following deposit and receipt accounts: The DON Proprietary Receipts, Pay of the Navy Deposit Fund, and Pay of the Marine Corps Deposit Fund.

Status of Fund Balance with Treasury

<i>As of September 30</i>		
(Amounts in thousands)		
	2013	2012
Unobligated Balance		
Available	\$ 28,252,529	\$ 28,451,635
Unavailable	5,066,166	4,098,080
Obligated Balance not yet Disbursed	112,478,843	112,927,456
Non-Budgetary FBWT	126,117	263,260
Non-FBWT Budgetary Accounts	(3,237,799)	(2,637,746)
Total	\$ 142,685,856	\$ 143,102,685

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

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

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

Non-budgetary FBWT includes accounts that do not have budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts and nonentity FBWT. For the DON, Non-budgetary FBWT consists of balances in receipt accounts and clearing accounts. Due to the DON systems inability to segregate Budgetary FBWT balances, Non-FBWT Budgetary Accounts are used to reconcile the Status of FBWT.

Other

<i>As of September 30</i>			
(Amounts in thousands)			
	2013		2012
Fund Balances Per Treasury Versus Agency			
Fund Balance per Treasury	\$	144,200,615	\$ 144,586,439
Fund Balance per the DON		142,685,856	143,102,685
Reconciling Amount	\$	1,514,759	\$ 1,483,754

NOTE 4. INVESTMENTS AND RELATED INTEREST

<i>As of September 30</i>				
(Amounts in thousands)				
	2013			
	Cost	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	\$ 8,332	\$ (15)	\$ 8,317	\$ 8,318
Accrued Interest	8	-	8	8
Total	\$ 8,340	\$ (15)	\$ 8,325	\$ 8,326

<i>As of September 30</i>				
(Amounts in thousands)				
	2012			
	Cost	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities				
Nonmarketable, Market-Based				
Other Funds	\$ 7,985	\$ (28)	\$ 7,957	\$ 7,957
Accrued Interest	11	-	11	11
Total	\$ 7,996	\$ (28)	\$ 7,968	\$ 7,968

Other Funds represents the DON Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the DON 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, the DON Trust Funds are reported as funds from dedicated collections.

NOTE 5. ACCOUNTS RECEIVABLE

<i>As of September 30</i>			
(Amounts in thousands)			
	2013		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	\$ 280,871	\$ N/A	\$ 280,871
Nonfederal Receivables (From the Public)	3,873,235	(20,094)	3,853,141
Total	\$ 4,154,106	\$ (20,094)	\$ 4,134,012

As of September 30
(Amounts in thousands)

	2012		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	\$ 195,181	\$ N/A	\$ 195,181
Nonfederal Receivables (From the Public)	3,636,386	(20,014)	3,616,372
Total	<u>\$ 3,831,567</u>	<u>\$ (20,014)</u>	<u>\$ 3,811,553</u>

The accounts receivable represent the DON's claim for payment from other entities. Intra-governmental Receivables primarily represents amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules. Refer to Note 2, Nonentity Assets for additional information on non-Federal Accounts Receivable. Since the DON is at risk of not collecting on these public accounts receivable, the DON is recognizing an allowance for uncollectible amounts. The methodology used in determining the allowance amount is discussed in Note 1.K.

The DON is currently working on an effort to drive compliance with Office of Management and Budget (OMB) Circular A-11, Section 20.4(b)(4). Non-compliance results in unsupported departmental level adjustments which negatively impacts achievement of the DON's audit readiness goals for its Statement of Budgetary Resources. The DON is partnering with the DFAS to clarify guidance, resolve funding issues and standardize business practices. In addition, the DON and DFAS are aggressively pursuing collection mechanisms for amounts currently due from the public.

NOTE 6. OTHER ASSETS

As of September 30
(Amounts in thousands)

	2013	2012
Intragovernmental Other Assets		
Advances and Prepayments	\$ 467,313	\$ 346,428
Outstanding Contract Financing Payments	50,425,911	45,824,661
Advances and Prepayments	269,634	282,061
Other Assets (With the Public)	13,930	12,247
Total Nonfederal Other Assets	<u>50,709,475</u>	<u>46,118,969</u>
Total	<u>\$ 51,176,788</u>	<u>\$ 46,465,397</u>

Intra-governmental 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 conveying certain rights to the Government that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and 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 due to system limitations and all amounts are reported as OCFP.

The balance of OCFP includes \$49.1 billion in contract financing payments and an additional \$1.3 billion in estimated future payments to contractors upon delivery and government acceptance of a satisfactory product. (See additional discussion in Note 13, Other Liabilities).

Nonfederal Other Assets - Other Assets (With the Public)

Other Assets (With the Public) includes advance pay to the 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

<i>As of September 30</i>			
(Amounts in thousands)			
	2013		2012
Cash	\$	71,703	\$ 65,511
Foreign Currency		27,274	28,329
Total	\$	98,977	\$ 93,840

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 as to its use.

NOTE 8. INVENTORY AND RELATED PROPERTY

<i>As of September 30</i>			
(Amounts in thousands)			
	2013		2012
Inventory, Net	\$	46	\$ -
Operating Materials & Supplies, Net		75,063,189	68,340,085
Total	\$	75,063,235	\$ 68,340,085

Operating Materials and Supplies, Net

<i>As of September 30</i>				
(Amounts in thousands)				
	2013			
OM&S Categories	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
Held for Use	\$ 67,741,862	\$ (8,704)	\$ 67,733,158	SP, LAC, MAC
Held for Repair	7,341,940	(11,909)	7,330,031	SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,467,965	(1,467,965)	-	NRV
Total	\$ 76,551,767	\$ (1,488,578)	\$ 75,063,189	

As of September 30

(Amounts in thousands)

OM&S Categories	2012				Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net		
Held for Use	\$ 64,466,653	\$ (28,046)	\$ 64,438,607		SP, LAC, MAC
Held for Repair	4,700,125	(798,647)	3,901,478		SP, LAC, MAC
Excess, Obsolete, and Unserviceable	1,249,665	(1,249,665)	-		NRV
Total	\$ 70,416,443	\$ (2,076,358)	\$ 68,340,085		

Legend for Valuation Methods:

LAC = Latest Acquisition Cost

NRV = Net Realizable Value

SP = Standard Price

MAC = Moving Average Cost

The DON assigns Operating Materials & Supplies (OM&S) items to a category based upon the type and condition of the asset. OM&S Held for Use includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged material held as inventory that is more economical to repair than to dispose. The DON is currently using the allowance method of accounting for repairables in the legacy accounting system and the direct method of accounting for repairables in Navy Enterprise Resource Planning (ERP). Excess, Obsolete, and Unserviceable OM&S consists of scrap material or items that cannot be economically repaired and are awaiting disposal.

The consumption method shall be applied when accounting for OM&S and valued at moving average cost using historical cost or any method approximating historical cost (e.g., standard cost or latest acquisition cost). Exceptions to the consumption method are provided when (1) the OM&S are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost beneficial to apply the consumption method. In any of these events, the purchase method is allowed. Legacy accounting systems cannot support the consumption method of accounting, thus the various reporting activities are currently using the purchase method. As financial reporting entities begin to purchase material in Navy ERP, the consumption method will be properly applied.

OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The Moving Average Cost valuation method is used for a majority of the OM&S categories; however Actual Cost and Latest Acquisition Cost are also valuation methods applied depending on the legacy inventory system used to forecast OM&S cost.

Ammunition and Munitions are maintained in the DON Ordnance Information System and valued at latest acquisition cost.

Principal End and Secondary Items include OM&S such as shipboard hull, mechanical and electronic equipment, and uninstalled aircraft engines. They are items of such importance that central inventory control is required to provide the readiness of the material for the Fleet. These items possess one of the following characteristics: essential for combat or training; high dollar value; difficult to procure or produce; or critical basic material or component parts. Principal End and Secondary Items are valued at Moving Average Cost.

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

NOTE 9. GENERAL PP&E, NET

As of September 30

(Amounts in thousands)

2013					
	Depreciation/ Amortization Method	Service Life	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value
Major Asset Classes					
Land	N/A	N/A	\$ 659,876	\$ N/A	\$ 659,876
Buildings, Structures, and Facilities	S/L	20 or 40	46,837,512	(25,252,572)	21,584,940
Leasehold Improvements	S/L	lease term	6,530	(3,014)	3,516
Software	S/L	2-5 or 10	5,763	(2,166)	3,597
General Equipment	S/L	5 or 10	17,540,068	(9,981,526)	7,558,542
Military Equipment	S/L	Various	430,595,909	(201,884,661)	228,711,248
Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	10,410,579	N/A	10,410,579
Other			1,019,688	-	1,019,688
Total General PP&E			\$ 507,075,925	\$ (237,123,939)	\$ 269,951,986

As of September 30

(Amounts in thousands)

2012					
	Depreciation/ Amortization Method	Service Life	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value
Major Asset Classes					
Land	N/A	N/A	\$ 612,657	\$ N/A	\$ 612,657
Buildings, Structures, and Facilities	S/L	20 or 40	43,733,681	(23,834,274)	19,899,407
Leasehold Improvements	S/L	lease term	6,530	(2,702)	3,828
Software	S/L	2-5 or 10	3,405	(3,008)	397
General Equipment	S/L	5 or 10	14,858,936	(8,900,915)	5,958,021
Military Equipment	S/L	Various	416,154,006	(222,121,894)	194,032,112
Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	7,189,011	N/A	7,189,011
Other			1,156,020	-	1,156,020
Total General PP&E			\$ 483,714,246	\$ (254,862,793)	\$ 228,851,453

Legend for Valuation Methods:

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

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.

The DON estimates values for capitalized Military Equipment using department internal records such as budgetary information for aircraft and expenditure data for ships. Currently, the DON is not reporting the construction of Military Equipment in the appropriate Construction-in-Progress account. The DON is reporting the value of the construction of its Military Equipment as an Advance. The DON is currently in the process of readying the Navy ERP system to allow for the proper recording of the construction of its assets.

Other General PP&E consists of Real Property held in Caretaker Status. Caretaker is defined as those properties that Navy still owns, but which are being held awaiting further disposal action to another entity, such as Defense Base Closure and Realignment Commission (BRAC) property awaiting sale or transfer to another Federal agency. As of September 30, 2013, the accumulated depreciation related to these assets in Caretaker status are currently included in the total accumulated depreciation of Buildings Structures and Facilities still in service and is unknown at this time. The DON is researching the dollar value of depreciation expenses related to these assets.

Heritage Assets

Categories	Measure Quantity	As of September 30, 2012	Additions	Deletions	As of September 30, 2013
Buildings and Structures	Each	10,035	-	-	10,035
Archaeological Sites	Each	18,534	4,526	-	23,060
Museum Collection Items (Objects, Not Including Fine Art)	Each	503,938	10,764	12	514,690
Museum Collection Items (Objects, Fine Art)	Each	40,813	105		40,918

Stewardship Land

		(Acres in thousands)			
Facility Code	Facility Title	As of September 30, 2012	Additions	Deletions	As of September 30, 2013
9110	Government Owned Land	4	-	1	3
9120	Withdrawn Public Land	2,030	-	-	2,030
9130	Licensed and Permitted Land	21	5	-	26
Grand Total					2,059
TOTAL - All Other Lands					25
TOTAL - Stewardship Lands					2,034

Heritage Assets and Stewardship Land

The Federal Accounting Standards Advisory Board's 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.

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

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

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

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

The DON's stewardship land consists mainly of mission essential land acquired by donation or devise. The DON held the above acres of land as of September 30, 2013.

The Marine Corps continues to make updates to their beginning balances as a result of audit findings.

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

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

<i>As of September 30</i>		
(Amounts in thousands)		
	2013	2012
Intragovernmental Other Liabilities	\$ 476,783	\$ 519,939
Accounts Payable	\$ 4,725	\$ 20,837
Federal Employee and Veteran Benefits	1,718,646	1,670,271
Environmental and Disposal Liabilities	21,663,602	21,599,934
Other Liabilities	4,501,869	4,924,700
Total Liabilities Not Covered by Budgetary Resources	\$ 28,365,625	\$ 28,735,681
Total Liabilities Covered by Budgetary Resources	\$ 10,402,265	\$ 8,913,483
Total Liabilities	\$ 38,767,890	\$ 37,649,164

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

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

Nonfederal Liabilities

Accounts payable not covered by budgetary resources is related to cancelled year accounts payable that are not budgeted. Federal Employee and Veteran Benefits consist of unfunded FECA actuarial liabilities not due during the current fiscal year. Environmental liabilities are estimates related to future events, and consist of liabilities related to active installations, Defense Base Closure and Realignment Commission sites, equipment and weapons programs, and chemical weapons disposal. Finally, Other Liabilities include annual leave, estimated legal contingent liabilities, and the disposal of excess structures that are not currently budgeted for but will become funded as future events occur.

See Note 12, Environmental and Disposal Liabilities for additional details.

NOTE 11. ACCOUNTS PAYABLE

<i>As of September 30</i>			
(Amounts in thousands)			
	2013		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	\$ 1,897,903	\$ N/A	\$ 1,897,903
Nonfederal Payables (to the Public)	398,830	-	398,830
Total	\$ 2,296,733	\$ -	\$ 2,296,733

<i>As of September 30</i>			
(Amounts in thousands)			
	2012		
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
Intragovernmental Payables	\$ 1,587,406	\$ N/A	\$ 1,587,406
Nonfederal Payables (to the Public)	231,951	117	232,068
Total	\$ 1,819,357	\$ 117	\$ 1,819,474

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 transactions by customer at the transaction level. Buyer-side accounts payable are adjusted to agree with interagency seller-side accounts receivable. This is accomplished by 1) reclassifying amounts between federal and nonfederal cost categories, 2) accruing additional accounts payable and expenses, and 3) applying both supported and unsupported undistributed disbursements at the reporting entity level.

NOTE 12. ENVIRONMENTAL AND DISPOSAL LIABILITIES

<i>As of September 30</i>			
(Amounts in thousands)			
		2013	2012
Environmental Liabilities--Nonfederal			
Accrued Environmental Restoration Liabilities			
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	\$	2,609,056	\$ 2,511,374
Active Installations—Military Munitions Response Program (MMRP)		2,041,359	1,979,961
Other Accrued Environmental Liabilities—Non-BRAC			
Environmental Corrective Action	\$	56,959	\$ 65,352
Environmental Closure Requirements		378,647	374,704
Environmental Response at Operational Ranges		13,305	14,168
Asbestos		308,480	337,428
Non-Military Equipment		541,000	519,390
Other		764	810
Base Realignment and Closure Installations			
Installation Restoration Program	\$	1,362,309	\$ 1,417,953
Military Munitions Response Program		114,019	153,939
Environmental Corrective Action / Closure Requirements		13,894	22,879
Environmental Disposal for Military Equipment / Weapons Programs			
Nuclear Powered Military Equipment / Spent Nuclear Fuel	\$	14,076,334	\$ 14,055,948
Other Weapons Systems		147,476	146,028
Total	\$	21,663,602	\$ 21,599,934

The above table excludes estimated total cleanup costs associated with General Property, Plant, and Equipment of \$2.8 billion for FY 2013 and \$2.8 billion for FY 2012.

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

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

Applicable Laws and Regulations for Cleanup Requirements

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

- Superfund Amendments and Reauthorization Act of 1986
- The Resource Conservation and Recovery Act of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984
- 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 (only Defense Base Closure and Realignment Commission (BRAC))

Methods for Assigning Total Cleanup Costs to Current Operating Periods

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

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

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

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

Description of the Types of Environmental Liabilities and Disposal Liabilities

Accrued Environmental Restoration Liabilities

The DON environmental cleanup cost estimate was based on 3,919 IRP and 365 MMRP sites at 207 active installations. As of September 30, 2013, the DON estimated and reported \$4.7 billion for environmental restoration liabilities. This amount is comprised of \$2.7 billion in Active Installations-IRP liabilities and \$2.0 billion in Active Installations-MMRP liabilities.

Other Accrued Environmental Liabilities – Non-BRAC

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

Base Realignment and Closure Installations

BRAC environmental sites are environmental sites at the DON installations that are or will be closed under the congressionally mandated BRAC process. As of September 30, 2013, the DON has estimated and reported \$1.51 billion for BRAC funded environmental liabilities. This amount includes \$1.4 billion for IRP, \$0.1 billion for MMRP, and

\$0.01 billion for environmental corrective action and closure requirements. MMRP includes military munitions, chemical residues from military munitions, and munitions scrap at locations on a BRAC installation.

Environmental Disposal for Military Equipment / Weapons Programs

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

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

Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of September 30, 2013, there are no changes to the environmental liability estimates due to changes in laws, regulations, and agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

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

The environmental liabilities for the 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.

NOTE 13. OTHER LIABILITIES

As of September 30

(Amounts in thousands)

	2013		
	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	\$ 150,533	\$ -	\$ 150,533
Disbursing Officer Cash	100,883	-	100,883
Judgment Fund Liabilities	771	-	771
FECA Reimbursement to the Dept. of Labor	165,467	193,509	358,976
Custodial Liabilities	3,708,752	-	3,708,752
Employer Contribution and Payroll Taxes Payable	36,736	-	36,736
Other Liabilities	117,357	-	117,357
Total Intragovernmental	4,280,499	193,509	4,474,008
Accrued Funded Payroll and Benefits	1,528,567	-	1,528,567
Advances from Others	526,004	-	526,004
Deposit Funds and Suspense Accounts	198,608	-	198,608
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	161,461	63,107	224,568
Excess/Obsolete Structures	79,243	218,880	298,123
Accrued Unfunded Annual Leave	3,000,903	-	3,000,903
Contract Holdbacks	516,623	-	516,623
Employer Contribution and Payroll Taxes Payable	23,703	-	23,703
Contingent Liabilities	21,115	2,276,229	2,297,344
Other Liabilities	(79)	-	(79)
Total Other Liabilities	\$ 10,336,647	\$ 2,751,725	\$ 13,088,372

As of September 30
(Amounts in thousands)

	2012		
	Current Liability	Noncurrent Liability	Total
Intragovernmental			
Advances from Others	\$ 212,571	\$ -	\$ 212,571
Deposit Funds and Suspense Account Liabilities	-	-	-
Disbursing Officer Cash	95,170	-	95,170
Judgment Fund Liabilities	6,533	-	6,533
FECA Reimbursement to the Dept. of Labor	162,613	204,193	366,806
Custodial Liabilities	3,526,910	-	3,526,910
Employer Contribution and Payroll Taxes Payable	30,938	-	30,938
Other Liabilities	147,232	-	147,232
Total Intragovernmental	4,181,967	204,193	4,386,160
Accrued Funded Payroll and Benefits	980,016	-	980,016
Advances from Others	493,118	-	493,118
Deposit Funds and Suspense Accounts	262,812	-	262,812
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	151,304	26,488	177,792
Excess/Obsolete Structures	66,094	525,598	591,692
Accrued Unfunded Annual Leave	2,940,264	-	2,940,264
Contract Holdbacks	73,563	-	73,563
Employer Contribution and Payroll Taxes Payable	21,557	-	21,557
Contingent Liabilities	15,364	2,610,012	2,625,376
Other Liabilities	6,646	-	6,646
Total Other Liabilities	\$ 9,192,705	\$ 3,366,291	\$ 12,558,996

Intragovernmental Other Liabilities consists primarily of Unemployment Compensation unfunded liabilities.

Contingent Liabilities includes \$1.3 billion related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. It is DoD policy that these rights should not be misconstrued as rights of ownership. The DON is under no obligation to pay contractors for amounts greater than the amounts of progress payments authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but not yet paid are estimable, the DON has recognized a contingent liability for the estimated unpaid costs that are considered conditional for payment pending delivery and government acceptance.

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

The abnormal balance in non-Federal Other Liabilities is under investigation. It is likely related to ongoing general ledger posting issues to be addressed through audit readiness efforts.

NOTE 14. COMMITMENTS AND CONTINGENCIES

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

Counsel (OGC) considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The DON records contingent liabilities in Note 13, Other Liabilities.

For FY 2013, the DON materiality threshold for reporting litigation, claims, or assessments is \$52.1 million. The DON OGC conducts a review of litigation and claims threatened or asserted involving the DON to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The DON currently has 16 cases that meet the existing FY 2013 materiality threshold. The DON legal counsel was unable to express an opinion concerning the likely outcome on 13 of 16 cases.

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

NOTE 15. FEDERAL EMPLOYEE AND VETERAN BENEFITS

<i>As of September 30</i>				
(Amounts in thousands)				
2013				
	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits				
FECA	\$ 1,718,646		\$ -	\$ 1,718,646
Other	537		(537)	-
Total Other Benefits	\$ 1,719,183		\$ (537)	\$ 1,718,646
Total	\$ 1,719,183		\$ (537)	\$ 1,718,646

<i>As of September 30</i>				
(Amounts in thousands)				
2012				
	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Actuarial Benefits				
FECA	\$ 1,670,271		\$ -	\$ 1,670,271
Other	489		(489)	-
Total Other Benefits	\$ 1,670,760		\$ (489)	\$ 1,670,271
Total	\$ 1,670,760		\$ (489)	\$ 1,670,271

The DON reports an actuarial liability for the Federal Employee's Compensation Act (FECA). 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. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. 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 DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to the DON only at the end of each fiscal year.

The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period.

NOTE 16. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

<i>As of September 30</i>		
(Amounts in thousands)		
	2013	2012
Intragovernmental Cost	\$ 46,766,773	\$ 50,908,881
Nonfederal Cost	109,889,047	129,385,410
Total Cost	<u>\$ 156,655,820</u>	<u>\$ 180,294,291</u>
Intragovernmental Revenue	\$ (2,951,971)	\$ (3,312,422)
Nonfederal Revenue	(8,070,917)	(7,287,485)
Total Revenue	<u>\$ (11,022,888)</u>	<u>\$ (10,599,907)</u>
Total Net Cost	<u>\$ 145,632,932</u>	<u>\$ 169,694,384</u>

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The Department of Defense's (DoD) current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act. The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," 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 Generally Accepted Accounting Principles 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 USGAAP. One such action is the revision of its accounting systems to record transactions based on the U.S. Standard General Ledger. Until such time as all of the DON's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by USGAAP, the 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.

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

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.

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.

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of \$12.3 billion is due to certain cash receipts recorded as "Appropriations Received" on the SBR but recognized as exchange or non-exchange revenue (usually in special and trust fund accounts) and reported on the SCNP in accordance with SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.

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

NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30
(Amounts in thousands)

	2013	2012
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 158,004,011	\$ 154,814,226

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

Apportionment Categories for Obligations Incurred

The direct and reimbursable obligations under Categories A and B 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.

Permanent, Indefinite Appropriations

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

The Environmental Restoration, Navy (ER, N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. There were 3 transfers from ER, N for \$3 billion to the Operation and Maintenance, Navy appropriation. There were no transfers into ER, N during this period.

NOTE 19. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

As of September 30
(Amounts in thousands)

	2013	2012
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations incurred	\$ 178,352,739	\$ 194,177,904
Less: Spending authority from offsetting collections and recoveries (-)	(19,223,668)	(21,354,258)
Obligations net of offsetting collections and recoveries	159,129,071	172,823,646
Less: Offsetting receipts (-)	(86,119)	(226,131)
Net obligations	159,042,952	172,597,515
Other Resources:		
Donations and forfeitures of property	6,897	1,742
Transfers in/out without reimbursement (+/-)	(654,769)	(138,094)
Imputed financing from costs absorbed by others	746,117	816,514
Other (+/-)	36,973,812	4,114,238
Net other resources used to finance activities	37,072,057	4,794,400
Total Resources Used to Finance Activities	\$ 196,115,009	\$ 177,391,915
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders (-)	\$ (3,189,785)	\$ (6,516,469)
Unfilled Customer Orders	518,632	340,369
Resources that fund expenses recognized in prior periods (-)	(730,358)	(158,378)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	86,119	226,131
Resources that finance the acquisition of assets (-)	(15,379,331)	(15,764,666)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
Other (+/-)	(36,336,129)	(3,977,906)
Total resources used to finance items not part of the Net Cost of Operations	\$ (55,030,852)	\$ (25,850,919)
Total resources used to finance the Net Cost of Operations	\$ 141,084,157	\$ 151,540,996
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	\$ 50,811	\$ 7,230
Increase in environmental and disposal liability	168,218	434,868
Increase in exchange revenue receivable from the public (-)	20,716	139,587
Other (+/-)	141,273	203,339
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	381,018	785,024
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 3,263,335	\$ 19,679,709
Revaluation of assets or liabilities (+/-)	(4,940,274)	(4,152,446)
Other (+/-)		
Operating Material and Supplies Used	6,351,889	4,125,346
Other	(507,191)	(2,284,245)
Total Components of Net Cost of Operations that will not Require or Generate Resources	4,167,759	17,368,364
Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	\$ 4,548,777	\$ 18,153,388
Net Cost of Operations	\$ 145,632,934	\$ 169,694,384

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. Differences between budgetary and proprietary data are previously identified deficiencies.

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

NOTE 20. FUNDS FROM DEDICATED COLLECTIONS

<i>As of September 30</i>		
(Amounts in thousands)		
BALANCE SHEET	2013	2012
ASSETS		
Fund balance with Treasury	\$ 23,331	\$ 22,722
Investments	8,326	7,968
Total Assets	<u>\$ 31,657</u>	<u>\$ 30,690</u>
LIABILITIES and NET POSITION		
Other Liabilities	\$ 3,894	\$ 1,159
Total Liabilities	<u>\$ 3,894</u>	<u>\$ 1,159</u>
Cumulative Results of Operations	27,762	29,532
Total Liabilities & Net Position	<u>\$ 31,656</u>	<u>\$ 30,691</u>
<i>For the period ended September 30</i>		
	2013	2012
STATEMENT OF NET COST		
Program Costs	\$ 24,426	\$ 19,924
Net Cost of Operations	<u>\$ 24,426</u>	<u>\$ 19,924</u>
<i>For the period ended September 30</i>		
	2013	2012
STATEMENT OF CHANGES IN NET POSITION		
Net Position Beginning of the Period	\$ 29,156	\$ 25,545
Net Cost of Operations	24,426	19,924
Budgetary Financing Sources	23,032	23,911
Change in Net Position	<u>\$ (1,394)</u>	<u>\$ 3,987</u>
Net Position End of Period	<u>\$ 27,762</u>	<u>\$ 29,532</u>

Funds from Dedicated Collections are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. The DON currently has four funds from dedicated collections, for which a brief description follows below. There have been no changes in legislation during or subsequent to the reporting period that significantly changes the purpose or that redirects a material portion of the accumulated balances of any of these four funds. Generally, revenues for the DON's funds from dedicated collections are inflows of resources to the Government.

Special Funds from Dedicated Collections

Wildlife Conservation, Military Reservations, Navy

This fund, authorized by 16 United States Code 670b, provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Proceeds from the sale of fishing and hunting permits are used for

these programs at the 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

The DON General Gift Fund

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

Ships Stores Profit, Navy

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

U.S. Naval Academy General Gift Fund

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

Fund Reclassification

Effective for FY 2013 reporting, the DON has reclassified the Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Trust Fund and the Ford Island Improvement Account in accordance with clarifying language provided by the Statement of Federal Financial Accounting Standards 43: Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, Identifying and Reporting Funds from Dedicated Collection.

The reclassified funds were evaluated against SFFAS 43 and determined to no longer meet the criteria for reporting as "dedicated collections" because the funds' primary source of financing came from the Federal government rather than from the public.

NOTE 21. FIDUCIARY ACTIVITIES

For the period ended September 30

(Amounts in thousands)

	Schedule of Fiduciary Activities	
	2013	2012
Fiduciary net assets, beginning of year	\$ 30,812	\$ 32,769
Contributions	36,617	46,803
Investment earnings	2,335	2,560
Distributions to and on behalf of beneficiaries	(44,859)	(51,320)
Increase/(Decrease) in fiduciary net assets	(5,907)	(1,957)
Fiduciary net assets, end of period	\$ 24,905	\$ 30,812

For the period ended September 30
(Amounts in thousands)

	Fiduciary Net Assets	
	2013	2012
Fiduciary Assets		
Cash and cash equivalents	\$ 24,905	\$ 30,812

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

The DON's Fiduciary Activity consists of funds in the Savings Deposit Program. Under 10, USC, §1035, and Department of Defense Financial Management Regulation (FMR), Volume 7A, Chapter 51, service members of both the Navy and Marine Corps who are on a permanent duty assignment outside the United States or its possessions can earn interest at a rate prescribed by the president, not to exceed 10 percent a year, on up to \$10 thousand deposited into the program. This limitation shall not apply to deposits made on or after September 1, 1966 in the case of those members in a missing status during the Vietnam conflict, the Persian Gulf conflict, or a contingency operation.

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

NOTE 22. LEASES

As of September 30
(Amounts in thousands)

	2013			
	Land and Buildings	Equipment	Other	Total
Entity as Lessee - Operating Leases				
Future Payments Due				
Fiscal Year				
2014	\$ 117,022	\$ 2,502	\$ 39,536	\$ 159,060
2015	119,489	2,627	41,266	163,382
2016	122,012	2,758	43,092	167,862
2017	124,593	2,896	45,021	172,510
2018	127,232	3,041	47,059	177,332
After 5 Years	129,931	3,193	49,213	182,337
Total	\$ 740,279	\$ 17,017	\$ 265,187	\$ 1,022,483