

Department of Defense
Navy Working Capital Fund
CONSOLIDATED BALANCE SHEET
As of March 31, 2007 and 2006

| | 2007 Consolidated | 2006 Consolidated |
|---|----------------------------------|----------------------------------|
| | <hr/> | <hr/> |
| 1. ASSETS (Note 2) | | |
| A. Intragovernmental: | | |
| 1. Fund Balance with Treasury (Note 3) | | |
| a. Entity | \$ 869,052,452.07 | \$ 550,084,484.08 |
| b. Non-Entity Seized Iraqi Cash | 0.00 | 0.00 |
| c. Non-Entity-Other | 0.00 | 0.00 |
| 2. Investments (Note 4) | 0.00 | 0.00 |
| 3. Accounts Receivable (Note 5) | 389,954,554.75 | 172,583,702.26 |
| 4. Other Assets (Note 6) | 1,949,384.37 | 5,581,863.26 |
| 5. Total Intragovernmental Assets | <hr/> \$ 1,260,956,391.19 | <hr/> \$ 728,250,049.60 |
| B. Cash and Other Monetary Assets (Note 7) | \$ 0.00 | \$ 0.00 |
| C. Accounts Receivable, Net (Note 5) | 68,885,094.40 | 63,297,300.85 |
| D. Loans Receivable (Note 8) | 0.00 | 0.00 |
| E. Inventory and Related Property, Net (Note 9) | 12,771,863,317.06 | 14,052,529,206.30 |
| F. General Property, Plant and Equipment, Net (Note 10) | 3,714,982,831.32 | 3,783,211,359.61 |
| G. Investments (Note 4) | 0.00 | 0.00 |
| H. Other Assets (Note 6) | 335,104,103.10 | 385,832,284.49 |
| 2. TOTAL ASSETS | <hr/> <hr/> \$ 18,151,791,737.07 | <hr/> <hr/> \$ 19,013,120,200.85 |
| 3. LIABILITIES (Note 11) | | |
| A. Intragovernmental: | | |
| 1. Accounts Payable (Note 12) | \$ 146,002,080.04 | \$ 221,706,723.45 |
| 2. Debt (Note 13) | 144,925,110.16 | 261,294,199.15 |
| 3. Other Liabilities (Note 15 & 16) | 247,204,290.18 | 379,392,159.42 |
| 4. Total Intragovernmental Liabilities | <hr/> \$ 538,131,480.38 | <hr/> \$ 862,393,082.02 |
| B. Accounts Payable (Note 12) | \$ 1,546,687,941.52 | \$ 1,786,398,567.22 |
| C. Military Retirement and Other Federal Employment Benefits (Note 17) | 1,185,039,105.63 | 1,192,551,548.64 |
| D. Environmental and Disposal Liabilities (Note 14) | 0.00 | 0.00 |
| E. Loan Guarantee Liability (Note 8) | 0.00 | 0.00 |
| F. Other Liabilities (Note 15 & Note 16) | 3,035,203,482.48 | 3,068,536,906.11 |
| 4. TOTAL LIABILITIES | <hr/> \$ 6,305,062,010.01 | <hr/> \$ 6,909,880,103.99 |
| 5. NET POSITION | | |
| A. Unexpended Appropriations - Earmarked Funds (Note 23) | \$ 0.00 | \$ 0.00 |
| B. Unexpended Appropriations - Other Funds | 1,175,171.10 | 88,483,723.97 |
| C. Cumulative Results of Operations - Earmarked Funds | 0.00 | 0.00 |
| D. Cumulative Results of Operations - Other Funds | 11,845,554,555.96 | 12,014,756,372.89 |
| 6. TOTAL NET POSITION | <hr/> \$ 11,846,729,727.06 | <hr/> \$ 12,103,240,096.86 |
| 7. TOTAL LIABILITIES AND NET POSITION | <hr/> <hr/> \$ 18,151,791,737.07 | <hr/> <hr/> \$ 19,013,120,200.85 |

Department of Defense
 Navy Working Capital Fund
CONSOLIDATED STATEMENT OF NET COST
 For the periods ended March 31, 2007 and 2006

| | 2007 Consolidated | 2006 Consolidated |
|---|-----------------------------------|-----------------------------------|
| 1. Program Costs | | |
| A. Gross Costs | \$ 11,421,693,284.69 | \$ 11,881,342,165.72 |
| B. (Less: Earned Revenue) | (10,162,201,787.07) | (10,034,183,940.00) |
| C. Net Program Costs | <u>\$ 1,259,491,497.62</u> | <u>\$ 1,847,158,225.72</u> |
| 2. Cost Not Assigned to Programs | 0.00 | 0.00 |
| 3. (Less: Earned Revenue Not Attributable to Programs) | 0.00 | 0.00 |
| 4. Net Cost of Operations | <u><u>\$ 1,259,491,497.62</u></u> | <u><u>\$ 1,847,158,225.72</u></u> |

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended March 31, 2007 and 2006

| | 2007 Earmarked Funds | 2007 All Other Funds |
|--|----------------------|----------------------|
| CUMULATIVE RESULTS OF OPERATIONS | | |
| 1. Beginning Balances | \$ 0.00 | \$ 12,928,685,207.90 |
| 2. Prior Period Adjustments: | | |
| 2.A. Changes in accounting principles (+/-) | 0.00 | 0.00 |
| 2.B. Corrections of errors (+/-) | 0.00 | 0.00 |
| 3. Beginning balances, as adjusted | 0.00 | 12,928,685,207.90 |
| 4. Budgetary Financing Sources: | | |
| 4.A. Other adjustments (rescissions, etc.) | 0.00 | 0.00 |
| 4.B. Appropriations used | 0.00 | 85,186,008.35 |
| 4.C. Nonexchange revenue | 0.00 | 0.00 |
| 4.D. Donations and forfeitures of cash and cash equivalents | 0.00 0.00 | 0.00 0.00 |
| 4.E. Transfers-in/out without reimbursement | 0.00 | 0.00 |
| 4.F. Other budgetary financing sources | 0.00 | 0.00 |
| 5. Other Financing Sources: | | |
| 5.A. Donations and forfeitures of property | 0.00 | 0.00 |
| 5.B. Transfers-in/out without reimbursement (+/-) | 0.00 | 9,659,223.04 |
| 5.C. Imputed financing from costs absorbed by others | 0.00 | 228,133,340.81 |
| 5.D. Other (+/-) | 0.00 | (146,617,726.52) |
| 6. Total Financing Sources | 0.00 | 176,360,845.68 |
| 7. Net Cost of Operations (+/-) | 0.00 | 1,259,491,497.62 |
| 8. Net Change | 0.00 | (1,083,130,651.94) |
| 9. Cumulative Results of Operations | 0.00 | 11,845,554,555.96 |
| UNEXPENDED APPROPRIATIONS | | |
| 10. Beginning Balances | \$ 0.00 | \$ 2,896,179.45 |
| 11. Prior Period Adjustments: | | |
| 11.A. Changes in accounting principles | 0.00 | 0.00 |
| 11.B. Corrections of errors | 0.00 | 0.00 |
| 12. Beginning balances, as adjusted | 0.00 | 2,896,179.45 |
| 13. Budgetary Financing Sources: | | |
| 13.A. Appropriations received | 0.00 | 83,465,000.00 |
| 13.B. Appropriations transferred-in/out | 0.00 | 0.00 |
| 13.C. Other adjustments (rescissions, etc.) | 0.00 | 0.00 |
| 13.D. Appropriations used | 0.00 | (85,186,008.35) |
| 14. Total Budgetary Financing Sources | 0.00 | (1,721,008.35) |
| 15. Unexpended Appropriations | 0.00 | 1,175,171.10 |
| 16. Net Position | 0.00 | 11,846,729,727.06 |

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended March 31, 2007 and 2006

| | 2007 Eliminations | 2007 Consolidated |
|--|-------------------|----------------------|
| CUMULATIVE RESULTS OF OPERATIONS | | |
| 1. Beginning Balances | \$ 0.00 | \$ 12,928,685,207.90 |
| 2. Prior Period Adjustments: | | |
| 2.A. Changes in accounting principles (+/-) | 0.00 | 0.00 |
| 2.B. Corrections of errors (+/-) | 0.00 | 0.00 |
| 3. Beginning balances, as adjusted | 0.00 | 12,928,685,207.90 |
| 4. Budgetary Financing Sources: | | |
| 4.A. Other adjustments (rescissions, etc.) | 0.00 | 0.00 |
| 4.B. Appropriations used | 0.00 | 85,186,008.35 |
| 4.C. Nonexchange revenue | 0.00 | 0.00 |
| 4.D. Donations and forfeitures of cash and cash equivalents | 0.00 0.00 | 0.00 0.00 |
| 4.E. Transfers-in/out without reimbursement | 0.00 | 0.00 |
| 4.F. Other budgetary financing sources | 0.00 | 0.00 |
| 5. Other Financing Sources: | | |
| 5.A. Donations and forfeitures of property | 0.00 | 0.00 |
| 5.B. Transfers-in/out without reimbursement (+/-) | 0.00 | 9,659,223.04 |
| 5.C. Imputed financing from costs absorbed by others | 0.00 | 228,133,340.81 |
| 5.D. Other (+/-) | 0.00 | (146,617,726.52) |
| 6. Total Financing Sources | 0.00 | 176,360,845.68 |
| 7. Net Cost of Operations (+/-) | 0.00 | 1,259,491,497.62 |
| 8. Net Change | 0.00 | (1,083,130,651.94) |
| 9. Cumulative Results of Operations | 0.00 | 11,845,554,555.96 |
| UNEXPENDED APPROPRIATIONS | | |
| 10. Beginning Balances | \$ 0.00 | \$ 2,896,179.45 |
| 11. Prior Period Adjustments: | | |
| 11.A. Changes in accounting principles | 0.00 | 0.00 |
| 11.B. Corrections of errors | 0.00 | 0.00 |
| 12. Beginning balances, as adjusted | 0.00 | 2,896,179.45 |
| 13. Budgetary Financing Sources: | | |
| 13.A. Appropriations received | 0.00 | 83,465,000.00 |
| 13.B. Appropriations transferred-in/out | 0.00 | 0.00 |
| 13.C. Other adjustments (rescissions, etc) | 0.00 | 0.00 |
| 13.D. Appropriations used | 0.00 | (85,186,008.35) |
| 14. Total Budgetary Financing Sources | 0.00 | (1,721,008.35) |
| 15. Unexpended Appropriations | 0.00 | 1,175,171.10 |
| 16. Net Position | 0.00 | 11,846,729,727.06 |

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended March 31, 2007 and 2006

| | 2006 Earmarked Funds | 2006 All Other Funds |
|--|----------------------|----------------------|
| CUMULATIVE RESULTS OF OPERATIONS | | |
| 1. Beginning Balances | \$ 0.00 | \$ 13,540,238,799.85 |
| 2. Prior Period Adjustments: | | |
| 2.A. Changes in accounting principles (+/-) | 0.00 | 0.00 |
| 2.B. Corrections of errors (+/-) | 0.00 | 0.00 |
| 3. Beginning balances, as adjusted | 0.00 | 13,540,238,799.85 |
| 4. Budgetary Financing Sources: | | |
| 4.A. Other adjustments (rescissions, etc.) | 0.00 | 0.00 |
| 4.B. Appropriations used | 0.00 | 869,290.70 |
| 4.C. Nonexchange revenue | 0.00 | 0.00 |
| 4.D. Donations and forfeitures of cash | 0.00 | 0.00 |
| and cash equivalents | 0.00 | 0.00 |
| 4.E. Transfers-in/out without reimbursement | 0.00 | 0.00 |
| 4.F. Other budgetary financing sources | 0.00 | 0.00 |
| 5. Other Financing Sources: | | |
| 5.A. Donations and forfeitures of property | 0.00 | 0.00 |
| 5.B. Transfers-in/out without reimbursement (+/-) | 0.00 | (32,508,770.27) |
| 5.C. Imputed financing from costs absorbed by others | 0.00 | 276,111,321.89 |
| 5.D. Other (+/-) | 0.00 | 77,203,956.44 |
| 6. Total Financing Sources | 0.00 | 321,675,798.76 |
| 7. Net Cost of Operations (+/-) | 0.00 | 1,847,158,225.72 |
| 8. Net Change | 0.00 | (1,525,482,426.96) |
| 9. Cumulative Results of Operations | 0.00 | 12,014,756,372.89 |
| UNEXPENDED APPROPRIATIONS | | |
| 10. Beginning Balances | \$ 0.00 | \$ 6,286,014.67 |
| 11. Prior Period Adjustments: | | |
| 11.A. Changes in accounting principles | 0.00 | 0.00 |
| 11.B. Corrections of errors | 0.00 | 0.00 |
| 12. Beginning balances, as adjusted | 0.00 | 6,286,014.67 |
| 13. Budgetary Financing Sources: | | |
| 13.A. Appropriations received | 0.00 | 83,067,000.00 |
| 13.B. Appropriations transferred-in/out | 0.00 | 0.00 |
| 13.C. Other adjustments (rescissions, etc) | 0.00 | 0.00 |
| 13.D. Appropriations used | 0.00 | (869,290.70) |
| 14. Total Budgetary Financing Sources | 0.00 | 82,197,709.30 |
| 15. Unexpended Appropriations | 0.00 | 88,483,723.97 |
| 16. Net Position | 0.00 | 12,103,240,096.86 |

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the periods ended March 31, 2007 and 2006

| | 2006 Eliminations | 2006 Consolidated |
|--|-------------------|----------------------|
| CUMULATIVE RESULTS OF OPERATIONS | | |
| 1. Beginning Balances | \$ 0.00 | \$ 13,540,238,799.85 |
| 2. Prior Period Adjustments: | | |
| 2.A. Changes in accounting principles (+/-) | 0.00 | 0.00 |
| 2.B. Corrections of errors (+/-) | 0.00 | 0.00 |
| 3. Beginning balances, as adjusted | 0.00 | 13,540,238,799.85 |
| 4. Budgetary Financing Sources: | | |
| 4.A. Other adjustments (rescissions, etc.) | 0.00 | 0.00 |
| 4.B. Appropriations used | 0.00 | 869,290.70 |
| 4.C. Nonexchange revenue | 0.00 | 0.00 |
| 4.D. Donations and forfeitures of cash | 0.00 | 0.00 |
| and cash equivalents | 0.00 | 0.00 |
| 4.E. Transfers-in/out without reimbursement | 0.00 | 0.00 |
| 4.F. Other budgetary financing sources | 0.00 | 0.00 |
| 5. Other Financing Sources: | | |
| 5.A. Donations and forfeitures of property | 0.00 | 0.00 |
| 5.B. Transfers-in/out without reimbursement (+/-) | 0.00 | (32,508,770.27) |
| 5.C. Imputed financing from costs absorbed by others | 0.00 | 276,111,321.89 |
| 5.D. Other (+/-) | 0.00 | 77,203,956.44 |
| 6. Total Financing Sources | 0.00 | 321,675,798.76 |
| 7. Net Cost of Operations (+/-) | 0.00 | 1,847,158,225.72 |
| 8. Net Change | 0.00 | (1,525,482,426.96) |
| 9. Cumulative Results of Operations | 0.00 | 12,014,756,372.89 |
| UNEXPENDED APPROPRIATIONS | | |
| 10. Beginning Balances | \$ 0.00 | \$ 6,286,014.67 |
| 11. Prior Period Adjustments: | | |
| 11.A. Changes in accounting principles | 0.00 | 0.00 |
| 11.B. Corrections of errors | 0.00 | 0.00 |
| 12. Beginning balances, as adjusted | 0.00 | 6,286,014.67 |
| 13. Budgetary Financing Sources: | | |
| 13.A. Appropriations received | 0.00 | 83,067,000.00 |
| 13.B. Appropriations transferred-in/out | 0.00 | 0.00 |
| 13.C. Other adjustments (rescissions, etc) | 0.00 | 0.00 |
| 13.D. Appropriations used | 0.00 | (869,290.70) |
| 14. Total Budgetary Financing Sources | 0.00 | 82,197,709.30 |
| 15. Unexpended Appropriations | 0.00 | 88,483,723.97 |
| 16. Net Position | 0.00 | 12,103,240,096.86 |

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended March 31, 2007 and 2006

| | <u>2007 Combined</u> | <u>2006 Combined</u> |
|--|------------------------------------|------------------------------------|
| BUDGETARY FINANCING ACCOUNTS | | |
| BUDGETARY RESOURCES: | | |
| 1. Unobligated balance, brought forward, October 1 | \$ 2,547,952,741.29 | \$ 2,816,659,416.98 |
| 2. Recoveries of prior year unpaid obligations | (4,909.86) | 0.00 |
| 3. Budget authority | | |
| 3.A. Appropriation | 83,465,000.00 | 83,067,000.00 |
| 3.B. Borrowing authority | 0.00 | 0.00 |
| 3.C. Contract authority | 6,351,281,875.01 | 6,671,538,946.98 |
| 3.D. Spending authority from offsetting collections | | |
| 3.D.1 Earned | | |
| 3.D.1.a. Collected | 11,330,196,101.66 | 11,076,186,175.09 |
| 3.D.1.b. Change in receivables from Federal sources | (155,156,845.69) | (263,750,718.98) |
| 3.D.2 Change in unfilled customer orders | | |
| 3.D.2.a. Advance received | 11,139,734.27 | 48,690,798.86 |
| 3.D.2.b. Without advance from Federal sources | 5,309,696,410.47 | 4,854,281,117.72 |
| 3.D.3. Anticipated for rest of year, without advances | 13,381,785,099.66 | 15,957,238,983.51 |
| 3.D.4. Previously unavailable | 0.00 | 0.00 |
| 3.D.5. Expenditure transfers from trust funds | 0.00 | 0.00 |
| 3.E. Subtotal | <u>36,312,407,375.38</u> | <u>38,427,252,303.18</u> |
| 4. Nonexpenditure transfers, net, anticipated and actual | 0.00 | (27,789,578.07) |
| 5. Temporarily not available pursuant to Public Law | 0.00 | 0.00 |
| 6. Permanently not available | (3,274,117,090.19) | (2,855,037,149.34) |
| 7. Total Budgetary Resources | <u><u>\$ 35,586,238,116.62</u></u> | <u><u>\$ 38,361,084,992.75</u></u> |

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended March 31, 2007 and 2006

| | 2007 Combined | 2006 Combined |
|---|------------------------------|------------------------------|
| Status of Budgetary Resources: | | |
| 8. Obligations incurred: | | |
| 8.A. Direct | \$ 526,308.35 | \$ 0.00 |
| 8.B. Reimbursable | 8,976,045,390.02 | 11,584,787,611.73 |
| 8.C. Subtotal | <u>8,976,571,698.37</u> | <u>11,584,787,611.73</u> |
| 9. Unobligated balance: | | |
| 9.A. Apportioned | 16,101,798,477.77 | 15,786,404,693.75 |
| 9.B. Exempt from apportionment | 660,133,567.60 | (108,489,743.03) |
| 9.C. Subtotal | <u>16,761,932,045.37</u> | <u>15,677,914,950.72</u> |
| 10. Unobligated balance not available | 9,847,734,372.88 | 11,098,382,430.30 |
| 11. Total status of budgetary resources | <u>\$ 35,586,238,116.62</u> | <u>\$ 38,361,084,992.75</u> |
| Change in Obligated Balance: | | |
| 12. Obligated balance, net | | |
| 12.A. Unpaid obligations, brought forward, October 1 | 12,112,506,938.92 | 12,667,319,650.50 |
| 12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1 | <u>\$ (7,376,260,847.66)</u> | <u>\$ (7,638,228,489.28)</u> |
| 12.C. Total unpaid obligated balance | 4,736,246,091.26 | 5,029,091,161.22 |
| 13. Obligations incurred net (+/-) | <u>\$ 8,976,571,698.37</u> | <u>\$ 11,584,787,611.73</u> |
| 14. Less: Gross outlays | (11,772,445,873.38) | (11,521,335,464.00) |
| 15. Obligated balance transferred, net | | |
| 15.A. Actual transfers, unpaid obligations (+/-) | 0.00 | (526,121.95) |
| 15.B. Actual transfers, uncollected customer payments from Federal sources (+/-) | <u>0.00</u> | <u>(32,537.97)</u> |
| 15.C. Total Unpaid obligated balance transferred, net | 0.00 | (558,659.92) |
| 16. Less: Recoveries of prior year unpaid obligations, actual | <u>4,909.86</u> | <u>0.00</u> |
| 17. Change in uncollected customer payments from Federal sources (+/-) | (5,154,539,564.78) | (4,590,530,398.74) |
| 18. Obligated balance, net, end of period | | |
| 18.A. Unpaid obligations | 9,316,637,673.77 | 12,730,245,676.28 |
| 18.B. Less: Uncollected customer payments (+/-) from Federal sources (-) | <u>(12,530,800,412.44)</u> | <u>(12,228,791,425.99)</u> |
| 18.C. Total, unpaid obligated balance, net, end of period | <u>(3,214,162,738.67)</u> | <u>501,454,250.29</u> |
| Net Outlays | | |
| 19. Net Outlays: | | |
| 19.A. Gross outlays | 11,772,445,873.38 | 11,521,335,464.00 |
| 19.B. Less: Offsetting collections | (11,341,335,835.93) | (11,124,876,973.95) |
| 19.C. Less: Distributed Offsetting receipts | 0.00 | 0.00 |
| 19.D. Net Outlays | <u>\$ 431,110,037.45</u> | <u>\$ 396,458,490.05</u> |

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended March 31, 2007 and 2006

| | 2007 Combined | 2006 Combined |
|--|---------------------|---------------------|
| | <hr/> | <hr/> |
| NONBUDGETARY FINANCING ACCOUNTS | | |
| BUDGETARY RESOURCES | | |
| 1. Unobligated balance, brought forward, October 1 | \$ 0.00 | \$ 0.00 |
| 2. Recoveries of prior year unpaid obligations | 0.00 | 0.00 |
| 3. Budget authority | | |
| 3.A. Appropriation | 0.00 | 0.00 |
| 3.B. Borrowing authority | 0.00 | 0.00 |
| 3.C. Contract authority | 0.00 | 0.00 |
| 3.D. Spending authority from offsetting collections | | |
| 3.D.1 Earned | | |
| 3.D.1.a. Collected | 0.00 | 0.00 |
| 3.D.1.b. Change in receivables from Federal sources | 0.00 | 0.00 |
| 3.D.2 Change in unfilled customer orders | | |
| 3.D.2.a. Advance received | 0.00 | 0.00 |
| 3.D.2.b. Without advance from Federal sources | 0.00 | 0.00 |
| 3.D.3 Anticipated for rest of year, without advances | 0.00 | 0.00 |
| 3.D.4 Previously unavailable | 0.00 | 0.00 |
| 3.D.5 Expenditure transfers from trust funds | 0.00 | 0.00 |
| 3.E. Subtotal | <hr/> 0.00 | <hr/> 0.00 |
| 4. Nonexpenditure transfers, net, anticipated and actual | 0.00 | 0.00 |
| 5. Temporarily not available pursuant to Public Law | 0.00 | 0.00 |
| 6. Permanently not available | 0.00 | 0.00 |
| 7. Total Budgetary Resources | <hr/> <hr/> \$ 0.00 | <hr/> <hr/> \$ 0.00 |

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the periods ended March 31, 2007 and 2006

| | 2007 Combined | 2006 Combined |
|---|----------------|----------------|
| Status of Budgetary Resources: | | |
| 8. Obligations incurred: | | |
| 8.A. Direct | \$ 0.00 | \$ 0.00 |
| 8.B. Reimbursable | 0.00 | 0.00 |
| 8.C. Subtotal | <u>0.00</u> | <u>0.00</u> |
| 9. Unobligated balance: | | |
| 9.A. Apportioned | 0.00 | 0.00 |
| 9.B. Exempt from apportionment | 0.00 | 0.00 |
| 9.C. Subtotal | <u>0.00</u> | <u>0.00</u> |
| 10. Unobligated balance not available | 0.00 | 0.00 |
| 11. Total Status of Budgetary Resources | <u>\$ 0.00</u> | <u>\$ 0.00</u> |
| Change in Obligated Balance: | | |
| 12. Obligated balance, net | | |
| 12.A. Unpaid obligations, brought forward, October 1 | 0.00 | 0.00 |
| 12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1 | <u>\$ 0.00</u> | <u>\$ 0.00</u> |
| 12.C. Total unpaid obligated balance | 0.00 | 0.00 |
| 13. Obligations incurred net (+/-) | <u>\$ 0.00</u> | <u>\$ 0.00</u> |
| 14. Less: Gross outlays | 0.00 | 0.00 |
| 15. Obligated balance transferred, net | | |
| 15.A. Actual transfers, unpaid obligations (+/-) | 0.00 | 0.00 |
| 15.B. Actual transfers, uncollected customer payments from Federal sources (+/-) | <u>0.00</u> | <u>0.00</u> |
| 15.C. Total Unpaid obligated balance transferred, net | 0.00 | 0.00 |
| 16. Less: Recoveries of prior year unpaid obligations, actual | 0.00 | 0.00 |
| 17. Change in uncollected customer payments from Federal sources (+/-) | 0.00 | 0.00 |
| 18. Obligated balance, net, end of period | | |
| 18.A. Unpaid obligations | 0.00 | 0.00 |
| 18.B. Less: Uncollected customer payments (+/-) from Federal sources (-) | <u>0.00</u> | <u>0.00</u> |
| 18.C. Total, unpaid obligated balance, net, end of period | <u>0.00</u> | <u>0.00</u> |
| Net Outlays | | |
| 19. Net Outlays: | | |
| 19.A. Gross outlays | 0.00 | 0.00 |
| 19.B. Less: Offsetting collections | 0.00 | 0.00 |
| 19.C. Less: Distributed Offsetting receipts | <u>0.00</u> | <u>0.00</u> |
| 19.D. Net Outlays | <u>\$ 0.00</u> | <u>\$ 0.00</u> |

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF FINANCING
For the periods ended March 31, 2007 and 2006

| | 2007 Consolidated | 2006 Consolidated |
|---|-----------------------------|-----------------------------|
| | <hr/> | <hr/> |
| Resources Used to Finance Activities: | | |
| Budgetary Resources Obligated | | |
| 1. Obligations incurred | \$ 8,976,571,698.37 | \$ 11,584,787,611.73 |
| 2. Less: Spending authority from offsetting collections and recoveries (-) | (16,495,870,490.85) | (15,715,407,372.69) |
| 3. Obligations net of offsetting collections and recoveries | (7,519,298,792.48) | (4,130,619,760.96) |
| 4. Less: Offsetting receipts (-) | 0.00 | 0.00 |
| 5. Net obligations | <hr/> (7,519,298,792.48) | <hr/> (4,130,619,760.96) |
| Other Resources | | |
| 6. Donations and forfeitures of property | 0.00 | 0.00 |
| 7. Transfers in/out without reimbursement (+/-) | 9,659,223.04 | (32,508,770.27) |
| 8. Imputed financing from costs absorbed by others | 228,133,340.81 | 276,111,321.89 |
| 9. Other (+/-) | (146,617,726.52) | 77,203,956.44 |
| 10. Net other resources used to finance activities | <hr/> 91,174,837.33 | <hr/> 320,806,508.06 |
| 11. Total resources used to finance activities | <hr/> \$ (7,428,123,955.15) | <hr/> \$ (3,809,813,252.90) |
| Resources Used to Finance Items not Part of the Net Cost of Operations | | |
| 12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided | | |
| 12a. Undelivered Orders (-) | 2,160,679,972.87 | (846,882,426.15) |
| 12b. Unfilled Customer Orders | 5,320,836,144.74 | 4,902,971,916.58 |
| 13. Resources that fund expenses recognized in prior periods | 0.00 | 0.00 |
| 14. Budgetary offsetting collections and receipts that do not affect net cost of operations | 0.00 | 0.00 |
| 15. Resources that finance the acquisition of assets | (2,003,689,832.13) | (1,921,064,920.78) |
| 16. Other resources or adjustments to net obligated resources that do not affect net cost of operations | | |
| 16a. Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-) | 0.00 | 0.00 |
| 16b. Other (+/-) | 136,958,503.48 | (44,695,186.17) |
| 17. Total resources used to finance items not part of the net cost of operations | <hr/> \$ 5,614,784,788.96 | <hr/> \$ 2,090,329,383.48 |
| 18. Total resources used to finance the net cost of operations | <hr/> \$ (1,813,339,166.19) | <hr/> \$ (1,719,483,869.42) |

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF FINANCING
For the periods ended March 31, 2007 and 2006

| | 2007 Consolidated | 2006 Consolidated |
|---|---------------------------------|---------------------------------|
| | <hr/> | <hr/> |
| Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period: | | |
| Components Requiring or Generating Resources in Future Period: | | |
| 19. Increase in annual leave liability | 0.00 | 0.00 |
| 20. Increase in environmental and disposal liability | 0.00 | 0.00 |
| 21. Upward/Downward reestimates of credit subsidy expense (+/-) | 0.00 | 0.00 |
| 22. Increase in exchange revenue receivable from the public (-) | 0.00 | 0.00 |
| 23. Other (+/-) | 0.00 | 0.00 |
| 24. Total components of Net Cost of Operations that will require or generate resources in future periods | <hr/> 0.00 | <hr/> 0.00 |
| Components not Requiring or Generating Resources: | | |
| 25. Depreciation and amortization | 99,556,258.81 | 102,813,355.65 |
| 26. Revaluation of assets or liabilities (+/-) | 1,133,642,733.51 | 957,727,426.14 |
| 27. Other (+/-) | | |
| 27a. Trust Fund Exchange Revenue | 0.00 | 0.00 |
| 27b. Cost of Goods Sold | 5,572,287,268.31 | 2,505,907,070.18 |
| 27c. Operating Material & Supplies Used | 0.00 | 0.00 |
| 27d. Other | (3,732,655,596.82) | 194,243.17 |
| 28. Total components of Net Cost of Operations that will not require or generate resources | <hr/> 3,072,830,663.81 | <hr/> 3,566,642,095.14 |
| 29. Total components of net cost of operations that will not require or generate resources in the current period | <hr/> \$ 3,072,830,663.81 | <hr/> \$ 3,566,642,095.14 |
| 30. Net Cost of Operations | <hr/> <hr/> \$ 1,259,491,497.62 | <hr/> <hr/> \$ 1,847,158,225.72 |

Note 1. Significant Accounting Policies**1.A. Basis of Presentation**

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

The NWCF is unable to fully implement all elements of GAAP and the OMB Circular A-136, due to limitations of its financial management processes and systems and nonfinancial systems and processes that feed into the financial statements. The NWCF derives its reported values and information for major asset and liability categories, largely from nonfinancial systems, such as inventory and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with GAAP. The NWCF continues to implement processes and system improvements addressing these limitations many of which are detailed below. The NWCF currently has two auditor identified financial statement weakness: (1) valuation of inventory and operating materials and supplies and (2) fund balance with treasury.

1.B. Mission of the Reporting Entity

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

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

1.C. Appropriations and Funds

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

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

1.D. Basis of Accounting

For FY 2007, the NWCF's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the NWCF's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP.

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

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

1.E. Revenues and Other Financing Sources

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

The NWCF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Statement of Financing. The U.S. has cost sharing agreements with other countries.

Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

1.F. Recognition of Expenses

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

1.G. Accounting for Intragovernmental Activities

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

The U.S. Treasury Financial Management Service (FMS) is responsible for eliminating transactions between the DoD and other federal agencies. The U.S. Treasury Financial Manual, Part 2 – Chapter 4700, “Agency Reporting Requirements for the Financial Report of the United States Government” and the U.S. Treasury’s “Federal Intragovernmental Transactions Accounting Policy Guide,” provide guidance for reporting and reconciling intragovernmental balances. While the NWCF is unable to fully reconcile intragovernmental transactions with all federal partners, the NWCF is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees’ Compensation Act transactions with the Department of Labor (DOL), and benefit program transactions with the Office of Personnel Management (OPM). The DoD’s proportionate share of public debt and related expenses to the federal government are not included. The Federal Government does not apportion debt and its related costs to federal agencies. The DoD’s financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

1.H. Transactions with Foreign Governments and International Organizations

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

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

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

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

1.J. Foreign Currency

Not Applicable.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for doubtful accounts due from the public are based upon analysis of collection experience by fund type. The DoD does not recognize an allowance for estimated doubtful amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual at <http://www.fms.treas.gov/tfm/vol1/07-03.pdf>.

1.L. Direct Loans and Loan Guarantees

Not Applicable.

1.M. Inventories and Related Property

The NWCF’s inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for material

management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). At the current time, NWCF does not report any inventory using the moving average cost method. However, by utilizing new system development processes, the NWCF will be transitioning to the moving average cost method with the implementation of the Navy Enterprise Resource Planning (ERP).

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

Related property includes operating materials and supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and aircraft engines, are generally recorded using the consumption method and are reported on the balance sheet as OM&S. When current systems cannot fully support the consumption method, NWCF uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2007, NWCF expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user.

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

The NWCF recognizes condemned material as "excess, obsolete, and unserviceable." The cost of disposal is greater than the potential scrap value; therefore, the net value of condemned material is zero. Potentially redistributed material, presented in previous years as "excess, obsolete, and unserviceable," is included in the "held for use" or "held for repair" categories according to its condition. Past audits identified uncertainties about completeness and existence of reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the NWCF. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make suitable for sale. It may be more economical to repair than to procure these inventory items. Because the NWCF often relies on weapon systems and machinery no longer in production, the NWCF supports a process that encourages the

repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force.

Work in process balances include costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs. Work in process also includes the value of finished products or completed services pending the submission of bills to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including amounts withheld from payment to ensure performance, and amounts paid to other government plants for accrued costs of end items of material ordered but not delivered. Work in process includes munitions in production and depot maintenance work with its associated labor, applied overhead, and supplies used in the delivery of maintenance services.

1.N. Investments

Not Applicable.

1.O. General Property, Plant and Equipment

The Department of Defense is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property Plant and Equipment (PP&E) to one that is specific for each individual category. In FY 2006, the capitalization threshold was revised from \$100,000 to \$20,000 for real property. The DON has not implemented the \$20,000 real property capitalization threshold yet pending an evaluation of real property systems, processes, and procedures that will have to be revised in order to implement the lowered threshold. The \$100,000 capitalization threshold remains unchanged for the remaining General PP&E categories.

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

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

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

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

1.P. Advances and Prepayments

It is DoD policy to record payments in advance of the receipt of goods and services as advances or prepayments and report the advances as an asset on the Balance Sheet, and to recognize the expense and/or proper asset classification when it receives the related goods and services.

1.Q. Leases

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

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

1.R. Other Assets

The NWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the NWCF provides financing payments. One type of financing payment that the NWCF makes for real property is

based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line on the Balance Sheet and in the related note.

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

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Federal Government. These payments are designed to alleviate the potential financial burden on contractors performing on certain long-term contracts and facilitate competition for defense contracts. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property and ships are reported as construction in progress in Note 10.

1.S. Contingencies and Other Liabilities

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

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

1.T. Accrued Leave

The NWCF reports as liabilities military leave and civilian earned leave except sick leave that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

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

Cumulative results of operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfer in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

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

1.W. Comparative Data

Financial statement fluctuations greater than two percent of total assets on the Balance Sheet or ten percent from the prior period presented, but no less than \$100 thousand, are explained within the notes to the financial statements.

1.X. Unexpended Obligations

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

1.Y. Undistributed Disbursements and Collection

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

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

| | |
|----------------|-------------------------|
| Note 2. | Nonentity Assets |
|----------------|-------------------------|

| As of March 31 | 2007 | 2006 |
|---|----------------------|----------------------|
| 1. Intragovernmental Assets | | |
| A. Fund Balance with Treasury | \$ 0.00 | \$ 0.00 |
| B. Accounts Receivable | 0.00 | 0.00 |
| C. Total Intragovernmental Assets | \$ 0.00 | \$ 0.00 |
| 2. Nonfederal Assets | | |
| A. Cash and Other Monetary Assets | \$ 0.00 | \$ 0.00 |
| B. Accounts Receivable | 2,856,569.23 | 2,769,020.24 |
| C. Other Assets | 0.00 | 0.00 |
| D. Total Nonfederal Assets | \$ 2,856,569.23 | \$ 2,769,020.24 |
| 3. Total Nonentity Assets | \$ 2,856,569.23 | \$ 2,769,020.24 |
| 4. Total Entity Assets | \$ 18,148,935,167.84 | \$ 19,010,351,180.61 |
| 5. Total Assets | \$ 18,151,791,737.07 | \$ 19,013,120,200.85 |
| 6. Other Information Related to Nonentity Assets | | |

Definitions

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

Composition of Nonentity Assets

The Nonentity Assets amount of \$2.9 million represents interest, penalties, fines and administrative fees. These fees do not belong to NWCF and will be distributed directly to the U.S. Treasury.

| | |
|----------------|-----------------------------------|
| Note 3. | Fund Balance with Treasury |
|----------------|-----------------------------------|

| As of March 31 | 2007 | 2006 |
|--|-------------------|-------------------|
| 1. Fund Balances | | |
| A. Appropriated Funds | \$ 0.00 | \$ 0.00 |
| B. Revolving Funds | 869,052,452.07 | 550,084,484.08 |
| C. Trust Funds | 0.00 | 0.00 |
| D. Special Funds | 0.00 | 0.00 |
| E. Other Fund Types | 0.00 | 0.00 |
| F. Total Fund Balances | \$ 869,052,452.07 | \$ 550,084,484.08 |
| 2. Fund Balances Per Treasury Versus Agency | | |
| A. Fund Balance per Treasury | \$ 869,052,452.07 | \$ 550,084,484.08 |
| B. Fund Balance per NWCF | 869,052,452.07 | 550,084,484.08 |
| 3. Reconciling Amount | | |
| | \$ 0.00 | \$ 0.00 |

4. Explanation of Reconciliation Amount:

No reconciling amount to report this period.

5. Information Related to Fund Balance with Treasury:**Fluctuations and Abnormalities**

Fund Balance with Treasury (FBWT) increased \$319.0 million, 58%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. This increase was primarily driven by Supply Management, Navy with a \$314.6 million increase due to the following business events:

- An increase of \$83.4 million was received through a cash warrant in 1st Quarter, FY 2007.
- An increase of \$111.2 million was reported as a result of increased recovery of costs of operations and sales of material in excess of inventory replenishment from 2nd Quarter, FY 2006 through 2nd Quarter, FY 2007. Throughout FY 2006 and continuing into 2nd Quarter, FY 2007, replenishment orders were being paid later and the related cash disbursements processed later than in previous fiscal years.
- An increase of \$78.0 million was collected from Commander, Naval Installation Command (CNIC) reimbursable sales throughout FY 2006 and continuing into 2nd Quarter, FY 2007; the result of supply operations being transferred from CNIC to Supply Management, Navy.
- An increase of approximately \$42 million in collections for previously expended supply items resulted from the Global War on Terror (GWOT) supplemental that was received in 4th Quarter, FY 2006.

Composition of Fund Balance with Treasury

The FBWT of \$869.1 million reflects the FY 2006 ending balance of \$1.2 billion plus current FY 2007 collections, disbursements, and other cash transactions recorded in the Navy Working Capital Fund (NWCF) U.S. Treasury sub-limit 97X4930.002. The following table details the amounts recorded as of March 31, 2007:

| | |
|------------------------------|-------------------------------|
| | <i>(Amounts in thousands)</i> |
| Collections | \$ 11,341,356 |
| Disbursements | \$ (11,772,446) |
| Other Cash Transactions, Net | \$ 55,654 |

Other Disclosures Related to Funds Balance with Treasury

As a part of the Department of Navy's (DON) Financial Management Strategic Plan, the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) competitively engaged an accounting firm to conduct a review of Navy Working Capital Fund (NWCF) cash management practices and make recommendations for improvement. The review identified NWCF cash management challenges and inconsistencies from not applying the same policies and procedures throughout NWCF for reconciling cash. Opportunities were also identified to assist activities in reducing the rework required to resolve unmatched disbursements and unmatched collections, which can distort cash balances. For example, a payment is processed against a Navy appropriation due to a human error in reading a contract. The correct appropriation should have been an Army appropriation. When this payment is processed by the Navy activity, it will be an unmatched disbursement. Until this unmatched disbursement is corrected, it distorts the cash balance for the Navy and Army appropriation.

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

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

| |
|---|
| Status of Fund Balance with Treasury |
|---|

| As of March 31 | 2007 | 2006 |
|---|--------------------------|--------------------------|
| 1. Unobligated Balance | | |
| A. Available | \$ 13,167,708,487.50 | \$ 10,626,736,956.89 |
| B. Unavailable | 114,717,404.50 | 192,321,440.62 |
| 2. Obligated Balance not yet Disbursed | \$ 9,316,637,673.77 | \$ 12,730,213,138.31 |
| 3. Nonbudgetary FBWT | \$ 0.00 | \$ 0.00 |
| 4. NonFBWT Budgetary Accounts | \$ (21,730,011,113.70) | \$ (23,031,338,764.46) |
| 5. Total | <u>\$ 869,052,452.07</u> | <u>\$ 517,932,771.36</u> |

5. Information Related to Status of Fund Balance with Treasury:**Fluctuations and Abnormalities**

Total Status of Fund Balance with Treasury increased \$351.1 million, 68%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. An increase of \$314.6 million is attributable to Supply Management, Navy and is explained above under Fund Balance with Treasury. NWCF budgetary accounts are tied to NWCF proprietary accounts; therefore, any change in NWCF proprietary account amounts will have a similar effect on the budgetary accounts.

There was an overall NWCF difference between total Status of Fund Balance with Treasury and Fund Balance with Treasury in 2nd Quarter, FY 2006 of \$32.2 million. This difference was researched and analyzed by NWCF and Defense Finance and Accounting Service (DFAS) during the 3rd and 4th quarters in FY 2006 and has been resolved. This difference in budgetary accounts resulted from system problems creating budgetary account balances throughout the history of the NWCF and has been resolved as discrepancies have been identified.

Definitions

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

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

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

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

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

Disclosure of Restrictions

All unobligated unavailable balances are restricted to future use and are not apportioned for current use. The unavailable balances are restricted due to the accrual of the debt that is attributable to the Transportation Activity, Military Sealift Command.

Differences Between the Status of Fund Balance with Treasury and the Total of the Fund Balance with Treasury

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

Disclosures Related to Suspense/Budget Clearing Accounts

| As of March 31 | 2005 | 2006 | 2007 | (Decrease)/ Increase from FY 2006 - 2007 |
|---|----------------|----------------|----------------|--|
| Account | | | | |
| F3845 – Personal Property Proceeds | \$ 0.00 | \$ 0.00 | \$ 0.00 | 0.00 |
| F3875 – Disbursing Officer Suspense | 0.00 | 0.00 | 0.00 | 0.00 |
| F3880 – Lost or Cancelled Treasury Checks | 0.00 | 0.00 | 0.00 | 0.00 |
| F3882 – Uniformed Services Thrift Savings Plan Suspense | 0.00 | 0.00 | 0.00 | 0.00 |
| F3885 – Interfund/IPAC Suspense | 0.00 | 0.00 | 0.00 | 0.00 |
| F3886 – Thrift Savings Plan Suspense | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | 0.00 |

Per Office of Under Secretary of Defense, (Comptroller) (OUSD(C)) direction, the NWCF Suspense/Budget Clearing Accounts are being reported under DON General Funds, Index 17.

| |
|---|
| Disclosures Related to Problem Disbursements |
|---|

| As of March 31 | 2005 | 2006 | 2007 | (Decrease)/ Increase from FY 2006 to 2007 |
|---|----------------------------|--------------------------|--------------------------|---|
| 1. Total Problem Disbursements, Absolute Value | | | | |
| A. Unmatched Disbursements (UMDs) | \$ 1,253,691,500.17 | \$ 133,100,577.35 | \$ 82,694,774.44 | (50,405,802.91) |
| B. Negative Unliquidated Obligations (NULO) | 862,699.96 | 236,389.88 | 3,894,906.26 | 3,658,516.38 |
| C. In-Transit Disbursements | 33,391,783.87 | 605,500,912.40 | 549,980,389.27 | (55,520,523.13) |
| Total | \$ 1,287,945,984.00 | \$ 738,837,879.63 | \$ 636,570,069.97 | (102,267,809.66) |

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

Abnormalities and Fluctuations

Unmatched Disbursements (UMDs) decreased \$50.4 million, 38%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. This decrease is a direct result of an ongoing initiative to clean up aged UMDs. In order to comply with OUSD(C)'s direction to eliminate DON's UMDs over 120 days old by June 30, 2006, an initiative began during 4th Quarter, FY 2005, which increased coordination between the DFAS and NWCF activities concerning the reduction of UMDs. As part of this initiative, DFAS and NWCF activities performed root cause analysis that discovered several system and process weaknesses. Several different root causes have been identified throughout FY 2006 and FY 2007. These include the need for strict system edits for processing material bills; accounts payable not being established correctly in Mechanization of Contract Administration System (MOCAS); incorrect data elements on data entry; and system timing issues. DON and DFAS have implemented several changes to working capital fund accounting systems to prevent UMDs and have manually cleared the aged UMDs as these system weaknesses were identified. These efforts are continuing into FY 2007.

Negative Unliquidated Obligations (NULOs) increased \$3.7 million from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The breakdown of this information was reported but not identifiable in detail in previous years. The DON submitted a plan of action and milestones in March 2006 to the OUSD(C) that describes how DON will resolve this reporting issue. The DON and DFAS have incorporated all NULOs as part of the UMD corrective action plan.

Total In-transit Disbursements decreased \$55.5 million, 9%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. These amounts are due to disbursements and collections made by a DoD disbursing activity and have not yet been posted to the accounting system. DFAS and NWCF activities are working together to align system process schedules that minimize the amount of these transactions each month.

Starting 2nd Quarter, FY 2007, in-transit disbursements are reported as absolute value as opposed to net amounts disclosed in prior years. This reporting change applies to amounts in the note schedule for both the current and comparative years.

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

Definitions

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

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

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

| | |
|----------------|---|
| Note 4. | Investments and Related Interest |
|----------------|---|

| As of March 31 | 2007 | | | | |
|---|---------|------------------------|-----------------------------------|------------------|----------------------------|
| | Cost | Amortization Method | Amortized (Premium) / Discount | Investments, Net | Market Value Disclosure |
| 1. Intragovernmental Securities | | | | | |
| A. Nonmarketable, Market-Based | | | | | |
| 1. Military Retirement Fund | \$ 0.00 | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Medicare Eligible Retiree Health Care Fund | 0.00 | | 0.00 | 0.00 | 0.00 |
| 3. US Army Corps of Engineers | 0.00 | | 0.00 | 0.00 | 0.00 |
| 4. Other Funds | 0.00 | | 0.00 | 0.00 | 0.00 |
| 5. Total Nonmarketable, Market-Based | 0.00 | | 0.00 | 0.00 | 0.00 |
| B. Accrued Interest | 0.00 | | | 0.00 | 0.00 |
| C. Total Intragovernmental Securities | \$ 0.00 | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Other Investments | | | | | |
| A. Total Other Investments | \$ 0.00 | | \$ 0.00 | \$ 0.00 | N/A |
| 3. Intragovernmental Securities | | | | | |
| A. Nonmarketable, Market-Based | | | | | |
| 1. Military Retirement Fund | \$ 0.00 | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Medicare Eligible Retiree Health Care Fund | 0.00 | | 0.00 | 0.00 | 0.00 |
| 3. US Army Corps of Engineers | 0.00 | | 0.00 | 0.00 | 0.00 |
| 4. Other Funds | 0.00 | | 0.00 | 0.00 | 0.00 |
| 5. Total Nonmarketable, Market-Based | 0.00 | | 0.00 | 0.00 | 0.00 |
| B. Accrued Interest | 0.00 | | | 0.00 | 0.00 |
| C. Total Intragovernmental Securities | \$ 0.00 | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 4. Other Investments | | | | | |
| A. Total Other Investments | \$ 0.00 | | \$ 0.00 | \$ 0.00 | N/A |

Not Applicable.

| | |
|----------------|----------------------------|
| Note 5. | Accounts Receivable |
|----------------|----------------------------|

| As of March 31 | 2007 | | | 2006 |
|--|-------------------|--|--------------------------|--------------------------|
| | Gross Amount Due | Allowance For Estimated Uncollectibles | Accounts Receivable, Net | Accounts Receivable, Net |
| 1. Intragovernmental Receivables | \$ 389,954,554.75 | N/A | \$ 389,954,554.75 | \$ 172,583,702.26 |
| 2. Nonfederal Receivables (From the Public) | \$ 68,914,451.51 | \$ (29,357.11) | \$ 68,885,094.40 | \$ 63,297,300.85 |
| 3. Total Accounts Receivable | \$ 458,869,006.26 | \$ (29,357.11) | \$ 458,839,649.15 | \$ 235,881,003.11 |

4. Other Information Related to Accounts Receivable:**Fluctuations and Abnormalities**

Intragovernmental Accounts Receivable increased \$217.4 million, 126%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The primary drivers contributing to this increase are described below:

(Amounts in thousands)

| Business Activity | Increases | Decreases | Explanations |
|---|------------------|-----------|--|
| Research and Development, Naval Undersea Warfare Center | \$114,239 | | The accounts receivable balance for 2nd Quarter, FY 2006 reflected an understated balance due to a system processing error. This error was corrected in 3rd Quarter, FY 2006 and the current balance reflects a return to normal business levels. |
| Base Support, Public Works Centers | \$41,102 | | This increase is attributable to the addition of 28 Public Works Detachments in November 2006. The increase in 2nd Quarter, FY 2007 is reflective of the additional workload that was assumed with these new sites, therefore increasing billings and accounts receivable. |
| Totals | \$155,341 | | |

Aged Accounts Receivable

| As of March 31 | 2007 | | 4th Quarter 2006 | |
|---|--------------------------|-------------------------|--------------------------|-------------------------|
| | Intragovernmental | Nonfederal | Intragovernmental | Nonfederal |
| CATEGORY | | | | |
| Nondelinquent | | | | |
| Current | \$ 568,804,666.77 | \$ 27,954,873.53 | \$ 699,169,758.09 | \$ 40,406,575.25 |
| Noncurrent | 681,388.16 | 7,411,576.91 | 0.00 | 0.00 |
| Delinquent | | | | |
| 1 to 30 days | \$ 1,940,034.24 | \$ 17,048,554.85 | \$ 2,764,983.94 | \$ 2,419,102.39 |
| 31 to 60 days | 405,521.90 | 242,666.44 | 1,220,270.97 | 3,792,197.68 |
| 61 to 90 days | 618,245.01 | 986,839.90 | 3,094,999.42 | 953,105.12 |
| 91 to 180 days | 3,344,482.96 | 3,413,170.28 | 2,118,462.56 | 2,134,844.70 |
| 181 days to 1 year | 2,549,762.32 | 3,961,744.54 | 470,233.48 | 2,030,877.37 |
| Greater than 1 year and less than or equal to 2 years | 407,262.95 | 3,161,725.93 | 698,849.43 | 3,262,108.05 |
| Greater than 2 years and less than or equal to 6 years | 14,600.96 | 2,510,298.19 | 2,503.25 | 2,409,803.62 |
| Greater than 6 years and less than or equal to 10 years | 0.00 | 1,464,551.62 | 0.00 | 1,844,952.89 |
| Greater than 10 years | 0.00 | 4,663,058.22 | 0.00 | 4,597,167.93 |
| Subtotal | \$ 578,765,965.27 | \$ 72,819,060.41 | \$ 709,540,061.14 | \$ 63,850,735.00 |
| Less Supported Undistributed Collections | (194,674,914.56) | (5,405,807.36) | (148,182,152.92) | (8,724,020.61) |
| Less Eliminations | (15,978,973.80) | 0.00 | (106,135,868.79) | 0.00 |
| Less Other | 21,842,477.84 | 1,501,198.46 | (10,970,998.96) | 14,255,551.47 |
| Total | \$ 389,954,554.75 | \$ 68,914,451.51 | \$ 444,251,040.47 | \$ 69,382,265.86 |

Information Related to Aged Accounts Receivable

The eliminations line in this chart reflects the amount of internal Navy Working Capital Fund (NWCF) eliminations as reported in the financial statements. The \$16.0 million represents the amounts attributable to other NWCF activities.

The "Other" amount of \$21.8 million in Intragovernmental Receivables and \$1.5 million in Nonfederal Receivables represents a required adjustment to reconcile account totals with the Seller Elimination Report (SER) by reclassifying Accounts Receivable Nonfederal to Intragovernmental. The NWCF is working with the major commands and Defense Finance and Accounting Service (DFAS) as part of the Department of the Navy's Financial Improvement Program to correct this issue.

NonDelinquent Noncurrent Aged Accounts Receivable

The nondelinquent noncurrent accounts receivable are attributable to Base Support, Navy. These represent amounts that have been billed; however, due to contractual arrangements, payment is not yet due. Intragovernmental billings are made to various governmental agencies for services provided to these agencies located on Naval bases. Nonfederal billings are made to various public entities for services provided to these public entities located on Naval bases.

Aging Category Variances - Intragovernmental

Delinquent 1 to 180 days accounts receivable total \$6.3 million in 2nd Quarter, FY 2007. The composition of \$4.7 million, 75%, of these aging categories are as follows:

- Supply Management business area is reporting \$3.7 million as a result of sales of operations that have not liquidated due to various timing issues. Timing issues include: the day of the month that billings are generated in comparison to treasury reporting cut off dates; when the customer processes the billing transactions into their system; days it takes for the customer to generate payment; and the number of days it takes for the transaction to return to NAVSUP and liquidate the receivable. In the first week of April 2007, \$1.7 million of this amount was collected.
- Research and Development business area is reporting \$851 thousand as a result of prevalidation errors and manual billing errors. The delay in the timely liquidation of receivables due to prevalidation or postpayment processing errors result in rejected transactions that take additional time to research and correct. For example, when a funding document contains both direct cite and reimbursable funding, and direct cite expenditures are incorrectly posted against reimbursable funds, the NWCF receivable will not clear. This results in a rejected receivable transaction. In order to clear the NWCF receivable, a complete manual reconciliation of the funding document has to be performed in order to resolve the erroneous direct cite expenditures.
- Depot Maintenance business area is reporting \$61.2 thousand where billings were generated in the month of February 2007 in accordance with the Defense (DoD) Material Return Program (MRP). Under MRP during the 1st Quarter, FY 2007, the Marine Corps Maintenance Centers identified excess on hand repair parts for automotive equipment to the Department of Army and requested credit for the return of these items. The Army is the source of supply (SOS) for this type of equipment. In response to the MRP request, the Army identified that a payment, equal to the standard unit price of the items, would be made for the return of the equipment. The equipment was released during the month of February and generated the accounts receivable. Under DoD regulations for the MRP, the SOS has 120 days after receipt of the equipment to provide payment. Communication between Marine Corps and Army in March 2007 indicated that the items had been received and payment should be released no later than June 2007.

(Amount in Thousands)

| Intragovernmental Aging Category | FY 2007 Amount | FY 2006 Amounts | Change |
|--|-----------------------|------------------------|---------------|
| 1 – 180 Days Delinquent in FY 2006 compared to 181 Days – 1 Year Delinquent in FY 2007 | \$2,550 | \$9,199 | (\$6,649) |
| 181 Days – 2 Year in FY 2006 compared to 1 Year – 2 Years in FY 2007 | \$407 | \$1,169 | (\$762) |

Delinquent 181 days to 1 year accounts receivable decreased \$6.6 million, 72%, when compared with the 1 – 180 days delinquent categories from 4th Quarter, FY 2006. A decrease of \$4.8 million is attributable as follows:

- Depot Maintenance business area reported a decrease of \$149.8 thousand. In the category of 181 days to 1 year in 4th Quarter, FY 2006, there were several documents totaling \$267.9 thousand related to the MRP program where the Army is the SOS. Due to system problems, personnel turnover, as well as other issues, the Marine Corps has had difficulty tracking the specific MRP shipment of these items. Currently, there is an ongoing effort to work with DFAS and the Army to reconcile this record. If records are not reconciled and the aged accounts not resolved by May 2007, the Marine Corps plans to write off these receivables. This category has decreased as a result of researching this issue and determining that the bill had been received.
- Supply Management business area reported a decrease of \$2.6 million. These receivables are bills for material sales and carcass billings to other Navy or DoD activities. Aggressive collection efforts by DFAS and the Supply Management business area have resulted in the collection of these aged receivables.
- Research and Development business area reported a decrease of \$2.1 million. This decrease is attributable to various reasons, including DFAS field sites and NWCF activities aggressively researching and taking necessary actions to clear over aged receivables; NWCF activities assigning personnel to work with DFAS and customers to clear receivables; manually researching and correcting prevalidation errors; and researching and correcting erroneous interfund billings.

Delinquent greater than 2 years and equal to or less than 6 years accounts receivable decreased \$761.8 thousand, 65%, from 4th Quarter, FY 2006 to 2nd Quarter, FY 2007. Research and Development business area reported a decrease of \$637.8 thousand as a result of DFAS and NWCF sites partnering to resolve delinquent receivables. This decrease resulted from the liquidation of several small dollar value receivables spread across five NWCF activities.

Aging Category Variances - Nonfederal

Delinquent 1 to 180 days accounts receivable total \$21.7 million in 2nd Quarter, FY 2007. Base Support business area is reporting \$15.8 million, 76%, in receivables with various private customers for utilities and public works services. These private customers include such companies as McDonalds, Subway, Verizon, and Voyager, among others. Since this business area primarily prepares manual billings, it takes an extended period of time to collect and relieve the accounts receivable.

(Amount in Thousands)

| Nonfederal Aging Category | FY 2007 Amount | FY 2006 Amounts | Change |
|--|-----------------------|------------------------|---------------|
| 1 – 180 Days Delinquent in FY 2006 compared to 181 Days – 1 Year Delinquent in FY 2007 | \$3,962 | \$9,299 | (\$5,337) |
| 181 Days – 2 Year in FY 2006 compared to 1 Year – 2 Years in FY 2007 | \$3,162 | \$5,293 | (\$2,131) |

Delinquent 181 days to 1 year accounts receivable decreased \$5.3 million, 57%, when compared with the 1 – 180 days delinquent categories from 4th Quarter, FY 2006. A decrease of \$4.5 million is attributable as follows:

- Supply Management business area reported a decrease of \$2.4 million. This decrease is a result of aggressive collection efforts by DFAS and the Supply Management business area to resolve aged accounts receivables. Aggressive collection actions include: processing demand letters; placing phone calls to delinquent customers; and increasing the frequency of phone calls to customers. Since this business area primarily prepares manual billings for their nonfederal customers, it takes an extended period of time to collect and relieve the accounts receivable. When a billing is manual, it takes a longer period of time for the customer to receive the bill. Also, with manual billing there is an increased risk for human error that can result in extended time for the proper liquidation of the bills. Manual billings are mailed to customers, which also creates additional time between billing and collection.
- Base Support business area reported a decrease of \$2.1 million. Since this business area primarily prepares manual billings, it takes an extended period of time to collect and relieve the accounts receivable. Therefore, this decrease is a result of billings to private companies where the billing process does not follow the automated system interface for financial management.

Delinquent greater than 1 year and equal to or less than 2 years accounts receivable decreased \$2.1 million, 40%, when compared with the 181 days – 2 year categories from 4th Quarter, FY 2006. Supply Management business area reported a decrease of \$1.6 million. Since this business area primarily prepares manual billings, it takes an extended period of time to collect and relieve the accounts receivable.

Delinquent greater than 6 years and equal to or less than 10 years accounts receivable decreased \$380.4 thousand, 21%, from 4th Quarter, FY 2006 to 2nd Quarter, FY 2007. This decrease is attributable to the NWCF component business area. Due to a lack of sufficient detailed data at the summary level, NWCF cannot determine the source of this decrease at this time.

The DON is taking corrective actions to eliminate intragovernmental and nonfederal receivables older than 30 days. Some of these corrective actions include:

- NWCF and DFAS are working together to ensure timely collection/resolution of delinquent receivables, as well as timely submission of receivables to debt collection in accordance with guidance. The DON is also expecting to develop and implement instructions on the use of the Delinquent Aged Accounts Receivable Report (DAARR) to resolve receivables.
- NWCF Commands are actively monitoring and establishing business rules and processes to ensure that receivables are liquidated in a timely manner. NWCF Commands are also teaming with local nonfinancial personnel to reduce the number of errors that arise from nonfinancial feeder systems.

- DFAS is setting up a Government Receivables Debt Collection Office to act as a liaison between government agencies, ensuring timely collection of government receivables.

Other Disclosures

The accounts receivable aging schedule prior year column represents 4th Quarter, FY 2006 ending balances, rather than the ending balances as 2nd Quarter, FY 2006. Therefore, the prior year accounts receivable balance on the aging schedule will not agree with the prior year balance on the Balance Sheet nor the prior year balance in the first schedule in this note.

| | |
|----------------|---------------------|
| Note 6. | Other Assets |
|----------------|---------------------|

| As of March 31 | 2007 | 2006 |
|--|-------------------|-------------------|
| 1. Intragovernmental Other Assets | | |
| A. Advances and Prepayments | \$ 1,949,384.37 | \$ 5,581,863.26 |
| B. Other Assets | 0.00 | 0.00 |
| C. Total Intragovernmental Other Assets | \$ 1,949,384.37 | \$ 5,581,863.26 |
| 2. Nonfederal Other Assets | | |
| A. Outstanding Contract Financing Payments | \$ 25,688,924.34 | \$ 0.00 |
| B. Other Assets (With the Public) | 309,415,178.76 | 385,832,284.49 |
| C. Total Nonfederal Other Assets | \$ 335,104,103.10 | \$ 385,832,284.49 |
| 3. Total Other Assets | \$ 337,053,487.47 | \$ 391,414,147.75 |

4. Information Related to Other Assets:**Fluctuations and Abnormalities**

Intragovernmental Other Assets, Advances and Prepayments decreased \$3.6 million, 65% from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. This decrease is the result of a decrease in unexpended advances to the Defense Logistics Agency for hazardous waste removal at the end of the 2nd Quarter, FY 2007 as compared to 2nd Quarter, FY 2006.

Total Nonfederal Other Assets decreased \$50.7 million, 13%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The balance reported for 2nd Quarter, FY 2006 contained a reduction of \$5.6 million due to a reclassification of assets. This reclassification was not necessary in 2nd Quarter, FY 2007 due to improved business processes. Therefore, after adjusting the 2nd Quarter, FY 2006 balance for this reclassification, the overall change was a decrease of \$56.3 million, 14%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The primary drivers of the overall decrease are as follows:

- Nonfederal Other Assets, Outstanding Contract Financing Payments increased from \$0 to \$25.7 million from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The balance of this line is the estimated future funded payments that will be paid to the contractor. This amount is a direct result of a manual Journal Voucher directed by the Office of Under Secretary of Defense (Comptroller) (OUSD(C)) to satisfy the Department of the Defense, Inspector General (DoDIG) Audit "Financial Management: Report on Recording and Accounting for DoD Contract Financing Payment," of May 10, 2005. The data that was provided to determine the amount of the manual entry was derived from OUSD(C) query of the Mechanization of Contract Administration System (MOCAS) data. The Navy Working Capital Fund (NWCF) compared the MOCAS query data to NWCF account data, but was unable to reconcile with the MOCAS query data. Therefore, NWCF is unable to substantiate the balance on this line for 2nd Quarter, FY 2007.

- After adjusting the 2nd Quarter, FY 2006 balance for the reclassification of assets described above, Nonfederal Other Assets, Other Assets (With the Public) decreased \$82.0 million, 21%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The primary drivers attributing to this are as follows:

(Amounts in Thousands)

| Business Activity | Increases | Decreases | Explanations |
|--|------------------|------------------|--|
| Transportation, Military Sealift Command (MSC) | | \$114,647 | This decrease is a result of three events. In January 2007, MSC exercised an option to purchase one Maritime Prepositioning Ship (MPS) that had previously been under long-term charter for \$49.4 million. In July 2006 and January 2007, MSC paid semi-annual payments to the Federal Financing Bank (FFB) for MPS ships totaling \$64.8 million. The remaining decrease of \$428.2 thousand represents a decrease in travel advances for MSC. |
| Supply Management, Navy | \$18,184 | | This increase is a result of progress payments issued to Raytheon Company to provide F/A-18 Advanced Target Forward Looking Infrared spares during FY 2007. |
| Totals | \$18,184 | \$114,647 | |

Composition of Other Assets (With the Public)

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

Outstanding debt principal. As required by the OUSD(C) memorandum of January 22, 1999, MSC is correctly recording these payments as an operating expense. The outstanding debt principal amount is reported in the NWCF Balance Sheet as an other asset in order to reconcile with the amount reported by FFB. The misclassification by FFB has generated this long-standing reporting problem. See additional discussion in Note 13, Debt.

Prepayments made to vendors. Prepayments made to vendors are discussed in further detail below under Contract Financing Payments.

Travel advances. Travel advances are given for various travel orders to civilian employees. The balance represents advances that are to be liquidated when the travel is completed.

Contract Financing Payments

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Department of the Navy (DON) that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the 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 of a satisfactory product.

The Contract Financing Payment balance of \$25.7 million is comprised of estimated future funded payments that will be paid to the contractor upon future delivery and Federal Government acceptance of a satisfactory product. (See additional discussion in Note 16, Commitments and Contingencies).

| | |
|----------------|---------------------------------------|
| Note 7. | Cash and Other Monetary Assets |
|----------------|---------------------------------------|

| As of March 31 | 2007 | 2006 |
|---|---------|---------|
| 1. Cash | \$ 0.00 | \$ 0.00 |
| 2. Foreign Currency | 0.00 | 0.00 |
| 3. Other Monetary Assets | 0.00 | 0.00 |
| 4. Total Cash, Foreign Currency, & Other Monetary Assets | \$ 0.00 | \$ 0.00 |

Not Applicable.

| | |
|----------------|---|
| Note 8. | Direct Loan and/or Loan Guarantee Programs |
|----------------|---|

As of March 31

Direct Loan and/or Loan Guarantee Programs

Not Applicable

| |
|--|
| Summary of Direct Loans and Loan Guarantees |
|--|

| As of March 31 | 2007 | 2006 |
|--|----------------|----------------|
| Direct Loan Programs | | |
| 1. Foreign Military Loan Liquidating Account | \$ 0.00 | \$ 0.00 |
| 2. Military Housing Privatization Initiative | 0.00 | 0.00 |
| 3. Foreign Military Financing Account | 0.00 | 0.00 |
| 4. Military Debt Reduction Financing Account | 0.00 | 0.00 |
| 5. Defaulted Guaranteed Loans Receivable: | | |
| A. Foreign Military Financing Account | 0.00 | 0.00 |
| B. Military Housing Privatization Initiative | 0.00 | 0.00 |
| C. Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 |
| 6. Total Loans Receivable | \$ 0.00 | \$ 0.00 |

| As of March 31 | 2007 | 2006 |
|--|----------------|----------------|
| Loan Guarantee Programs | | |
| 1. Foreign Military Liquidating Account | \$ 0.00 | \$ 0.00 |
| 2. Military Housing Privatization Initiative | 0.00 | 0.00 |
| 3. Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 |
| 4. Total Loan Guarantee Liability | \$ 0.00 | \$ 0.00 |

| |
|-------------------------------|
| Direct Loans Obligated |
|-------------------------------|

| As of March 31 | 2007 | 2006 |
|---|----------------|----------------|
| Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method): | | |
| 1. Foreign Military Loan Liquidating Account | | |
| A. Loans Receivable Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Loan Losses | 0.00 | 0.00 |
| E. Value of Assets Related to Direct Loans, Net | \$ 0.00 | \$ 0.00 |
| Direct Loans Obligated After FY 1991 (Present Value Method): | | |
| 2. Military Housing Privatization Initiative | | |
| A. Loans Receivable Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | 0.00 | 0.00 |
| E. Value of Assets Related to Direct Loans | \$ 0.00 | \$ 0.00 |
| 3. Foreign Military Financing Account | | |
| A. Loans Receivable Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | 0.00 | 0.00 |
| E. Value of Assets Related to Direct Loans | \$ 0.00 | \$ 0.00 |
| 4. Military Debt Reduction Financing Account | | |
| A. Loans Receivable Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | 0.00 | 0.00 |
| E. Value of Assets Related to Direct Loans, Net | \$ 0.00 | \$ 0.00 |
| 5. Total Direct Loans Receivable | \$ 0.00 | \$ 0.00 |

| |
|---|
| Total Amount of Direct Loans Disbursed |
|---|

| As of March 31 | 2007 | 2006 |
|--|----------------|----------------|
| Direct Loan Programs | | |
| 1. Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| 2. Foreign Military Financing Account | 0.00 | 0.00 |
| 3. Military Debt Reduction Financing Account | 0.00 | 0.00 |
| 4. Total | \$ 0.00 | \$ 0.00 |

Subsidy Expense for Post FY 1991 Direct Loan

As of March 31

| 2007 | Interest Differential | Defaults | Fees | Other | Total |
|--|-----------------------|---------------------------|-----------------------|-------------------|----------------|
| 1. New Direct Loans Disbursed: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Foreign Military Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Military Debt Reduction Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2006 | Interest Differential | Defaults | Fees | Other | Total |
| 2. New Direct Loans Disbursed: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Foreign Military Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Military Debt Reduction Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2007 | Modifications | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total |
| 3. Direct Loan Modifications and Reestimates: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Foreign Military Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Military Debt Reduction Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2006 | Modifications | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total |
| 4. Direct Loan Modifications and Reestimates: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Foreign Military Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Military Debt Reduction Financing Account | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| | | 2007 | 2006 | | |
| 5. Total Direct Loan Subsidy Expense: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | | | |
| Foreign Military Financing Account | 0.00 | | 0.00 | | |
| Military Debt Reduction Financing Account | 0.00 | | 0.00 | | |
| Total | \$ 0.00 | \$ 0.00 | | | |

Subsidy Rate for Direct Loans by Program

| As of March 31 | Interest Differential | Defaults | Fees and other Collections | Other | Total |
|---|-----------------------|----------|----------------------------|-------|-------|
| Budget Subsidy Rates for Direct Loans: | | | | | |
| 1. Military Housing Privatization Initiative | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| 2. Foreign Military Financing Account | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| 3. Military Debt Reduction Financing Account | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |

Schedule for Reconciling Subsidy Cost Allowance Balances for Post FY1991 Direct Loans

| As of March 31 | 2007 | 2006 |
|---|---------|---------|
| Beginning Balances, Changes and Ending Balance: | | |
| 1. Beginning Balance of the Subsidy Cost Allowance | \$ 0.00 | \$ 0.00 |
| 2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component | | |
| A. Interest Rate Differential Costs | \$ 0.00 | \$ 0.00 |
| B. Default Costs (Net of Recoveries) | 0.00 | 0.00 |
| C. Fees and Other Collections | 0.00 | 0.00 |
| D. Other Subsidy Costs | 0.00 | 0.00 |
| E. Total of the above Subsidy Expense Components | \$ 0.00 | \$ 0.00 |
| 3. Adjustments | | |
| A. Loan Modifications | \$ 0.00 | \$ 0.00 |
| B. Fees Received | 0.00 | 0.00 |
| C. Foreclosed Property Acquired | 0.00 | 0.00 |
| D. Loans Written Off | 0.00 | 0.00 |
| E. Subsidy Allowance Amortization | 0.00 | 0.00 |
| F. Other | 0.00 | 0.00 |
| G. Total of the above Adjustment Components | \$ 0.00 | \$ 0.00 |
| 4. Ending Balance of the Subsidy Cost Allowance before Re-estimates | \$ 0.00 | \$ 0.00 |
| 5. Add or Subtract Subsidy Re-estimates by Component | | |
| A. Interest Rate Re-estimate | \$ 0.00 | \$ 0.00 |
| B. Technical/Default Reestimate | 0.00 | 0.00 |
| C. Total of the above Reestimate Components | \$ 0.00 | \$ 0.00 |
| 6. Ending Balance of the Subsidy Cost Allowance | \$ 0.00 | \$ 0.00 |

| |
|-----------------------------------|
| Defaulted Guaranteed Loans |
|-----------------------------------|

As of March 31

| | 2007 | 2006 |
|--|---------|---------|
| Defaulted Guaranteed Loans from Pre-FY 1992 Guarantees (Allowance for Loss Method): | | |
| 1. Foreign Military Liquidating Account | | |
| A. Defaulted Guaranteed Loans Receivable, Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Loan Losses | 0.00 | 0.00 |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net | \$ 0.00 | \$ 0.00 |
| Defaulted Guaranteed Loans from Post-FY 1991 Guarantees (Present Value Method): | | |
| 2. Military Housing Privatization Initiative | | |
| A. Defaulted Guaranteed Loans Receivable, Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | 0.00 | 0.00 |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net | \$ 0.00 | \$ 0.00 |
| 3. Armament Retooling & Manufacturing Support Initiative | | |
| A. Defaulted Guaranteed Loans Receivable, Gross | \$ 0.00 | \$ 0.00 |
| B. Interest Receivable | 0.00 | 0.00 |
| C. Foreclosed Property | 0.00 | 0.00 |
| D. Allowance for Subsidy Cost (Present Value) | 0.00 | 0.00 |
| E. Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net | \$ 0.00 | \$ 0.00 |
| 4. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable | | |
| | \$ 0.00 | \$ 0.00 |

| |
|-------------------------------------|
| Guaranteed Loans Outstanding |
|-------------------------------------|

| As of March 31 | Outstanding Principal of Guaranteed Loans, Face Value | Amount of Outstanding Principal Guaranteed |
|--|---|---|
| Guaranteed Loans Outstanding | | |
| 1. Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| 2. Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 |
| 3. Foreign Military Liquidating Account | 0.00 | 0.00 |
| 4. Total | \$ 0.00 | \$ 0.00 |
| 2007 | | |
| New Guaranteed Loans Disbursed | | |
| 1. Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| 2. Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 |
| 3. Foreign Military Liquidating Account | 0.00 | 0.00 |
| 4. Total | \$ 0.00 | \$ 0.00 |
| 2006 | | |
| New Guaranteed Loans Disbursed | | |
| 1. Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| 2. Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 |
| 3. Foreign Military Liquidating Account | 0.00 | 0.00 |
| 4. Total | \$ 0.00 | \$ 0.00 |

| |
|--|
| Liabilities for Post FY 1991 Loan Guarantees, Present Value |
|--|

| As of March 31 | 2007 | 2006 |
|---|----------------|----------------|
| Liabilities for Loan Guarantee Programs from Pre-FY 1992 (Allowance for Loss): | | |
| 1. Foreign Military Liquidating Account | \$ 0.00 | \$ 0.00 |
| 2. Total Loan Guarantee Liability (Pre-FY 1992) | \$ 0.00 | \$ 0.00 |
| Liabilities for Loan Guarantee Programs Post-FY 1991 (Present Value): | | |
| 3. Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 |
| 4. Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 |
| 5. Total Loan Guarantee Liability (Post-FY 1991) | \$ 0.00 | \$ 0.00 |
| 6. Total Loan Guarantee Liability | \$ 0.00 | \$ 0.00 |

Subsidy Expense for Loan Guarantees by Program

As of March 31

| 2007 | Interest Differential | Defaults | Fees | Other | Total |
|---|-----------------------|---------------------------|-----------------------|-------------------|----------------|
| 1. New Loan Guarantees Disbursed: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2006 | Interest Differential | Defaults | Fees | Other | Total |
| 2. New Loan Guarantees Disbursed: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2007 | Modifications | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total |
| 3. Modifications and Reestimates: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2006 | Modifications | Interest Rate Reestimates | Technical Reestimates | Total Reestimates | Total |
| 4. Modifications and Reestimates: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| | 2007 | 2006 | | | |
| 5. Total Loan Guarantee: | | | | | |
| Military Housing Privatization Initiative | \$ 0.00 | \$ 0.00 | | | |
| Armament Retooling & Manufacturing Support Initiative | 0.00 | 0.00 | | | |
| Total | \$ 0.00 | \$ 0.00 | | | |

Subsidy Rates for Loan Guarantees by Program

| As of March 31 | Interest Supplements | Defaults | Fees and other Collections | Other | Total |
|--|----------------------|----------|----------------------------|-------|-------|
| Budget Subsidy Rates for Loan Guarantees: | | | | | |
| 1. Military Housing Privatization Initiative | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| 2. Armament Retooling & Manufacturing Support Initiative | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |

Schedule for Reconciling Loan Guarantee Liability Balances for Post-FY 1991 Loan Guarantees

| As of March 31 | 2007 | | 2006 | |
|---|------|------|------|------|
| Beginning Balance, Changes, and Ending Balance: | | | | |
| 1. Beginning Balance of the Loan Guarantee Liability | \$ | 0.00 | \$ | 0.00 |
| 2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component | | | | |
| A. Interest Supplement Costs | \$ | 0.00 | \$ | 0.00 |
| B. Default Costs (Net of Recoveries) | | 0.00 | | 0.00 |
| C. Fees and Other Collections | | 0.00 | | 0.00 |
| D. Other Subsidy Costs | | 0.00 | | 0.00 |
| E. Total of the above Subsidy Expense Components | \$ | 0.00 | \$ | 0.00 |
| 3. Adjustments | | | | |
| A. Loan Guarantee Modifications | \$ | 0.00 | \$ | 0.00 |
| B. Fees Received | | 0.00 | | 0.00 |
| C. Interest Supplements Paid | | 0.00 | | 0.00 |
| D. Foreclosed Property and Loans Acquired | | 0.00 | | 0.00 |
| E. Claim Payments to Lenders | | 0.00 | | 0.00 |
| F. Interest Accumulation on the Liability Balance | | 0.00 | | 0.00 |
| G. Other | | 0.00 | | 0.00 |
| H. Total of the above Adjustments | \$ | 0.00 | \$ | 0.00 |
| 4. Ending Balance of the Loan Guarantee Liability before Reestimates | \$ | 0.00 | \$ | 0.00 |
| 5. Add or Subtract Subsidy Reestimates by Component | | | | |
| A. Interest Rate Reestimate | | 0.00 | | 0.00 |
| B. Technical/default Reestimate | | 0.00 | | 0.00 |
| C. Total of the above Reestimate Components | \$ | 0.00 | \$ | 0.00 |
| 6. Ending Balance of the Loan Guarantee Liability | \$ | 0.00 | \$ | 0.00 |

Administrative Expenses

| | |
|----------------|---------------------------------------|
| Note 9. | Inventory and Related Property |
|----------------|---------------------------------------|

| As of March 31 | 2007 | 2006 |
|--|-----------------------------|-----------------------------|
| 1. Inventory, Net | \$ 12,316,535,150.07 | \$ 13,294,499,863.50 |
| 2. Operating Materials & Supplies, Net | 455,328,166.99 | 758,029,342.80 |
| 3. Stockpile Materials, Net | 0.00 | 0.00 |
| 4. Total | \$ 12,771,863,317.06 | \$ 14,052,529,206.30 |

Fluctuations and Abnormalities

Total Inventory and Related Property decreased \$1.3 billion, 9%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The majority of this decrease is attributable to Inventory, Net. The decrease is described in the following sections.

Inventory, Net

| As of March 31 | 2007 | | | 2006 | Valuation Method |
|--|-----------------------------|-------------------------------|--------------------------|-----------------------------|------------------|
| | Inventory, Gross Value | Revaluation Allowance | Inventory, Net | Inventory, Net | |
| 1. Inventory Categories | | | | | |
| A. Available and Purchased for Resale | \$ 23,079,044,252.28 | \$ (22,679,897,875.10) | 399,146,377.18 | \$ 1,313,224,890.15 | LAC,MAC |
| B. Held for Repair | 10,806,461,604.17 | 818,115,767.07 | 11,624,577,371.24 | 11,594,091,897.13 | LAC,MAC |
| C. Excess, Obsolete, and Unserviceable | 984,943,497.39 | (984,943,497.39) | 0.00 | 0.00 | NRV |
| D. Raw Materials | 0.00 | 0.00 | 0.00 | 0.00 | MAC,SP,LAC |
| E. Work in Process | 292,811,401.65 | 0.00 | 292,811,401.65 | 387,183,076.22 | AC |
| F. Total | \$ 35,163,260,755.49 | \$ (22,846,725,605.42) | 12,316,535,150.07 | \$ 13,294,499,863.50 | |

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses
 SP = Standard Price
 AC = Actual Cost

NRV = Net Realizable Value
 O = Other
 MAC = Moving Average Cost

2. Information Related to Inventory, Net:

Fluctuations and Abnormalities

Total Inventory, Net decreased \$978.0 million, 7%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. A net decrease of \$771.2 million is attributed to Supply Management, Navy (NAVSUP) and is described as follows:

- A decrease of \$701.0 million is due to the disposal of obsolete weapons systems inventory and inventory that is beyond economic repair with the retirement of the F-14 aircraft. NAVSUP began the disposal of the F-14 aircraft program in 3rd Quarter, FY 2006 and anticipates the retirement to be completed during FY 2007.
- A decrease of \$206.1 million is a result of the inventory losses due to revaluation using the cost of goods sold (COGS) model per Office of Under Secretary of Defense (Comptroller) guidance received 4th Quarter, FY 2003.
- A decrease of \$164.7 million is due to the transfer of inventory categorized as War Reserve Material to the Navy General Fund. This transfer was directed by Chief of Naval Operations and was completed in June 2006.
- An increase of \$300.6 million is due to the transfer of inventory between Depot Maintenance, Aviation and NAVSUP that occurred during the 3rd Quarter and 4th Quarter, FY 2006. This transfer was an effort to improve supply chain management by leveraging NAVSUP efficiencies for inventory management and replenishment. When this transfer occurred, Depot Maintenance, Aviation reported this amount in Operating Materials and Supplies; however,

NAVSUP recognizes these items as Inventory, Net. Therefore, the value transfers out of Operating Materials and Supplies and into Inventory, Net.

Restrictions on Inventory Use, Sale, or Disposition

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

- 1) Distributions without reimbursement are made when authorized by Department of Defense directives;
- 2) War reserve material includes petroleum products and subsistence items that are considered restricted; and
- 3) Inventory, with the exception of safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

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

Composition of Inventory

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

Inventory Categories

Inventory represents property that is (1) held for sale, (2) in the process of production for sale or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.

Inventory Available and Purchased for Resale includes consumable spare and repair parts and repairable items owned and managed by the Department of Navy (DON). In some cases, the consumable and repairable items are managed by other Military Services, the Defense Logistics Agency, or the General Services Administration. Material available and purchased for resale includes material held due to a managerial determination that it should be retained to support military or national contingencies. Federal Accounting Standards requires disclosure of the amount of Inventory Held for "Future Sale." The Navy Working Capital Fund (NWCF) currently has no inventory held for future sale reported for 2nd Quarter, FY 2007 in Inventory Held for Sale, Net. All inventory is currently planned for sale next fiscal year. There is no management or valuation difference between the two categories.

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

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

Work in Process balance includes costs related to the production or servicing of items, including direct material, direct labor, applied overhead and other direct costs pending billing to the customer. The work in process designation may also be used to accumulate the amount paid to a contractor under cost reimbursable contracts, including the amount withheld from payment to ensure performance, and the amount paid to other Government plants for accrued costs of end items of material ordered but not delivered.

Decision Criteria for Identifying the Category to which Inventory is Assigned

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

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

Other Disclosures Related to Inventory

The general ledger values in the accounting system do not reconcile with the supporting detail record in NAVSUP logistics system. NAVSUP has determined that program changes must be made to the Material Financial Control System to correct systemic posting problems, which contribute to a reconciling difference between the systems. Once the adjustments posting logic system change requests and required journal vouchers are approved, funded, and developed, the final adjustments will be made to inventory and financial systems to align data. Adjustments are planned to occur in FY 2007.

The NAVSUP inventory is currently being reported at an approximation of historical cost using the latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed to capture material management information rather than accounting data. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the Statement of Federal Financial Accounting Systems (SFFAS) No. 3, "Accounting for Inventory and Related Property." Since the implementation of the OUSD(C) COGS Model, prior year values in equity, inventory, and inventory allowance accounts have been impacted and remain noncompliant with SFFAS No. 3 and generally accepted accounting practices. The Navy ERP will value inventory at moving average cost and will be compliant with necessary guidance.

Operating Materials and Supplies, Net

| As of March 31 | 2007 | | | 2006 | | Valuation Method |
|--|--------------------------|-----------------------|--------------------------|--------------------------|--|------------------|
| | OM&S Gross Value | Revaluation Allowance | OM&S, Net | OM&S, Net | | |
| 1. OM&S Categories | | | | | | |
| A. Held for Use | \$ 455,328,166.99 | \$ 0.00 | \$ 455,328,166.99 | \$ 758,029,342.80 | | SP, LAC, MAC |
| B. Held for Repair | 0.00 | 0.00 | 0.00 | 0.00 | | SP, LAC, MAC |
| C. Excess, Obsolete, and Unserviceable | 0.00 | 0.00 | 0.00 | 0.00 | | NRV |
| D. Total | \$ 455,328,166.99 | \$ 0.00 | \$ 455,328,166.99 | \$ 758,029,342.80 | | |

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

SP = Standard Price

AC = Actual Cost

NRV = Net Realizable Value

O = Other

MAC = Moving Average Cost

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

Fluctuations and Abnormalities

Total Operating Materials and Supplies, Net decreased \$302.7 million, 40%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The primary driver of this decrease is attributable to Depot Maintenance, Aviation, which transferred \$300.6 million in inventory to NAVSUP in 3rd and 4th Quarter, FY 2006. This transfer was an effort to improve supply chain management by leveraging NAVSUP efficiencies for inventory management and replenishment. When the transfer occurred, Depot Maintenance, Aviation reported these items as OM&S; however, NAVSUP recognizes this amount as Inventory Held for Sale. Therefore, the value transfers out of OM&S and into Inventory, Net.

Restrictions on OM&S

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

Composition of OM&S

The OM&S Held for Use represents property that is consumed during normal operations and includes consumable spare and repair parts for use on customer work by various activities. Federal Accounting Standards require disclosure of the amount of OM&S held for "future use." The NWCF reports that \$12.3 million of OM&S categorized as held for future use and is included in the "held for use" category.

Decision Criteria for Identifying OM&S Category

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

| Category | Condition Code |
|---------------------------------|-----------------------|
| Held for Use | D |
| Held for Repair | J, K, L, M, N, R |
| Excess, Obsolete, Unserviceable | V |

Stockpile Materials, Net

| As of March 31 | 2007 | | | 2006 | | Valuation Method |
|--|----------------------------|------------------------------|--------------------------|--------------------------|------|------------------|
| | Stockpile Materials Amount | Allowance for Gains (Losses) | Stockpile Materials, Net | Stockpile Materials, Net | | |
| 1. Stockpile Materials Categories | | | | | | |
| A. Held for Sale | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | 0.00 | AC, LCM |
| B. Held in Reserve for Future Sale | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | AC, LCM |
| C. Total | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | 0.00 | |

Legend for Valuation Methods:

LAC = Latest Acquisition Cost
 SP = Standard Price
 AC = Actual Cost

NRV = Net Realizable Value
 LCM = Lower of Cost or Market
 O = Other

Not Applicable.

Note 10. General PP&E, Net

| As of March 31 | 2007 | | | | | 2006 |
|--|---|-----------------|----------------------|--|---------------------|----------------------------|
| | Depreciation/ Amortization Method | Service Life | Acquisition Value | (Accumulated Depreciation/ Amortization) | Net Book Value | Prior FY Net Book Value |
| 1. Major Asset Classes | | | | | | |
| A. Land | N/A | N/A | \$ 42,999,888.29 | N/A | \$ 42,999,888.29 | \$ 45,822,108.76 |
| B. Buildings, Structures, and Facilities | S/L | 20 Or 40 | 6,153,393,721.77 | \$ (4,110,894,695.70) | 2,042,499,026.07 | 2,058,105,236.24 |
| C. Leasehold Improvements | S/L | lease term | 302,302.82 | (239,323.05) | 62,979.77 | 93,210.05 |
| D. Software | S/L | 2-5 Or 10 | 477,625,292.25 | (297,578,181.57) | 180,047,110.68 | 216,266,779.64 |
| E. General Equipment | S/L | 5 or 10 | 3,343,091,989.75 | (2,600,378,520.05) | 742,713,469.70 | 750,150,324.55 |
| F. Military Equipment | S/L | Various | 0.00 | 0.00 | 0.00 | 0.00 |
| G. Assets Under Capital Lease | S/L | lease term | 0.00 | 0.00 | 0.00 | 0.00 |
| H. Construction-in- Progress | N/A | N/A | 703,734,648.93 | N/A | 703,734,648.93 | 704,280,232.49 |
| I. Other | | | 2,925,707.88 | 0.00 | 2,925,707.88 | 8,493,467.88 |
| J. Total General PP&E | | | \$ 10,724,073,551.69 | \$ (7,009,090,720.37) | \$ 3,714,982,831.32 | \$ 3,783,211,359.61 |

¹ Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

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

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

Heritage Assets and Stewardship Land

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

Other Disclosures Related to General PP & E

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

| |
|-----------------------------------|
| Assets Under Capital Lease |
|-----------------------------------|

| As of March 31 | 2007 | 2006 |
|--|---------|---------|
| 1. Entity as Lessee, Assets Under Capital Lease | | |
| A. Land and Buildings | \$ 0.00 | \$ 0.00 |
| B. Equipment | 0.00 | 0.00 |
| C. Accumulated Amortization | 0.00 | 0.00 |
| D. Total Capital Leases | \$ 0.00 | \$ 0.00 |

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

| | |
|-----------------|---|
| Note 11. | Liabilities Not Covered by Budgetary Resources |
|-----------------|---|

As of March 31

| | 2007 | 2006 |
|---|----------------------------|----------------------------|
| 1. Intragovernmental Liabilities | | |
| A. Accounts Payable | \$ 0.00 | \$ 0.00 |
| B. Debt | 0.00 | 0.00 |
| C. Other | 2,856,569.23 | 2,769,020.24 |
| D. Total Intragovernmental Liabilities | \$ 2,856,569.23 | \$ 2,769,020.24 |
| 2. Nonfederal Liabilities | | |
| A. Accounts Payable | \$ 0.00 | \$ 0.00 |
| B. Military Retirement and Other Federal Employment Benefits | 1,185,039,105.63 | 1,192,551,548.64 |
| C. Environmental Liabilities | 0.00 | 0.00 |
| D. Other Liabilities | 0.00 | 0.00 |
| E. Total Nonfederal Liabilities | \$ 1,185,039,105.63 | \$ 1,192,551,548.64 |
| 3. Total Liabilities Not Covered by Budgetary Resources | \$ 1,187,895,674.86 | \$ 1,195,320,568.88 |
| 4. Total Liabilities Covered by Budgetary Resources | \$ 5,117,166,335.15 | \$ 5,714,559,535.11 |
| 5. Total Liabilities | \$ 6,305,062,010.01 | \$ 6,909,880,103.99 |

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

The Other Intragovernmental Liabilities amount of \$2.9 million represents interest, penalties, fines and administrative fees. These fees do not belong to Navy Working Capital Fund (NWCF), but are assessed to contracts and legal documents that cite NWCF lines of accounting. These fees will be distributed directly to the U.S. Treasury.

The \$1.2 billion included in Military Retirement Benefits and Other Employment-Related Actuarial Liabilities represents Federal Employees' Compensation Act actuarial liabilities.

| | |
|-----------------|-------------------------|
| Note 12. | Accounts Payable |
|-----------------|-------------------------|

| As of March 31 | 2007 | | | 2006 |
|--|----------------------------|--|----------------------------|----------------------------|
| | Accounts Payable | Interest, Penalties, and Administrative Fees | Total | Total |
| 1. Intragovernmental Payables | \$ 146,002,080.04 | \$ N/A | \$ 146,002,080.04 | \$ 221,706,723.45 |
| 2. Nonfederal Payables (to the Public) | 1,546,687,941.52 | 0.00 | 1,546,687,941.52 | 1,786,398,567.22 |
| 3. Total | \$ 1,692,690,021.56 | \$ 0.00 | \$ 1,692,690,021.56 | \$ 2,008,105,290.67 |

4. Information Related to Accounts Payable:**Fluctuations and Abnormalities**

Intragovernmental Accounts Payable decreased \$75.7 million, 34%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The primary driver of the decrease is attributable to Depot Maintenance, Shipyards, which decreased \$79.1 million. This decrease is a reflection of the efforts of Depot Maintenance, Shipyards to transition from working capital fund to mission funding. The transition from working capital fund to mission funding began in FY 1999. As work is completed and accounting records are closed, the accounts payable balances will continue to decrease accordingly.

Nonfederal Accounts Payable decreased \$239.7 million, 13%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. A decrease of \$217.8 million was attributable to Research & Development, Naval Surface Warfare Center (NSWC) and Naval Undersea Warfare Centers (NUWC). A system error at NSWC and NUWC discovered in 2nd Quarter, FY 2006 resulted in an inflated nonfederal accounts payable balance. This error was corrected in 3rd Quarter, FY 2006. The current balance reflects a return to normal business levels.

| | |
|-----------------|-------------|
| Note 13. | Debt |
|-----------------|-------------|

| As of March 31 | 2007 | | | 2006 | |
|---|--------------------------|---------------------------|--------------------------|----------------------------|--------------------------|
| | Beginning Balance | Net Borrowing | Ending Balance | Net Borrowing | Ending Balance |
| 1. Agency Debt (Intragovernmental) | | | | | |
| A. Debt to the Treasury | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| B. Debt to the Federal Financing Bank | 173,224,071.82 | (28,298,961.66) | 144,925,110.16 | (120,224,190.88) | 261,294,199.15 |
| C. Total Agency Debt | \$ 173,224,071.82 | \$ (28,298,961.66) | \$ 144,925,110.16 | \$ (120,224,190.88) | \$ 261,294,199.15 |
| 2. Total Debt | \$ 173,224,071.82 | \$ (28,298,961.66) | \$ 144,925,110.16 | \$ (120,224,190.88) | \$ 261,294,199.15 |

3. Information Related to Debt:**Fluctuations and Abnormalities**

Intragovernmental Debt decreased \$116.4 million, 45%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. A decrease of \$114.2 million is a result of the following events at Transportation Activity, Military Sealift Command (MSC):

- In January 2007, MSC paid an additional \$49.4 million on the debt principle that was associated with one Maritime Prepositioning Ship (MPS), the United States Naval Ship 2nd Lt. John P. Bobo.
- In July 2006 and January 2006, MSC paid semi-annual payments to the Federal Financing Bank (FFB) for MPS ships totaling \$64.8 million.

Other Information Related to Debt

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

The FFB is one of the institutions that provided loans to the vessel owners. The FFB reports that MSC has a debt in the amount of \$145.0 million, which represents an outstanding principal balance of \$142.8 million and accrued interest payable of \$2.2 million. The MSC does not owe this debt to FFB. This debt is a public debt owed by the private vessel owners. In order to simplify the payments to FFB and to meet its requirements, FFB cross disburses the semi-annual principal and interest payments directly from the Navy Working Capital Fund (NWCF). This is done instead of having MSC make capital hire payments to the vessel owners, who would in turn make loan obligation payments to FFB.

It is not uncommon for the Federal Government to make payments directly to the bank (FFB) and mirrors other time charters where payment is assigned directly to a bank. This occurred when the ownership of these vessels was transferred to private vessel owners; however, when establishing the loan, FFB coded the loan as a government debt.

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

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

Other Disclosures

For presentation purposes in the above numeric schedule, the 2006 ending balance represents the 2nd Quarter, FY 2006 ending balance. The 2007 beginning balance reflects the 4th Quarter, FY 2006 ending balance.

| | |
|-----------------|---|
| Note 14. | Environmental Liabilities and Disposal Liabilities |
|-----------------|---|

| As of March 31 | 2007 | | | 2006 | |
|---|-------------------|----------------------|----------------|----------------|----------------|
| | Current Liability | Noncurrent Liability | Total | Total | |
| 1. Environmental Liabilities-- | | | | | |
| Nonfederal | | | | | |
| A. Accrued Environmental Restoration Liabilities | | | | | |
| 1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR) | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Active Installations—Military Munitions Response Program (MMRP) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 3. Formerly Used Defense Sites—IRP and BD/DR | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 4. Formerly Used Defense Sites--MMRP | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| B. Other Accrued Environmental Liabilities—Active Installations | | | | | |
| 1. Environmental Corrective Action | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 2. Environmental Closure Requirements | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 3. Environmental Response at Operational Ranges | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 4. Other | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| C. Base Realignment and Closure (BRAC) | | | | | |
| 1. Installation Restoration Program | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 2. Military Munitions Response Program | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 3. Environmental Corrective Action / Closure Requirements | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 4. Other | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| D. Environmental Disposal for Weapons Systems Programs | | | | | |
| 1. Nuclear Powered Aircraft Carriers | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 2. Nuclear Powered Submarines | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 3. Other Nuclear Powered Ships | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 4. Other National Defense Weapons Systems | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 5. Chemical Weapons Disposal Program | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 6. Other | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 2. Total Environmental Liabilities | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |

Not Applicable.

| |
|----------------------------------|
| Environmental Disclosures |
|----------------------------------|

| As of March 31 | 2007 | 2006 |
|---|------|------|
| A. Amount of operating and capital expenditures used to remediate legacy waste. Legacy wastes are the remediation efforts covered by IRP, MMRP, and BD/DR regardless of funding source. | 0.00 | 0.00 |
| B. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment. | 0.00 | 0.00 |
| C. The estimated cleanup costs associated with general property, plant, and equipment placed into service during each fiscal year. | 0.00 | 0.00 |
| D. Changes in total cleanup costs due to changes in laws, regulations, and/or technology. | 0.00 | 0.00 |
| E. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods. | 0.00 | 0.00 |

| | |
|-----------------|--------------------------|
| Note 15. | Other Liabilities |
|-----------------|--------------------------|

| As of March 31 | 2007 | | | 2006 |
|---|----------------------------|-------------------------|----------------------------|----------------------------|
| | Current Liability | Noncurrent Liability | Total | Total |
| 1. Intragovernmental | | | | |
| A. Advances from Others | \$ 212,114,354.05 | \$ 0.00 | \$ 212,114,354.05 | \$ 339,518,662.04 |
| B. Deposit Funds and Suspense Account Liabilities | 0.00 | 0.00 | 0.00 | 0.00 |
| C. Disbursing Officer Cash | 0.00 | 0.00 | 0.00 | 0.00 |
| D. Judgment Fund Liabilities | 0.00 | 0.00 | 0.00 | 0.00 |
| E. FECA Reimbursement to the Department of Labor | 0.00 | 0.00 | 0.00 | 0.00 |
| F. Other Liabilities | 35,089,936.13 | 0.00 | 35,089,936.13 | 39,873,497.38 |
| G. Total Intragovernmental Other Liabilities | \$ 247,204,290.18 | \$ 0.00 | \$ 247,204,290.18 | \$ 379,392,159.42 |
| 2. Nonfederal | | | | |
| A. Accrued Funded Payroll and Benefits | \$ 615,455,245.89 | \$ 0.00 | \$ 615,455,245.89 | \$ 685,290,183.51 |
| B. Advances from Others | 196,141,033.35 | 0.00 | 196,141,033.35 | 216,770,287.88 |
| C. Deferred Credits | 0.00 | 0.00 | 0.00 | 11,800,000.00 |
| D. Deposit Funds and Suspense Accounts | 161,727,633.46 | 0.00 | 161,727,633.46 | 108,799,956.34 |
| E. Temporary Early Retirement Authority | 0.00 | 0.00 | 0.00 | 0.00 |
| F. Nonenvironmental Disposal Liabilities | | | | |
| (1) Military Equipment (Nonnuclear) | 0.00 | 0.00 | 0.00 | 0.00 |
| (2) Excess/Obsolete Structures | 0.00 | 0.00 | 0.00 | 0.00 |
| (3) Conventional Munitions Disposal | 0.00 | 0.00 | 0.00 | 0.00 |
| G. Accrued Unfunded Annual Leave | 0.00 | 0.00 | 0.00 | 0.00 |
| H. Capital Lease Liability | 0.00 | 0.00 | 0.00 | 0.00 |
| I. Other Liabilities | 2,036,190,645.44 | 25,688,924.34 | 2,061,879,569.78 | 2,045,876,478.38 |
| J. Total Nonfederal Other Liabilities | \$ 3,009,514,558.14 | \$ 25,688,924.34 | \$ 3,035,203,482.48 | \$ 3,068,536,906.11 |
| 3. Total Other Liabilities | \$ 3,256,718,848.32 | \$ 25,688,924.34 | \$ 3,282,407,772.66 | \$ 3,447,929,065.53 |

4. Information Related to Other Liabilities:

Fluctuations and Abnormalities

Total Intragovernmental Other Liabilities decreased by \$132.2 million, 35%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. This decrease is attributable to Depot Maintenance, Shipyards, which decreased \$105.8 million in advance billings. Portsmouth and Norfolk Naval Shipyards advanced billed in February 2005 and February 2006 and these advances are being reduced as work is being performed against these open orders.

Composition of Intragovernmental Other Liabilities (Line 1.F)

Intragovernmental other liabilities represent liabilities of:

| | (Thousands) |
|------------------------------------|-----------------|
| • Retirement Benefits | \$18,240 |
| • Health Benefits | 13,669 |
| • Custodial Liabilities (Treasury) | 2,857 |
| • Life Insurance | <u>323</u> |
| Total | <u>\$35,090</u> |

Nonfederal Deposit Funds and Suspense Account Liabilities include amounts for unsupported undistributed collections.

Composition of Nonfederal Other Liabilities (Line 2.I.)

Nonfederal other liabilities totaled \$2.1 billion at the end of 2nd Quarter, FY 2007, which includes amounts that are significant portions of the total liabilities presented in the Navy Working Capital Fund (NWCF) Balance Sheet. A breakout of the major components of nonfederal other liabilities follow:

- a. Accrual of contractual services represents an accrued liability for direct work performed by contractors or material and supplies purchased for a direct order in which a request for payment has not been received. The accrual is based on the level of effort performed for the direct order on a monthly basis.
- b. Depot level repairable carcass return liability represents the value of returned items that have been received by an accountable activity from an end-use activity, but a serviceable asset has not been issued.
- c. In addition, the portion of other liabilities that consists of progress billings are maintained to show the balance of payments taken for accrued costs charged to work in process or the value of material procured and held for specific orders received from customers within Department of Defense (DoD).
- d. Liability for future funded payments, per the Department of the Defense, Inspector General (DoDIG) Audit, "Financial Management: Report on Recording and Accounting for DoD Contract Financing Payment," of May 10, 2005, and the Office of Under Secretary of Defense, (Comptroller) (OUSD(C)) direction, a contingent liability for outstanding contract financing payments based on cost in excess of progress payments was recognized for the first time in 4th Quarter, FY 2006. The recognized data was derived from an OUSD(C) query of the

Mechanization of Contract Administration System (MOCAS). The NWCF field level account data does not reconcile with the MOCAS data; therefore, NWCF cannot support this OUSD(C) directed adjustment. Also, current business processes and contract clauses do not support this OUSD(C) directed adjustment.

e. The remainder of the other liabilities amount includes property furnished by other liability.

Contingent Liabilities Balance

Contingent Liabilities balance includes \$25.7 million in estimated future contract financing payments that will be paid to the contractor upon delivery and Federal Government acceptance of a satisfactory product. In accordance with contract terms, specific rights to the contractor's work vests with the Federal Government when a specific type of contract financing payments is made, thereby protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Department of the Navy (DON) is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Federal Government acceptance of a satisfactory product. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to DON and the amount of potential future payments are estimable; DON has recognized a contingent liability for estimated future payments, which are conditional pending delivery and Federal Government acceptance of a satisfactory product.

Capital Lease Liability

| As of March 31 | 2007 | | | | 2006 | |
|--|--------------------|-----------|---------|---------|---------|---------|
| | Asset Category | | | | | |
| | Land and Buildings | Equipment | Other | Total | Total | |
| 1. Future Payments Due | | | | | | |
| A. 2007 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| B. 2008 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| C. 2009 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| D. 2010 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| E. 2011 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| F. 2012 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| G. After 5 Years | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| H. Total Future Lease Payments Due | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| I. Less: Imputed Interest Executory Costs | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| J. Net Capital Lease Liability | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Capital Lease Liabilities Covered by Budgetary Resources | | | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 3. Capital Lease Liabilities Not Covered by Budgetary Resources | | | | \$ 0.00 | \$ 0.00 | \$ 0.00 |

Not Applicable.

Note 16. Commitments and Contingencies**Legal Contingencies:**

The Department of the Navy (DON) is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON will accrue contingent liabilities for legal actions in those instances where the DON's Office of General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Federal Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from DON's resources, either directly or by reimbursement to the Judgment Fund. The DON General Fund records all Judgment Fund liabilities, including any related to Navy Working Capital Fund, in Note 11, "Liabilities not Covered by Budgetary Resources," and Note 12, "Accounts Payable." See DON General Fund Notes 11 and 12 for details.

The Navy Working Capital Fund currently has five cases that meet the existing FY 2006 NWCF materiality threshold of \$5.0 million, with all five cases against the Navy and none against the United States Marine Corps. DON legal counsel was unable to express an opinion concerning the likely outcome of these cases. This declaration is fully supported by the Preliminary and Final Legal Representation letters and the subsidiary management summary schedule.

For FY 2007, NWCF materiality threshold for reporting litigation, claims, or assessments is \$4.5 million. The Office of Navy General Counsel conducts a review of litigation and claims threatened or asserted involving NWCF to which Office of General Counsel attorney's devoted substantial attention in the form of legal consultation or representation. However, the FY 2007 preliminary and final Legal Representation letters are not due until 3rd and 4th Quarters respectively.

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

Other Commitments and Contingencies

The NWCF does not have obligations related to canceled appropriations for which the reporting entity has a contractual commitment for payment.

The NWCF has contractual arrangements which may require future financial obligations (i.e. undelivered orders). These undelivered orders are estimated at \$5.5 billion as of March 31, 2007. Included in this total is \$25.7 million that is also included in the balance for nonfederal other liabilities related to contracting financing payments. No budgetary adjustments were considered in the Office of the Under Secretary Defense (Comptroller) direction for the Journal Voucher to adjust contingent liabilities. The NWCF also has difficulties creating budgetary accounts from proprietary accounts. This has been reported as an internal weakness. Defense Finance and Accounting Service is working with DON in the Financial Improvement Program to correct this weakness. In FY 2007, the NWCF plans to start reporting budgetary accounts from the field level accounting systems.

| | |
|-----------------|--|
| Note 17. | Military Retirement and Other Federal Employment Benefits |
|-----------------|--|

| As of March 31 | 2007 | | | | 2006 |
|--|---------------------------|---------------------------|--|---------------------|---------------------------|
| | Present Value of Benefits | Assumed Interest Rate (%) | (Less: Assets Available to Pay Benefits) | Unfunded Liability | Present Value of Benefits |
| 1. Pension and Health Actuarial Benefits | | | | | |
| A. Military Retirement Pensions | \$ 0.00 | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| B. Military Retirement Health Benefits | 0.00 | | 0.00 | 0.00 | 0.00 |
| C. Military Medicare-Eligible Retiree Benefits | 0.00 | | 0.00 | 0.00 | 0.00 |
| D. Total Pension and Health Actuarial Benefits | \$ 0.00 | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Other Actuarial Benefits | | | | | |
| A. FECA | \$ 1,185,039,105.63 | | \$ 0.00 | \$ 1,185,039,105.63 | \$ 1,192,551,548.64 |
| B. Voluntary Separation Incentive Programs | 0.00 | | 0.00 | 0.00 | 0.00 |
| C. DoD Education Benefits Fund | 0.00 | | 0.00 | 0.00 | 0.00 |
| D. Total Other Actuarial Benefits | \$ 1,185,039,105.63 | | \$ 0.00 | \$ 1,185,039,105.63 | \$ 1,192,551,548.64 |
| 3. Other Federal Employment Benefits | \$ 0.00 | | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 4. Total Military Retirement and Other Federal Employment Benefits: | \$ 1,185,039,105.63 | | \$ 0.00 | \$ 1,185,039,105.63 | \$ 1,192,551,548.64 |

Actuarial Cost Method Used:

Assumptions:

Market Value of Investments in Market-based and Marketable Securities:

5. Information Related to Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

Actuarial Cost Method Used

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

Assumptions

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

2006

5.170% in Year 1

5.313% in Year 2 and thereafter

To provide more specificity concerning the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) or medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2006 were also used to adjust the methodology's historical payments to current year constant dollars.

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

| <u>CBY</u> | <u>COLA</u> | <u>CPIM</u> |
|------------|-------------|-------------|
| 2006 | 3.50% | 4.00% |
| 2007 | 3.13% | 4.01% |
| 2008 | 2.40% | 4.01% |
| 2009 | 2.40% | 4.013% |
| 2010+ | 2.43% | 4.09% |

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2006 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

Changes in Actuarial Liability

There have been no changes in the calculation of Actuarial Liability since last reporting period.

Other Employment – Related Actuarial Liabilities

Other Employment – Related Actuarial Liabilities represents the actuarial liability associated with FECA for the amount of \$1.2 billion.

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

| Intragovernmental Costs and Exchange Revenue | | |
|--|------|------|
| As of March 31 | 2007 | 2006 |

| As of March 31 | 2007 | 2006 |
|-------------------------------------|-------------------------------|-------------------------------|
| 1. Intragovernmental Costs | \$ 2,225,617,355.67 | \$ 2,236,033,138.68 |
| 2. Public Costs | 9,196,075,929.02 | 9,645,309,027.04 |
| 3. Total Costs | \$ 11,421,693,284.69 | \$ 11,881,342,165.72 |
| 4. Intragovernmental Earned Revenue | \$ (9,660,954,740.50) | \$ (9,591,170,866.09) |
| 5. Public Earned Revenue | (501,247,046.57) | (443,013,073.91) |
| 6. Total Earned Revenue | \$ (10,162,201,787.07) | \$ (10,034,183,940.00) |
| 7. Net Cost of Operations | \$ 1,259,491,497.62 | \$ 1,847,158,225.72 |

8. Information Related to the Statement of Net Cost:**Fluctuations and Abnormalities**

Net Program Costs decreased \$587.7 million, 32%, from 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007. The primary driver for the net decrease was due to gross costs decreasing \$459.6 million. A decrease of \$540.8 million in the Depot Maintenance, Shipyards business area was caused by the transition from working capital fund to mission funding. The transition from working capital fund to mission funding began in FY 1999. As work is completed and accounting records are closed, the gross costs will continue to decrease accordingly.

Composition of Statement of Net Cost

The Navy Working Capital Fund (NWCF) generally records transactions on an accrual basis as required by generally accepted accounting principles (GAAP). Information presented on the Statement of Net Cost represents the net result of post closing adjustments and eliminating entries made in compiling and consolidating the NWCF financial statements. These entries significantly affected the reported amounts of intragovernmental program cost, program cost with the public, earned revenue and net program cost. The post closing adjustments were made in order to increase or decrease certain NWCF account balances reported as of March 31, 2007, to ensure agreement with related balances reported by Department of Defense (DoD) and other federal reporting entities. Eliminating entries are required adjustments made as part of the financial process. This process enables the matching of trading partner data recorded at each financial statement consolidation level: NWCF, DoD and Federal Government levels.

Other Disclosures Related to the Statement of Net Cost

This statement is unique because its principles are driven by an understanding of net cost of programs and or organizations that the Federal Government supports through appropriations. This

statement provides gross and net cost information that can relate to the amount of output for a given program and or organization administered by a responsible reporting entity.

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

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

From 2nd Quarter, FY 2006 to 2nd Quarter, FY 2007, the NWCF's financial management systems were unable to meet all of the requirements for full accrual accounting. Many of the NWCF's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. The NWCF has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Until all of the NWCF's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, the NWCF's financial data will be based on transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

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

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

| As of March 31 | 2007 | | 2006 | |
|--|-------------------------------------|------------------------------|-------------------------------------|------------------------------|
| | Cumulative Results of Operations | Unexpended Appropriations | Cumulative Results of Operations | Unexpended Appropriations |
| 1. Prior Period Adjustments | | | | |
| Increases (Decreases) to Net Position Beginning Balance | | | | |
| A. Changes in Accounting Standards | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| B. Errors and Omissions in Prior Year Accounting Reports | 0.00 | 0.00 | 0.00 | 0.00 |
| C. Total Prior Period Adjustments | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| 2. Imputed Financing | | | | |
| A. Civilian CSRS/FERS Retirement | \$ 82,968,483.95 | \$ 0.00 | \$ 113,019,208.53 | \$ 0.00 |
| B. Civilian Health | 144,743,431.00 | 0.00 | 162,584,625.00 | 0.00 |
| C. Civilian Life Insurance | 421,425.86 | 0.00 | 507,488.36 | 0.00 |
| D. Judgment Fund | 0.00 | 0.00 | 0.00 | 0.00 |
| E. IntraEntity | 0.00 | 0.00 | 0.00 | 0.00 |
| F. Total Imputed Financing | \$ 228,133,340.81 | \$ 0.00 | \$ 276,111,321.89 | \$ 0.00 |

3. Information Related to the Statement of Changes in Net Position:**Imputed Financing**

The amounts remitted to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System, Federal Employee Retirement System, Federal Employee Health Benefits Program and the Federal Employee Group Life Insurance Program do not fully cover the Federal Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Federal Government's cost of providing these benefits to the employees and contributions made by and for them. OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for computation of imputed financing cost. DFAS provides the costs to the Office of the Under Secretary of Defense (Personnel and Readiness) for validation. Approved imputed costs are provided to the reporting components for inclusion in their financial statements.

Composition of "Other" line

The amount reported on Cumulative Results of Operations, Other Financing Sources, Other is the result of the financial closure of three Navy Working Capital Fund (NWCF) activities. Beginning October 1, 1999, the Depot Maintenance, Ordnance and Shipyards business areas transitioned from the NWCF to the Navy General Fund. Closure of the residual financial records for one of these activities occurred in the 3rd Quarter, FY 2006 and the other in 2nd Quarter, FY 2007. The net effect of the

closure of the residual financial records (i.e. accounts receivable; accounts payable; and unsupported undistributed collections and disbursements) at these activities resulted in a net loss.

| | |
|-----------------|--|
| Note 20. | Disclosures Related to the Statement of Budgetary Resources |
|-----------------|--|

| As of March 31 | 2007 | 2006 |
|--|---------------------|---------------------|
| 1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | \$ 5,538,539,322.63 | \$ 8,432,732,669.95 |
| 2. Available Borrowing and Contract Authority at the End of the Period | 9,199,210,701.26 | 10,802,579,876.44 |

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

Intraentity Transactions

The SBR does include intraentity transactions, which have not been eliminated because the statements are presented as combined and combining.

Apportionment Categories

Office of Management and Budget Circular A-136 requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B and exempt from apportionment. These amounts are as follows:

| <i>(Amounts in thousands)</i> | | |
|-------------------------------------|-----------|--------------|
| Obligations Incurred – Direct | Line 8.A. | \$ 526 |
| Obligations Incurred – Reimbursable | Line 8.B. | \$ 8,976,045 |

Undelivered Orders

Undelivered Orders presented in the SBR includes Undelivered Orders, Unpaid for both direct and reimbursable funds.

Other Disclosures Related to Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) is an image of the monthly Report on Budget Execution, Standard Form 133 (SF 133). These reports should be produced using budgetary accounts. However, the Navy Working Capital Fund (NWCF) uses proprietary accounts because its financial accounting systems were not designed to produce budgetary accounting data. All field level accounting systems have been updated to include budgetary accounts. The Department of the Navy (DON) and the Defense Finance and Accounting Service (DFAS) have implemented a process that allows the field level accounting systems to report budgetary accounts to Defense Departmental Reporting System (DDRS). As of the end of 2nd Quarter, FY 2007, all but three NWCF business areas had implemented this interface. These three remaining business areas expect to implement interfaces during FY 2007.

| | |
|-----------------|--|
| Note 21. | Disclosures Related to the Statement of Financing |
|-----------------|--|

Information Related to the Statement of Financing:

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

The accounting systems of Defense Finance and Accounting Service (DFAS), and Navy Working Capital Fund (NWCF), as well as, the Navy Enterprise Resource Planning include budgetary accounts. However, since some of the legacy accounting systems do not include budgetary accounts, NWCF budgetary data is not in agreement with proprietary expenses and assets capitalized. The detailed level of information required to appropriately complete the SBR is being developed for those activities that cannot provide the data due to system deficiencies. As a result, the SBR is generated by DFAS using data extracted from the proprietary accounts.

As a result of these system deficiencies, Resources that Finance the Acquisition of Assets on the Statement of Financing was adjusted upward by \$1.1 billion at the end of 2nd Quarter, FY 2007 to bring it into balance with the Statement of Net Cost.

The following Statement of Financing lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

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

Composition of Other Lines

There are four "Other" lines on the Consolidated Statement of Financing for 2nd Quarter, FY 2007. The compositions of those lines are described below:

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

The amount reported as other is the result of the financial closure of two NWCF activities. Beginning October 1, 1999, the Depot Maintenance, Ordnance and Shipyards business areas transitioned from the NWCF to the Navy General Fund. Closure of the residual financial records for one of these activities occurred in the 3rd Quarter, FY 2006 and the other in 2nd Quarter,

FY 2007. The net effect of the closure of the residual financial records (i.e. accounts receivable; accounts payable; and unsupported undistributed collections and disbursements) at these activities resulted in a net loss.

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

The amount reported as other resources used to finance items not part of the net cost of operations is comprised of transfers of assets out of NWCF.

Components Not Requiring or Generating Resources, Other

This amount consists of overhead costs distributed to work in process; costs originally recorded into another expense account that are transferred to an inventory work in process; internal use software in development; and a completed asset account.

Other Disclosures

Liabilities not covered by budgetary resources consist of nonentity assets (interest, penalties, fines and administrative fees) and Military Retirement Benefits and Other Employment Actuarial Liabilities for the Navy Working Capital Fund. Therefore, amounts reported as requiring resources in future periods do not have a relationship to liabilities not covered by budgetary resources.

Note 22.

Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 23.**Earmarked Funds****BALANCE SHEET**

As of March 31, 2007

| | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
|--|--------------------------|--|-----------------------|----------------|----------------|
| ASSETS | | | | | |
| Fund balance with | | | | | |
| Treasury | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Investments | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Accounts and Interest Receivable | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other Assets | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total Assets | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| LIABILITIES and NET POSITION | | | | | |
| Military Retirement Benefits and Other Federal Employment Benefits | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Other Liabilities | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total Liabilities | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Unexpended Appropriations | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Cumulative Results of Operations | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total Liabilities and Net Position | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| STATEMENT OF NET COST | | | | | |
| For the period ended March 31, 2007 | | | | | |
| Program Costs | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Less Earned Revenue | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Net Program Costs | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Less Earned Revenues Not Attributable to Programs | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Net Cost of Operations | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |

Not applicable.

Navy Working Capital Fund

| STATEMENT OF CHANGES IN NET POSITION For the period ended March 31, 2007 | Military Retirement Fund | Medicare Eligible Retiree Health Care Fund | Other Earmarked Funds | Eliminations | Total |
|--|-----------------------------|--|--------------------------|--------------|---------|
| Net Position Beginning of the Period | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Net Cost of Operations | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Budgetary Financing Sources | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other Financing Sources | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Change in Net Position | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Net Position End of Period | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |

| | |
|-----------------|--------------------------|
| Note 24. | Other Disclosures |
|-----------------|--------------------------|

| As of March 31 | 2007 | | | |
|----------------|--------------------|-----------|-------|-------|
| | Asset Category | | | |
| | Land and Buildings | Equipment | Other | Total |

**1. ENTITY AS LESSEE-
Operating Leases**

Future Payments Due

Fiscal Year

| | | | | | | | | |
|---------------|----|------|----|------|----|------|----|------|
| 2007 | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 |
| 2008 | | 0.00 | | 0.00 | | 0.00 | | 0.00 |
| 2009 | | 0.00 | | 0.00 | | 0.00 | | 0.00 |
| 2010 | | 0.00 | | 0.00 | | 0.00 | | 0.00 |
| 2011 | | 0.00 | | 0.00 | | 0.00 | | 0.00 |
| 2012 | | 0.00 | | 0.00 | | 0.00 | | 0.00 |
| After 5 Years | | 0.00 | | 0.00 | | 0.00 | | 0.00 |

**Total Future Lease
Payments Due**

| | | | | | | | | |
|--|----|------|----|------|----|------|----|------|
| | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 | \$ | 0.00 |
|--|----|------|----|------|----|------|----|------|

Not Applicable.

| | |
|-----------------|---------------------|
| Note 25. | Restatements |
|-----------------|---------------------|

Not Applicable