

**Department of Defense**  
**Navy Working Capital Fund**  
**CONSOLIDATED BALANCE SHEET**  
**As of June 30, 2006 and 2005**

	<b>2006 Consolidated</b>	<b>2005 Consolidated</b>
	<hr/>	<hr/>
<b>1. ASSETS (Note 2)</b>		
A. Intragovernmental:		
1. Fund Balance with Treasury (Note 3)		
a. Entity	\$ 490,185,450.51	\$ 1,085,784,243.29
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)	186,717,905.28	462,618,589.54
4. Other Assets (Note 6)	5,298,952.26	2,376,062.90
5. Total Intragovernmental Assets	<hr/> \$ 682,202,308.05	<hr/> \$ 1,550,778,895.73
B. Cash and Other Monetary Assets (Note 7)	\$ 0.00	\$ 0.00
C. Accounts Receivable, Net (Note 5)	65,030,677.56	58,611,923.76
D. Loans Receivable (Note 8)	0.00	0.00
E. Inventory and Related Property, Net (Note 9)	13,689,533,929.53	16,141,900,509.77
F. General Property, Plant and Equipment, Net (Note 10)	3,712,048,950.44	3,786,538,840.12
G. Investments (Note 4)	0.00	0.00
H. Other Assets (Note 6)	431,949,104.26	703,478,391.32
<b>2. TOTAL ASSETS</b>	<hr/> <hr/> \$ 18,580,764,969.84	<hr/> <hr/> \$ 22,241,308,560.70
<b>3. LIABILITIES (Note 11)</b>		
A. Intragovernmental:		
1. Accounts Payable (Note 12)	\$ 210,650,489.72	\$ 169,552,270.73
2. Debt (Note 13)	265,993,716.00	503,910,102.26
3. Other Liabilities (Note 15 & 16)	249,874,899.63	620,071,127.64
4. Total Intragovernmental Liabilities	<hr/> \$ 726,519,105.35	<hr/> \$ 1,293,533,500.63
B. Accounts Payable (Note 12)	\$ 1,648,060,610.71	\$ 2,066,850,851.06
C. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,192,551,548.64	1,168,225,461.54
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)	3,180,995,256.71	3,331,666,264.07
<b>4. TOTAL LIABILITIES</b>	<hr/> \$ 6,748,126,521.41	<hr/> \$ 7,860,276,077.30
<b>5. NET POSITION</b>		
A. Unexpended Appropriations - Earmarked Funds (Note 23)	\$ 0.00	\$ 0.00
B. Unexpended Appropriations - Other Funds	11,949,075.74	140,695,000.00
C. Cumulative Results of Operations - Earmarked Funds	0.00	0.00
D. Cumulative Results of Operations - Other Funds	11,820,689,372.69	14,240,337,483.40
<b>6. TOTAL NET POSITION</b>	<hr/> \$ 11,832,638,448.43	<hr/> \$ 14,381,032,483.40
<b>7. TOTAL LIABILITIES AND NET POSITION</b>	<hr/> <hr/> \$ 18,580,764,969.84	<hr/> <hr/> \$ 22,241,308,560.70

Department of Defense  
 Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF NET COST**  
 For the periods ended June 30, 2006 and 2005

	<b>2006 Consolidated</b>	<b>2005 Consolidated</b>
<b>1. Program Costs</b>		
A. Gross Costs	\$ 17,757,915,489.27	\$ 18,452,370,003.83
B. (Less: Earned Revenue)	(15,794,422,147.46)	(16,573,256,185.65)
C. Net Program Costs	<u>\$ 1,963,493,341.81</u>	<u>\$ 1,879,113,818.18</u>
<b>2. Cost Not Assigned to Programs</b>	0.00	0.00
<b>3. (Less: Earned Revenue Not Attributable to Programs)</b>	0.00	0.00
<b>4. Net Cost of Operations</b>	<u><u>\$ 1,963,493,341.81</u></u>	<u><u>\$ 1,879,113,818.18</u></u>

Department of Defense  
Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
<b>CUMULATIVE RESULTS OF OPERATIONS</b>		
<b>1. Beginning Balances</b>	\$ 13,540,238,799.85	\$ 16,021,873,283.75
<b>2. Prior Period Adjustments:</b>		
2.A. Changes in accounting principles (+/-)	0.00	0.00
2.B. Corrections of errors (+/-)	0.00	0.00
<b>3. Beginning balances, as adjusted</b>	<u>13,540,238,799.85</u>	<u>16,021,873,283.75</u>
<b>4. Budgetary Financing Sources:</b>		
4.A. Appropriations received		
4.A.1 Earmarked funds	0.00	0.00
4.A.2 All other funds	0.00	0.00
4.B. Appropriations transferred-in/out (+/-)	0.00	0.00
4.C. Other adjustments (rescissions, etc.) (+/-)	0.00	0.00
4.D. Appropriations used		
4.D.1 Earmarked Funds	0.00	0.00
4.D.2 All other Funds	112,803,938.93	146,405,000.00
4.E. Nonexchange revenue		
4.E.1 Earmarked funds	0.00	0.00
4.E.2 All other funds	0.00	0.00
4.F. Donations and forfeitures of cash and cash equivalents		
4.F.1 Earmarked funds	0.00	0.00
4.F.2 All other funds	0.00	0.00
4.G. Transfers-in/out without reimbursement (+/-)	3,903,000.00	65,385,000.00
4.H. Other budgetary financing sources (+/-)		
4.H.1 Earmarked funds	0.00	0.00
4.H.2 All other funds	0.00	0.00
<b>5. Other Financing Sources:</b>		
5.A. Donations and forfeitures of property		
5.A.1 Earmarked funds	0.00	0.00
5.A.2 All other funds	0.00	0.00
5.B. Transfers-in/out without reimbursement (+/-)	(58,332,852.91)	(17,036,620.27)
5.C. Imputed financing from costs absorbed by others	413,474,404.35	408,762,566.37
5.D. Other (+/-)	(227,904,575.72)	(505,937,928.27)
<b>6. Total Financing Sources</b>		
6.A. Earmarked funds	0.00	0.00
6.B. All other funds	243,943,914.65	97,578,017.83
<b>7. Net Cost of Operations (+/-)</b>		
7.A. Earmarked funds	0.00	0.00
7.B. All other funds	1,963,493,341.81	1,879,113,818.18
<b>8. Net Change</b>		
8.A. Earmarked funds	0.00	0.00
8.B. All other funds	(1,719,549,427.16)	(1,781,535,800.35)
<b>9. Ending Balances</b>		
9.A. Earmarked funds	0.00	0.00
9.B. All other funds	11,820,689,372.69	14,240,337,483.40

Department of Defense  
Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
<b>10. Total all funds</b>	\$ <u>11,820,689,372.69</u>	\$ <u>14,240,337,483.40</u>

Department of Defense  
Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
<b>UNEXPENDED APPROPRIATIONS</b>		
<b>1. Beginning Balances</b>	\$ 6,286,014.67	\$ 0.00
<b>2. Prior Period Adjustments:</b>		
2.A. Changes in accounting principles (+/-)	0.00	0.00
2.B. Corrections of errors (+/-)	0.00	0.00
<b>3. Beginning balances, as adjusted</b>	6,286,014.67	0.00
<b>4. Budgetary Financing Sources:</b>		
4.A. Appropriations received		
4.A.1 Earmarked funds	0.00	0.00
4.A.2 All other funds	118,467,000.00	287,100,000.00
4.B. Appropriations transferred-in/out (+/-)	0.00	0.00
4.C. Other adjustments (rescissions, etc) (+/-)	0.00	0.00
4.D. Appropriations used		
4.D.1 Earmarked Funds	0.00	0.00
4.D.2 All other Funds	(112,803,938.93)	(146,405,000.00)
4.E. Nonexchange revenue		
4.E.1 Earmarked funds	0.00	0.00
4.E.2 All other funds	0.00	0.00
4.F. Donations and forfeitures of cash and cash equivalents		
4.F.1 Earmarked funds	0.00	0.00
4.F.2 All other funds	0.00	0.00
4.G. Transfers-in/out without reimbursement (+/-)	0.00	0.00
4.H. Other budgetary financing sources (+/-)		
4.H.1 Earmarked funds	0.00	0.00
4.H.2 All other funds	0.00	0.00
<b>5. Other Financing Sources:</b>		
5.A. Donations and forfeitures of property		
5.A.1 Earmarked funds	0.00	0.00
5.A.2 All other funds	0.00	0.00
5.B. Transfers-in/out without reimbursement (+/-)	0.00	0.00
5.C. Imputed financing from costs absorbed by others	0.00	0.00
5.D. Other (+/-)	0.00	0.00
<b>6. Total Financing Sources</b>		
6.A. Earmarked funds	0.00	0.00
6.B. All other funds	5,663,061.07	140,695,000.00
<b>7. Net Cost of Operations (+/-)</b>		
7.A. Earmarked funds	0.00	0.00
7.B. All other funds		
<b>8. Net Change</b>		
8.A. Earmarked funds	0.00	0.00
8.B. All other funds	5,663,061.07	140,695,000.00
<b>9. Ending Balances</b>		
9.A. Earmarked funds	0.00	0.00
9.B. All other funds	11,949,075.74	140,695,000.00

Department of Defense  
Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION**  
For the periods ended June 30, 2006 and 2005

	2006 Consolidated	2005 Consolidated
<b>10. Total all funds</b>	\$ <u>11,949,075.74</u>	\$ <u>140,695,000.00</u>



Department of Defense  
Navy Working Capital Fund  
**COMBINED STATEMENT OF BUDGETARY RESOURCES**  
For the periods ended June 30, 2006 and 2005

	2006 Combined	2005 Combined
<b>Status of Budgetary Resources:</b>		
8. Obligations incurred:		
8.A. Direct	\$ 0.00	\$ 0.00
8.B. Reimbursable	17,112,064,528.00	17,616,058,733.99
8.C. Subtotal	<u>17,112,064,528.00</u>	<u>17,616,058,733.99</u>
9. Unobligated balance:		
9.A. Apportioned	10,425,857,282.72	9,036,368,128.68
9.B. Exempt from apportionment	(124,484,391.26)	287,100,000.00
9.C. Subtotal	<u>10,301,372,891.46</u>	<u>9,323,468,128.68</u>
10. Unobligated balance not available	14,088,629,430.22	289,607,984.02
<b>11. Total status of budgetary resources</b>	<u>\$ 41,502,066,849.68</u>	<u>\$ 27,229,134,846.69</u>
<b>Change in Obligated Balance:</b>		
12. Obligated balance, net		
12.A. Unpaid obligations, brought forward, October 1	12,667,319,650.50	11,860,610,248.99
12.B. Less: Uncollected customer payments from Federal sources, brought forward, October 1	<u>\$ (7,638,228,489.28)</u>	<u>\$ (7,621,902,197.34)</u>
12.C. Total unpaid obligated balance	5,029,091,161.22	4,238,708,051.65
13. Obligations incurred net (+/-)	<u>\$ 17,112,064,528.00</u>	<u>\$ 17,616,058,733.99</u>
14. Less: Gross outlays	(17,496,283,602.62)	(17,026,336,286.94)
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	<u>0.00</u>	<u>0.00</u>
17. Change in uncollected customer payments from Federal sources (+/-)	(3,415,028,656.90)	(3,187,349,708.80)
18. Obligated balance, net, end of period		
18.A. Unpaid obligations	12,283,100,575.88	12,450,332,696.04
18.B. Less: Uncollected customer payments (+/-) from Federal sources (-)	<u>(11,053,257,146.18)</u>	<u>(10,809,251,906.14)</u>
18.C. Total, unpaid obligated balance, net, end of period	<u>1,229,843,429.70</u>	<u>1,641,080,789.90</u>
<b>Net Outlays</b>		
<b>19. Net Outlays:</b>		
19.A. Gross outlays	17,496,283,602.62	17,026,336,286.94
19.B. Less: Offsetting collections	(17,004,526,079.00)	(16,909,653,523.48)
19.C. Less: Distributed Offsetting receipts	0.00	0.00
<b>19.D. Net Outlays</b>	<u>\$ 491,757,523.62</u>	<u>\$ 116,682,763.46</u>

Department of Defense  
Navy Working Capital Fund  
**COMBINED STATEMENT OF BUDGETARY RESOURCES**  
For the periods ended June 30, 2006 and 2005

	2006 Combined	2005 Combined
	<hr/>	<hr/>
<b>NONBUDGETARY FINANCING ACCOUNTS</b>		
<b>BUDGETARY RESOURCES</b>		
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
<b>7. Total Budgetary Resources</b>	<hr/> <hr/> \$ 0.00	<hr/> <hr/> \$ 0.00



Department of Defense  
Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF FINANCING**  
For the periods ended June 30, 2006 and 2005

	<b>2006 Consolidated</b>	<b>2005 Consolidated</b>
	<hr/>	<hr/>
<b>Resources Used to Finance Activities:</b>		
Budgetary Resources Obligated		
1. Obligations incurred	\$ 17,112,064,528.00	\$ 17,616,058,733.99
2. Less: Spending authority from offsetting collections and recoveries (-)	(20,419,554,735.90)	(20,097,003,232.28)
3. Obligations net of offsetting collections and recoveries	(3,307,490,207.90)	(2,480,944,498.29)
4. Less: Offsetting receipts (-)	0.00	0.00
5. Net obligations	<hr/> (3,307,490,207.90)	<hr/> (2,480,944,498.29)
Other Resources		
6. Donations and forfeitures of property	0.00	0.00
7. Transfers in/out without reimbursement (+/-)	(58,332,852.91)	(17,036,620.27)
8. Imputed financing from costs absorbed by others	413,474,404.35	408,762,566.37
9. Other (+/-)	(227,904,575.72)	0.00
10. Net other resources used to finance activities	<hr/> 127,236,975.72	<hr/> 391,725,946.10
<b>11. Total resources used to finance activities</b>	<hr/> \$ (3,180,253,232.18)	<hr/> \$ (2,089,218,552.19)
<b>Resources Used to Finance Items not Part of the Net Cost of Operations</b>		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
12a. Undelivered Orders (-)	(378,402,972.31)	(908,155,214.51)
12b. Unfilled Customer Orders	3,505,966,940.67	3,686,997,961.00
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	(2,954,511,736.91)	(3,223,977,148.99)
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 (+/-)	286,237,428.63	17,036,620.27
<b>17. Total resources used to finance items not part of the net cost of operations</b>	<hr/> \$ 459,289,660.08	<hr/> \$ (428,097,782.23)
<b>18. Total resources used to finance the net cost of operations</b>	<hr/> \$ (2,720,963,572.10)	<hr/> \$ (2,517,316,334.42)

Department of Defense  
Navy Working Capital Fund  
**CONSOLIDATED STATEMENT OF FINANCING**  
For the periods ended June 30, 2006 and 2005

	<b>2006 Consolidated</b>	<b>2005 Consolidated</b>
	<hr/>	<hr/>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
Components Requiring or Generating Resources in Future Period:		
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	166,370,507.73	156,062,117.34
26. Revaluation of assets or liabilities (+/-)	1,084,698,800.73	254,466,345.06
27. Other (+/-)		
27a. Trust Fund Exchange Revenue	0.00	0.00
27b. Cost of Goods Sold	3,433,193,362.28	3,985,802,649.53
27c. Operating Material & Supplies Used	0.00	0.00
27d. Other	194,243.17	99,040.67
28. Total components of Net Cost of Operations that will not require or generate resources	<hr/> 4,684,456,913.91	<hr/> 4,396,430,152.60
<b>29. Total components of net cost of operations that will not require or generate resources in the current period</b>	<hr/> \$ 4,684,456,913.91	<hr/> \$ 4,396,430,152.60
<b>30. Net Cost of Operations</b>	<hr/> <hr/> \$ 1,963,493,341.81	<hr/> <hr/> \$ 1,879,113,818.18

<b>Note 1.</b>	<b>Significant Accounting Policies</b>
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**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 DoD Financial Management Regulation, the Office of Management and Budget 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 excluded from the statements or otherwise 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 Office of Management and Budget 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 systems and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with GAAP. The NWCF currently has one auditor identified financial statement weakness: valuation of inventory and operating materials and supplies.

The NWCF continues to implement processes and system improvements addressing these limitations many of which are detailed below.

**1.B. Mission of the Reporting Entity**

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

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

**1.C. Appropriations and Funds**

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

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

#### **1.D. Basis of Accounting**

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

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

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

**1.H. Transactions with Foreign Governments and International Organizations**

Each year 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 Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between the NWCF's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

**1.J. Foreign Currency**

Not Applicable.

**1.K. Accounts Receivable**

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

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

**1.L. Direct Loans and Loan Guarantees**

Not Applicable.

### **1.M. Inventories and Related Property**

Most of the NWCF's inventories are currently reported at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed to capture material management rather than accounting. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, the NWCF is transitioning to the inventory to the moving average cost method.

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

Related property includes 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, the NWCF uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2006, the NWCF expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user.

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

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

Past audits identified uncertainties about completeness and existence of reported values of inventory. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the NWCF. This inventory is retained to support military or national contingencies. Inventory held for repair is

damaged inventory that requires repair to make suitable for sale. It is more economical to repair than to procure these inventory items. Because the NWCF often relies on weapon systems and machinery no longer in production, the NWCF supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force.

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

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

Not Applicable.

**1.O. General Property, Plant and Equipment**

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," established generally accepted accounting principles for valuing and reporting equipment (e.g. ships, aircraft, combat vehicles, weapons) in federal financial statements. The standard requires the capitalization and depreciation of the costs of military equipment, including the cost of modifications and upgrades.

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

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

General Property, Plant and Equipment (PP&E) assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost equals or exceeds 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 WCF assets. These assets remain capitalized and reported on WCF financial statements.

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

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

#### **1.P. Advances and Prepayments**

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

#### **1.Q. Leases**

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

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

leases. The NWCF expects to continue to reduce the level of owned assets while increasing the number of leased assets. The NWCF will strive to displace commercial leases with more economical GSA leases.

**1.R. Other Assets**

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

The Federal Acquisition Regulation allows the NWCF to make financing payments, under fixed price contracts. The NWCF reports these financing payments as “Other Assets” because the NWCF becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the NWCF is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the NWCF for the full amount of the advance.

**1.S. Contingencies and Other Liabilities**

The SFFAS No. 5, “Accounting for Liabilities of the Federal Government,” as amended by 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 civilian annual leave and military leave that has been accrued and not used as of the Balance Sheet date. 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 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 previous period presented are explained within the notes to the financial statements.

**1.X. Unexpended Obligations**

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

**1.Y. Undistributed Disbursements and Collections**

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the 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.

<b>Note 2.</b>	<b>Nonentity Assets</b>
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As of June 30	2006	2005
<b>1. Intragovernmental Assets</b>		
A. Fund Balance with Treasury	\$ 0.00	\$ 0.00
B. Accounts Receivable	0.00	0.00
C. Total Intragovernmental Assets	\$ 0.00	\$ 0.00
<b>2. Nonfederal Assets</b>		
A. Cash and Other Monetary Assets	\$ 0.00	\$ 0.00
B. Accounts Receivable	2,887,233.97	5,220,619.84
C. Other Assets	0.00	0.00
D. Total Nonfederal Assets	\$ 2,887,233.97	\$ 5,220,619.84
<b>3. Total Nonentity Assets</b>	\$ 2,887,233.97	\$ 5,220,619.84
<b>4. Total Entity Assets</b>	\$ 18,577,877,735.87	\$ 22,236,087,940.86
<b>5. Total Assets</b>	\$ 18,580,764,969.84	\$ 22,241,308,560.70

**Abnormalities and/or Fluctuations**

The total nonentity assets (Line 3) decreased \$2.3 million, 45%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006 in nonfederal accounts receivable. In 4<sup>th</sup> Quarter, FY 2005, there were two large contracts closed by Mechanization Of Contract Administration System (MOCAS) that were considered not collectible and closed. The closure of this debt resulted in the cancellation of all associated interest, penalties fines, and administrative fees receivable, thus reducing this line.

**Definitions**

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

**Composition of Nonentity Assets**

Nonentity nonfederal accounts receivable represents interest, penalties, fines, and administrative fees. These fees do not belong to the Navy Working Capital Fund and when collected, will be submitted to the Department of the Treasury.

**Other Disclosures Related to Nonentity Assets**

No further disclosures required.

<b>Note 3.</b>	<b>Fund Balance with Treasury</b>
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As of June 30

	2006	2005
<b>1. Fund Balances</b>		
A. Appropriated Funds	\$ 0.00	\$ 0.00
B. Revolving Funds	490,185,450.51	1,085,784,243.29
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	\$ 490,185,450.51	\$ 1,085,784,243.29
<b>2. Fund Balances Per Treasury Versus Agency</b>		
A. Fund Balance per Treasury	\$ 490,185,450.51	\$ 1,085,784,243.29
B. Fund Balance per NWCF	490,185,450.51	1,085,784,243.29
<b>3. Reconciling Amount</b>	\$ 0.00	\$ 0.00

**4. Explanation of Reconciliation Amount:**

No reconciling amount reported.

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

Fund Balance with Treasury (FBWT) decreased \$595.6 million, 55%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. This decrease is attributable to:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Depot Maintenance (Shipyards)		208,069	This decrease is a result of the balance of unliquidated advance billings declining as work is performed this fiscal year. The Shipyards processed advance billings in 2 <sup>nd</sup> Quarter, FY 2005 and 2 <sup>nd</sup> Quarter, FY 2006 to increase their fund balance with treasury.
Transportation (Military Sealift Command (MSC))		190,125	MSC transferred \$50 million in September 2005 as directed by Public Law 108-287, DoD Appropriations Act, 2005 to Operation and Maintenance, Navy general fund for rate stabilization due to an excess cash balance. In addition, during the 4th Quarter, FY 2005 MSC incurred an operating loss based on unbudgeted capital hire expenses for ten Maritime Prepositioning Ships that were not purchased as anticipated. Expenses related to these ships

			were incurred without any additional offsetting revenues or increases to rates.
Research and Development (Space and Naval Warfare Systems Command)		138,036	A decrease occurred in September 2005 as a result of transferring \$50 million in September 2005 as directed by Public Law 108-287, DoD Appropriations Act, 2005 to Operation and Maintenance, Navy general fund for rate stabilization due to an excess cash balance. Also, in 4 <sup>th</sup> Quarter, FY 2005 a reduction in advances from government agencies (Advances) occurred and has continued throughout the intervening period. This reduction in Advances has occurred as a result of a reduction in the volume of business with other Federal agencies. Another event that contributed to the decrease was a late June 2006 billing that did not clear Treasury before month-end.
<b>Totals</b>		<b>536,230</b>	

### Composition of Fund Balance with Treasury

The FBWT of \$490.2 million reflects the FY 2005 ending balance of \$977.9 million plus current FY 2006 collections, disbursements, and other cash transactions recorded in the Navy Working Capital Fund (NWCF) Treasury sub-limit 97X4930.002. The following table details the amounts recorded as of June 30, 2006.

*(Amounts in thousands)*

Collections	\$ 17,004,526
Disbursements	\$(17,496,284)
Other Cash Transactions, Net	\$ 4,079

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

*(Amounts in thousands)*

#### Activity

Base Support (Navy)	Public Law 109-62	\$70
Depot Maintenance (Aviation)	Public Law 109-62	\$23
Supply Management (Navy)	Public Law 109-62	\$243
Component	Public Law 109-62	\$894
Research and Development (Naval Research Lab)	Public Law 109-62	\$2,673
Supply Management (Navy)	Public Law 109-148	\$118,467
Transportation (Military Sealift Command)	Payment of Debt	<u>\$(118,291)</u>
Total		\$4,079

**Intragovernmental Payment and Collection (IPAC)**

IPAC differences are reconcilable differences that represent amounts recorded by Treasury but not reported by the organization. IPAC differences for the Department of the Navy cannot be differentiated between NWCF and General Fund, therefore no IPAC differences are being reported for the NWCF. All amounts, if applicable, will be reported on the Department of the Navy General Fund statement.

**Other Disclosures Related to Fund Balance with Treasury**

No further disclosures required.

<b>Status of Fund Balance with Treasury</b>
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As of June 30	2006	2005
<b>1. Unobligated Balance</b>		
A. Available	\$ 8,527,838,016.91	\$ 7,775,687,737.52
B. Unavailable	192,321,440.62	161,168,407.84
<b>2. Obligated Balance not yet Disbursed</b>	\$ 12,283,100,575.88	\$ (6,880,377,070.45)
<b>3. Nonbudgetary FBWT</b>	\$ 0.00	\$ 0.00
<b>4. NonFBWT Budgetary Accounts</b>	\$ (20,512,975,057.63)	\$ 0.00
<b>5. Total</b>	<u>\$ 490,284,975.78</u>	<u>\$ 1,056,479,074.91</u>

**6. Information Related to Status of Fund Balance with Treasury:****Fluctuations and/or Abnormalities**

There are no abnormalities to disclose for this period.

Total Status of Fund Balance with Treasury decreased \$566.2 million, 54%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. This decrease is a result of the following line changes:

- Unobligated Balance Available (Line 1.A) increased \$752.2 million, 10%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. An increase of \$624.7 million is attributable to two business events at Supply Management, Navy. The first business event occurred at the beginning of FY 2006, when the commitments were not closed out of the Central Database, thus resulting in an increase in this line for this fiscal year. The second business event constitutes the remainder of the increase and is a result of an increase in budget authority that was received for FY 2006. This results in a larger portion of the authority available this fiscal year.
- Unobligated Balance Unavailable (Line 1.B) increased \$31.2 million, 19%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The increase is attributable to Supply Management, Navy closing of Enterprise Resource Planning (ERP) Supply Maintenance Aviation Re-Engineering Team (SMART) Pilot during the 4<sup>th</sup> Quarter, FY 2005. During the final required closure transactions of the SMART ERP, under the guidance available at that time, Unobligated Balance Available was closed into Unapportioned Authority (Unobligated Balance, Unavailable). However, current Contract Authority guidance requires that this closure should have been into the Contract Authority account. Supply Management, Navy is working with Defense Finance and Accounting Service (DFAS) to research the implications of this action.

Unobligated Balance, Unavailable consists of the recording of Supply Management, Navy cash warrants which were received during FY 2003, FY 2004, FY 2005 and the ERP closeout balance. In FY 2006, the cash warrant received by Supply Management, Navy

was recorded as Contract Authority liquidated based on the current Contract Authority guidance. Supply Management, Navy and DFAS will work together to determine if the balance should be adjusted to reflect the current Contract Authority guidance.

- Obligated Balance not yet Disbursed (Line 2) increased \$19.2 billion, 279%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006 and NonFBWT Budgetary Accounts (Line 4) decreased \$20.5 billion, 100%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The change in these two lines is a result of the implementation of new reporting requirements in the 1<sup>st</sup> Quarter, FY 2006 that changed the reporting presentation of these two lines. The net change of these lines resulted in a decrease of \$1.4 billion, 20%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. This decrease is attributable to Supply Management, Navy's implementation of new Contract Authority Guidance issued by the Office of the Under Secretary of Defense on September 8, 2005, establishing comprehensive accounting and reporting requirements for Defense Working Capital Funds Contract Authority. The guidance changes the nature of some previously established accounting processes and balances reported and carried forward.

### **Definitions**

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

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

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

Non budgetary FBWT includes entity and nonentity fund balance with treasury accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

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

### **Disclosure of Restrictions**

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

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

There is a difference of \$99.5 thousand between the Total of the Status of Fund Balance with Treasury and the Total of the Fund Balance with Treasury. This is a result of an internal weakness of creating budgetary accounts from proprietary accounts in the footnotes. Defense Finance and Accounting Service (DFAS) is working with the Department of Navy (DON) in the Financial Improvement Plan to correct this weakness.

**Disclosures Related to Suspense/Budget Clearing Accounts**

As of June 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
<b>Account</b>				
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
<b>Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>0.00</b>

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

<b>Disclosures Related to Problem Disbursements and In-Transit Disbursements</b>
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As of June 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
<b>1. Total Problem Disbursements, Absolute Value</b>				
A. Unmatched Disbursements (UMDs)	\$ 126,000,000.00	\$ 726,294,808.88	\$ 112,860,456.20	(613,434,352.68)
B. Negative Unliquidated Obligations (NULO)	0.00	825,548.62	260,537.61	(565,011.01)
<b>2. Total In-transit Disbursements, Net</b>	\$ 0.00	\$ (14,697,398.94)	\$ (1,783,789.08)	12,913,609.86

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

#### Abnormalities and/or Fluctuations

There are no abnormalities to disclose for this period.

Unmatched Disbursements (UMDs) (Line 1.A) decreased \$613.4 million, 84%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. In order to comply with Under Secretary of Defense, Comptroller's direction to eliminate Department of Navy's (DON) UMDs over 120 days old by June 30, 2006, an initiative began in 3<sup>rd</sup> Quarter, FY 2005, which increased coordination between DFAS and Navy Working Capital Fund (NWCF) activities on the reduction of UMDs. As part of this initiative, DFAS and NWCF activities performed root cause analysis that discovered several system and process weaknesses. Some examples of these weaknesses and related correction of UMDs are:

- A weakness was identified in the cash accounting system on the misalignment of charges that occurred prior to FY 1999. These undistributed collections were cleared prior to the end of 4<sup>th</sup> Quarter, FY 2005. The DFAS manually resolved the aged balances and the cash accounting system was updated to correct this weakness and prevent future undistributed collections.
- Several different root causes have been identified by DFAS field sites and DON activities. 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 due to the reasons listed above. DFAS and DON activities have manually cleared the aged UMDs as these system weaknesses were identified.
- The Transportation, Military Sealift Command (MSC) identified incorrectly charged transactions due to a system weakness in the Visual Interfund System Transaction Accountability (VISTA). The deficiencies in the system were corrected by the end of

4<sup>th</sup> Quarter, FY 2005. DON and DFAS manually cleared the aged UMDs that were a result of this weakness and the system correction has prevented future UMDs from occurring.

Negative Unliquidated Obligations (NULOs) (Line 1.B.) decreased \$565.0 thousand, 68%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The breakdown of this information was not identifiable and reported in previous years. The DON submitted a plan of action and milestones in March 2006 to the Under Secretary of Defense, Comptroller that describes how the DON will resolve this line. DON and DFAS have incorporated all NULOs as part of the UMD corrective action plan.

Total In-transit Disbursements, Net (Line 2) increased \$12.9 million, 88% from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The breakdown of this information was not identifiable and reported in previous years. However, these amounts are due to disbursements and collections made by a Department of Defense 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.

### **Unmatched Disbursements**

An unmatched disbursement 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).

### **Negative Unliquidated Obligations**

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

### **In-transit Disbursements**

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

<b>Note 4.</b>	<b>Investments and Related Interest</b>
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As of June 30	2006				
	Par Value / Cost	Amortization Method	Unamortized (Premium) / Discount	Investments, Net	Market Value Disclosure
<b>1. Intragovernmental Securities</b>					
A. Nonmarketable, Market-Based	\$ 0.00		\$ 0.00	\$ 0.00	\$ 0.00
B. Accrued Interest	0.00			0.00	0.00
C. Total Intragovernmental Securities	<u>\$ 0.00</u>		<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
<b>2. Other Investments</b>					
A. Total Investments	<u>\$ 0.00</u>		<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>N/A</u>

As of June 30	2005				
	Par Value / Cost	Amortization Method	Unamortized (Premium) / Discount	Investments, Net	Market Value Disclosure
<b>3. Intragovernmental Securities</b>					
A. Nonmarketable, Market-Based	\$ 0.00		\$ 0.00	\$ 0.00	\$ 0.00
B. Accrued Interest	0.00			0.00	0.00
C. Total Intragovernmental Securities	<u>\$ 0.00</u>		<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
<b>4. Other Investments</b>					
A. Total Investments	<u>\$ 0.00</u>		<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>N/A</u>

Not Applicable.

<b>Note 5.</b>	<b>Accounts Receivable</b>
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As of June 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
<b>1. Intragovernmental Receivables</b>	\$ 186,717,905.28	N/A	\$ 186,717,905.28	\$ 462,618,589.54
<b>2. Nonfederal Receivables (From the Public)</b>	\$ 65,057,611.52	\$ (26,933.96)	\$ 65,030,677.56	\$ 58,611,923.76
<b>3. Total Accounts Receivable</b>	\$ 251,775,516.80	\$ (26,933.96)	\$ 251,748,582.84	\$ 521,230,513.30

**4. Other Information Related to Accounts Receivable:**

**Fluctuations**

Intragovernmental Accounts Receivable (Line 1) decreased \$275.9 million, 60%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The primary drivers attributing to this decrease are described below:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Component		280,025	The value of Intragovernmental Unsupported or Undistributed collections reduced between 3 <sup>rd</sup> Quarter, FY 2005 and 3 <sup>rd</sup> Quarter, FY 2006 resulting in a decrease in receivables. This decrease is primarily attributed to the improved business process of preparing adjustments for unsupported undistributed receivables. Both Navy and the Defense Finance and Accounting Service (DFAS) have dedicated resources to review and analyze the unsupported undistributed values. As a result of this extensive review and analysis, we have been able to reduce the adjustment for unsupported undistributed. As part of the initiative to assert the fund balance with treasury line, Navy and DFAS have been working together to ensure that current cash processes limit the inflow of undistributed.
Transportation (Military Sealift Command)	19,058		Two major programs (Prepositioning of Supply Ships and the Naval Fleet Auxiliary Force) experienced higher revenues and increased sales activity throughout FY 2006. This has resulted in an increase in intragovernmental accounts receivable in FY 2006.
<b>Totals</b>	<b>19,058</b>	<b>280,025</b>	

Nonfederal Accounts Receivable (Line 2) increased \$6.4 million, 11%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. An increase of \$4.5 million is attributed to Supply Management, Navy. The increase was

driven by the Seller Elimination Report (SER) trading partner adjustment in 3<sup>rd</sup> Quarter, FY 2006 which was required to align the trial balance data between Federal and Public accounts receivables. This adjustment is necessary based on Office of the Secretary of Defense guidance to align trial balance data with the SER trading partner data to reflect the Federal to Public ratio received.

### **Allowance Method**

The Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," and the Department of Defense (DoD) Financial Management Regulation require that federal agencies establish an allowance for doubtful accounts receivable nonfederal. This account has been established within the Navy Working Capital Fund (NWCF). This amount is low, as the NWCF requires an advance deposit from all nonfederal entities prior to the commencement of work. Therefore, an assumption is made that the amount of doubtful accounts should be negligible. The allowance amount represents a percentage of the total that was billed after the total project cost has been adjusted to reflect the advance deposit.

### **Allocation of Undistributed Collections**

The DoD policy is to allocate supported undistributed collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts receivable. Supported undistributed collections in the amount of \$361.6 million were applied against accounts receivable. Unsupported undistributed collections should be recorded in United States Standard General Ledger account 2400, Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections. The NWCF follows this allocation procedure. This is required because the potential exists that some of these unsupported undistributed collections do not belong to the NWCF and will have to be paid to the appropriate fund holder.

### **Material Intragovernmental Differences**

The NWCF's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the NWCF is unable to reconcile intragovernmental accounts receivable balances with most trading partners. Through an ongoing Business Transformation Agency effort, the DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations. The Department of the Navy (DON) is also working on short-term solutions to gather the required information as outlined in the DON Financial Improvement Plan.

### **Nonfederal Refunds Receivable**

The total amount of nonfederal refunds receivables does not exceed ten percent of the nonfederal accounts receivable, net amount on the Balance Sheet.

## Aged Accounts Receivable

As of June 30	2006		2005	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
<b>CATEGORY</b>				
<b>Nondelinquent</b>				
Current	\$ 608,910,237.73	\$ 28,518,810.94	\$ 629,999,088.16	\$ 28,209,420.97
Noncurrent	525,296.00	7,990,255.00	267,531.00	8,249,957.00
<b>Delinquent</b>				
1 to 30 days	\$ 32,965,022.08	\$ 4,322,530.00	\$ 0.00	\$ 0.00
31 to 60 days	4,219,763.05	1,061,330.55	0.00	0.00
61 to 90 days	2,338,760.84	4,034,303.00	20,614,414.79	7,948,882.81
91 to 180 days	2,436,877.60	3,369,284.00	2,138,741.47	5,173,566.00
181 days to 1 year	3,152,060.62	5,020,100.80	8,055,755.36	3,225,938.00
Greater than 1 year and less than or equal to 2 years	860,221.39	2,537,278.63	3,199,778.00	10,465,954.00
Greater than 2 years and less than or equal to 6 years	17,407.00	2,275,091.00	1,487,343.00	11,606,970.00
Greater than 6 years and less than or equal to 10 years	0.00	1,803,692.00	697,030.00	3,305,810.00
Greater than 10 years	0.00	4,935,625.00	934.00	10,668,689.00
<b>Subtotal</b>	<b>\$ 655,425,646.31</b>	<b>\$ 65,868,300.92</b>	<b>\$ 666,460,615.78</b>	<b>\$ 88,855,187.78</b>
Less Supported Undistributed Collections	(351,819,692.61)	(9,738,527.26)	(114,199,127.22)	(43,904,483.72)
Less Eliminations	(106,966,859.52)	0.00	(95,148,520.31)	0.00
Less Other	(9,921,188.90)	8,927,837.86	5,505,621.29	13,662,819.70
<b>Total</b>	<b>\$ 186,717,905.28</b>	<b>\$ 65,057,611.52</b>	<b>\$ 462,618,589.54</b>	<b>\$ 58,613,523.76</b>

Current systems do not allow for the identification of the aging of the undistributed amounts. Aging information is not automatically generated and readily available in all feeder financial systems and therefore must be manually reported.

The Other line referenced in the above chart for intragovernmental receivables in the amount of \$9.9 million and nonfederal receivables in the amount of \$8.9 million consists of:

- For intragovernmental receivables and nonfederal receivables there is \$9.8 million reflected as a reclassification for Foreign Military Sales (FMS) from intragovernmental to public as required per the change in Department of Defense Financial Management Regulation Volume 15, Chapter 3. The NWCF is unable to properly categorize all FMS sales due to varying methods for compiling the data. Therefore, some FMS sales appear differently on the Monthly Receivables Report (MRR) than what is reported on the Seller Elimination Report (SER).
- For intragovernmental and nonfederal receivables there are \$95 thousand and \$897 thousand respectively, reflected as adjustments for differences between the Seller Elimination Report and the Accounts Receivable Single Source Submission Report. The Accounts Receivable Single Source Submission Report is the report that is used to create the MRR.

As noted in this footnote, “Aging information is not automatically generated and readily available in all feeder financial systems and therefore must be manually reported.” The top portion of this chart is derived from the MRR, which is manually maintained by DFAS and NWCF activities. The bottom portion of this chart is derived from the accounting adjustments required in the preparation of the financial statements. In order to prepare this chart, the NWCF must make adjustments to the “other” line on this chart in order to reconcile the two portions.

The eliminations line in this chart is the amount of internal NWCF eliminations as reported in the financial statements. The \$107.0 million represents the amounts attributable to other NWCF activities.

Delinquent Intragovernmental Receivables over 30 days old totaled \$13.0 million and Nondelinquent Noncurrent Intragovernmental Receivables totaled \$525 thousand in 3<sup>rd</sup> Quarter, FY 2006.

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

- Standard Accounting and Reporting System (STARS) rejects that are being researched by DFAS. When errors occur that result in a STARS reject, additional time is needed to resolve the error, thus resulting in a longer period before the receivable is liquidated. Efforts are underway at all Commands to team with DFAS in clearing existing rejects and implementing business rules/processes that will reduce or eliminate these rejects in the future.
- Receivables that are awaiting liquidation via pending Intragovernmental Payment and Collection (IPAC) processing. The IPAC processing requires a greater amount of time between the time the receivable is established until the time the receivable is liquidated due to coordination with Agencies outside the Department of the Navy.
- Varying business practices and financial systems at different federal agencies sometimes requires longer processing of billing transactions. When agencies manually validate billing transactions, liquidation of the receivable is delayed longer than 30 days.
- Transactions contain non-standard lines of accounting that do not pass system edits resulting in errors that take additional time to research and correct.
- An intragovernmental receivable cannot be transferred to a collection activity. Therefore, if a dispute arises with an intragovernmental receivable, then the receivable becomes overage during the dispute process

Delinquent Nonfederal Receivables over 30 days old totaled \$25.0 million and Nondelinquent Noncurrent Nonfederal Receivables totaled \$8.0 million in 3<sup>rd</sup> Quarter, FY 2006.

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

- When an airline ticket is cancelled it generally takes longer than 30 days to receive a credit for that charge. Nonfederal receivables are established at the time of cancellation for the majority of the NWCF Commands. NWCF Commands are actively monitoring and establishing business rules and processes that ensure that receivables are liquidated in a timely manner.
- Bankcard disputes are major contributors to the nonfederal receivables over 30 days old for most NWCF Commands. Input of disputed bankcard transactions into feeder systems are

generally performed by nonfinancial personnel, this leads to various errors in financial systems due to the incorrect coding of transactions. These errors are researched and corrected by financial personnel in NWCF and therefore result in longer time to liquidate. Also, some vendors do not issue credits as soon as they are notified due to various billing cycles and processes. Efforts are underway at all NWCF Commands to resolve these nonfederal receivables in a timely manner and they are teaming with local nonfinancial personnel to reduce the number of errors.

- The time period for billing and collection on Foreign Military Sales normally exceeds 30 days, thus resulting in nonfederal receivables over 30 days old.

**Other Disclosures Related to Accounts Receivable**

No further disclosures required.

<b>Note 6.</b>	<b>Other Assets</b>
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As of June 30	2006	2005
<b>1. Intragovernmental Other Assets</b>		
A. Advances and Prepayments	\$ 5,298,952.26	\$ 2,376,062.90
B. Total Intragovernmental Other Assets	\$ 5,298,952.26	\$ 2,376,062.90
<b>2. Nonfederal Other Assets</b>		
A. Outstanding Contract Financing Payments	\$ 0.00	\$ 0.00
B. Other Assets (With the Public)	431,949,104.26	703,478,391.32
C. Total Nonfederal Other Assets	\$ 431,949,104.26	\$ 703,478,391.32
<b>3. Total Other Assets</b>	<u>\$ 437,248,056.52</u>	<u>\$ 705,854,454.22</u>

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

Intragovernmental Other Assets, Advances and Prepayments (Line 1.A) increased \$2.9 million, 123%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. This increase is the result of buyer side trading partner adjustments for Advances to Others that exceeded the value of similar adjustments made in FY 2005. The trading partner contributing the largest amount to this adjustment is the Defense Logistics Agency (DLA). The DLA is our largest trading partner because of increased purchases of fuel in support of missions.

Nonfederal Other Assets, Other Assets With the Public (Line 2.B) decreased \$271.5 million, 39%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. This decrease is primarily the result of the payoff of three Military Prepositioning Ships in January 2006.

**Advances and Prepayments**

The buyer side advances to others account balances were adjusted to agree with seller side advances from others account balances as reported on the books of other Department of Defense (DoD) reporting entities. Additionally, the buyer side prepayment balances were adjusted to agree with seller side deferred credits as reported on the books of other DoD reporting entities.

**Composition of Other Assets (With the Public)**

Other Assets (With the Public) includes an amount of \$257.4 million relating to the outstanding debt principal amount reported for the Military Sealift Command involving Time Charter arrangements made for the long term use of the Afloat Prepositioning Force – Navy ships. The outstanding debt principal amount is reported in the Navy Working Capital Fund Balance Sheet Other Assets (With the Public). See Note 13 for material disclosures.

**Other Disclosures Related to Other Assets**

The NWCF is able to compare, but is unable to validate other assets balances with the corresponding balances of its intragovernmental trading partners.

<b>Note 7.</b>	<b>Cash and Other Monetary Assets</b>
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As of June 30	2006	2005
<b>1. Cash</b>	\$ 0.00	\$ 0.00
<b>2. Foreign Currency</b>	0.00	0.00
<b>3. Total Cash, Foreign Currency, &amp; Other Monetary Assets</b>	\$ 0.00	\$ 0.00

Not Applicable.

<b>Note 8.</b>	<b>Direct Loan and/or Loan Guarantee Programs</b>
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As of June 30

**Direct Loan and/or Loan Guarantee Programs** The entity operates the following direct loan and/or Loan guarantee program(s)

Military Housing Privatization Initiative

Armament Retooling & Manufacturing Support Initiative

Not Applicable

## Direct Loans Obligated After FY 1991

As of June 30	2006	2005
<b>Loan Programs</b>		
<b>1. Military Housing Privatization Initiative</b>		
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
<b>2. Total Loans Receivable</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>

<b>Total Amount of Direct Loans Disbursed</b>
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As of June 30	2006	2005
<b>Direct Loan Programs</b>		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
<b>2. Total</b>	<u>\$ 0.00</u>	<u>\$ 0.00</u>

## Subsidy Expense for Post FY 1991 Direct Loan

As of June 30

2006	Interest Differential	Defaults	Fees	Other	Total
<b>1. New Direct Loans Disbursed:</b> Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2005	Interest Differential	Defaults	Fees	Other	Total
<b>2. New Direct Loans Disbursed:</b> Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2006	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
<b>3. Direct Loan Modifications and Reestimates:</b> Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
<b>4. Direct Loan Modifications and Reestimates:</b> Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
		2006	2005		
<b>5. Total Direct Loan Subsidy Expense:</b> Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00		

## Subsidy Rate for Direct Loans

As of June 30	Interest Differential	Defaults	Fees and other Collections	Other	Total
<b>Direct Loan Programs</b>					
1. Military Housing Privatization Initiative	0.00%	0.00%	0.00%	0.00%	0.00%

## Schedule for Reconciling Subsidy Cost Allowance Balances for Post 1991 Direct Loans

As of June 30	2006	2005
<b>1. Beginning Balance of the Subsidy Cost Allowance</b>	\$ 0.00	\$ 0.00
<b>2. Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component</b>		
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
<b>E. Total of the above Subsidy Expense Components</b>	\$ 0.00	\$ 0.00
<b>3. Adjustments</b>		
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
<b>G. Total of the above Adjustment Components</b>	\$ 0.00	\$ 0.00
<b>4. Ending Balance of the Subsidy Cost Allowance before Re-estimates</b>	\$ 0.00	\$ 0.00
<b>5. Add or Subtract Subsidy Re-estimates by Component</b>		
A. Interest Rate Re-estimate	\$ 0.00	\$ 0.00
B. Technical/Default Reestimate	0.00	0.00
<b>C. Total of the above Reestimate Components</b>	\$ 0.00	\$ 0.00
<b>6. Ending Balance of the Subsidy Cost Allowance</b>	\$ 0.00	\$ 0.00

## Defaulted Guaranteed Loans from Post FY 1991 Guarantees

As of June 30	2006	2005
<b>Loan Guarantee Program(s)</b>		
<b>1. Military Housing Privatization Initiative</b>		
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
<b>2. Armament Retooling &amp; Manufacturing Support Initiative</b>		
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
<b>3. Total Value of Assets Related to Defaulted Guaranteed Loans Receivable</b>	\$ 0.00	\$ 0.00

## Guaranteed Loans Outstanding

As of June 30	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
<b>Guaranteed Loans Outstanding</b>		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	\$ 0.00	\$ 0.00
<b>3. Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
<b>2006</b>		
<b>New Guaranteed Loans Disbursed</b>		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	\$ 0.00	\$ 0.00
<b>3. Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
<b>2005</b>		
<b>New Guaranteed Loans Disbursed</b>		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	\$ 0.00	\$ 0.00
<b>3. Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>

**Liabilities for Post FY 1991 Loan Guarantees, Present Value**

As of June 30	2006	2005
<b>Loan Guarantee Program(s)</b>		
1. Military Housing Privatization Initiative	\$ 0.00	\$ 0.00
2. Armament Retooling & Manufacturing Support Initiative	0.00	0.00
<b>3. Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>

## Subsidy Expense for Post FY 1991 Loan Guarantees

As of June 30

2006	Interest Differential	Defaults	Fees	Other	Total
<b>1. New Loan Guarantees Disbursed:</b>					
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
<b>Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
2005	Interest Differential	Defaults	Fees	Other	Total
<b>2. New Loan Guarantees Disbursed:</b>					
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
<b>Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
2006	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
<b>3. Modifications and Reestimates:</b>					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0	\$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0	0.00
<b>Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
2005	Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates	Total
<b>4. Modifications and Reestimates:</b>					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0	\$ 0.00
Armament Retooling & Manufacturing Support Initiative	0.00	0.00	0.00	0	0.00
<b>Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
2006	2005				
<b>5. Total Loan Guarantee:</b>					
Military Housing Privatization Initiative	\$ 0.00	\$ 0.00			
Armament Retooling & Manufacturing Support Initiative	0.00	0.00			
<b>Total</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>			

**Subsidy Rates for Loan Guarantees**

As of June 30	Interest Supplements	Defaults	Fees and other Collections	Other	Total
<b>Loan Guarantee Programs:</b>					
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%

<b>Schedule for Reconciling Loan Guarantee Liability Balances for Post FY 1991 Loan Guarantees</b>
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As of June 30	2006	2005
<b>1. Beginning Balance of the Loan Guarantee Liability</b>	\$ 0.00	\$ 0.00
<b>2. Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component</b>		
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
<b>E. Total of the above Subsidy Expense Components</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
<b>3. Adjustments</b>		
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
<b>H. Total of the above Adjustments</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
<b>4. Ending Balance of the Loan Guarantee Liability before Reestimates</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
<b>5. Add or Subtract Subsidy Reestimates by Component</b>		
A. Interest Rate Reestimate	0.00	0.00
B. Technical/default Reestimate	0.00	0.00
<b>C. Total of the above Reestimate Components</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
<b>6. Ending Balance of the Loan Guarantee Liability</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>

Navy Working Capital Fund

**Administrative Expenses**

<b>Note 9.</b>	<b>Inventory and Related Property</b>
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As of June 30	2006	2005
1. Inventory, Net	\$ 13,097,936,764.51	\$ 15,432,367,134.89
2. Operating Materials & Supplies, Net	591,597,165.02	709,533,374.88
3. Stockpile Materials, Net	0.00	0.00
<b>4. Total</b>	<b>\$ 13,689,533,929.53</b>	<b>\$ 16,141,900,509.77</b>

**Abnormalities and/or Fluctuations**

Total Inventory and Related Property decreased \$2.5 billion, 15%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The majority of this decrease was attributable to Inventory, Net. The decrease is described in the following section.

## Inventory, Net

As of June 30	2006			2005	Valuation Method
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	
<b>1. Inventory Categories</b>					
A. Available and Purchased for Resale	\$ 24,851,618,914.93	\$ (24,026,713,099.56)	824,905,815.37	\$ 4,359,061,894.07	LAC,MAC
B. Held for Repair	11,570,204,825.70	317,620,229.57	11,887,825,055.27	10,695,469,848.39	LAC,MAC
C. Excess, Obsolete, and Unserviceable	1,185,385,017.69	(1,185,385,017.69)	0.00	0.00	NRV
D. Raw Materials	0.00	0.00	0.00	0.00	MAC,SP,LAC
E. Work in Process	385,205,893.87	0.00	385,205,893.87	377,835,392.43	AC
<b>F. Total</b>	<b>\$ 37,992,414,652.19</b>	<b>\$ (24,894,477,887.68)</b>	<b>13,097,936,764.51</b>	<b>\$ 15,432,367,134.89</b>	

### 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:

### Abnormalities and/or Fluctuations

Total Inventory, Net (Line 1.F.) decreased by \$2.3 billion, 15%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The primary drivers of this decrease are attributed to Supply Management, Navy (NAVSUP). The decrease is due to the disposal of inventory within the normal business process that is beyond economic repair, above required retention level and obsolete weapon systems. There were also increased disposals due to the retirement of the F-14 aircraft program during 3<sup>rd</sup> Quarter, FY 2006.

### Restrictions on Inventory Use, Sale, or Disposition

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

### Composition of Inventory

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

### Inventory Categories

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

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

In June 2006, Supply Management, Navy executed the required transfer of War Reserve Material to Navy General Fund. There are no amounts included in Inventory Available and Purchased for Resale (Line 1.A) for War Reserve Material.

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 reflects a net realizable value of zero.

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

### **Inventory Work in Process**

Work in Process at Depot Maintenance activities and Research and Development activities of approximately \$181.0 million and \$206.2 million respectively, is included as inventory Work in Process in Note 9.A. This amount represents work that has been completed, expenses incurred, and waiting to be billed to the customer.

### **Changes in Accounting Methods**

The Enterprise Resource Planning (ERP) Supply Maintenance Aviation Re-engineering Team (SMART) Pilot concluded its objectives in April 2005, transferring \$1.9 billion at Latest Acquisition Cost (LAC) into Material Financial Control System (MFCS).

**Decision Criteria for Identifying the Category to which Inventory is Assigned.**

In order to standardize reporting of the categories Held for Use, Held for Repair, and Excess, Obsolete, Unserviceable, DON implemented the Under Secretary of Defense (Comptroller) (USD(C) condition code crosswalk as defined in the memorandum “Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies,” dated August 12, 2002. In addition, the condition code crosswalk was amended to include code “V” in the Excess, Obsolete, Unserviceable category in September 2002.

<b>Inventory Category</b>	<b>Condition Code</b>
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

**Changes in the Criteria for Identifying the Category to which Inventory is Assigned.**

None

**Other Disclosures Related to Inventory**

The general ledger values in the accounting system do not reconcile with the supporting detail record in the Navy segment of the Supply Management Activity logistics system. Supply Management, Navy (NAVSUP) has determined that program changes must be made to MFCS to correct systemic posting problems, which contribute to a reconciling difference between the systems. Twenty-four (24) reconciliation System Change Requests (SCR) for Phase Two have been implemented at the NAVSUP field activity. The NAVSUP is working with the field activity to determine journal voucher accounts and values. Once that is completed, the journal vouchers will be submitted to the Office of Financial Operations (FMO) and the Defense Finance and Accounting Service (DFAS). Once the journal vouchers and the adjustments posting logic SCR are approved, funded, and developed, the final adjustments will be made to inventory and financial systems to align data. Adjustments are planned to occur in 4<sup>th</sup> Quarter, FY 2006.

## Operating Materials and Supplies, Net

As of June 30	2006			2005	Valuation Method
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	
<b>1. OM&amp;S Categories</b>					
A. Held for Use	\$ 591,597,165.02	\$ 0.00	\$ 591,597,165.02	\$ 709,533,374.88	SP, LAC
B. Held for Repair	0.00	0.00	0.00	0.00	SP, LAC
C. Excess, Obsolete, and Unserviceable	0.00	0.00	0.00	0.00	NRV
<b>D. Total</b>	<b>\$ 591,597,165.02</b>	<b>\$ 0.00</b>	<b>\$ 591,597,165.02</b>	<b>\$ 709,533,374.88</b>	

### Legend for Valuation Methods:

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

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

### Fluctuations and/or Abnormalities

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

### Restrictions on OM&S

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

### Changes From Prior Year's Accounting Methods

None

### 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 Navy Working Capital I Fund (NWCF) reports that \$11.9 million of OM&S categorized as Held for Future Use and is included in the "Held for Use" category.

### Government Furnished Material (GFM) and Contractor Acquired Material (CAM)

Generally, the values of NWCF's GFM and CAM in the hands of contractors are not included in OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in other existing logistics systems in accordance with Volume 6B, Chapter 10 of DoD Financial Management Regulation (FMR).

### Decision Criteria for Identifying OM&S Category

In order to standardize reporting of the categories Held for Use, Held for Repair, and Excess, Obsolete, Unserviceable, DODN implemented the Under Secretary of Defense (Comptroller) (USD(C) condition

code crosswalk as defined in the memorandum “Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies,” dated August 12, 2002. In addition, the condition code crosswalk was amended to include code “V” in the Excess, Obsolete, Unserviceable category in September 2002.

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

**Changes in Criteria for Identifying OM&S Category**

None

**Other Disclosures Related to OM&S**

None

## Stockpile Materials, Net

As of June 30	2006			2005	
	Stockpile Materials Amount	Allowance for Gains (Losses)	Stockpile Materials, Net	Stockpile Materials, Net	Valuation Method
<b>1. Stockpile Materials Categories</b>					
A. Held for Sale	\$ 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	AC, LCM
C. Total	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	

**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 June 30	2006					2005	
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value	
<b>1. Major Asset Classes</b>							
A. Land	N/A	N/A	\$ 45,822,108.76	N/A	\$ 45,822,108.76	\$ 45,842,495.76	
B. Buildings, Structures, and Facilities	S/L	20 Or 40	5,919,657,139.81	\$ (3,896,386,286.34)	2,023,270,853.47	1,985,232,499.21	
C. Leasehold Improvements	S/L	lease term	302,302.82	(216,650.34)	85,652.48	115,882.76	
D. Software	S/L	2-5 Or 10	479,668,844.94	(277,208,462.69)	202,460,382.25	207,153,422.23	
E. General Equipment	S/L	5 or 10	3,288,294,121.64	(2,562,095,385.55)	726,198,736.09	862,009,372.08	
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	706,022,293.39	N/A	706,022,293.39	674,723,501.18	
I. Other			8,188,924.00	0.00	8,188,924.00	11,461,666.90	
J. Total General PP&E			\$ 10,447,955,735.36	\$ (6,735,906,784.92)	\$ 3,712,048,950.44	\$ 3,786,538,840.12	

<sup>1</sup> Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

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

**3. Information Related to General Property, Plant and Equipment (GPP&E):****Abnormalities and/or Fluctuations**

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

**Adjustments Resulting From Changes in Accounting Standards**

None

**Military Equipment**

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

**Heritage Assets and Stewardship Land**

Heritage assets and stewardship land are reported on the books of the Department DON.

**Contractor Held GPP&E**

For those activities with GPP&E real property in the possession of contractors, the value of this real property is included in the values reported for the Major Asset Classes of Buildings, Structures, and Facilities. The value of personal property in Major Asset Classes of Automated Data Processing Software and Equipment does not include all of the GPP&E in the possession of contractors. The net book amount of such property is immaterial in relation to the total GPP&E net book value. In accordance with an approved strategy with the Office of Management and Budget, the Government Accountability Office, and the Inspector General Department of Defense, the Department of Defense is developing new policies and a contractor reporting process to capture GPP&E information for future reporting purposes for compliance with federal accounting standards.

**Other Disclosures Related to GPP&E**

Supply Management, Navy has initiatives underway to identify corrective actions for the reporting of land, buildings, and software during FY 2006. These deficiencies were identified in the DON's Financial Improvement Program.

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

<b>Assets Under Capital Lease</b>
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As of June 30	2006	2005
<b>1. Entity as Lessee, Assets Under Capital Lease</b>		
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.

**Other Disclosures Related to Assets Under Capital Lease**

No further disclosures required.

<b>Note 11.</b>	<b>Liabilities Not Covered by Budgetary Resources</b>
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As of June 30	2006	2005
<b>1. Intragovernmental Liabilities</b>		
A. Accounts Payable	\$ 0.00	\$ 0.00
B. Debt	0.00	0.00
C. Other	2,887,233.97	5,220,619.84
<b>D. Total Intragovernmental Liabilities</b>	<b>\$ 2,887,233.97</b>	<b>\$ 5,220,619.84</b>
<b>2. Nonfederal Liabilities</b>		
A. Accounts Payable	\$ 0.00	\$ 0.00
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	1,192,551,548.64	1,168,225,461.54
C. Environmental Liabilities	0.00	0.00
D. Other Liabilities	0.00	0.00
<b>E. Total Nonfederal Liabilities</b>	<b>\$ 1,192,551,548.64</b>	<b>\$ 1,168,225,461.54</b>
<b>3. Total Liabilities Not Covered by Budgetary Resources</b>	<b>\$ 1,195,438,782.61</b>	<b>\$ 1,173,446,081.38</b>
<b>4. Total Liabilities Covered by Budgetary Resources</b>	<b>\$ 5,552,687,738.80</b>	<b>\$ 6,686,829,995.92</b>
<b>5. Total Liabilities</b>	<b>\$ 6,748,126,521.41</b>	<b>\$ 7,860,276,077.30</b>
<b>6. Information Related to Liabilities Not Covered and Covered by Budgetary Resources:</b>		

**Abnormalities and/or Fluctuation**

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

**Definitions**

Liabilities Not Covered by Budgetary Resources are those liabilities that are not considered covered as of the balance sheet date.

The Other Intragovernmental Liabilities amount of \$2.9 million represents interest, penalties, fines & administrative fees. These fees do not belong to the NWCF and will be distributed directly to the Department of Treasury.

**Other Disclosures Related to Liabilities Not Covered by Budgetary Resources**

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

There are no reported Nonfederal Other Liabilities.



<b>Note 12.</b>	<b>Accounts Payable</b>
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As of June 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
1. Intragovernmental Payables	\$ 210,650,489.72	\$ N/A	\$ 210,650,489.72	\$ 169,552,270.73
2. Nonfederal Payables (to the Public)	1,648,060,610.71	0.00	1,648,060,610.71	2,066,850,851.06
<b>3. Total</b>	<u>\$ 1,858,711,100.43</u>	<u>\$ 0.00</u>	<u>\$ 1,858,711,100.43</u>	<u>\$ 2,236,403,121.79</u>

**4. Information Related to Accounts Payable:**

**Abnormalities and/or Fluctuations**

Intragovernmental Accounts Payable (Line 1) increased \$41.1 million, 24%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The primary drivers of the increase are summarized below:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Transportation, (Military Sealift Command)	25,377		The increase is due to the increase in program costs for the Naval Fleet Auxiliary Program. Also, the Military Sealift Command (MSC) has experienced significant increases in the Defense Energy Service Center (DESC) fuel costs. This increase in fuel costs contributed to the increase..
Research and Development, (Naval Air Warfare Center)	3,970		Intragovernmental Accounts Payable increased as a result of the continued efforts to clear unmatched and unsupported disbursements during 3rd Quarter, FY 2006.
<b>Totals</b>	<b>29,347</b>		

Nonfederal Accounts Payable (Line 2) decreased \$418.8 million, 20%, from 3<sup>rd</sup> Quarter FY 2005, to 3<sup>rd</sup> Quarter, FY 2006. The primary drivers of the increase related to Component required quarter end adjustments. Buyer side trading partner adjustments, and adjustments for unsupported or undistributed payables in current quarter were greater than similar adjustments made in 3<sup>rd</sup> quarter FY 2005 by \$386.7 million. Due to system weakness, and internal weakness identified within DoD, NWCF is unable to fully reconcile intragovernmental transactions with all federal partners.

**Definition**

Intragovernmental accounts payable consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Interest, penalties, and administrative fees are not applicable to intragovernmental accounts payables. Nonfederal accounts payable are payments to nonfederal government entities (to the public).

### **Undistributed Disbursements**

Undistributed disbursements are the difference between disbursements/collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on the accounting reports. In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end.

### **Allocation of Undistributed Disbursements**

The Department of Defense (DoD) policy requires allocating supported undistributed disbursements between federal and nonfederal categories based on the percentage of federal and nonfederal Accounts Payable. Supported undistributed disbursements in the amount of \$404.2 million have been applied against accounts payable. Unsupported undistributed disbursements have been recorded in United States Standard General Ledger account 2120, Disbursements in Transit. Accounts Payable was adjusted downward by \$477.2 million for in-transit payments. NWCF followed this allocation policy.

### **Composition of Undistributed Disbursements**

The majority of the undistributed disbursements represent Mechanization of Contract Administration Services (MOCAS) payments, which have not been liquidated. MOCAS payments represent those payments made to contractors for materials or services. Accruals are made when the service is performed and remain in this account until the provider submits an invoice for payment. Therefore, if a copy of the invoice is not received by the NWCF activity prior to the Defense Finance and Accounting Service making payment, the payment will go to undistributed disbursements. The amounts accrued to cover the anticipated materials and services are captured as Contract Accruals on the Other Accrued Expense line (Note 15.A., Other Liabilities, Nonfederal: Other Liabilities) and are not considered accounts payable.

### **Trading Partner Data**

For the majority of intra agency sales, NWCF's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the NWCF was unable to reconcile the majority of its intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payable. Through an ongoing Business Transformation Agency effort, DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations. The Department of the Navy (DON) has outlined some processes for review and implementation in the DON Financial Improvement Plan, which should provide some near-term solutions.

### **Eliminating Adjustments**

The DoD summary level seller accounts receivables were compared to NWCF's accounts payable. An adjustment was posted to the NWCF's accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to the NWCF. As required, adjustments were made to reclassify accounts payable from federal to nonfederal.

### Other Disclosures Related to Accounts Payable

Analysis of the NWCF accounts payable reveals that the variances discussed above are a result of business processes, not specific business events. The business processes of identifying unsupported undistributed, eliminations, and trading partner data results in the majority of the variances in both intragovernmental and nonfederal accounts payable are detailed below:

(Amounts in thousands)

<b>Intragovernmental Accounts Payable</b>	<b>3rd Qtr FY 2006 Trial Balance Amount</b>	<b>3rd Qtr FY 2005 Trial Balance Amount</b>	<b>Change</b>	<b>Change %</b>
Accounts Payable Prior to Adjustments	323,829	864,546	-540,717	-63%
Unsupported Undistributed	36,079	-50,631	86,710	-171%
Trading Partner	-40,172	-549,214	509,042	-93%
Eliminations	-109,085	-95,149	-13,936	15%
Other	0	0	0	0%
<b>Total</b>	<b>210,651</b>	<b>169,552</b>	<b>41,099</b>	<b>24%</b>

(Amounts in thousands)

<b>Nonfederal Accounts Payable</b>	<b>3rd Qtr FY 2006 Trial Balance Amount</b>	<b>3rd Qtr FY 2005 Trial Balance Amount</b>	<b>Change</b>	<b>Change %</b>
Accounts Payable Prior to Adjustments	1,643,968	1,676,098	-32,130	-2%
Unsupported Undistributed	-36,079	50,631	-86,710	-171%
Trading Partner	40,172	340,122	299,950	-88%
Other	0	0	0	0%
<b>Total</b>	<b>1,648,061</b>	<b>2,066,851</b>	<b>418,790</b>	<b>-20%</b>

<b>Note 13.</b>	<b>Debt</b>
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As of June 30	2006			2005	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
<b>1. Agency Debt (Intragovernmental)</b>					
A. Debt to the Treasury	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
B. Debt to the Federal Financing Bank	381,518,390.03	(115,524,674.03)	265,993,716.00	(2,367,615.10)	503,910,102.26
C. Total Agency Debt	\$ 381,518,390.03	\$ (115,524,674.03)	\$ 265,993,716.00	\$ (2,367,615.10)	\$ 503,910,102.26
<b>2. Total Debt</b>	<b>\$ 381,518,390.03</b>	<b>\$ (115,524,674.03)</b>	<b>\$ 265,993,716.00</b>	<b>\$ (2,367,615.10)</b>	<b>\$ 503,910,102.26</b>

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

Intragovernmental Debt decreased \$237.9 million, 47%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. This decrease was a result of the required principal payments for the Maritime Prepositioning Ships (MPS) loan in July 2005 and in January 2006; and Military Sealift Command paid off three MPS under this long term charter in January 2006 valued at \$217 million.

**Other Information Related to Debt**

The Afloat Prepositioning Force – Navy (APF-N) program, with Congressional approval, provides ships for time charter to meet requirements not available in the marketplace. These ships are built or converted by private interim vessel owners using private, non-government financing obtained from various banking institutions. There were no payments made by the government during the building/conversion phase. APF-N 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 Federal Financing Bank (FFB) is one of the institutions that provided loans to the vessel owners. The FFB is reporting a debt in the amount of \$266.0 million, which represents an outstanding principal balance of \$257.4 million and accrued interest payable of \$8.6 million, for the Military Sealift Command. The Military Sealift Command does not owe this debt to the FFB. This debt is a public debt owed by the private vessel owners. In order to simplify the payments to the FFB and to meet its requirements, the FFB cross-disburses the semi-annual principal and interest payments directly from the Navy Working Capital Fund (NWCF). This is done instead of having the Military Sealift Command make Capital Hire payments to the vessel owners, who would in turn make its loan obligation payments to the FFB.

The direction of the vessel owner to have the government make payments directly to a bank, in this case the FFB, is not an uncommon practice, 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, FFB when establishing the loan coded the loan as a government debt.

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

As required by the Department of Defense Appropriations Act passed in December 1985, 10 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.

<b>Note 14.</b>	<b>Environmental Liabilities and Disposal Liabilities</b>
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As of June 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
<b>1. Environmental Liabilities--</b>				
<b>Nonfederal</b>				
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
2. Active Installations—Military Munitions Response Program (MMRP)	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
4. Formerly Used Defense Sites--MMRP	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
2. Environmental Closure Requirements	0.00	0.00	0.00	0.00
3. Environmental Response at Operational Ranges	0.00	0.00	0.00	0.00
4. Other	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
2. Military Munitions Response Program	0.00	0.00	0.00	0.00
3. Environmental Corrective Action / Closure Requirements	0.00	0.00	0.00	0.00
4. Other	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
2. Nuclear Powered Submarines	0.00	0.00	0.00	0.00
3. Other Nuclear Powered Ships	0.00	0.00	0.00	0.00
4. Other National Defense Weapons Systems	0.00	0.00	0.00	0.00
5. Chemical Weapons Disposal Program	0.00	0.00	0.00	0.00
6. Other	0.00	0.00	0.00	0.00
<b>2. Total Environmental Liabilities</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>

Not Applicable.

## Environmental Disclosures

As of June 30	2006	2005
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

<b>Note 15.</b>	<b>Other Liabilities</b>
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As of June 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
<b>1. Intragovernmental</b>				
A. Advances from Others	\$ 228,581,739.68	\$ 0.00	\$ 228,581,739.68	\$ 561,277,244.67
B. Deposit Funds and Suspend 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	21,293,159.95	0.00	21,293,159.95	58,793,882.97
<b>G. Total Intragovernmental Other Liabilities</b>	<b>\$ 249,874,899.63</b>	<b>\$ 0.00</b>	<b>\$ 249,874,899.63</b>	<b>\$ 620,071,127.64</b>
<b>2. Nonfederal</b>				
A. Accrued Funded Payroll and Benefits	\$ 741,071,355.84	\$ 0.00	\$ 741,071,355.84	\$ 743,420,984.17
B. Advances from Others	209,784,278.69	0.00	209,784,278.69	132,243,880.80
C. Deferred Credits	11,800,000.00	0.00	11,800,000.00	0.00
D. Deposit Funds and Suspend Accounts	94,849,351.94	0.00	94,849,351.94	348,307,342.91
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	2,122,757,987.36	732,282.88	2,123,490,270.24	2,107,694,056.19
<b>J. Total Nonfederal Other Liabilities</b>	<b>\$ 3,180,262,973.83</b>	<b>\$ 732,282.88</b>	<b>\$ 3,180,995,256.71</b>	<b>\$ 3,331,666,264.07</b>
<b>3. Total Other Liabilities</b>	<b>\$ 3,430,137,873.46</b>	<b>\$ 732,282.88</b>	<b>\$ 3,430,870,156.34</b>	<b>\$ 3,951,737,391.71</b>
<b>4. Information Related to Other Liabilities:</b>				

## Abnormalities and/or Fluctuations

The Total Intragovernmental Other Liabilities (Line 1.G) decreased by \$370.2 million, 60%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. This decrease is primarily attributable to Intragovernmental Advances from Others (Line 1.A) decreasing by \$332.7 million. The primary drivers of this decrease are as follows:

(Amounts in thousands)

Business Activity	Increases	Decreases	Explanations
Depot Maintenance (Shipyards)		198,468	The decrease is the result of the liquidation of advance billings. Advance revenues recognition decreased by at the Puget Sound Naval shipyard as it transitions out of the Navy Working Capital Fund during FY 2006.
Research and Development (Space and Naval Warfare Systems Center)		58,524	The decrease in advances from others is the result of higher execution levels than normal due to emergent workload from federal agencies associated with the Global War on Terror. The FY 2006 results for 3 <sup>rd</sup> Quarter, FY 2006 reflect a return to more normal execution levels.
Supply Management (Navy)		55,888	The decrease is a result of an adjustment of the Cooperative Logistics Supply Support Agreement (CLSSA) advances from Intragovernmental Other Liabilities to Nonfederal Other Liabilities due to a system error that results in these advances being recorded as incorrectly. The system will be corrected in 4 <sup>th</sup> Quarter, FY 2006.
<b>Total</b>		<b>312,880</b>	

### Composition of Other Liabilities (Line 1.F)

Intragovernmental Other Liabilities represents liabilities of:

	(Thousands)
• Health Benefits	\$ 8,146
• Life Insurance	182
• Retirement Benefits	10,078
• Custodial Liabilities	<u>2,887</u>
Total	<u>\$ 21,293</u>

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

Nonfederal Other Liabilities (Line 2.I) total \$2.1 billion in 3<sup>rd</sup> Quarter, FY 2006, which includes amounts that are significant portions of the total liabilities presented in the Navy Working Capital Fund (NWCF) Balance Sheet. A breakout of the major components of Nonfederal Other Liabilities follows:

a. Accrual of Contractual Services total \$1.6 billion. 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 totals \$450.5 million. This 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 other liabilities amount includes Property Furnished by Other Liability and totals \$95.8 million. This account is used to record intrafund transfers of assets when such transfers are between activities with different reporting systems (e.g. Financial Inventory Reporting activities transfer assets with Transactions Item Reporting activities). The logic currently in place was approved by the Defense Finance and Accounting Service upon implementation of the Material Financial Control System.

The remainder of the other liabilities total \$1.9 million. This amount consists of Progress Payments, which 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 DoD.

#### **Intragovernmental Reconciliation for Fiduciary Transactions with Department of Labor (DOL)**

With respect to the major fiduciary balances, NWCF was able to reconcile with the DOL.

#### **Other Disclosures Related to Other Liabilities**

No further disclosures required.

## Capital Lease Liability

As of June 30	2006				2005	
	Asset Category					
	Land and Buildings	Equipment	Other	Total	Total	
<b>1. Future Payments Due</b>						
A. 2006	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
B. 2007	0.00	0.00	0.00	0.00	0.00	0.00
C. 2008	0.00	0.00	0.00	0.00	0.00	0.00
D. 2009	0.00	0.00	0.00	0.00	0.00	0.00
E. 2010	0.00	0.00	0.00	0.00	0.00	0.00
F. 2011	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
<b>2. Capital Lease Liabilities Covered by Budgetary Resources</b>				\$ 0.00	\$ 0.00	\$ 0.00
<b>3. Capital Lease Liabilities Not Covered by Budgetary Resources</b>				\$ 0.00	\$ 0.00	\$ 0.00

Not Applicable.

<b>Note 16.</b>	<b>Commitments and Contingencies</b>
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**Information Related to Commitments and Contingencies:**

**Legal Contingencies:**

The Department of the Navy (DON) is a party in various administrative proceedings and legal actions, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from the Department's resources, either directly or by reimbursement to the Judgment Fund. The DON records Judgment Fund liabilities in Accounts Payable, which are detailed in Note 12.

For fiscal year (FY) 2005, the Navy Working Capital Fund (NWCF) materiality threshold for reporting litigation, claims, or assessments was \$6.0 million. The materiality threshold for FY 2006 has been set at \$5.0 million. Based on information contained in the FY 2005 Legal Representation Letters, management does not have sufficient reason to believe that it is likely that the Government will be liable for the maximum amounts claimed in individual or aggregated cases.

The NWCF currently has eight cases that meet the existing FY 2005 materiality threshold. DON legal counsel was unable to express an opinion concerning the likely outcome of these cases. The Legal Representation Letters will be updated in the 4<sup>th</sup> Quarter, FY 2006 using the new materiality threshold of \$5.0 million

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

The NWCF does have contractual arrangements which may require future financial obligations (e.g. undelivered orders). The NWCF is unable to determine the amount at this time due system limitations.

**Other Commitments and Contingencies**

No further disclosures required.

<b>Note 17.</b>	<b>Military Retirement Benefits and Other Employment Related Actuarial Liabilities</b>
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As of June 30	2006			2005	
	Actuarial Present Value of Projected Plan Benefits	Assume Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
<b>1. Pension and Health Benefits</b>					
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 Benefits	\$ 0.00		\$ 0.00	\$ 0.00	\$ 0.00
<b>2. Other</b>					
A. FECA	\$ 1,192,551,548.64		\$ 0.00	\$ 1,192,551,548.64	\$ 1,168,225,461.54
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	\$ 1,192,551,548.64		\$ 0.00	\$ 1,192,551,548.64	\$ 1,168,225,461.54
<b>3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:</b>	<b>\$ 1,192,551,548.64</b>		<b>\$ 0.00</b>	<b>\$ 1,192,551,548.64</b>	<b>\$ 1,168,225,461.54</b>

Actuarial Cost Method Used:

Assumptions:

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

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

##### Abnormalities and/or Fluctuations

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

##### Actuarial Cost Method Used

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

## **Assumptions**

The assumptions relate to Federal Employees' Compensation Act (FECA). The projected annual benefit payments are discounted to the present value using OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost-of-living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. The interest rate assumptions used in the discount calculations are as follows for June 30, 2006:

4.5285 percent in year 1,  
5.020 percent in year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors, cost of living adjustments (COLAs), medical inflation factors, and consumer price index medical (CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2005 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:

<b><u>CBY</u></b>	<b><u>COLA</u></b>	<b><u>CPIM</u></b>
2006	3.33%	4.09%
2007	2.93%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.01%
2010+	2.40%	4.01%

## **Changes in Actuarial Liability**

There have been no changes in the calculation of actuarial liability since last reporting period.

## **Market Value of Investments in Market-based and Marketable Securities**

Not Applicable.

<b>Note 18.</b>	<b>General Disclosures Related to the Statement of Net Cost</b>
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Intragovernmental Costs and Exchange Revenue		
As of June 30	2006	2005

As of June 30	2006	2005
1. Intragovernmental Costs	\$ 3,465,522,592.26	\$ 3,244,443,057.15
2. Public Costs	14,292,392,897.01	15,207,926,946.68
<b>3. Total Costs</b>	<b>\$ 17,757,915,489.27</b>	<b>\$ 18,452,370,003.83</b>
4. Intragovernmental Earned Revenue	\$ (15,067,837,520.82)	\$ (15,161,140,739.66)
5. Public Earned Revenue	(726,584,626.64)	(1,412,115,445.99)
<b>6. Total Earned Revenue</b>	<b>\$ (15,794,422,147.46)</b>	<b>\$ (16,573,256,185.65)</b>
<b>7. Net Cost of Operations</b>	<b>\$ 1,963,493,341.81</b>	<b>\$ 1,879,113,818.18</b>

**Information Related to the Statement of Net Cost:****Abnormalities and/or Fluctuations**

Net Cost of Operations (Line 7) increased \$84.4 million, 4%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The primary drivers of this increase are described below:

- Total Costs (Line 3) decreased \$694.5 million, 4%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The primary drivers of this decrease are summarized below:
  - Intragovernmental Costs (Line 1) increased by \$221.1 million, 7%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. An increase of \$216 million is attributed to Base Support, Public Works Centers in FY 2006 due to the new Installation Claimant Consolidation (ICC2) sites and the integration of the Public Works Detachments at all Naval Facilities Engineering Centers.

- Public Costs (Line 2) decreased by \$915.5 million, 6%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006 due to the following events:

(Amounts in thousands)

<b>Business Area</b>	<b>Increase</b>	<b>Decrease</b>	<b>Explanation</b>
Supply Management (Navy)		574,476	Previously unrecognized expenses associated with the system that tracks the return of items (carcass) were recognized in 3 <sup>rd</sup> Quarter, FY 2005 as a current period adjustment. Subsequent reporting periods reflect a lower expense value as a result of this adjustment. The Enterprise Resource Planning Supply Maintenance Aviation Re-engineering Team (SMART ERP) pilot termination caused a return to a legacy system inventory value. This termination caused an adjustment in 3 <sup>rd</sup> Quarter, FY 2005 for \$215,000 in inventory value from Moving Average Cost to Latest Acquisition Cost, therefore reducing net cost.
Research and Development (Naval Surface Warfare Center)		24,117	The decrease is attributable to a decrease in general and administrative labor; general and administrative contractual costs; and production contractual costs in 1 <sup>st</sup> Quarter, FY 2006 and subsequent quarters due to decreased workload execution during 1 <sup>st</sup> Quarter, FY 2006 and subsequent reporting periods.
Research and Development (Naval Undersea Warfare Center)		13,880	The decrease is attributable to a decrease in labor and other expenses for the service cost centers due to decreased workload execution during 1 <sup>st</sup> Quarter, FY 2006 and subsequent reporting periods.
Depot Maintenance (Aviation)		41,007	This decrease is due to workload in material component repair work starting in 1 <sup>st</sup> Qtr FY 2006 and expanding in subsequent quarters. Some component units had to be scrapped, some were identified incorrectly, and others were awaiting parts. Also there was a material shortage for Rotor Heads, H-53 and H-46 Transmissions, Rotor Blades, various Landing Gear parts, hydraulic parts creating work stoppages.
<b>Total</b>		<b>653,480</b>	

- Total Earned Revenue (Line 6) decreased by \$778.8 million, 5%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. The primary driver of this decrease is described below:

- Intragovernmental Earned Revenue (Line 4) decreased \$93.3 million, less than 1%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006.
- Public Earned Revenue (Line 5) decreased \$685.5 million, 49%, from 3<sup>rd</sup> Quarter, FY 2005 to 3<sup>rd</sup> Quarter, FY 2006. A decrease of \$642.7 is attributable to Supply Management, Navy's one-time financial transfer of material in May 2005, from moving average cost in SMART ERP to latest acquisition cost in MFCS. The increased value of material was recorded as an Other Gain (financing source). This Other Gain (financing source) closed at the end of FY 2005 and is reflected in Cumulative Results of Operations.

### **Composition of Statement of Net Cost**

The Navy Working Capital Fund (NWCF) generally records transactions on an accrual basis as required by Federal generally accepted accounting principles (GAAP). Information presented on the Statement of Net Cost represents the net result of post closing adjustments and eliminating entries made in compiling and consolidating the NWCF financial statements. These entries significantly affected the reported amounts of Intragovernmental Program Cost, Program Cost with the Public, Earned Revenue and Net Program Cost. The post closing adjustments were made in order to increase or decrease certain NWCF account balances reported as of June 30, 2006 to ensure agreement with related balances reported by other Department of Defense (DoD) and other federal reporting entities. Eliminating entries are required adjustments made as part of the financial process. This process enables the matching of trading partner data recorded at each financial statement consolidation level: the NWCF, DoD and Federal Government levels.

### **Other Disclosures Related to the Statement of Net Cost**

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

The NWCF is able to compare, but is unable to validate its intragovernmental costs and revenues with corresponding balances of its intragovernmental trading partners. There were no material differences identified during the 2<sup>nd</sup> Quarter, FY 2006.

The NWCF does not report any heritage assets or stewardship land.

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

undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the current revision of its accounting systems to record transactions based on the 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 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.

<b>Note 19.</b>	<b>Disclosures Related to the Statement of Changes in Net Position</b>
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As of June 30	2006		2005	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<b>1. Prior Period Adjustments</b>				
<b>Increases (Decreases) to Net Position Beginning Balance</b>				
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
<b>C. Total Prior Period Adjustments</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>	<b>\$ 0.00</b>
<b>2. Imputed Financing</b>				
A. Civilian CSRS/FERS Retirement	\$ 165,292,468.08	\$ 0.00	\$ 172,700,842.14	\$ 0.00
B. Civilian Health	247,434,264.00	0.00	235,329,295.60	0.00
C. Civilian Life Insurance	747,672.27	0.00	732,428.63	0.00
D. Judgment Fund	0.00	0.00	0.00	0.00
E. IntraEntity	0.00	0.00	0.00	0.00
<b>F. Total Imputed Financing</b>	<b>\$ 413,474,404.35</b>	<b>\$ 0.00</b>	<b>\$ 408,762,566.37</b>	<b>\$ 0.00</b>

### 3. Information Related to the Statement of Changes in Net Position:

#### Abnormalities and/or Fluctuations

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

#### Imputed Financing

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

<b>Note 20.</b>	<b>Disclosures Related to the Statement of Budgetary Resources</b>
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As of June 30	2006	2005
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 7,964,253,216.11	\$ 7,809,263,059.45
2. Available Borrowing and Contract Authority at the End of the Period	9,459,717,911.45	8,521,457,860.35

### 3. Information Related to the Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) is an image of the monthly Report on Budget Execution, 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. The Department of the Navy (DON) and the Defense Finance and Accounting Service (DFAS) continue with the implementation of new accounting systems designed to produce both proprietary and budgetary reports and use the U S Standard General Ledger. The Defense Industrial Financial Management System (DIFMS) has been fully implemented at all Research and Development (R&D) activities that were scheduled for conversion. R&D activity Space and Naval Warfare Systems Center, San Diego has successfully implemented the Enterprise Resource Planning (ERP) pilot program (Project Cabrillo) thus moving off DIFMS. Also, the Naval Air Warfare Centers (NAWCs) have moved from DIFMS to their ERP pilot program "Sigma". The ERPs are programmed to complete the SBR at the activity level. The Defense Working Capital Fund Accounting System (DWAS) implementations have been completed. Although, these legacy systems have been replaced, the capability to produce the SBR and SF 133 is still being developed by the DON.

The change in Receivables from Federal Source line of the SBR includes USSGL 4251, Reimbursements and Other income Earned. The amount posted on this line is the ending balance less the beginning balance for the current fiscal year. In this case the ending balance is less than the beginning balance, which nets to a negative balance change for this fiscal year. This is a reflection of the DON aggressive efforts to collect on reimbursable operations; the fuel business transferred to Defense Logistics Agency; collections of aged outstanding fuel receivables and the continuing efforts between the DFAS partnering with the DON to reduce accounts receivable.

As of June 30, 2006, the SBR does not measure the NWCF's budget execution against budgetary resources. Budgetary resources are recorded in the accounting records and reported on the basis of customer orders received and contract authority invoked. On these reports, the spending authority from offsetting collections during the period of execution is based upon the approved President's Budget estimate of anticipated customer orders.

For the SBR, Supply Management's revenue is defined as gross sales less credit returns. For the balance sheet, revenue does not include credit returns because the inventory valuation model

considers credit returns as inventory allowances. The difference in “meanings” causes variances in the reports. On these budgetary reports, the net outlays (collections and disbursements) year to date is reported based on the amounts reported to U.S. Treasury from the Defense Cash Accountability System and Centralized Expenditures/Reimbursement Processing System.

As of June 30, 2006, the differences between the U.S. Treasury and the NWCF activity ledgers have been minimal, and the cause is related to timing or the type of transactions. The differences are recorded as undistributed disbursements and collections on the departmental reports. While there may be no impact upon the U.S. Treasury balance, the above differences have created distortions in the accounts receivable and accounts payable from a budgetary reporting perspective on the SBR. Also, problems with undistributed collections and disbursements have created abnormal balances for accounts receivable and accounts payable on the 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**

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

*(Amounts in thousands)*

Obligations Incurred – Direct	Line 8.A.	\$	0
Obligations Incurred – Reimbursable	Line 8.B.	\$	17,112,065
Exempt from apportionment	Line 9.B.	\$	0

### **Undelivered Orders**

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

### **Spending Authority from Offsetting Collections**

Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the "Adjustments" line on the SBR), are not included in the Spending Authority from Offsetting Collections and Adjustments line on the SBR or the Spending Authority for Offsetting Collections and Adjustments line on the Statement of Financing.

### **Other Disclosures Related to the Statement of Budgetary Resources**

No further disclosures required.

<b>Note 21.</b>	<b>Disclosures Related to the Statement of Financing</b>
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**Information Related to the Statement of Financing:**

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

The Defense Finance and Accounting Service (DFAS), Navy Working Capital Fund (NWCF) accounting systems, and Navy Enterprise Resource Planning include budgetary accounts. However, some of the legacy accounting systems do not include budgetary accounts, thus 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 the Statement of Financing line, Resources that Finance the Acquisition of Assets, was adjusted upward by \$1.3 billion at the end of 3<sup>rd</sup> Quarter, FY 2006 to bring it into balance with the Statement of Net Cost.

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

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

**Composition of Other Line**

The amount reported as Other (Line 9) on the Consolidated Statement of Financing is the result of the financial closure of three Navy Working Capital Fund (NWCF) activities during fiscal year 2006. On October 1, 1999, the Naval Weapons Station, Seal Beach and the Naval Weapons Station, Yorktown migrated from the NWCF to the Navy General Fund. Closure of the residual financial records occurred in the 2<sup>nd</sup> Quarter FY 2006. Public Works Center, San Francisco was operationally closed on September 27, 1997.

Closure of the residual financial records occurred in the 3<sup>rd</sup> Quarter FY 2006. The closure of the residual financial records for these activities resulted in a net loss to deferred accumulated operating results.

Other resources used to finance items not part of the net cost of operations (Line 16b) consists of \$58.2 million in transfers of assets out of the NWCF and \$228.0 million of net loss to deferred accumulated operating results explained above.

Other resources that do not affect net cost (Line 27d) consist of adjustments to inventory held for repair valuation accounts.

There were no allocation transfers.

Liabilities not covered by budgetary resources consist of nonentity assets (interest, penalties, fines and administrative fees) and Military Retirement Benefits and Other Employment Actuarial Liabilities for the Navy Working Capital Fund. There are no amounts for resources in future periods for the Navy Working Capital Fund as revenues are generated to cover liabilities during current years. Therefore, amounts reported as requiring resources in future periods do not have a relationship to liabilities not covered by budgetary resources.

<b>Note 22.</b>	<b>Disclosures Related to the Statement of Custodial Activity</b>
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Not Applicable.

<b>Note 23.</b>	<b>Earmarked Funds</b>
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<b>BALANCE SHEET</b>				
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As of June 30

MRF

MERHCF

Other Earmarked  
FundsTotal Earmarked  
Funds**ASSETS**

Fund balance with

Treasury	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Investments		0.00		0.00		0.00		0.00
Accounts and Interest Receivable		0.00		0.00		0.00		0.00
Other Assets		0.00		0.00		0.00		0.00
Total Assets	\$	0.00	\$	0.00	\$	0.00	\$	0.00

**LIABILITIES and NET  
POSITION**

Military Retirement

Benefits and Other

Employment Related

Actuarial Liabilities	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Other Liabilities		0.00		0.00		0.00		0.00
Unexpended Appropriations		0.00		0.00		0.00		0.00
Cumulative Results of Operations		0.00		0.00		0.00		0.00
Total Liabilities and Net Position	\$	0.00	\$	0.00	\$	0.00	\$	0.00

**STATEMENT OF  
NET COST**

As of June 30

Program Costs	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Less Earned Revenue		0.00		0.00		0.00		0.00
Net Program Costs	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Less Earned Revenues Not Attributable to Programs		0.00		0.00		0.00		0.00
Net Cost of Operations	\$	0.00	\$	0.00	\$	0.00	\$	0.00

**STATEMENT OF  
CHANGES IN NET  
POSITION**

As of June 30

Net Position Beginning of the Period	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Net Cost of Operations		0.00		0.00		0.00		0.00
Other Nonexchange Revenue		0.00		0.00		0.00		0.00
Change in Net Position	\$	0.00	\$	0.00	\$	0.00	\$	0.00
Net Position End of Period	\$	0.00	\$	0.00	\$	0.00	\$	0.00

Not Applicable.

<b>Note 24.</b>	<b>Other Disclosures</b>
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As of June 30	2006 Asset Category			
	Land and Buildings	Equipment	Other	Total

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

Future Payments Due  
Fiscal Year

2006	\$	0.00	\$	0.00	\$	0.00	\$	0.00
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
After 5 Years		0.00		0.00		0.00		0.00

**Total Future Lease  
Payments Due**

	\$	0.00	\$	0.00	\$	0.00	\$	0.00
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Not Applicable.