Fiscal Year 2010 Department of the Navy Annual Financial Report

Never Losing Sight of Our Priorities

A CH-53E Super Stallion Helicopter flies near the amphibious transport dock ship USS Ponce (LPD 15).

Contents

The Honorable Ray Mabus

Secretary of the Navy

THE SECRETARY OF THE NAVY
WASHINGTON, D.C. 20350-1000

October 2010

Today the Navy and Marine Corps are conducting missions across the spectrum of military operations, from major combat and ballistic missile defense to humanitarian assistance and disaster relief. Fifteen thousand Marines are at the forefront of our nation's defense, serving in and around Helmand Province, Afghanistan. They are fighting the Taliban and al-Qaeda in their sector and assisting the Afghan Provincial Government in reestablishing control. The Navy in Afghanistan is contributing specialists in a number of areas, including Special Operations Forces, Explosive Ordnance Disposal Teams, and Electronic Warfare capability. The Navy has over 12,000 Sailors on the ground in Central Command supporting joint and coalition efforts in both Iraq and Afghanistan, and another 9,000 Sailors at sea supporting combat operations.

Additionally, the Navy and Marine Corps today are engaged around the world in numerous other security and stability operations which includes:

- Implementing the President's decision to accelerate sea-based ballistic missile defense
- Continuing the preeminence of the ballistic missile submarines in our deterrence force
- Combating piracy in the Gulf of Aden
- Stemming the flow of illegal narcotics into the United States
- Solidifying our relationships with traditional allies and forging partnerships with new friends
- Responding to natural disasters around the globe

There are four strategic, tactical and management imperatives that have formed our key priorities:

Taking care of our Sailors, Marines, Civilians and their Families. Sailors and Marines are the pillars of our success. As our most important asset, they must always come first in our minds and actions. The Department must ensure adequate compensation, medical care, and family support services for our brave men and women.

Energy Reform. Producing and using energy is an issue of national security and essential to maintaining our war-fighting capabilities. We rely too heavily on fossil fuels, leaving us vulnerable to price and supply shocks. In FY10, I issued five energy targets, meant to lead us to a new era of energy self-sufficiency. Among our new initiatives, we conducted an airborne test of the "Green Hornet," an F/A-18 Super Hornet fighter jet running on a bio-fuel blend. Afloat, the USS MAKIN ISLAND (LHD 8), the first ship constructed with a hybrid-electric drive that dramatically lowers fuel consumption at lower speeds, saved approximately $2 million in a single transit to her new homeport in San Diego.

Acquisition Excellence. Acquisition costs are rising faster than our budget, and without deliberate, sustained action to reverse this trend, we put the size and capability of the future force at risk. The Navy and Marine Corps have aggressively pursued ways to make the acquisition process more rigorous. We have a clear focus on controlling costs. We will continue to raise standards, improve processes, instill discipline in procurement, and strengthen the professional corps that manages our major defense acquisition programs. Additionally, we will work closely with shipyards, aircraft manufacturers, and weapon systems providers to ensure goals are met.

Unmanned Systems. Today's security environment requires that the Navy and Marine Corps investigate the contributions unmanned systems can make to our war-fighting capability. Unmanned systems are unobtrusive, versatile, persistent, and can reduce the exposure of our Sailors and Marines to unnecessary threats. Navy and Marine Corps unmanned systems have already made key contributions to operations in Afghanistan, Iraq and the counter-piracy effort off the coast of Africa. We continue to support research and development activities to improve these capabilities and increase the level of autonomy in unmanned systems.

As we pursue these initiatives, we work hard to be good stewards of the resources allocated to us by Congress. We aspire to a world in which violence and aggression have been eliminated, but we understand that peace and stability are often secured only when strong nations and good people are willing and prepared to use decisive force against those who threaten it. The Navy and Marine Corps have stood ready to do so, and will continue to ensure a response against those choosing aggression.

The Department of the Navy's Fiscal Year 2010 Annual Financial Report, "Never Losing Sight of Our Priorities," represents our continuing and enduring commitment to the prudent stewardship of public resources and continued efforts at financial transparency and accountability.

Ray Mabus

The Honorable Gladys J. Commons

Assistant Secretary of the Navy (Financial Management and Comptroller)

THE ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
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October 2010

Throughout the world, our Sailors and Marines represent the United States of America and provide security and assistance where needed. With over $200 billion of budgetary resources entrusted to the Department of the Navy (DON) during Fiscal Year (FY) 2010, we are keenly aware of the responsibility placed on us by the U.S. taxpayers and Congress to manage those resources carefully to support our personnel and missions in the field. The responsibility for carefully overseeing and prudently spending DON's resources requires continual efforts to improve transparency and accountability through improved financial systems and reporting.

KEY ACCOMPLISHMENTS IN FY 2010

FY 2010 saw the continuation of key activities by our naval forces and its agility and responsiveness in reacting to unexpected events worldwide.

Our People. The focus on Operation IRAQI FREEDOM changed as we successfully transitioned our Sailors and Marines out of Iraq to Afghanistan in keeping with President Obama's focus and priorities.

The Navy and Marine Corps went beyond armed conflict when they responded to natural disasters around the globe. Eleven Navy ships, including the hospital ship USNS COMFORT (T-AH) arrived off the coast of Port-au-Prince, Haiti in January after a 7.0 magnitude earthquake caused severe damage to the capital and surrounding areas. COMFORT deployed with a crew of 850 that included Navy doctors, nurses, corpsmen, technicians and support staff ready to help the earthquake survivors. Approximately 2,000 Marines of the 22nd Marine Expeditionary Unit also arrived in Haiti to provide disaster relief.

During the oil spill in the Gulf of Mexico in April, Navy ships and submersibles participated in recovery efforts. The Navy sustained logistical support, equipment and assistance in skimming and salvage operations. Naval Sea Systems Command sent 66,000 feet of inflatable oil boom, skimming systems, related support equipment, and personnel to support clean-up efforts for the oil spill.

In September, helicopters from the amphibious assault ship USS PELELIU (LHA 5) and the 15th MEU began delivering humanitarian aid supplies to the government of Pakistan as part of ongoing American support to provide relief to flood victims. In addition, Sailors with KEARSARGE Amphibious Ready Group (ARG) and embarked Marines of 26th MEU supported the Pakistani humanitarian assistance and disaster relief efforts.

During FY 2010, we continued the effective and efficient utilization of our talented workforce by expanding opportunities for women. The Navy selected 21 women to begin submarine officer training in July, after lifting the ban on female submariners. These women will begin serving onboard missile attack and ballistic missile submarines in late 2011. Also, in July, Rear Admiral Nora W. Tyson, Commander, Carrier Strike Group TWO (CSG 2) became the first female to command a Carrier Strike Group.

Taking care of our service members and their families is an enduring priority. In FY 2010, the Navy expanded its Child and Youth Program to include 7,000 child care spaces fleet-wide and 31 new Child Development Centers. The Marine Corps opened a new center that offers care to infants, children, and teens.

Energy Independence. The U.S. Naval Forces must become more self-sufficient and less reliant on other countries for energy sources. Secretary Mabus has named energy independence as one of his key initiatives, with 2020 being the target for meeting his energy goals. The DON has already made great strides toward these energy goals. For example, we conducted a test flight of the "Green Hornet," an F/A-18 Super Hornet Strike Fighter jet running on a bio-fuel blend. Similarly, the Marine Corps is working toward powering the Light Armored Vehicle (LAV-25), and other selected tactical vehicles and equipment, with bio-fuel blends. Additionally, USS MAKIN ISLAND (LHD 8) is the first amphibious assault ship constructed with gas turbine engines and an electric power drive.

American Recovery and Reinvestment Act (ARRA).As of August 2010, DON has invested $1.2 billion in 222 projects using ARRA funding. Examples of these projects include F-18 engine efficiency improvements and construction of new, energy efficient facilities for our Sailors, Marines, and their families. New and improved facilities will increase the quality of life of our people, and efficiencies achieved through energy conservation will generate future savings for the Department.

The DON's investments also have created and saved 2,677 American jobs, which benefit our nation's economy.

FINANCIAL PRIORITIES

Supporting the War-fighter. Without a doubt, our most important priority during FY 2010 was providing support for the war fighter in Operation IRAQI FREEDOM and Operation ENDURING FREEDOM. Supporting the war-fighter will continue to be our main priority as naval forces move from Iraq to Afghanistan.

Improving and Standardizing Business Processes. We continued our efforts to improve the accuracy, reliability, and accessibility of financial information to ensure we make the most informed business decisions. One of our successful initiatives is the Navy Enterprise Resource Planning (ERP) program. Several Navy commands have successfully deployed Navy ERP, with the most recent being the Naval Sea Systems Command (General Fund operations) in 2010.

In addition, pursuant to new financial improvement priorities established by the Under Secretary of Defense (Comptroller), DON has asserted audit readiness of Appropriations Received, a significant line item on the DON General Fund Statement of Budgetary Resources. The DON has also asserted audit readiness of significant components of Military Equipment, which represent approximately $180 billion of DON General Fund total assets, and accounting for civilian payroll and temporary duty travel processes using the Defense Travel System.

Providing Better Cost Analysis. We have created a more open, transparent process that includes all stakeholders providing a more wholesome discussion and understanding of the cost relationship to requirements, cost drivers, learning curves, and changes in buying strategy. This improved process, along with our improved cost analysis systems, will enable us to produce better cost estimates for planning, programming, budgeting, and managing our resources.

Supporting the Financial Management (FM) Workforce. In FY 2010, we stayed on top of the changing needs of our FM workforce. We continued to pay attention to the need for additional training, career development, and work place experience to ensure our workforce is prepared to grow as the Department changes. We've increased online training options to allow more accessibility at a reduced cost and with increased scheduling flexibility.

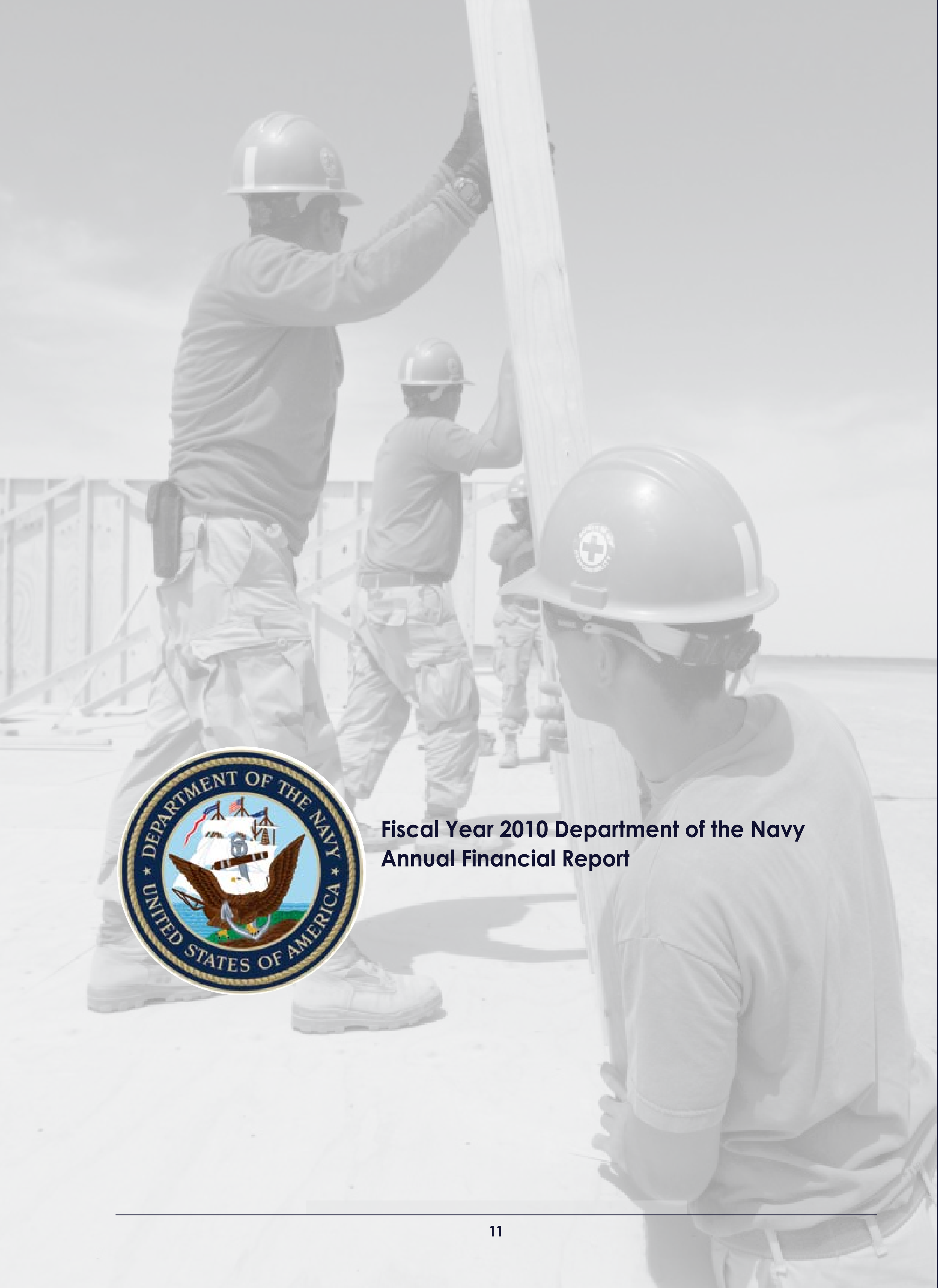
Reforming Acquisition Processes. We continually improve our acquisition processes. We want to be a smarter buyer on behalf of the taxpayer by providing greater and more effective oversight over vendors who provide material and core platform support to the DON. We are also rebuilding the acquisition workforce through a number of parallel efforts. These include expansion of recruitment at all levels, including interns, journeymen, and highly qualified experts, and the retention and credentialing of qualified personnel at the middle and senior career levels.

OUR COMMITMENT

Secretary Mabus and I are committed to using the taxpayers' dollars wisely. A noteworthy example in this regard is the transparency and accountability with which we reported on funds from the Recovery Act. Our goal is to move toward such transparency in all DON financial transactions. As we go forward, we will continue to improve the quality of our financial data so the U.S. taxpayers can rely on our fiscal prudency as they rely on our Sailors and Marines.

Gladys J. Commons

Gladys J. Commons



Fiscal Year 2010 Department of the Navy Annual Financial Report

Introduction

Fiscal Year (FY) 2010 reflected an enduring commitment to our priorities.

- Supporting our national defense
- Conducting overseas contingency operations
- Building a Force for the future
- Protecting our people and resources
- Promoting ethical conduct throughout the Department
- Providing first-rate facilities to support our Forces

These priorities help to protect our nation and global interests, demonstrate our stewardship of public resources, and most importantly, support our Sailors, Marines, and their families, whose service and sacrifice sustain our preeminence as a global maritime force. We provide a perspective on the breadth and depth of these priorities throughout our Management's Discussion and Analysis.

- **Fiscal Year in Review** – a photo spread representing some of our priorities in action during FY 2010
- **Organization and Mission** – an overview of how we are structured to support our mission
- **Strategic Management** – a summary of key accomplishments during FY 2010 aligned with our strategic objectives
- **Management Assurances** – an overview of our responsibility for the integrity of our programs and operations and the stewardship of public resources
- **Financial Condition and Results of Operations** – a perspective of fiscal transparency and accountability relative to our FY 2010 financial statements
- **Looking Forward** – an overview of how we will remain focused on priorities in FY 2011

During FY 2010, we demonstrated an enduring commitment to our priorities.
We provide a glimpse of some of these priorities in the photos that follow and as described below.

- Supporting our national defense through maritime partnerships, disaster response, readiness, humanitarian assistance, and maritime security
- Conducting overseas contingency operations in Afghanistan
- Building a Force for the future through energy reform
- Providing first-rate facilities to support our Forces and their families

Maritime Partnerships: Chief of Naval Operations Admiral Gary Roughead responds during a press conference at the 19th Biennial International Sea Power Symposium in Newport, Rhode Island.

Oct 2009 – Dec 2009

Contingency Operations: A Hospital Corpsman assigned to Combined Anti-Armor Team 2 patrols the Nawa District of Helmand Province, Afghanistan.

Disaster Response: Marines assigned to Battalion Landing Team, 3rd Battalion, 2nd Marine regiment distribute rations in Leogane, Haiti following a 7.0 magnitude earthquake.

Jan 2010 – Mar 2010

Family Support: A child development center on Naval Base Point Loma, California is being funded by the American Recovery and Reinvestment Act.

Energy Reform: Biofuel powers an F/A-18 Super Hornet Strike Fighter jet during test flight operations at Naval Air Station Patuxent River, Maryland.

Apr 2010 – Jun 2010

Readiness: Amphibious transport dock ship USS New Orleans (LPD 18) is part of Southern Partnership Station, an annual deployment of U.S. military training teams to the U.S. Southern Command area of responsibility.

Humanitarian Assistance: A Navy Lieutenant assigned to multi-purpose amphibious assault ship USS Iwo Jima (LHD 7) treats a Colombian child during Continuing Promise 2010, an annual humanitarian and civic assistance mission to provide support to Central America, South America, and the Caribbean.

Jul 2010 – Sep 2010

Maritime Security: Marines assigned to the 15th Marine Expeditionary Unit, Maritime Raid Force, approach the Magellan Star in the Gulf of Aden during a counter-piracy mission.

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

- Department of the Navy Mission

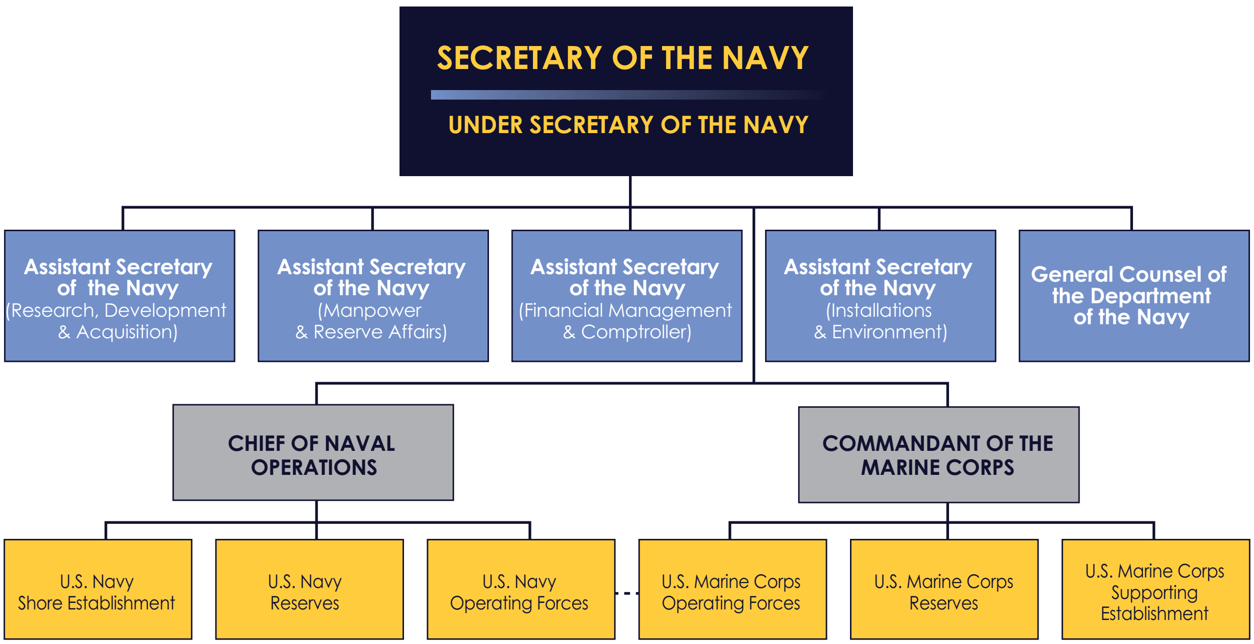
Organization and Mission

We are structured to respond to a broad range of mission requirements that preserve our nation's freedom and protect U.S. global interests. The Secretary of the Navy, a civilian appointed by the President, conducts all Department of the Navy (DON) affairs under the authority, direction, and control of the Secretary of Defense. Under the purview of the Secretary of the Navy are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, the General Counsel, and two key military leaders—the Chief of Naval Operations, a four-star Admiral, responsible for the command and operating efficiency of the U.S. Navy, and the Commandant of the Marine Corps, a four-star General, responsible for the performance of the U.S. Marine Corps.

The U.S. Navy and the U.S. Marine Corps have numerous commands that operate under the

Founded April 30, 1798

Title 10 U.S. Code, Section 5061



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

The chart above is a simplified illustration of the DON organizational structure. The full structure is shown online at www.navy.mil under "About the Navy."

United States Navy	United States Marine Corps
Founded October 13, 1775	*Founded November 10, 1775*
Title 10 U.S. Code, Section 5062	*Title 10 U.S. Code, Section 5063*

authority and responsibility of a commander or other designated official and typically support a network of subordinate commands. Each command has a clearly defined mission that supports the overall DON mission in support of the Department of Defense's (DoD) responsibilities. Both Services provide ready forces to support the U.S. joint military commands in conducting their worldwide missions.

Civilians: 206,139
(Full-time Equivalents)

U.S. Navy Active: 328,303
(Officers, Enlisted, & Midshipmen)

U.S. Marine Corps Active: 202,441
(Officers & Enlisted)

U.S. Navy Reserve: 65,006
(Drilling Reserve & Full-time Support)

U.S. Marine Corps Reserve: 39,222
(Drilling Reserve & Full-time Support)

Personnel Data as of Fiscal Year Ended September 30, 2010

Strategic Management

We are committed to improving core capabilities that support the U.S. maritime strategy, "A Cooperative Strategy for 21st Century Seapower." These core capabilities are critical to U.S. maritime power and reflect an increased emphasis on activities that prevent war and build partnerships—forward presence, deterrence, sea control, power projection, maritime security, humanitarian assistance, and disaster response.

The cooperative strategy, guided by the objectives articulated in the National Strategy for Maritime Security, National Security Strategy, National Defense Strategy, and National Military Strategy, was developed to be a unified and enduring strategy that will apply maritime power to the crucial responsibility of protecting U.S. vital interests in an increasingly interconnected and uncertain world. It binds the three maritime services—U.S. Navy, U.S. Marine Corps, and U.S. Coast Guard—closer together than ever before in a mission to more fully safeguard maritime interests at home and abroad.

Our six strategic objectives (on the pages that follow) support the U.S. maritime strategy by focusing on key efforts that will increase our effectiveness, improve the lives of our Sailors, Marines, and their families, and result in greater security for our nation and U.S. global interests. A summary of key accomplishments by objective begins on the next page.

In addition, as a separate and supporting element of our strategic objectives, we are committed to transforming the way we do business. A summary of our key business transformation initiatives follows our discussion on objectives.

Objective 1: Provide a Total Naval Workforce Capable and Optimized to Support the National Defense Strategy

Our Sailors, Marines, and civilians are the critical component to the U.S. maritime strategy, and we must ensure that we provide them with adequate compensation, medical care, and career training opportunities. These are key factors in attracting and retaining highly motivated and qualified naval personnel.

We remain committed to providing a competitive pay and benefits package to aid in recruitment and retention. The package includes basic pay, housing allowances, and incentives for critical specialties in health care, explosive ordnance disposal, and nuclear propulsion.

Through the Navy Safe Harbor Program and the Marine Corps Wounded Warrior Regiment, we provide support and assistance to our wounded, ill, and injured service members and their families. We also continue to provide encouragement and support for our wounded Sailors and Marines, in partnership with the Department of Veterans Affairs, long after they have left the Service.

Our medical community has continued to strive for excellence in the care of our Sailors and Marines. Navy Medicine has reached out to its civilian colleagues, and we have established partnerships with civilian hospitals to improve our understanding and care for those affected by traumatic brain injuries, mental health issues, amputation, and disfiguring injuries.

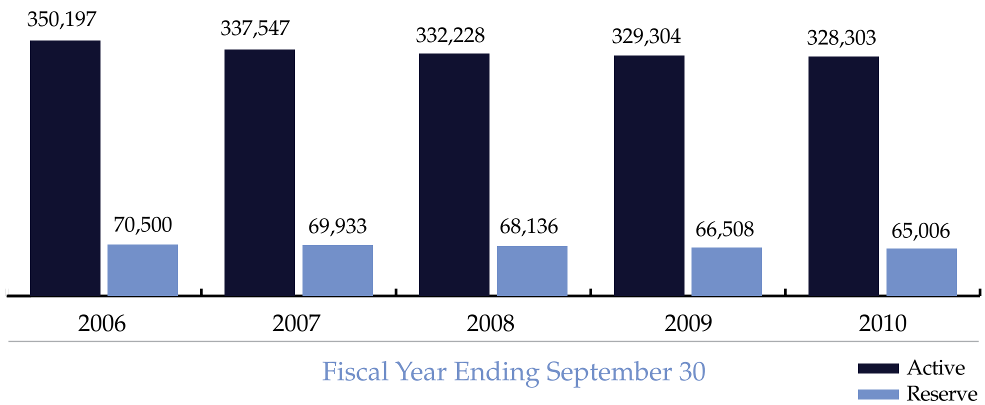
Using advanced technologies, we have shifted training from the traditional classroom to the use of simulators, trainers, computer-based interactive curriculums, and other media-based approaches. This initiative provides our naval workforce with appropriate training in a more efficient manner and prepares them to better perform mission-critical tasks.

A Marine assigned to Marine Aviation Weapons and Tactics Squadron One (MAWTS-1) performs a virtual parachute landing while a Sailor operates the Virtual Parachute Trainer.

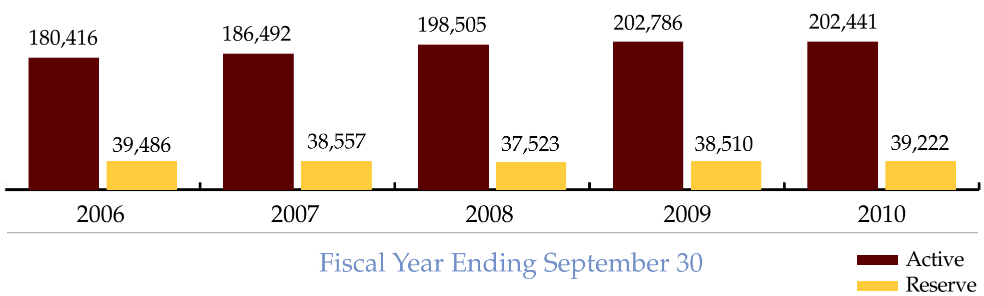
U.S. Navy

The Navy continues to resize and reshape its forces to meet its mission requirements more efficiently and effectively. This is especially important in an environment of limited budgetary resources and rising personnel costs. Over the last five years, the Navy has resized its active and reserve components by 6% and 8%, respectively. The Navy has been able to accomplish all assigned missions at this level because of force structure changes, efficiencies gained through technology, modifications in workforce mix, and new manning practices.

U.S. Navy End Strength



U.S. Marine Corps End Strength



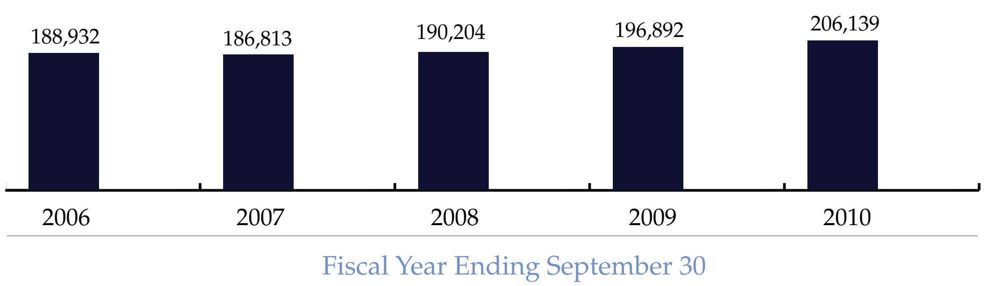
U.S. Marine Corps

The Marine Corps has accomplished its goal of growing the active force to 202,100. This growth in force should begin to reduce the strain on individual Marines assigned to continually high operational tempo units, such as amphibious assault, reconnaissance, combat service support, and explosive ordnance disposal. The Marine Corps anticipates continued success in meeting recruiting and retention goals to maintain the planned force level, grow a more senior and experienced baseline force, and meet the requirements of engaging in overseas operations.

Navy and Marine Corps Civilian Personnel

The size of the civilian workforce, which has increased by 9% over the last five fiscal years,

Civilian Personnel (Full-Time Equivalents*)



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

continues to support the mission and daily functions of the Navy and Marine Corps. Civilian personnel provide various types of support, such as research and development, engineering, acquisition, depot maintenance, and financial management and budget.

Objective 2: Use the Navy-Marine Corps Team to Aggressively Prosecute Overseas Contingency Operations

Our Navy-Marine Corps team has become an integral part of continuing overseas contingency operations. With the shift in operational focus from Iraq to Afghanistan, our naval forces are providing greater support to the Afghanistan theater, both in the conduct of direct operational missions, as well as increased combat support for U. S. and coalition forces on the ground. Significant tactical air support for Afghanistan comes from our carriers and as the ground infrastructure in Afghanistan increases, more carriers will be required to bring these assets to bear on the battlefield.

Fleet Response Plan

We remain focused on providing ready naval forces, from individual units to carrier and expeditionary strike groups, that are forward deployed and capable of providing a substantial surge force. The Fleet Response Plan (FRP), which supports the National Military Strategy, provides the readiness for this capability. The FRP provides adaptable, flexible, and sustainable naval forces necessary not only to fight current ongoing contingencies, but also to support the needs of the combatant commanders to maintain a global forward presence and any other evolving national defense requirements.

Individual Augmentees

Individual augmentees (IAs) have been instrumental in fulfilling combatant commanders' mission requirements for overseas contingency operations. They are assigned individually, rather than as part of a traditional unit, to fill shortages or provide specialized knowledge or skill sets. The Navy identifies both active and reserve service members with specific skill sets to fill IA roles, and the Marine Corps relies principally on activated reserve members to fill IA positions vacated by forward-deployed active component Marines.

Sailors participate in the U.S. Navy Individual Augmentee Combat Training course at Fort Jackson, South Carolina.

Marine Corps Operating Forces

Marine Expeditionary Forces (MEFs) provide highly trained, versatile expeditionary forces capable of rapid response to global contingencies. Each MEF consists of a command element, one infantry division, one aircraft wing, and one Marine logistics group.

Embedded within each MEF are three Marine Expeditionary Units, which deploy regularly in the Expeditionary Strike Groups. Each MEF also has an embedded capability to source a Marine Expeditionary Brigade.

Integrated with Marine Corps infantry units in Afghanistan are Female Engagement Teams (FETs). These teams of female Marines directly interact with the local female population in Afghanistan, where public interaction between men and women is prohibited. The FETs collect information regarding the local communities' needs and foster communication between U.S. and Afghan forces while respecting local customs.

A Hospital Corpsman, assigned to the Marine Corps Female Engagement Team, patrols the streets of Musa Qa'leh, Afghanistan.

Objective 3: Build the Navy-Marine Corps Force for Tomorrow

Sustaining U.S. maritime preeminence requires our naval forces to prepare continually for future challenges as well as threats to national security and U.S. global interests. Key initiatives in this regard are energy reform, unmanned systems, and acquisition reform.

Energy Reform

Reducing our naval forces' reliance on fossil fuels is critical to our national security, environment, and naval capabilities. Our nation and naval forces rely heavily on a finite source of fuel from volatile global regions. To a certain extent, we have ceded this strategic resource to other nations, creating an obvious vulnerability to our national security. In addition, our reliance on fossil fuels affects our naval forces' operational independence, both in terms of the resources required to obtain fuel and to transport it to the ships, aircraft, and equipment, and the Sailors and Marines whose duty it is to protect the ships and convoys moving the fuel.

With these risks in mind, we have taken a bolder, more aggressive stance toward energy reform by committing to five energy goals (see chart). These goals require adoption of new fuels and development of new systems and energy efficient practices and techniques over the next 10 years.

We have already made great strides toward these energy goals. As previously illustrated in our Fiscal Year in Review section, the Navy conducted a test flight of the "Green Hornet," an F/A-18 Super Hornet Strike Fighter jet running on a biofuel blend. The Green Hornet biofuel program is the first aviation program to test and evaluate the performance of a biofuel blend in supersonic operations (i.e., greater than 750 miles per hour). Similarly, the Marine Corps is working toward powering the Light Armored

Department of the Navy Energy Goals

Energy Efficient Acquisition: Evaluation of energy factors will be mandatory when awarding contracts for systems and buildings.

Sail the "Great Green Fleet": DON will demonstrate a Green Strike Group in local operations by 2012 and sail it by 2016.

Reduce Non-Tactical Petroleum Use: By 2015, DON will reduce petroleum use in the commercial fleet by 50%.

Increase Alternative Energy Ashore: By 2020, DON will produce at least 50% of shore-based energy requirements from alternative sources; 50% of DON installations will be net-zero.

Increase Alternative Energy Use DON-Wide: By 2020, 50% of total DON energy consumption will be from alternative sources.

Vehicle (LAV-25), as well as other selected tactical vehicles and equipment with biofuel blends.

Another noteworthy example of our progress toward energy reform is the USS Makin Island (LHD 8). Makin Island is the first amphibious assault ship constructed with gas turbine engines and an electric drive to power it at low speeds. During its transit from Pascagoula, Mississippi to its new homeport in San Diego, Makin Island consumed over 900,000 gallons less fuel than a steam ship completing the same transit, saving more than $2 million in fuel costs. We project that this hybrid engine will save nearly $250 million in fuel costs over the ship's lifetime.

Unmanned Systems

Unmanned systems expand our naval capabilities in intelligence, surveillance, and reconnaissance (ISR), and reduce the exposure of our naval forces to unnecessary threats. For example, unmanned aerial vehicles have been an integral part of our ISR operations overseas and unmanned ground vehicles have detected and neutralized thousands of improvised explosive devices. We will continue to support research and development activities in unmanned systems to keep pace with the evolving complexities of the global security environment.

Acquisition Reform

The replacement costs of our aging ships, aircraft, and weapons systems continue to rise faster than our procurement budgets' top-line. This has resulted in a reduction in the number of ships and aircraft available to support the Navy's forward deployed mission. This erosion in the number of available ships and aircraft has also increased the operating tempo required of the remaining smaller fleet. This trend towards growth in individual unit acquisition costs,

The USS Makin Island (LHD 8) is the first amphibious assault ship constructed with a hybrid engine.

therefore, places at risk our future forward presence capability to support our nation's foreign policy and protect its interests. In accordance with Weapons System Acquisition Reform Act of 2009, and in coordination with strong DoD-wide initiatives being taken by the Secretary of Defense and his staff in this area, we are aggressively working to examine and streamline the Navy's design and construction processes. The result will be improved management of the design and schedule processes so that the impact on acquisition and total weapons systems life cycle costs can be better estimated earlier in the design and scheduling processes. This will enable the cost impact of design and scheduling changes to be better forecasted and their impact on future fleet sizes to be better understood and anticipated.

In addition, a healthy industrial base and strong performance from our industry partners improve our ability to deliver an affordable combat capability to the fleet. We have worked diligently to procure our ships, aircraft, and weapon systems at a rate intended to bring stability to the industrial base and enable efficient production. We will continue to work with our shipyards, aircraft manufacturers, and weapon systems providers to benchmark performance, to identify improvements, to provide the proper incentives for capital

A Petty Officer 1st Class, assigned to Explosive Ordnance Disposal Mobile Unit (EODMU) 2, Company 2-2, discusses components of the mini Remote Ordnance Neutralization System robot with soldiers assigned to the 5th Iraqi Army Bomb Disposal Company.

investments, and to reward strong performance with terms and conditions that reflect our desire for a strong government-industry partnership.

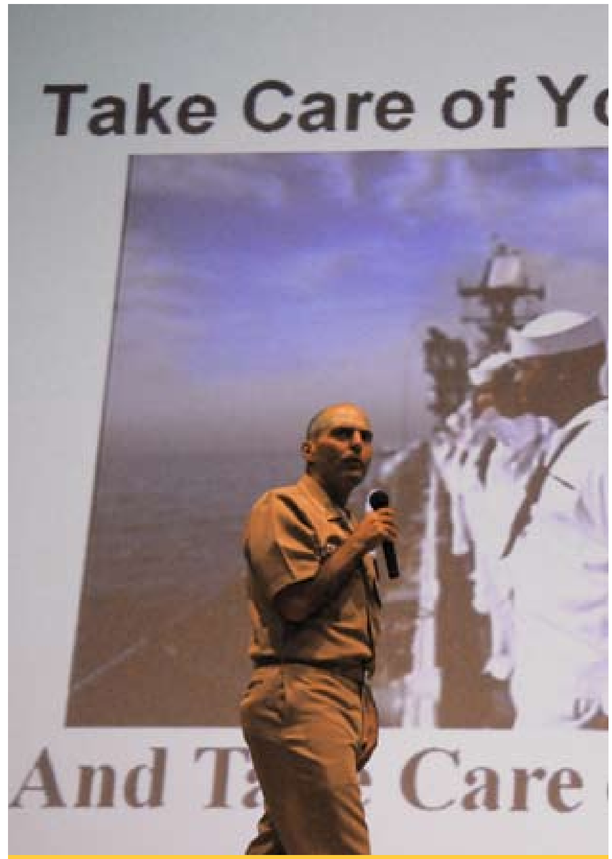
We are also rebuilding the acquisition workforce through a number of parallel efforts. These include expansion of recruitment at all levels, including interns, journeymen, and highly qualified experts, and the retention and credentialing of qualified personnel at the middle and senior career levels.

Objective 4: Safeguard the People and Resources of the Navy-Marine Corps Team

We promote and enhance a culture of safety excellence, guided by our Department of the Navy Safety Vision. Our safety vision provides a roadmap for implementing, tracking, and refining command-level safety programs and for improving our overall safety culture. Through our seasonal safety campaigns, we aim to reduce the risk of accidents, mishaps, and fatalities. For example, during our recent summer safety campaign, we focused on motor vehicle safety, alcohol awareness, and water safety because the majority of last summer's fatalities fell into these categories. In addition, through our Safety Excellence Award Program, we recognize those commands and programs that best exemplify the highest regard for the safety of our Sailors, Marines, and civilians, and the protection of our aircraft, ships, and facilities from mishaps.

Objective 5: Strengthen Ethics as a Foundation of Exemplary Conduct within the Department of the Navy

We promote and enhance an ethics culture rooted in the core values of honor, courage, and commitment. Through our Department-wide Core Values Training Program, we promote understanding and application of these guiding principles in our everyday decisions. At the U.S. Naval Academy, our midshipmen practice ethical decision-making using interactive technology that simulates real-life ethical dilemmas. The Department's Ethics Counselor



Command Master Chief Dominick Torchia, assigned to the Naval Safety Center, gives a safety presentation to Sailors at Fleet Activities Yokosuka, Japan.

Certification and Training Program enhances professionalism among our ethics counselors. In addition, through our Ethics Leadership Award Program, we recognize those within the Department who best exemplify the highest standards of ethical conduct.

Objective 6: Provide First-Rate Facilities to Support Stationing, Training, and Operations of Naval Forces

We continue to invest in military construction projects to keep pace with evolving mission requirements and quality of life initiatives. As part of the Defense Policy Review Initiative, an

An aerial view of Apra Harbor on U.S. Naval Base Guam, where efforts are underway to prepare the base for relocation of 8,000 U.S. Marines and their families.

international alliance to enhance the security environment was initiated with the U.S. and the Government of Japan signing an agreement for the relocation of approximately 8,000 U.S. Marines and their families from Okinawa to Guam. In support of this realignment, efforts are underway to relocate a Navy facility from Guam's Apra Harbor to another site on base. This will allow construction to begin on improving the wharves and building other waterfront activities needed to support the Marines' pier-side requirements.

We have received funds through the American Recovery and Reinvestment Act for military construction projects that will improve the quality of life for our Sailors and Marines. One example is construction of new Navy barracks at San Clemente Island, California. Three two-story buildings with 53 two-person units will replace the overcrowded, pre-World War II living quarters. Another example is construction of a new hospital at Marine Corps Base Camp Pendleton, California. The 500,000 square foot, multilevel hospital will provide the most advanced medical care to our naval personnel and their families.

Business Transformation

As a separate and supporting element of our priority objectives, we are committed to transforming the way we do business by using our people, processes, and systems more effectively. The DON Financial Improvement Program is the integrating financial element of our business transformation strategy and a supporting initiative of the DoD Financial Improvement and Audit Readiness Plan, which organizes and prioritizes the financial improvement and audit readiness efforts of DoD Components. Audit readiness is a goal of business transformation and a key metric for measuring its success and progress. Navy Enterprise Resource Planning is the key system driver of our business transformation and a key enabler of the DoD Enterprise Transition Plan, which organizes and prioritizes efforts to modernize DoD business and financial systems. Continuous Process Improvement/Lean Six Sigma (CPI/LSS) initiatives, part of the DoD-wide CPI/LSS program, enable more effective and efficient operations across the DON enterprise.

DON Financial Improvement Program

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

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

We asserted audit readiness of key business processes related to the DON General Fund SBR, to include Appropriations Received, Civilian Payroll, and Travel initiated through the Defense Travel System. We plan to assert audit readiness of the entire DON General Fund SBR in FY 2013. Additionally, DON and our primary service provider, the Defense Finance and Accounting Service (DFAS), have forged a strong partnership and, together, have made considerable progress in moving closer to fully reconciling DON's Fund Balance with Treasury. Jointly, with DFAS, DON has launched initiatives to bring transparency to DON's full transaction universe, which will allow meaningful testing and provide audit trails. These DFAS initiatives will yield considerable value to our audit readiness efforts over the next year. In addition, despite various challenges, the Marine Corps SBR audit continues to move forward, providing significant insight and lessons that have led DON to enhance its overall SBR Audit Readiness Plan.

We also asserted audit readiness of significant components of military equipment—ships (including submarines), aircraft, intercontinental ballistic missiles, satellites, and ordnance. Validation of our assertion will begin in FY 2011.

Marine Corps Financial Improvement and Audit Readiness Initiative

By means of an independent study, we analyzed the value of the Marine Corps' effort to pursue financial audit readiness in terms of the bottom line impact for improving the efficiency and effectiveness of their financial processes and controls. This impact was measured in terms of the direct return for every dollar appropriated by Congress. The results of this analysis showed that for every dollar invested, nearly three dollars in value were created and that the resulting economies translated directly into the Marine Corps having the capability to purchase more mission supportive weapons for the same amount of appropriated resources. In the future, we will use this return on investment metric as a guide as we implement the substantial lessons learned from the ongoing Marine Corps audit experience to the Navy.

The Marine Corps is the first major operational war-fighting organization to achieve audit readiness for any of the four financial statements and therefore, over a broad part of their business operations. The Marine Corps selected the SBR as the first statement to assert for audit readiness because it is the most heavily used and therefore, most heavily relied upon in the day-to-day management of their resources. The Marine Corps' audit readiness efforts also provide a meaningful pilot for DON as we continue to discover how to use the audit process to improve resource management.

An Aviation Ordnanceman aboard the aircraft carrier USS John C. Stennis (CVN 74), whose crew streamlined ordnance test and repair processes.

Navy Enterprise Resource Planning

Navy Enterprise Resource Planning (Navy ERP) is an integrated business management system that unifies, standardizes, and streamlines Navy business operations. It is replacing multiple older, more costly information systems, leading to lower operational costs for the Navy. Navy commands who have implemented Navy ERP have realized measurable improvements in accuracy, timeliness, and accessibility of information and efficiencies in business and reporting processes. Expansion of the Navy ERP Program over the next few years will continue to drive enterprise-wide efficiencies and provide financial transparency and total asset visibility across the enterprise; it will be a major positive force contributing toward Navy's financial audit readiness.

The Navy deployed Release 1.1 (Single Supply Solution) in March 2010. The new release consolidates wholesale and retail supply functions. Commands that have implemented Navy ERP are the Naval Air Systems Command (October 2007), Naval Supply Systems Command (October 2008), and Space and Naval Warfare Systems Command (October 2009).

The Navy will continue to expand Navy ERP throughout the enterprise. Other Commands scheduled for implementation are Naval Sea Systems Command (General Fund operations, October 2010 and Working Capital Fund operations, October 2011); Strategic Systems Programs (October 2012); and Office of Naval Research (October 2012). More information on Navy ERP is available at *http://www.erp.navy.mil*.

Continuous Process Improvement

Continuous Process Improvement (CPI) is a primary enabler for managing the effectiveness and efficiency of our processes in support of the warfighter and business operations and a critical path toward financial audit readiness. CPI provides our workforce with proven performance improvement tools to build a strong warfighter support foundation for improving cycle time and reliability, aligning the work of subordinate organizations to enterprise-wide goals, and optimizing costs. Under the purview of the Deputy Under Secretary of the Navy for Business Operations and Transformation, we are bringing together processes and organizations for the accomplishment of strategic and corporate business objectives.

The following are a few examples of successful CPI projects.

- The USS Stennis (CVN 74) crew significantly reduced inefficiencies in their ordnance test and repair processes, resulting in over four hours saved for each Ordnance Test Readiness Review. Conducting reviews that are more efficient shortens the turnaround time for high demand ordnance items used by Aviation Squadrons.
- The Naval Air Systems Command reduced fuel-servicing wait times for Aviation Support Equipment by 20% (4,800 man-hours) and increased annual fuel availability by 30% (9,000 gallons).
- The Navy eliminated duplicative procedures in its internal acquisition reporting process resulting in an annual savings of $0.4 million.

Management Assurances

Commanders and managers throughout the Department of the Navy must ensure the integrity of their programs and operations. Part of this responsibility entails compliance with Federal requirements for financial reporting, financial management systems, and internal controls, such as the Federal Financial Management Improvement Act (FFMIA) and the Federal Managers' Financial Integrity Act (FMFIA). These requirements promote the production of more timely, reliable, and accessible financial information, supported by the development and implementation of more effective internal controls. More useful financial information and effective controls save money and improve efficiency, thereby enhancing public confidence in our stewardship of public resources, which is critical for the protection and sustainment of our nation and vital U.S. interests.

We recognize that our success in complying with both the FFMIA and FMFIA is closely linked with achieving financial audit readiness under the Chief Financial Officers (CFO) Act of 1990. Therefore, we have realigned our efforts to comply with FFMIA and FMFIA and integrated them with our financial improvement and audit readiness efforts to achieve compliance with the CFO Act.

Below is a summary of our compliance efforts under FFMIA and FMFIA.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act (FFMIA) of 1996 requires agencies to implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger (USSGL) at the transaction level. FFMIA supports the same objectives as the Chief Financial Officers Act of 1990 but with a systems emphasis. Our legacy financial management systems and feeder systems are not yet substantially compliant with Federal financial management systems requirements, generally accepted accounting principles, and the USSGL at the transaction level. While FFMIA compliancy requires a solid systems element, the improvements in process documentation and internal control testing being made through our Financial Improvement Program, combined with the ongoing deployment of Navy ERP, will move us toward these goals over the next several years. Navy ERP will be compliant with the Department of Defense (DoD) Standard Financial Information Structure (SFIS), which includes support for the USSGL at the transaction level. SFIS is DoD's common business language that supports standardization of financial reporting for all DoD Components.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires agencies to evaluate their system of internal accounting and administrative controls and to report on the effectiveness of these controls in an annual

Sailors and more than 1,000 friends and family members aboard the aircraft carrier USS Nimitz (CVN 68) depart Bremerton, Wash. for a Tiger Cruise to the ship's homeport in San Diego, Calif.

statement of assurance. The FMFIA was the model for the Sarbanes-Oxley Act of 2002, which applies to publicly traded companies. Application of the Sarbanes-Oxley Act led to the Federal Government's reevaluation of internal control policies under FMFIA, including the addition of Appendix A to Office of Management and Budget (OMB) Circular A-123 in December 2004, "Management's Responsibility for Internal Control." Appendix A of the revised circular requires agencies to provide a separate statement of assurance on the effectiveness of internal controls over financial reporting.

We assessed our systems of internal controls over non-financial operations and financial reporting, in effect as of June 30, 2010. Based on these assessments, we provided qualified assurance on the effectiveness of our internal controls over non-financial operations, and provided no assurance on the effectiveness of our internal controls over financial reporting. For more information on the results of these assessments, see our FMFIA FY 2010 Annual Statement of Assurance at *http://www.fmo.navy.mil/services/mic/soa_index.htm*.

Financial Condition and Results of Operations

The accompanying financial statements and related disclosures represent our enduring commitment to fiscal accountability and transparency. Through our Financial Improvement Program and related business transformation initiatives discussed earlier, we have made significant progress toward improving the quality and timeliness of our financial information. However, we

are currently unable to fully implement all elements of U.S. generally accepted accounting principles and OMB Circular A-136, "Financial Reporting Requirements," due to limitations of our financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the Department of Defense, Office of Inspector General, was unable to express an opinion on our FY 2010 financial statements. It should be noted that these limitations exist primarily in our proprietary accounting processes and less so in the budgetary accounting performed to manage and report on the application of budget authority to the purposes and programs approved in appropriations acts. Despite documented material weaknesses and because of compensating measures and close oversight, we believe the budgetary information used for decision-making is accurate and reliable.

For financial reporting purposes, we are organized into two reporting entities: DON General Fund and Navy Working Capital Fund, which include financial information for both the U.S. Navy and the U.S. Marine Corps. Each reporting entity has a separate set of financial statements and related disclosures.

DON General Fund

The General Fund (GF) appropriations support overall Departmental operations. Enacted appropriations comprise the majority of the GF account structure, which includes five major appropriation groups:

- Operation and Maintenance
- Military Personnel
- Procurement

- Research, Development, Test, and Evaluation
- Military Construction

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

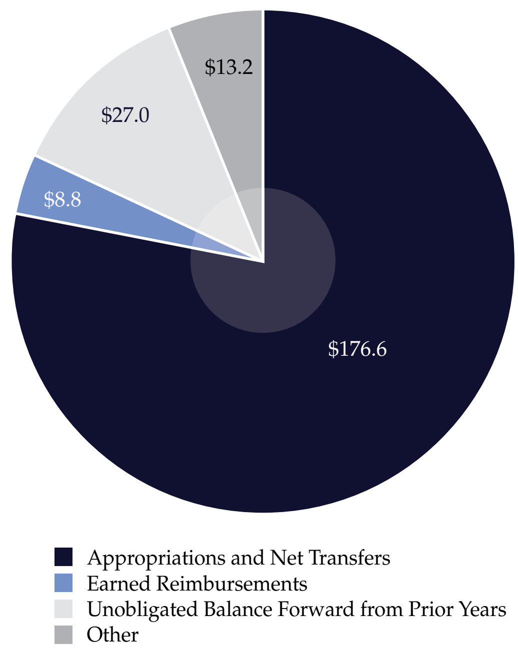
Results of Operations

The Combined Statement of Budgetary Resources presents total budgetary resources of $225.6 billion that were available to the DON GF during FY 2010 and the status of those resources at fiscal year-end. Total budgetary resources were up $1.7 billion, 0.8%, in FY 2010 over FY 2009. Most of the increase came from increased budgetary authority from appropriations, which comprised 77% of total budgetary resources. Enacted appropriations increased $8.7 billion, 5%, for a total of $174.0 billion when compared to FY 2009. The majority of the increase was in the Procurement and Operation and Maintenance appropriation accounts. The DON obligated $190.6 billion of the $225.6 billion total resources in FY 2010; this represents a decrease of $6.3 billion, 3%, over FY 2009.

The Combined Statement of Net Cost presents net cost of operations of $155.1 billion during FY 2010. Net cost of operations represents gross costs incurred by the DON GF less earned revenue. Net cost of operations increased $11.0 billion, 7%, when compared to FY 2009.

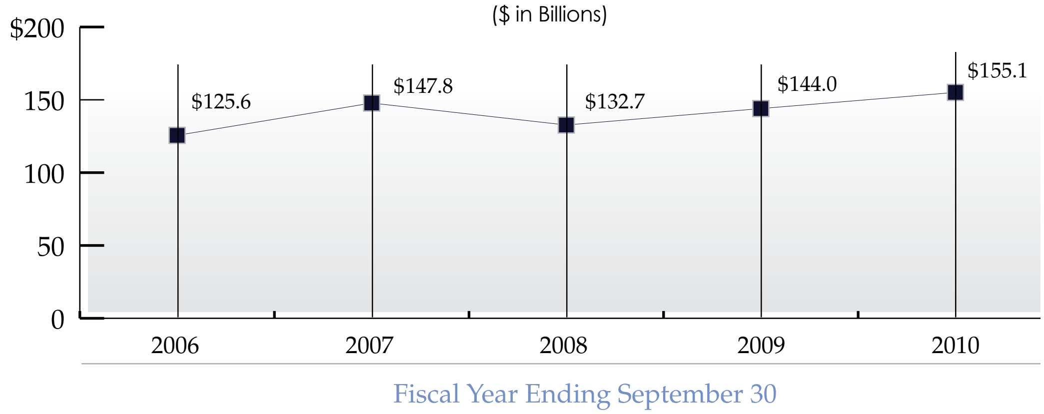
DON GF Sources of Funds, FY 2010

($ in Billions)



DON GF Net Cost of Operations, FY 2006 – 2010

($ in Billions)

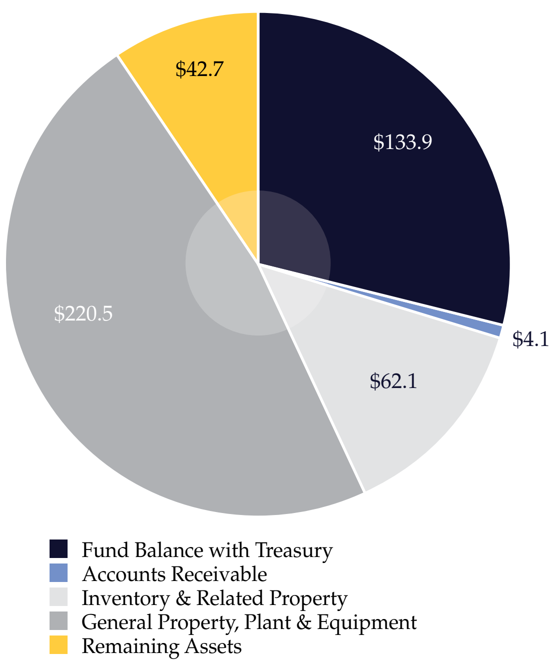


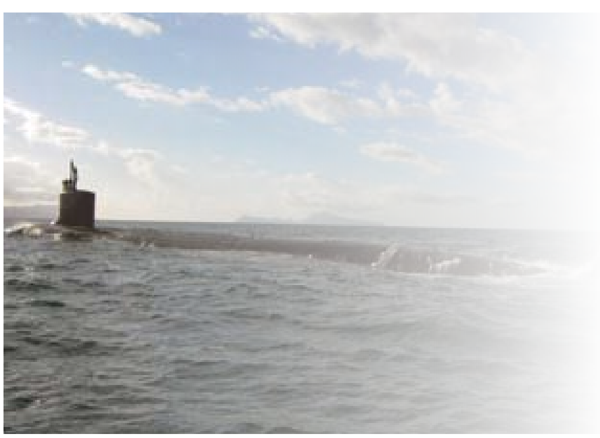
Financial Position

The DON continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets (what is owned) and total liabilities (what is owed). As of September 30, 2010, net position totaled $426.0 billion, which represents an increase of $17.3 billion, or 4%, from FY 2009. Increases in total assets and total liabilities of $19.0 billion and $1.6 billion, respectively, contributed to the overall increase in net position.

DON GF Total Assets, FY 2010

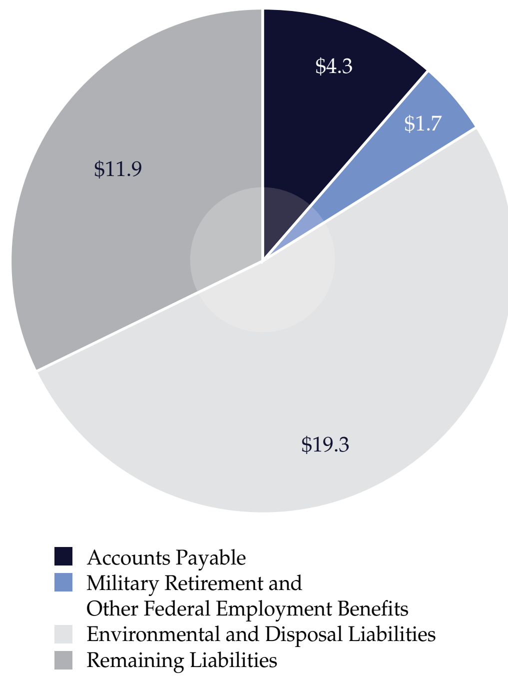
($ in Billions)





DON GF Total Liabilities, FY 2010

($ in Billions)



Navy Working Capital Fund

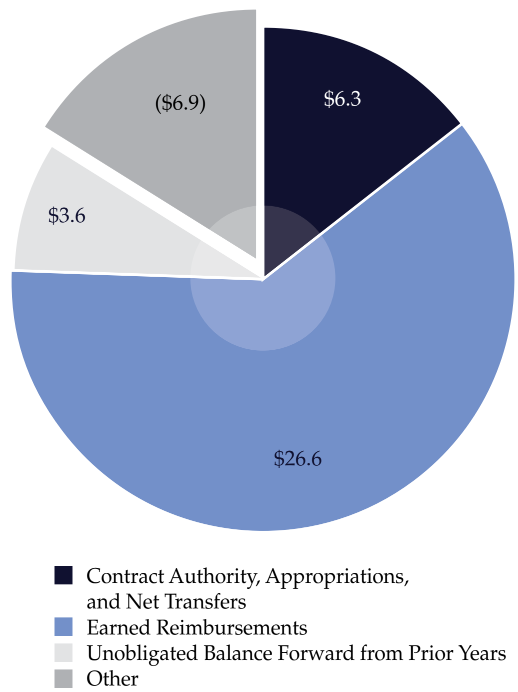
The Navy Working Capital Fund (NWCF) is a revolving fund established to meet the diverse requirements of the Navy and Marine Corps operating forces. Under the revolving fund concept, an appropriation or a transfer of funds finances initial NWCF operations. General or appropriated fund payments from customers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

Results of Operations

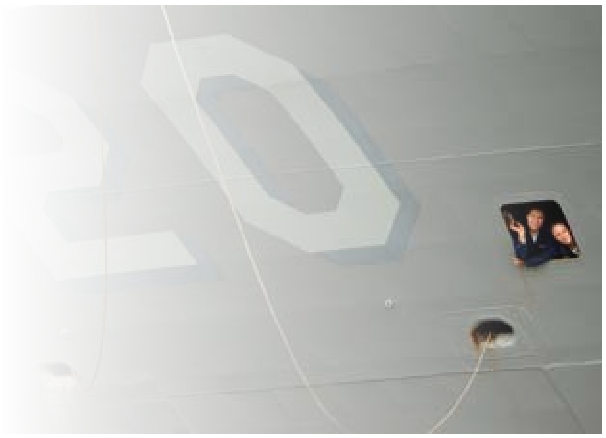
The Combined Statement of Budgetary Resources presents total budgetary resources of $29.7 billion that were available to NWCF during FY 2010 and the status of those resources at fiscal year-end. Total budgetary resources decreased $0.3 billion, 1%, in FY 2010 over FY 2009. A net decrease of $0.2 billion in budget authority contributed to the overall decrease in budgetary resources. NWCF budget authority is comprised of enacted appropriations, contract authority, and spending authority from offsetting collections, of which the latter accounts for 90% of total budgetary resources. NWCF business activities obligated $26.8 billion of the $29.7 billion total resources in FY 2010; this represents an increase of $0.3 billion, 1%, over FY 2009.

NWCF Sources of Funds, FY 2010

($ in Billions)



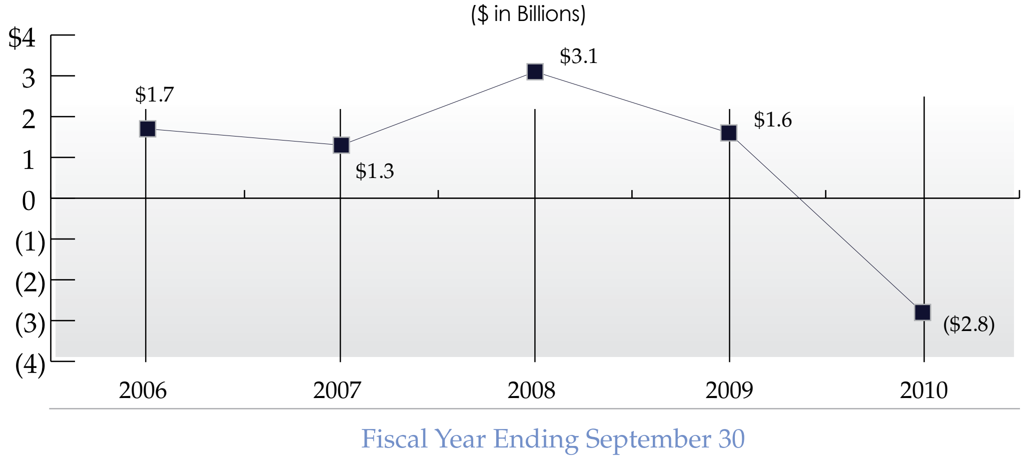
Note: In the above chart, Other includes budgetary resources permanently not available of $7.7 billion, which is offset against $0.8 billion sum total of Recoveries of prior year unpaid obligations and Change in unfilled customer orders.



The Combined Statement of Net Cost presents net cost of operations of $(2.8) billion during FY 2010. Net cost of operations represents gross costs incurred by NWCF less earned revenue. Sources of earned revenue include DON, Army, and Air Force General Funds, Defense Working Capital Funds, other Navy and DoD

NWCF Net Cost of Operations, FY 2006 – 2010

($ in Billions)



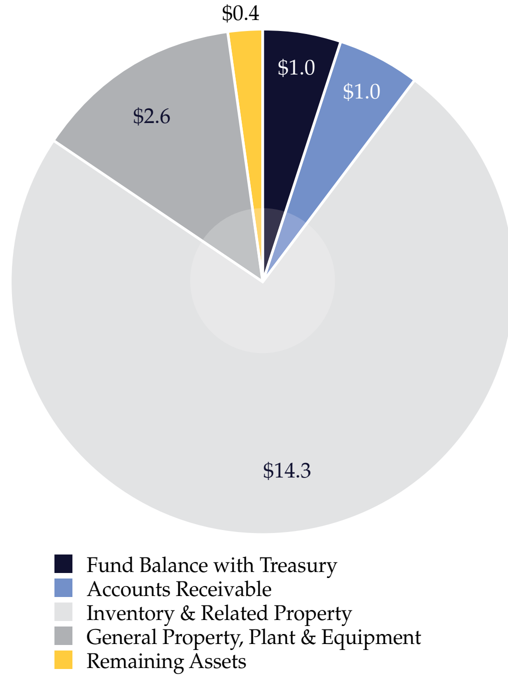
appropriations, and non-DoD fund sources. Earned revenue exceeded gross costs by $4.4 billion, 282%, in FY 2010 over FY 2009, which accounts for the negative net cost of operations.

Financial Position

The NWCF continued to report a positive net position on its Consolidated Balance Sheet. Net position is the difference between total assets (what is owned) and total liabilities (what is owed). As of September 30, 2010, net position totaled $13.3 billion, which represents an increase of $2.4 billion, 22%, from FY 2009. An increase of $1.6 billion in total assets contributed to the overall increase in net position. Total liabilities decreased $0.9 billion.

NWCF Total Assets, FY 2010

($ in Billions)



Navy Working Capital Fund Business Activities By Business Area

Supply Management	Depot Maintenance
Supply Management, Navy (*https://www.navsup.navy.mil*) Supply Management, Marine Corps (*http://www.logcom.usmc.mil*)	Depot Maintenance, Aviation (*http://www.navair.navy.mil*) Depot Maintenance, Marine Corps (*http://www.logcom.usmc.mil*)
Base Support	**Transportation**
Facilities Engineering Commands (*https://portal.navfac.navy.mil*) Naval Facilities Engineering Service Center (*https://portal.navfac.navy.mil*)	Military Sealift Command (*http://www.msc.navy.mil*)
Research and Development	
Naval Research Laboratory* (*http://www.nrl.navy.mil*) Naval Surface Warfare Center (*http://www.navsea.navy.mil*) Naval Undersea Warfare Center (*http://www.navsea.navy.mil*)	Naval Air Warfare Center (*http://www.navair.navy.mil*) Space and Naval Warfare Systems Centers (*http://enterprise.spawar.navy.mil*) *Also see Office of Naval Research (*http://www.onr.navy.mil*)

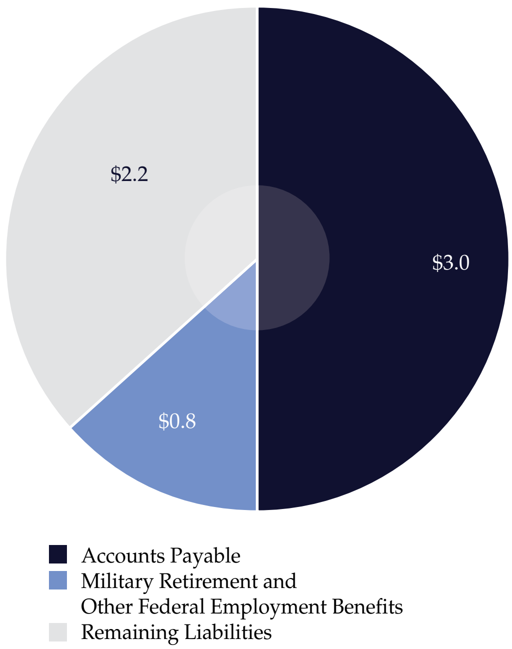
Cash Management

The DON manages working capital fund cash at the Departmental level. It must maintain cash levels at seven to ten days of operational costs, plus have sufficient cash reserves to meet six months of projected capital outlays, as required by the Department of Defense Financial Management Regulation. For FY 2010, the seven-day cash requirement was $828 million and the ten-day requirement was $1.139 billion.

Supply Management, Navy received a $48 million reimbursement for ordered items delivered to Defense Logistics Agency. In July 2010, DON received $203.5 million of Fuel Supplemental Funding.

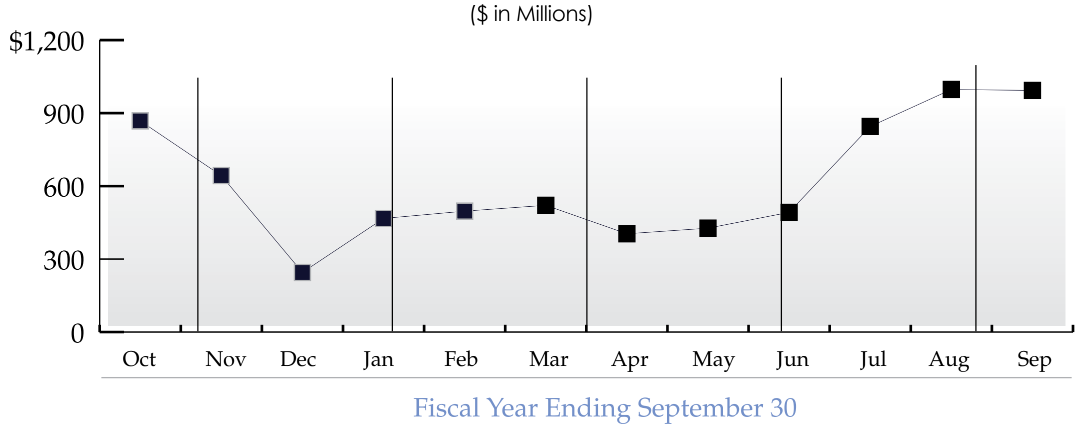
NWCF Total Liabilities, FY 2010

($ in Billions)



Navy Working Capital Fund Cash Balances October 1, 2009 to September 30, 2010

($ in Millions)



Note: Cash balances above represent the combined total of monthly cash balances for five business areas and the corporate account.

The aircraft carrier USS Harry S. Truman (CVN 75) transits the Arabian Sea in support of maritime security operations.

Looking Forward

Our achievements during FY 2010 established a firm foundation that will assure future success in executing our mission and building a sound business operating environment. In FY 2011, we will remain focused on priorities that increase our effectiveness and efficiency, improve the lives of our Sailors and Marines, and result in greater security for our nation and U.S. global interests. Highlighted below are a few of these priorities.

Maritime Security

The creation and maintenance of maritime security is essential to mitigating threats short of war, including piracy, terrorism, weapons proliferation, drug trafficking, and other illicit activities. Countering these threats far from our nation's shores protects the American homeland, enhances global stability, and secures freedom of navigation for all nations. The U.S. maritime services—Navy, Marine Corps, and Coast Guard—will continue to operate closely with other joint forces, allies, and coalition partners to prevent war and build partnerships pursuant to the U.S. maritime strategy.

Taking Care of Our People

Development and retention of highly qualified and dedicated people are vital to our continued success. We will continue to provide expanded career opportunities, opportunities for life-long learning, and a continuum of care and family support. We will also continue to support a wide array of readiness programs, including deployment support services, morale and welfare services, and child and teen programs.

A high efficiency lighting system, designed by Naval Sea Systems Command, is one of many energy conservation initiatives at the Department of the Navy.

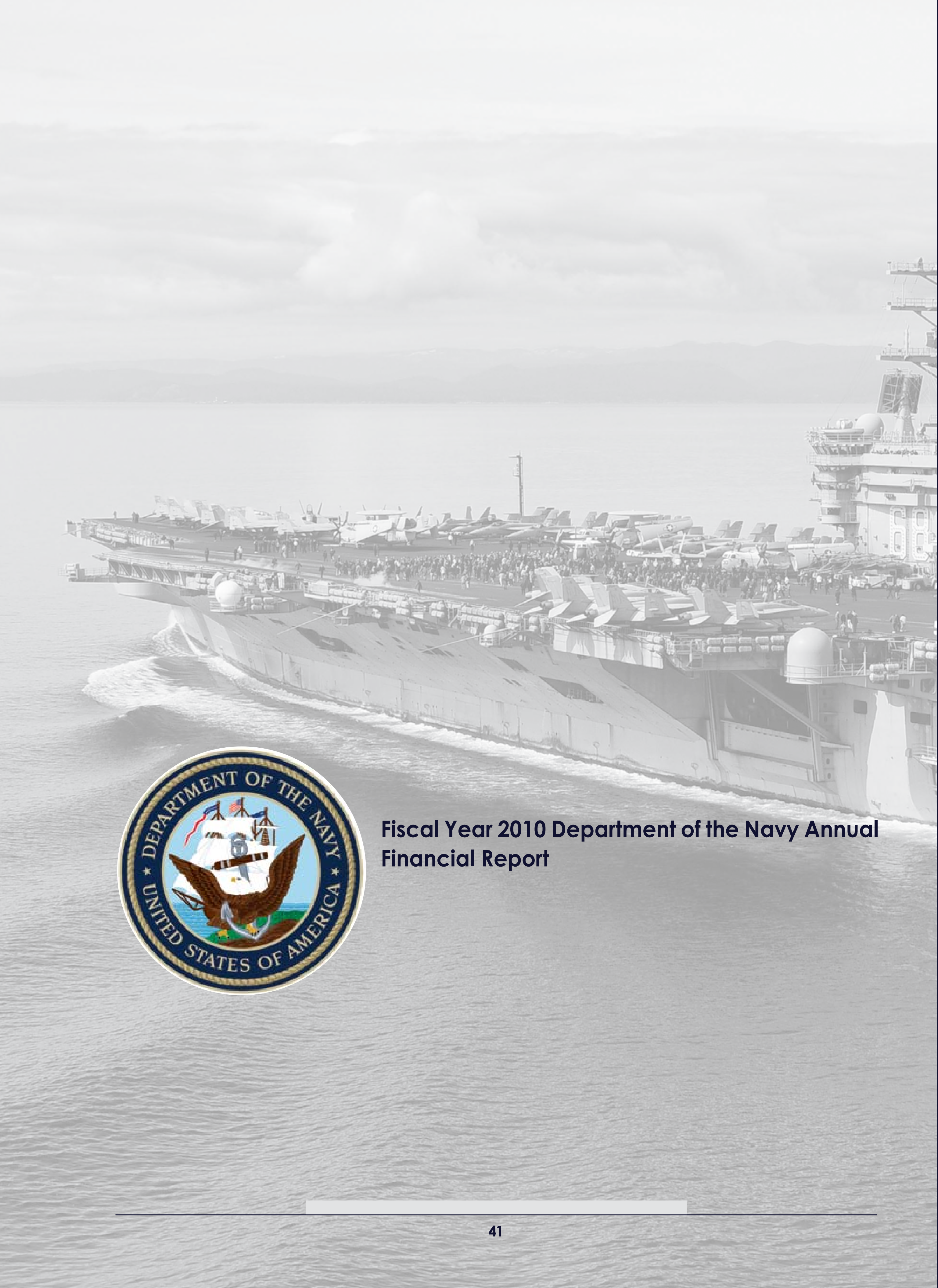
Energy Reform

Readily available energy is essential for deploying our Sailors and Marines around the globe in support of our nation's interests. Since our operational flexibility and sustainability are directly linked to our energy supplies, energy reliability is a strategic concern for our force. We will continue to work toward achieving greater energy independence and conservation ashore and afloat.

Business Transformation

A top priority of the Under Secretary of the Navy is to develop a business transformation plan that will serve as a roadmap from the existing suite of business systems to the future target environment of improved systems. The future environment will be charted using a portfolio management process and link existing business systems to the phasing-in of Navy ERP. Transformation efforts build upon many of the initiatives underway in various business mission areas.

We will continue to implement meaningful and sustainable changes in Navy-Marine Corps business management in order to continue the drive to improve effectiveness, realize efficiencies, and provide a more straightforward and tighter focus on business transformation.



Fiscal Year 2010 Department of the Navy Annual Financial Report

Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with Generally Accepted Accounting Principles for Federal entities and the formats prescribed by Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Principal Statements

The Fiscal Year 2010 Department of the Navy General Fund principal statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the General Fund for the fiscal year ending September 30, 2010, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2009.

The following statements comprise the Department of the Navy General Fund principal statements:

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

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

Department of Defense
Department of the Navy General Fund

CONSOLIDATED BALANCE SHEET

As of September 30, 2010 and 2009

($ in Thousands)

	2010 Consolidated	Restated 2009 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 133,919,522	$ 125,074,999
Investments (Note 4)	9,465	9,621
Accounts Receivable (Note 5)	394,557	373,313
Other Assets (Note 6)	263,633	418,505
Total Intragovernmental Assets	134,587,177	125,876,438
Cash and Other Monetary Assets (Note 7)	107,277	160,509
Accounts Receivable, Net (Note 5)	3,691,483	3,681,949
Inventory and Related Property, Net (Note 9)	62,053,484	62,424,699
General Property, Plant, and Equipment, Net (Note 10)	220,504,519	218,470,785
Other Assets (Note 6)	42,276,508	33,647,679
TOTAL ASSETS	$ 463,220,448	$ 444,262,059
Stewardship Property, Plant, and Equipment (Note 10) *		
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,657,333	$ 1,289,643
Other Liabilities (Note 15 & Note 16)	4,994,706	4,786,951
Total Intragovernmental Liabilities	6,652,039	6,076,594
Accounts Payable (Note 12)	2,682,893	2,652,609
Military Retirement and Other Federal Employment Benefits (Note 17)	1,692,851	1,494,427
Environmental and Disposal Liabilities (Note 14)	19,333,895	18,604,432
Other Liabilities (Note 15 & Note 16)	6,873,542	6,796,504
TOTAL LIABILITIES	37,235,220	35,624,566
Commitments and Contingencies (Note 16) *		
NET POSITION		
Unexpended Appropriations - Other Funds	169,307,091	152,638,280
Cumulative Results of Operations - Earmarked Funds	33,682	26,171
Cumulative Results of Operations - Other Funds	256,644,455	255,973,042
TOTAL NET POSITION	425,985,228	408,637,493
TOTAL LIABILITIES AND NET POSITION	$ 463,220,448	$ 444,262,059

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

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Consolidated	Restated 2009 Consolidated
Program Costs		
Gross Costs	$ 160,351,993	$ 149,391,922
Military Personnel	48,744,274	44,985,257
Operations, Readiness, & Support	58,676,332	56,015,152
Procurement	32,484,136	27,839,617
Research, Development, Test, & Evaluation	19,526,997	19,975,119
Family Housing & Military Construction	920,254	576,777
Less: Earned Revenue	(5,246,995)	(4,781,266)
Net Cost of Operations	$ 155,104,998	$ 144,610,656

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Earmarked Funds	2010 Other Funds
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 26,171	$ 255,973,042
Prior Period Adjustments:		
Correction of errors (+/-)	-	-
Beginning Balances, as adjusted	26,171	255,973,042
Budgetary Financing Sources:		
Appropriations used	-	157,582,719
Nonexchange revenue	270	(782)
Donations & forfeitures of cash & cash equivalents	27,374	-
Other Financing Sources:		
Donations and forfeitures of property	-	5,258
Transfers in/out without reimbursement (+/-)	-	1,243,648
Imputed financing from costs absorbed by others	-	884,867
Other (+/-)	2	(3,959,434)
Total Financing Sources	27,646	155,756,276
Net Cost of Operations (+/-)	20,135	155,084,863
Net Change	7,511	671,413
Cumulative Results of Operations	$ 33,682	$ 256,644,455
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ -	$ 153,212,818
Prior Period Adjustments:		
Correction of errors (+/-)	-	(574,538)
Beginning Balances, as adjusted	-	152,638,280
Budgetary Financing Sources:		
Appropriations received	-	174,174,405
Appropriations transferred-in/out (+/-)	-	2,589,140
Other adjustments (rescissions, etc) (+/-)	-	(2,512,015)
Appropriations used	-	(157,582,719)
Total Budgetary Financing Sources	-	16,668,811
Unexpended Appropriations	-	169,307,091
Net Position	$ 33,682	$ 425,951,546

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Consolidated	Restated 2009 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 255,999,213	$ 235,996,617
Prior Period Adjustments:		
Correction of errors (+/-)	-	(94,740)
Beginning Balances, as adjusted	255,999,213	235,901,877
Budgetary Financing Sources:		
Appropriations used	157,582,719	159,650,282
Nonexchange revenue	(512)	174
Donations & forfeitures of cash & cash equivalents	27,374	24,051
Other Financing Sources:		
Donations and forfeitures of property	5,258	(667)
Transfers in/out without reimbursement (+/-)	1,243,648	208,053
Imputed financing from costs absorbed by others	884,867	779,646
Other (+/-)	(3,959,432)	4,046,453
Total Financing Sources	155,783,922	164,707,992
Net Cost of Operations (+/-)	155,104,998	144,610,656
Net Change	678,924	20,097,336
Cumulative Results of Operations	$ 256,678,137	$ 255,999,213
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 153,212,818	$ 121,305,364
Prior Period Adjustments:		
Correction of errors (+/-)	(574,538)	27,207,894
Beginning Balances, as adjusted	152,638,280	148,513,258
Budgetary Financing Sources:		
Appropriations received	174,174,405	165,233,492
Appropriations transferred-in/out (+/-)	2,589,140	1,711,873
Other adjustments (rescissions, etc) (+/-)	(2,512,015)	(3,170,061)
Appropriations used	(157,582,719)	(159,650,282)
Total Budgetary Financing Sources	16,668,811	4,125,022
Unexpended Appropriations	169,307,091	152,638,280
Net Position	$ 425,985,228	$ 408,637,493

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Combined	Restated 2009 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 27,048,361	$ 28,028,796
Recoveries of prior year unpaid obligations	16,099,877	24,029,026
Budget Authority:		
Appropriations received	174,202,102	165,257,844
Spending authority from offsetting collections:		
Earned		
Collected	8,853,881	7,806,105
Change in receivables from Federal sources	(60,947)	(144,220)
Change in unfilled customer orders		
Advances received	(24,024)	323,916
Without advance from Federal sources	(582,631)	78,479
Subtotal	182,388,381	173,322,124
Nonexpenditure Transfers, net, anticipated and actual	2,589,140	1,711,873
Permanently not available	(2,512,014)	(3,170,061)
Total Budgetary Resources	225,613,745	223,921,758
Status of Budgetary Resources:		
Obligations incurred:		
Direct	179,434,110	186,657,507
Reimbursable	11,176,960	10,215,890
Subtotal	190,611,070	196,873,397
Unobligated balance:		
Apportioned	31,804,999	23,983,393
Subtotal	31,804,999	23,983,393
Unobligated balances not available	3,197,676	3,064,968
Total Status of Budgetary Resources	$ 225,613,745	$ 223,921,758

The accompanying notes are an integral part of the statements.

Department of Defense
Department of the Navy General Fund

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Combined	Restated 2009 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 101,403,501	$ 93,776,544
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(3,798,476)	(3,864,218)
Total Unpaid Obligated Balance	97,605,025	89,912,326
Obligations incurred, net (+/-)	190,611,070	196,873,397
Less: Gross outlays	(174,313,017)	(165,217,414)
Less: Recoveries of prior year unpaid obligations, actual	(16,099,877)	(24,029,026)
Change in uncollected customer payments from Federal sources (+/-)	643,578	65,742
Obligated balance, net, end of period		
Unpaid obligations	101,601,677	101,403,501
Less: Uncollected customer payments from Federal sources	(3,154,898)	(3,798,476)
Total Unpaid Obligated Balance, net, end of period	98,446,779	97,605,025
Net Outlays:		
Gross Outlays	174,313,017	165,217,414
Less: Offsetting collections	(8,829,857)	(8,130,022)
Less: Distributed Offsetting receipts	(141,386)	(321,451)
Net Outlays	$ 165,341,774	$ 156,765,941

The accompanying notes are an integral part of the statements.

Fiscal Year 2010 Department of the Navy Annual Financial Report

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

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

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

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

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

The Department of Defense Inspector General (DoDIG) issued an audit report dated November 8, 2010 and identified several financial statement material weaknesses: Financial Management Systems; Fund Balance with Treasury; Accounts Receivable; Inventory and Related Property; General Plant, Property, and Equipment (GPP&E); Accounts Payable; Statement of Net Cost; Problem Disbursements; and Unobligated Balances. The DON GF (as identified in the DON FY 2010 Annual Statement of Assurance dated September 1, 2010) recognizes those weaknesses as well as weaknesses associated with Collections and Disbursements, Procure to Pay Processes, General Equipment, Military Equipment, Real Property as related to the GPP&E line on the Balance Sheet, and Operating Materiel and Supplies (OM&S) (and the associated weaknesses with Inventory).

1.B. Mission of the Reporting Entity

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

1.C. Appropriations and Funds

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

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

These general funds also include supplemental funds enacted by the American Recovery and Reinvestment Act (Recovery Act) of 2009. Details relating to Recovery Act appropriated funds are available on-line at *http://www.defenselink.mil/recovery*.

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

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits, or purposes, and remain available over time. The DON GF is required to separately account for and report on the receipt, use, and retention of revenues and other financing sources for earmarked funds.

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

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

The DON GF receives allocation transfers for the EOP for the Foreign Military Financing Program and for the International Military Education and Training program, meeting the OMB exception; however, activities for these funds are reported separately from the DoD financial statements. The DON GF also receives allocation transfers from the U.S. Forest Service and the Federal Highway Administration and reports financial activity for those funds to the parent.

1.D. Basis of Accounting

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

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

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

1.E. Revenues and Other Financing Sources

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

The DON GF 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 Note 21, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost sharing agreements with countries having a mutual or reciprocal defense agreement, or where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

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

1.G. Accounting for Intragovernmental Activities

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

The U.S. Treasury's Federal Intragovernmental Transactions Accounting Policy Guide and Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government, provide guidance for reporting and reconciling intragovernmental balances. While DON GF is unable to fully reconcile intragovernmental transactions with all federal agencies, DON GF 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, and benefit program transactions with the Office of Personnel Management.

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

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

1.H. Transactions with Foreign Governments and International Organizations

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

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

The DON GF's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of DON's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits.

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

1.J. Foreign Currency

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

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

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

1.K. Accounts Receivable

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

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

The DON GF manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self-propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in DON GF's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The DON GF holds materiel based on military need and support for contingencies. The DoD is currently developing a methodology to be used to account for "inventory held for sale" and "inventory held in reserve for future sale" with a completion date of year-end FY 2011 reporting.

Related property includes OM&S and stockpile materiel. The DON GF 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 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, DON GF uses the purchase method. Under this method, materiel and supplies are expensed when purchased. During FY 2010 and FY 2009, DON GF expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. This is a material weakness for DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for using the consumption method of accounting.

The DON GF values OM&S assets using several cost valuation methods. Most OM&S is valued 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 logistics systems were designed for materiel management rather than accounting purposes. Although these systems provide visibility and accountability over inventory and related property items, they do not maintain historical cost data necessary to comply with Statement of Federal Financial Accounting Standards (SFFAS) No. 3, Accounting for Inventory and Related Property. Additionally, these legacy inventory systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). The DON is continuing to transition OM&S to the moving average cost method. Most transitioned balances, however, were not baselined to auditable historical cost, and remain noncompliant with SFFAS No. 3.

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

The DON recognizes excess, obsolete, and unserviceable inventory and OM&S at a net realizable value of $0 pending development of an effective means of valuing such materiel.

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

The DON GF reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments using the effective interest rate method or another method obtaining similar results. The DON GF's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The DON GF invests in nonmarketable market-based U.S. Treasury securities, which are issued to federal agencies by the U.S. Treasury's Bureau of Public Debt. They are not traded on any securities exchange but mirror the prices of particular U.S. Treasury securities traded in the government securities market.

1.O. General Property, Plant and Equipment

The DON GF uses the estimated historical cost for valuing military equipment. The DoD identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, program acquisitions, and disposals to establish a baseline. The military equipment baseline is updated using expenditure, acquisition, and disposal information.

The DoD's General Property, Plant, and Equipment (PP&E) capitalization threshold is $100 thousand except for real property, which is $20 thousand. The DON has not fully implemented the threshold for real property; therefore, DON is primarily using the capitalization threshold of $100 thousand for General PP&E and most real property.

General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD's capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

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

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

1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy is to record advances or prepayments in accordance with USGAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The DON GF has not implemented this policy primarily due to system limitations.

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

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

1.R. Other Assets

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

The DON GF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DON GF may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts. It is DoD policy to record certain contract financing payments as other assets. The DON GF has not fully implemented this policy primarily due to system limitations.

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

1.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 DON GF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. The DON GF's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

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

1.T. Accrued Leave

The DON GF reports liabilities for military leave and accrued compensatory and annual leave for civilians. Sick leave for civilians is expensed as taken. The liabilities are based on current pay rates.

1.U. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended Appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred. Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.V. Treaties for Use of Foreign Bases

The DoD has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The DON purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. Treaty terms generally allow DON continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, use of the foreign bases is prohibited and losses are recorded for the value of any nonretrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

1.W. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury.

Supported disbursements and collections are evidenced by collaborating documentation. Unsupported disbursements and collections do not have supporting documentation for the transaction and most likely would not meet audit scrutiny.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Supported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly. Unsupported undistributed disbursements are recorded as disbursements intransit and reduce nonfederal accounts payable. Unsupported undistributed collections are recorded in nonfederal other liabilities.

1.X. Significant Events

None reported at this time.

1.Y. Fiduciary Activities

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

Note 2. Nonentity Assets

As of September 30	2010	Restated 2009
(Amounts in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	$ 421,725	$ 289,564
B. Accounts Receivable	-	-
C. Total Intragovernmental Assets	$ -	$ -
D. Total Intragovernmental Assets	421,725	289,564
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ 107,278	$ 160,509
B. Accounts Receivable	3,483,615	3,462,365
C. Other Assets	-	-
D. Total Nonfederal Assets	$ 3,590,893	$ 3,622,874
3. Total Nonentity Assets	$ 4,012,618	$ 3,912,438
4. Total Entity Assets	$ 459,207,830	$ 440,349,621
5. Total Assets	$ 463,220,448	$ 444,262,059

Nonentity assets are assets for which the Department of the Navy (DON) maintains stewardship accountability and reporting responsibility, but are not available for DON's normal operations.

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

Cash and Other Monetary Assets
This nonentity asset category represents disbursing officers' cash, foreign currency, and undeposited collections as reported on the Disbursing Officer's Statement of Accountability. These assets are held by DON disbursing officers as agents of the U.S. Treasury and are not available for DON's use in normal operations.

Nonentity Nonfederal Accounts Receivable (Public)
The primary component of nonentity accounts receivable is an advance payment made to a contractor, which remains in litigation and includes associated accrued interest. These receivable balances are being reported in nonentity accounts receivable since the original appropriation year has been cancelled, and any funds collected as a result of this litigation would be remitted to the U.S. Treasury.

The DON General Fund restated its FY 2009 Nonentity Assets balance by $505.6 million. Refer to Note 26, Restatements, for additional details.

Note 3. Fund Balance with Treasury

As of September 30	2010	Restated 2009
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ 131,782,542	$ 123,186,669
B. Revolving Funds	1,689,432	1,580,966
C. Trust Funds	23,615	15,400
D. Special Funds	2,208	2,400
E. Other Fund Types	421,725	289,564
F. Total Fund Balances	$ 133,919,522	$ 125,074,999
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 135,351,248	$ 126,394,135
B. Fund Balance per DON	133,919,522	125,074,999
3. Reconciling Amount	$ 1,431,726	$ 1,319,136

The total reconciling amount of $1.4 billion in Fund Balance with Treasury (FBWT) is mainly due to trust receipts, saving deposit program differences, and parent-child transactions. The reconciling difference related to allocation transfers results from instances in which the Department of the Navy (DON) allocates to or is allocated funds from various governmental entities. In cases in which DON is allocated funds, the amount is excluded from the Fund Balance per DON, but included in Fund Balance per Treasury. In cases in which DON allocates funds, the amount is included in the Fund Balance per

DON, but it is excluded from the Fund Balance per Treasury. In addition, canceled authority balances are still carried at Treasury but not at DON.

Other Fund Types (Line 1.E) consists primarily of amounts in the following deposit and receipt accounts: General Fund Proprietary Receipts, Pay of the Navy Deposit Fund.

Status of Fund Balance with Treasury

As of September 30	2010	Restated 2009
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	$ 31,804,998	$ 23,983,394
B. Unavailable	3,197,676	3,064,968
2. Obligated Balance not yet Disbursed	101,601,677	101,403,501
3. Nonbudgetary FBWT	479,502	431,148
4. NonFBWT Budgetary Accounts	(3,164,331)	(3,808,011)
5. Total	$ 133,919,522	$ 125,075,000

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

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

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

Nonbudgetary FBWT includes accounts that do not have budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts and nonentity FBWT. For DON General Fund (GF), Nonbudgetary FBWT consists of balances in receipt accounts and clearing accounts.

NonFBWT Budgetary Accounts reduces the Status of FBWT. For DON GF, NonFBWT Budgetary Accounts include Trust Fund investments in U.S. Treasury securities, unfilled customer orders without advance, and reimbursements receivable.

Unobligated balances are segregated to show available and unavailable amounts in the note schedule. Unobligated, Unavailable balances are restricted to future use and are not apportioned for current use.

Although funds have been appropriated, expired single year appropriations, such as Operation and Maintenance and Military Personnel accounts, are not generally available for obligation because the period for obligation established by law in the applicable appropriation act has lapsed. Multi-year accounts and "X" or no year accounts are restricted based on their appropriation type. Trust funds and Earmarked funds are restricted to their intended use.

The DON GF restated the following FY 2009 Status of FBWT lines: Unobligated Balance, Available by $83.4 million; Unobligated Balance, Unavailable by $60.5 million; and Obligated Balance not yet Disbursed by $143.9 million. Refer to Note 26, Restatements, for additional details.

Note 4. Investments and Related Interest

As of September 30	2010				
(Amounts in thousands)	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
1. Intragovernmental Securities					
A. Nonmarketable, Market-Based					
1. Military Retirement Fund	$ -		$ -	$ -	$ -
2. Medicare Eligible Retiree Health Care Fund	-		-	-	-
3. US Army Corps of Engineers	-		-	-	-
4. Other Funds	9,480		(30)	9,450	9,453
5. Total Nonmarketable, Market-Based	$ 9,480		$ (30)	$ 9,450	$ 9,453
B. Accrued Interest	15		-	15	15
C. Total Intragovernmental Securities	$ 9,495		$ (30)	$ 9,465	$ 9,468
2. Other Investments					
A. Total Other Investments	$ -		$ -	$ -	$ -

As of September 30	2009				
(Amounts in thousands)	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure
1. Intragovernmental Securities					
A. Nonmarketable, Market-Based					
1. Military Retirement Fund	$ -		$ -	$ -	$ -
2. Medicare Eligible Retiree Health Care Fund	-		-	-	-
3. US Army Corps of Engineers	-		-	-	-
4. Other Funds	9,631		(40)	9,591	9,601
5. Total Nonmarketable, Market-Based	$ 9,631		$ (40)	$ 9,591	$ 9,601
B. Accrued Interest	30		-	30	30
C. Total Intragovernmental Securities	$ 9,661		$ (40)	$ 9,621	$ 9,631
2. Other Investments					
A. Total Other Investments	$ -		$ -	$ -	$ -

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

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

Other Funds (Line 1.A.4) represents DON Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the Navy General Gift Fund. These investments are Nonmarketable Market-Based U.S. Treasury securities reported at cost, net of amortized premiums and discounts. In accordance with the Statement of Federal Financial Accounting Standards No. 27, "Identifying and Reporting Earmarked Funds," DON Trust Funds are reported as earmarked funds.

Note 5. Accounts Receivable

As of September 30	2010					
		Gross Amount Due		Allowance For Estimated Uncollectibles		Accounts Receivable, Net
(Amounts in thousands)						
1. Intragovernmental Receivables	$	394,557		N/A	$	394,557
2. Nonfederal Receivables (From the Public)		3,711,724		(20,241)		3,691,483
3. Total Accounts Receivable	$	4,106,281	$	(20,241)	$	4,086,040

As of September 30	2009					
		Gross Amount Due		Allowance For Estimated Uncollectibles		Accounts Receivable, Net
(Amounts in thousands)						
1. Intragovernmental Receivables	$	373,313		N/A	$	373,313
2. Nonfederal Receivables (From the Public)		3,714,338		(32,389)		3,681,949
3. Total Accounts Receivable	$	4,087,651	$	(32,389)	$	4,055,262

The accounts receivable represent the Department of the Navy's (DON) claim for payment from other entities. The DON only recognizes an allowance for uncollectible amounts from the public. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules.

Note 6. Other Assets

As of September 30	2010		Restated 2009	
(Amounts in thousands)				
1. Intragovernmental Other Assets				
A. Advances and Prepayments	$	263,633	$	418,505
B. Other Assets		-		-
C. Total Intragovernmental Other Assets	$	263,633	$	418,505
2. Nonfederal Other Assets				
A. Outstanding Contract Financing Payments	$	42,042,591	$	33,239,169
B. Advances and Prepayments		220,572		398,856
C. Other Assets (With the Public)		13,345		9,654
D. Total Nonfederal Other Assets	$	42,276,508	$	33,647,679
3. Total Other Assets	$	42,540,141	$	34,066,184

Nonfederal Other Assets - Outstanding Contract Financing Payments (OCFP)
Contract terms and conditions for certain types of contract financing payments convey certain rights to the Government that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal

Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the Department of the Navy (DON) is not obligated to make payment to the contractor until delivery and acceptance. Some of the amounts reported as OCFP may be progress payments based on percentage or stage of completion. However, DON is unable to identify these due to system limitations and all amounts are reported as OCFP.

The balance of OCFP includes $41.7 billion in contract financing payments and an additional $380.1 million in estimated future payments to contractors upon delivery and government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

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

The DON General Fund restated its FY 2009 OCFP balance by $505.6 million. Refer to Note 26, Restatements, for additional details.

Note 7. Cash and Other Monetary Assets

As of September 30	2010	2009
(Amounts in thousands)		
1. Cash	$ 64,352	$ 65,429
2. Foreign Currency	42,925	95,080
3. Other Monetary Assets	-	-
4. Total Cash, Foreign Currency, & Other Monetary Assets	$ 107,277	$ 160,509

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

Restriction on Cash, Foreign Currency and Other Monetary Assets
Total Cash, Foreign Currency, and Other monetary assets reported are nonentity assets that are not available for DON's use in normal operations. Therefore, the $107.3 million in Cash and Foreign Currency is restricted as to its use.

Note 8. Direct Loan and Loan Guarantees

Not applicable.

Note 9. Inventory and Related Property

As of September 30	2010	2009
(Amounts in thousands)		
1. Inventory, Net	$ -	$ -
2. Operating Materiel & Supplies, Net	62,053,484	62,424,699
3. Stockpile Materiel, Net	-	-
4. Total	$ 62,053,484	$ 62,424,699

Inventory, Net

Not applicable.

Operating Materiel and Supplies, Net

As of September 30	2010			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
(Amounts in thousands)				
1. OM&S Categories				
A. Held for Use	$ 57,697,650	$ -	$ 57,697,650	SP, LAC, MAC
B. Held for Repair	6,401,691	(2,045,857)	4,355,834	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable	1,328,957	(1,328,957)	-	NRV
D. Total	$ 65,428,298	$ (3,374,814)	$ 62,053,484	

As of September 30	2009			
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	Valuation Method
(Amounts in thousands)				
1. OM&S Categories				
A. Held for Use	$ 57,668,809	$ -	$ 57,668,809	SP, LAC, MAC
B. Held for Repair	6,414,636	(1,658,746)	4,755,890	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable	809,170	(809,170)	-	NRV
D. Total	$ 64,892,615	$ (2,467,916)	$ 62,424,699	

Legend for Valuation Methods:

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

General Composition of Operating Materiel and Supplies (OM&S)

OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The categories of OM&S are Ammunitions and Munitions, Principal End and Secondary Items, Sponsor Owned Materiel (SOM), Realtime Reutilization Asset Management (RRAM) Materiel and Other OM&S.

Ammunition and Munitions are maintained in the Department of the Navy (DON) Ordnance Information System and valued at latest acquisition cost.

Principal End and Secondary Items include OM&S such as shipboard hull, mechanical and electronic equipment, and uninstalled aircraft engines. They are items of such importance that central inventory control is required. They normally possess one of the following characteristics: essential for combat or training; high dollar value; difficult to procure or produce; or critical basic materiel or components.

SOM is defined as programmatic materiel required in support of Program Managers' mission requirements for production, life cycle maintenance, and installation of systems and equipment. The materiel usage may involve, but is not limited to: item fabrication, assembly, testing, manufacture, development, repair, or research and development.

Materiel maintained and valued in RRAM is considered excess to the owner, or materiel manager responsible for the materiel, but may not be excess to DON. Standard price is used to value all stock-numbered items. Part-numbered items are valued by best available information. Stock-numbered items represent common items available in the supply system. Part-numbered items are older, unique items only used in specific types of OM&S.

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

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

Decision Criteria for Identifying the Category to Which OM&S Is Assigned
The DON General Fund assigns OM&S items to a category based upon the type and condition of the asset. OM&S Available and Purchased for Resale includes spare and repair parts, clothing and textiles, and petroleum products. OM&S Held for Repair consists of damaged materiel held as inventory that is more economical to repair than to dispose. Excess, Obsolete, and Unserviceable OM&S consists of scrap materiel or items that cannot be economically repaired and are awaiting disposal. Raw Materials consists of items consumed in the production of goods for sale or in the provision of services for a fee.

Stockpile Materiel, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30	2010				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 614,992	N/A	$ 614,992
B. Buildings, Structures, and Facilities	S/L	20 Or 40	36,123,500	$ (21,104,162)	15,019,338
C. Leasehold Improvements	S/L	Lease term	6,530	(2,079)	4,451
D. Software	S/L	2-5 Or 10	11,594	(10,921)	673
E. General Equipment	S/L	5 or 10	14,979,935	(6,472,441)	8,507,494
F. Military Equipment	S/L	Various	353,215,833	(161,790,209)	191,425,624
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	Lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	3,717,174	N/A	3,717,174
J. Other			1,214,773	-	1,214,773
K. Total General PP&E			$ 409,884,331	$ (189,379,812)	$ 220,504,519

As of September 30	2009				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 576,770	N/A	$ 576,770
B. Buildings, Structures, and Facilities	S/L	20 Or 40	34,992,199	$ (21,019,586)	13,972,613
C. Leasehold Improvements	S/L	Lease term	6,530	(1,768)	4,762
D. Software	S/L	2-5 Or 10	11,594	(10,363)	1,231
E. General Equipment	S/L	5 or 10	11,565,043	(6,152,590)	5,412,453
F. Military Equipment	S/L	Various	348,505,864	(153,186,170)	195,319,694
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	Lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	3,183,262	N/A	3,183,262
J. Other			-	-	-
K. Total General PP&E			$ 398,841,262	$ (180,370,477)	$ 218,470,785

Legend for Valuation Methods:

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

Restrictions on the Use or Convertibility of General Property, Plant, & Equipment (PP&E)
The Department of the Navy (DON) has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow DON continued use of these properties until the treaties expire. There are no other known restrictions on General PP&E.

Accounting Standards for Military Equipment
The DON estimates values for Capitalized Military Equipment using department internal records. The Capital Asset Management System-Military Equipment (CAMS-ME) is a Department of Defense (DoD) wide system used to provide DON's Military Equipment valuations. The DoD identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, program acquisitions, and disposals to establish a baseline. The military equipment baseline is updated using expenditure, acquisition, and disposals information.

Other General PP&E consists of Real Property held in Caretaker Status. Caretaker is defined as those properties that Navy still owns, but which are being held awaiting further disposal action, such as BRAC property awaiting sale or transfer to another Federal agency.

Heritage Assets and Stewardship Land
The Federal Accounting Standards Advisory Board's SFFAS No. 29, "Heritage Assets and Stewardship Land," requires note disclosures for these types of assets. The DON's policy is to preserve its heritage assets, which are items of historical, cultural, educational, or artistic importance.

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

- Buildings and Structures. Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including Multi-Use Heritage Assets.
- Archeological Sites. Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Historical Places in accordance with Section 110 National Historical Preservation Act.
- Museum Collection Items. Items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant technical or architectural characteristics.

The beginning and ending dates for the reported heritage assets are October 1, 2009 and September 30, 2010, respectively:

Categories	Measure Quantity	As of September 30, 2009	Additions	Deletions	As of September 30, 2010
Buildings and Structures	Each	11,452	11,819	97	23,174
Archaeological Sites	Each	19,014	356	-	19,370
Museum Collection Items (Objects, Not Including Fine Art)	Each	566,049	53,401	2,398	617,052
Museum Collection Items (Objects, Fine Art)	Each	28,955	2,653	6	31,602

The DON's stewardship land consists mainly of mission essential land acquired by donation or devise. Fiscal Year Ended September 30, 2009 stewardship land data is not yet available due to limitations of DON's financial and nonfinancial management processes and systems that feed into the financial statements. The DON held the following acres of land as of September 30, 2008.

(acres in Thousands)

Facility Code	Facility Title	As of September 30, 2009	Additions	Deletions	As of September 30, 2010
9110	Government Owned Land	6	-	-	6
9111	State Owned Land	-	-	-	-
9120	Withdrawn Public Land	1,986	43	-	2,029
9130	Licensed and Permitted Land	21	-	-	21
9140	Public Land	-	-	-	-
9210	Land Easement	-	-	-	-
9220	In-Leased Land	-	-	-	-
9230	Foreign Land	-	-	-	-
				Grand Total	2,056
				TOTAL - All Other Lands	27
				TOTAL - Stewardship Lands	2,029

Relationship of Heritage Assets to DON's Mission

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

Assets under Capital Lease

Not applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2010	Restated 2009
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ -	$ -
B. Debt	-	-
C. Other	571,299	449,392
D. Total Intragovernmental Liabilities	$ 571,299	$ 449,392
2. Nonfederal Liabilities		
A. Accounts Payable	$ 77,278	$ 43,148
B. Military Retirement and Other Federal Employment Benefits	1,692,779	1,494,427
C. Environmental Liabilities	19,333,895	18,604,432
D. Other Liabilities	4,550,479	4,524,248
E. Total Nonfederal Liabilities	$ 25,654,431	$ 24,666,255
3. Total Liabilities Not Covered by Budgetary Resources	$ 26,225,730	$ 25,115,647
4. Total Liabilities Covered by Budgetary Resources	$ 11,009,490	$ 10,508,919
5. Total Liabilities	$ 37,235,220	$ 35,624,566

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided. Budgetary Authority to satisfy these liabilities is expected to be provided in a future Department of Defense Appropriations Act.

Conversely, Liabilities Covered by Budgetary Resources includes those that are incurred by the reporting entity, which are covered by realized budgetary resources as of the balance sheet date. Budgetary resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year.

Realized budgetary resources include:

- New budget authority
- Spending authority from offsetting collections (credited to an appropriation or fund account)
- Recoveries of unexpired budget authority through downward adjustments of prior year obligations
- Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and
- Permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by the Office of Management and Budget without further action by the Congress or without a contingency first having to be met.

Accounts payable not covered by budgetary resources is related to cancelled year accounts payable that are not budgeted. Military retirement and other federal employment benefits are future actuarial liabilities. Environmental liabilities are estimates related to future events, such as cleanup of nuclear powered assets that will be budgeted for when those assets are removed from service. Finally, other liabilities for annual leave, estimated legal contingent liabilities, and the disposal of excess structures are not currently budgeted for but will become funded as future events occur.

Military Retirement and Other Federal Employment Benefits consists of Federal Employees' Compensation Act (FECA) actuarial liabilities not due and payable during the current fiscal year. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Intragovernmental Liabilities – Other (Not Covered by Budgetary Resources) (Line 1.C) consists primarily of FECA liabilities due to the Department of Labor.

Nonfederal Liabilities – Other (Not Covered by Budgetary Resources) (Line 2.D) consists primarily of liabilities for annual leave, estimated legal contingencies, and for the disposal of excess and obsolete structures.

DON GF restated its FY 2009 Total Liabilities Covered by Budgetary Resources balance by $69.9 million. Refer to Note 26, Restatements, for additional details.

Note 12. Accounts Payable

As of September 30	2010		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 1,657,333	$ N/A	$ 1,657,333
2. Nonfederal Payables (to the Public)	2,682,876	17	2,682,893
3. Total	$ 4,340,209	$ 17	$ 4,340,226

As of September 30	Restated 2009		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 1,289,643	$ N/A	$ 1,289,643
2. Nonfederal Payables (to the Public)	2,652,599	10	2,652,609
3. Total	$ 3,942,242	$ 10	$ 3,942,252

Accounts Payable include amounts owed to federal and nonfederal entities for goods and services received by the Department of the Navy (DON). The DON General Fund's accounting systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side accounts payable are adjusted to agree with intraagency seller-side accounts receivable. This is accomplished by reclassifying amounts between federal and nonfederal cost categories, and accruing additional costs when necessary.

DON GF restated its FY 2009 Nonfederal Payables (to the Public) by $69.0 million. Refer to Note 26, Restatements, for additional details.

Note 13. Debt

Not applicable.

Note 14. Environmental Liabilities

As of September 30	2010	2009
(Amounts in thousands)		
1. Environmental Liabilities–Nonfederal		
A. Accrued Environmental Restoration Liabilities		
1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 2,464,830	$ 2,267,235
2. Active Installations—Military Munitions Response Program (MMRP)	824,373	895,417
3. Formerly Used Defense Sites—IRP and BD/DR	-	-
4. Formerly Used Defense Sites–MMRP	-	-
B. Other Accrued Environmental Liabilities—Non-BRAC		
1. Environmental Corrective Action	$ 77,011	$ 127,947
2. Environmental Closure Requirements	553,204	575,754
3. Environmental Response at Operational Ranges	14,380	14,035
4. Asbestos	206,305	46,784
5. Non-Military Equipment	78,818	79,667
6. Other	810	922
C. Base Realignment and Closure Installations		
1. Installation Restoration Program	$ 1,459,029	$ 1,588,246
2. Military Munitions Response Program	146,931	107,492
3. Environmental Corrective Action / Closure Requirements	33,814	34,071
4. Asbestos	-	-
5. Non-Military Equipment	-	-
6. Other	-	-
D. Environmental Disposal for Military Equipment / Weapons Programs		
1. Nuclear Powered Military Equipment / Spent Nuclear Fuel	$ 13,290,837	$ 12,672,448
2. Non-Nuclear Powered Military Equipment	-	-
3. Other National Defense Weapons Systems	183,553	194,414
4. Other	-	-
E. Chemical Weapons Disposal Program		
1. Chemical Demilitarization - Chemical Materials Agency (CMA)	$ -	$ -
2. Chemical Demilitarization - Assembled Chemical Weapons Alternatives (ACWA)	-	-
3. Other	-	-
2. Total Environmental Liabilities	$ 19,333,895	$ 18,604,432

The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment was $2.5 billion for Fiscal Year (FY) 2010 and $1.7 billion for FY 2009.

The "Other" type of environmental liabilities under Other Accrued Environmental Costs (Line 1.B.6) represents an environmental estimate for disposal of Polychlorinated Biphenyls (PCBs) transformers located at various Naval installations.

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

1. Applicable Laws and Regulations of Cleanup Requirements
The following is a list of significant laws that affect DON's conduct of environmental policy and regulations.

- The Comprehensive Environmental Response, Compensation, and Liability Act of 1980, commonly referred to as the Superfund legislation
- The Resource Conservation and Recovery Act of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984
- The Clean Water Act of 1977, amended the Federal Water Pollution Control Act
- The Atomic Energy Act of 1954
- The Nuclear Waste Policy Act of 1982
- The Low Level Radioactive Waste Policy Amendments Act of 1986
- The National Environmental Policy Act of 1970 (BRAC only)

2. Methods for Assigning Total Cleanup Costs to Current Operating Periods
Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) Funded Liabilities).

Active Installations - Environmental Restoration: Accrued restoration (cleanup) liabilities represent the cost to correct past environmental areas that are funded under the Defense Environmental Restoration Program in accordance with "Management Guidance for DERP," and "Environmental and Non-Environmental Liabilities," Chapter 13 of Volume 4 of Department of Defense Financial Management Regulation (DoD FMR). These liabilities relate to Property, Plant, and Equipment, including acquired land and Stewardship Land, as those major asset categories are described in Chapter 6 of Volume 4 of DoD FMR. Environmental restoration activities may be conducted at operating installations, and at Closed, Transferred, and Transferring Ranges. Environmental restoration measurements involve the use of cost estimates that consider, on a current cost basis, the anticipated costs of the level of effort required to affect the restoration, as well as applicable legal and/or regulatory requirements. Program management and support costs are included in the estimates. The estimates are based on DON's cost-to-complete (CTC) module of the Normalization of Data System (NORM) and other Verified, Validated and Accredited (VAA'd) systems. Verification, validation, and accreditation of CTC module was completed in FY 2002. Such cost estimates are based on the current technology available. The DON, as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services), used the site inventory and estimated cost data prepared for FY 09 DERP report to the Congress. The Accrued Environmental Restoration (Cleanup) Costs do not include the costs of environmental compliance; pollution prevention, conservation activities, contamination, or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations.

The DON Environmental Restoration Program cost estimate was 3,734 Installation Restoration Program (IRP) and 278 Military Munitions Response Program (MMRP) sites at active installations while those installations covered by Base Realignment and Closure (BRAC) funding include 208 IRP sites and 32 MMRP sites. In addition, the DON Environmental Corrective Action Program at BRAC installations includes 31 sites.

Active Installations - Military Munitions Response Program: This area represents the environmental liabilities associated with the identification, investigation and removal and remedial actions to address environmental contamination at ranges that were closed prior to September 30, 2002. The contamination may include munitions, chemical residues from military munitions and munitions scrap at ranges on active installations that pose a threat to human health or the environment. The amount reported is the portion of the liability that can be estimated based on site level investigations and characterizations. The estimate produced is based on site-specific information and use of cost models validated in accordance with DoD Instruction 5000.61, "DoD Modeling and Simulation, Verification, Validation, and Accreditation," of May 2003. CTC is not estimated until there is sufficient site-specific data available to estimate the total cost to complete for MMRP-eligible sites. However, DON uses the cost of the study as the estimate until the study is completed. Beginning in FY 2001, DON began an inventory of closed ranges and transferring ranges and individual restoration sites under the MMRP or Unexploded Ordnance (UXO) program and completed it in September 2002. Currently there are 278 closed range sites at active installations and 32 MMRP sites at BRAC installations.

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

3. Description of the Types of Environmental Liabilities and Disposal Liabilities

Accrued Environmental Restoration (DERP Funded) Liabilities.

The DON Environmental Restoration includes those sites that have been identified as legacy cleanup sites. As of 4th Quarter, FY 2010, DON estimated and reported \$3.3 billion for environmental restoration liabilities. This amount is comprised of \$2.5 billion in Active Installations-IRP liabilities and \$824.4 million in Active Installations – MMRP liabilities, which represents UXO. The DoD FMR, Volume 6B, Chapter 10 requires that "any estimate produced must be based on site specific information and use cost models validated in accordance with DoD Instruction 5000.61." The DON is supporting this requirement by continuing to validate its range inventory as well as by pursuing the process of obtaining valid cost estimates for each range.

Other Accrued Environmental Costs (Non-BRAC funds).
The DON defines Non-BRAC environmental units as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retro fill, and/or disposal of PCBs transformers, underground storage tank remedial investigation and closure. As part of the DON FIP efforts, the Navy completed surveying, identifying, and estimating, Non-BRAC units and began recognizing the estimated environmental liability 1st Quarter, FY 2007. For FY 2010, the total Other Accrued Environmental Liabilities is $930.5 million.

Base Realignment and Closure.
BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated BRAC process. For FY 2010, DON estimated and reported $1.6 billion for BRAC funded environmental liabilities. This amount includes $1.5 billion for IRP, $146.9 million for MMRP, and $33.8 million for environmental corrective action and closure requirements. MMRP includes military munitions, chemical residues from military munitions, and munitions scrap at locations on a BRAC installation.

Environmental Disposal for Weapons Systems Programs.
Environmental Disposal for Weapons Systems are those estimates associated with the environmental disposal costs for DON Nuclear Weapons Programs that includes Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. The DON reported an environmental disposal liability for Weapons Systems Programs of $13.5 billion in FY 2010. This amount includes Nuclear Powered Military Equipment of $10.6 billion, Spent Nuclear Fuel (Other) of $2.7 billion, and Other Weapons Systems of $183.6 million.

4. Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to Inflation, Deflation, Technology, or Applicable Laws and Regulations
Estimated environmental liabilities are adjusted for price growth (inflation) and increases in labor rates and materials. Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of FY 2010, there are no changes to the environmental liability estimates due to changes in laws, regulations, and agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

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

Overall, DON has a reasonable level of confidence in the estimates recognized on the financial statements. This reasonable level of confidence in the estimates is because the estimates for DERP/BRAC programs are based on the CTC module of the NORM System. A verification, validation, and accreditation were completed by a third party for CTC module of NORM, while the environmental program managers continue to validate the data.

For the Weapons systems, the environmental program managers base their environmental disposal estimates on actual costs for similar projects. A change in the overall methodology in weapons systems reflects a more accurate estimate of what it will cost to dispose of the weapons systems. Given the fact that the planned date for opening the Department of Energy's (DOE's) planned waste repository has been delayed, there is uncertainty associated with the estimate for spent nuclear fuel. As DOE's plans are solidified, DON's estimates for spent nuclear fuel will change accordingly.

The DON believes that the total current environmental liabilities for BRAC are reasonable, based upon information available at the time in calculating the estimates. However, as the FY 2005 BRAC closure activities are implemented over the next several fiscal years, the actual results may vary materially from the required reportable estimates. The variance will depend on additional information obtained from planned or ongoing studies of the extent and concentration of site environmental contamination and based on property disposal requirements to meet community needs. In addition to the possibility of the estimates changing on current identified sites, DON may incur additional environmental cleanup and restoration costs if new sites are identified as BRAC activities are implemented.

The DON believes that the current environmental liabilities for Other Accrued Environmental Liabilities (Non-DERP) for FY 2010 are reasonable, based upon the information available at the time in calculating the estimates and completing the fence to fence survey. However, as internal controls are implemented to sustain this effort, changes to some of the estimates could occur. In addition to the possibility of some of the estimates changing for the current list of identified units, DON may incur additional units and changes to estimates as the inventory of units are reviewed annually. The BRAC Program Management Office has been notified that a status change was made in the Other Environmental Liabilities (OEL) database. BRAC is developing eligibility criteria for the reporting of these OEL units.

Note 15. Other Liabilities

As of September 30	2010		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
1. Intragovernmental			
A. Advances from Others	$ 302,441	$ -	$ 302,441
B. Deposit Funds and Suspense Account Liabilities	421,725	-	421,725
C. Disbursing Officer Cash	109,657	-	109,657
D. Judgment Fund Liabilities	26,687	-	26,687
E. FECA Reimbursement to the Dept. of Labor	168,025	214,077	382,102
F. Custodial Liabilities	3,481,236	-	3,481,236
G. Employer Contribution and Payroll Taxes Payable	77,587	-	77,587
H. Other Liabilities	193,271	-	193,271
I. Total Intragovernmental Other Liabilities	$ 4,780,629	$ 214,077	$ 4,994,706
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 1,091,417	$ -	$ 1,091,417
B. Advances from Others	689,422	-	689,422
C. Deferred Credits	-	-	-
D. Deposit Funds and Suspense Accounts	-	-	-
E. Temporary Early Retirement Authority	-	-	-
F. Nonenvironmental Disposal Liabilities			
(1) Military Equipment (Nonnuclear)	8,792	245,247	254,039
(2) Excess/Obsolete Structures	105,813	131,335	237,148
(3) Conventional Munitions Disposal	-	-	-
G. Accrued Unfunded Annual Leave	2,904,512	-	2,904,512
H. Capital Lease Liability	-	-	-
I. Contract Holdbacks	77,852	-	77,852
J. Employer Contribution and Payroll Taxes Payable	70,995	-	70,995
K. Contingent Liabilities	10,679	1,524,164	1,534,843
L. Other Liabilities	13,314	-	13,314
M. Total Nonfederal Other Liabilities	$ 4,972,796	$ 1,900,746	$ 6,873,542
3. Total Other Liabilities	$ 9,753,425	$ 2,114,823	$ 11,868,248

As of September 30	2009		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
1. Intragovernmental			
A. Advances from Others	$ 326,674	$ -	$ 326,674
B. Deposit Funds and Suspense Account Liabilities	289,564	-	289,564
C. Disbursing Officer Cash	162,411	-	162,411
D. Judgment Fund Liabilities	-	-	-
E. FECA Reimbursement to the Dept. of Labor	152,214	196,915	349,129
F. Custodial Liabilities	3,460,463	-	3,460,463
G. Employer Contribution and Payroll Taxes Payable			
H. Other Liabilities	65,521	-	65,521
	133,189	-	133,189
I. Total Intragovernmental Other Liabilities	$ 4,590,036	$ 196,915	$ 4,786,951
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 1,040,336	$ -	$ 1,040,336
B. Advances from Others	689,214	-	689,214
C. Deferred Credits	(298)	-	(298)
D. Deposit Funds and Suspense Accounts	-	-	-
E. Temporary Early Retirement Authority	-	-	-
F. Nonenvironmental Disposal Liabilities			
(1) Military Equipment (Nonnuclear)	3,484	262,383	265,867
(2) Excess/Obsolete Structures	105,559	598,971	704,530
(3) Conventional Munitions Disposal	-	-	-
G. Accrued Unfunded Annual Leave	2,706,765	-	2,706,765
H. Capital Lease Liability	-	-	-
I. Contract Holdbacks	109,884	-	109,884
J. Employer Contribution and Payroll Taxes Payable	2,257	-	2,257
K. Contingent Liabilities	9,947	1,237,052	1,246,999
L. Other Liabilities	30,950	-	30,950
M. Total Nonfederal Other Liabilities	$ 4,698,098	$ 2,098,406	$ 6,796,504
3. Total Other Liabilities	$ 9,288,134	$ 2,295,321	$ 11,583,455

Intragovernmental Other Liabilities (Line 1.H) consists primarily of Unemployment Compensation unfunded liabilities.

Nonfederal Other Liabilities (Line 2.L) is due to a crosswalk issue from Navy Enterprise Resource Planning to Defense Departmental Reporting System Budgetary and should be corrected during FY 2011.

Contingent Liabilities includes $380.1 million related to contracts authorizing progress payments based on cost as defined in Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The Department of the Navy (DON) General Fund (GF) is under no obligation to pay contractors for amounts greater than the amounts authorized in contracts until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of potential future payments are estimable, DON GF has recognized a contingent liability for estimated future payments which are conditional pending delivery and government acceptance.

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

Capital Lease Liability

Not applicable.

Note 16. Commitments and Contingencies

The Department of the Navy (DON) is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the Federal Government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON has accrued contingent liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. Others may be payable from DON's resources, either directly or by reimbursement to the Judgment Fund. The DON records Judgment Fund liabilities in Note 12, Accounts Payable; and Note 15, Other Liabilities.

For FY 2010, DON General Fund (GF) materiality threshold for reporting litigation, claims, or assessments is $47.8 million. The DON OGC conducts a review of litigation and claims threatened or asserted involving DON GF to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation.

The DON currently has 10 cases that meet the existing FY 2010 DON GF materiality threshold. DON legal counsel was unable to express an opinion concerning the likely outcome on 7 of 10 cases.

Due to the inherent uncertainties of litigation, lawyers generally refrain from expressing judgments as to outcomes except in those relatively few clear cases. In response to a Department of Defense (DoD), Inspector General Audit, "DoD Process for Reporting Contingent Legal Liabilities," DON developed a methodology to determine an estimate for contingent legal liabilities. DON recognized and disclosed an estimate for contingent legal liabilities. The methodology considers the likelihood of an unfavorable outcome or potential liability and provides an overall assessment of all cases currently pending and not on an individual case basis. The likelihood of an unfavorable or potential liability was determined by using an average of the data from the current year-to-date and the preceding two years. The total dollar amount of the cases closed was divided by the total dollar amount claimed in those closed cases for each of the last two years plus current year, which were then used to calculate the average. This average is based entirely on historical data and represents the percentage that has historically been paid on claims. The merits of each individual case have not been taken into consideration. The estimate for those cases considered reasonably possible to result in an adverse judgment against DON is $428.2 million. Until sufficient historical data can be collected for the Navy Working Capital Fund, the DON GF estimate will consider all DON funding sources together.

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

The DON GF has recorded in Note 15 a contingent liability in the amount of $156.2 million for Contract Incentives.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2010						
(Amounts in thousands)		Liabilities	Assumed Interest Rate (%)		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
1. Pension and Health Actuarial Benefits							
A. Military Retirement Pensions	$	-		$	-	$	-
B. Military Retirement Health Benefits		-			-		-
C. Military Medicare-Eligible Retiree Benefits		-			-		-
D. Total Pension and Health Actuarial Benefits	$	-		$	-	$	-
2. Other Actuarial Benefits							
A. FECA	$	1,692,779		$	-	$	1,692,779
B. Voluntary Separation Incentive Programs		-			-		-
C. DoD Education Benefits Fund		-			-		-
D. Other		72			(72)		-
E. Total Other Actuarial Benefits	$	1,692,851		$	(72)	$	1,692,779
3. Other Federal Employment Benefits	$	-		$	-	$	-
4. Total Military Retirement and Other Federal Employment Benefits:	$	1,692,851		$	(72)	$	1,692,779

As of September 30	2009						
(Amounts in thousands)		Liabilities	Assumed Interest Rate (%)		(Less: Assets Available to Pay Benefits)		Unfunded Liabilities
1. Pension and Health Actuarial Benefits							
A. Military Retirement Pensions	$	-		$	-	$	-
B. Military Retirement Health Benefits		-			-		-
C. Military Medicare-Eligible Retiree Benefits		-			-		-
D. Total Pension and Health Actuarial Benefits	$	-		$	-	$	-
2. Other Actuarial Benefits							
A. FECA	$	1,494,427		$	-	$	1,494,427
B. Voluntary Separation Incentive Programs		-			-		-
C. DoD Education Benefits Fund		-			-		-
D. Other		-			-		-
E. Total Other Actuarial Benefits	$	1,494,427		$	-	$	1,494,427
3. Other Federal Employment Benefits	$	-		$	-	$	-
4. Total Military Retirement and Other Federal Employment Benefits:	$	1,494,427		$	-	$	1,494,427

Federal Employee's Compensation Act

Actuarial Cost Method Used and Assumptions:

The Department of Navy's (DON) actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON only at the end of each fiscal year.

The estimate for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

Discount Rates

3.653% in Year 1

4.300% 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 or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2010 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 CBY were as follows:

CBY	COLA	CPIM
2010	N/A	N/A
2011	2.23%	3.45%
2012	1.13%	3.43%
2013	1.70%	3.64%
2014	1.90%	3.66%
2015	1.93%	3.73%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2010 to the average pattern observed during the most current three charge back years, and (4) a comparison thereafter of the estimated liability per case in the 2010 projection to the average pattern for the projections of the most recent three projections.

Note 18. Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue

As of September 30		2010		Restated 2009
(Amounts in thousands)				
1. Intragovernmental Costs	$	47,048,345	$	44,524,564
2. Public Costs		113,303,648		104,867,358
3. Total Costs	$	160,351,993	$	149,391,922
4. Intragovernmental Earned Revenue	$	(3,633,777)	$	(3,343,323)
5. Public Earned Revenue		(1,613,218)		(1,437,943)
6. Total Earned Revenue	$	(5,246,995)	$	(4,781,266)
7. Net Cost of Operations	$	155,104,998	$	144,610,656

Intragovernmental costs and revenue are related to transactions made between the Department of the Navy (DON) General Fund (GF) and another federal entity within the Federal Government.

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

Public costs and revenue are exchange transactions made between DON GF and a nonfederal entity.

The DON GF's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of generally accepted accounting principles (GAAP) for federal agencies. Most of DON's legacy systems were designed to record information on a budgetary basis, and do not track intragovernmental transactions by customer at the transaction level. Considering these systems limitations, DON GF is unable to accurately compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental trading partners. Buyer-side accounts payable and expenses were adjusted to match seller-side accounts receivable and revenues. This is accomplished by reclassifying amounts between federal and public cost categories, and accruing additional costs when necessary.

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

The DON's accounting systems generally do not capture information relative to Heritage Assets separately and distinctly from normal operations.

The DON GF restated its FY 2009 Public Costs by $597.5 million. Refer to Note 26, Restatements, for additional details.

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

Appropriations Received on the Statement of Changes in Net Position (SCNP) do not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $27.7 million is due to Trust Funds and Special Receipt Accounts included in the Appropriations Received line of the SBR. Refer to Note 20 for additional details.

In the SCNP, all offsetting balances (i.e. transfers-in and transfers-out, revenues, and expenses) for intradepartment activity between earmarked and other (nonearmarked) funds are reported on the same lines. The Eliminations column contains all appropriate elimination entries, which net to zero within each respective line, except for intraentity imputed financing costs.

Description of Other Lines
Other Financing Sources – Other (Line 5.D) represents net gains and losses recorded in relation to the capitalization of assets such as Real Property, Construction in Progress, Operating Materiel and Supplies, and Military Equipment.

Other Adjustments (Line 13.C) represents reductions to budget authority and rescissions in accordance with Public Law.

The Department of the Navy General Fund restated the following FY 2009 SCNP lines: Appropriations Used by $597.5 million; Net Cost of Operations by $597.5 million; Prior Period Adjustments by $22.9 million; and Unexpended Appropriations by $574.6 million. Refer to Note 26, Restatements, for additional details.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2010	Restated 2009
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period"	$ 137,981,530	$ 129,930,555
2. Available Borrowing and Contract Authority at the End of the Period	-	-

Apportionment Categories for Obligations Incurred
On the Statement of Budgetary Resources (SBR): Obligations Incurred includes $179.43 billion of Direct Program Obligations and $11.2 billion of Reimbursable Program Obligations.

On the Report on Budget Execution (SF-133):

- Direct Obligations, Category A, amounts apportioned quarterly, are $106.1 billion.
- Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are $73.5 billion.
- Total Direct Obligations are therefore $179.57 billion.
- The $133.4 million difference in direct obligations between the SBR and SF-133 is due to adjustments on the SBR to recognize fringe benefits, reclassify reimbursable obligations as noted below, and recognize other adjustments not captured in the field accounting systems.
- Category A Reimbursable Obligations are $2.0 million.
- Category B Reimbursable Obligations are $11.2 billion.
- Total Reimbursable Obligations are therefore $11.2 billion.

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

As noted above, in terms of obligations, differences exist between the SF-133 and the SBR for a number of reasons; including accruals recorded for fringe benefits, liabilities recorded for the Judgment Fund, and accruals recorded for trading partner advances and liabilities.

Appropriations Received on the Statement of Changes in Net Position (SCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources (SBR) due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of $27.7 million is due to Trust Funds and Special Receipt Accounts included in the Appropriations Received line of the SBR. Refer to Note 19 for additional details.

Legal limitations and restrictions affect the use of the unobligated balance of budget authority based upon program and fiscal year in the applicable appropriation language or in the alternative provisions section at the end of the appropriations act.

Permanent, Indefinite Appropriations
The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet, including the acquisition, alteration or conversion of vessels. For FY 2010, one transfer from NDSF for $16.7 million to Military Personnel, Navy appropriation was recorded; no transfers to NDSF occurred.

The Environmental Restoration, Navy (ER, N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. For FY 2010, three transfers from ER, N for $285.5 million to the Operation and Maintenance, Navy appropriation were recorded; no transfers to ER, N occurred.

The Department of the Navy General Fund restated the following FY 2009 SBR lines: Obligations Incurred, Direct by $143.9 million; Unobligated Balance, Apportioned by $83.4 million; Unobligated Balance Not Available by $60.5 million; Obligations Incurred, Net by $143.9 million; and Unpaid Obligations by $143.9 million. Refer to Note 26, Restatements, for additional details.

Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30	2010	Restated 2009
(Amounts in thousands)		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	$ 190,611,070	$ 196,873,397
2. Less: Spending authority from offsetting collections and recoveries (-)	(24,286,156)	(32,093,306)
3. Obligations net of offsetting collections and recoveries	166,324,914	164,780,091
4. Less: Offsetting receipts (-)	(141,386)	(321,451)
5. Net obligations	166,183,528	164,458,640
Other Resources:		
6. Donations and forfeitures of property	5,258	(667)
7. Transfers in/out without reimbursement (+/-)	1,243,648	208,053
8. Imputed financing from costs absorbed by others	884,867	779,646
9. Other (+/-)	(3,959,432)	4,046,453
10. Net other resources used to finance activities	(1,825,659)	5,033,485
11. Total Resources Used to Finance Activities	$ 164,357,869	$ 169,492,125
Resources Used to Finance Items not Part of the Net Cost of Operations:		
12. Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
12a. Undelivered Orders (-)	$ (8,050,975)	$ (32,725,630)
12b. Unfilled Customer Orders	(606,655)	402,395
13. Resources that fund expenses recognized in prior periods (-)	(2,110,921)	(2,992,872)
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	141,386	321,451
15. Resources that finance the acquisition of assets (-)	(21,358,668)	(29,671,802)
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 (-)	-	-
16b. Other (+/-)	2,710,529	22,663,745
17. Total resources used to finance items not part of the Net Cost of Operations	$ (29,275,304)	$ (42,002,713)
18. Total resources used to finance the Net Cost of Operations	$ 135,082,565	$ 127,489,412

As of September 30		2010		Restated 2009
(Amounts in thousands)				
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
19. Increase in annual leave liability	$	1,702,301	$	158,049
20. Increase in environmental and disposal liability		819,497		328,512
21. Upward/Downward reestimates of credit subsidy expense		-		-
22. Increase in exchange revenue receivable from the public (-)		(189,330)		-
23. Other (+/-)		699,205		81,906
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	$	3,031,673	$	568,467
Components not Requiring or Generating Resources:				
25. Depreciation and amortization	$	12,292,840	$	9,404,125
26. Revaluation of assets or liabilities (+/-)		413,703		1,634,709
27. Other (+/-)				
27a. Trust Fund Exchange Revenue		-		-
27b. Cost of Goods Sold		-		-
27c. Operating Material and Supplies Used		4,349,363		5,405,716
27d. Other		(65,146)		108,227
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	$	16,990,760	$	16,552,777
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	20,022,433	$	17,121,244
30. Net Cost of Operations	$	155,104,998	$	144,610,656

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

Due to the Department of the Navy (DON) financial system limitations, budgetary data do not agree with proprietary expenses and capitalized assets. Differences between budgetary and proprietary data are a previously identified deficiency. This causes a difference in net cost between the SNC and the Reconciliation of Net Cost of Operations to Budget that requires an adjustment to the Reconciliation of Net Cost of Operations to Budget. For 4th Quarter, FY 2010, an adjustment of $8.0 million was made to Resources that Finance the Acquisition of Assets so that proprietary accounts reconcile with the budgetary accounts.

The Reconciliation of Net Cost of Operations to Budget is presented as a consolidated statement. However, the following lines are presented as combined instead of consolidated 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

Description of Other Lines
Resources Used to Finance Activities – Budgetary Resources Obligated:
The balance of $(4.0) billion represents net gains and losses recorded in relation to the capitalization of assets such as Real Property, Construction in Progress, Operating Materials and Supplies, and Military Equipment.

Resources Used to Finance Items not Part of the Net Cost of Operations:
The balance of $2.7 billion reflects net gains and losses recorded in relation to the net change of the value of assets such as Military Construction, Ammunition, Real Property, and Shipbuilding and Conversion.

Components Requiring or Generating Resources in Future Periods:
The balance of $699.2 million consists primarily of accrued expenses for Contingent Legal Liabilities and FECA.

Components not Requiring or Generating Resources:
The balance of $(65.1) million consists primarily of bad debt expense and expenses not requiring budgetary resources.

The DON General Fund restated the following FY 2009 Reconciliation of Net Cost of Operations to Budget lines: (1) Obligations Incurred by $143.9 million; (12a) Undelivered Orders by $718.5 million; and (16b) Other by $22.9 million. Refer to Note 26, Restatements, for additional details.

Note 22. Disclosures Related to Incidental Custodial Collections

Not applicable.

Note 23. Earmarked Funds

BALANCE SHEET	2010 Military Retirement Fund	2010 Medicare Eligible Retiree Health Care Fund	2010 Other Earmarked Funds	2010 Eliminations	2010 Total
As of September 30					
(Amounts in thousands)					
ASSETS					
Fund balance with Treasury	$ -	-	25,823	-	25,823
Investments	-	-	9,465	-	9,465
Accounts & Interest Receivable	-	-	-	-	-
Other Assets	-	-	-	-	-
Total Assets	$ -	-	35,288	-	35,288
LIABILITIES and NET POSITION					
Military Retirement Benefits and Other Federal Employment Benefits	$ -	-	-	-	-
Other Liabilities	-	-	1,606	-	1,606
Total Liabilities	$ -	-	1,606	-	1,606
Unexpended Appropriations	-	-	-	-	-
Cumulative Results of Operations	-	-	33,682	-	33,682
Total Liabilities & Net Position	$ -	-	35,288	-	35,288

STATEMENT OF NET COST	Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
For the period ended September 30					
Program Costs	$ -	-	20,135	-	20,135
Less Earned Revenue	-	-	-	-	-
Net Program Costs	$ -	-	20,135	-	20,135
Less Earned Revenues Not Attributable to Programs	-	-	-	-	-
Net Cost of Operations	$ -	-	20,135	-	20,135

STATEMENT OF CHANGES IN NET POSITION	Military Retirement Fund	Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
For the period ended September 30					
Net Position Beginning of the Period	$ -	-	26,171	-	26,171
Net Cost of Operations	-	-	20,135	-	20,135
Budgetary Financing Sources	-	-	27,644	-	27,644
Other Financing Sources	-	-	2	-	2
Change in Net Position	$ -	-	7,511	-	7,511
Net Position End of Period	$ -	-	33,682	-	33,682

BALANCE SHEET	2009 Military Retirement Fund		Medicare Eligible Retiree Health Care Fund	Other Earmarked Funds	Eliminations	Total
As of September 30						
(Amounts in thousands)						
ASSETS						
Fund balance with Treasury	$	-	-	17,800	-	17,800
Investments		-	-	9,621	-	9,621
Accounts & Interest Receivable		-	-	-	-	-
Other Assets		-	-	-	-	-
Total Assets	$	-	-	27,421	-	27,421
LIABILITIES and NET POSITION						
Military Retirement Benefits and Other Federal Employment Benefits	$	-	-	-	-	-
Other Liabilities		-	-	1,250	-	1,250
Total Liabilities	$	-	-	1,250	-	1,250
Unexpended Appropriations		-	-	-	-	-
Cumulative Results of Operations		-	-	26,171	-	26,171
Total Liabilities & Net Position	$	-	-	27,421	-	27,421
STATEMENT OF NET COST						
For the period ended September 30						
Program Costs	$	-	-	22,279	-	22,279
Less Earned Revenue		-	-	-	-	-
Net Program Costs	$	-	-	22,279	-	22,279
Less Earned Revenues Not Attributable to Programs		-	-	-	-	-
Net Cost of Operations	$	-	-	22,279	-	22,279
STATEMENT OF CHANGES IN NET POSITION						
For the period ended September 30						
Net Position Beginning of the Period	$	-	-	24,230	-	24,230
Net Cost of Operations		-	-	22,279	-	22,279
Budgetary Financing Sources		-	-	24,215	-	24,215
Other Financing Sources		-	-	5	-	5
Change in Net Position	$	-	-	1,941	-	1,941
Net Position End of Period	$	-	-	26,171	-	26,171

Earmarked funds are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. The Department of the Navy (DON) has seven earmarked funds. Four are categorized as Special Funds and three are categorized as Trust Funds. A list of these earmarked funds and a brief description of each follows below. There have been no changes in legislation during or subsequent to the reporting period that significantly changes the purpose of any of the seven funds or that redirects a material portion of the accumulated balances of any of the seven funds. Generally, revenues for DON's earmarked funds are inflows of resources to the Government.

Special Earmarked Funds

Wildlife Conservation, Military Reservations, Navy –

This fund, authorized by 16 United States Code 670b, provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Proceeds from the sale of fishing and hunting permits are used for these programs at installations charging such user fees. These programs are carried out through cooperative plans agreed upon by the local representatives of the Secretary of Defense, the Secretary of the Interior, and the appropriate agency of the State in which the installation is located.

Kaho'olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy –

This fund, authorized by 107 Statute 1483, was established to recognize and fulfill the commitments made on behalf of the United States to the people of Hawaii and to return to the State of Hawaii the Island of Kaho'olawe. Congress has found it to be in the national interest and an essential element in the Federal Government's relationship with the State of Hawaii the conveyance, clearance, or removal of unexploded ordnance, environmental restoration, control of access to the Island and future use of the Island be undertaken in a manner consistent with the enhancement of that relationship, the Department of Defense's military mission, the federal interest, and applicable provisions of law. This fund is financed by congressional appropriations.

Rossmoor Liquidating Trust Settlement Account –

The Rossmoor Liquidating Trust account was established by Section 2208 of Public Law 104-106; the National Defense Authorization Act of 1996. Per the statute, monies awarded the United States when litigation is settled in favor of the Rossmoor Liquidating Trust is deposited into this account. The monies are made available to DON solely for the acquisition or construction of military family housing in, or in the vicinity of, San Diego, California.

Ford Island Improvement Account –

The Ford Island Improvement fund is authorized by 10 United States Code 2814 and was established to carry out improvements to property and facilities that will deliver overall benefits to DON at the Pearl Harbor Naval Complex at Ford Island, Hawaii. Ford Island is a central feature in the Pearl Harbor National Historic Landmark. The Ford Island legislation allows DON to sell or lease properties in Hawaii and use the proceeds to develop Ford Island.

Trust Earmarked Funds

DON General Gift Fund –

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

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

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

Note 24. Fiduciary Activities

For the period ended September 30	2010	2009
(Amounts in thousands)		
1. Fiduciary net assets, beginning of year	$ 26,731	$ 20,570
2. Fiduciary revenues	-	-
3. Contributions	39,172	39,680
4. Investment earnings	2,319	2,211
5. Gain (Loss) on disposition of investments, net	-	-
6. Administrative and other expenses	-	-
7. Distributions to and on behalf of beneficiaries	(39,838)	(35,730)
8. Increase/(Decrease) in fiduciary net assets	$ 1,653	$ 6,161
9. Fiduciary net assets, end of period	$ 28,384	$ 26,731

For the period ended September 30	2010	2009
(Amounts in thousands)		
Fiduciary Assets		
1. Cash and cash equivalents	$ 28,384	$ 26,731
2. Investments	-	-
3. Other Assets	-	-
Fiduciary Liabilities		
4. Less: Liabilities	$ -	$ -
Total Fiduciary Net Assets	$ 28,384	$ 26,731

The Department of the Navy's Fiduciary Activity consists of funds in the Savings Deposit Program. Under 10, USC, §1035, and Department of Defense Financial Management Regulation, Volume 7A, Chapter 51, deployed service members can earn 10 percent interest on up to $10 thousand deposited into the program. Funds are held in the program during the member's tour of duty and are paid out within 90 days after the member leaves the eligible region. The accounts included in the balance are 17X6025 and 17X6026.

Note 25. Other Disclosures

As of September 30	2010							
(Amounts in thousands)	Land and Buildings		Equipment		Other		Total	
1. Entity as Lessee - Operating Leases								
Future Payments Due								
Fiscal Year								
2010	$	76,647	$	-	$	3,029	$	79,676
2011		78,554		-		3,104		81,658
2012		80,512		-		3,182		83,694
2013		82,521		-		3,261		85,782
2014		84,583		-		3,343		87,926
After 5 Years		85,900		-		3,360		89,260
Total Future Lease Payments Due	$	488,717	$	-	$	19,279	$	507,996

Note 26. Restatements

As result of the FY 2010 financial audit and management review, the United States Marine Corps (USMC) General Fund (GF) determined the need to adjust FY 2010 Beginning Balances. The USMC GF identified six prior period adjustments to ensure the USMC GF Statement Budgetary Resources (SBR) would be presented accurately and in compliance with laws and regulations.

One adjustment impacted the SBR; the other adjustments were reclassifications of funds that did not impact the SBR. The total impact to the SBR was a $143.9 million increase to Unobligated balances not available and a decrease to Unobligated balance, brought forward. This change occurred because the methodology used to record obligations could not be adequately supported; therefore, management deobligated the funds.

Four adjustments were posted to record expenses in the proper accounting period. The net effect of these adjustments was a $574.5 million increase to Delivered Orders-Unpaid and a decrease to Undelivered Orders-Unpaid. This reclassification had no impact on accounting Unobligated balance, brought forward; Unpaid obligations, brought forward; or Obligations incurred.

The remaining adjustment of $505.6 million was to reclassify Contract Financing Payments, which were previously being recorded as Advances instead of being expensed, as normal Cash Disbursements. The effect on the SBR was to reclassify the status of obligations from Undelivered Orders-Paid to Delivered Orders-Paid. This had no impact on Unobligated balance, brought forward; Obligations incurred; or Gross outlays.

The net effect of the Prior Period Adjustments on the SBR is as follows (amounts in millions):

FY 2009 Statement of Budgetary Resources		
Obligations Incurred, Direct	$	(143.9)
Unobligated Balance, Apportioned		83.4
Unobligated Balance not Available		60.5
Total Status of Budgetary Resources	$	-
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Obligations Incurred, Net	$	(143.9)
Unpaid Obligations		(143.9)
Total Unpaid Obligated Balance, net, end of period	$	(143.9)

In addition, these adjustments also affected the following Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position lines:

FY 2009 Balance Sheet		
Other Assets, Nonfederal	$	(505.6)
Total Assets	$	(505.6)
Accounts, Payable, Nonfederal	$	69.0
Total Liabilities		69.0
Unexpended Appropriations - Other Funds		(574.6)
Net Position		(574.6)
Total Liabilities and Net Position	$	(505.6)

FY 2009 Statement of Net Cost		
Gross Costs	$	597.5
Net Cost of Operations	$	597.5

FY 2009 Statement of Changes in Net Position		
CUMULATIVE RESULTS OF OPERATIONS		
Budgetary Financing Sources:		
Appropriations Used	$	597.5
Net Cost of Operations		597.5
Net Change		-
Cumulative Results of Operations	$	-
UNEXPENDED APPROPRIATIONS		
Prior Period Adjustments:		
Correction of Errors	$	22.9
Budgetary Financing Sources:		
Appropriations Used		(597.5)
Unexpended Appropriations	$	(574.6)
Net Position	$	(574.6)

GENERAL FUND REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

Fiscal Year 2010 Department of the Navy Annual Financial Report

Department of the Navy

Investments in Research and Development
Yearly Investment in Research and Development

For Fiscal Years 2006 through 2010
($ in Millions)

Categories	FY10	FY09	FY08	FY07	FY06
Basic Research	$ 552	$ 523	$ 452	$ 448	$ 449
Applied Research	752	854	748	781	739
Development					
Advanced Technology Development	859	883	752	801	912
Advanced Component Development and Prototypes	3,910	3,464	3,329	3,229	3,223
System Development and Demonstration	7,325	8,288	8,141	8,731	7,819
Research, Development, Test, and Evaluation Management Support	1,293	1,245	1,112	1,034	1,022
Operational Systems Development	4,505	4,249	3,943	3,810	3,399
Totals	**$ 19,196**	**$ 19,506**	**$ 18,477**	**$ 18,834**	**$ 17,563**

Narrative Statement:

Investments in Research and Development

Investment values are based on Research and Development outlays (expenditures). Outlays are used because current Department of the Navy (DON) systems are unable to fully capture and summarize costs in accordance with standards promulgated by the Federal Accounting Standards Advisory Board.

Research and Development (R&D) programs are classified as Basic Research, Applied Research, and Development. The definition of each R&D category and subcategory is explained below.

A. Basic Research

Basic Research is the systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

The following are two representative program examples for the Basic Research category.

Ion Tiger

The Office of Naval Research (ONR) is converging two separate basic research efforts — unmanned aerial vehicles (UAVs) and fuel cell systems — to significantly improve battlefield surveillance capability.

The Ion Tiger is a hydrogen-powered fuel cell UAV in development at the Naval Research Laboratory (NRL), the corporate laboratory of the ONR. Previously flown with battery power, the Ion Tiger has demonstrated sound aerodynamics, high functionality, and low-heat and noise signatures. Test flights of Ion Tiger have exceeded 24 hours with a 6-pound payload. Tests demonstrated how an enduring surveillance solution can operate at a low cost with less possibility of detection. The trials exceeded flight duration seven-fold from previous designs.

Across the board, the military is seeking quieter and more efficient sources of energy. ONR is leading the Navy with support for alternative fuel research, and has been a leader and key supporter of fuel cell research for 20 years. By leveraging other ONR research, and cooperating with partner agencies, ONR and its partners anticipate success in this mission.

Fuel cells create an electric current by converting hydrogen and oxygen into water, making them very attractive as energy sources. Fuel cell technology is pollution-free, and expected to deliver twice the efficiency of an internal combustion engine. The fuel cell engine runs more quietly but with greater endurance than battery-powered systems. The relatively small 550- watt fuel cells provide an additional advantage for the UAV.

Fuel cell technology allows UAVs to conduct surveillance for longer periods of time, thus reducing the number of daily launches to collect data. It saves time and effort for the crew, and ultimately results in less wear to the UAV.

Transparent Urban Structures – Sensing Through Walls

ONR is investigating the ability of radar to peer deep within man-made non-metallic structures to detect, locate, and identify interior building features, large radar-cross-section objects, personnel, and electronic devices. This program is developing new structure-penetrating sensors to enable urban situational awareness, force protection, urban activity monitoring, and rescue operations.

Through-the-wall sensors use wideband radars in order to provide imagery resolutions on the order of one foot or less. Achieving wide bandwidths requires transmitting chirped or pulsed waveforms coupled with state-of-the-art wide dynamic range, very high signal-to-noise ratio receivers. In addition to advanced sensing hardware, sophisticated algorithms are being developed to remove the distorting effects of walls on imagery, generation of three dimensional imagery and detection, and classification of metallic objects.

These systems are also able to detect personnel within buildings. Sensitive Doppler detection can detect not only moving humans, but also stationary individuals and, depending on the noise, can even detect individuals by way of their respiration and heartbeat.

Characterizing building use is achieved by correlating the human activity and anomalous object detection with observing the types and quantities of electronic devices within buildings. Hence, the transparent urban structures system will also be able to map the radio-frequency environment within suspect buildings to increase the confidence of building usage estimates.

The through-the-wall detection and imaging problem poses significant challenges to development of reliable, high probability, low false alarm detection of personnel, objects and building features. ONR is making significant headway in advancing this technology into fieldable sensors.

B. Applied Research

Applied Research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is the practical application of such knowledge or understanding for the purpose of meeting the recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs are scientific studies, investigations, and research papers, hardware components, software codes, and limited construction of, or part of, a weapon system to include nonsystem specific development efforts.

The following are two representative program examples for the Applied Research category.

Noise-Induced Hearing Loss

The Noise-Induced Hearing Loss (NIHL) Program creates the capability to prevent and treat NIHL and tinnitus, the two largest disabilities reported by the Veterans Administration. For active duty military, reduced hearing also impacts readiness, survivability and effectiveness in the field.

Acoustic trauma is prevalent in military populations, often resulting in sensory-neural hearing loss from damage to the cochlea or neural structures of the inner ear. The Department of Veterans Affairs reports that noise-induced hearing loss and tinnitus (ringing in the ears) are currently the two largest disability categories for compensation, and continue to increase. Performance issues associated with communications are degraded in high noise environments and can compromise mission effectiveness.

Advances in hearing protection and restoration span a wide range of current technologies, including but not limited to, engineering solutions to quiet noise at the source, materials solutions to improve personal protective equipment and dampening effects, and scientific and medical breakthroughs.

The ONR NIHL Program is working on specific technologies including short-term solutions (applied research) and long-term initiatives (basic research) that span training and education, noise mitigation and protection, and medical technologies.

Prevention and treatment of noise-induced hearing loss will ensure naval warfighters have enhanced readiness and mission capability, as well as an improved quality of life.

Cyber Security

Cyberspace is "an unconstrained interaction space enabled by the convergence of multiple disciplines, technologies, and global networks." It is also an emerging battlespace in which the Navy must exercise information dominance, total control of information and knowledge in transit, at rest, and in processing while denying these capabilities to an adversary. Cyber security is an essential component of information dominance in cyberspace.

ONR basic and applied research in cyber security is creating capabilities required for configuring and securing computing and networking infrastructure supporting cyberspace operations, and defending information within our cyberspace domains from potential attacks. This work is enhancing the security aspect of information system infrastructure: software, hardware, and networks.

Cyber security is a major research focus involving multiple disciplines and technologies. This program addresses information security issues, starting from the root of most security breaches, with the goal of achieving robustness, and correctness of the underlying hardware and software of the system itself thereby minimizing potential attack surfaces. Interaction among computer processes within the network as well as between users and computers are weak links in cyber security. This program addresses this weakness through the trusted networked computer thrust and the secure information management, sharing and interaction thrust.

The foundation and methodology for evaluating security properties of cyberspace's protocols and processes are also investigated to better measure, verify and assess the collective security of cyberspace.

Networked, tightly interacting and cooperating physical and computing devices are part of the Navy cyber infrastructure. This research addresses the need for assuring cyber physical information integrity and trust boundary among tightly interacting and co-operating devices.

Finally, looking forward into the future to a candidate for replacing current underlying cyberspace technology, this program is investing in quantum information science for computation and communication. The program is also quantum processing promises techniques that potentially offer a more secure system.

C. Development

Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development is comprised of five stages, as defined below.

1. Advanced Technology Development is the systematic use of the knowledge or understanding gained from research directed toward proof of technological feasibility and assessment of operational and production rather than the development of hardware for service use. It employs demonstration activities intended to prove or test a technology or method.
2. Advanced Component Development and Prototypes evaluates integrated technologies in as realistic an operating environment as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components or complete weapon systems ready for operational and developmental testing and field use.
3. System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapons systems finalized for complete operational and developmental testing.
4. Research, Development, Test, and Evaluation Management Support is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the Research and Development program.
5. Operational Systems Development is concerned with development projects in support of programs or upgrades that are still in engineering and manufacturing development. These projects have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

The following are representative program examples for the Development category, which include two examples for the U.S. Marine Corps.

Free Electron Laser

The Free Electron Laser (FEL) is an Innovative Naval Prototype (INP) program and will provide Naval platforms with a highly effective and affordable point defense capability against surface and air threats, future anti-ship cruise missiles and swarms of small boats. Utilization of FEL also allows an unlimited magazine with speed-of-light delivery.

The Free Electron Laser generates high intensity laser light by utilizing the energy from unbound accelerated high energy electrons. This technology is commonly used in the Department of Energy's (DOE) particle colliders for basic sub-atomic research. The Free Electron Laser program is an investment by the Office of Naval Research to transition the accelerator technology from particle colliders to a future ship self defense weapon system.

The Navy's future Free Electron Laser (FEL) weapon system is being designed to be a game changing system. The capability of having speed-of-light delivery for a wide range of missions and threats is a key element of a future shipboard layered defense.

The program will demonstrate scalability of the necessary FEL physics and engineering for an eventual megawatt-class device. It will focus on the design, development, fabrication, integration and test of a 100-kW class FEL device. Future needs for ship integration and beam control are being considered.

This revolutionary technology allows for multiple payoffs to the warfighter. The ability to control the strength of the beam provides for graduated lethality, and the use of light vice an explosive munition provides for low per engagement and life cycle costs. FEL will provide an effective alternative to using expensive missiles against low value targets.

Large Displacement Unmanned Undersea Vehicle

The Large Displacement Unmanned Undersea Vehicle (LDUUV) is an unmanned vehicle that enables persistent sensing of the oceans to increase the influence and capability of the Navy. Its large displacement design will enable deployment and delivery of multiple smaller UUVs for expanded capability.

The LDUUV Program will develop fully autonomous long endurance land-launched UUVs capable of operating in the near-shore, littoral environment to extend and augment current Navy platform capability.

A key challenge in this program is development of long-endurance UUV power. The LDUUV program supports technology development in UUV power, which includes advanced air independent energy systems and autonomy to enable months of operations and sensing.

New energy sources for UUVs will increase the current energy density 5-10 times, allow for quick recharge or refueling, operate at an acceptable cost level, and enable pier-to-pier operation with months of endurance.

Autonomy will enable the LDUUV to automatically monitor its health, execute mission plans, and operate in a littoral environment.

Expeditionary Fighting Vehicle Program

The Expeditionary Fighting Vehicle (EFV) Program will field a successor to the Marine Corps' current amphibious vehicle, the Assault Amphibious Vehicle Model 7A1 (AAV7A1). The EFV will provide the principal means of tactical surface mobility for the Marine Air Group Task Force during both ship-to-objective maneuvers and sustained combat operations ashore.

The EFV program is an Acquisition Category-1D program managed by the Marine Corps. The EFV is the next generation of Marine Corps Assault Vehicles being developed to satisfy the requirements of the 21st Century Marine War Fighters. Along with the Landing Craft Air Cushion and the MV-22 Osprey, the EFV will provide the Marine Corps with the tactical mobility assets required within the Expeditionary Maneuver Warfare capstone. Acquisition of the EFV is critical to the Marine Corps.

During FY 2010, the EFV program continued engineering and logistics efforts to support design development, manufacturing planning, and design enhancements of both the EFV Command and Personnel variants. The program continued developmental and reliability test support as well as the design, integration and testing of vehicle modifications that will support the Milestone C Operational Assessment.

As assembly concluded, the System Development Demonstration (SDD-2) prototype vehicles completed Acceptance Testing and Contractor Verification Testing. Following completion of these tests, the vehicles were delivered to the Government to commence Developmental testing. Developmental testing was conducted on both modified SDD-1 vehicles and SDD-2 vehicles in preparation for Reliability Growth Testing, which will start in early FY 2011, and the Milestone C Operational Assessment later in FY 2011.

Efforts continued on the SDD-2 contract. This follow-on SDD Phase includes continued design, development, and reliability upgrades; increased reliability testing; modification of existing SDD prototypes; and manufacture and testing of seven additional SDD prototype vehicles.

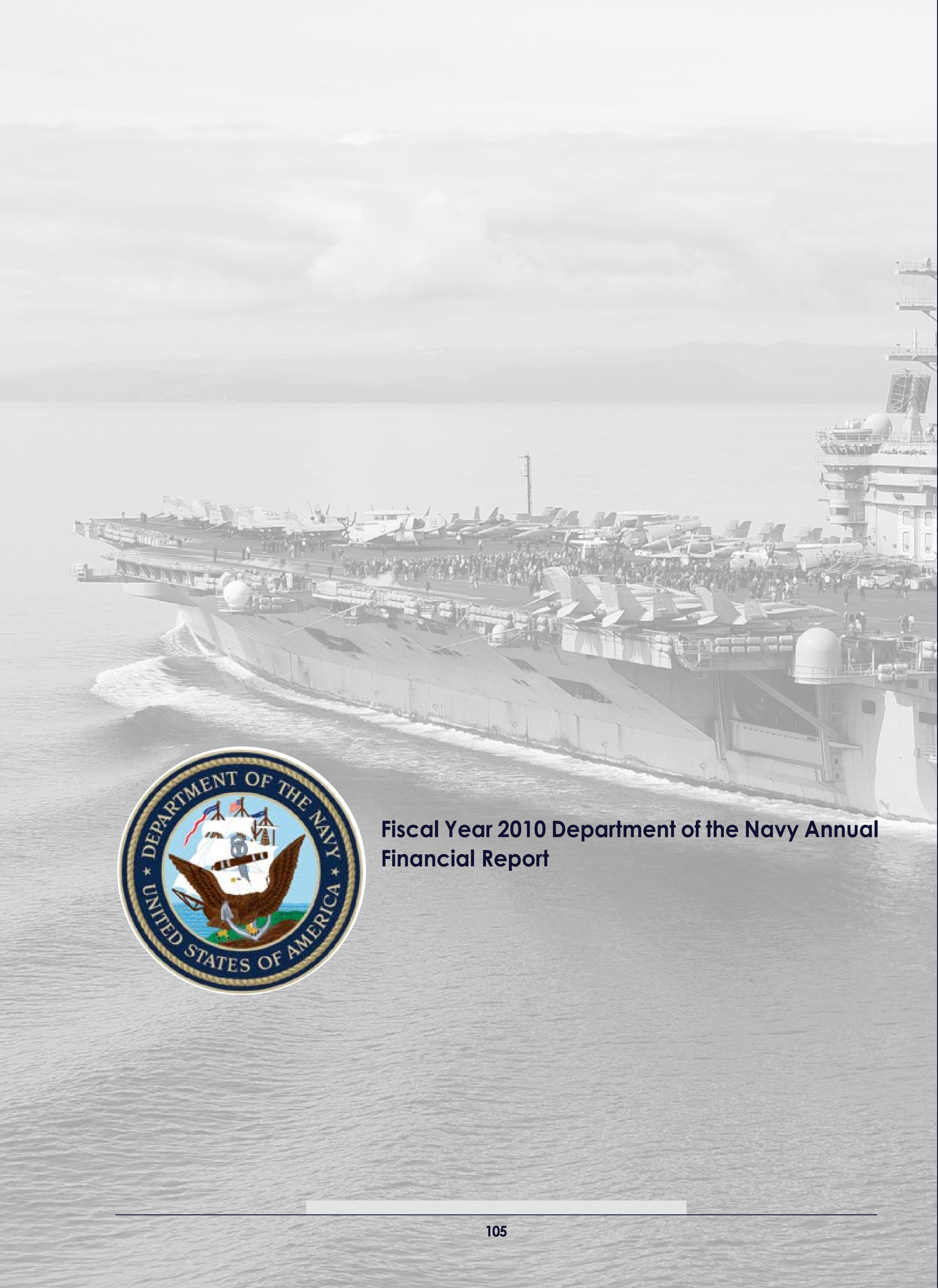
Joint Light Tactical Vehicle

The Joint Light Tactical Vehicle (JLTV) is a joint U.S. Army/U.S. Marine Corps program, with participation from the Australian Army. The JLTV family of vehicles consists of ten configurations with companion trailers capable of performing multiple mission roles. JLTV's capabilities represent a shift to adapt from a threat based, Cold War garrison force focused on containment to a capabilities-based, expeditionary force focused on flexibility, survivability, force protection, responsiveness, and agility. The JLTV family of vehicles must be capable of operating across a broad spectrum of terrain and weather conditions. The Military Services and the U.S. Special Operations Command require enhanced capabilities, greater than those provided by the existing High Mobility Multipurpose Wheeled Vehicle, to support the Joint Functional Concepts of Battlespace Awareness, Force Application, and Focused Logistics. The initial production of JLTVs will provide the Marine Air Group Task Force commander a family of tactical wheeled vehicles capable of providing combat forces protected, sustained, and netted mobility in irregular warfare operations and enhancing its contribution to the integrated Joint Task Force.

The JLTV program is in the Technology Development (TD) phase. In October 2008, the JLTV program office awarded three TD phase contracts. During fiscal year (FY) 2009, the JLTV program office awarded contracts for the incorporation of additional right-hand operations versions because the Australian Army joined the program in January 2009. The additional test assets from each contractor benefits the U.S. by further reducing schedule risk, performance risk, and U.S. test costs, as well as improving the quality and depth of data from the TD phase.

During FY 2010, major activities included the successful completion of Critical Design and Test Readiness Reviews with each vendor, the delivery of ballistic hulls and 21 prototype vehicles, as well as the commencement of Government test and evaluation activities. The Army and Marine Corps Combat Developers also conducted Quarterly Knowledge Point reviews to evaluate the state of program requirements and to incorporate lessons learned from the TD phase, in order to establish vehicle requirements that balance affordability with protection, payload, and performance, within a transportable platform.

Non-Federal Physical Property
The DON General Fund does not fund this type of Activity.



Fiscal Year 2010 Department of the Navy Annual Financial Report

Department of the Navy

General Property, Plant, and Equipment
Real Property Deferred Maintenance and Repair

For Fiscal Year Ended September 30, 2010

($ in Thousands)

Property Type	1. Plant Replacement Value	2. Required Work (Deferred Maintenance and Repair)	3. Percentage
Category 1: Enduring Facilities			
Navy	$ 135,190,000	$ 38,010,000	28.1%
Marine Corps	$ 43,466,090	$ 1,103,421	2.5%
Category 2: Excess Facilities or Planned for Replacement			
Navy	$ 2,340,000	$ 1,170,000	50.0%
Marine Corps	$ 859,028	$ 0	0.0%
Category 3: Heritage Assets			
Navy	$ 0	$ 0	0.0%
Marine Corps	$ 4,317,525	$ 109,603	2.5%

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

Narrative Statement:

1. The method used to assess Navy facilities condition is a combination of commercial Infrastructure Condition Assessment Program software and facilities inspection. The method used to assess Marine Corps facilities condition is a facilities inspection, which categorizes buildings as Adequate, Substandard, or Inadequate. The Department of the Navy (DON) calculates quality rating (Q-rating) using the formula below.

$$\underline{Q = 1 - (\text{Requirements }) \text{ X } 100}$$
$$\text{PRV}$$

DON's Q-rating is represented by the following bands: 100%-90% Q1; 90%-80% Q2; 80%-60% Q3; and less than 60% Q4.

2. The Navy models the "Requirements" value in the above formula from the condition rating and configuration rating. The condition rating is a measure (0 -100) of an asset's physical condition at a particular point in time. The Navy uses condition modeling software to capture condition assessment data to model system/component condition ratings. The condition assessment data is supplemented by eyes-on condition assessments that capture accurate facility components and confirm as-built condition. The condition assessment program has not been expanded to include utility systems yet. Therefore, the condition ratings are inaccurate and the deferred maintenance and repair backlog is understated for utility systems.

The configuration rating is a measure (0 - 100) of the asset's capability to support the current occupant or mission with respect to functionality. The configuration rating is calculated in the internet Navy Facility Assets Data Store (iNFADS) from an algorithm that weights configuration deficiency codes (code compliance, functional/space criteria, location/siting criteria or inadequate capacity/coverage) collected during Asset Evaluations. Deficiency codes identify impacts to the suitability of spaces for their intended use, including obsolescence of facility components that do not meet new standards.

3. The fiscal year 2010 target Q-rating value representing full investment requirement for the Navy is Q1. The DON follows the Office of the Secretary of Defense installation strategic plan goal of having facilities at a Q2 level on average as an acceptable rating. The table above shows that deferred maintenance for the Navy is valued at 28.1%, 50.0%, and 0.0% of plant replacement value (PRV) for categories 1 through 3, respectively. The deferred maintenance and repair estimates are based on the facility Q-ratings found in the Navy's real property inventory.

The table above also shows that deferred maintenance for the Marine Corps is valued at approximately 2.5% of PRV for categories 1 and 3. The percentage for category 1 and 3 facilities is the same because Marine Corps cannot separate the deferred maintenance between those categories at this time. Category 2 is zero because the Marine Corps does not hold deferred maintenance backlogs on facilities to be demolished.

4. Navy used the Facility Readiness Evaluation System (FRES) application to generate the Deferred Maintenance and Repair Report. FRES is updated with iNFADS data on a weekly basis and at the end of the fiscal year. The PRV and deferred maintenance and repair estimates for all three categories are reported for Commander, Navy Installations Command installations only, and only the Maintenance Fund Sources listed below are included. Facilities maintained by the Bureau of Medicine and Surgery, defense agencies, and Family Housing, Navy are excluded from the estimates.

- Operation and Maintenance, Navy
- Operation and Maintenance, Navy Reserve
- Research, Development, Test, and Evaluation
- Navy Working Capital Fund

5. Category 1 excludes Navy facilities assigned an Excess Action Code or identified as a single-use Heritage Asset in iNFADS. Category 2 represents Navy facilities assigned an Excess Action Code in iNFADS. Category 3 includes Navy facilities that are single-use Heritage Assets. iNFADS does not identify any Navy facilities as single-use Heritage Assets; therefore, the amounts recorded for this category are zero.

Description of Property Type categories:

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

Department of the Navy

Military Equipment Deferred Maintenance

For Fiscal Year Ended September 30, 2010

($ in Thousands)

	OP30 Amounts	Adjustments	Totals
1. Aircraft	$ 168,511	$ (63,730)	$ 104,781
2. Automotive Equipment	25,193	9,252	34,445
3. Combat Vehicles	72,183	53,588	125,771
4. Construction Equipment	1,373	3,570	4,943
5. Electronics and Communications Systems	190	36,986	37,176
6. Missiles	60,713	43,505	104,218
7. Ships	23,561	-	23,561
8. Ordnance Weapons and Munitions	16,108	44,529	60,637
9. General Purpose Equipment	-	-	-
10. All Other Items Not Identified Above	96,233	28,475	124,708
Total	**$ 464,065**	**$ 156,175**	**$ 620,240**

Narrative Statement:

Aircraft Deferred Maintenance

Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), component repair, and software maintenance. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircraft that failed Aircraft Service Period Adjustment (ASPA) inspections or reached fixed Period End Date (PED) at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance represents the difference between the validated requirements minus corresponding funding.

Airframe rework and maintenance (active and reserve) is currently performed under both the Standard Depot Level Maintenance (SDLM) and Integrated Maintenance Concept (IMC) programs. Currently, the AV-8B, C-130, C-2, E-2, E-6, EA-6B, F-5, F/A-18, H-1, H-46, H-53, H-60, P-3, and S-3 aircraft programs have been incorporated under the IMC concept. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, but with smaller work packages, thereby reducing out-of-service time. The goal of this program is to improve readiness while reducing operating and support costs. The Naval Air Systems Command's (NAVAIR) Industrial Strategy is to maintain the minimum level of organic capacity, consistent with force levels, that is necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR works in partnership with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance.

Combat Vehicles Deferred Maintenance

The combat vehicles category refers to deferred vehicle maintenance for the active and reserve Marine Corps assets. The combat vehicle category consists of weapons systems such as the M1A1 Tank, the Amphibious Assault Vehicle, the Hercules Recovery Vehicle, and the Light Armored Vehicle. The total requirement is the planned quantity of combat vehicles that require depot level maintenance in a year as determined by program managers and the operating forces with requirements validated by a modeling process. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Missiles Deferred Maintenance

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

Ships Deferred Maintenance

Fleet Type Commanders provide deferred ship maintenance data. Data is collected from the Current Ships' Maintenance Plan (CSMP) database, which captures maintenance actions at all levels (organizational, intermediate, depot) for active and reserve ships. Only depot level deferred maintenance is provided in the calculation of ship deferred maintenance. This includes maintenance actions deferred from actual depot maintenance work-packages as well as maintenance deferred before inclusion in a work package due to fiscal, operational, or capacity constraints. Although there are some deferred maintenance actions, no ships fall into the category of "unacceptable operating condition." Any ship that would be at risk of being in unacceptable operating condition would receive priority for maintenance funding to maintain acceptable operating condition.

Ordnance Weapons and Munitions Deferred Maintenance

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

Deferred Maintenance on All Other Items Not Identified Above

This category comprises deferred maintenance for software, radar equipment, arrest gear, lighting and surfacing equipment, and EFTM (external fuel transfer module). The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Software maintenance includes the operational and system test software that runs in the airborne avionics systems (e.g., mission computer, display computer, radar) and the software that runs the ground-based support labs used to perform software sustainment (e.g., compilers, editors, simulation, configuration management).

Heritage Assets Condition Information

The methodology used to report the condition of the heritage assets was a combination of visual assessment of the objects, historic value to the DON collection, and general display and storage standards for historic collections. The overall condition of the collection objects is good.

Statement of Disaggregated Budgetary Resources

For the periods ended September 30, 2010 and 2009	Research, Development, Test & Evaluation	Procurement	Military Personnel	Family Housing & Military Construction
BUDGETARY FINANCING ACCOUNTS				
BUDGETARY RESOURCES				
Unobligated balance, brought forward, October 1	$ 2,622,524	$ 18,735,372	$ 570,584	$ 2,870,677
Recoveries of prior year unpaid obligations	683,617	4,967,781	3,302,535	2,143,901
Budget authority				
Appropriation	20,106,958	48,523,145	46,395,894	3,806,446
Borrowing authority	-	-	-	-
Contract authority	-	-	-	-
Spending authority from offsetting collections				
Earned				
Collected	381,603	815,442	371,289	1,115,263
Change in receivables from Federal sources	2,378	15,174	(43,520)	(38,598)
Change in unfilled customer orders				
Advance received	(25,804)	-	(66)	(36,625)
Without advance from Federal sources	6,715	(88,739)	(2,471)	(500,091)
Anticipated for rest of year, without advances	-	-	-	-
Previously unavailable	-	-	-	-
Expenditure transfers from trust funds	-	-	-	-
Subtotal	20,471,850	49,265,022	46,721,126	4,346,395
Nonexpenditure transfers, net, anticipated and actual	(50,611)	1,535,984	695,779	(250,613)
Temporarily not available pursuant to Public Law	-	-	-	-
Permanently not available	(265,716)	(687,854)	(64,221)	(164,633)
Total Budgetary Resources	$ 23,461,664	$ 73,816,305	$ 51,225,803	$ 8,945,727
Status of Budgetary Resources:				
Obligations incurred:				
Direct	$ 20,311,792	$ 45,889,976	$ 50,434,292	$ 3,320,373
Reimbursable	373,757	869,524	375,116	2,938,665
Subtotal	20,685,549	46,759,500	50,809,408	6,259,038
Unobligated balance:				
Apportioned	2,531,197	26,421,734	45,766	2,613,873
Exempt from apportionment	-	-	-	-
Subtotal	2,531,197	26,421,734	45,766	2,613,873
Unobligated balance not available	244,918	635,071	370,629	72,816
Total status of budgetary resources	$ 23,461,664	$ 73,816,305	$ 51,225,803	$ 8,945,727
Change in Obligated Balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	$ 9,606,247	$ 62,486,021	$ 1,840,661	$ 5,343,466
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(246,397)	(294,064)	(39,990)	(1,594,129)
Total unpaid obligated balance	9,359,850	62,191,957	1,800,671	3,749,337
Obligations incurred net (+/-)	20,685,548	46,759,500	50,809,408	6,259,037
Less: Gross outlays	(19,557,071)	(44,782,867)	(46,653,892)	(3,966,993)
Obligated balance transferred, net				
Actual transfers, unpaid obligations (+/-)	-	-	-	-
Actual transfers, uncollected customer payments from Federal sources (+/-)	-	-	-	-
Total Unpaid obligated balance transferred, net	-	-	-	-
Less: Recoveries of prior year unpaid obligations, actual	(683,617)	(4,967,781)	(3,302,535)	(2,143,901)
Change in uncollected customer payments from Federal sources (+/-)	(9,093)	73,565	45,991	538,690
Obligated balance, net, end of period				
Unpaid obligations	10,051,107	59,494,873	2,693,642	5,491,609
Less: Uncollected customer payments (+/-) from Federal sources (-)	(255,489)	(220,499)	6,001	(1,055,440)
Total, unpaid obligated balance, net, end of period	9,795,618	59,274,374	2,699,643	4,436,169
Net Outlays				
Net Outlays:				
Gross outlays	19,557,071	44,782,867	46,653,892	3,966,993
Less: Offsetting collections	(355,799)	(815,442)	(371,223)	(1,078,638)
Less: Distributed Offsetting receipts	-	-	-	-
Net Outlays	$ 19,201,272	$ 43,967,425	$ 46,282,669	$ 2,888,355

Department of Defense • Department of the Navy General Fund

Statement of Disaggregated Budgetary Resources

For the periods ended September 30, 2010 and 2009	Operations, Readiness & Support	2010 Combined	2009 Combined
BUDGETARY FINANCING ACCOUNTS			
BUDGETARY RESOURCES			
Unobligated balance, brought forward, October 1	$ 2,249,205	$ 27,048,361	$ 28,028,796
Recoveries of prior year unpaid obligations	5,002,043	16,099,877	24,029,026
Budget authority			
Appropriation	55,134,659	173,967,102	165,257,844
Borrowing authority	-	-	-
Contract authority	-	-	-
Spending authority from offsetting collections			
Earned			
Collected	6,170,282	8,853,881	7,806,105
Change in receivables from Federal sources	3,619	(60,947)	(144,220)
Change in unfilled customer orders			
Advance received	38,472	(24,024)	323,916
Without advance from Federal sources	1,956	(582,631)	78,479
Anticipated for rest of year, without advances	-	-	-
Previously unavailable	-	-	-
Expenditure transfers from trust funds	-	-	-
Subtotal	61,348,988	182,153,381	173,322,124
Nonexpenditure transfers, net, anticipated and actual	658,601	2,589,140	1,711,873
Temporarily not available pursuant to Public Law	-	-0	-
Permanently not available	(1,094,591)	(2,277,014)	(3,170,061)
Total Budgetary Resources	$ 68,164,246	$ 225,613,745	$ 223,921,758
Status of Budgetary Resources:			
Obligations incurred:			
Direct	$ 59,477,678	$ 179,434,110	$ 186,657,507
Reimbursable	6,619,899	11,176,960	10,215,890
Subtotal	66,097,577	190,611,070	196,873,397
Unobligated balance:			
Apportioned	192,429	31,804,999	23,983,393
Exempt from apportionment	-	-	-
Subtotal	192,429	31,804,999	23,983,393
Unobligated balance not available	1,874,241	3,197,676	3,064,968
Total status of budgetary resources	$ 68,164,247	$ 225,613,745	$ 223,921,758
Change in Obligated Balance:			
Obligated balance, net			
Unpaid obligations, brought forward, October 1	$ 22,127,106	$ 101,403,501	$ 93,776,544
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(1,623,896)	(3,798,476)	(3,864,218)
Total unpaid obligated balance	20,503,210	97,605,025	89,912,326
Obligations incurred net (+/-)	66,097,577	190,611,070	196,873,397
Less: Gross outlays	(59,352,193)	(174,313,017)	(165,217,414)
Obligated balance transferred, net			
Actual transfers, unpaid obligations (+/-)	-	-	-
Actual transfers, uncollected customer payments from Federal sources (+/-)	-	-	-
Total Unpaid obligated balance transferred, net	-	-	-
Less: Recoveries of prior year unpaid obligations, actual	(5,002,043)	(16,099,877)	(24,029,026)
Change in uncollected customer payments from Federal sources (+/-)	(5,575)	643,578	65,742
Obligated balance, net, end of period			
Unpaid obligations	23,870,445	101,601,677	101,403,501
Less: Uncollected customer payments (+/-) from Federal sources (-)	(1,629,471)	(3,154,898)	(3,798,476)
Total, unpaid obligated balance, net, end of period	22,240,974	98,446,779	97,605,025
Net Outlays			
Net Outlays:			
Gross outlays	59,352,193	174,313,017	165,217,414
Less: Offsetting collections	(6,208,754)	(8,829,857)	(8,130,022)
Less: Distributed Offsetting receipts	(141,386)	(141,386)	(321,451)
Net Outlays	$ 53,002,053	$ 165,341,774	$ 156,765,941

Fiscal Year 2010 Department of the Navy Annual Financial Report

Appropriations, Funds, and Accounts Included in the Principal Statements

Entity Accounts

General Funds

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1000	Medicare-Eligible Retiree Health Fund Contribution, Navy
17 1001	Medicare-Eligible Retiree Health Fund Contribution, Marine Corps
17 1002	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy
17 1003	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps
17X1105	Military Personnel, Marine Corps
17 1105	Military Personnel, Marine Corps
17X1106	Operations and Maintenance, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps
17 1109	Procurement, Marine Corps
17 1116	Operation and Maintenance - Recovery Act, Marine Corps
17 1117	Operation and Maintenance - Recovery Act, Marine Corps Reserve
17X1205	Military Construction, Navy and Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1206	Military Construction - Recovery Act, Navy and Marine Corps
17 1235	Military Construction, Naval Reserve
17X1236	Payments to Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
17 1319	Research, Development, Test, and Evaluation, Navy
17 1320	Research, Development, Test and Evaluation - Recovery Act, Navy
17 1405	Reserve Personnel, Navy
17X1453	Military Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17X1507	Weapons Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17X1611	Shipbuilding and Conversion, Navy
17 1611	Shipbuilding and Conversion, Navy
17X1804	Operation and Maintenance, Navy
17 1804	Operation and Maintenance, Navy
17 1805	Operation and Maintenance - Recovery Act, Navy
17X1806	Operations and Maintenance, Navy Reserve
17 1806	Operation and Maintenance, Navy Reserve
17 1807	Operation and Maintenance - Recovery Act, Navy Reserve

17X1810	Other Procurement, Navy
17 1810	Other Procurement, Navy

Revolving Funds

17X4557	National Defense Sealift Fund, Navy
17 4557	National Defense Sealift Fund, Navy

Earmarked Trust Funds

17X8716	Department of the Navy General Gift Fund
17X8723	Ships Stores Profits, Navy
17X8733	United States Naval Academy General Gift Fund

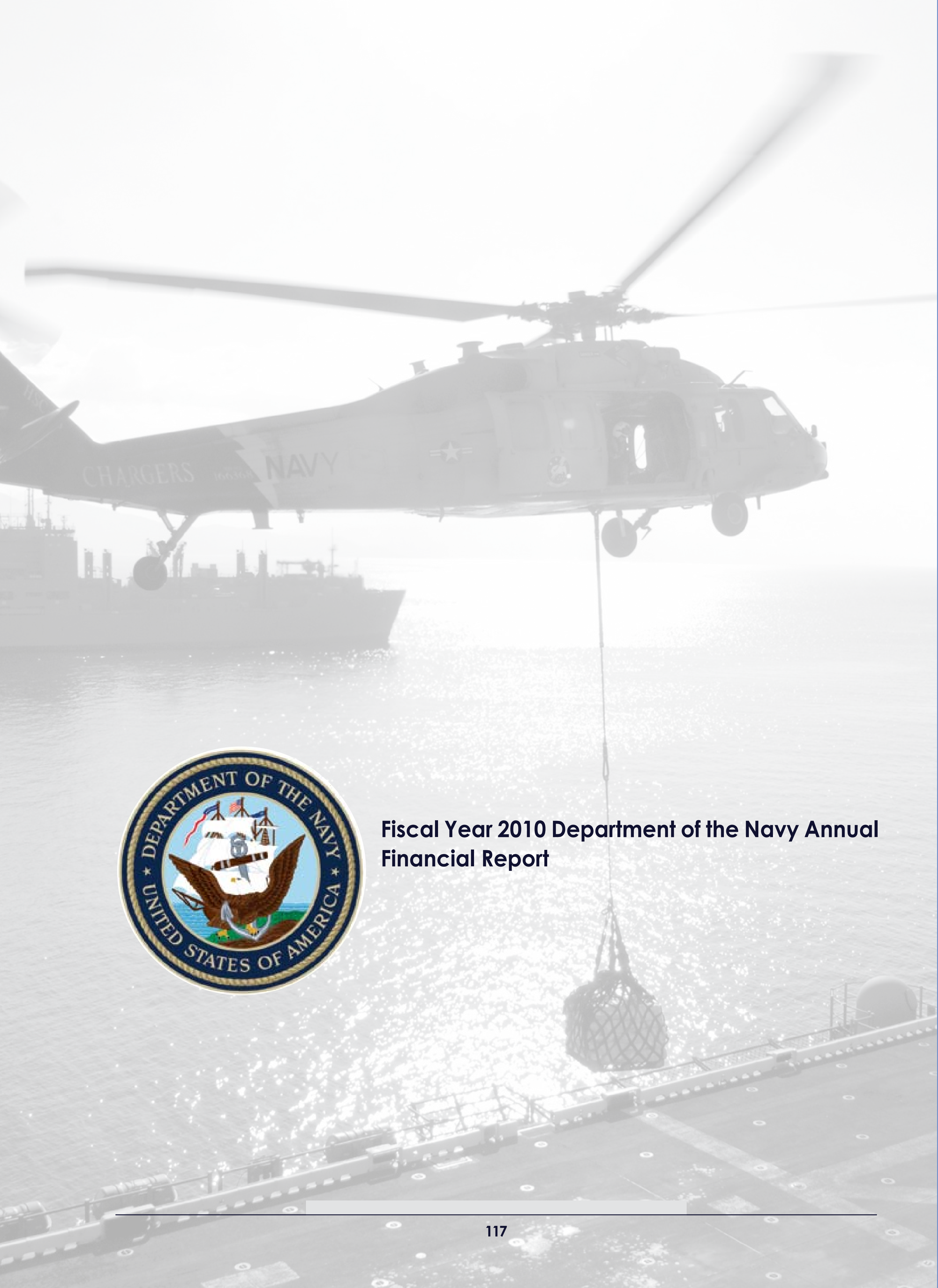
Earmarked Special Funds

17X5095	Wildlife Conservation, etc., Military Reservations, Navy
17X5185	Kaho Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
17X5429	Rossmoor Liquidating Trust Settlement Account
17X5562	Ford Island Improvement Account

General Fund Non- Entity Accounts

Deposit Funds

17X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)
17X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)
17X6025	Pay of the Navy, Deposit Fund (T)
17X6026	Pay of the Marine Corps, Deposit Fund (T)
17X6075	Withheld Allotment of Compensation for Payment of Employee Organization Dues, Navy
17X6083	Withheld Allotment of Compensation for Charitable Contributions, Navy
17X6134	Amounts Withheld for Civilian Pay Allotments, Navy
17X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
17X6705	Civilian Employees Allotment Account, Navy
17X6706	Commercial Communication Service, Navy
17 6763	Gains and Deficiencies on Exchange Transactions, Navy
17X6850	Housing Rentals, Navy
17X6999	Accounts Payable, Check Issue Underdrafts, Navy



Fiscal Year 2010 Department of the Navy Annual Financial Report

Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 United States Code 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with Generally Accepted Accounting Principles for Federal entities and the formats prescribed by Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Principal Statements

The Fiscal Year 2010 Navy Working Capital Fund principal statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the Navy Working Capital Fund for the fiscal year ending September 30, 2010, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2009.

The following statements comprise the Navy Working Capital Fund principal statements:

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

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

Department of Defense
Navy Working Capital Fund

CONSOLIDATED BALANCE SHEET

As of September 30, 2010 and 2009

($ in Thousands)

	2010 Consolidated	Restated 2009 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 992,689	$ 1,171,045
Accounts Receivable (Note 5)	965,699	560,596
Other Assets (Note 6)	227	717
Total Intragovernmental Assets	1,958,615	1,732,358
Cash and Other Monetary Assets (Note 7)	1,531	476
Accounts Receivable, Net (Note 5)	70,615	99,430
Inventory and Related Property, Net (Note 9)	14,264,715	12,649,050
General Property, Plant, and Equipment, Net (Note 10)	2,554,317	2,841,232
Other Assets (Note 6)	401,392	361,860
TOTAL ASSETS	$ 19,251,185	$ 17,684,406
Stewardship Property, Plant, and Equipment (Note 10) *		
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 159,514	$ 151,290
Other Liabilities (Note 15 & Note 16)	428,926	655,157
Total Intragovernmental Liabilities	588,440	806,447
Accounts Payable (Note 12)	2,828,324	3,326,652
Military Retirement and Other Federal Employment Benefits (Note 17)	770,309	931,160
Other Liabilities (Note 15 & Note 16)	1,752,328	1,730,608
TOTAL LIABILITIES	5,939,401	6,794,867
Commitments and Contingencies (Note 16) *		
NET POSITION		
Unexpended Appropriations - Other Funds	28,521	30,954
Cumulative Results of Operations - Other Funds	13,283,263	10,858,585
TOTAL NET POSITION	13,311,784	10,889,539
TOTAL LIABILITIES AND NET POSITION	$ 19,251,185	$ 17,684,406

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

The accompanying notes are an integral part of the statements.

Department of Defense
Navy Working Capital Fund

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Consolidated	Restated 2009 Consolidated
Program Costs		
Gross Costs	$ 27,458,067	$ 24,890,216
Operations, Readiness, & Support	27,458,067	24,978,369
Less: Earned Revenue	(30,276,489)	(23,340,001)
Net Cost of Operations	$ (2,818,422)	$ 1,550,214

The accompanying notes are an integral part of the statements.

Department of Defense
Navy Working Capital Fund

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Consolidated	Restated 2009 Consolidated
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$ 10,385,207	$ 9,894,936
Prior Period Adjustments:		
Correction of errors (+/-)	473,378	1,364,330
Beginning Balances, as adjusted	10,858,585	11,259,266
Budgetary Financing Sources:		
Appropriations used	205,977	30,778
Nonexchange revenue	212	-
Other Financing Sources:		
Transfers in/out without reimbursement (+/-)	(62,137)	(364,257)
Imputed financing from costs absorbed by others	591,919	470,522
Other (+/-)	(1,129,715)	1,012,490
Total Financing Sources	(393,744)	1,149,533
Net Cost of Operations (+/-)	(2,818,422)	1,550,214
Net Change	2,424,678	(400,681)
Cumulative Results of Operations	$ 13,283,263	$ 10,858,585
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 30,954	$ 60,156
Prior Period Adjustments:	30,954	60,156
Beginning Balances, as adjusted		
Budgetary Financing Sources:	203,544	1,576
Appropriations received	(205,977)	(30,778)
Appropriations transferred-in/out (+/-)	(2,433)	(29,202)
Total Budgetary Financing Sources	28,521	30,954
Unexpended Appropriations	13,311,784	10,889,539
Net Position	$ -	$ 10,416,161

The accompanying notes are an integral part of the statements.

Department of Defense
Navy Working Capital Fund

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Combined	2009 Combined
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	$ 3,554,313	$ 2,822,888
Recoveries of prior year unpaid obligations	660,572	182,409
Budget Authority:		
Appropriations received	203,544	1,576
Contract Authority	6,139,859	6,689,051
Spending authority from offsetting collections:		
Earned		
Collected	26,273,602	25,849,200
Change in receivables from Federal sources	369,979	(339,802)
Change in unfilled customer orders		
Advances received	(223,167)	248,350
Without advance from Federal sources	444,790	989,973
Subtotal	33,208,607	33,438,348
Permanently not available	(7,736,410)	(6,424,572)
Total Budgetary Resources	29,687,082	30,019,073
Status of Budgetary Resources:		
Obligations incurred:		
Reimbursable	26,786,142	26,464,761
Subtotal	26,786,142	26,464,761
Unobligated balance:		
Apportioned	-	3,350,323
Exempt from Apportionment	2,888,744	199,586
Subtotal	2,888,744	3,549,909
Unobligated balances not available	12,196	4,403
Total Status of Budgetary Resources	$ 29,687,082	$ 30,019,073

The accompanying notes are an integral part of the statements.

Department of Defense
Navy Working Capital Fund

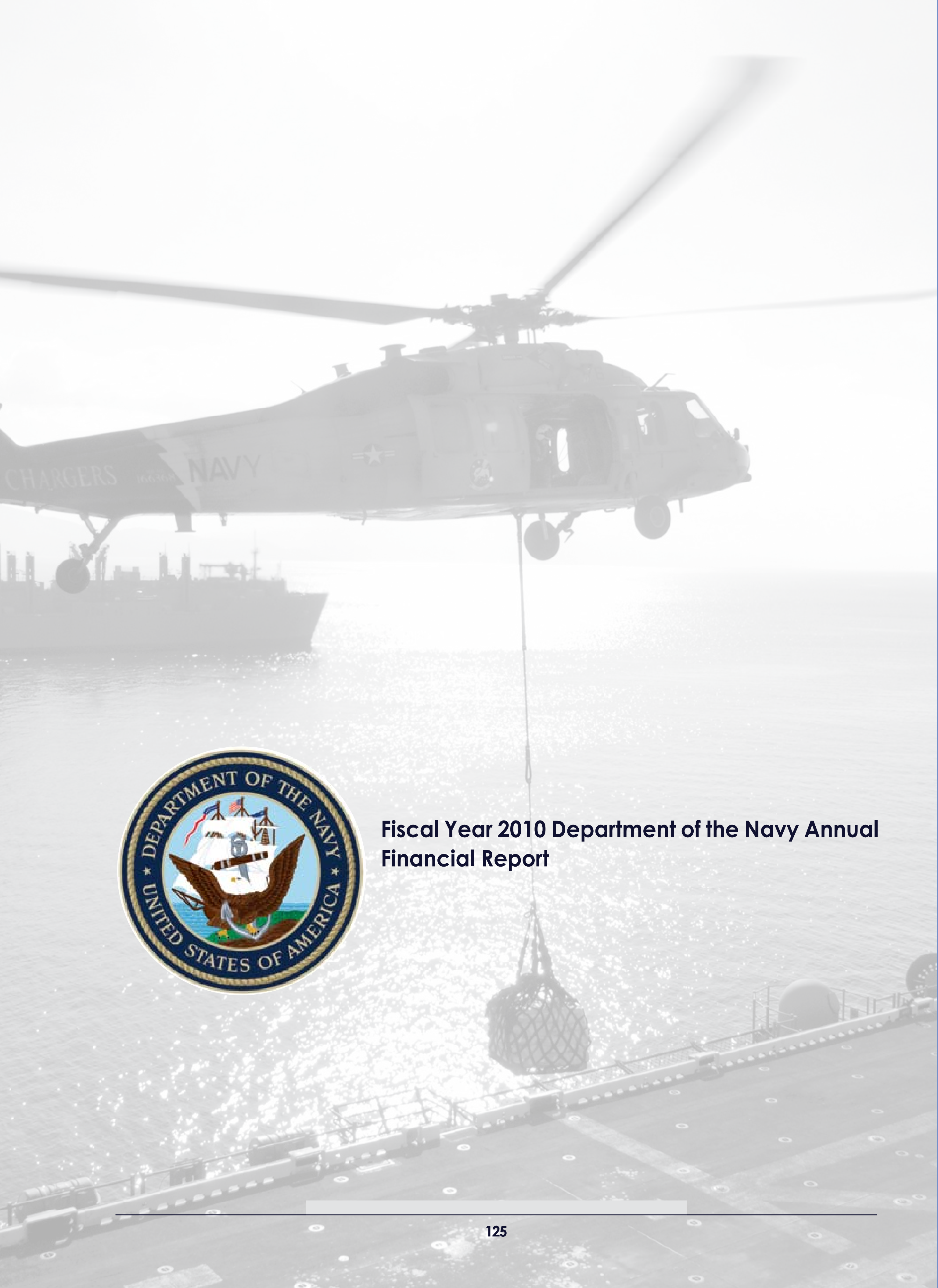
COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2010 and 2009

($ in Thousands)

	2010 Combined	2009 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	$ 12,411,972	$ 11,825,672
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(8,910,090)	(8,259,920)
Total Unpaid Obligated Balance	3,501,882	3,565,752
Obligations incurred, net (+/-)	26,786,142	26,464,761
Less: Gross outlays	(26,432,333)	(25,696,052)
Less: Recoveries of prior year unpaid obligations, actual	(660,572)	(182,409)
Change in uncollected customer payments from Federal sources (+/-)	(814,771)	(650,170)
Obligated balance, net, end of period		
Unpaid obligations	12,105,209	12,411,972
Less: Uncollected customer payments from Federal sources	(9,724,861)	(8,910,090)
Total Unpaid Obligated Balance, net, end of period	2,380,348	3,501,882
Net Outlays:		
Gross Outlays	26,432,333	25,696,052
Less: Offsetting collections	(26,050,433)	(26,097,551)
Net Outlays	$ 381,900	$ (401,499)

The accompanying notes are an integral part of the statements.



NAVY WORKING CAPTIAL FUND NOTES TO THE PRINCIPAL STATEMENTS

Fiscal Year 2010 Department of the Navy Annual Financial Report

Note 1. Significant Accounting Policies

1.A. Basis of Presentation

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

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

The Department of Defense Inspector General (DoDIG) issued an audit report dated November 8, 2010 and identified several financial statement material weaknesses: Financial Management Systems; Fund Balance with Treasury; Accounts Receivable; Inventory and Related Property; General Equipment; Accounts Payable; and Other Liabilities. The NWCF (as identified in the DON FY 2010 Annual Statement of Assurance dated September 01, 2010) recognizes those weaknesses as well as weaknesses associated with Collections and Disbursements, Procure to Pay Processes.

1.B. Mission of the Reporting Entity

The Department of the Navy (DON) was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The overall mission of 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.

1.C. Appropriations and Funds

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

Working capital funds (WCF) received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations which result in transactions that flow through the fund. The WCF resources the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

1.D. Basis of Accounting

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

The financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the sub-entities. The underlying data is largely derived from proprietary data from nonfinancial feeder systems, and accruals. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. At the consolidated level, these abnormal balances may not be evident. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

1.E. Revenues and Other Financing Sources

Depot Maintenance WCF activities recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items. Research and Development activities recognize revenue according to the percentage of completion method or as actual costs are incurred and billed. Revenue is recognized at the time service is rendered for Base Support WCF activities. The Transportation WCF activity, 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 remaining per diem projects, revenue is accrued in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered. MSC does not generate bills until actual invoiced costs on the project are recorded.

The NWCF does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 21, Reconciliation of Net Cost of Operations to Budget. The U.S. has cost-sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in a port.

1.F. Recognition of Expenses

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

1.G. Accounting for Intragovernmental Activities

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

The U.S. Treasury's Federal Intragovernmental Transactions Accounting Policy Guide and Treasury Financial Manual Part 2 – Chapter 4700, Agency Reporting Requirements for the Financial Report of the United States Government, provide guidance for reporting and reconciling intragovernmental balances. While NWCF is unable to fully reconcile intragovernmental transactions with all federal agencies, NWCF is able to reconcile balances pertaining to borrowings from the Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management.

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

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

1.H. Transactions with Foreign Governments and International Organizations

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

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

The NWCF's monetary resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military 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 checks issued, electronic fund transfers, interagency transfers, and deposits.

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

1.J. Foreign Currency

Not applicable.

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. The NWCF is in the process of developing a methodology for the allowances for uncollectible accounts due from the public and should see implementation later this year. The DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies in accordance with dispute resolution procedures defined in the Intragovernmental Business Rules published in the Treasury Financial Manual at *http://www.fms.treas.gov/tfm/vol1/07-03.pdf*.

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

The NWCF values approximately 45% of its resale inventory using the moving average cost method. The NWCF reports the remaining 55% of resale inventories at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The latest acquisition cost method is used because legacy inventory systems were designed for materiel 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 Statement of Federal Financial Accounting Standards (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). The NWCF is continuing to transition the balance of the inventories to the moving average cost method through the implementation of Navy Enterprise Resource Planning (ERP). Most transitioned balances, however, were not baselined to auditable historical cost and remain noncompliant with SFFAS No. 3.

The NWCF manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in NWCF's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The NWCF holds materiel based on military need and support for contingencies. The DoD is currently developing a methodology to be used to account for "inventory held for sale" and "inventory held in reserve for future sale" with a completion date of year end FY 2011 reporting.

Related property includes OM&S. The OM&S, including munitions not held for sale, are valued at standard purchase price. The NWCF uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, NWCF uses the purchase method. Under this method, materiel and supplies are expensed when purchased. During FY 2010 and FY 2009, 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. This is a material weakness for the DoD and long-term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

The NWCF recognizes excess, obsolete, and unserviceable inventory and OM&S at a net realizable value of $0 pending development of an effective means of valuing such materiel.

Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by NWCF. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory that requires repair to make it suitable for sale. Often, it is more economical to repair these items rather than to procure them. The NWCF often relies on weapon systems and machinery no longer in production. As a result, NWCF supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Work in process balances include (1) costs related to the production or servicing of items, including direct material, labor, applied overhead; (2) the value of finished products or completed services that are yet to be placed in service; and (3) munitions in production and depot maintenance work with its associated costs incurred in the delivery of maintenance services.

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

Not applicable.

1.O. General Property, Plant and Equipment

The DoD's General Property, Plant, and Equipment (PP&E) capitalization threshold is $100 thousand except for real property, which is $20 thousand. The NWCF has not fully implemented the threshold for real property; therefore the capitalization threshold is $100 thousand for General PP&E and most real property.

With the exception of USACE Civil Works and WCF, General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds DoD's capitalization threshold. The DoD also requires the capitalization of improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The DoD depreciates all General PP&E, other than land, on a straight-line basis.

The WCF capitalizes all PP&E used in the performance of its mission. These assets are capitalized as General PP&E, whether or not they meet the definition of any other PP&E category.

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 meets or exceeds the DoD capitalization threshold, federal accounting standards require that it be reported on NWCF's Balance Sheet.

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

1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, DoD's policy is to record advances or prepayments in accordance with USGAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The DoD's policy is to expense and/or properly classify assets when the related goods and services are received. The NWCF has not implemented this policy primarily due to system limitations.

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

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

1.R. Other Assets

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

The NWCF conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, NWCF may provide financing payments. Contract financing payments are defined in the Federal Acquisition Regulations, Part 32, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts. It is DoD policy to record certain contract financing payments as other assets. The NWCF has not fully implemented this policy primarily due to system limitations.

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

1.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. The NWCF's risk of loss and resultant contingent liabilities arise from pending or threatened litigation or claims and assessments due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

1.T. Accrued Leave

The NWCF reports liabilities for military leave and accrued compensatory and annual leave for civilians. Sick leave for civilians is expensed as taken. The liabilities are based on current pay rates.

1.U. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended Appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred. Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources (including appropriations, revenue, and gains), since inception. The cumulative results of operations also include donations and transfers in and out of assets that were not reimbursed.

1.V. Treaties for Use of Foreign Bases

The DoD has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The NWCF purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. Treaty terms generally allow NWCF continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, use of the foreign bases is prohibited and losses are recorded for the value of any nonretrievable capital assets. The settlement due to the U.S. or host nation is negotiated and takes into account the value of capital investments and may be offset by the cost of environmental cleanup.

1.W. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by the U.S. Treasury.

Supported disbursements and collections are evidenced by corroborating documentation. Unsupported disbursements and collections do not have supporting documentation for the transaction and most likely would not meet audit scrutiny.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Supported undistributed disbursements and collections are then applied to reduce accounts payable and receivable accordingly. Unsupported undistributed disbursements are recorded as disbursements intransit and reduce nonfederal accounts payable. Unsupported undistributed collections are recorded in nonfederal other liabilities.

1.X. Significant Events

None reported at this time.

1.Y. Fiduciary Activities

Not applicable.

Note 2. Nonentity Assets

As of September 30	2010	Restated 2009
(Amounts in thousands)		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	$ -	$ -
B. Accounts Receivable		
C. Total Intragovernmental Assets	-	-
D. Total Nonfederal Assets	$ -	$ -
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	$ -	$ -
B. Accounts Receivable	6,480	3,742
C. Other Assets	-	-
D. Total Nonfederal Assets	$ 6,480	$ 3,742
3. Total Nonentity Assets	$ 6,480	$ 3,742
4. Total Entity Assets	$ 19,244,705	$ 17,680,664
5. Total Assets	$ 19,251,185	$ 17,684,406

Nonentity assets are assets for which the Navy Working Capital Fund (NWCF) maintains stewardship accountability and reporting responsibility, but are not available for the NWCF normal operations.

The Nonentity Accounts Receivable amount represents interest, penalties, fines and administrative fees. These fees do not belong to the NWCF and will be distributed directly to the U.S. Treasury.

Note 3. Fund Balance with Treasury

As of September 30	2010	2009
(Amounts in thousands)		
1. Fund Balances		
A. Appropriated Funds	$ -	$ -
B. Revolving Funds	992,689	1,171,045
C. Trust Funds	-	-
D. Special Funds	-	-
E. Other Fund Types	-	-
F. Total Fund Balances	$ 992,689	$ 1,171,045
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	$ 992,689	$ 1,171,045
B. Fund Balance per DON	992,689	1,171,045
3. Reconciling Amount	$ -	$ -

Status of Fund Balance with Treasury

As of September 30	2010	2009
(Amounts in thousands)		
1. Unobligated Balance		
A. Available	$ 2,888,745	$ 3,549,908
B. Unavailable	12,194	4,405
2. Obligated Balance not yet Disbursed	12,105,210	12,411,972
3. Nonbudgetary FBWT	-	-
4. NonFBWT Budgetary Accounts	(14,013,460)	(14,795,240)
5. Total	$ 992,689	$ 1,171,045

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

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

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

NonFBWT Budgetary Accounts reduces the Status of FBWT. This amount is comprised of contract authority, accounts receivable, and unfilled orders without advance from customers for the Navy Working Capital Fund (NWCF).

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

Note 4. Investments and Related Interest

Not applicable.

Note 5. Accounts Receivable

As of September 30	2010		
(Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 965,699	N/A	$ 965,699
2. Nonfederal Receivables (From the Public)	70,615	-	70,615
3. Total Accounts Receivable	$ 1,036,314	$ -	$ 1,036,314

As of September 30	2009		
(Amounts in thousands)	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
1. Intragovernmental Receivables	$ 560,596	N/A	$ 560,596
2. Nonfederal Receivables (From the Public)	99,459	(29)	99,430
3. Total Accounts Receivable	$ 660,055	$ (29)	$ 660,026

The accounts receivable represent the Navy Working Capital Fund's (NWCF) claim for payment from other entities. The NWCF only recognizes an allowance for uncollectible amounts from the public. Claims with other federal agencies are resolved in accordance with the Intragovernmental Business Rules.

Note 6. Other Assets

As of September 30	2010	2009
(Amounts in thousands)		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	$ 227	$ 717
B. Other Assets	-	-
C. Total Intragovernmental Other Assets	$ 227	$ 717
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	$ 293,838	$ 332,318
B. Advances and Prepayments	103,024	17,438
C. Other Assets (With the Public)	4,530	12,104
D. Total Nonfederal Other Assets	$ 401,392	$ 361,860
3. Total Other Assets	$ 401,619	$ 362,577

Other Assets (With the Public) consists of prepayments made to vendors, and travel advances.

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Navy Working Capital Fund (NWCF) that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy. However, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Federal Government. The Federal Government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and NWCF is not obligated to make payment to the contractor until delivery and acceptance.

The balance of Outstanding Contract Financing Payments includes $266.6 million in contract financing payments and an additional $27.3 million in estimated future payments to contractors upon delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities.)

Note 7. Cash and Other Monetary Assets

As of September 30	2010	2009
(Amounts in thousands)		
1. Cash	$ 1,531	$ 476
2. Foreign Currency	-	-
3. Other Monetary Assets	-	-
4. Total Cash, Foreign Currency, & Other Monetary Assets	$ 1,531	$ 476

There are no restrictions on cash.

Note 8. Direct Loan and Loan Guarantees

Not applicable.

Note 9. Inventory and Related Property

As of September 30	2010	Restated 2009
(Amounts in thousands)		
1. Inventory, Net	$ 14,0]44,853	$ 12,424,960
2. Operating Materiel & Supplies, Net	219,862	224,090
3. Stockpile Materiel, Net	-	-
4. Total	$ 14,264,715	$ 12,649,050

Inventory, Net

As of September 30	2010			
(Amounts in thousands)	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
1. Inventory Categories				
A. Held for Use	$ 26,013,203	$ (16,247,006)	$ 9,766,197	LAC, MAC
B. Held for Repair	7,133,683	(3,070,881)	4,062,802	LAC, MAC
C. Excess, Obsolete, and Unserviceable	1,031,765	(1,031,765)	-	NRV
D. Raw Materiel	-	-	-	
E. Work in Process	215,854	-	215,854	AC
F. Total	$ 34,394,505	$ (20,349,652)	$ 14,044,853	

As of September 30	2009			
(Amounts in thousands)	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
1. Inventory Categories				
A. Held for Use	$ 31,319,720	$ (20,806,118)	$ 10,513,602	LAC, MAC
B. Held for Repair	5,834,220	(4,170,846)	1,663,374	LAC, MAC
C. Excess, Obsolete, and Unserviceable	1,176,397	(1,176,397)	-	NRV
D. Raw Materiel	-	-	-	
E. Work in Process	247,984	-	247,984	AC
F. Total	$ 38,578,321	$ (26,153,361)	$ 12,424,960	

Legend for Valuation Methods:

LAC = Latest Acquistion Cost
NRV = Net Realizable Value
MAC = Moving Average Cost
SP = Standard Price
LCM = Lower of Cost or Market
AC = Actual Cost
O = Other

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

1) Distributions without reimbursement are made when authorized by Department of Defense (DoD) directives;
2) War reserve materiel in the amount of $0.4 million includes repair items that are considered restricted; and
3) Inventory, with the exception of safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

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

Inventory available and purchased for resale includes consumable spare and repair parts as well as reparable items owned and managed by the Navy Working Capital Fund (NWCF) and includes all materiel available for customer purchase. Inventory held for repair consists of damaged materiel that requires repair to make it usable and all economically reparable materiel. Excess inventory includes scrap materiels or items that are uneconomical to repair and are awaiting disposal. Work in process includes costs related to the production or servicing of items, including direct materiel, 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.

Federal Accounting Standards require disclosure of the amount of inventory held for "future sale." The NWCF currently has $173.5 million reported for 4th Quarter, FY 2010 in Inventory Held for Sale, Net.

Inventory is assigned to categories based upon condition of the inventory items, or in the case of raw materiel and work-in-process based upon stage of fabrication.

The Supply Management, Navy's inventory is reported using the approximation of historical cost method. The approximation of historical cost is calculated by using the latest acquisition cost less the allowance for holding gains and losses. Legacy inventory systems were designed to capture materiel management information rather than accounting data. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, Accounting for Inventory and Related Property. Since the implementation of the Office of Under Secretary of Defense, Comptroller (OUSD (C)) Cost of Goods Sold Model, prior year values in equity, inventory, and inventory allowance accounts have been impacted and remain noncompliant with SFFAS No. 3 and generally accepted accounting principles. The Navy Enterprise Resource Planning System will value inventory at moving average cost and will be compliant with necessary guidance.

Operating Materiel and Supplies, Net

As of September 30	2010						
(Amounts in thousands)	OM&S Gross Value		Revaluation Allowance		OM&S, Net		Valuation Method
1. OM&S Categories							
A. Held for Use	$	219,862	$	-	$	219,862	SP, LAC, MAC
B. Held for Repair		-		-		-	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable		-		-		-	NRV
D. Total	$	219,862	$	-	$	219,862	

As of September 30	2009						
(Amounts in thousands)	OM&S Gross Value		Revaluation Allowance		OM&S, Net		Valuation Method
1. OM&S Categories							
A. Held for Use	$	224,090	$	-	$	224,090	SP, LAC, MAC
B. Held for Repair		-		-		-	SP, LAC, MAC
C. Excess, Obsolete, and Unserviceable		-		-		-	NRV
D. Total	$	224,090	$	-	$	224,090	

Legend for Valuation Methods:

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

Operating Materiel and Supplies (OM&S) held for use consists of property that is consumed during normal operations and includes consumable spare and repair parts for use on customer work by various activities.

There are no restrictions with regard to the use, sale, or disposition of OM&S applicable to NWCF activities.

The NWCF determines categories to which OM&S are assigned based upon readiness for issue and use as determined by condition of the individual inventory items.

Federal Accounting Standards require disclosure of the amount of OM&S held for "future use." The NWCF reports that $1.0 million of OM&S is held for future use and is included in the "held for use" category. These items are not readily available in the market and there is a more than remote chance that they will eventually be needed.

Stockpile Materiel, Net

Not applicable.

Note 10. General PP&E, Net

As of September 30	2010				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 37,317	N/A	$ 37,317
B. Buildings, Structures, and Facilities	S/L	20 Or 40	6,550,506	$ (4,812,815)	1,737,691
C. Leasehold Improvements	S/L	lease term	46	(14)	32
D. Software	S/L	2-5 Or 10	477,773	(369,301)	108,472
E. General Equipment	S/L	5 or 10	2,585,375	(2,086,154)	499,221
F. Military Equipment	S/L	Various	-	-	-
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	170,078	N/A	170,078
J. Other			1,506	-	1,506
K. Total General PP&E			$ 9,822,601	$ (7,268,284)	$ 2,554,317

As of September 30	2009				
(Amounts in thousands)	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
1. Major Asset Classes					
A. Land	N/A	N/A	$ 38,612	N/A	$ 38,612
B. Buildings, Structures, and Facilities	S/L	20 Or 40	6,435,611	$ (4,832,768)	1,602,843
C. Leasehold Improvements	S/L	lease term	46	(9)	37
D. Software	S/L	2-5 Or 10	488,682	(360,811)	127,871
E. General Equipment	S/L	5 or 10	2,624,542	(2,134,619)	489,923
F. Military Equipment	S/L	Various	-	-	-
G. Shipbuilding (Construction-in-Progress)	N/A	N/A	-	-	-
H. Assets Under Capital Lease	S/L	lease term	-	-	-
I. Construction-in-Progress (Excludes Military Equipment)	N/A	N/A	579,393	N/A	579,393
J. Other			2,553	-	2,553
K. Total General PP&E			$ 10,169,439	$ (7,328,207)	$ 2,841,232

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

There are no known restrictions on the use or convertibility of General Property, Plant and Equipment (PP&E).

The acquisition cost for General PP&E is captured and maintained in the applicable property accountability systems. There are no material amounts or types of General PP&E for which the acquisition cost is unknown.

General PP&E, Other consists of $1.5 million of assets awaiting disposal.

Military equipment, heritage assets and stewardship land are reported on the financial statements of the Department of the Navy General Fund (DON GF).

Assets under Capital Lease

Not applicable.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2010	2009
(Amounts in thousands)		
1. Intragovernmental Liabilities		
A. Accounts Payable	$ -	$ -
B. Debt	-	-
C. Other	163,568	206,742
D. Total Intragovernmental Liabilities	$ 163,568	$ 206,742
2. Nonfederal Liabilities		
A. Accounts Payable	$ -	$ -
B. Military Retirement and Other Federal Employment Benefits	770,308	931,160
C. Environmental Liabilities	-	-
D. Other Liabilities	-	-
E. Total Nonfederal Liabilities	$ 770,308	$ 931,160
3. Total Liabilities Not Covered by Budgetary Resources	$ 933,876	$ 1,137,902
4. Total Liabilities Covered by Budgetary Resources	$ 5,005,525	$ 5,656,965
5. Total Liabilities	$ 5,939,401	$ 6,794,867

Liabilities Not Covered by Budgetary Resources include liabilities for which congressional action is needed before budgetary resources can be provided.

Other Intragovernmental Liabilities consist of the unfunded portion of Federal Employees' Compensation Act (FECA) liability that will be funded by future year's budgetary resources.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current fiscal year. These liabilities primarily consist of FECA Actuarial liability of $770.3 million. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details and disclosures.

Note 12. Accounts Payable

As of September 30	2010		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 159,514	$ N/A	$ 159,514
2. Nonfederal Payables (to the Public)	2,828,324	-	2,828,324
3. Total	$ 2,987,838	$ -	$ 2,987,838

As of September 30	2009		
(Amounts in thousands)	Accounts Payable	Interest, Penalties, and Administrative Fees	Total
1. Intragovernmental Payables	$ 151,290	$ N/A	$ 151,290
2. Nonfederal Payables (to the Public)	3,326,652	-	3,326,652
3. Total	$ 3,477,942	$ -	$ 3,477,942

Accounts Payable include amounts owed to federal and nonfederal entities for goods and services received by Navy Working Capital Fund (NWCF). The NWCF's systems do not track intragovernmental transactions by customer at the transaction level. Buyer-side accounts payable are adjusted to agree with internal seller-side accounts receivable. Accounts payable was adjusted by reclassifying amounts between federal and nonfederal accounts payable

Note 13. Debt

As of September 30	2010		
(Amounts in thousands)	Beginning Balance	Net Borrowing	Ending Balance
1. Agency Debt (Intragovernmental)			
A. Debt to the Treasury	$ -	$ -	$ -
B. Debt to the Federal Financing Bank	-	-	- -
C. Total Agency Debt	$ -	$ -	$ -
2. Total Debt	$ -	$ -	$ -

As of September 30	2009		
(Amounts in thousands)	Beginning Balance	Net Borrowing	Ending Balance
1. Agency Debt (Intragovernmental)			
A. Debt to the Treasury	$ -	$ -	$ -
B. Debt to the Federal Financing Bank	16,881	(16,881)	- -
C. Total Agency Debt	$ 16,881	$ (16,881)	$ -
2. Total Debt	$ 16,881	$ (16,881)	$ -

Not applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

The Navy Working Capital Fund Environmental Liabilities are reported under the Department of the Navy General Fund.

Note 15. Other Liabilities

As of September 30	2010		
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
1. Intragovernmental			
A. Advances from Others	$ 204,262	$ -	$ 204,262
B. Deposit Funds and Suspense Account Liabilities	-	-	-
C. Disbursing Officer Cash	-	-	-
D. Judgment Fund Liabilities	-	-	-
E. FECA Reimbursement to the Dept. of Labor	71,969	91,600	163,569
F. Custodial Liabilities	6,480	-	6,480
G. Employer Contribution and Payroll Taxes Payable	54,615	-	54,615
H. Other Liabilities	-	-	-
I. Total Intragovernmental Other Liabilities	$ 337,326	$ 91,600	$ 428,926
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 1,002,417	$ -	$ 1,002,417
B. Advances from Others	235,076	-	235,076
C. Deferred Credits	-	-	-
D. Deposit Funds and Suspense Accounts	25	-	25
E. Temporary Early Retirement Authority	-	-	-
F. Nonenvironmental Disposal Liabilities			
(1) Military Equipment (Nonnuclear)	-	-	-
(2) Excess/Obsolete Structures	-	-	-
(3) Conventional Munitions Disposal	-	-	-
G. Accrued Unfunded Annual Leave	-	-	-
H. Capital Lease Liability	-	-	-
I. Contract Holdbacks	850	-	850
J. Employer Contribution and Payroll Taxes Payable	1,292	-	1,292
K. Contingent Liabilities	485,395	27,273	512,668
L. Other Liabilities	-	-	-
M. Total Nonfederal Other Liabilities	$ 1,725,055	$ 27,273	$ 1,752,328
3. Total Other Liabilities	$ 2,062,381	$ 118,873	$ 2,181,254

As of September 30		2009	
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total
1. Intragovernmental			
A. Advances from Others	$ 395,307	$ -	$ 395,307
B. Deposit Funds and Suspense Account Liabilities	-	-	-
C. Disbursing Officer Cash	-	-	-
D. Judgment Fund Liabilities	-	-	-
E. FECA Reimbursement to the Dept. of Labor	90,074	116,668	206,742
F. Custodial Liabilities	4,881	-	4,881
G. Employer Contribution and Payroll Taxes Payable	48,227	-	48,227
H. Other Liabilities	-	-	-
I. Total Intragovernmental Other Liabilities	$ 538,489	$ 116,668	$ 655,157
2. Nonfederal			
A. Accrued Funded Payroll and Benefits	$ 920,155	$ -	$ 920,155
B. Advances from Others	266,783	-	266,783
C. Deferred Credits	-	-	-
D. Deposit Funds and Suspense Accounts	31	-	31
E. Temporary Early Retirement Authority	-	-	-
F. Nonenvironmental Disposal Liabilities			
(1) Military Equipment (Nonnuclear)	-	-	-
(2) Excess/Obsolete Structures	-	-	-
(3) Conventional Munitions Disposal	-	-	-
G. Accrued Unfunded Annual Leave	-	-	-
H. Capital Lease Liability	-	-	-
I. Contract Holdbacks	1,531	-	1,531
J. Employer Contribution and Payroll Taxes Payable	-	-	-
K. Contingent Liabilities	504,532	30,861	535,393
L. Other Liabilities	6,715	-	6,715
M. Total Nonfederal Other Liabilities	$ 1,699,747	$ 30,861	$ 1,730,608
3. Total Other Liabilities	$ 2,238,236	$ 147,529	$ 2,385,765

Contingent Liabilities includes $27.3 million related to contracts authorizing progress payments based on cost as defined in the Federal Acquisition Regulation (FAR). In accordance with contract terms, specific rights to the contractor's work vest with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The NWCF is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and government acceptance. Due to the probability the contractor will complete their efforts and deliver satisfactory products, and because the amount of potential future payments are estimable, the NWCF has recognized a contingent liability for estimated future payments which are conditional pending delivery and government acceptance.

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

Capital Lease Liability

Not applicable.

Note 16. Commitments and Contingencies

The Department of the Navy (DON) is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests.

The DON has accrued contingent liabilities for legal actions where the Office of General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The DON records Judgment Fund liabilities in Note 12, Accounts Payable; and Note 15, Other Liabilities.

For FY 2010, the Navy Working Capital Fund (NWCF) materiality threshold for reporting litigation, claims, or assessments is $2.3 million. The DON WCF currently has 12 cases that meet the existing FY 2010 DON WCF threshold. The DON OGC was unable to express an opinion concerning the likely outcome of 1 of the 12 cases.

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

Contingencies that are considered both measurable and probable have been recognized as liabilities. Refer to note 15.

Note 17. Military Retirement and Other Federal Employment Benefits

As of September 30	2010			
(Amounts in thousands)	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
1. Pension and Health Actuarial Benefits				
A. Military Retirement Pensions	$ -		$ -	$ -
B. Military Retirement Health Benefits	-		-	-
C. Military Medicare-Eligible Retiree Benefits	-		-	-
D. Total Pension and Health Actuarial Benefits	$ -		$ -	$ -
2. Other Actuarial Benefits				
A. FECA	$ 770,309		$ -	$ 770,309
B. Voluntary Separation Incentive Programs	-		-	-
C. DoD Education Benefits Fund	-		-	-
D. Total Other Actuarial Benefits	$ 770,309		$ -	$ 770,309
3. Other Federal Employment Benefits	$ -		$ -	$ -
4. Total Military Retirement and Other Federal Employment Benefits:	$ 770,309		$ -	$ 770,309

As of September 30	2009			
(Amounts in thousands)	Liabilities	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
1. Pension and Health Actuarial Benefits				
A. Military Retirement Pensions	$ -		$ -	$ -
B. Military Retirement Health Benefits	-		-	-
C. Military Medicare-Eligible Retiree Benefits	-		-	-
D. Total Pension and Health Actuarial Benefits	$ -		$ -	$ -
2. Other Actuarial Benefits				
A. FECA	$ 931,160		$ -	$ 931,160
B. Voluntary Separation Incentive Programs	-		-	-
C. DoD Education Benefits Fund	-		-	-
D. Total Other Actuarial Benefits	$ 931,160		$ -	$ 931,160
3. Other Federal Employment Benefits	$ -		$ -	$ -
4. Total Military Retirement and Other Federal Employment Benefits:	$ 931,160		$ -	$ 931,160

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

The assumptions relate to Federal Employees' Compensation Act (FECA). Consistent with past practice, the projected annual benefit payments are discounted to the present value using Office of Management and Budget's economic assumptions for ten year U.S. Treasury notes and bonds.

The interest rate assumptions utilized when discounting were as follows:

Discount Rates
3.653% in Year 1
4.300% in Year 2 and thereafter

To provide more specificity concerning the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2010 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:

CBY	COLA	CPIM
2010	N/A	N/A
2011	2.23%	3.45%
2012	1.13%	3.43%
2013	1.70%	3.64%
2014	1.90%	3.66%
2015+	1.93%	3.73%

The model's resulting projections were analyzed to ensure that the estimates were reliable. The analysis was based on four tests: (1) a sensitivity analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2010 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the Discount Rates projection to the average pattern for the projections of the most recent three years.

Note 18. Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue				
As of September 30 (Amounts in thousands)		2010		Restated 2009
1. Intragovernmental Costs	$	4,739,000	$	4,977,049
2. Public Costs		22,719,067		19,913,166
3. Total Costs	$	27,458,067	$	24,890,216
4. Intragovernmental Earned Revenue	$	(23,961,250)	$	(22,176,527)
5. Public Earned Revenue		(6,315,239)		(1,163,474)
6. Total Earned Revenue	$	(30,276,489)	$	(23,340,001)
7. Net Cost of Operations	$	(2,818,422)	$	1,550,214

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

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Federal Government supported by appropriations or other means. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The DoD's current processes and systems do not capture and report accumulated cost for major programs based upon the performance measures as required by the Government Performance and Results Act. The DoD is in the process of reviewing available data and developing a cost reporting methodology as required by the Statement of Federal Financial Accounting Standards (SFFAS) No. 4. "Managerial Cost Accounting Concepts and Standards for the Federal Government," as amended by SFFAS No. 30, "Inter-entity Cost Implementation."

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

The Navy Working Capital Fund's (NWCF) financial management systems do not track intragovernmental transactions by customer at the transactional level. Buyer-side expenses are adjusted to agree with internal seller-side revenues. Expenses are generally adjusted by reclassifying amounts between federal and nonfederal expenses.

The data presented is largely derived from proprietary data obtained from nonfinancial feeder systems, and accruals. Many of the NWCF's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of USGAAP.

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

The Prior Period Adjustment (PPA) restates FY 2009 Inventory Available and Purchase for Resale and Inventory Allowance account.

In the current environment, inventory is recorded for Supply Management Activity Group at standard cost. The inventory is then converted in the general ledger from standard cost to Latest Acquisition Cost (LAC) utilizing journal vouchers (JVs). The JVs are calculated and adjusted at the lowest activity level. In July 2008, the Available and Purchase for Resale, Inventory, Net became negative and has continued to increase monthly in FY 2009 and FY 2010. The negative inventory can be attributed to inventory returns from customers that were inaccurately creating allowance values based on the posting of the inventory reports. When inventory items were returned, the transaction was recorded as a debit to the Inventory account, and a credit to the Inventory Allowance account. There was no reduction in the allowance account when the returned inventory items were issued either for re-use or disposal. Therefore, the balance in the Inventory Allowance account was never reduced. Inventory reports are not able to track items that have been previously returned. In order to prevent overstatement of allowances, no allowance should be created when materials are returned. The current process is causing a cumulative overstatement in Inventory Allowance by $473.4 million for prior year and approximately $47.9 million for current year, for a total of $521.3 million.

The current FY 2010 and comparative FY 2009 Balance Sheet, Statement of Changes in Net Position, and Statement of Net Cost lines were impacted as follows:

1. Inventory and Related Property, Net increased by $473.4 million in FY 2009.
2. Total Assets increased by $473.4 million in FY 2009.
3. Cumulative Results of Operations increased by $473.4 million in FY 2009.
4. Correction of Errors was increased by $385.2 million in FY 2009.
5. Net Cost of Operations was decreased by $88.2 million in FY 2009.
6. Gross Costs decreased by $88.2 million in FY 2009.

The overall change in the financial statements as a whole is an increase in net position and elimination of the negative inventory balance.

Other Financing Sources, Other is comprised of a loss reported during the trading partner elimination process, an adjustment made to reclassify the Cost Of Goods Sold model PPA amount properly to Other Losses, and an adjustment made to reconcile Personal Property Management System (PPMS) to Internet Naval Facilities Assets Data Store (iNFADS) for Naval Facilities Engineering Command.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2010	2009
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period"	$ 8,331,652	$ 8,206,543
2. Available Borrowing and Contract Authority at the End of the Period	-	-

Obligations Incurred – Direct	Category A	$0
Obligations Incurred – Reimbursable	Category B	$6.3 billion
Obligations Incurred – Reimbursable	Exempt from Apportionment	$20.4 billion

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

Defense Departmental Reporting System- Budgetary (DDRS-B), is the system used to produce the SF133 and DDRS-Audited Financial Statements (AFS) is the system used to produce quarterly financial reports. The Differences between the SF133 and Statement of Budgetary Resources for 4th Quarter, FY 2010 are as follows:

Unobligated balance, brought forward, October 1 –
A $1.4 million journal voucher (JV) was posted to DDRS-AFS in September 2009 to record the activity's employee benefits accruals and expenses for FEGLI, FEHB, Retirement, and VSIP to reconcile to the Department of Labor amounts, per guidance. This quarterly data call is only posted in DDRS-AFS, and not to DDRS-B. As the JV is not posted in DDRS-B, the expenses did not close with the same cumulative results. This results in a disconnect between DDRS-AFS and DDRS-B beginning balances.

Obligations Incurred, Reimbursable –
The amount of $(0.4) million is to record the FY 2010 accrual of employee benefits in DDRS-AFS. Guidance requires the activity's employee benefits accruals and expenses to reconcile to the Department of Labor amounts. This information is input in DDRS-AFS and not in FACTS II.

Note 21. Reconciliation of Net Cost of Operations to Budget

As of September 30	2010	Restated 2009
(Amounts in thousands)		
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
1. Obligations incurred	$ 26,786,142	$ 26,464,761
2. Less: Spending authority from offsetting collections and recoveries (-)	(27,525,776)	(26,930,130)
3. Obligations net of offsetting collections and recoveries	(739,634)	(465,369)
4. Less: Offsetting receipts (-)	-	-
5. Net obligations	(739,634)	(465,369)
Other Resources:		
6. Donations and forfeitures of property	-	-
7. Transfers in/out without reimbursement (+/-)	(62,137)	(364,257)
8. Imputed financing from costs absorbed by others	591,919	470,522
9. Other (+/-)	(1,129,715)	1,012,490
10. Net other resources used to finance activities	(599,933)	1,118,755
11. Total Resources Used to Finance Activities	$ (1,339,567)	$ 653,386
Resources Used to Finance Items not Part of the Net Cost of Operations:		
12. Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
12a. Undelivered Orders (-)	$ (125,109)	$ (412,286)
12b. Unfilled Customer Orders	221,623	1,238,321
13. Resources that fund expenses recognized in prior periods (-)	(207,938)	(109,799)
14. Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	-	-
15. Resources that finance the acquisition of assets (-)	(4,826,279)	(4,998,100)
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 (-)	-	-
16b. Other (+/-)	1,191,852	(648,232)
17. Total resources used to finance items not part of the Net Cost of Operations	$ (3,745,851)	$ (4,930,096)
18. Total resources used to finance the Net Cost of Operations	$ (5,085,418)	$ (4,276,710)

As of September 30		2010		Restated 2009
(Amounts in thousands)				
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Period:				
19. Increase in annual leave liability	$	-	$	-
20. Increase in environmental and disposal liability		-		-
21. Upward/Downward reestimates of credit subsidy expense		-		-
22. Increase in exchange revenue receivable from the public (-)		-		-
23. Other (+/-)		3,912		1,092
24. Total components of Net Cost of Operations that will Require or Generate Resources in future periods	$	3,912	$	1,092
Components not Requiring or Generating Resources:				
25. Depreciation and amortization	$	263,064	$	590,752
26. Revaluation of assets or liabilities (+/-)		277,334		1,130,600
27. Other (+/-)				
27a. Trust Fund Exchange Revenue		-		-
27b. Cost of Goods Sold		10,377,119		13,867,252
27c. Operating Material and Supplies Used		-		-
27d. Other		(8,654,433)		(9,762,772)
28. Total Components of Net Cost of Operations that will not Require or Generate Resources	$	2,263,084	$	5,825,832
29. Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$	2,266,996	$	5,826,924
30. Net Cost of Operations	$	(2,818,422)	$	1,550,214

Due to Navy Working Capital Fund (NWCF) financial system limitations, budgetary data do not agree with proprietary expenses and capitalized assets. The difference between budgetary and proprietary data is a previously identified deficiency. As a result of these system limitations, resources that finance the acquisition of assets on the reconciliation of Net Cost of Operations to Budget was adjusted downward by $6.2 billion (absolute amount) at the end of 4th Quarter, FY 2010 to bring it into balance with the Statement of Net Cost.

The following Reconciliation of Net Cost of Operations to Budget lines are presented as combined instead of consolidated due to intra-agency budgetary transactions not being eliminated:

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

Other Resources Used to Finance Activities consists of gains and losses associated with: 1) transfers of assets out of NWCF; and 2) the inventory stratification process.

Other Resources Used to Finance Items not Part of the Net Cost of Operations consists of gains and losses associated with: 1) transfers of assets out of NWCF; and 2) the inventory stratification process.

Other Components not Requiring or Generating Resources consists of overhead costs distributed to work in process, as well as costs originally recorded into another expense account that are transferred to one of three accounts: inventory work in process, internal use software in development, or completed assets.

Note 22. Disclosures Related to Incidental Custodial Collections

Navy Working Capital Fund (NWCF) collected $4.0 million of incidental custodial revenues generated primarily from interest, penalties, fines and administrative fees. These funds are not available for use by NWCF. At the end of each fiscal year, the accounts are closed and the balances rendered to the U.S. Treasury.

Note 23. Earmarked Funds

Not applicable.

Note 24. Fiduciary Activities

Not applicable.

Note 25. Other Disclosures

Not applicable.

Note 26. Restatements

The Prior Period Adjustment (PPA) restates FY 2009 Inventory Available and Purchase for Resale and Inventory Allowance account.

In the current environment, inventory is recorded for Supply Management Activity Group at standard cost. The inventory is then converted in the general ledger from standard cost to Latest Acquisition Cost (LAC) utilizing journal vouchers (JVs). The JVs are calculated and adjusted at the lowest activity level. In July 2008, the Available and Purchase for Resale, Inventory, Net became negative and has continued to increase monthly in FY 2009 and FY 2010. The negative inventory can be attributed to inventory returns from customers that were inaccurately creating allowance values based on the posting of the inventory reports. When inventory items were returned, the transaction was recorded as a debit to the Inventory account, and a credit to the Inventory Allowance account. There was no reduction in the allowance account when the returned inventory items were issued either for re-use or disposal. Therefore, the balance in the Inventory Allowance account was never reduced. Inventory reports are not able to track items that have been previously returned. In order to prevent overstatement of allowances, no allowance should be created when materials are returned. The current process is causing a cumulative overstatement in Inventory Allowance by $473.4 million for prior year and approximately $47.9 million for current year, for a total of $521.3 million.

The current FY 2010 and comparative FY 2009 Balance Sheet, Statement of Changes in Net Position, and Statement of Net Cost lines were impacted as follows:

1. Inventory and Related Property, Net increased by $473.4 million in FY 2009.
2. Total Assets increased by $473.4 million in FY 2009.
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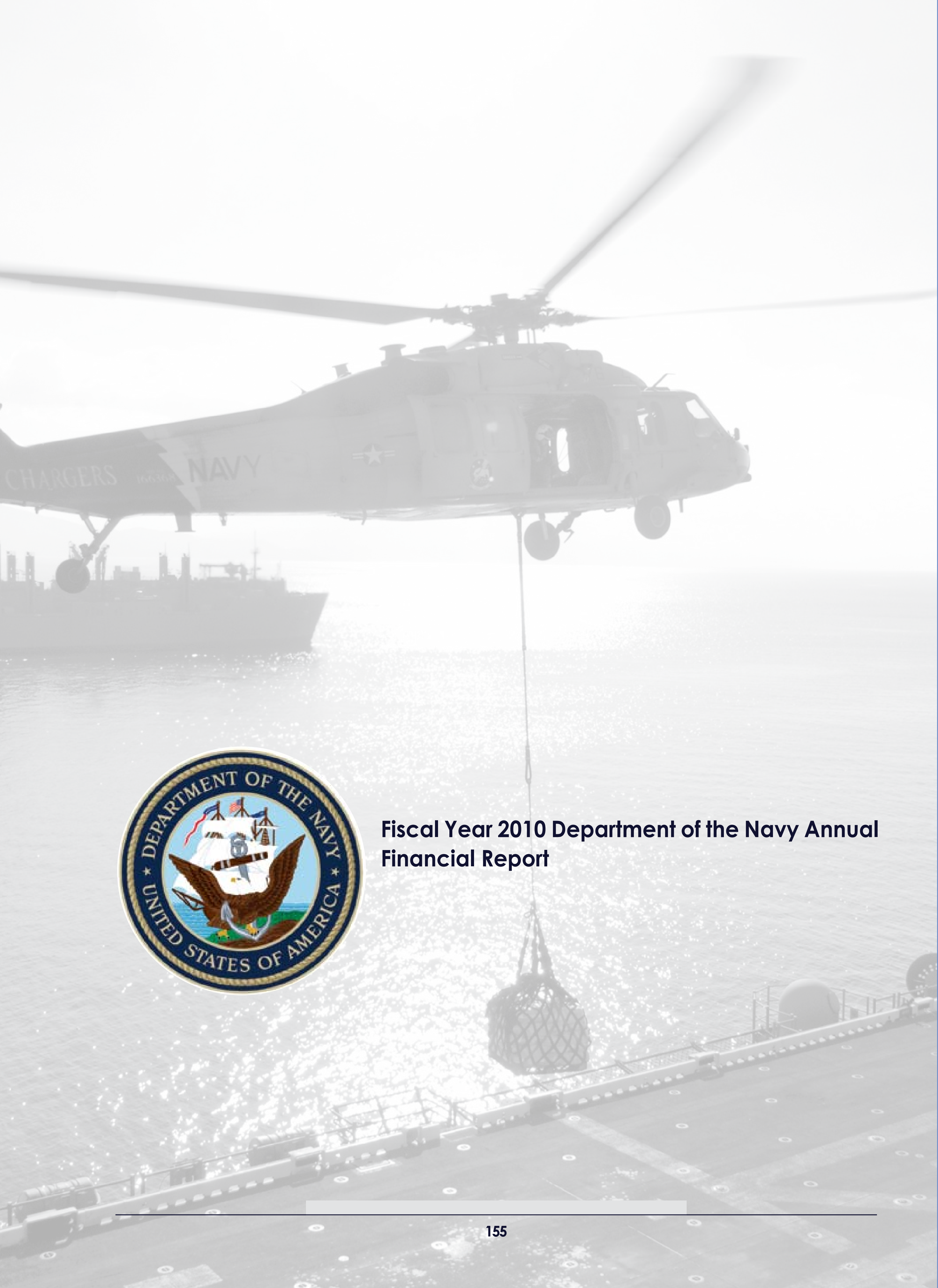
5. Net Cost of Operations was decreased by $88.2 million in FY 2009.
6. Gross Costs decreased by $88.2 million in FY 2009.

The overall change in the financial statements as a whole is an increase in net position and elimination of the negative inventory balance.

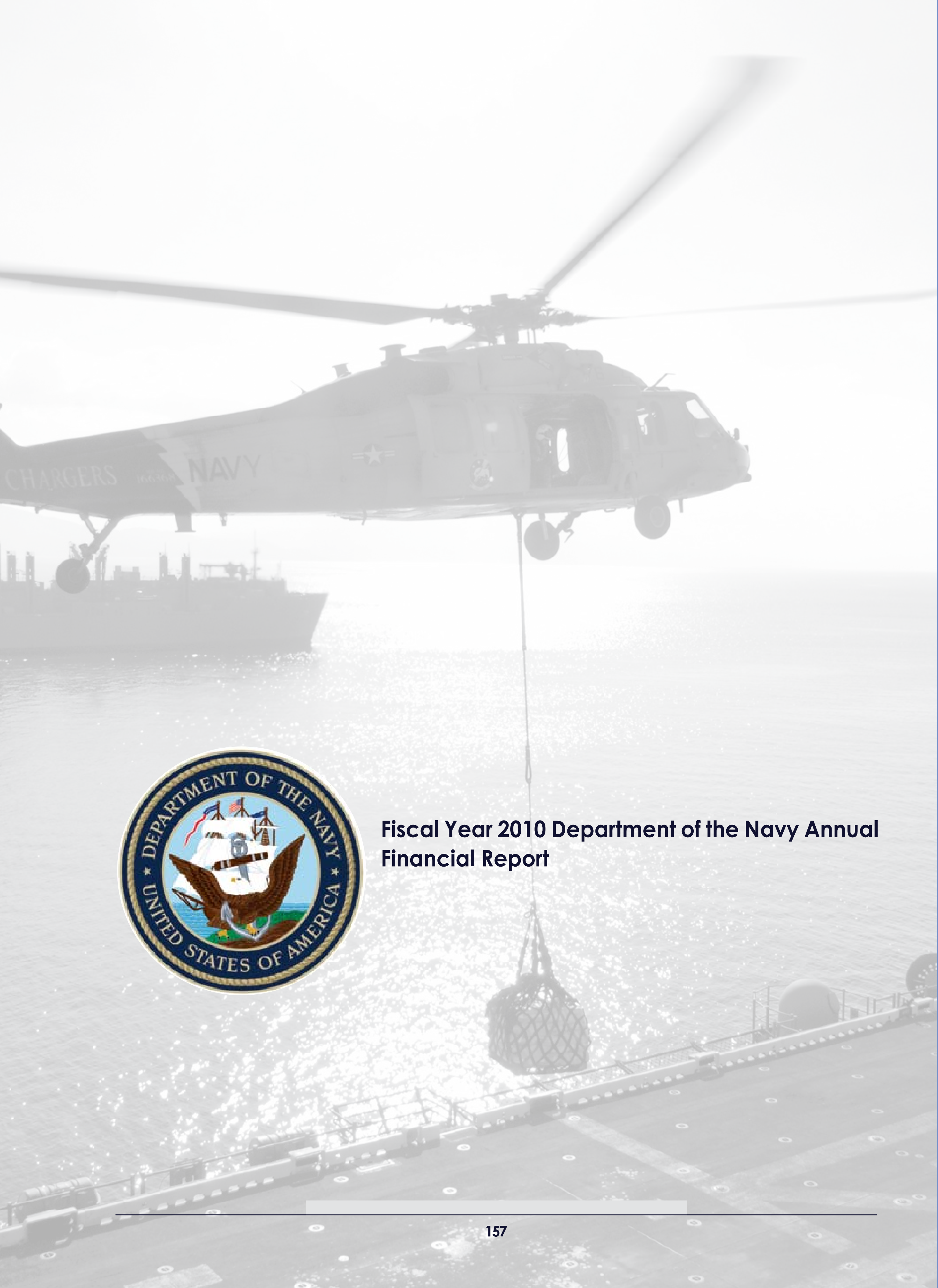


Fiscal Year 2010 Department of the Navy Annual Financial Report

General Property, Plant, and Equipment
Real Property Deferred Maintenance and Repair

For Fiscal Year Ended September 30, 2010

The Navy Working Capital Fund real property deferred maintenance and repair information for fiscal year ended September 30, 2010 is reported with the Department of the Navy General Fund deferred maintenance and repair. See Department of the Navy General Fund Required Supplementary Information.



Fiscal Year 2010 Department of the Navy Annual Financial Report

Appropriations, Funds, and Accounts Included in the Principal Statements

Reporting Entity

Navy Working Capital Fund (NWCF)

Fund/Account Treasury Symbol and Title

97X4930.002

Navy Working Capital Fund Activity Group Treasury Symbol and Title

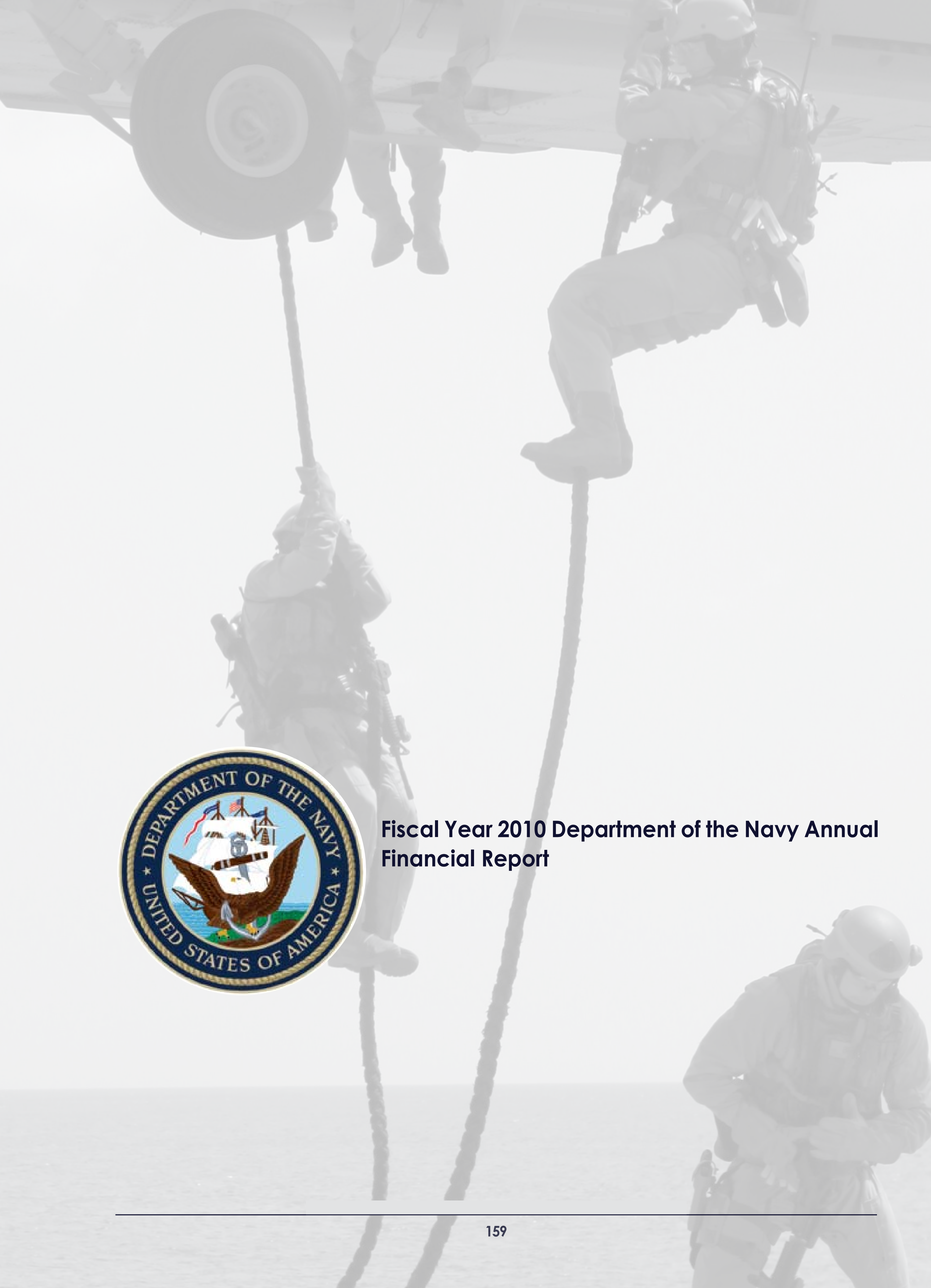
97X4930.NA1*	Depot Maintenance – Shipyards[a]
97X4930.NA2	Depot Maintenance – Aviation
97X4930.NA4A*	Depot Maintenance – Other, Marine Corps
97X4930.NA3*	Ordnance[b]
97X4930.ND*	Transportation
97X4930.NE*	Base Support
97X4930.NH*	Research and Development
97X4930.NC*	Supply Management
97X4930.NC2A*	Supply Management, Marine Corps

Notes

* Represents alpha or numeric characters which identify an activity or reporting segment of the activity group.

a Depot Maintenance, Shipyards became a part of the DON General Fund in FY 2007. The Depot Maintenance, Shipyards information included in this report represents residual NWCF accounting.

b The Ordnance activity group became a part of the DON General Fund in FY 2000. The Ordnance information included in this report represents residual NWCF accounting for this group.



Fiscal Year 2010 Department of the Navy Annual Financial Report

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202–4704

November 9, 2010

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

SUBJECT: Independent Auditor's Report on the Department of the Navy General Fund FY 2010 and FY 2009 Basic Financial Statements (Report No. D-2011-005)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy General Fund Consolidated Balance Sheet as of September 30, 2010 and 2009, and the Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of Department of Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Department of the Navy General Fund FY 2010 and FY 2009 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance with Laws and Regulations (Report). The Report is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy General Fund FY 2010 and FY 2009 Basic Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and that the Department of the Navy financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2010. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government Accountability Office, "Government Auditing Standards," and Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit

Requirements for Federal Financial Statements," as amended,[*] to determine whether material amounts on the financial statements were presented fairly.

Prior audits have identified, and the Department of the Navy has acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses may affect the reliability of certain information contained in the Basic Financial Statements. Therefore, we are unable to express, and we do not express, an opinion on the Basic Financial Statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information, presented with the Basic Financial Statements. Accordingly, we express no opinion on that information.

Summary of Internal Control

In planning our work, we considered Department of the Navy internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control.

Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified material weaknesses continue to exist in the following areas.

- Financial Management Systems
- Fund Balance with Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Statement of Net Cost
- Problem Disbursements
- Unobligated Balance

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

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[*] OMB Memorandum No. 09-33, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," September 23, 2009.

Internal control work that we conducted as part of our prior audits would not necessarily disclose all deficiencies. The Attachment offers additional details on material internal control weaknesses.

The Department of the Navy reported the nine weaknesses identified above in the General Fund preliminary management representation letter. However, it did not report the Department of Navy Accounts Receivable, Statement of Net Cost, and Unobligated Balance in the FY 2010 Statement of Assurance or final management representation letter. The Department of the Navy stated these weaknesses were included within one or all of the segment weaknesses reported in the FY 2010 Statement of Assurance and final management representation letter; however, we did not verify this statement.

Summary of Compliance With Laws and Regulations

We limited our work to determining compliance with selected provisions of applicable laws and regulations related to financial reporting because management acknowledged that instances of noncompliance identified in prior audits continued to exist. The Assistant Secretary of the Navy (Financial Management Comptroller) acknowledged to us that Department of the Navy financial management systems do not substantially comply with Federal financial management system requirements, U.S. GAAP, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether the Department of the Navy complied with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

Management's Responsibilities

Management is responsible for:

- preparing the financial statements in conformity with U.S. GAAP;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management and Comptroller), who provided technical comments that we have incorporated as appropriate. Department of the Navy officials expressed their continuing commitment to addressing the problems this report outlines.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; that the requirements of applicable laws and regulations are met; and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses, which could adversely affect the Department of the Navy financial management operations.

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continue to exist in the following areas.

Financial Management Systems

Department of the Navy legacy financial management system and feeder system deficiencies include the inability to comply with Federal financial management systems requirements, implement elements of U.S. GAAP, and adequately implement the U.S. Government Standard General Ledger.

Fund Balance With Treasury

Deficiencies associated with Fund Balance with Treasury include unmatched disbursements and collections; undistributed disbursements, abnormal balances; and the inability to reconcile Department of the Navy fund records with the Department of Treasury records and the Statement of Budgetary Resources.

Accounts Receivable

For the Accounts Receivable line, the audit trails are inadequate and the accounts receivable sub-ledgers do not reconcile with the general ledger.

Inventory and Related Property, Net

Legacy systems do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property." Completeness issues also exist because the legacy systems were not designed to provide the value of Operating Material and Supplies using the moving average cost method or to ensure that all of the items are included in the values reported on the Balance Sheet. Some Department of the Navy commands have not used the consumption method for expensing Operating Material and Supplies. In addition, some commands are unable to provide Operation Material and Supplies at the detail-transaction level and only maintain beginning and ending balances.

General Property, Plant, and Equipment

Completeness issues may exist with recognizing internal use software and leasehold improvements. The Department of the Navy is currently working with the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics) and Department of the Navy major commands to fully implement Statement of Federal Financial Accounting Standards No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment." In addition, the Department of the Navy is working with the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer to ensure that documentation for real property is available, beginning with FY 1999; an imputed cost policy is properly implemented; and Form DD 1354, "Transfer and Acceptance of Military Property," is properly used throughout the Department of the Navy.

Accounts Payable

The Department of the Navy is not recording Intragovernmental Accounts Payable transactions and Accounts Payable with the Public completely, accurately, or in a timely manner. Other issues include the lack of sufficient systems, processes, and data to support reconciliation of buyer-side trading partner information.

Statement of Net Cost

The Department of the Navy currently derives the information on the Statement of Net Cost from budgetary accounts instead of using an accrual basis. In addition, the costs are not aligned with major programs and goals, as required in Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards," but are instead aligned with the major appropriations. Furthermore, Department of the Navy costs are not categorized and reported by the responsible Component, as required by Statement of Federal Financial Accounting Standards No. 4.

Problem Disbursements

Inaccurate or missing accounting data have resulted in unmatched disbursements and collections requiring the use of suspense accounts. The suspense accounts cause difficulty in reconciling Department of the Navy General Fund records with Department of Treasury records.

Unobligated Balances

Deficiencies exist in recorded unobligated amounts because financial systems are not fully integrated, and not all commands sufficiently review unliquidated obligations. Additionally, reimbursable transactions are not properly documented or reported on the Disbursing Officer Statement of Accountability.

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

Compliance With Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. We limited our work to determining compliance with selected provisions of the applicable laws and regulations because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continued to exist. Therefore, we did not determine whether the Department of the Navy complied with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on overall compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires DOD to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2010, the Department of the Navy did not fully comply with FFMIA. The Department of the Navy acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2010.

Antideficiency Act

Section 1341, title 31, United States Code (31 U.S.C. § 1341[1990]) limits the Department of the Navy and its agents to making or authorizing only expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the Department of the Navy or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. According to 31 U.S.C. § 1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act (ADA), the head of the agency must report immediately to the President and Congress all relevant facts and a statement of actions taken. As stated in 31 U.S.C. § 1517 (2004), DOD and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. During FY 2010, the Department of the Navy reported four cases of violation of the ADA. Therefore, the Department of the Navy did not comply with 31 U.S.C. § 1341 (1990), 1351 (2004), and 1517 (2004).

DOD internal guidance limits the time from identification to reporting of ADA violations to 12 months. Our review of the Department of the Navy ADA violations reported in FY 2010 showed that the Department of the Navy did not process three of four ADA violation cases within 12 months.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on April 2, 2010, that the Department of the Navy financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements and that previously identified material weaknesses continued to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: the Federal Credit Report Act of 1990, Pay and Allowance System for Civilian Employees, Prompt Payment Act, and Provisions Governing Claims of the United States Government.

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

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

November 9, 2010

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

SUBJECT: Independent Auditor's Report on the Department of the Navy Working Capital Fund FY 2010 and FY 2009 Basic Financial Statements (Report No. D-2011-006)

The Chief Financial Officers Act of 1990, as amended, requires the Department of Defense Inspector General to audit the accompanying Department of the Navy Working Capital Fund Consolidated Balance Sheet as of September 30, 2010 and 2009, and the Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and related notes for the fiscal years then ended. The financial statements are the responsibility of Department of the Navy management. The Department of the Navy is also responsible for implementing effective internal control and for complying with laws and regulations.

We are unable to express an opinion on the Department of the Navy Working Capital Fund FY 2010 and FY 2009 Basic Financial Statements because of limitations on the scope of our work. Thus, the financial statements may be unreliable. In addition to our disclaimer of opinion on the financial statements, we are including the required Report on Internal Control and Compliance With Laws and Regulations (Report). The Report is an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy Working Capital Fund FY 2010 and FY 2009 Basic Financial Statements would not substantially conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and that Department of the Navy financial management and feeder systems were unable to adequately support material amounts on the financial statements as of September 30, 2010. Section 1008(d) of the FY 2002 National Defense Authorization Act limits the Department of Defense Inspector General to performing only those audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. Accordingly, we did not perform auditing procedures required by U.S. Government Accountability Office, "Government Auditing Standards," and Office of Management and Budget (OMB) Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," as amended,* to determine whether material amounts on the financial statements were presented fairly.

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* OMB Memorandum No. 09-33, Technical Amendments to OMB Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," September 23, 2009.

Prior audits have identified, and the Department of the Navy has acknowledged, the long-standing material internal control weaknesses identified in the Summary of Internal Control. These pervasive material weaknesses may affect the reliability of certain information contained in the Basic Financial Statements. Therefore, we are unable to express, and we do not express, an opinion on the Basic Financial Statements. Additionally, the purpose of the audit was not to express an opinion on Management's Discussion and Analysis, Required Supplementary Information, and Other Accompanying Information, presented with the Basic Financial Statements. Accordingly, we express no opinion on that information.

Summary of Internal Control

In planning our work, we considered Department of the Navy internal control over financial reporting and compliance with applicable laws and regulations. We did this to determine our procedures for auditing the financial statements and to comply with OMB guidance, but our purpose was not to express an opinion on internal control.

Accordingly, we do not express an opinion on internal control over financial reporting and compliance with applicable laws and regulations. However, previously identified material weaknesses continue to exist in the following areas.

- Financial Management Systems
- Fund Balance with Treasury
- Accounts Receivable
- Inventory and Related Property, Net
- General Property, Plant, and Equipment
- Accounts Payable
- Other Liabilities
- Statement of Budgetary Resources

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Internal control work that we conducted as part of our prior audits would not necessarily disclose all deficiencies. The Attachment offers additional details on material internal control weaknesses.

The Navy reported the eight weaknesses in its preliminary management representation letter. However, it did not report Financial Management Systems, Accounts Receivable, Other Liabilities, and Statement of Budgetary Resources in the FY 2010 Statement of Assurance and final management representation letter. The Navy stated these weaknesses were included within one or all of the segment weaknesses reported in the FY 2010 Statement of Assurance and final management representation letter; however, we did not verify this statement.

Summary of Compliance With Laws and Regulations

We limited our work to determining compliance with selected provisions of applicable laws and regulations related to financial reporting because management acknowledged that instances of noncompliance identified in prior audits continued to exist. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that the Department of the Navy financial management systems do not substantially comply with Federal financial management system requirements, U.S. GAAP, and the U.S. Government Standard General Ledger at the transaction level. Therefore, we did not determine whether the Department of the Navy complied with all applicable laws and regulations related to financial reporting. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion. See the Attachment for additional details on compliance with laws and regulations.

Management's Responsibilities

Management is responsible for:

- preparing the financial statements in conformity with U.S. GAAP;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management and Comptroller), who provided no comments. The Department of the Navy officials expressed their continuing commitment to address the problems this report outlines.

Patricia A. Marsh

Patricia A. Marsh, CPA
Assistant Inspector General
Defense Business Operations

Attachment:
As stated

Report on Internal Control and Compliance With Laws and Regulations

Internal Control

Management is responsible for implementing and maintaining effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; that the requirements of applicable laws and regulations are met; and that assets are safeguarded against misappropriation and abuse. Our purpose was not to, and we do not, express an opinion on internal control over financial reporting. However, we have identified the following material weaknesses that could adversely affect the Department of the Navy financial management operations.

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continue to exist in the following areas.

Financial Management Systems

Department of the Navy financial management systems do not comply with U.S. GAAP and the U.S. Government Standard General Ledger at the transaction level. As a result, the Department of the Navy financial management and feeder systems cannot provide adequate evidence to support various material amounts on the financial statements.

Fund Balance With Treasury

The Department of the Navy Working Capital Fund activities do not reconcile cash accounts to the Department of the Treasury cash account balance on a regular basis. In addition, system interfaces do not exist between the financial reporting systems, which results in unmatched disbursements and collections.

Accounts Receivable

The Department of the Navy does not reconcile subsidiary records to corresponding general ledger accounts on a regular basis, resulting in a control weakness and no audit trail. The Department of the Navy also posts unmatched collections to accounts receivable using journal vouchers, leaving no audit trail. Trading partner adjustments posted to intragovernmental accounts receivable are not always supported by transactions. The Department of the Navy does not always record and post collection of contract overpayments, travel advances, employee debt, and other public accounts.

Inventory and Related Property, Net

The Department of the Navy Working Capital Fund supply management activities record inventory at the latest acquisition cost. To comply with U.S. GAAP, the latest acquisition cost must be converted to an approximation of historical cost. However, the Department of the Navy does not have adequate data, processes, and methodologies to make accurate conversions. Consequently, auditors would not be able to verify the converted inventory balances.

General Property, Plant, and Equipment

The Department of the Navy Working Capital Fund cannot establish or support ownership and valuation of General Equipment because of the lack of supporting documentation, improper interpretation of guidance, underutilization of the accounting system of record, and system limitations. In addition, the Department of the Navy cannot substantiate that the asset records represent all General Equipment assets; include all costs ancillary to the asset or assign a correct useful life; and reconcile its property accountability system with its financial systems, causing its presentation and disclosure of assets to be inaccurate.

Accounts Payable

The Accounts Payable line item is adversely affected by insufficient or inconsistent reconciliations and supporting documentation; undistributed disbursements; the inability to capture trading partner information; and a lack of direct system interfaces, which causes matching difficulties. Unmatched disbursements are transferred to accounts payable using journal vouchers, leaving no audit trail and often causing abnormal balances.

Other Liabilities

The Department of the Navy needs to resolve unsupported, undistributed disbursements. Additionally, it needs to analyze contract accruals to determine whether these amounts are properly posted to Other Liabilities.

Statement of Budgetary Resources

The Statement of Budgetary Resources is populated from proprietary accounts at a business-area-level. Guidance and training need to be provided on appropriate accounts that should be maintained. In addition, beginning balances need to be verified, reconciliation procedures need to be established, and performance reviews need to be performed.

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

Compliance With Laws and Regulations

Management is responsible for compliance with existing laws and regulations related to financial reporting. We limited our work to determining compliance with selected provisions of the applicable laws and regulations because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continued to exist. Therefore, we did not determine whether the Department of the Navy complied with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to, and we do not, express an opinion on overall compliance with applicable laws and regulations.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires DOD to establish and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. For FY 2010, the Department of the Navy did not fully comply with FFMIA. The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged that many of its critical financial management and feeder systems did not substantially comply with Federal financial management system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level as of September 30, 2010.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on April 2, 2010, that the Department of the Navy financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements and that previously identified material weaknesses continued to exist. Therefore, we did not perform detailed testing related to previously identified material weaknesses. In addition, we did not perform audit work related to the following selected provisions of laws and regulations: the Government Performance and Results Act, the Antideficiency Act, the Prompt Payment Act, and the Improper Payments Information Act.

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

Cover Credits

A The Military Sealift Command maritime prepositioning ship USNS 1st Lt. Jack Lummus (T-AK-3011) receives cargo from the U.S. Agency for International Development (USAID) and the U.S. Marine Corps at Blount Island Command. The supplies are being sent to Haiti as part of Operation Unified Response following a 7.0 magnitude earthquake near Port-au-Prince on Jan. 12, 2010. (U.S. Navy photo by Mass Communication Specialist 1st Class Leah Stiles/Released)

B Sailors assigned to the attack submarine USS Texas (SSN 775) replant marsh grass at Pierce Marsh, in Hitchcock, Texas. The submariners participated in a Galveston Bay Foundation, Natural Restoration Conservation Services and Energy Company NRG project to help restore 200 acres of eroded vegetation. U.S. Navy photo by Mass Communication Specialist 2nd Class Roadell Hickman (RELEASED)

C A high efficiency lighting system designed by Naval Sea Systems Command is on display at the Naval Energy Forum. Lighting, fuel saving and fleet readiness-enhancing initiatives were exhibited during the two-day event. (U.S. Navy photo by Alan Baribeau/Released)

D An SA-330 Puma helicopter flies from the Military Sealift Command dry cargo/ammunition ship USNS Lewis and Clark (T-AKE 1) to deliver mail to the guided-missile cruiser USS Lake Champlain (CG 57). (U.S. Navy photo by Mass Communication Specialist 2nd Class Daniel Barker/Released)

E An aircraft director guides an F/A-18E Super Hornet assigned to the “Royal Maces” of Strike Fighter Squadron Two Seven (VFA-27) to the No. 2 catapult for launch off the flight deck of USS Kitty Hawk (CV 63). U.S. Navy photo by Photographer’s Mate Airman Stephen W. Rowe (RELEASED)

F Friends and family members of Sailors aboard the Navy’s first littoral combat ship USS Freedom (LCS 1) wave flags and signs to greet them after completion of her maiden deployment. (U.S. Navy photo by Mass Communication Specialist 2nd Class Daniel Barker/Released)

G Marines disembark the amphibious dock landing ship USS Fort McHenry (LSD 43) in Morehead City, N.C. (U.S. Navy photo by Mass Communication Specialist 1st Class Darryl I. Wood/Released)

H Wind turbines at U.S. Naval Station Guantanamo Bay reduce fuel consumption by 650,000 gallons annually. (U.S. Army photo by Staff Sgt. Blair Heusdens/Released)

For More Information

Assistant Secretary of the Navy Financial Management and Comptroller
http://www.finance.hq.navy.mil/FMC

Navy
http://www.navy.mil

Marine Corps
http://www.marines.mil

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