United States Department of the Navy Annual Financial Report

Fiscal Year 2003

Department of the Navy

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MESSAGE FROM THE SECRETARY OF THE NAVY

The Secretary of the Navy
Washington, D.C. 20350-1000

December 2003

Our people – Sailors, Marines, and Civilians – are the cornerstone of the Department of the Navy. Ships, submarines, and aircraft protect and advance the nation's interests only when crewed and maintained by well-trained and highly motivated people. The unwavering service and dedication of the Department's Total Force – our people – continue to sustain the Department during this challenging time of conflict.

The attacks of September 11, 2001 characterize an era of danger and uncertainty. Our courageous men and women in uniform face this era's inherent challenges in the Global War on Terrorism. Alongside our sister services, the Navy – Marine Corps Team has exerted superior force against our adversaries. Our naval forces will continue to provide the nation with overwhelming combat power in this current war, and the means to deter, detect, and interdict threats to the homeland.

Concurrent with the prosecution of the war on terrorism, the Department is well along the course of transformation. There are several marks of progress in this effort. Deployment of the first Expeditionary Strike Group – a Sea Strike concept of Naval Power 21 – represents the joint transformational capabilities of the Navy and Marine Corps. Increased emphasis on public- private housing ventures exemplifies the Department's commitment to quality of life improvements for our military personnel. Similarly, strategic sourcing reflects the Department's commitment to modernization and recapitalization of our forces. Additionally, the Department of Defense's transition plan for business modernization and systems integration in support of the Business Enterprise Architecture is a key component of our business transformation efforts. The Department will build upon these and other successes to achieve a culture of transformation ready to meet the challenges of the 21st century.

In the midst of war and transformation, a constant remains – accountability. The Department is committed to fiscal accountability as it affects execution of the National Military Strategy. Indeed, efficient and effective management of financial resources enhances our enduring roles of assurance and deterrence, command of the seas, power projection, and homeland security. This Fiscal Year 2003 Annual Financial Report provides a means for Congress and the public to assess our performance.

Gordon R. England

Message from the Assistant Secretary of the Navy (Financial Management & Comptroller)

The Assistant Secretary of the Navy
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, D.C. 20350-1000

December 2003

I am pleased to present the Department of the Navy's Fiscal Year 2003 Annual Financial Report. This report reflects the Department's continuing commitment to fiscal accountability and proper stewardship of public resources.

Providing Congress and the public with relevant, reliable, and timely financial information, affirmed by favorable audit opinions, remains a priority of the Department of the Navy. A key step toward achieving this goal is the mid-range financial improvement plan. This comprehensive plan identifies interim financial improvements and links those improvements to the Department of Defense transition plan that is in support of the Business Enterprise Architecture. The objective of the Department of the Navy's mid-range plan is to ensure material financial statement line items are auditable so that ultimately a favorable audit opinion will be achieved on the Department of the Navy and Department of Defense-wide financial statements.

Financial information combined with nonfinancial information on program performance enables Congress and public to assess the efficiency and effectiveness of Department of the Navy operations. The Department of the Navy's balanced scorecard for risk management provides a means for this assessment. Developed in coordination with the Department of Defense, the scorecard integrates the objectives of the Fiscal Year 2002 President's Management Agenda with the risk framework delineated in the Fiscal Year 2001 Quadrennial Defense Review Report. The scorecard includes performance measures by which the Department of the Navy can track progress in achieving strategic goals related to the President's Management Agenda initiatives and the four areas of risk in the Quadrennial Defense Review Report — Force Management, Institutional, Operational, and Future Challenges.

The Department of the Navy will build upon its transformational efforts to achieve excellence in business and financial management. This commitment to excellence supports our naval forces, Department of Defense transformation goals, and ultimately, the security of our nation.

Dionel M. Aviles

Department of the Navy

Management's Discussion and Analysis

The Department of the Navy (DON) was established on April 30, 1798. The official seal of the Department of the Navy is engraved on the Navy and Marine Memorial. The Navy and Marine Memorial is dedicated to the thousands of Americans who have perished in the sea and to those whose destiny still is linked with our naval and maritime services.

Management's Discussion and Analysis

Managing the Courses of Change: Transformation and Reform in the 21st Century

Introduction

The Navy tradition of continuous forward deployment characterizes the Department's transformation and management reform efforts in Fiscal Year (FY) 2003. A continuous focus on force and support structure transformation has led to significant progress in these two areas. Similarly, the Department's continuous focus on the President's Management Agenda initiatives has yielded noteworthy results. The progress made in transformation and reform while engaged in the Global War on Terrorism and various humanitarian, crisis-response and combat operations signifies the historic strength, endurance, and commitment of the Department of the Navy (DON).

Force Transformation

The Naval Transformation Roadmap is DON's guide for achieving transformational capabilities critical to executing the enduring roles of assurance and deterrence, command of the seas, power projection, and homeland security. Among the transformational capabilities being pursued are those that enhance power projection - namely, Sea Strike. In August 2003, DON deployed the first Expeditionary Strike Group (ESG-1), a Sea Strike achievement. ESG-1 facilitates broad application of Sea Strike capabilities by integrating the complementary striking power of Navy and Marine Corps forces. This integration of the Navy and Marine Corps into the joint force is the keystone of naval transformation.

Modernization of naval forces facilitates force transformation. As part of its modernization efforts, DON signed a block buy contract in August 2003 for construction of a 2003 Virginia class fast attack submarine.

The FY 2004 Department of Defense Appropriations Act included Language and funding to support a five-ship multi-year procurement in FY 2004-2008. Pending Congressional authorization, DON plans to transition the block buy contract to a multi-year procurement in FY 2004.

United States Navy

The Navy shall be organized, trained, and equipped primarily for prompt and sustained combat incident to operations at sea. It is responsible for the preparation of naval forces necessary for the effective prosecution of war except as otherwise assigned and, in accordance with integrated joint mobilization plans, for the peacetime components of the Navy to meet the needs of war.

(Section 5062, Title 10, U.S. Code)

Founded 13 October 1775

United States Marine Corps

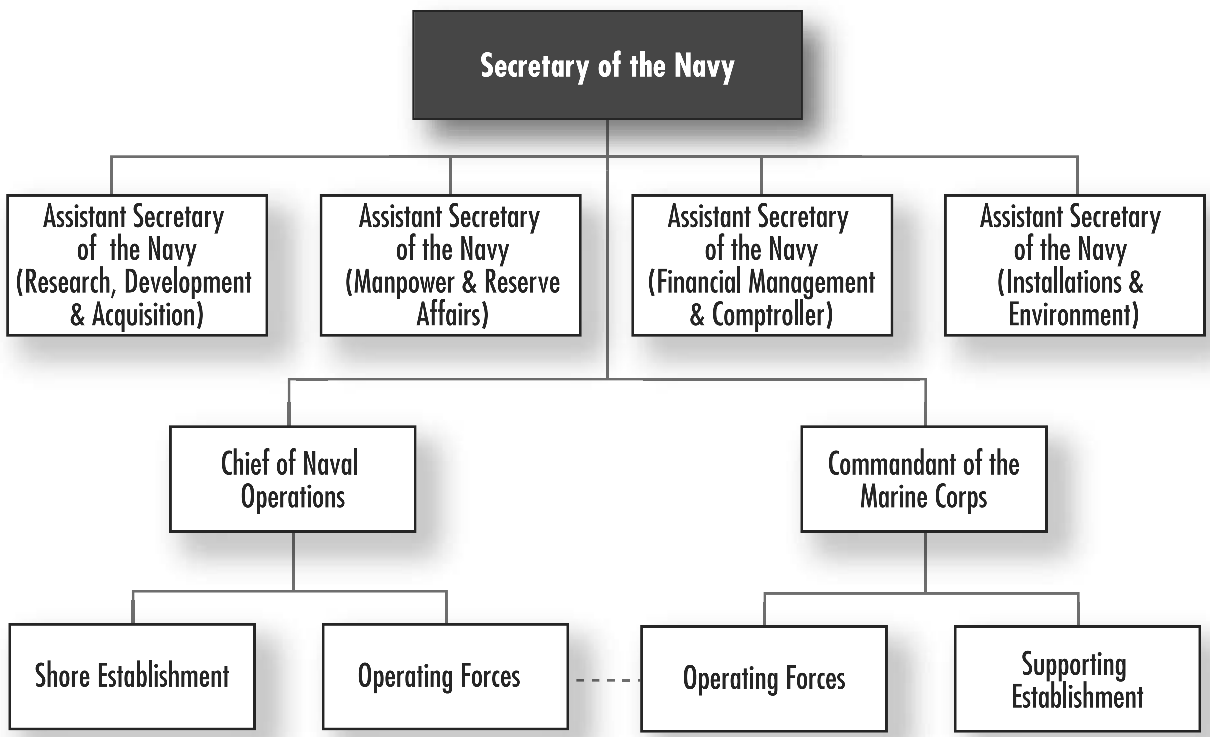
The Marine Corps shall be organized, trained, and equipped to provide fleet marine forces of combined arms, together with supporting air components, for service with the fleet in the seizure or defense of advanced naval bases and for the conduct of such land operations as may be essential to the prosecution of a naval campaign.

(Section 5063, Title 10, U.S. Code)

Founded 10 November 1775

Support Structure Transformation

DON's continued focus on support structure transformation has led to several notable achievements in FY 2003. Specifically, DON increased public-private ventures to accelerate improvements to military family housing. DON's accelerated efforts support the Department of Defense (DoD) goal to eliminate inadequate family housing units by FY 2007. Also, the Navy Marine Corps Intranet (NMCI) was successfully installed for the Secretary of the Navy and his staff. This represents a key step in the NMCI program. In addition, DON in support of the DoD transition plan for business modernization and systems integration that is based on the DoD Business Enterprise Architecture developed a financial management improvement plan. The latter represents a key step toward achieving a favorable audit opinion on the FY 2007 DoD-wide financial statements.



Management Reform and Risk Management

DON, in coordination with DoD, developed a balanced scorecard for risk management that integrates the objectives of the FY 2002 President's Management Agenda with the risk framework delineated in the FY 2001 Quadrennial Defense Review Report. DON will track progress in achieving strategic goals related to the President's Management Agenda initiatives (see illustration) and the four areas of risk–Force Management, Institution, Operations, and Future Challenges–by means of performance measures. To the right is an example of the balanced scorecard (excluding scores).

DON developed the strategic goals and performance measures in the balanced scorecard in support of the President's Management Agenda government-wide initiative, Budget and Performance Integration. As part of this initiative and beginning with the FY 2004 budget submission, the Office of Management and Budget assessed and evaluated the effectiveness of selected DoD programs based on these goals and performance measures. Among the DON programs contributing to this selection were the Joint Strike Fighter F/A-18 E/F, Family Housing, and the Navy Marine Corps Intranet. The performance assessment yielded an overall rating of adequate or better in six out of seven DON program areas reviewed.

The following is a discussion of each strategic goal and related performance measure by risk category, as presented in the balanced scorecard extract. While the goals and performance measures primarily relate to Budget and Performance Integration, some also apply to the other President's Management Agenda initiatives. The applicability of each goal and related performance measure to the President's Management Agenda initiatives is also included in the discussion.

President's Management Agenda

Five Government-Wide Initiatives:

- Strategic Management of Human Capital
- Competitive Sourcing
- Improved Financial Performance
- Expanded Electronic Government
- Budget and Performance Integration

Program Initiatives Related to Department of Defense:

- Privatization of Military Housing
- A "Right-Sized" Overseas Presence
- Coordination of Veterans Affairs and Defense Programs and Systems

(A copy of the President's Management Agenda is available at the Office of Management and Budget's website)

RISK CATEGORY	STRATEGIC GOAL	PERFORMANCE MEASURE
Force Management	Ensure Sustainable Military Tempo	Ships Deployed
		Marine Expeditionary Units Deployed
		Active/Reserve Navy/Marine Corps End Strength
	Maintain Reasonable Force Costs	Civilian Manpower Levels
Institution	Streamline Decision Processes, Drive Financial Management and Acquisition Excellence	Number of Navy Marine Corps Intranet Seats
		Implement Enterprise Resource Planning
	Improve Readiness and Quality of Key Facilities	Number of Privatization Projects
Operations	Ensure Force Levels	Battle Force Ships
		Number of Marine Corps Land Forces
	Ensure Force Readiness	Navy/Marine Corps Personnel Readiness Ratings
		Active Steaming Days Per Quarter
Future Challenges	Define and Develop Transformational Capabilities	Implement Enhanced Naval Capabilities to Project Offense, Defense and Sovereignty Around the Globe
		Major Platform Research and Development

Risk Category: Force Management

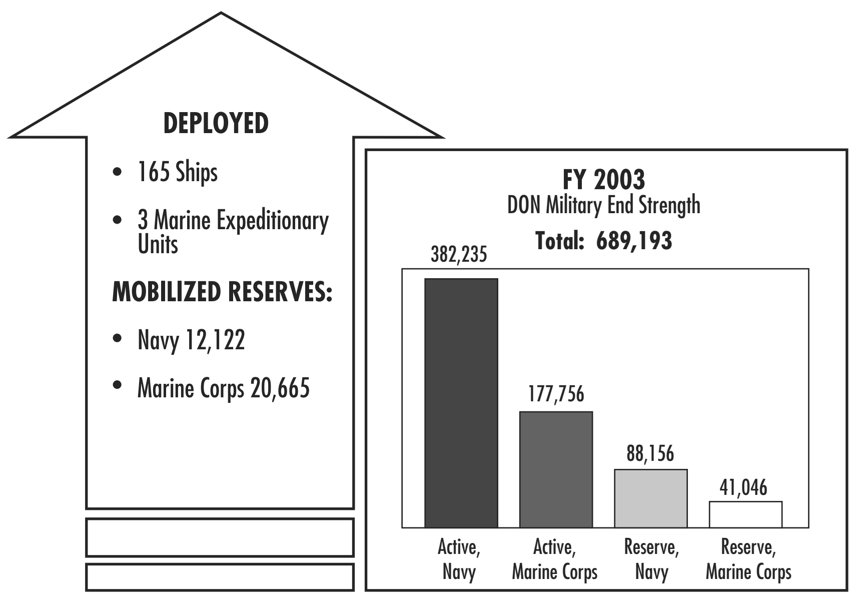
The ability to recruit, retain, train, and equip sufficient numbers of quality personnel and sustain the readiness of the force while accomplishing its many operational tasks.

~ FY 2001 Quadrennial Defense Review Report

Strategic Goal 1: Ensure Sustainable Military Tempo

DON must be able to provide and maintain ready forces necessary to support military operations at any tempo. In FY 2003, operating tempo remained high primarily due to the Global War on Terrorism. However, DON sustained a force structure necessary to meet deployment requirements of the Global War on Terrorism and other military operations. Components of the FY 2003 force structure included ships deployed, Marine Expeditionary Units deployed, and military end strength (Navy and Marine Corps, Active and Reserve). The following is an illustration of these components.

FY 2003 Military Tempo: Measures of Performance

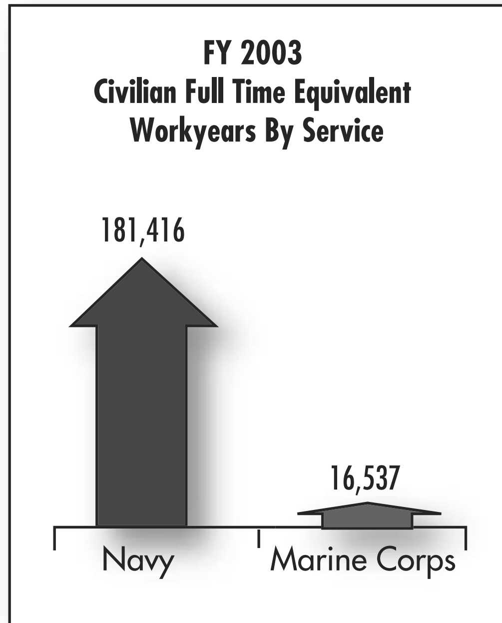


Military Tempo and the President's Management Agenda.

DON's goal to ensure sustainable military tempo supports Strategic Management of Human Capital, and Budget and Performance Integration. One of the expected near-term results of Strategic Management of Human Capital is a high-performing workforce. Sustainable military tempo relies in part on armed forces who are well-trained, competent, and ready to achieve mission objectives - all characteristics of a high-performing workforce. This is also consistent with the expected long-term results of Budget and Performance Integration: better control over resources and accountability.

Strategic Goal 2: Maintain Reasonable Force Costs

DON continues to work at becoming a more efficient organization. Reducing the number of civilian full time equivalent (FTE) workyears (how DON tracks civilian personnel) is one way DON strives to improve operational efficiency. Over the past 13 years, DON has reduced civilian FTE workyears by approximately 44 percent - total FY 1990 civilian FTE workyears were nearly 350,000 compared to 197,953 in FY 2003. Through civilian FTE workyear reductions, DON increases cost-saving opportunities for modernization and recapitalization requirements. (See Chart)



Force Costs and the President's Management Agenda.

DON's goal to maintain reasonable force costs supports Strategic Management of Human Capital, and Budget and Performance Integration. DON civilian FTE workyear reductions promote efficiency and greater effectiveness, which is a goal of Strategic Management of Human Capital, as well as better control over resources and accountability for results, an expected long-term result of Budget and Performance Integration.

Sailors aboard USS Constellation (CV 64) lower the colors for the last time during the ships decommissioning ceremony.

Risk Category: Institution

The ability to develop management practices and controls that use resources efficiently and promote the effective operation of the Defense establishment.

~FY 2001 Quadrennial Defense Review Report

***Strategic Goal 1:* Streamline Decision Processes, Drive Financial Management and Acquisition Excellence**

This strategic goal distills the business transformation initiative underway in the Department of Defense. DON remains committed to business transformation as exemplified by its information technology initiative, the Navy Marine Corps Intranet (NMCI), and its financial management initiative, the Enterprise Resource Planning (ERP) system pilots.

NMCI. In FY 2003, DON continued its phased-in seat management approach for implementing NMCI. Of the 297,213 seats ordered, approximately 109,602 have been cut over. NMCI was installed for the Secretary of the Navy and his staff in August 2003.

ERP. Ongoing in FY 2003 are four DON ERP system pilots:

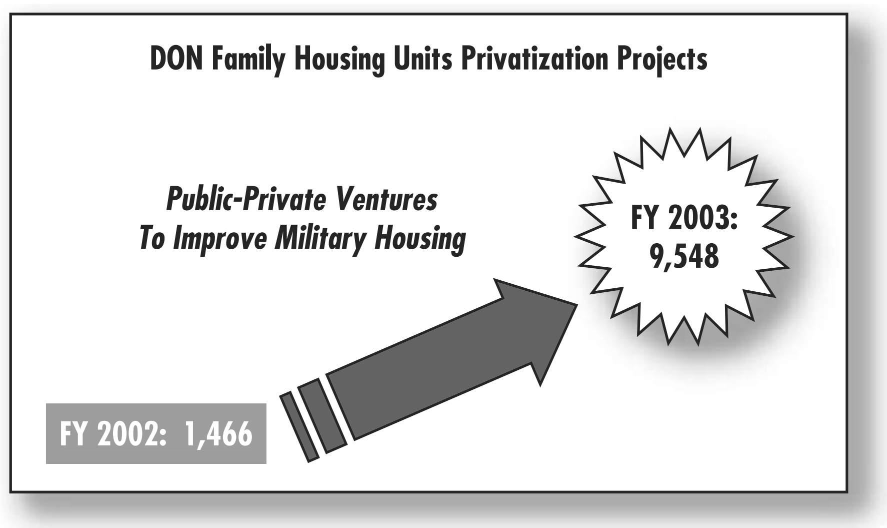
- SIGMA (Program Management under the DON General Fund and Navy Working Capital Fund);
- CABRILLO (Warfare Center Management under the Navy Working Capital Fund only);
- SMART (Aviation Supply and Maintenance under the DON General Fund and Navy Working Capital Fund); and
- NEMAIS (Regional Ship Maintenance under the DON General Fund and Navy Working Capital Fund).

The pilots use commercial off-the-shelf software approved and certified by the Joint Financial Management Improvement Program. DON successfully reached the "go-live" point on all four pilots.

Business Transformation and the President's Management Agenda. DON's goal to streamline decision processes, and drive financial management and acquisition excellence supports Improved Financial Performance, and Budget and Performance Integration. NMCI and ERP extend access to real-time, decision-quality information to all levels of management. Improving the timeliness of information to support operating, budget, and policy decisions is consistent with the Improved Financial Performance, and Budget and Performance Integration initiatives.

<u>Strategic Goal 2</u>: Improve Readiness and Quality of Key Facilities

Among key facilities slated for improvement are housing units for DON military personnel and their families. DON has accelerated progress toward family housing improvements by engaging in public-private ventures (see below). These ventures provide private-sector capital and expertise to build and manage family housing units.



Key Facilities and the President's Management Agenda. DON's goal to improve readiness and quality of key facilities supports Privatization of Military Housing, and Budget and Performance Integration. Increased reliance on public-private partnerships is a goal of Privatization of Military Housing and improves performance of the Family Housing Program, consistent with Budget and Performance Integration.

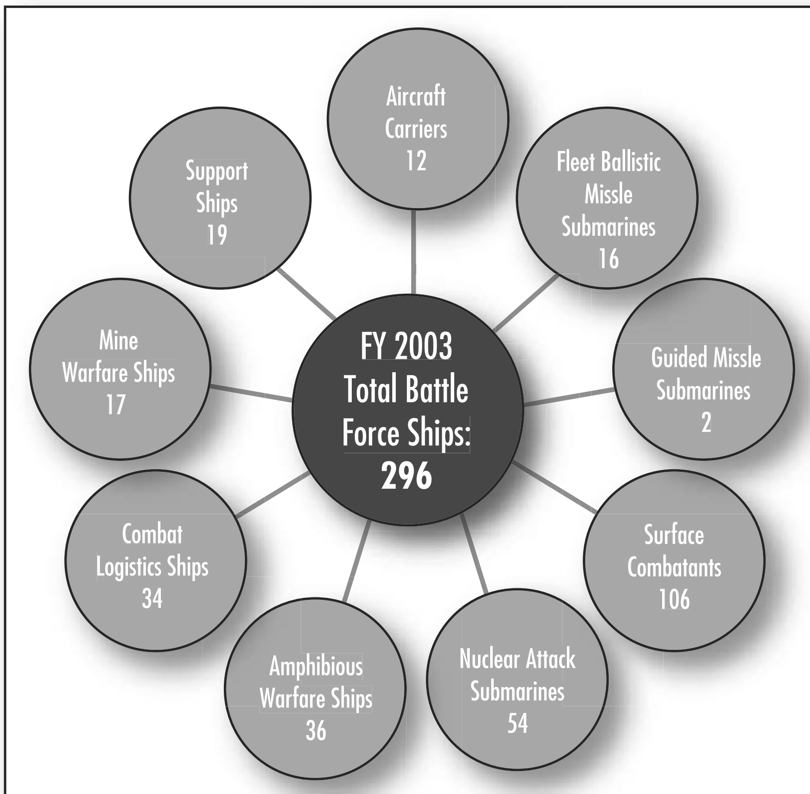
Risk Category: Operations

The ability to achieve military objectives in a near-term conflict or other contingency.

~FY 2001 Quadrennial Defense Review Report

Strategic Goal 1: Ensure Force Levels

Projecting power from the sea is critical to the security of the U.S. and its interests abroad. DON remains focused on the fleets' and Marine Corps' ability to fulfill deployment requirements for U.S. and related international defense missions. Battle force ships and Marine Corps land forces are components of DON's total force structure (see illustrations below).



FY 2003
Marine Corps Land Forces

- Marine Expeditionary Forces: 3
- Marine Expeditionary Brigades: 4
- Battalions: 71

Force Levels and the President's Management Agenda. DON's goal to ensure force levels supports Strategic Management of Human Capital, and Budget and Performance Integration. One of the expected near-term results of Strategic Management of Human Capital is a high-performing workforce. DON's total force structure relies in part on armed forces who are well-trained, competent, and ready to achieve mission objectives - all characteristics of a high-performing workforce. This is also consistent with the expected long-term results of Budget and Performance Integration: better control over resources and accountability for results.

<u>Strategic Goal 2:</u> Ensure Force Readiness

DON armed forces must be fully prepared to meet the demands of the Global War on Terrorism and other operational activities. Measures of force readiness include the number of Navy and Marine Corps personnel on deployment, and active steaming days per quarter (i.e., number of days ships are away from homeport). DON refers to the latter measure as active force operating tempo (OPTEMPO). DON has established 54 days and 28 days as OPTEMPO goals for deployed and non-deployed forces, respectively. Non-deployed OPTEMPO levels comprise training of fleet units; however, fleet units must be combat ready and rapidly deployable. In FY 2003, DON exceeded both OPTEMPO goals.

FY 2003
DON Force Readiness

Military Personnel Deployed:
38,655
(as of September 4, 2003)

OPTEMPO Goals Exceeded:
- 67.3 Days Deployed

Force Readiness and the President's Management Agenda.

DON's goal to ensure force readiness supports Strategic Management of Human Capital, and Budget and Performance Integration. One of the expected near-term results of Strategic Management of Human Capital is a high-performing workforce. Force readiness relies in part on armed forces who are well-trained, competent, and ready to achieve mission objectives - all characteristics of a high-performing workforce. This is also consistent with the expected long-term results of Budget and Performance Integration: better control over resources and accountability for results.

Risk Category: Future Challenges

The ability to invest in new capabilities and develop new operational concepts needed to dissuade or defeat mid- to long- term military challenges.

~FY 2001 Quadrennial Defense Review Report

Strategic Goal: Define and Develop Transformational Capabilities

DON remains focused on defining and developing transformational capabilities. Inherent to this goal is the integration of the Navy - Marine Corps Team into the joint force, part of the Naval Power 21 vision. To realize this integration, DON deployed the first Expeditionary Strike Group (ESG-1) in late August 2003. ESG-1 is a new combination of operational assets, leveraging the robust capabilities of the Peleliu Amphibious Ready Group and the 13th Marine Expeditionary Unit (Special Operations Capable). Together, the Amphibious Ready Group and Marine Expeditionary Unit become a more flexible, powerful unit, capable of projecting power from the sea over the land. This power projection is critical to countering emergent threats and strategies that seek to compromise the security of the U.S. and its interests worldwide.

"TOP 3" Platforms	Description	FY 2003 (in Millions)
Joint Strike Fighter (JSF)	JSF is a family of aircraft that meets the needs of the U.S. Navy, U.S. Marine Corps, U.S. Air Force, and allies. (Procurement of the U.S. Marine Corps and U.S. Navy JSF variants expected to begin in FYs 2006 and 2008, respectively.)	$1,663
DD(X)	DD(X) is a family of advanced multi-mission warships capable of long-range firepower in support of forces ashore. (Construction of lead ship expected in FY 2005.)	$ 570
C4I	Command, Control, Communication, Computers and Intelligence (C4I) programs enhance combat capability of U.S. Naval forces. Among the C4I concepts is Information Technology for the 21st Century (IT-21), which supports C4I system linkages afloat, ashore, and to the Internet. These linkages ensure that accurate and relevant information can be gathered swiftly and transmitted securely to forces and their commanders.	$ 594

Research and Development (R&D) is a key component in developing transformational capabilities. DON continues funding for several R&D platform efforts in FY 2003. The top three platforms (in terms of FY 2003 funding under Research, Development, Test and Evaluation, Navy) are the Joint Strike Fighter, DD(X), and C4I (see chart).

Transformational Capabilities and the President's Management Agenda. DON's goal to define and develop transformational capabilities supports Budget and Performance Integration. Continued investment of time and funds to transform the DON force structure promotes better control of resources and accountability for results, an expected long-term result of Budget and Performance Integration.

Management Integrity

As required by implementing guidance from the Office of Management and Budget and DoD, under the Federal Managers' Financial Integrity Act of 1982, DON must evaluate its system of internal accounting and administrative controls (i.e., management controls) on an annual basis. The objective of this evaluation is to determine whether reasonable assurance exists that:

- obligations and costs are in compliance with applicable laws;

- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

- revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial, and statistical reports and to maintain accountability over the assets.

For FY 2003, DON issued a "qualified" Statement of Assurance, citing existing (no new) material weaknesses in its management controls. With the exception of these weaknesses, DON's system of internal accounting and administrative controls in effect during the 12-month period ending June 30, 2003, taken as a whole, provides reasonable assurance that it can execute its mission effectively and protect its critical assets. The basis for reasonable assurance includes an established control environment, continued emphasis on risk assessment, specific control activities, continuous communication and flow of information, and monitoring performed by both command management and the audit /investigative /inspection community. Additionally, recent military actions (e.g., Operation Iraqi Freedom) confirm the strength of DON's management controls, as it effectively executes its missions.

Reporting Results

For financial reporting purposes, DON is organized into two reporting entities: the DON General Fund and the Navy Working Capital Fund. Below is a discussion of each reporting entity.

General Fund

The DON General Fund (GF) supports overall Department operations. Direct appropriations from Congress replenish the GF. Included among the various GF appropriations are Operation and Maintenance; Military Personnel; Family Housing; Procurement; Military Construction; and Research, Development, Test, and Evaluation.

Fiscal Year 2003 Overview

Asset Composition

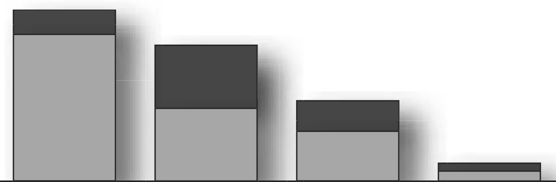
FY 2003 marked a shift in GF asset composition with general property, plant, and equipment (PP&E) replacing Fund Balance with Treasury as the largest component of total GF assets (see chart). General PP&E accounted for 53 percent of total GF assets in FY 2003 while Fund Balance with Treasury accounted for 26 percent of total GF assets. This shift was the direct result of DON's implementation of the Federal Accounting Standards Advisory Board's (FASAB's) new accounting standard — Statement of Federal Financial Accounting Standard Number 23, "Eliminating the Category National Defense Property, Plant and Equipment" (issued in May 2003). Pursuant to this new accounting standard, DON reported military equipment as part of General PP&E in FY 2003. The net book value (i.e., acquisition value less accumulated depreciation) of military equipment was $133 billion (see "Valuation of Military Equipment").

Implementation of the new accounting standard also affected operating materials and supplies (OM&S) in FY 2003. Previously expensed, tactical missiles and torpedoes were classified as OM&S, held for use. DON reported a value of $23 billion for tactical missiles and torpedoes in FY 2003, contributing to an 83 percent increase in OM&S, held for use.

Valuation of Military Equipment. *Revisions to DoD's accounting processes and systems (under the Business Enterprise Architecture initiative) preclude DoD and DON from accumulating the information necessary to value and report military equipment in accordance with generally accepted accounting principles, as required by FASAB's Statement of Federal Financial Accounting Standards Number 23. In the interim, DoD and DON will base the value of military equipment for financial statement presentation purposes on data provided by the Bureau of Economic Analysis, Department of Commerce.*

(For more details, see Note 10 in General Fund Notes to the Principal Statements.)

Asset Composition: FY 2002 vs. FY 2003
($ in Thousands)



General PP&E	Fund Balance	Inventory*	Other**
$26,109,437	$68,249,955	$33,003,595	$8,530,186
$158,407,450	$78,414,878	$53,611,634	$10,540,281

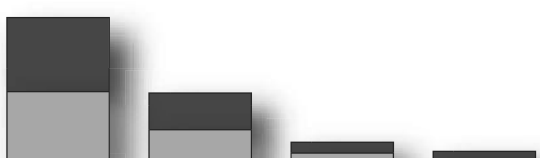
FY 2002 Total Assets: $135,893,173 thousand
FY 2003 Total Assets: $300,974,243 thousand

* includes operating materials and supplies, held for use
** comprised of investments, accounts receivable, other assets, and cash and other monetary assets

Liability Composition

Liability composition remained relatively constant between FY 2002 and FY 2003 (see chart). Environmental liabilities comprised 57 percent of total DON liabilities in FYs 2002 and 2003, with the vast majority of environmental liabilities classified as noncurrent (i.e., not payable within the current year of operations). Of the noncurrent environmental liabilities, over 70 percent were attributable to nuclear powered aircraft carriers and nuclear powered submarines. The noncurrent liability for nuclear powered aircraft carriers increased by 14 percent in FY 2003 due to the addition of the Ronald Reagan aircraft carrier and an adjustment for inflation. The noncurrent liability for nuclear powered submarines remained unchanged in FY 2003. Additional changes to environmental liabilities in FY 2003 included an 11 percent decrease for accrued environmental restoration at active installations. This decrease was a result of adjusted predictions using more conservative estimates that approximate the expected rate of execution.

Liability Composition: FY 2002 vs. FY 2003
($ in Thousands)



Environmental Liabilities	Other Liabilities*	Accounts Payable	Military Retirement
$15,469,073	$7,675,117	$2,258,607	$1,546,375
$15,614,424	$7,645,875	$2,777,555	$1,589,971

FY 2002 Total Liabilities: $26,949,173 thousand
FY 2003 Total Liabilities: $27,627,825 thousand

* includes intragovernmental debt

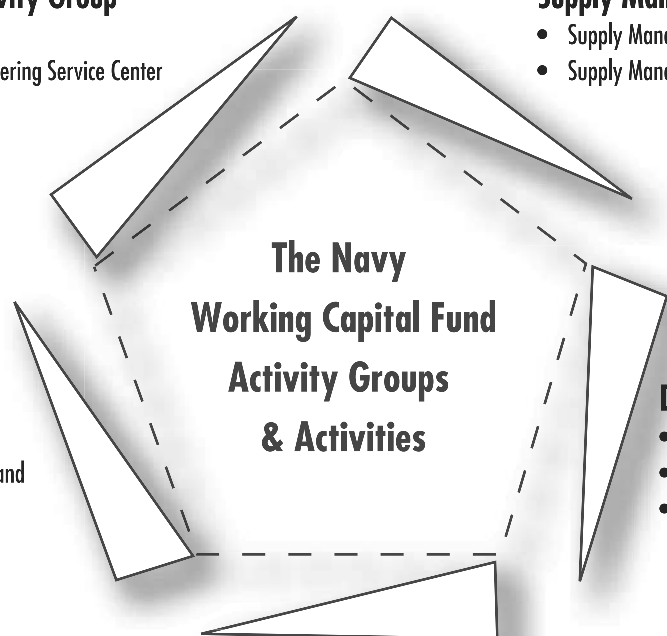
WORKING CAPITAL FUND

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 transfer of funds finances the initial cost of goods and services. Reimbursements from a customer's appropriated account replenish the initial working capital and permit continuing operations without further appropriation by Congress. Unlike profit-oriented businesses, the goal of the revolving fund is to break even over time.

Included in the NWCF are five Activity Groups comprised of one or more activities (see illustration below). Activity Groups stabilize or fix the price of goods and services in their budget to protect customers from unforeseen fluctuations.

Base Support Activity Group
- Public Works Centers
- Naval Facilities Engineering Service Center

Supply Management Activity Group
- Supply Management — Navy
- Supply Management — Marine Corps



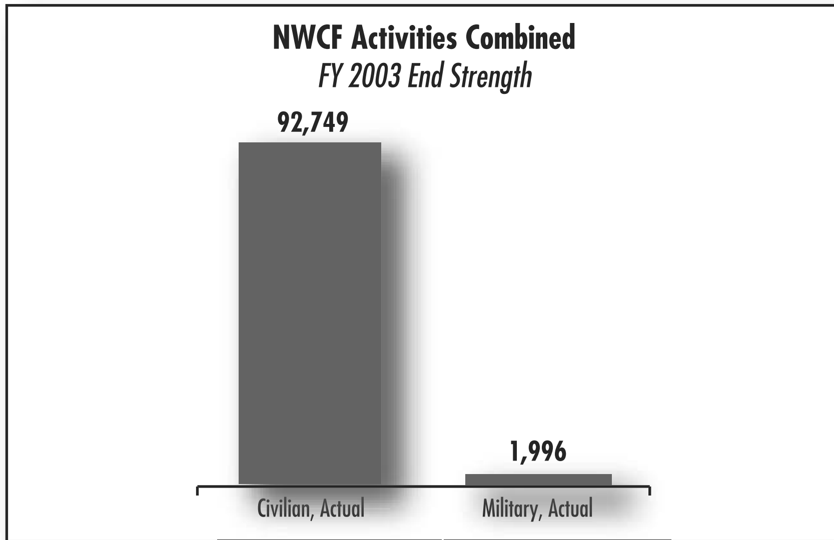
Transportation Activity Group
- Military Sealift Command

Depot Maintenance Activity Group
- Naval Shipyards
- Aviation Depots
- Marine Corps Depots

Research & Development Activity Group
- Naval Research Laboratory
- Naval Surface Warfare Center
- Naval Undersea Warfare Center
- Naval Air Warfare Center
- Space & Naval Warfare Systems Centers

Fiscal Year 2003 Overview

A brief discussion of NWCF personnel, net cost of operations, and cash management follows.



Personnel

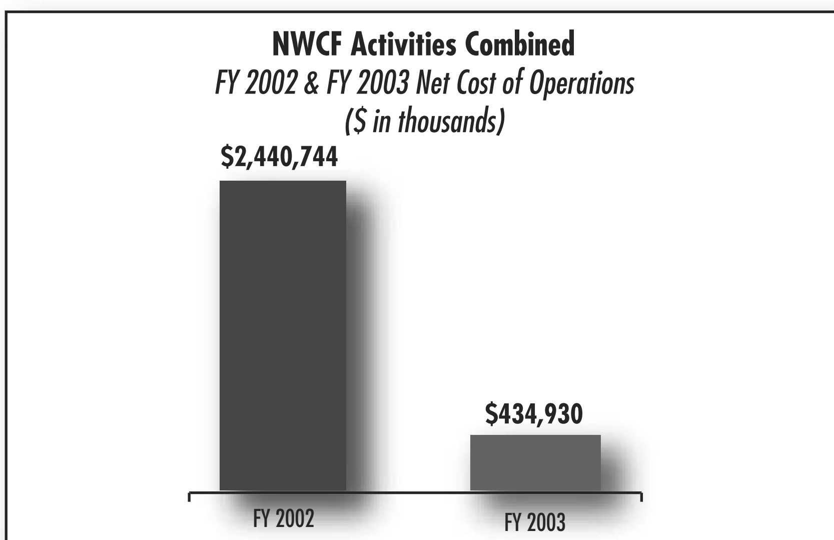
Historically, civilians have comprised the majority of the workforce at NWCF activities. FY 2003 continues this trend. Civilians account for 98 percent of total FY 2003 end strength (actual).

Net Cost of Operations

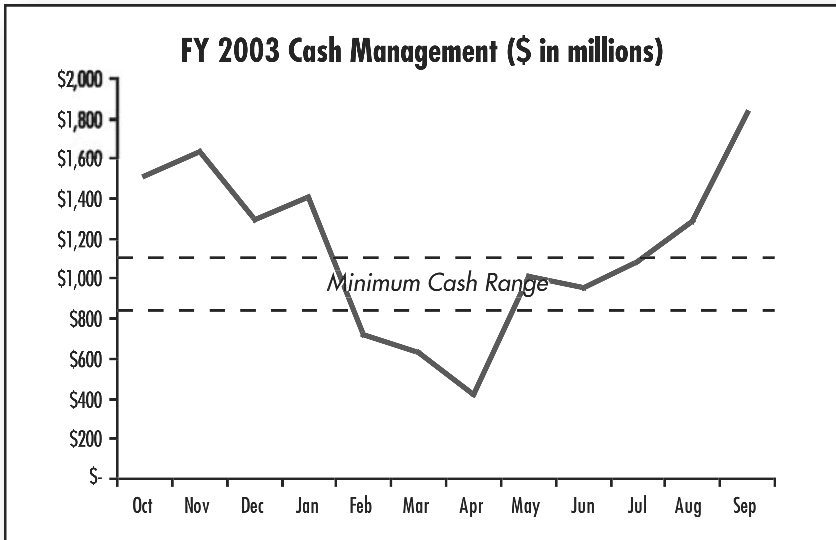
The NWCF Consolidating Statements of Net Cost classifies earned revenue and program costs by activity group. Included in this statement is the total net cost for each activity group, presented as the sum of:

- intra-governmental net costs (i.e., intra-governmental gross costs less intra-governmental earned revenue), and
- net costs with the public (i.e., gross costs with the public less revenue with the public).

NWCF net cost of operations is the combined total net cost for the activity groups, or "total net program costs," plus any costs not assigned to programs less any earned revenue not attributable to programs. In FYs 2002 and 2003, costs not assigned to programs and earned revenue not attributable to programs were zero.



In FY 2003, the combined total net cost for the five NWCF activity groups — Supply Management, Depot Maintenance, Research and Development, Transportation, and Base Support — was $1.3 billion.



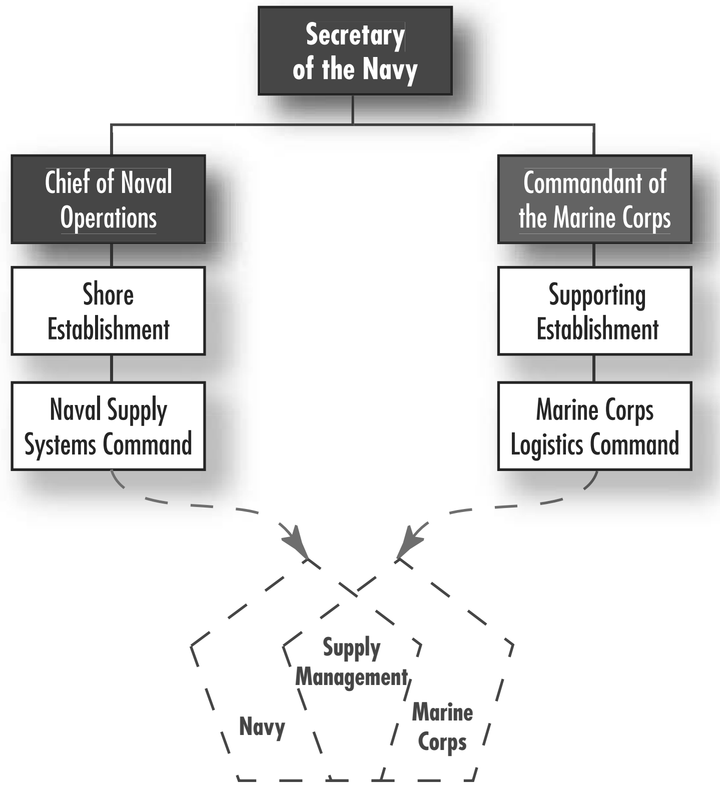
Cash Management

DON manages NWCF cash levels at the Department level. The Department of Defense Financial Management Regulation requires working capital fund cash levels be maintained at seven to ten days of operational costs, and be sufficient to meet six months of capital outlays. DON sets seven- and ten-day cash requirements on an annual basis. For FY 2003, the seven-day requirement was $808 million, and the ten-day requirement, $1.1 billion. As illustrated, the cash levels fell below the minimum range in February, March, and April due to system processing issues associated with the Naval Air Systems Command's conversion to its Enterprise Resource Planning system and Port Hueneme's conversion to the Defense Industrial Financial Management System.

Fiscal Year 2003 Overview By Activity

A discussion of each NWCF Activity Group follows. Included in this discussion are:

- Mission,
- Personnel,
- Net Cost of Operations, and
- Program Performance.



Supply Management

The Supply Management Activity Group consists of Navy and Marine Corps components. Supply Management, Navy and Marine Corps recoup costs through a cost recovery rate that includes various operating costs, such as inventory management., which are then added to the acquisition cost of an item to establish a standard selling price.

Supply Management – Navy

In response to recapitalization and Sea Enterprise, one of the operational initiatives augmenting Seapower 21 (Navy's strategy for implementing the Naval Power 21 vision), the Naval Supply Systems Command (NAVSUP) conducted structural, customer, and functional alignment reviews to capture business efficiencies. These reviews led to specific cost-saving opportunities, including:

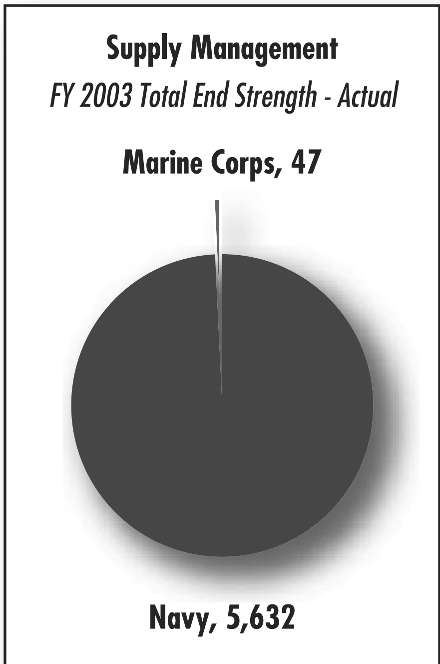
- Consolidation of the Naval Petroleum Office, Naval Transportation Support Center, and Naval Ammunition Logistics Center into a single command – Naval Operational Logistics Support Center, to centralize overhead functions and operational logistics support; and
- Centralization of information technology functions under Naval Supply Information Systems Activity to parallel private sector information technology structures.

In addition to alignment reviews, One Touch Supply (OTS) exemplifies NAVSUP's commitment to capturing business efficiencies. Marking its first anniversary of operations during FY 2003, OTS provides users with a web-based, single point of entry into the naval supply system. OTS capabilities include:

- Providing real-time availability of supplies,
- Cross-referencing parts to stock-numbered inventories, and
- Processing modifications to standard supply requisitions.

Supply Management – Navy Mission:

To provide a means of managing, controlling, financing and accounting for the acquisition and sale of secondary spares, consumable and repair parts necessary to support weapon systems and associated equipment to a wide variety of Navy activities and other government agencies.



Supply Management – Marine Corps

In FY 2003, Supply Management – Marine Corps continues to focus on logistical transformation of distribution and maintenance systems under the Marine Corps Integrated Logistics Capabilities initiative. Goals of this initiative include:

- Customizing management of 4th echelon maintenance and secondary reparables;
- Transferring 2nd and 3rd echelon maintenance to the intermediate level; and
- Consolidating supply functions at the retail level.

This initiative is improving customer relationships and expanding knowledge of customers' operational requirements. The latter enables managers to develop more efficient budget forecasts.

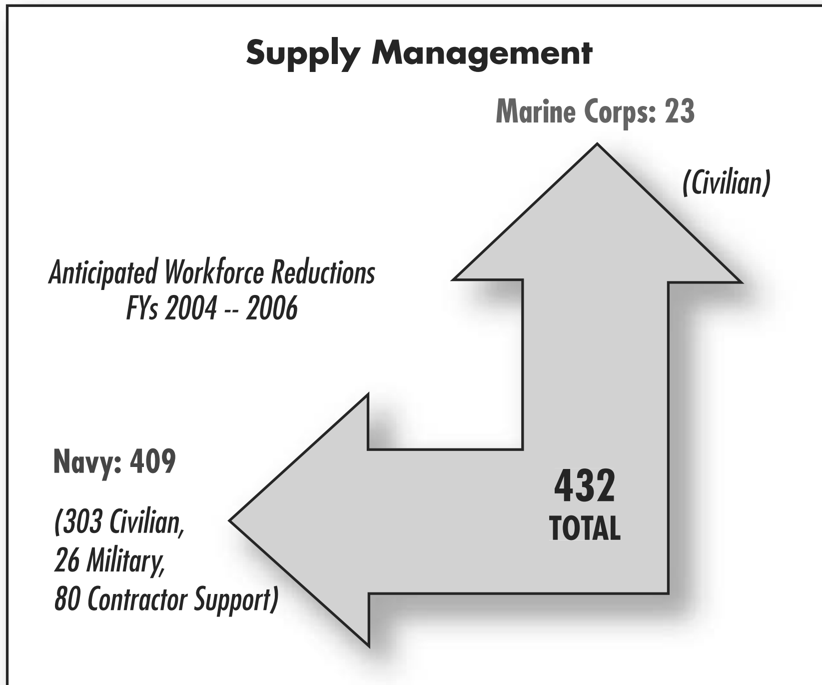
During FY 2003, Supply Management – Marine Corps decapitalized management of hazardous waste material at Camp Butler (Okinawa, Japan) and fuel at several Marine Corps activities. As a test pilot for the Joint Environment Material Management Service, Supply Management – Marine Corps decapitalized hazardous waste at Camp Butler to Defense Logistics Agency (DLA) and Supply Management – Navy. Also, Supply Management – Marine Corps decapitalized fuel at Twenty-Nine Palms, California; Okinawa, Japan; Barstow, California; Albany, Georgia; and Quantico, Virginia. Supply Management – Marine Corps had projected decapitalization at all Marine Corps activities by FY 2003, but delays associated with implementation of the super station concept and the Fuels Automated System at various commands affected DLA/Navy Petroleum Office capitalization schedules.

Personnel

Total FY 2003 end strength (civilian and military personnel, actual) for Supply Management was 5,679. Civilian personnel comprise 93 percent of total end strength for Supply Management – Navy, and 100 percent, for Supply Management – Marine Corps.

Supply Management – Marine Corps Mission:
To perform inventory management functions that result in sale of consumable and reparable items to support both Department of Defense and other government agencies.

Over the next two fiscal years, Supply Management activities anticipate workforce reductions to result from their transformation and strategic sourcing efforts. Supply Management – Navy expects to downsize the civilian, military, and contractor workforce by a total of 409 personnel by FY 2006. Supply Management – Marine Corps expects to downsize the civilian workforce by 21 personnel in FY 2004 and by two additional personnel in FY 2005, for a total of 23 personnel. A graphical summary of Supply Management workforce reductions is provided.



Net Cost of Operations

In FY 2003, net cost of operations for Supply Management activities increased by 122 percent. This increase was primarily attributable to the rise in program costs between FYs 2002 and 2003, which was approximately $1.3 billion (an 18 percent increase).

Program Performance

In FY 2003, Supply Management activities remain focused on customer support, as exemplified below.

Supply Management – Navy

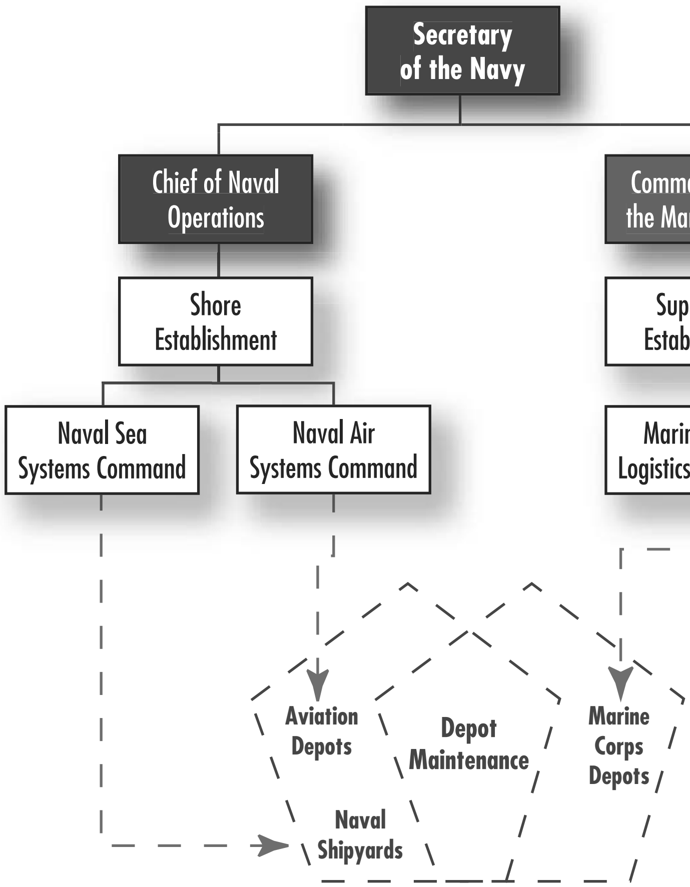
Since 1998, Supply Management – Navy has used average customer wait time (i.e., turnaround) to improve customer support. FY 2003 goals for average customer wait time for aviation and maritime supplies were 10.1 days and 24 days, respectively. As of June 2003, Supply Management – Navy reduced average customer wait time to 9.21 days for aviation supplies and 20.72 days for maritime supplies.

Supply Management – Marine Corps

Supply Management – Marine Corps uses Supply Channel Performance metrics that support goals of Marine Corps Integrated Logistics Capabilities and are based on best practices currently utilized by the private sector. Among the metrics used is accuracy in filling customer supply orders. In FY 2003, Supply Management – Marine Corps achieved their performance goal of 100 percent accuracy in filling customer orders.

Supply Management: Net Cost of Operations ($ in thousands)

	FY 2003	FY 2002
Program Costs	$ 8,456,945	$ 7,167,805
Less: Earned Revenue	(6,895,749)	(6,463,455)
Net Cost of Operations	**$ 1,561,196**	**$ 704,350**



Depot Maintenance

The Depot Maintenance Activity Group consists of Naval Shipyards, Aviation Depots, and Marine Corps Depots. These activities provide vital services that ensure force levels and force readiness.

Naval Shipyards (NSYs)

In FY 2003, Puget Sound NSY, under regional maintenance consolidation, joined the Intermediate Maintenance Facility Pacific Northwest, and will transfer to mission funding as a Pacific Fleet activity on 1 October 2003. This transfer supports the Navy's initiative to combine intermediate and depot maintenance, thereby allowing more flexibility in accomplishing the Navy's overall maintenance program.

Aviation Depots

The Naval Air Systems Command (NAVAIR) Depots have provided direct and immediate support to our forces during Operation Iraqi Freedom. Specifically, the NAVAIR Depot Cherry Point Aircraft Assessment Planning Branch deployed 11 emergency essential personnel to various sites worldwide, including Bahrain; Naples, Italy; and Okinawa, Japan. The NAVAIR Depot North Island F/A-18 and Helicopter Multi Lines responded to urgent fleet requests to accelerate the production and delivery of aircraft to the war zone.

Naval Shipyards Mission:
To provide logistics support for assigned ships and service craft; perform authorized work in connection with construction, overhaul, repair, alteration, drydocking and outfitting of ships and craft as assigned; perform design, manufacturing, refit and restoration, research and development and test work, and provide services and material to other activities and units as directed by competent authority.

Aviation Depots Mission:
To provide responsive worldwide maintenance, engineering, and logistics support to the Fleet and ensure a core industrial resource base essential for mobilization; repair aircraft, engines, and components, and manufacture parts and assemblies; provide engineering services in the development of hardware design changes, and furnish technical and other professional services on maintenance and logistics problems.

Marine Corps Depots

Marine Corps Depots are located in Albany, Georgia and Barstow, California. The two maintenance centers return unserviceable equipment to serviceable condition, perform maintenance up to the depot repair level, and overhaul, rebuild, and modify all types of ground equipment used by the Marine Corps and other DoD services.

Marine Corps Depots:

To provide quality, responsive maintenance and maintenance-related products and services to the Fleet Marine Force and other customers while maintaining the core industrial base necessary to support mobilization, surge and reconstitution requirements.

Personnel

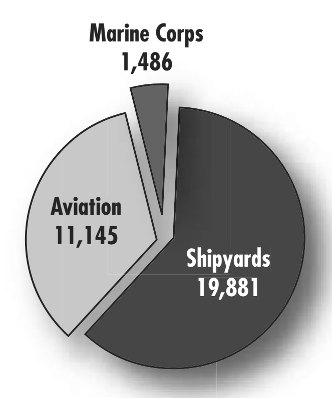
Total FY 2003 end strength (civilian and military personnel) for Depot Maintenance was 32,512. The chart depicts total end strength, by activity. Military personnel comprise one percent or less of total end strength (actual) by activity. Beginning in FY 2004, Depot Maintenance activities anticipates changes in workforce. Naval shipyards are executing a significant hiring plan and budgeting lower overtime. This hiring plan will facilitate revitalization of the aging workforce and ensure the right number of employees with the right skills will be available to successfully complete the highly technical upcoming workload within condensed timeframes. Also, NWCF civilian end strength will decrease with the transition of Puget Sound NSY to Pacific Fleet mission funding.

Aviation Depots anticipate an increase in military end strength and workyears due to projected workload requirements but expect a decrease in civilian end strength and workyears. Civilian workforce reductions reflect a renewed focus on utilizing contractor labor and overtime for flexibility and workload fluctuations.

Marine Corps Depots' reconstitution and regeneration workload influx will result in an increased requirement of civilian end strength and workyears from the FY 2004 President's Budget. The FY 2005 budget submission reflects a significant increase in FY 2004 personnel to accommodate this workload.

Depot Maintenance

FY 2003 Total End Strength - Actual

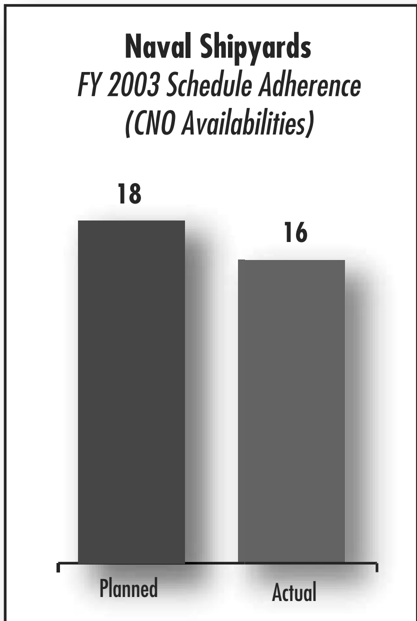


Depot Maintenance: Net Cost of Operations ($ in thousands)

	FY 2003	FY 2002
Program Costs	$ 5,192,971	$ 5,234,807
Less: Earned Revenue	(5,346,593)	(4,787,303)
Net Cost of Operations	**$ (153,622)**	**$ 447,504**

Net Cost of Operations

In FY 2003, net cost of operation for Depot Maintenance activities decreased by 134 percent. This was primarily attributable to the 12 percent increase in earned revenue between FYs 2002 and 2003.



Program Performance

Below are highlights of Depot Maintenance program performance.

Naval Shipyards

20/11 Initiative. Naval shipyards are committed to minimizing turnaround for ship support services. To this end, Portsmouth Naval Shipyard (NSY) has implemented the 20/11 initiative. The goal of this initiative is to reduce the duration of engineered refueling overhauls from 24 months to 20 months, and depot maintenance periods from 13 months to 11 months. Currently, Portsmouth NSY has reduced engineered refueling overhauls to 22 months and depot maintenance periods to 12 months.

Schedule Adherence. Naval shipyards express schedule adherence in cumulative months for all Chief of Naval Operations (CNO) availabilities that are complete or expected to complete in the respective fiscal year. In FY 2003, the estimate of completions was 18 CNO availabilities on or ahead of schedule. The actual outcome was 16 CNO availabilities, 7.1 months late (see chart). Availabilities primarily responsible for late completion were the USS PHILADELPHIA, USS ENTERPRISE, and USS ASHEVILLE.

Labor Hour Cost. Naval shipyards (NSYs) express labor hour cost as an index, calculated as cumulative actual cost divided by the cumulative direct labor manhours. NSYs compare actual cost and direct labor manhours to budget estimates based on historical or engineered study estimates.

Aviation Depots

Depot Component Program. NAVAIR Depot Jacksonville works a varied mix of avionic, structural/mechanical, and engine components every quarter for the Naval Inventory Control Point. In the third quarter of FY 2003, NAVAIR Depot Jacksonville exceeded its quarterly goal of 10,500 units with 12,800 components. This was Jacksonville's third consecutive record for FY 2003 quarterly component production.

Engine Reliability Improvement Program. NAVAIR Depot Cherry Point manages the Engine Reliability Improvement Program for restoring the T58-16 engine to its original design and power specifications. The T58-16 engine powers the CH-46E, the Marine Corps' primary aircraft for transporting combat troops. In April 2003, Cherry Point delivered the first four Engine Reliability Improvement Program engines under budget and ahead of schedule. Cherry Point will deliver a total of 446 engines under the Engine Reliability Improvement Program, at a production rate of eight engines per month.

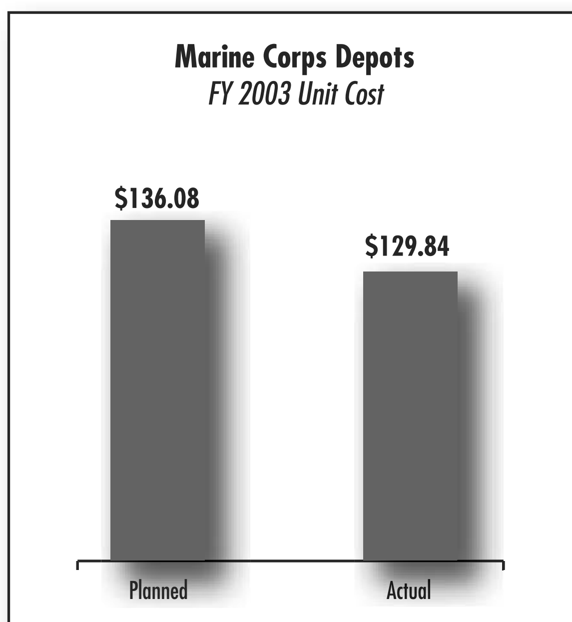
Marine Corps Depots

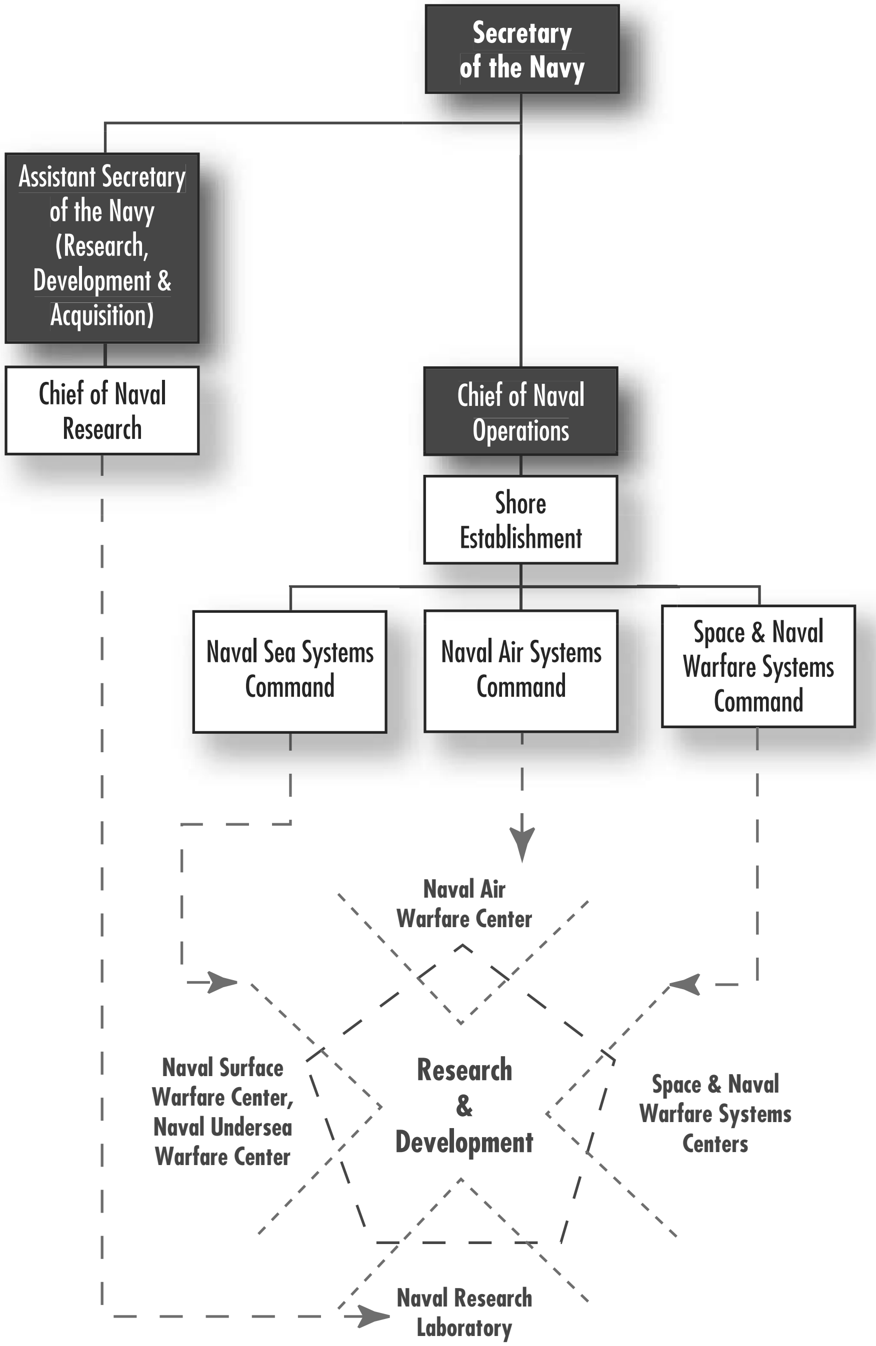
Business Improvement Initiatives. Marine Corps Depots have been successful in implementing the Theory of Constraints and Lean Thinking initiatives to eliminate inefficient shop-level procedures. Accomplishments in FY 2003 associated with Theory of Constraints and Lean Thinking include:

Theory of Constraints	Lean Thinking
• Improved Readiness	• Significant Increase in Shop Floor Space
• Reduced Repair Cycle Time *(by at least 50%)*	• Streamlined Process Flow
• Improved Schedule Conformance *(on or ahead of schedule)*	• Increased Morale

As a result of successful implementation of the business initiatives above, Marine Corps Depots have been registered under the Organization of International Standards (ISO 9002), guaranteeing them as viable participants to share business revenues with ISO-registered civilian contractors.

Unit Cost. In FY 2003, Marine Corps Depots reduced production of the material-intensive M1A1 Main Battle Tank, resulting in a significant decrease in direct material costs and a lower unit cost. Actual unit cost in FY 2003 was $129.84 (see chart).





Research and Development

The Research and Development Activity Group consists of the Naval Research Laboratory and four Naval Warfare Centers. These activities perform a wide range of research, development, test, evaluation, and engineering support functions.

Naval Research Laboratory (NRL)

In FY 2003, NRL provided a clear technological advantage for our forces in Operations Enduring Freedom and Iraqi Freedom. From across the lab community, NRL fielded more than 42 research projects. Some of the critical new capabilities stemming from these projects included:

- MK-8 Two Man Low Visibility Sea Kayak used to detect and dispose of mines;
- Shared Reconnaissance Pod, a digital infrared reconnaissance system deployed aboard USS NIMITZ; and
- Dragon Eye, a five-pound Advanced Tactical Reconnaissance Unmanned Air Vehicle with a 45-inch wingspan designed for the Marine Corps to fit in a backpack, be assembled and operated by non-aviation personnel, and provide day and night reconnaissance and surveillance.

NRL Mission:
To operate the Navy's full spectrum corporate laboratory, conducting a broadly based multidisciplinary program of scientific research and advanced technological development directed toward maritime applications of new and improved materials, techniques, equipment, systems and ocean, atmospheric, and space sciences and related technologies.

NRL sites include:
Washington D.C. • Stennis Space Center, Bay St. Louis, Missouri • Naval Support Activity, Monterey Bay, California • Chesapeake Bay, Maryland Detachment

Naval Surface Warfare Center (NSWC) and Naval Undersea Warfare Center (NUWC)

Under the purview of the Naval Sea Systems Command (NAVSEA), NSWC and NUWC perform broad and diverse support functions related to surface and undersea warfare, respectively. During FY 2003, NSWC focused on seamless collaboration with NUWC in several endeavors including Integrated Maritime Portable Acoustic Scoring and Simulation, Shallow Water Array Performance, and Submarine Electronic Warfare.

NUWC engineers and technicians provide real-time technical support and guidance to the Fleet using various technological capabilities such as a secure web-based chat room and a wearable communications system. NUWC utilized the chat room to orchestrate highly successful Tomahawk launches during Operation Iraqi Freedom. Also, NUWC created the Remote Technical Assistance Support System, an Internet-based application that provides audio, video, and text communications and is worn by Sailors.

Effective 1 October 2003, NSWC and NUWC operations will become more tightly integrated through centralized product management and implementation of 12 Product Area Directors. Each warfare center will have a Commander and Senior Executive Service Technical Director. The divisions of each warfare center will have a local Commander and Technical Operations Manager who will oversee daily operations. The Product Area Directors will be responsible for long-range planning and stewardship of technical capabilities within their product area, regardless of geographical location and division affiliation.

NSWC Mission:
To operate the Navy's full spectrum research, development, test and evaluation, engineering and fleet support center for ship hull, mechanical, and electrical systems, surface combat systems, coastal warfare systems, and other offensive and defensive systems associated with surface warfare.

NUWC Mission:
To operate the Navy's full spectrum research, development, test and evaluation, engineering and fleet support center for submarines, autonomous underwater systems and offensive and defensive weapon systems associated with undersea warfare.

> ***Aircraft Division, NAWC Mission:***
> *To operate the Navy's principal research, development, test and evaluation (RDT&E), engineering, and fleet support activity for naval aircraft engines, avionics, and aircraft support systems and ship/shore/air operations.*
> ***Weapons Division, NAWC Mission:***
> *To operate as the Navy's full spectrum RDT&E in-service engineering center for air warfare weapons systems (except anti-submarine warfare systems), missiles and missile subsystems, sircraft weapons integration, and assigned airborne electronic warfare systems; and as DON's air, land, and sea test ranges.*

Naval Air Warfare Center (NAWC)

NAWC has provided invaluable support to our forces engaged in Operations Enduring Freedom (OEF) and Iraqi Freedom (OIF). Responding to an OEF rapid deployment capability request from Marine Heavy Helicopter Squadron 461, teams from NAVAIR Patuxent River provided a flight clearance and prototype ramp-mounted weapons system (M3M) to the squadron in 40 days. The M3M consists of a .50 caliber machine gun mounted to the ramp of the CH-53E Super Stallion that can be installed and removed in under two minutes. In support of OIF, NAWC has provided technical and operational training expertise to the war fighter. Specifically, NAVAIR Fleet Weapons Support Teams provided a range of support services to fleet units worldwide, including missile and bomb inspections, weapons training, weapon and support equipment troubleshooting, testing and repair, missile exercise preparations, and air weapons bulletin support. Similarly, the NAWC Weapons Division supported operational Navy and Marine Corps training exercises on its sea, land, and electronic warfare ranges, including bomb and missile live fire exercises, electronic warfare operations, and fleet squadron combat readiness exercises.

NAWC is planning to expand the responsibilities of Chief of Naval Installations in FY 2004. Specifically, NAWC will transfer Base Operating Support functions to Chief of Naval Installations effective 1 October 2003.

> ***SSCs Mission:***
> *To operate the Navy's full spectrum research, development, test and evaluation, engineering and fleet support centers for command, control, and communication systems and ocean surveillance and the integration of those systems which overarch multiplatforms.*

Space and Naval Warfare Systems Centers (SSCs) – Charleston and San Diego

Under the purview of the Space and Naval Warfare Systems Command (SPAWAR), SSC Charleston and SSC San Diego provide scientific and technical expertise to the Fleet. Specifically, SSC Charleston is engineering and fielding over 150 Internet Protocol voice and data satellite packages to be installed across Iraq in support of deployed forces under Coalition Joint Task Force – 7. These systems will provide deployed service members with high-speed commercial Internet access for personal e-mail and distance education. Also, SSC San Diego's Marine Mammal program provides force protection support in Bahrain. Deployed to Manama Harbor, Mark 6 Marine Mammal System dolphins can locate water-borne intruders and suspicious objects that pose threats to military forces.

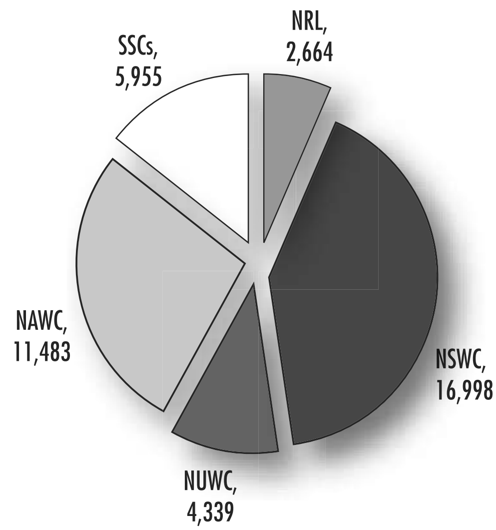
Personnel

Total end strength (civilian and military personnel, actual) in FY 2003 for Research and Development (R&D) was 41,439. Civilian employees comprised at least 97 percent of total end strength (actual) per activity.

Beginning in FY 2004, R&D activities anticipate changes in workforce.

- NRL budget estimates for FY 2004 and beyond include a 10 workyear savings in General and Administrative attributable to efficiencies in business support functions.
- NAWC anticipates a decrease in civilian and military end strength and workyears due to Chief of Naval Installation initiatives.
- SSCs plan to downsize their indirect workforce by 67 employees. Also, SSCs will continue their efforts to attract and retain talented C4ISR (Command, Control, Communications, Computers, Intelligence, Surveillance, and Reconnaissance) professionals to revitalize the workforce and compensate for the loss of personnel eligible to retire in the near future.

Research & Development
FY 2003 Total End Strength - Actual



Net Cost of Operations

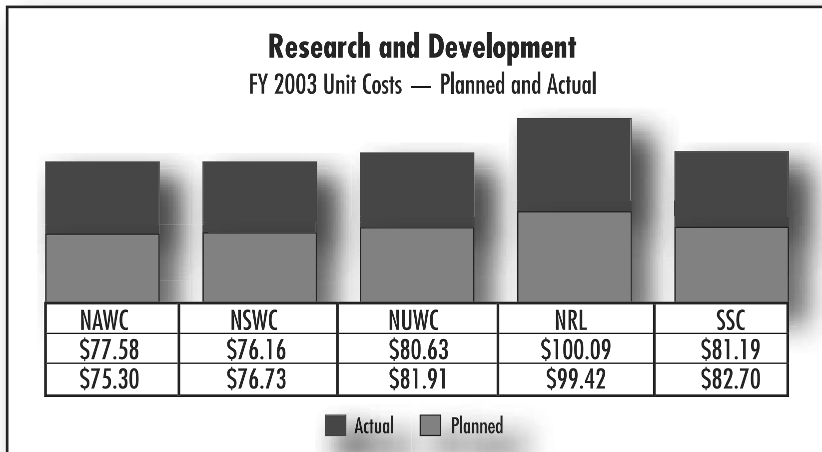
In FY 2003, net cost of operations for Research and Development (R&D) activities decreased by 96 percent.

Researched Development: Net Cost of Operations ($ in thousands)

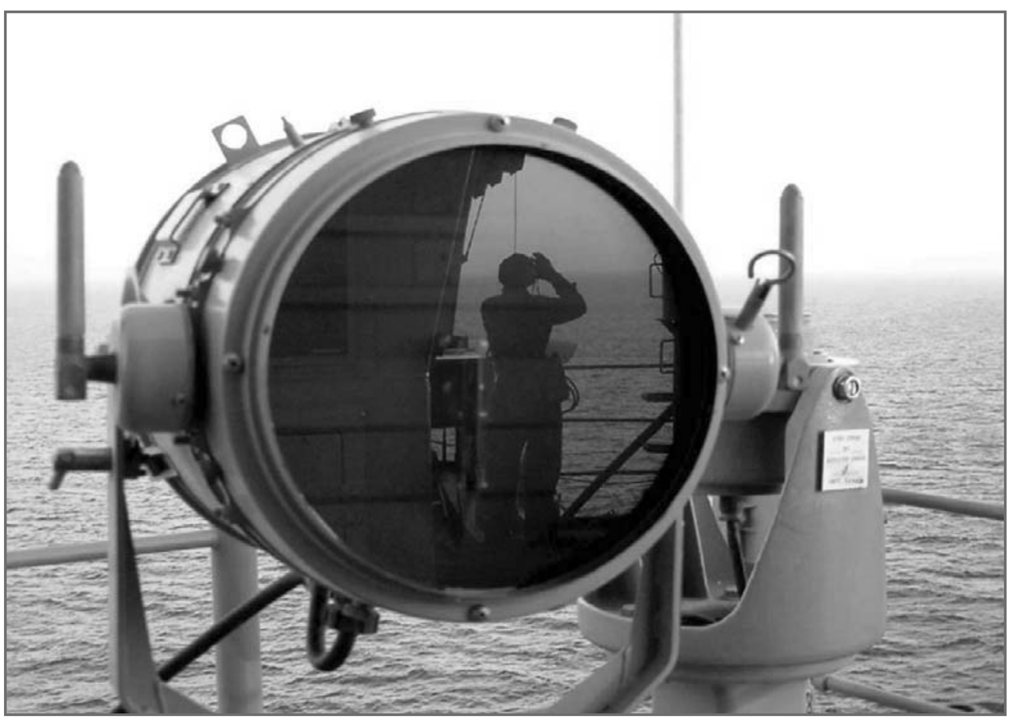
	FY 2003	FY 2002
Program Costs	$ 9,573,205	$ 9,158,580
Less: Earned Revenue	(9,585,868)	(9,470,297)
Net Cost of Operations	**$ (12,663)**	**$ (311,717)**

Program Performance

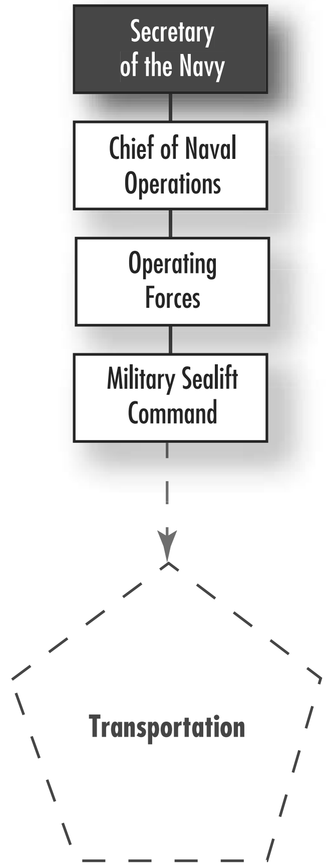
The span of R&D activities' products and services is broad and diverse. The primary measure of performance applicable across all R&D activities is cost per direct labor hour, calculated as direct labor (civilian and military labor plus overhead) divided by direct labor hours. This financial indicator measures the activities' cost effectiveness in performance of their mission. The chart below presents FY 2003 planned and actual cost per direct labor hour for each R&D activity.



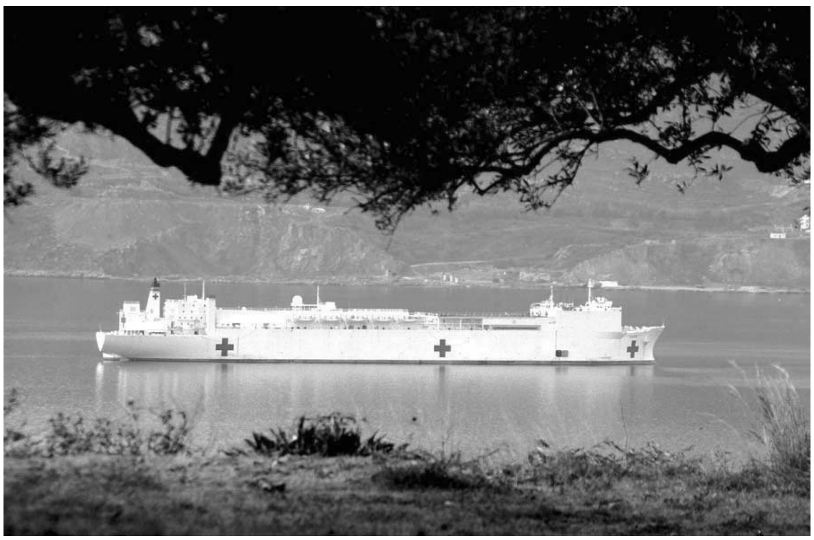
NAWC	NSWC	NUWC	NRL	SSC
$77.58	$76.16	$80.63	$100.09	$81.19
$75.30	$76.73	$81.91	$99.42	$82.70



Transportation



Since the commencement of the Global War on Terrorism in 2001 and the buildup for Operation Iraqi Freedom in 2003, the Military Sealift Command (MSC) has been at the forefront of the U.S. response. Having dual reporting responsibilities to DON and the U.S. Transportation Command, MSC has provided a variety of services and supplies to U.S. and allied forces worldwide. For example, USNS COMFORT, part of the Naval Fleet Auxiliary Force, provided medical care during Operation Iraqi Freedom.



USNS COMFORT is one of the Military Sealift Command's two hospital ships and part of the Naval Fleet Auxiliary Force.

MSC Mission:
To provide ocean transportation of equipment, fuel, supplies and ammunition to sustain U.S. forces worldwide during peacetime and in war for as long as operational requirements dictate.

For purposes of the Navy Working Capital Fund, MSC supports three separate and distinct ship programs:

- Naval Fleet Auxiliary Force (NFAF) provides fuel, food, ammunition, spare parts and other supplies, enabling the Navy fleet to operate at the highest possible operating tempo;
- Special Mission Ships (SMS) provide oceanographic and hydrographic surveys, underwater surveillance, missile flight data collection and tracking, acoustic research and submarine support, and other support for Department of Defense sponsors; and
- Afloat Pre-Positioning Force Ships – Navy (APF-N) provide military equipment and supplies for a contingency forward deployed in key ocean areas before it is needed.

MSC ships are unique compared to other U.S. Navy ships in that they are non-combatant; include both government-owned and chartered vessels; and are crewed primarily by civilian mariners from the U.S. Civil Service and from private operating companies.

"Forward...From the Sea"

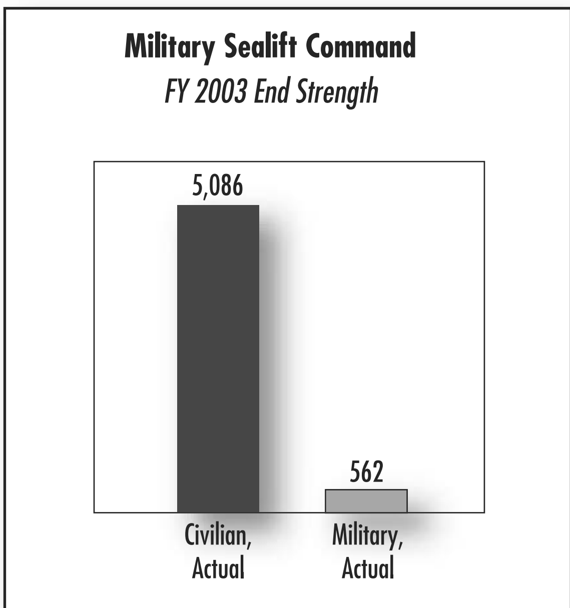
MSC Headquarters - Washington, DC
MSC Europe - Naples, Italy
MSC Far East - Yokohama, Japan
MSC Pacific - San Diego, California
MSC Atlantic - Camp Pendleton, Virginia
MSC Central - Manama, Bahrain

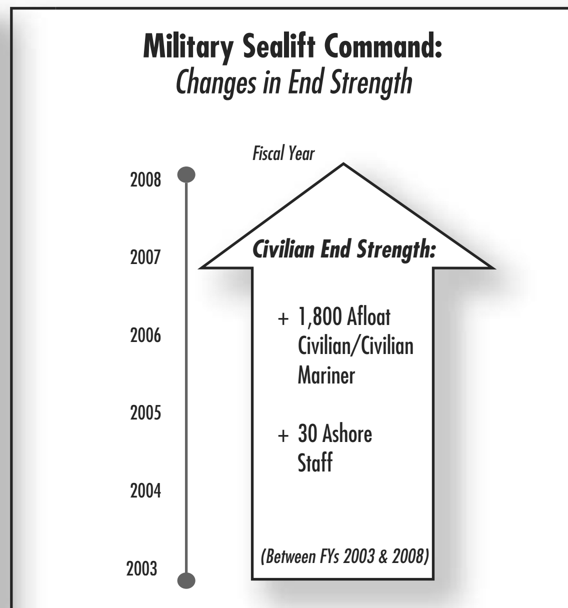
MSC is currently reexamining its organizational processes, functions and structure in order to improve efficiencies and cost-effectiveness. While no major organizational changes were made in FY 2003, the Commander Naval Surface Force, U.S. Atlantic Fleet is expected to merge with MSC Atlantic as early as FY 2004. This merger will enable the Commander Naval Surface Force, U.S. Atlantic Fleet to realize efficiencies due to the pending decommissioning of USN AOE-1 Class oiler/ammunition ships.

USNS CONCORD is one of Military Sealift Command's six combat stores ships and part of the Naval Fleet Auxiliary Force.

Personnel

Total end strength in FY 2003 was 5,648 (see chart). However, over the next five years, total end strength will change. Increases in both civilian and military end strength will occur primarily to meet crewing demands of additional ships – AOE-6 Class and 12 USNS LEWIS and CLARK Class ships. Beginning FY 2005, decreases in military end strength will occur primarily due to elimination of military detachments on board two of MSC's Special Mission Ships: USNS ZEUS, MSC's only cable repair ship, and USNS CAPABLE, one of six ocean surveillance ships. The illustration below provides a graphic summary of MSC changes in end strength.





Net Cost of Operations

In FY 2003, net cost of operations for the Military Sealift Command decreased by 58 percent, while program costs and earned revenue grew by 29 percent and 21 percent, respectively.

Military Sealift Command: Net Cost of Operations ($ in thousands)

	FY 2003	FY 2002
Program Costs	$ 1,789,147	$ 1,387,148
Less: Earned Revenue	(1,844,089)	(1,518,664)
Net Cost of Operations	**$ (54,942)**	**$ (131,516)**

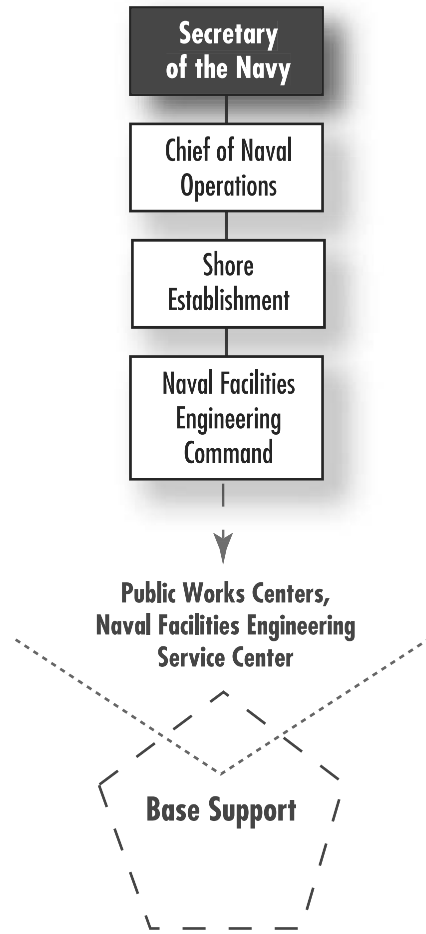
Program Performance

To ensure mobility of combat-ready naval forces, it is critical that MSC meet its readiness goals. MSC bases readiness on “goal days,” calculated as the number of days ships are available to perform a mission multiplied by the number of ships in the program. In FY 2003, MSC exceeded 100 percent readiness in the APF-N ship program with the addition of USNS WHEAT. In the SMS ship program, readiness fell from 100.1 percent in FY 2002 to 87.6 percent in FY 2003, with the deactivation of seven ships. The chart below presents the goal days, actual days, and readiness percentage for all three ship programs in the past four fiscal years.

	GOAL DAYS	ACTUAL DAYS	READINESS %
NFAF			
FY 2003	24,153	24,179	100.1%
FY 2002	24,091	24,212	100.5%
FY 2001	22,020	22,017	100.0%
FY 2000	21,594	21,329	98.8%
APF-N			
FY 2003	6,205	7,396	1119.2%
FY 2002	6,020	6,020	100.0%
FY 2001	5,842	5,689	97.4%
FY 2000	5,673	5,605	98.8%
SMS			
FY 2003	10,220	8,957	87.6%
FY 2002	10,128	10,142	100.1%
FY 2001	9,942	9,630	96.9%
FY 2000	9,785	9,445	96.5%

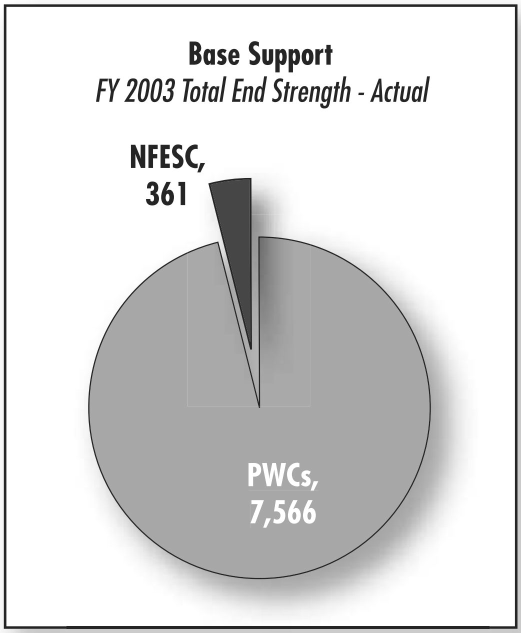
Base Support

The Base Support Activity Group consists of nine Public Works Centers (PWCs) and the Naval Facilities Engineering Service Center (NFESC). The PWCs provide a range of services to meet the diverse needs of their clients. These services include facilities maintenance, transportation support, and family housing. NFESC, located in Port Hueneme, California, provides the Navy with specialized facilities engineering and technology support. NFESC responsibilities range from providing shore establishment physical security to environmental waste management to energy conservation systems.



Public Works Center Mission: *To provide utility services, facilities maintenance, family housing services, transportation support, engineering services, and shore facilities support to afloat and ashore operating forces and other activities.*

Naval Facilities Engineering Services Center Mission: *To provide engineering, design, construction, technology implementation, and management support worldwide to shore, ocean, and waterfront activities and to amphibious and expeditionary operations.*



Personnel

Total end strength in (actual) FY 2003 for Base Support activities was 7,927, with military personnel comprising one percent of the total.

Net Cost of Operations

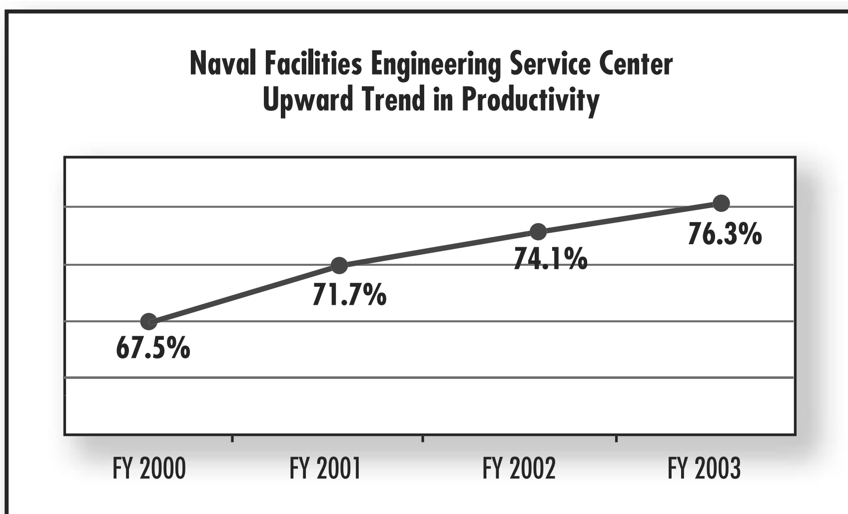
In FY 2003, program costs and earned revenue for Base Support activities decreased by 5 percent and 6 percent, respectively, with an overall decrease in net cost of operations of 60 percent.

Base Support: Net Cost of Operations ($ in thousands)

	FY 2003	FY 2002
Program Costs	$ 1,569,729	$ 1,654,492
Less: Earned Revenue	(1,584,722)	(1,691,934)
Net Cost of Operations	**$ (14,993)**	**$ (37,442)**

Program Performance

NFESC productivity continues an upward trend in FY 2003. Since FY 2000, NFESC workload has increased and manual processes have been automated, reflecting an overall increase in productivity (see chart).



Conclusion

The financial statements have been prepared to report the financial position and results of operations for the entity, pursuant to the requirements of the Title 31, United States Code, Section 3515(b).

While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the 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.

To the extent possible, the financial statements have been prepared in accordance with federal accounting standards. At times, the Department is unable to implement all elements of the standards due to financial management systems limitations. The Department continues to implement system improvements to address these limitations. There are other instances when the Department's application of the accounting standards is different from the auditor's application of the standards. In those situations, the Department has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

Department of the Navy

General Fund Principal Statements

PRINCIPAL STATEMENTS

The FY 2003 Department of the Navy, General Fund Principal Financial 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, 2003, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2002.

The following statements are included in 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
- Combined Statement of Financing

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
CONSOLIDATED BALANCE SHEET
As of September 30, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 78,191,653	$ 67,999,880
Non-Entity Seized Iraqi Cash	0	0
Non-Entity - Other	223,225	250,075
Investments (Note 4)	9,801	9,625
Accounts Receivable (Note 5)	496,863	742,467
Other Assets (Note 6)	187,865	67,081
Total Intragovernmental Assets	$ 79,109,407	$ 69,069,128
Cash and Other Monetary Assets (Note 7)	$ 282,995	$ 130,664
Accounts Receivable (Note 5)	3,382,133	2,799,887
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	53,611,634	33,003,595
General Property, Plant and Equipment (Note 10)	158,407,450	26,109,437
Investments (Note 4)	0	0
Other Assets (Note 6)	6,180,624	4,780,462
TOTAL ASSETS	$ 300,974,243	$ 135,893,173
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,035,033	$ 748,279
Debt (Note 13)	0	127
Environmental Liabilities (Note 14)	0	0
Other Liabilities (Note 15 & Note 16)	3,859,913	3,489,503
Total Intragovernmental Liabilities	$ 4,894,946	$ 4,237,909
Accounts Payable (Note 12)	$ 1,742,522	$ 1,510,329
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,589,971	1,546,375
Environmental Liabilities (Note 14)	15,614,424	15,469,073
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	3,785,962	4,185,487
Debt Held by Public (Note 13)	0	0
TOTAL LIABILITIES	$ 27,627,825	$ 26,949,173
NET POSITION		
Unexpended Appropriations (Note 18)	$ 50,781,179	$ 64,774,328
Cumulative Results of Operations	222,565,239	44,169,672
TOTAL NET POSITION	$ 273,346,418	$ 108,944,000
TOTAL LIABILITIES AND NET POSITION	$ 300,974,243	$ 135,893,173

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
Program Costs		
Intragovernmental Gross Costs	$ 35,142,574	$ 29,911,090
(Less: Intragovernmental Earned Revenue)	(3,186,968)	(1,209,933)
Intragovernmental Net Costs	$ 31,955,606	$ 28,701,157
Gross Costs With the Public	$ 81,168,783	$ 75,636,020
(Less: Earned Revenue From the Public)	(1,919,696)	(1,721,649)
Net Costs With the Public	$ 79,249,087	$ 73,914,371
Total Net Cost	$ 111,204,693	$ 102,615,528
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 111,204,693	$ 102,615,528

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
Cumulative Results of Operations		
Beginning Balances	$ 44,169,672	$ 46,641,359
Prior period adjustments (+/-)	152,557,286	0
Beginning Balances, as adjusted	$ 196,726,958	$ 46,641,359
Budgetary Financing Sources:		
Appropriations Received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (recissions, etc) (+/-)	0	0
Appropriations used	136,481,490	99,612,675
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	51,765	5,871
Imputed financing from costs absorbed by others	509,719	525,294
Other (+/-)	0	0
Total Financing Sources	$ 137,042,974	$ 100,143,840
Net Cost of Operations (+/-)	$ 111,204,693	$ 102,615,527
Ending Balances	$ 222,565,239	$ 44,169,672

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
Unexpended Appropriations		
Beginning Balances	$ 64,774,328	$ 63,535,842
Prior period adjustments (+/-)	0	0
Beginning Balances, as adjusted	$ 64,774,328	$ 63,535,842
Budgetary Financing Sources:		
Appropriations Received	$ 122,132,688	$ 99,524,458
Appropriations transferred in/out (+/-)	1,810,288	2,727,308
Other adjustments (recissions, etc) (+/-)	(1,454,635)	(1,363,575)
Appropriations used	(136,481,490)	(99,649,705)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ (13,993,149)	$ 1,238,486
Net Cost of Operations (+/-)	$ 0	$ 0
Ending Balances	$ 50,781,179	$ 64,774,328

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined Budgetary Financing Accounts	2002 Combined Budgetary Financing Accounts
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations Received	$ 122,169,428	$ 99,561,202
Borrowing Authority	0	0
Contract Authority	739	0
Net transfers (+/-)	1,662,142	2,676,247
Other	0	0
Unobligated Balance:		
Beginning of period	11,908,983	13,835,828
Net transfers, actual (+/-)	145,546	51,061
Anticipated Transfers Balances	0	0
Spending Authority from Offsetting Collections:		
Earned		
Collected	6,792,556	6,489,962
Receivable from Federal sources	(1,211,532)	(263,453)
Change in unfilled customer orders		
Advances received	(59,842)	1,286
Without advance from Federal sources	308,282	186,518
Anticipated for the rest of year, without advances	0	0
Transfers from trust funds	0	0
Subtotal	$ 5,829,464	$ 6,414,313
Recoveries of prior year obligations	$ 7,009,339	$ 2,286,834
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(1,452,574)	(1,399,956)
Total Budgetary Resources	$ 147,273,067	$ 123,425,529
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	$ 124,497,950	$ 99,307,751
Reimbursable	8,079,881	12,208,795
Subtotal	$ 132,577,831	$ 111,516,546
Unobligated balance:		
Apportioned	$ 13,697,001	$ 10,590,567
Exempt from apportionment	0	0
Other available	0	0
Unobligated Balances Not Available	998,235	1,318,416
Total, Status of Budgetary Resources	$ 147,273,067	$ 123,425,529

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined Budgetary Financing Accounts	2002 Combined Budgetary Financing Accounts
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net-beginning of period	$ 56,100,186	$ 52,333,850
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, net-end of period:		
Accounts Receivable	(897,842)	(2,109,374)
Unfilled customer order from Federal sources	(2,335,476)	(2,027,193)
Undelivered Orders	63,419,000	55,633,755
Accounts Payable	3,335,212	4,603,000
Outlays:		
Disbursements	119,051,033	105,540,310
Collections	(6,732,714)	(6,491,249)
Subtotal	$ 112,318,319	$ 99,049,061
Less: Offsetting receipts	(246,802)	(213,345)
Net Outlays	$ 112,071,517	$ 98,835,716

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
COMBINED STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined	2002 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 132,577,831	$ 111,516,546
Less: Spending Authority from offsetting collections and recoveries (-)	(12,838,803)	(8,701,148)
Obligations net of offsetting collections and recoveries	$ 119,739,028	$ 102,815,398
Less: Offsetting receipts (-)	(246,802)	(213,345)
Net obligations	$ 119,492,226	$ 102,602,053
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	51,765	0
Imputed financing from costs absorbed by others	509,719	525,294
Other (+/-)	0	0
Net other resources used to finance activities	$ 561,484	$ 525,294
Total resources used to finance activities	$ 120,053,710	$ 103,127,347
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	$ (3,213,420)	$ (10,676,267)
Unfilled Customer Orders	248,440	187,805
Resources that fund expenses recognized in prior periods	(31,284)	(620,162)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0
Resources that finance the acquisition of assets	(26,444,222)	7,487,846
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	0	0
Total resources used to finance items not part of the Net Cost of Operations	$ (29,440,486)	$ (3,620,778)
Total resources used to finance the Net Cost of Operations	$ 90,613,224	$ 99,506,569

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
COMBINED STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined	2002 Combined
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 Periods:		
Increase in annual leave liability	$ 0	$ 263,070
Increase in environmental and disposal liability	0	595,543
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	428,344	117,595
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 428,344	$ 976,208
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 16,936,476	$ 916,360
Revaluation of assets and liabilities (+/-)	3,203,729	(1,684,365)
Other (+/-)	22,920	2,900,757
Total components of Net Cost of Operations that will not require or generate resources	$ 20,163,125	$ 2,132,752
Total components of Net Cost of Operations that will not require generate resources in the current period	$ 20,591,469	$ 3,108,960
Net Cost of Operations	$ 111,204,693	$ 102,615,529

The accompanying notes are an integral part of these statements.

Department of the Navy

General Fund Notes to the Principal Statements

Note 1. Significant Accounting Policies

A. Basis of Presentation.
These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON), as required by the "Chief Financial Officers (CFO) Act of 1990," expanded by the "Government Management Reform Act (GMRA) of 1994," and other appropriate legislation. The financial statements have been prepared from the books and records of the DON in accordance with the "Department of Defense Financial Management Regulation" (DoD FMR), the Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements," and to the extent possible, Federal Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which the DON is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. The DON's financial statements are in addition to the financial reports also prepared by the DON pursuant to OMB directives that are used to monitor and control the DON's use of budgetary resources.

The DON is unable to fully implement all elements of Federal GAAP and the OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. Reported values and information for the DON's major asset and liability categories are derived largely from nonfinancial feeder systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with Federal GAAP. As a result, the DON cannot currently implement every aspect of Federal GAAP and OMB Bulletin No. 01-09. The DON continues to implement process and system improvements addressing the limitation of its financial and nonfinancial feeder systems. A more detailed explanation of these financial statement elements is provided in the applicable note.

Fiscal Year (FY) 2003 represents the eighth year that the DON has prepared audited financial statements as required by the CFO Act and the GMRA.

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 DoD, as stated in the FY 2002 Annual Defense Report is to assure allies and friends, dissuade future military competition, deter threats and coercion against U.S. interests, and defeating adversaries if deterrence fails.

C. Appropriations and Funds.
The DON's appropriations and funds are divided into the general, revolving funds, trust, special, and deposit funds. These appropriations and funds are used to fund and report how the resources have been used in the course of executing the DON's missions.

- General funds are used for financial transactions arising under Congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and construction accounts.

- Revolving funds receive their initial working capital through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders. The National Defense Sealift Fund is the DON's only revolving fund.

- Trust funds represent the receipt and expenditure 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 funds account for receipts of the government that are earmarked for a specific purpose.

- Deposit funds generally are used to (1) hold assets for which the DON is acting as an agent or a custodian or whose distribution awaits legal determination, or (2) account for unidentified remittances.

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

Entity Accounts:

General Funds

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing, Navy and Maine Corps (Operations and Maintenance)
17X0810	Environmental Restoration, Navy
17 1105	Military Personnel, 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 1205	Military Construction, Navy
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 1405	Reserve Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17 1611	Shipbuilding and Conversion, Navy
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement, Navy

Revolving funds

17 4557	National Defense Sealift Fund, Navy

Trust funds

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

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

Non Entity Accounts:
Special funds (Receipt Accounts)

17 3041	Recoveries Under the Foreign Military Sales Program
17 3210	General Fund Proprietary Receipts, Defense Military, Not Otherwise Classified

Deposit funds

17X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy
17X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy
17X6025	Pay of the Navy, Deposit Fund
17X6026	Pay of the Marine Corps
17X6050	Employee Payroll Allotment Account (U.S. Bonds)
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
17X6275	Withheld State and Local Income Taxes
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 (fiscal year)
17X6850	Housing Rentals, Navy
17X6875	Suspense, Navy
17X6999	Accounts Payable, Check Issue Underdrafts, Navy

D. Basis of Accounting.

The DON generally records transactions on a budgetary basis and not an accrual accounting basis as is required by Federal GAAP. For FY 2003, DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of the DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Federal GAAP and, therefore, were not designed to collect and record financial information on the full accrual accounting basis as required by Federal GAAP. The DON has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of Federal GAAP. One such action is the current revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until such time as all of the DON's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by Federal GAAP, the DON's financial data will be based on budgetary transactions (obligations, disbursements, and collections), and transactions from nonfinancial feeder systems, adjusted for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities. However, when possible, the financial statements are presented on the accrual basis of accounting as required. One example of information presented on the budgetary basis is the data on the Statement on Net Cost. Much of this information is based on obligations and disbursements and may not always represent accrued costs.

In addition, the DON identifies programs based upon the major appropriation groups provided by Congress. The DON is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standard (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

E. Revenues and Other Financing Sources.

Financing sources for general funds are provided primarily through congressional appropriations that are received on both an annual and a multiyear basis. When authorized, these appropriations are supplemented by revenues generated by sales of goods or services through a reimbursable order process. The DON recognizes revenue as a result of costs incurred or services performed on behalf of other federal agencies and the public. Revenue is recognized when earned under the reimbursable order process.

The DON does not include non-monetary support provided by U.S. Allies for common defense in mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has agreements with foreign countries that include both direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port. DOD is reviewing these types of financing and costs reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the financial statements in accordance with generally accepted accounting principles. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

F. Recognition of Expenses.
For financial reporting purposes, the DON policy requires the recognition of operating expenses in the period incurred. However, because the DON's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and environmental liabilities. Expenditures for capital and other long-term assets are not recognized as expenses in the DON's operations until depreciated in the case of Property, Plant and Equipment (PP&E) or consumed in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as annual and military leave earned but not taken, are financed in the period in which payment is made.

Operating expenses were adjusted as a result of elimination of balances between DoD components. See Note 19.I, Intra-governmental Expenses and Revenue for disclosure of adjustment amounts.

G. Accounting for Intra-governmental Activities.
The DON, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the DON as though the agency was a stand-alone entity.

The DON's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The DON's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

The DON's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The DON funds a portion of the civilian and military pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The DON recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the Statement of Net Cost; and recognizes corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

DoD reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Fund (MRF) financial statements. DoD recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization General Fund column of the DoD Agency-wide consolidating/combining statements.

To prepare reliable financial statements, transactions occurring between components or activities within the DON must be eliminated. However, the DON, as well as the rest of the federal government, cannot accurately identify all intra-governmental transactions by customer. The Defense Finance and Accounting Services (DFAS) is responsible for eliminating transactions between components or activities of the DON. For FYs 1999 and beyond seller entities within DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intra-governmental balances were then eliminated.

The Department of the Treasury, Financial Management Services (FMS) is responsible for eliminating transactions between the Department and other federal agencies. In September 2000, the FMS issued the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide." The Department was not able to fully implement the policies and procedures in this guide related to reconciling intra-governmental assets, liabilities, revenues, and expenses for non-fiduciary transactions. The DON, however, was able to implement the policies and procedures contained in the "Intra-governmental Fiduciary Transactions Accounting Guide" as updated by the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide," issued October 2002, for reconciling intra-governmental transactions. These transactions pertain to investments in Federal securities, borrowings from the United States (U.S.) Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor (DoL), and benefit program transactions with the OPM.

H. Transactions with Foreign Governments and International Organizations.
Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of this Act, DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Customers may be required to make payments in advance.

I. Funds with the U.S. Treasury.
The DON'S financial resources are maintained in U.S. Treasury accounts. The majority of cash collections, disbursements, and adjustments are processed worldwide at the DFAS, Military Services, and the U. S. Army Corps of Engineers (USACE) disbursing stations, as well as the Department of State financial service centers. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the DON's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at Note 3. Differences between accounting offices' detail-level records and Treasury's FBWT accounts are disclosed in Note 21.B, specifically, differences caused by in-transit disbursements and unmatched disbursements (which are not recorded in the accounting offices' detail-level records).

J. Foreign Currency.
The DON conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations (operation and maintenance, military personnel, military construction, family housing operations and maintenance, and family housing construction.) The gains and losses are computed 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 adjustment to the original obligation amount at the time of payment. These currency fluctuations are not separately identified.

K. Accounts Receivable.
As presented in the Balance Sheet statement, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. The Department 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. Material disclosures are provided at Note 5.

L. Loans Receivable.
Not Applicable.

M. Inventories and Related Property.
Effective October 1, 2002, Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, revises accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). The standard renames National Defense Property, Plant, and Equipment to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the costs of military equipment, including the costs of modifications and upgrades. Likewise, military equipment (previously referred to as National Defense Property, Plant, and Equipment) also includes items, which will now be classified as Operating Materials and Supplies (OM&S).

Implementation of the new accounting principles requires the adjustment of October 1, 2002, the OM&S balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed in as discussed further in Notes 9.

The DON uses the LAC method because its inventory systems were designed for material management rather than accounting. The systems provide accountability and visibility over inventory items. They do not maintain the historical costs data necessary to comply with the SFFAS No. 3, "Accounting for Inventory Related Property." Neither can they directly produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). DoD is transitioning to a Moving Average Cost methodology for valuing inventory and OM&S that when fully implemented will allow the DON to comply with SFFAS No. 3.

SSFAS No. 3 distinguishes between "inventory held for sale" and "inventory held in reserve for future sale." There is no management or valuation difference between the two USSGL accounts. Further, the DoD manages only military or government-specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD material management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DoD holds material based on military need and support for contingencies. Therefore, the DON does not attempt to account separately for items held for current or future use.

Related property includes OM&S and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD uses the consumption method of accounting for OM&S, for the most part, expensing material when it is issued to the end user. Where current systems cannot fully support the consumption method, the DON uses the purchase method - that is, expensed when purchased. The DON reported significant amounts using the purchase method either because the systems could not support the consumption method or because management deems that the item is in the hands of the end user.

DoD implemented new policy in FY 2002 to account for condemned material (only) as "Excess, Obsolete, and Unserviceable." The net value of condemned material is zero, because the costs of disposal are greater than the potential scrap value. Material that can be potentially redistributed, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

In addition, past audit results identified uncertainties about the completeness and existence of quantities used to produce the reported values. Material disclosures related to inventory and related property are provided at Note 9.

N. Investments in U.S. Treasury Securities.
Investments in U.S. Treasury securities are reported at cost, net of unamortized premiums or discounts. Premium or discounts are amortized into interest income over the term of the investment using the effective interest rate method or other methods if similar results are obtained. The DON's intent is to hold investments to maturity; unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities.

The DON invests in non-marketable securities. The two types of non-marketable securities are par value and market based Intra-governmental securities. The Bureau of Public Debt issues non-marketable Par Value Intra-governmental Securities. Non-marketable, Market Based Intra-governmental Securities mimic marketable securities, but are not traded publicly. See Note 4 for material disclosures.

O. General Property, Plant and Equipment.
A change in accounting principle regarding military equipment (e.g., ships, aircraft, combat vehicles, weapons) was effective for accounting periods beginning after September 30, 2002. Until the change in accounting principle, the acquisition costs for military equipment classified as National Defense Property, Plant, and Equipment (PP&E) were expensed in the period incurred. In addition, valuation, condition, and deferred maintenance information for these items was presented off-balance sheet. Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property,* Plant, and Equipment, establishes new generally accepted accounting principles for valuing and reporting military equipment in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

Implementation of the new accounting principles requires the adjustment of the October 1, 2002, General Property, Plant, and Equipment balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed. As discussed further in Note 10, the adjustment was based on data provided by the Bureau of Economic Analysis, Department of Commerce.

General PP&E, exclusive of Military Equipment, is capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100,000. Also, improvement costs over the DoD capitalization threshold of $100,000 for General PP&E, are required to be capitalized. All General PP&E, other than land and Military Equipment, is depreciated on a straight-line basis. Land is not depreciated.

When it is in the best interest of the government, the DON provides to contractors government property necessary to complete contract work. Such property is either owned or leased by the DON, or purchased directly by the contractor for the government based on contract terms. When the value of contractor procured General PP&E exceeds the DoD capitalization threshold, such PP&E is required to be included in the value of General PP&E reported on the DON's Balance Sheet. DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, the DON currently reports only government property in the possession of contractors that is maintained in the DON'S property systems.

To bring the DON into fuller compliance with federal accounting standards, DoD has issued new property accountability and reporting regulations that require the DoD Components to maintain, in DoD Component property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with federal accounting standards. Material disclosures are provided at Note 10.

P. Advances and Prepayments.
Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

Q. Leases.
Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) the DON records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The DON records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair value. The DON deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest was necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases. In addition, the DON classifies leases that do not transfer substantially all of the benefits or risks of ownership as operating leases and records payment expenses over the lease term.

R. Other Assets.
DON conducts business with commercial contractors under two primary types of contracts— fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the DON provides financing payments. One type of financing payment that the DON makes, for real property, is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in Note 10, General PP&E, Net.

In addition, based on the Federal Acquisition Regulation (FAR), the DON makes financing payments under fixed price contracts that are not based on a percentage of completion. The DON reports these financing payments as advances or prepayments in the "Other Assets" line item. The DON treats these payments as advances or prepayment because the DON becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the DON is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the DON for the full amount of the advance.

DoD has completed a review of all applicable federal accounting standards; applicable public laws on contract financing; FAR Parts 32, 49, and 52; and the OMB guidance in 5 Code of Federal Regulations Part 1315, "Prompt Payment." DoD concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering what further action is appropriate.

S. Contingencies and Other Liabilities.
The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the DON. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable and the amount of loss 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 that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The DON's loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents; medical malpractice; property or environmental damages; and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for the DON's assets. This type of liability has two components— nonenvironmental and environmental. Recognition of an anticipated environmental disposal liability begins when the asset is placed into service, consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment." Based upon the DON's policies and consistent with SFFAS No.5 "Accounting for Liabilities of Federal Government," a nonenvironmental disposal liability is recognized for an asset when management makes a decision to dispose of the asset. The Department has agreed to the recognition of nonenvironmental disposal liability for nuclear powered assets when the asset is placed in service. Such amounts are developed in conjunction with and not easily identifiable separately from environmental disposal costs. Material disclosures are provided at Notes 14 and 15.

T. Accrued Leave.
Civilian annual leave and military leave that has been accrued and not used as of the balance sheet date are reported as liabilities. The liability reported at the end of the fiscal year reflects the current pay rates.

U. Net Position.
Net Position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts of authority, which 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 difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, this included the cumulative amount of donations and transfers of assets in and out without reimbursement.

V. Treaties for Use of Foreign Bases.
The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements are retained by the host country. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Department. Therefore, in the event treaties or other agreements are terminated whereby use of the foreign bases is no longer allowed, losses will be recorded for the value of any non-retrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

W. Comparative Data.
The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2003. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater 10 percent between FY 2002 and FY 2003, are explained within the Notes to the Financial Statements.

X. Unexpended Obligations.
The DON obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods/services not yet delivered.

Y. Data Collection Approach.
The DON financial statements include information from both financial systems and non-financial feeder systems. The Defense Finance Accounting Service Cleveland Center (DFAS-CL) collects the financial system information and incorporates it into the financial statements. The DON collects financial information from non-financial feeder systems through a data call process and submits it to DFAS-CL for incorporation into the financial statements. For FY 2003, the DON utilized a web-based data collection instrument (DCI) that captures all required financial information from non-financial feeder systems for the General Fund (GF) statements. This is the fifth year DON has used the DCI to collect non-financial feeder information. The DCI identifies the information requirements to the source provider, provides an audit trail, and integrates into the DFAS-CL financial statement preparation process.

NOTE 2. NONENTITY AND ENTITY ASSETS

As of September 30,	2003 Nonentity	2003 Entity	2003 Total	2002 Nonentity Assets
(Amounts in thousands)				
1. Intra-governmental Assets:				
A. Fund Balance with Treasury	$ 223,225	$ 78,191,653	$ 78,414,878	$ 250,075
B. Investments	0	9,801	9,801	0
C. Accounts Receivable	0	496,863	496,863	0
D. Other Assets	0	187,865	187,865	0
E. Total Intra-governmental Assets	$ 223,225	$ 78,886,182	$ 79,109,407	$ 250,075
2. Non-Federal Assets:				
A. Cash and Other Monetary Assets	$ 282,995	$ 0	$ 282,995	$ 130,664
B. Accounts Receivable	2,642,168	739,965	3,382,133	2,460,546
C. Loans Receivable	0	0	0	0
D. Inventory & Related Property	0	53,611,634	53,611,634	0
E. General Property, Plant and Equipment	0	158,407,450	158,407,450	0
F. Investments	0	0		0
G. Other Assets	0	6,180,624	6,180,624	0
H. Total Non-Federal Assets	$ 2,925,163	$ 218,939,673	$ 221,864,836	$ 2,591,210
3. Total Assets:	$ 3,148,388	$ 297,825,855	$ 300,974,243	$ 2,841,285

4. Other Information Related to Nonentity and Entity Assets.

Fluctuation and/or Abnormalities

An explanation of fluctuations and abnormalities in any particular line are included in the note for that particular asset. See notes 3-10.

Definitions

Assets are categorized as:

- Entity accounts consist of resources that the DON has the authority to use, or when management is legally obligated to use funds to meet entity obligations.
- Nonentity accounts are assets held by an entity, but are not available for use in the operations of the entity.

Other Disclosures

- Nonentity Assets. As of September 30, 2003, DON holds $3,148,388 thousand nonentity assets. These assets are not available for use by the DON in its day-to-day operations but the DON maintains stewardship accountability and responsibility to report. There are three categories of significant nonentity assets held by the DON: (1) the Nonentity Intra-governmental Fund Balance with Treasury, (2) Cash and Other Monetary Assets, and (3) the Nonentity Nonfederal Accounts Receivable.

- Non-Entity Nonfederal Accounts Receivable (public). Non-Entity Accounts Receivable with the public contains $1,333,494 thousand (principal) in advance payments made to contractors and $ 1,075,791 thousand in associated accrued interest that remain in litigation. These balances are being reported in Non-Entity Accounts Receivable since the original appropriation year has been cancelled, and any funds collected as a result of this litigation would go to treasury and not be available for the DON's use in normal operations. See Note 5 for additional information.

Reference
For Additional Line Item discussion, see:
- Note 3, Fund Balance with Treasury
- Note 4, Investments
- Note 5, Accounts Receivable
- Note 6, Other Assets
- Note 7, Cash and Other Monetary Assets
- Note 8, Direct Loands and/or Loan Guarantee Programs
- Note 9, Inventory and Related Property, Net
- Note 10, General Property, Plant, and Equipment (PP&E), Net

For regulatory discussion on Nonentity and Entity Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1004.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30,	2003	2002
(Amounts in thousands)		
1. Fund Balances:		
A. Appropriated Funds	$ 76,290,090	$ 66,480,155
B. Revolving Funds	1,779,963	1,491,480
C. Trust Funds	18,877	15,995
D. Other Fund Types	325,948	262,325
E. Total Fund Balances	$ 78,414,878	$ 68,249,955
2 Fund Balances Per Treasury Versus Agency:		
A. Fund Balance per Treasury	$ 78,414,878	$ 68,249,955
B. Fund Balance per Agency	78,414,878	68,249,955
C. Reconciling Amount	$ 0	$ 0

3. Explanation of Reconciliation Amount:
Not Applicable.

4. Other Information Related to Fund Balance with Treasury:

Fluctuation and/or Abnormalities
The DON reported an increase of $10,164,923 thousand, 15 percent, in Fund Balance with the Treasury (FBWT) in FY 2003 when compared with FY 2002. The majority of the change is due to an increase in the DON appropriations in FY 2003. When comparing FY 2003 Revolving Fund with FY 2002 there is an increase of $288,483 thousand or 19 percent. This increase is a result of additional funding for the revolving fund (4557 account - National Defense Sealift Fund, Navy) that provided funding for transportation for the deployment of Operation IRAQI Freedom. Also, a portion of the increase in the Fund Balance with Treasury was caused by a transfer directed by the Defense Appropriations Act, 2003, Public Law 107-248, Section 8112. This law transferred $120 million from the NWCF Fund Balance with Treasury to Operations and Maintenance, Navy. DON also increased $2,882 thousand, 18 percent, in Trust Fund due to additional donations. An increase of $63,623 thousand, 24 percent, in Other Fund Types in FY 2003 when compared with FY 2002 is a result of an significant increase in the Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund.

The $26,850 thousand, 11 percent, reduction in Nonentity FBWT occurred primarily as a result in $47,000 thousand decrease in Withheld State and Local Taxes, a $28, 000 thousand decrease of Defense Military Receipts

Not Other Classified and a $19,794 thousand decrease in Military Thrift Savings Plan. The decrease is offset by an increase of $55,000 thousand in Recoveries under Foreign Military Sales and $13,747 in Pay of the Navy Deposit Fund. The reason for the overall decrease is the timing as to when payments from the nonentity accounts is distributed. For example withheld State and Local taxes can fluctuate month to month based upon the timing of payrolls, and the various due date requirements of each state and local government.

Other Disclosures
To deal with reconciliation of check issue discrepancy and deposit differences that are aged 90 days or greater some of the following actions are being taken: (1) Follow-up action with disbursing officers on the status of their resolving transactions listed on their statement of differences; (2) Weekly teleconferences with the field sites and site visits; and (3) improving training.

Reference
See Note Disclosure 1.I. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Funds with the U.S. Treasury.

For regulatory discussion on Fund Balance with Treasury, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 100501.

NOTE 4. INVESTMENTS

As of September 30,	2003					2002
	Cost	Amorti-zation Method	Amortized (Premium/ Discount)	Investments, Net	Market Value Disclosure	Investments, Net
(Amounts in thousands)						
1. Intragovernmental Securities:						
A. Marketable	$ 0		$ 0	$ 0	$ 0	$ 0
B. Non-Marketable, Par Value	0		0	0	0	0
C. Non-Marketable, Market-Based	9,856	N/A	(150)	9,706	9,706	9,465
D. Subtotal	$ 9,856		$ (150)	$ 9,706	$ 9,706	$ 9,465
E. Accrued Interest	95			95	95	160
F. Total Intragovernmental Securities	$ 9,951		$ (150)	$ 9,801	$ 9,801	$ 9,625

2. Other Investments: None

3. Other Information Related to Investments

Other Disclosures
The two DON Trust Funds are the Naval Academy General Gift Fund and the Navy General Gift Fund, which have a total Investment, net of $9,801 thousand (included $95 thousand of accrued interest.) These investments are Non-Marketable Market-Based securities reported at cost, net of amortized premiums and discounts.

Reference
See Note Disclosure 1.N. – Investments in U.S. Treasury for additional DoD policies governing Investments in U.S. Treasury Securities.

For regulatory discussion on Investments, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1006.

NOTE 5. ACCOUNTS RECEIVABLE

As of September 30,	2003			2002
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivables:	$ 496,863	N/A	496,863	$ 742,467
2. Non-Federal Receivables (From the Public):	$ 3,665,123	$ (282,990)	$ 3,382,133	$ 2,799,887
3. Total Accounts Receivable:	$ 4,161,986	$ (282,990)	$ 3,878,996	$ 3,542,354

4. Other Information Related to Accounts Receivables:

Fluctuation and/or Abnormalities
The DON reported a decrease of $245,604 thousand, 33 percent, in Intra-governmental Receivables in FY 2003 when compared to FY 2002. The decrease is due to improving the process to capture trading partner information and intra-governmental eliminations process. Also contributing to the decrease is a result of a correction that was made to overstated Receivables reflected in the program year 1998 and 1999. The correction was found during system conversion and the adjustment was made in October 2002. In addition, the Marine Corps made a concerted effort to research and write off the invalid receivables that resulted in the reduction of the Intra-governmental Receivables of $145,202 thousand.

The DON reported an overall increase of $582,246 thousand, 21 percent, in Non-federal Receivables in FY 2003 when compared to FY 2002. The increase of $56,839 thousand is interest related to pending contract settlement that is expected to be collected through litigation. The remaining portion of the increase is a result of improved reporting of receivables from non-accounting systems. Detailed listing is under other DON disclosures.

Allowance Method
For all program groups except Military Personnel appropriations, the DON estimate for the entity allowance is 3 percent. The entity allowance for Military Personnel is estimated to be 14 percent. Each estimate is based on write-offs of accounts receivable over the last three-year period. The nonentity allowance was established at 50 percent excluding interest receivables pertaining to pending litigation.

Intra-governmental Accounts Receivable Adjustments

- Allocation of Undistributed Collections.

Undistributed disbursements and collections are allocated between federal and non-federal categories based on the percentage of federal and non-federal Accounts Payable and Accounts Receivable as submitted in the field level general ledgers. This allocation was suggested as appropriate in a DFAS Arlington memorandum dated October 4, 2000, which required disclosure to the audit community of the applicable methodology used to allocate undistributed.

- Elimination Adjustments.

The DON's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the DON was unable to reconcile intra-governmental accounts receivable balances with its trading partners. Through the ongoing Business Management Modernization Program (BMMP), the Department intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations.

Intrafund transactions are eliminated based upon trading partner information obtained from the Bureau of Naval Personnel System (BUPERS), Standard Accounting and Reporting System – Field Level (STARS-FL), and the Standard Accounting and Reporting System – Headquarters Module (STARS-HQ). The elimination data obtained from these systems included seller appropriation, grantor (buyer) appropriation, grantor subhead, grantor code, reimbursable source code, accounts receivable, revenue and unearned revenue.

Other Disclosures

- Nonentity Non-Federal Accounts Receivables includes the following:

(Amounts in thousands)	Nonentity Non-Federal Accounts Receivable (Gross) As of September 30, 2003
Contract Litigation Principal and Interest	$2,409,285
DDMS	13,480
CDS/MOCAS system debts	245,997
Civilian Pay (DCPS) debt	2,941
In-service Debt & Other Debt	43,741
JAG	5,146
Penalties, Fines and Admin. Fees and Interest	148,565

The contract litigation includes principal of $1,333,494 thousand, and accrued interest receivable of $1,075,791 thousand.

Other Debt represents foreign military sales and DON provided services to the public.

- Abnormal Account Balances.

Abnormal Accounts Payable and Accounts Receivable balances may occur for two main reasons – 1) the application of undistributed disbursement/collections and 2) as a result of the intra-governmental transaction elimination process. DFAS Arlington has provided guidance in a memorandum dated March 1, 2001 to record accruals, for financial statement presentation purposes, to correct abnormal balances.

Undistributed disbursements/collections are recorded in Accounts Payable and Accounts Receivable, respectively. For a variety of reasons, the application of undistributed transactions may result in abnormal balances.

In accordance with the DoD FMR, Volume 6B, Chapter 13, adjustments are recorded, at the appropriation level, to bring the DON's intra-governmental accounts into agreement with its trading partners' intra-governmental accounts. These elimination process adjustments may also result in abnormal Accounts Payable and Accounts Receivable.

Reference

See Note Disclosure 1.K. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Accounts Receivable.

For regulatory discussion on Accounts Receivable, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1007.

Note 6. Other Assets

As of September 30, (Amounts in thousands)		2003		2002
1. Intra-governmental Other Assets:				
A. Advances and Prepayments	$	187,865	$	67,081
B. Other Assets		0		0
C. Total Intra-governmental Other Assets	$	187,865	$	67,081
2. Non-Federal Other Assets:				
A. Outstanding Contract Financing Payments	$	5,809,610	$	4,609,272
B. Other Assets (With the Public)		371,014		171,190
C. Total Non-Federal Other Assets	$	6,180,624	$	4,780,462
3. Total Other Assets:	$	6,368,489	$	4,847,543

4. Other Information Related to Other Assets:

Fluctuation and/or Abnormalities

The DON reported an increase of $120,784 thousand, 180 percent, in Intra-governmental Other Assets, Advances and Prepayment in FY 2003 when compared with FY 2002. The increase is a result of advances to the Navy Working Capital Fund for work at the shipyards that has been delayed and the Defense Security Services.

DON also reported an increase of $1,400,162 thousand, 29 percent, in Nonfederal Other Assets. This change reflects an increase of $1,200,338 thousand, 26 percent, in outstanding contract financing payments and an increase of $199,824 thousand, 117 percent, in advances with the public. This increase reflects increased funding and therefore increased activity in the procurement accounts such as Aircraft Procurement, Shipbuilding and Conversion, Weapons Procurement, and Other Procurement and advances with the public as a result of Operation Iraqi Freedom and subsequent events respectively.

Other Disclosures

- Advances and Prepayment.
  The buyer-side advances to others balances were adjusted to agree with seller-side advances from others on the books or other DoD reporting entities. Additionally, the buyer-side prepayment balances were adjusted to agree with seller-side deferred credits on the books of other DoD reporting entities.

- Outstanding Contract Financing Payments.
  The DON has reported outstanding financing payments for fixed price contracts as an advance and prepayment, because under the terms of the fixed price contracts, the DON becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the DON is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the DON for the full amount of the outstanding contract financing payments. DoD has completed its review of all applicable federal accounting standards; applicable public laws on contract financing; FAR Parts 32,48, and 52; and the OMB guidance in 5 CFR Part 1315, "Prompt Payment." The DON has concluded that the SFFAS No. 1, "Accounting for Selected Assets and Liabilities" does not fully or adequately addresses the subject of progress payment accounting and is considering what further action is appropriate.

The following table displays the Outstanding Contract Financing Payments attributed by program:

(Amounts in thousands)	As of September 30, 2003
Aircraft Procurement	$4,210,169
Shipbuilding and Conversion	603,396
Weapons Procurement	393,739
Other Procurement	478,028
Other (O&M, RDT&E)	124,278
Total	$5,809,610

Reference
See Note Disclosure 1.R. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Other Assets.

For regulatory discussion on Other Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1008.

NOTE 7. CASH AND OTHER MONETARY ASSETS

As of September 30,		2003		2002
(Amounts in thousands)				
1. Cash	$	224,881	$	130,162
2. Foreign Currency (non-purchased)		58,114		502
3. Other Monetary Assets		0		0
4. Total Cash, Foreign Currency, & Other Monetary Assets	$	282,995	$	130,664

5. Other Information Related to Cash and Other Monetary Assets

Fluctuation and/or Abnormalities
The DON reported an increase of $152,331 thousand, 117 percent, in Total Cash, and Foreign Currency in FY 2003 when compared with FY 2002. The increase is mainly due to the deployment for Operation IRAQI Freedom and subsequents events related to that action. The Disbursing Officers had more cash and foreign currency on hand than they would have under normal operational requirements.

Definitions
Cash - The total of cash resources under the control of the DON, which includes coin, paper currency, purchased foreign currency, negotiable instruments, and amounts on deposit in banks and other financial institutions. Cash available for agency use should include petty cash funds and cash held in revolving funds, which will not be transferred into the U.S. Government General Fund.

Foreign Currency - consists of the total U.S. dollar equivalent of non-purchased foreign currencies held in foreign currency fund accounts. Non-purchased foreign currency is limited to the Treasury Index 97X7000 fund account (formerly called FT accounts).

Other Monetary Assets - includes gold, special drawing rights, and U.S. Reserves in the International Monetary Fund. This category is principally for use by the Department of the Treasury.

Restriction on Cash - All cash and other monetary assets reported are classified as nonentity, which means that the assets are not available for the DON's use in normal operations.

Other Disclosures
Cash and Foreign Currency reported consists primarily of cash held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange mission. The primary source of the amounts reported is the Standard Form 1219, Statement of Accountability reported by DoD Disbursing Officers.

The DON translates foreign currency to U.S.dollars utilizing the Department of the Treasury Prevailing Rate of Exchange. This rate is the most favorable rate that would legally be available to the U.S. Government's acquisition of foreign currency for its official disbursement and accommodation of exchange transactions.

Reference
See Note Disclosure 1.J. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Foreign Currency.

For regulatory discussion on Cash and Other Monetary Assets, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1009.

Note 8.A. Direct Loan and/or Loan Guarantee Programs

The DoD operates the following Direct Loan and/or Loan Guarantee Program:
Military Housing Privatization Initiative

Other Information Related to Direct Loan and/or Loan Guarantee Programs.
The Military Housing Privatization Initiative (MHPI) fosters a mutually beneficial relationship between the DoD and the private sector. For the DoD, the MHPI results in the construction of more housing built to market standards, at a lower cost than through the military construction process. Commercial construction (Private Sector) is faster and less costly than military construction and significantly stretches and leverages the DoD's limited housing funds. The MHPI also provides protection against specific risks, such as base closure or member deployment, for the private sector partner.

An analysis of loans receivables, loan guarantees, the liability for loan guarantees, and the nature and amounts of the subsidy and administrative costs associated with the direct loans and loan guarantees is provided in the following sections of this note.

DoD operates a loan guarantee program authorized by the National Defense Authorization Act for FY 1996, Public Law 104-106 Stat. 186 Section 2801, includes a series of powerful authorities that allow DoD to work with the private sector to renovate military housing. DoD's goals are to:

- obtain private capital to leverage government dollars,
- make efficient use of limited resources, and
- use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to American taxpayers.

The Act also provides DoD with a variety of authorities to obtain private sector financing and expertise to improve military housing. DoD uses these authorities individually, or in combination. They include:

- guarantees, both loan and rental
- conveyance/leasing of existing property and facilities
- differential lease payments
- investments, both limited partnerships and stock/bond ownership
- direct loans

In addition, the "Federal Credit Reform Act of 1990" governs all amended direct loan obligations and loan guarantee commitments made after FY 1991 resulting in direct loans or loan guarantees.

- Direct loans - are reported net of allowance for subsidy at present value, and
- Loan Guarantee Liabilities - are reported at present value.

Reference:
For regulatory discussion on Direct Loans and Loan Guarantee, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1010.

NOTE 9. INVENTORY AND RELATED PROPERTY

As of September 30,	2003	2002
(Amounts in thousands)		
1. Inventory, Net (Note 9.A.)	$ 0	$ 0
2. Operating Materials & Supplies, Net (Note 9.B.)	53,611,634	33,003,595
3. Stockpile Materials, Net (Note 9.C.)	0	0
4. Total	$ 53,611,634	$ 33,003,595

NOTE 9.A. INVENTORY, NET
Not Applicable.

NOTE 9.B. OPERATING MATERIALS AND SUPPLIES, NET

As of September 30,	2003			2002	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories:					
A. Held for Use	$ 49,948,474	$ 0	$ 49,948,474	$ 27,307,223	LAC, SP, AC, O
B. Held for Repair	5,213,580	(1,550,420)	3,663,160	5,217,802	LAC, SP, AC, O
C. Excess, Obsolete, and Unserviceable	1,186,642	(1,186,642)	0	478,570	LAC, SP, AC, O
D. Total	$ 56,348,696	$ (2,737,062)	$ 53,611,634	$ 33,003,595	

Legend for Valuation Methods:

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

2. Restrictions on Operating Materials & Supplies: None

3. Information Related to Operating Materials and Supplies

Fluctuation and/or Abnormalities

Held for Use
The DON reported an increase of $22,641,251 thousand, 83 percent, in Operating Materials & Supplies (OM&S), Held for Use in FY 2003 when compared with FY 2002. The majority of the increase resulted from the implementing the new accounting standard SFFAS No. 23 "Eliminating the Category of National Defense Property, Plant, and Equipment." The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. The related implementation of SFFAS No. 23 also can be found in NOTE: 10 under equipment. Resulting from implementing this new accounting standard was a reclassification of conventional missiles and torpedoes from Military Equipment to OM&S. This fact resulted in reporting a value of $22,687,045 thousand for tactical missiles and torpedoes in FY 2003 and therefore, an increase of OM&S.

The Office of the Under Secretary of Defense (Comproller) (OUSD(C)) memorandum of July 6, 2001 adoped Moving Average Cost (MAC) as the approved valuation method for valuing Held for Use, Held for Repair, and Excess, Obsolete and Unserviceable categories of OM&S. OUSD(C) memorandum of 12 August 12, 2002 required that beginnning with FY 2002, the Department would no longer use the Supply System Inventory Report (SSIR) as the basis for its financial presentation but that the reporting categories will be based upon condition codes. The DON commands had been reporting Held for Use, Held for Repair, and Excess, obsolete and Unserviceable at net value. Beginning with FY 2002, to implement the OUSD(C) memoranda, DON required the major commands to report the gross value with an allowance account for Held for Use, Held for Repair, and Excess, Obsolete and Unserviceable, not the net value. When the financial records were adjusted for this process change at the consolidated DON level, an error was made resulting in a duplicate adjustment at the consolidated DON level for the Held for Use, Held for Repair, and Excess, Obsolete and Unserviceable categories of OM&S. For Held for Use as a result of this error in the amount of $263,046 thousand in of 2002 was understated. The error was discovered and corrected in FY 2003.

Also contributing to the fluctuation in Held for Use are the following: $126 million increase in Material and On-hand Inventory at the Fleet Hospitals; $101 million increase in reporting from the Real-Time Reutilization Asset Management (RRAM) is due to additional DON activities and correcting error found in FY 2002 reporting. The total of the increase is offset by the decrease of $489 million in Sponsored Owned Materials (SOM) transferred out due to Operation IRAQI Freedom and correcting deficiencies in converting to the SIMs System.

Held for Repair
The DON reported a decrease of $1,554,642 thousand, 30 percent, in OM&S, Held for Repair in FY 2003 when compared with FY 2002. Held for Repair was overstated by $3,392,371 thousand in FY 2002 because of the error described above. The error was corrected in FY 2003. The total of the decrease is offset by the increase of $1,824,457 thousand due to the implementation of the OUSD(C) policy for accounting for "Excess, Obsolete, and Unserviceable (EOU) OM&S." This increase recognized the value of OM&S that previously was included in EOU.

Excess, Obsolete, and Unserviceable (EOU)
The DON reported a decrease of $ 478,570 thousand, 100 percent, in OM&S, EOU in FY 2003 when compared with FY 2002. EOU was overstated by $478,570 thousand in FY 2002 because of the error described under Held for Use. The error was corrected in FY 2003.

Other Information Related to Operating Material and Supplies, Net

General Composition of Operating Materials and Supplies (OM&S)
OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines.

The general composition of OM&S is as follows:

(Amounts in thousands)	September 30, 2003
Ammunition and Munitions	$31,978,960
Appropriation Purchase Account (APA) Principal End Item	8,114,346
Sponsor Owned Material	10,476,114
APA Secondary Inventory	1,178,226
Real-time Reutilization Asset Management (RRAM)	1,472,773
Other	391,215
Total	$53,611,634

Balances
In addition to the account balances shown in Table 9.B., the Statement of Federal Financial Accounting Standards (SFFAS) No. 3 "Accounting For Inventory and Related Property" requires disclosure of the amount of OM&S held for "Future Use." This information is not captured by current OM&S systems which were designed for material management rather than accounting. However, the DON estimates that $ 12,512,547 thousand of the OM&S Held for Use will be used more than 24 months after the end of FY 2003.

Decision Criteria For Identifying The Category To Which Operating Materials And Supplies Are Assigned
In order to standardize reporting of the categories Held for Use, Held for Repair, and Excess, Obsolete, Unserviceable, DON implemented the Under Secretary of Defense (Comptroller) (USD(C)) condition code crosswalk as defined in the memorandum "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies" dated 12 August 2002. In addition, On 15 September 2002, USD(C) amended the condition code crosswalk to include code "V" in the Excess, Obsolete, Unserviceable category. OM&S was reported as follows:

OM&S Category	Condition Codes
Held for Use	A, B, C, D
Held for Repair	E, F, G, J, K, L, M, N, R
Excess,Obsolete, Unserviceable	P, H, S, V

Valuation Method for OM&S
In July, 2001, the OUSD(C) issued a memo requiring MAC as the approved valuation method for Inventory Held for Sale and Operating Materials and Supplies. " Each Military Department and Defense Agency responsible for material amounts of inventory or operating materials and supplies shall implement the moving average cost valuation method as systems are renovated or replaced." The DON is participating in the DoD Business Management Modernization Program that is currently reviewing and designing the Business Enterprise Architecture (BEA). The BEA provides for a master plan that includes guidance on transition plan strategy concepts, considerations, processes, and principles. MAC will be implemented as systems are renovated or replaced. Until then, the DON continues to value the OM&S using different valuation methodologies such as standard purchase price or actual cost.

Government Furnished Material (GFM) and Contractor Acquired Material (CAM)
Generally, the value of the DON's GFM and CAM in the hands of contractors is not included in the OM&S values reported above. DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in other existing logistics systems.

Other Disclosures

Ammunition and Munitions
Ammunition and Munitions are maintained and valued in The Conventional Ammunition Integrated Management System (CAIMS). The DON has begun the analysis and cost benefit identification of conforming CAIMS to Federal Accounting Standards. The amount reported for Ammunition and Munitions includes $22,687,045 thousand of tactical missiles and torpedoes that were previously reported as Military Equipment.

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

Sponsor Owned Material (SOM)
SOM is defined as "programmatic material required to support Program Manager (PM) mission requirements for production, life cycle maintenance, and installation of systems and equipment consistent with the mission Charter. The material usage may involve, but is not limited to: item fabrication, assembly, testing, manufacture, development, repair, or research and development (R&D)."

Real-time Reutilization Asset Management (RRAM)
This material is considered excess to the owner, but may not be excess to the Navy. Standard price is used to value all stock-numbered items. Part-numbered items are valued by best available information.

Other Operating Material & Supplies
Other OM&S totaled $391,215 thousand as of September 30, 2003. This consists primarily of $340,390 thousand in Fleet Hospitals and War Reserves, $50,825 thousand material in the possession of the US Coast Guard.

Reference
See Note Disclosure 1.M. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

For regulatory discussion on OM&S, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 101107.

Note 9.C. Stockpile Materials, Net
Not Applicable.

Note 10. General Property, Plant, and Equipment (PP&E) (Net)

As of September 30,	2003					2002
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
(Amounts in thousands)						
1. Major Asset Classes:						
A. Land	N/A	N/A	$ 603,961	N/A	$ 603,961	$ 645,924
B. Buildings, Structures, and Facilities	S/L	20 - 40	34,086,371	$ (13,078,647)	21,007,724	20,250,075
C. Leasehold Improvements	S/L	lease term	0	0	0	0
D. Software	S/L	2-5 Or 10	1,058	(635)	423	635
E. Equipment	S/L	5 Or 10	417,852,336	(284,612,995)	133,239,341	844,791
F. Assets Under Capital Lease [1]	S/L	lease term	206	(60)	146	910
G. Construction-in-Progress	N/A	N/A	3,555,855	N/A	3,555,855	4,367,102
H. Other			0	0	0	0
I. Total General PP&E			$ 456,099,787	$ (297,692,337)	$ 158,407,450	$ 26,109,437

[1] Note 15.B for additional information on Capital Leases

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

2. Information Related to General PP&E, Net

Fluctuation and/or Abnormalities

Equipment
The DON reported an increase of $ 132,394,550 thousand, 15,672 percent, in Equipment in FY 2003 when compared with FY 2002. The majority of the increase resulted from the implementation of the new accounting standard SFFAS No. 23 "Eliminating the Category of National Defense Property, Plant, and Equipment." The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. The DON reported Net Book Value of $132,660,000 thousand for military equipment in FY 2003. See Military Equipment below for detail disclosure.

Construction-In-Process (CIP)
The DON reported a decrease of $811,247 thousand,19 percent, in CIP in FY 2003 when compared with FY 2002. The decrease is the implementation of the "automatic transfer to user" resulted better tracking the transfer-out information.

Assets Under Capital Lease
The DON reported a decrease of $764 thousand, 84 percent, in Assets Under Capital Lease in FY 2003 when compared with FY 2002. The decrease is due to the expiration of leases.

Software
The DON reported a decrease of $212 thousand, 33 percent, Net Book Value in Software in FY 2003 when compared with FY 2002. The decrease in the Net Book Value in Software is due to the depreciation expenses recorded with no further acquisition in FY 2003.

Other Information Related to General PP&E, Net

Military Equipment.
The Federal Accounting Standards Advisory Board issued the Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, in May 2003. This standard, which is effective for accounting periods beginning after September 30, 2002, establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

The Department has determined that it is not practical at this time to accumulate from internal records the information necessary to value military equipment in accordance with generally accepted accounting principles, because the Department is currently working to revise its accounting processes and systems to support the informational needs of management and compliance with generally accepted accounting principles. In the interim, the Department will base the value of military equipment for financial statement presentation purposes on data provided by the Bureau of Economic Analysis (BEA), Department of Commerce.

The data provided by BEA consist of investment and net book value data for 84 groups of equipment such as aircraft, ships and combat vehicles. BEA uses Department budget data for equipment acquisitions and actual quantities of equipment items delivered to calculate the Department's annual investment in equipment, after recognizing any equipment transfers or war losses. The Department adjusted BEA data to eliminate equipment items that are not accounted for as military equipment, such as spares, munitions, and inventory items, which are accounted for and reported as Inventory and Related Property. For the DON, the BEA analysis provided for an Acquisition value of $415,310,000 thousand for military equipment, less an Accumulated Depreciation value of $282,650,000 thousand giving a Net Book Value of $132,660,000 thousand for military equipment.

Property in the Possession of Contractors.
The value of the DON's General PP&E real property in the possession of contractors is included in the values reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E above the DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. Per the DoD FMR Volume 6B Chapter 10, DON is not supplementing General PP&E information with values from the Defense Contract Management Agency's CPMS (DD Form 1662) database. In accordance with an approved strategy with OMB, the GAO and the Inspector General, DoD, the DoD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with Federal GAAP.

Other Disclosures

Real Property
The Internet Naval Facility Asset Database Store (iNFADS) is used to derive real property values for financial reporting purposes.

Leasehold Improvements
No leasehold improvements are reported for FY 2003, because the DON's real property system does not track leasehold improvements as a separate component of a building's total value. However, the DON is in the process of surveying commands to determine the value of leasehold improvements.

Software
To ensure that the costs associated with Internal Use Software are correctly recognized and reported, the DON uses the Defense Property Accountability System (DPAS) to capture this information.

Construction-in-Progress (CIP)
CIP balances were obtained from the Facilities Information System (FIS).

Preponderant Use
Per the DoD FMR, Volume 4, Chapter 6, legal ownership is not always the determinant factor when establishing which DoD Component recognizes a particular General PP&E asset for accounting and reporting purposes. If the following four criteria are met, the preponderant user should report the property regardless of legal ownership or funding:

The asset embodies a probable future benefit;
The DoD Component that reports the asset obtains the benefit and controls access to the benefit inherent in the asset;
The transaction or event giving the Component the right to, and control over, the benefit has already occurred; and
The predominantly used assets, taken as a whole, are material to the Component's financial statements.

During the course of FY 2003, DON continued to identify properties whose preponderant users are other DoD Components. Until the Department is able to reconcile with the DoD Components the listing of properties and values, the DON will disclosure in the note. Those entities utilizing material amounts of DON owned property are as follows (dollar values include both acquisition value and improvements meeting the capitalization threshold):

(Amounts in thousands)	**FY 2003**
Defense Commissary Agency (DeCA)	$ 50,411,967
DoD Schools	39,471,583
Defense Logistics Agency (DLA)	20,621,503

<u>Reference</u>
See Note Disclosure 1.N. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing General PP&E.

For regulatory discussion on General PP&E, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1012.

Note 10.A. Assets Under Capital Lease

As of September 30, (Amounts in thousands)	2003	2002
1. Entity as Lessee, Assets Under Capital Lease:		
A. Land and Buildings	$ 0	$ 0
B. Equipment	206	1,116
C. Other	0	0
D. Accumulated Amortization	(60)	(206)
E. Total Capital Leases	$ 146	$ 910

2. Description of Lease Arrangements:

Leased assets consist primarily of personal property reported via the DPAS system. Disclosures pertaining to future payments due are provided at Note 15.

3. Other Information Related to Assets Under Capital Lease

Fluctuation and/or Abnormalities
The DON reported a decrease of $910 thousand, 82 percent, in Equipment Leases and $146 thousand, 71 percent, in the Accumulated Amortization in FY 2003 when compared with FY 2002. The decrease is due to the expiration of the leases in FY 2003.

Reference
See Note Disclosure 1.Q. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Leases.

Note 11. Liabilities Not Covered and Covered by Budgetary Resources

As of September 30, (Amounts in thousands)	2003 Covered by Budgetary Resources	2003 Not Covered by Budgetary Resources	2003 Total	2002 Not Covered by Budgetary Resources
1. Intra-governmental Liabilities:				
A. Accounts Payable	$ 1,035,033	$ 0	$ 1,035,033	$ 2,396
B. Debt	0	0	0	127
C. Environmental Liabilities	0	0	0	0
D. Other	554,865	3,305,048	3,859,913	3,024,434
E. Total Intra-governmental Liabilities	$ 1,589,898	$ 3,305,048	$ 4,894,946	$ 3,026,957
2. Non-Federal Liabilities:				
A. Accounts Payable	$ 1,742,522	$ 0	$ 1,742,522	$ 0
B. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	0	1,589,971	1,589,971	1,546,375
C. Environmental Liabilities	0	15,614,424	15,614,424	15,469,073
D. Loan Guarantee Liability	0	0	0	0
E. Other Liabilities	487,621	3,298,341	3,785,962	3,078,597
F. Total Non-Federal Liabilities	$ 2,230,143	$ 20,502,736	$ 22,732,879	$ 20,094,045
3. Total Liabilities:	$ 3,820,041	$ 23,807,784	$ 27,627,825	$ 23,121,002

4. Other Information:

Fluctuation and/or Abnormalities

An explanation of fluctuations and abnormalities for a particular line is included in the specific note for that asset. See notes 12-17.

Definitions

- Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date.
- Liabilities Covered by Budgetary Resources are those that are incurred by the reporting entity which are covered by realized budget 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.
- Available budgetary resources include:
  (1) new budget authority,
  (2) spending authority from offsetting collections (credited to an appropriation or fund account),
  (3) recoveries of unexpired budget authority through downward adjustments of prior year obligations,
  (4) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and
  (5) 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 OMB without further action by the Congress or without a contingency first having to be met.

Other Disclosures Related to Liabilities Not Covered by Budgetary Resources

Intra-governmental Liabilties – Other (Not covered by Budgetary Resources) includes the following:

(Amounts in thousands)

FECA	$562,106
Unemployment	49,390
Judgment	49,157
DOD Education Trust	2,228
Liabilities to Treasury	2,642,167
Total	$3,305,048

Judgment Fund
During FY 2003, the DON made substantial progress in identifying and resolving Judgment Fund liabilities. Amounts recorded in the DON General Fund Judgment Fund include any and all amounts that are also applicable to the Navy Working Capital Fund. This methodology is necessary as current accounting systems cannot distinguish between the two funds. Reporting the Judgment Fund is in compliance with OUSD(C) guidance to resolve any outstanding debt due to the Department of Treasury. The DON is in the process of working with the appropriate Management Commands to obtain documentation that supports the amounts that have been remitted to Department of Treasury, or provide the necessary funding to liquidate the liabilities. DON is working with the Department of Treasury to validate the amounts recorded in this account. On September 30, 2003, the DON reported $49,157 thousand as the outstanding Judgment Fund liability. Of this amount, $49,153 thousand is attributed to Navy and $4 thousand is attributed to Marine Corps.

Liability to Treasury
Unliquidated progress payments and associated accrued interest receivables for contractor debt is reported as an unfunded liability to Department of the Treasury. Collections on this debt will be due and payable to Treasury as the appropriations are in a cancelled status. See Note 5 for further disclosure.

Nonfederal Liabilities – Other (Not covered by Budgetary Resources) includes the following

(Amounts in thousands):

Annual Leave	$2,269,191
Capital Lease Liabilities	146
Accounts Payable – Cancelled Appropriations	23,238
Military Equipment (Non-nuclear Nonenvironmental Disposal Liabilities)	574,916
Disposal Liabilities for Excess/Obsolete Structures	324,270
Contract Incentive	106,580
Total	$3,298,341

Note Reference
For additional line item discussion, see:
- Note 8, Direct Loans and/or Loan Guarantee Programs
- Note 12, Accounts Payable
- Note 13, Debt
- Note 14, Environmental Restoration Liabilities, and Environmental Disposal Liabilities
- Note 15, Other Liabilities
- Note 16, Commitments and Contingencies
- Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities.

NOTE 12. ACCOUNTS PAYABLE

As of September 30,	2003			2002
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intra-governmental Payables:	$ 1,035,033	N/A	$ 1,035,033	$ 748,278
2. Non-Federal Payables (to the Public):	$ 1,742,522	$ 0	$ 1,742,522	$ 1,510,329
3. Total	$ 2,777,555	$ 0	$ 2,777,555	$ 2,258,607

4. Other Information:

Fluctuation and/or Abnormalities
Intra-governmental payable increased $286,755 thousand, 38 percent when compared with FY 2002. Payables with Other Defense Organizations Working Capital Funds increased $251,939 thousand from FY 2002. Payable with Navy Working Capital Fund increased $71,752 thousand from the FY 2002 amount. A decrease of $25,871 thousand in the Other Defense Organizations General Funds, a $7,006 thousand decrease in Air Force General Funds and a decrease of $5,528 thousand in Army General Fund offset these increases in payables. The varying needs and execution requirements of the DON, including Operation Iraqi Freedom and subsequent events, generally cause fluctuations in the intra-governmental payables. Additionally, timing differences and buyer side trading partner identification problems that are inherent in DoD accounting systems affect the intra-governmental elimination process. Schedule Part B of the Required Supplementary Information of this report identifies DON's trading partners for FY 2003.

For Nonfederal Accounts Payable in FY 2003 when compared with FY 2002, DON reported an increase of $232,193 thousand, 15 percent. Effecting this increase were Military Personnel payables increasing by $470,801 thousand along with Operations and Maintenance in the amount of $192,133 thousand. A $197,133 thousand in Procurement non-federal payables and $133,386 thousand in Military Construction and Family Housing offset these increases. Generally, the overall increase in DON's nonfederal payables can be attributed to the higher level of funding and budget execution.

Definitions
Intra-governmental Accounts Payable consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Interest, penalties and administrative fees are not applicable to intra-governmental payables.

Non-Federal Payables (to the Public) are payments to nonfederal government entities.

Undistributed Disbursements.

Undistributed disbursements are the difference between disbursements/collections recorded at the detailed level to a specific obligation, payable, or receivable in the activity field records versus those reported by the U.S. Treasury via the reconciled DD 1329 and DD1400. This should agree with the undistributed reported on accounting reports (SF 133/ (M) 1002). In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records.

Intra-governmental Eliminations

For the majority of intra-agency sales the DON's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the DON was unable to reconcile intra-governmental accounts payable to the related intra-governmental accounts receivable that generated the payable.

The DoD summary level seller accounts receivables were compared to the DON's accounts payable. An adjustment was posted to the DON'S accounts payable based on the comparison with the accounts receivable of the DoD Components providing goods and services to the DON.

DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intra-governmental transactions is so large that after-the-fact reconciliation can not be accomplished with the existing or foreseeable resources.

Other Disclosures

Abnormal Account Balances

Abnormal Accounts Payable balances may occur because 1) the DON does not always record Accounts Payable upon receipt and acceptance of goods and services; 2) the application of undistributed disbursements; and 3) as a result of the intra-governmental transaction elimination process. Per DoDFMR Vol. 6B, Ch. 13, when an abnormal balance is created, an adjustment to Accounts Payable and expenses should be made accordingly to recognize the shortfall.

For Intra-governmental elimination, adjustments are recorded at the appropriation level, to bring the DON's intra-governmental accounts into agreement with its trading partners' intragovernrmental accounts. These elimination process adjustments may also result in abnormal accounts payable and accounts receivable.

The DON has initiated the development of an Accounts Payable Implementation Strategy to improve the recording and reporting of accounts payable. The strategy addresses the overall the DON approach to recording accounts payable, including accounts payable from commercial and intra-governmental sources. Development of the implementation strategy is in its final stages and includes several recommendations for improvements. These address, for example, the timely recording of accounts payable transactions, the proper classification of accounts payable between the government and the public, the identification of intra-governmental trading partners and related transactions, and the support of end-of-period adjusting entries for undistributed disbursements and intra-governmental eliminations.

Reference

See Note Disclosure 1.G. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing accounting for Intra-governmental Activities.

NOTE 13. DEBT

As of September 30,	2003			2002
	Beginning Balance	Net Borrowings	Ending Balance	Ending Balance
(Amounts in thousands)				
1. Public Debt:				
A. Held by Government Accounts	N/A	N/A	N/A	N/A
B. Held by the Public	N/A	N/A	N/A	N/A
C. Total Public Debt	N/A	N/A	N/A	N/A
2. Agency Debt:				
A. Debt to the Treasury	$ 0	$ 0	$ 0	$ 0
B. Debt to the Federal Financing Bank	0	0	0	0
C. Debt to Other Federal Agencies	0	0	0	127
D. Total Agency Debt	$ 0	$ 0	$ 0	$ 127
3. Total Debt:	$ 0	$ 0	$ 0	$ 127
4. Classification of Debt:				
A. Intra-governmental Debt			$ 0	$ 127
B. Non-Federal Debt			N/A	N/A
C. Total Debt			$ 0	$ 127

5. Other Information Related to Debt

Fluctuation and/or Abnormalities
The DON reported a decrease of $127 thousand, 100 percent, in Debt to Other Federal Agencies in FY 2003 when compared with FY 2002 resulting in no amount for Debt to other Federal Agencies being reported. This change is due to the interest payable from DON's contribution to the Education Benefit Trust Fund, which is part of the DoD Military Trust Fund, being moved from the USSGL account 2140, Accrued Interest Payable, to USSGL account 2290, Other Unfunded Employment Related Liability. Therefore, the interest payable from the DON's contribution to the Education Benefit Trust Fund is no longer reported on the Debt to Other Agencies line.

Reference
See Note Disclosure 1.G. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Accounting for Intra-governmental Activities, Public Debt.

For regulatory discussion on Debt, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1015.

NOTE 14. ENVIRONMENTAL LIABILITIES

As of September 30,	2003			2002
	Current Liability	Noncurrent Liability	Total	Total
(Amounts in thousands)				
1. Environmental Liabilities - Non Federal				
A. Accrued Environmental Restoration (DERP funded) Costs:				
1. Active Installations--Environmental Restoration (ER)	$ 516,113	$ 2,616,014	$ 3,132,127	$ 3,520,838
2. Active Installations--ER for Closed Ranges	14,288	326,978	341,266	349,975
3. Formerly Used Defense Sites (FUDS) – ER	0	0	0	0
4. FUDS--ER for Transferred Ranges	0	0	0	0
B. Other Accrued Environmental Costs (Non-DERP funds)				
1. Active Installations--Environmental Corrective Action	0	0	0	0
2. Active Installations—Environmental Closure Requirements	0	0	0	0
3. Active Installations--Environ.Response at Active Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. BRAC Installations--Environmental Restoration (ER)	606,278	549,668	1,155,946	1,293,311
2. BRAC Installations--ER for Transferring Ranges	4,707	10,844	15,551	29,896
3. BRAC Installations--Environmental Corrective Action	0	0	0	0
4. Other	0	0	0	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	5,565,000	5,565,000	4,890,000
2. Nuclear Powered Submarines	0	4,888,900	4,888,900	4,888,900
3. Other Nuclear Powered Ships	0	269,100	269,100	269,100
4. Other National Defense Weapons Systems	4,729	241,805	246,534	227,053
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	0	0	0
E. Total Nonfederal Environmental Liabilities:	$ 1,146,115	$ 14,468,309	$ 15,614,424	$ 15,469,073
2. Total Environmental Liabilities:	$ 1,146,115	$ 14,468,309	$ 15,614,424	$ 15,469,073

3. Information Related to Environmental Liabilities:

Fluctuation and/or Abnormalities

Accrued Environmental Restoration – The DON reported a decrease of $388,711 thousand, 11 percent, for Accrued Environmental Restoration at active installations when compared to FY 2002. The decrease is a result of adjusted predictions using more conservative estimates that approximate the expected rate of execution.

BRAC Installations – Environmental Restoration (ER) and ER for Transferring Ranges. The DON reported a decrease of $ 137,365 thousand, 11 percent and $14,345 thousand, 48 percent, for BRAC-ER and ER for Transferring Ranges, respectively in FY 2003 when compared to FY 2002. The decrease is a result of adjusted predictions using more conservative estimates that approximate the expected rate of execution.

DON reported an increase of $675,000 thousand, 14 percent, in Nuclear Powered Aircraft Carriers in FY 2003 compared with FY 2002. The increase in this area is a result of adding the environmental liability of an aircraft carrier, the Ronald Reagan, and an adjustment for inflation.

Other Information Related to Environmental Liabilities

Environmental Restoration (DERP Funded) Cost Liabilities: For FY 2003, the DON estimated and reported $3,473,393 thousand for environmental restoration liabilities. This amount is comprised of $ 3,132,127 thousand in Active Installations - Environmental Restoration (ER) liabilities and $ 341,266 thousand in Active Installations – ER for Closed Ranges liabilities, which represents Unexploded Ordnance Cost (UXO) related to twelve sites. 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 plans to support this requirement and continue validating its range inventory and pursuing the process of obtaining valid cost estimates for each range.

Other Accrued Environmental Costs (Non-DERP funds): The DON developed guidance for the DON Major Commands to use as they begin to identify site data and develop estimates for the DON’s “ongoing” operations. The DON continued review of program areas such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retrofill, and/or disposal of PCB transformers, underground storage tank remedial investigation and closure. For these areas the DON has identified an estimated total potential long-term liability of $21,063 thousand with the largest item being underground storage tank corrective action. In addition to cleanup costs associated with ongoing operations, the Kaho’Olawe Island Trust Fund provides for cleanup of Kaho’Olawe Island. Congress initially set a funding limit of $400,000 thousand with annual execution of $25,000 thousand. Further investigation is needed prior to recognizing an estimate on the financial statements for cleanup of Kaho’Olawe Island.

Base Realignment and Closure (BRAC): For FY 2003, the DON estimated and reported $ 1,171,497 thousand for BRAC funded environmental restoration liabilities. This amount includes $ 1,155,946 thousand for environmental restoration (ER) and $ 15,551 thousand for transferring ranges. It includes military munitions, chemical residues from military munitions, and munitions scrap at locations on or associated with a military range on a BRAC installation.

Environmental Disposal for Weapons Systems Programs: The DON reported an environmental disposal liability for Weapons Systems Programs of $ 10,969,534 thousand FY 2003. This amount includes nuclear powered aircraft carriers of $ 5,565,000 thousand, nuclear powered submarines of $ 4,888,900 thousand, other nuclear powered ships of $269,100 thousand and other national defense weapons systems of $246,534 thousand. The liability amount associated with nuclear powered submarines and nuclear powered ships did not change from FY 2002 to FY 2003.

Methodology Used to Estimate Environmental Liabilities

Accrued Environmental Restoration (DERP Funded) Costs:

Accrued Environmental Restoration Activity (ER): Accrued restoration (cleanup) liabilities represent the cost to correct past environmental problems that are funded under the Defense Environmental Restoration Program in accordance with “Management Guidance for the DERP,” and “Accrued Environmental Restoration (Cleanup) Liabilities,” Chapter 14 of Volume 4 of the DoD FMR. These liabilities relate to PP&E, including acquired land and Stewardship Land, as those major asset categories are described in Chapter 6 of Volume 4 of the DoD FMR. Environmental restoration activities may be conducted at operating installations, at FUDS, 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 the DON’s cost-to-complete (CTC) module of the DON Normalization of Data System (NORM). Certification of the CTC module was completed early in FY 2002. Such cost estimates are based on the current technology available.

Site inventory and estimated cost data prepared for the DERP report to the Congress was used by the DON as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services). 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 Department of the Navy's Environmental Restoration (ER,N) Program includes 3,668 clean-up sites while those installations covered by Base Realignment and Closure (BRAC) funding includes 1,020 clean-up sites.

Active Installations – Environmental Restoration For Closed Ranges: This represents the environmental liabilities associated with the identification, investigation and removal and remedial actions to address environmental contamination at ranges that are closed or will be 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 cost models validated in accordance with DoD Instruction 5000.61. Total liabilities (cost-to-complete) are not estimated until there is sufficient site specific data available to estimate the total liability. Beginning in FY 2001, the Department began an inventory of closed ranges and transferring ranges under the Military Munitions Response Program (MMRP) or UXO program. The inventory was completed September 2002 and contains 196 closed ranges at active installations and 16 transferring ranges at BRAC sites.

Information regarding changes

Survey data of the Department of the Navy Environmental Restoration Program cost estimate changes for sites that had over 10 percent change or 500 thousand indicates diverse reasons for change in estimates. Multiple reasons may apply both as plus-ups and deducts at any site. The reasons for changes are estimation changes (26 percent), regulatory changes (60 percent), and technical changes (15 percent). Reasons for changes in estimation are as follows: cost-to-complete (CTC) overlooked or previously unknown, better site characterization with sampling, cost avoidance rerun CTC, re-estimation based on different assumptions and/or escalation, and re-estimation of costs based on lessons learned. Reasons for changes in the area of regulatory are as follows: addition of range rule/munitions requirements, additional or extended long-term monitoring requirements or 5 year reviews, no further action agreement with regulator, and risk based corrective action. Reasons for changes in the area of technical are as follows: additional contamination level reduction with sampling, additional or extended remedial action operation, additional sites and incomplete site data, and technical solution changed.

Reference

The following is a summary of significant laws that affect the Department's conduct of environmental policy and regulations.

The National Environmental Policy Act (NEPA) of 1970 requires the Department to consider the environmental impacts of proposed actions in the decision making process. Per DON regulations, the action proponent will determine the level or amount of NEPA documentation required. The Resource Conservation and Recovery Act (RCRA) of 1976 as amended by the Hazardous and Solid Waste Amendments of 1984 (HSWA), was the first comprehensive federal effort to deal with safe disposal of all types of hazardous wastes, and provides for "cradle to grave" tracking of hazardous wastes. Permits are required for treatment, storage or disposal. Requirements for underground storage tanks (USTs) are also contained in RCRA.

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), commonly referred to as the Superfund, provided for Federal agencies authority to response to the release or the substantial threat of release of hazardous substances into the environment. CERCLA was amended several times one of which was the Community Environmental Response Facilitation Act of 1992. The Department must identify real property on each facility that is not contaminated and that offers the greatest opportunity for expedited reuse and redevelopment. When property is transferred, BRAC or non-BRAC, the Department is still responsible for any remediation or corrective action or any response action found to be necessary after the transfer.

For the nuclear powered aircraft carriers, submarines, and other nuclear ships, the following significant laws affect the Department's conduct of environmental policy and regulations. The Atomic Energy Act of 1954, as amended, assures the proper management of source, special nuclear, and byproduct material. As in all cases with nuclear power, the Department coordinates all actions with the Department of Energy. The Nuclear Waste Policy Act of 1982 required all owners and generators of high-level nuclear waste and spent nuclear fuel, to pay their respective shares of the full cost of the program. Finally, the Low Level Radioactive Waste Policy Amendments Act of 1986, provides for the safe and efficient management of low-level radioactive waste.

For additional information concerning applicable laws and regulations, methodology for assigning estimated cleanup costs, and description of sites and technology used for cleanup consult the the "FY 2002 Defense Environmental Restoration Program Annual Report to Congress."

For regulatory discussion on Environmental Liabilities, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1016.

Note 15.A. Other Liabilities

As of September 30, (Amounts in thousands)	2003 Current Liability	2003 Noncurrent Liability	2003 Total	2002 Total
1. Intra-governmental:				
A. Advances from Others	$ 0	$ 0	$ 0	$ 0
B. Deferred Credits	0	0	0	0
C. Deposit Funds and Suspense Account Liabilities	223,225	0	223,225	250,075
D. Resources Payable to Treasury	0	0	0	930
E. Disbursing Officer Cash	282,996	0	282,996	130,664
F. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accounts Payable-- Cancelled Appropriations	0	0	0	0
H. Judgement Fund Liabilities	49,157	0	49,157	105,842
I. FECA Reimbursement to the Department of Labor	248,250	313,855	562,105	566,145
J. Capital Lease Liability	0	0	0	0
K. Other Liabilities	2,740,858	1,572	2,742,430	2,435,847
L. Total Intra-governmental Other Liabilities	$ 3,544,486	$ 315,427	$ 3,859,913	$ 3,489,503
2. Non-Federal:				
A. Accrued Funded Payroll and Benefits	$ 394,706	$ 0	$ 394,706	$ 1,011,367
B. Advances from Others	0	0	0	1,135
C. Deferred Credits	0	0	0	0
D. Loan Guarantee Liability	0	0	0	0
E. Liability for Subsidy Related to Undisbursed Loans	0	0	0	0
F. Deposit Funds and Suspense Accounts	0	0	0	0
G. Temporary Early Retirement Authority	2,933	0	2,933	2,209
H. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	574,916	574,916	566,153
(2) Excess/Obsolete Structures	37,733	286,537	324,270	332,575
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
I. Accounts Payable--Cancelled Appropriations	23,238	0	23,238	68,833
J. Accrued Unfunded Annual Leave	2,269,191	0	2,269,191	2,031,961
K. Accrued Entitlement Benefits for Military Retirees and Survivors	0	0	0	0
L. Capital Lease Liability	146	0	146	910
M. Other Liabilities	124,982	71,580	196,562	170,344
N. Total Non-Federal Other Liabilities	$ 2,852,929	$ 933,033	$ 3,785,962	$ 4,185,487
3. Total Other Liabilities:	$ 6,397,415	$ 1,248,460	$ 7,645,875	$ 7,674,990

4. Other Information Related to Other Liabilities:

Fluctuation and/or Abnormalities

Intra-governmental Other Liabilities. The DON reported a decrease of $930 thousand, 100 percent, in Resources Payables To Treasury (line 1D) in FY 2003 when compared to FY 2002. The decrease is due to the reduction in Interest Payable to Treasury for Marine Corps. The DON also reported an increase of $152,332 thousand, 117 percent, in Disbursing Officer Cash (line 1E) in FY 2003 when compared to FY 2002. The increase is the result of deployment of Operation IRAQI Freedom. In addition, the DON reported a decrease of $56,685 thousand, 54 percent, in the Judgment Fund Liabilities (line 1H) in FY 2003. The decrease is due to the aggressive effort of the DON to reconcile and resolve claims under the Contract Dispute Act. The DON also reported an increase of $306,583 thousand, 13 percent, in Other Liabilities (line 1K) in FY 2003. The increase of $56,839 thousand is due to the interest from pending litigation.

Nonfederal Other Liabilities. The DON reported a decrease of $616,661 thousand, 61 percent in Accrued Funded Payroll and Benefits in FY 2003 when compared to FY 2002. The decrease is due to the timing difference between the end of the pay period and the calendar quarter end. There is also a decrease of $1,135 thousand, 100 percent, in Advances from Others in FY 2003 is due to unfilled custom orders with advance being filled/earned prior to September 30, 2003. Accounts Payable – Cancelled Appropriations decreased $45,595 thousand, 66 percent, in FY 2003 due to better management of Accounts Payable in the canceling years. The FY 98 canceling years are totally independent from the FY 97 canceling years. Capital Leases Liability decreased $764 thousand, 84 percent, is due to the expiration of leases.

Other Disclosures

Intra-governmental Other Liabilities

Judgment Fund (Line1.H)

The DON must reimburse the Department of the Treasury for payments made from the Judgment Fund on its behalf. These payments are a result of claims being resolved under the Contracts Dispute Act. Great strides have been made in reconciling and identifying the outstanding Judgment Fund Liability. Since the beginning of FY 2003, the DON has reduced the Judgment Fund from $105,842 thousand to $49,157 thousand as of September 30, 2003. However, per the Department of the Treasury's records the DON liability for the Judgement Fund as of September 30, 2003 was $64,439 thousand. In several cases a settlement agreement was entered into rather than a judgment rendered and therefore, the DON believes it has no legal authority to reimburse the Judgment Fund. This fact resulted in a $15,282 thousand difference between Treasury's and the DON's Judgment Fund balance.

Other Liabilities (Line 1.K.) includes the following:

(Amounts in thousands)	Total
Liability to Treasury & Others	$2,644,396
Unemployment	50,961
Employment Benefit	47,073
Total Intragovernmental Other Liabilities	**$2,742,430**

With respect to the major fiduciary balances, the DON must reconcile with the DOL and OPM. In FY 2003, the DON reported the following Intra-governmental Fiduciary liabilities: $562,106 thousand in FECA, $50,961 thousand in Unemployment, $47,073 thousand in Employment Benefit, and $49,157 thousand in Judgment Fund.

Nonfederal Other Liabilities

Nonenvironmental Disposal Liability Disclosure

The DON has agreed to recognize the nonenvironmental disposal liability for nuclear powered assets when the asset is initially placed in service. The nonenvironmental cost are included with the environmental disposal costs and reported in Note 14.

Excess/Obsolete Structures
Included in the reported amounts is the current cost basis estimates of disposing of, or demolishing, approximately $324,270 thousand worth of square feet of excess/obsolete structures at active installations, in accordance with disposal plans directed by Defense Reform Initiative Directive No. 36 Dated May 5, 1998. The expected completion date is FY 2003. This target includes both the Navy and the Marine Corps real property assets.

Other Liabilities (Line 2.M.) includes $89,982 thousand Contract Holdbacks and $106,580 thousand Contract Incentives.

Reference
See Note Disclosure 1.S. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Contingencies and Other Liabilities.

NOTE 15.B. CAPITAL LEASE LIABILITY

As of September 30,	2003				2002
	Asset Category				
(Amounts in thousands)	Land and Buildings	Equipment	Other	Total	Total
1. Future Payments Due:					
A. Fiscal Year 2004	$ 0	$ 146	$ 0	$ 146	$ 910
B. Fiscal Year 2005	0	0	0	0	0
C. Fiscal Year 2006	0	0	0	0	0
D. Fiscal Year 2007	0	0	0	0	0
E. Fiscal Year 2008	0	0	0	0	0
F. After 5 Years	0	0	0	0	0
G. Total Future Lease Payments Due	$ 0	$ 146	$ 0	$ 146	$ 910
H. Less: Imputed Interest Executory Costs	0	0	0	0	0
I. Net Capital Lease Liability	$ 0	$ 146	$ 0	$ 146	$ 910
2. Capital Lease Liabilities Covered by Budgetary Resources:				$ 146	$ 910
3. Capital Lease Liabilities Not Covered by Budgetary Resources:				$ 0	$ 0

4. Other Information Related to Capital Lease Liability

Fluctuation and/or Abnormalities
The DON reported $764 thousand, 84 percent, decrease in Capital Lease Liability in FY 2003 compared with FY 2002 is due to the expiration of leases.

Other Information Related to Capital Lease Liability
The liabilities associated with capital leases are captured in legacy systems and are often not recorded. The DON has recognized a liability equal to the net value of the assets (i.e. gross value less accumulated amortization). The resulting liability was recorded as a payment due in FY 2003. The proper breakout of future payments to appropriate years will be done when a process for capturing lease liabilities is implemented.

Reference
See Note Disclosure 1.Q. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Leases.

For regulatory discussion on Capital Lease Liability, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1017.

NOTE 16. COMMITMENTS AND CONTINGENCIES

Other Information Related to Commitments and Contingencies

For FY 2003, the DON is subject to various asserted claims. These claims are in various stages ranging from investigation to appeal. While remaining unresolved as of the close of FY 2003, prior experience affords the DON the ability to forecast the possible loss associated with the claims. It is to be noted that most claims are settled for less than the amount initially claimed, dismissed outright, or fail to materialize. As of September 30, 2003, contingent liabilities consist of an estimated $103,936 thousand resulting from contractual actions; and approximately $26,282 thousand for employee related actions; $5,517 thousand for civil litigation; $69,733 thousand for foreign tax; and $4,000 thousand for site closure costs. In addition to contingent liabilities, contractual commitments for cancelled appropriations consist of an estimated $9,892 thousand.

Category	$ in thousands
Contractual Actions	$ 103,936
Employee Related Actions	$ 26,282
Civil Litigation	$ 5,517
Foreign Tax	$ 69,733
Site Closure Costs	$ 4,000
Total	$ 209,468,087

In addition to contingent liabilities, contractual commitments for cancelled appropriations consist of an estimated $ 9,892 thousand.

Category	$ in thousands
Contractual Commitments	$ $9,892
Total	$ $9,982

Reference
See Note Disclosure 1.S. – Significant Accounting Policies for additional discussion on financial reporting requirements and DoD policies governing Contingencies and Other Liabilities.

For regulatory discussion on Commitment and Contingencies, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1018.

NOTE 17. MILITARY RETIREMENT BENEFITS AND OTHER EMPLOYMENT RELATED ACTUARIAL LIABILITIES

As of September 30, (Amount in Thousands)	2003				2002
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
1. Pension and Health Benefits:					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Benefits	$ 0		$ 0	$ 0	$ 0
2. Other					
A. FECA	$ 1,589,971		$ 0	$ 1,589,971	$ 1,546,375
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Educational Benefits Fund	0		0	0	0
D. Total Other	$ 1,589,971		$ 0	$ 1,589,971	$ 1,546,375
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,589,971		$ 0	$ 1,589,971	$ 1,546,375

4. Other Information Pertaining to Military Retirement Benefits and other Employment Related-Related Actuarial Liabilities:

Reporting of Military Retirement Benefits by the Military Retirement Fund (MRF). The portion of the military retirement benefits actual liability applicable to the DON is reported on the financial statements of MRF.

Reporting of Liability Pertaining to Military Health Benefits Compensation. Health benefits are funded centrally at the DoD level. As such, the portion of the health benefits actuarial liability that is applicable to DON is reported only on the DoD Agency-wide financial statements.

Federal Employees Compensation Act (FECA).
- Actuarial Cost Method Used:
- Assumptions:

Future Workers' Compensation

The DON's actuarial liability for workers' compensation benefits is developed by DOL and provided to DON at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. Interest rate assumptions utilized for discounting were as follows:

FY 2003
5 percent in Year 1
5 percent in Year 2 and thereafter

Inflation factors were applied to provide more specifically the effects on the liability for future workers' compensation benefits. Cost of living adjustments (COLAs) were used as a wage inflation factor and consumer price index medical (CPIMs) were used as medical inflation factors. These factors 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 charge back years (CBY) were as follows:

CBY	COLA	CPIM
2003	3 percent	4 percent
2004	3 percent	4 percent
2005+	3 percent	4 percent

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on two tests: (1) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual payments, and (2) a comparison of the ratio of the estimated liability to the actual payment of the beginning year calculated for the current projection to the liability-payment ratio calculated for the prior projection.

The estimate was allocated between General Fund and Navy Working Capital Fund using a percentage based on the number of civilian employees taken from the Navy Budget Tracking System. The following table details the numbers used in support of the allocation:

	Personnel	Allocation %
DON General Fund	103,318	53%
DON Working Capital Fund	91,704	47%
Total	195,022	100%

Voluntary Separation Incentive (VSI) Program. The Voluntary Separation Incentive (VSI) Fund (recorded on the books of the U.S. Treasury) is used to accumulate funds to finance, on an actuarially sound basis, the liabilities of the DoD incurred under this program. The VSI benefit is an annual annuity paid to members who have separated under this program, and is paid for a period of time equal to twice the members' years of service. These benefits are paid by the VSI fund, which receives contributions from the services from their military personnel accounts. Contributions amounts are determined by the DoD, Office of the Actuary in conjunction with the OUSD(C), based on a comparison of liabilities to assets.

DoD Education Benefits Fund. The DoD Education Benefits Fund is designed to accumulate funds for the educational programs described under Title 10 United States Code, section 2006. This program promotes the recruitment and retention of members for the All-Volunteer Forces program and the Total Force Concept of the Armed Forces and aids in the readjustment of members of the Armed Forces to civilian life after separation from military service.

Reference

For regulatory discussion on Military Retirement Benefits and Other Employee Related Actuarial Liabilities, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1019.

NOTE 18. UNEXPENDED APPROPRIATIONS

As of September 30, (Amounts in thousands)	2003		2002	
1. Unexpended Appropriations:				
A. Unobligated, Available	$	2,169,736	$	10,567,040
B. Unobligated, Unavailable		998,235		1,318,416
C. Unexpended Obligations		47,613,208		52,888,872
D. Total Unexpended Appropriations	$	50,781,179	$	64,774,328

Other Information Pertaining to Unexpended Appropriations:

Fluctuation and/or Abnormalities
The DON reported a decrease of $13,993,149 thousand, 22 percent, on Total Unexpended Appropriations in FY 2003 when compared with FY 2002. The decrease in Unobligated, Available and Unavailable and Unexpended Obligations is a result of improved program execution. The Unobligated, Available is subject to obligations in future years for those multi-year accounts and therefore, is still available for obligating.

NOTE 19.A. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Fluctuation and/or Abnormalities
The DON reported an increase of $8,589,165 thousand, 8 percent, in the Net Cost of Operations FY 2003 when compared to FY 2002. Effecting this increase was the implementation of the new accounting standard SFFAS No. 23 “Eliminating the Category of National Defense Property, Plant, and Equipment.” The standard requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. The DON reported Net Book Value of $132,660,000 thousand for military equipment and recorded current period depreciation expenses of $16,500,000 thousand in FY 2003.

Intra-governmental Gross Costs increased by $5,231,484 thousand, 17 percent, over FY 2002, and is coupled with an increase in Intra-governmental Earned Revenue of $1,977,035 thousand, 163 percent. Similarly, Gross Costs with the public increased $5,532,763 thousand, 7 percent, over FY 2002 and is coupled with an increase in Earned Revenue from the public of $198,047 thousand, 12 percent. The result was an overall increase in the Net Cost of operations of $8,589,165 thousand, 8 percent, which is driven by the increased level of the DON’s execution of program budgets. DON program costs showed the following major fluctuations from FY 2002: Military Personnel costs increased $6,439,690 thousand, 22 percent; Operations and Maintenance costs increased $7,899,491 thousand, 23 percent; RDT&E costs increased $1,822,672 thousand, 18 percent; while Procurement costs decreased $10,559,703 thousand, 38 percent over FY 2002 execution levels. Another factor represents $2,475,541 thousand in costs for trading partner difference which must be accrued on the DON’s book at the component level and are not identifiable to any one program.

Other Disclosures Related to the Statement of Net Cost
The Consolidated Statement of Net Cost in the federal government is unique because its principles are driven on understanding the net cost of programs and/or organizations that the federal government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

The amounts presented in the Statement of Net Cost (SoNC) are based on obligations and disbursements and therefore may not in all cases report actual accrued costs. The DON generally records transactions on a cash basis and not an accrual basis as is required by Federal GAAP. Therefore, the DON systems do not capture actual costs.

As such, information presented in the SoNC is based on budgetary obligations, disbursements, and collection transactions, as well as non-financial feeder systems; then adjusted to record known accruals for major items such as payroll expenses, accounts payable, and environmental liabilities.

NOTE 19.B. GROSS COST AND EARNED REVENUE BY BUDGET FUNCTIONAL CLASSIFICATION
Not Applicable.

NOTE 19.C. GROSS COST TO GENERATE INTRA-GOVERNMENTAL REVENUE AND EARNED REVENUE (TRANSACTIONS WITH OTHER FEDERAL—NON-DOD—ENTITIES) BY BUDGET FUNCTIONAL CLASSIFICATION
Not Applicable.

NOTE 19.D. IMPUTED EXPENSES

As of September 30, (Amount in thousands)	2003	2002
1. Civilian (e.g.,CSRS/FERS) Retirement	$ 231,585	$ 183,704
2. Civilian Health	232,822	235,713
3. Civilian Life Insurance	904	880
4. Military Retirement Pension	0	0
5. Military Retirement Health	0	0
6. Judgment Fund	44,408	104,997
7. Total Imputed Expenses	$ 509,719	$ 525,294

Other Information Related to Imputed Expenses

The DON financial statements have recognized an imputed expense for civilian employee pensions, life insurance, and health benefits in the Statement of Net Cost. Imputed expenses for employee benefits were calculated using cost factors provided by OPM applied against gross basic pay for all categories of civilian service employees. The gross basic pay amounts were extracted directly from the Defense Civilian Pay System (DCPS).

NOTE 19.E. BENEFIT PROGRAM EXPENSES
Not Applicable.

NOTE 19.F. EXCHANGE REVENUE
Disclosures Related to Exchange Revenue: None.

NOTE 19.G. AMOUNTS FOR FOREIGN MILITARY SALES (FMS) PROGRAM PROCUREMENTS FROM CONTRACTORS
Not Applicable.

Note 19.H. Stewardship Assets

Other Information Related to Stewardship Assets

Stewardship assets include Heritage Assets, Stewardship Land, Non-Federal Physical Property, and Investments in Research and Development. The current year cost of acquiring, constructing, improving, reconstructing, or renovating stewardship assets are included in the Statement of Net Cost.

Note 19.I. Intra-governmental Revenue and Expense

The majority of DON accounting systems do not capture trading partner data at the transaction level in a manner that facilities trading partner aggregations. Therefore, DON was unable to reconcile intra-governmental revenue balances with its trading partners. DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intra-governmental transactions is so large that after-the-fact reconciliation can not be accomplished with existing or foreseeable resources.

Note 20. Disclosures Related to the Statement of Changes in Net Position

As of September 30, (Amounts in thousands)	Cumulative Results of Operations 2003	Unexpended Appropriations 2003	Cumulative Results of Operations 2002	Unexpended Appropriations 2002
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance:				
A. Changes in Accounting Standards	$ 152,557,286	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	(27,802,492)	1,553,324
C. Other Prior Period Adjustments	0	0	0	0
D. Total Prior Period Adjustments	$ 152,557,286	$ 0	$ (27,802,492)	$ 1,553,324
2. Imputed Financing:				
A. Civilian CSRS/FERS Retirement	$ 231,585	$ 0	$ 183,704	$ 0
B. Civilian Health	232,822	0	235,713	0
C. Civilian Life Insurance	904	0	880	0
D. Military Retirement Pension	0	0	0	0
E. Military Retirement Health	0	0	0	0
F. Judgment Fund	44,408	0	104,997	0
G. Total Imputed Financing	$ 509,719	$ 0	$ 525,294	$ 0

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

The changes in accounting standards is a result of implementing the Statement of Federal Financial Accounting Standands No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment." Implementing this new standard resulted in a prior period adjust of $152,557,286 thousand that represents military equipment and recognizing conventional missiles and torpedoes as operating, materials, and supplies.

Other Disclosures

Imputed Financing
The DON financial statements have recognized an imputed financing source for civilian employee pensions, life insurance, and health benefits in the Statement of Net Cost. Imputed financing sources for employee benefits were calculated using cost factors provided by OPM applied against gross basic pay for all categories of civilian service employees. The gross basic pay amounts were extracted directly from the Defense Civilian Pay System (DCPS).

Judgment Fund
Treasury provided information related to amounts paid for Judgment Fund liabilities on behalf of the DON, which the DON may or may not be required to repay. Judgment Fund payments made out of the following Treasury appropriations do not require reimbursement, and therefore represent imputed financing to the DON: 20X1740, 20X1741, and 20X1742. Only those payments made from Treasury appropriation 20X1743 are required to be repaid by DON.

NOTE 21.A. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30, (Amounts in thousands)	2003	2002
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 64,855,940	$ 61,642,520
2. Available Borrowing and Contract Authority at the End of the Period	739	0

Information Related to the Statement of Budgetary Resources

The Net Amount of Budgetary Resources Obligated for Undelivered Orders on Note 21A is greater than Undelivered Orders (Line 14C) on the SBR. The reason for the variance is due to USSGL account 4802, Undelivered Orders-Paid, being reflected in Note 21 A but not mapped to the SBR line 14C.

The difference of $36,740 thousand between the SBR Appropriations Received when compared with the Statement of Change of Net Position Appropriations Received is due to the Trust Fund.

Other Disclosures

Obligations Incurred includes $124,497,950 thousand Direct Obligations and $8,079,881 thousand Reimbursable Obligations. Contract Authority of $739 thousand represents a line of credit established in the Naval Academy Gift and Museum Fund for museum renovation.

Due to accounting system deficiencies, intra-governmental transactions were not eliminated for the presentation of a Consolidated Statement of Budgetary Resources (SBR).

In FY 2003, DoD treated Foreign Military Sales (FMS) Trust Fund transactions as nonfederal, and are presented as such in the Balance Sheet (BS) and the Statement of Net Cost. Accounts Receivable and Revenues related to FMS are recognized in the SBR. Therefore, reconciling differences exist between the SBR and the BS. OUSD(C) Accounting Policy is currently researching the issue to determine the proper treatment of FMS Trust Fund transactions to ensure proper reporting.

Note 21.B. Disclosures Related to Problem Disbursements, In-transit Disbursements and Suspense/Budget Clearing Accounts

As of September 30, (Amounts in thousands)	2001	2002	2003	(Decrease)/Increase from 2002 to 2003
1. Total Problem Disbursements				
A. Absolute Unmatched Disbursements	$ 366,000	$ 352,000	$ 144,000	$ (208,000)
B. Negative Unliquidated Obligations	69,000	41,000	42,000	1,000
2. Total In-transit Disbursements, Net	$ 65,256	$ 51,551	$ (11,621)	$ (63,172)

3. Other Information Related to Problem Disbursements and In-transit Disbursement :

<u>Definitions</u>
Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign.

UMDs occur when payments do not match to a corresponding obligation in the accounting system.

NULOs occur when payments have a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments use available funds for valid receiving reports on delivered goods and services under valid contracts.

In-Transits represents the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity but not yet posted in an accounting system.

<u>Other Disclosures</u>

Unmatched Disbursements, Negative Unliquidated Obligations, and In-transit Disbursement, Net represent disbursements of the DON funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. For the most part, these payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

The elimination of both Problem Disbursements and In-transits is one of the highest financial management priorities of the OUSD(C). Problem Disbursements and In-transits represent a significant financial management concern since: (1) accuracy of accounting reports is affected; (2) availability of funds is more difficult to determine; and (3) the required research and resolution process becomes much more labor intensive as the age of the problem disbursements increase. As a result the DON has efforts underway to improve the systems and to resolve all previous problem disbursements and process all in-transit disbursements.

4. Suspense/Budget Clearing Accounts

As of September 30,	2001	2002	2003	(Decrease)/ Increase from 2002 to 2003
Account				
F3875	$ 43,344	$ 112,731	$ (262,678)	$ (375,409)
F3880	(1,749)	2,510	(3,631)	(6,141)
F3882	0	23,965	(4,172)	(28,137)
F3885	801,469	445,921	(412,370)	(858,291)
F3886	(1)	622	(2)	(624)
Total	$ 843,063	$ 585,749	$ (682,853)	$ (1,268,602)

5. Other Information Related to Suspense/Budget Clearing Accounts

The DON has made a concerted effort to reduce balances in the suspense and budget clearing accounts related to disbursements that are disclosed on line 4 of this note. Additionally, the DON is establishing policies and procedures to ensure accurate and consistent use of these accounts. The information presented indicates the significant reductions the DON has achieved in the various suspense/ budget clearing accounts. On September 30th of each fiscal year, all of the uncleared suspense/budget clearing account balances are reduced to zero (as required by the Department of the Treasury) by transferring the balances to proper appropriation accounts. On October 1st of the following year, the uncleared suspense/clearing account balances are only reestablished for transactions that were less than 60 days old at the end of the FY (excluding transactions dated before January 1, 2001).

The suspense accounts F3875/3885/3886 temporarily hold collections or disbursements until they can be assigned or identified to a valid appropriation. Each suspense account represents the source of transaction coming from, i.e. Disbursing Officer's (DO) suspense (F3875), Interfund/IPAC (F3885), and Payroll (TSP) (F3886) suspense. DFAS-CL has implemented several initiatives to improve the suspense clearing process and works with DOs to reduce suspense. Matching criteria are currently being developed that will automate the manual process now used to clear Interfund transactions from suspense. These initiatives should result in reduced suspense balances at year-end. The suspense F3880 represents the Treasury checks that have either been lost by the payee and need reissued or never cashed by the payee, cancelled by Treasury and require to be transferred to the original appropriation in accordance to the DoD FMR, Volume 5, Chapter 8. Account F3882 Uniformed Services Thrift Savings Plan was first established in FY 2002, so there will be not be any trend information for FY 2001 and prior.

Note 22. Disclosures Related to the Statement of Financing

Fluctuation and/or Abnormalities
When comparing Statement of Financing for FY 2003 to FY 2002, the variances are a result of report mapping changing from the old format in FY 2002 to the new format in FY 2003.

Budgetary data is not in agreement with proprietary expenses and assets capitalized. This fact causes a difference in net cost between the Statement of Net Cost and the Statement of Financing. Adjustments are posted to the Statement of Financing for these differences.

Other Disclosures

The increase of resources that finance the acquisition of assets is primarily due to the implementation of SFFAS No. 23 "Eliminating the Category of National Defense Property, Plant, and Equipment." Correspondingly, there is also an increase in the reported depreciation for the military equipment.

The Statement of Financing is presented as combined or combining statements rather than consolidated statements due to intra-governmental transactions not being eliminated. Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the "Adjustments" line on the Statement of Budgetary Resources), are not included in "Spending Authority From Offsetting Collections and Adjustments" line on the Statement of Budgetary Resources or on the Statement of Financing.

The Statement of Financing was expanded to further articulate and detail the relationship between new obligations from budgetary accounting and net cost of operation from proprietary accounting. Some items that were reported last year as a single line were subdivided to reflect its components. Several new line items were added to separately identify and further explain the use of resources to finance net obligations or net cost of operations. This change notes key differences between the net obligations and net cost of operations.

Note 23. Disclosures Related to the Statement of Custodial Activity

Not Applicable.

Note 24.A. Other Disclosures - Leases

Entity as Lessee – Operating Leases

As of September 30,	2003				2002
(Amounts in thousands)					
B. Future Payments Due:	Land and Buildings	Equipment	Other	Total	Total
Fiscal Year					
2004	$ 14,476	$ 4	$ 1,116	$ 15,596	$ 10,934
2005	15,381	93	0	15,474	9,220
2006	17,291	178	0	17,469	9,464
2007	17,355	204	0	17,559	9,619
2008	17,367	204	0	17,571	8,955
After 5 Years	0	0	0	0	0
Total Future Lease Payments Due	$ 81,870	$ 683	$ 1,116	$ 83,669	$ 48,192

Other Information Related to Entity as Lessee — Operating Leases

Fluctuations and/or Abnormalities
The DON reported an increase of $35,477 thousand, 74%, increase in Operating Leases Future Payment in FY 2003 when compared to FY 2002 is due to additional leases are reported by Commands in FY 2003.

Other Disclosures
The value for lease information is derived from the DON data collection process. This process only provides summary values and no details for each of the leases at this time.

Definitions
Lessee – A person or entity who receives the use and possession of leased property (e.g. real estate or equipment) from a lessor in exchange for a payment of funds.

Operating Lease - A lease which does not transfer substantially all the benefits and risk of ownership. Payments should be charged to expense over the lease term as it becomes payable.

Note 24.B. Other Disclosures

Not Applicable.

Department of the Navy

General Fund Supporting Consolidating/ Combining Statements

Department of Defense
Department of the Navy
CONSOLIDATING BALANCE SHEET
As of September 30, 2003 and 2002
($ in thousands)

	Navy	Marine Corps	Component Level
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ 73,421,996	$ 4,769,657	$ 0
Non-Entity Seized Iraqi Cash	0	0	0
Non-Entity - Other	223,225	0	0
Investments (Note 4)	9,801	0	0
Accounts Receivable (Note 5)	449,402	162,287	(29,669)
Other Assets (Note 6)	0	10,514	177,351
Total Intragovernmental Assets	$ 74,104,424	$ 4,942,458	$ 147,682
Cash and Other Monetary Assets (Note 7)	$ 281,053	$ 1,942	$ 0
Accounts Receivable (Note 5)	3,326,236	55,897	0
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property (Note 9)	53,097,159	514,475	0
General Property, Plant and Equipment (Note 10)	153,489,661	4,917,789	0
Investments (Note 4)	0	0	0
Other Assets (Note 6)	5,936,773	243,851	0
TOTAL ASSETS	$ 290,235,306	$ 10,676,412	$ 147,682
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ (1,723,694)	$ 88,156	$ 2,755,728
Debt (Note 13)	0	0	0
Environmental Liabilities (Note 14)	0	0	0
Other Liabilities (Note 15 & Note 16)	3,780,090	79,823	0
Total Intragovernmental Liabilities	$ 2,056,396	$ 167,979	$ 2,755,728
Accounts Payable (Note 12)	$ 600,797	$ 1,277,025	$ (135,300)
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,362,866	227,105	0
Environmental Liabilities (Note 14)	15,614,424	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	3,417,897	368,065	0
Debt Held by Public (Note 13)	0	0	0
TOTAL LIABILITIES	$ 23,052,380	$ 2,040,174	$ 2,620,428
NET POSITION			
Unexpended Appropriations (Note 18)	$ 49,436,482	$ 3,817,443	$ (2,472,746)
Cumulative Results of Operations	217,746,444	4,818,795	0
TOTAL NET POSITION	$ 267,182,926	$ 8,636,238	$ (2,472,746)
TOTAL LIABILITIES AND NET POSITION	$ 290,235,306	$ 10,676,412	$ 147,682

Department of Defense
Department of the Navy
CONSOLIDATING BALANCE SHEET
As of September 30, 2003 and 2002
($ in thousands)

	Combined Total	Eliminations	2003 Consolidated	2002 Consolidated
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	$ 78,191,653	$ 0	$ 78,191,653	$ 67,999,880
Non-Entity Seized Iraqi Cash	0	0	0	0
Non-Entity - Other	223,225	0	223,225	250,075
Investments (Note 4)	9,801	0	9,801	9,625
Accounts Receivable (Note 5)	582,020	85,157	496,863	742,467
Other Assets (Note 6)	187,865	0	187,865	67,081
Total Intragovernmental Assets	$ 79,194,564	$ 85,157	$ 79,109,407	$ 69,069,128
Cash and Other Monetary Assets (Note 7)	$ 282,995	$ 0	$ 282,995	$ 130,664
Accounts Receivable (Note 5)	3,382,133	0	3,382,133	2,799,887
Loans Receivable (Note 8)	0	0	0	0
Inventory and Related Property (Note 9)	53,611,634	0	53,611,634	33,003,595
General Property, Plant and Equipment (Note 10)	158,407,450	0	158,407,450	26,109,437
Investments (Note 4)	0	0	0	0
Other Assets (Note 6)	6,180,624	0	6,180,624	4,780,462
TOTAL ASSETS	$ 301,059,400	$ 85,157	$ 300,974,243	$ 135,893,173
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$ 1,120,190	$ 85,157	$ 1,035,033	$ 748,279
Debt (Note 13)	0	0	0	127
Environmental Liabilities (Note 14)	0	0	0	0
Other Liabilities (Note 15 & Note 16)	3,859,913	0	3,859,913	3,489,503
Total Intragovernmental Liabilities	$ 4,980,103	$ 85,157	$ 4,894,946	$ 4,237,909
Accounts Payable (Note 12)	$ 1,742,522	$ 0	$ 1,742,522	$ 1,510,329
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,589,971	0	1,589,971	1,546,375
Environmental Liabilities (Note 14)	15,614,424	0	15,614,424	15,469,073
Loan Guarantee Liability (Note 8)	0	0	0	0
Other Liabilities (Note 15 and Note 16)	3,785,962	0	3,785,962	4,185,487
Debt Held by Public (Note 13)	0	0	0	0
TOTAL LIABILITIES	$ 27,712,982	$ 85,157	$ 27,627,825	$ 26,949,173
NET POSITION				
Unexpended Appropriations (Note 18)	$ 50,781,179	$ 0	$ 50,781,179	$ 64,774,328
Cumulative Results of Operations	222,565,239	0	222,565,239	44,169,672
TOTAL NET POSITION	$ 273,346,418	$ 0	$ 273,346,418	$ 108,944,000
TOTAL LIABILITIES AND NET POSITION	$ 301,059,400	$ 85,157	$ 300,974,243	$ 135,893,173

Department of Defense
Department of the Navy
CONSOLIDATING STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	Navy	Marine Corps	Marine Corps Component Level	DON Component Level
Program Costs				
Military Personnel				
Intragovernmental Gross Costs	$ 9,976,728	$ 2,158,831	$ 0	$ 0
(Less Intragovernmental Earned Revenue)	(70,213)	1,064	0	0
Intragovernmental Net Costs	$ 9,906,515	$ 2,159,895	$ 0	$ 0
Gross Costs With the Public	$ 15,841,374	$ 8,668,473	$ 0	$ 0
(Less: Earned Revenue From the Public)	(281,482)	0	0	0
Net Costs With the Public	$ 15,559,892	$ 8,668,473	$ 0	$ 0
Net Program Cost	$ 25,466,407	$ 10,828,368	$ 0	$ 0
Operations and Maintenance				
Intragovernmental Gross Costs	$ 16,589,828	$ 194,073	$ 0	$ 0
(Less Intragovernmental Earned Revenue)	(2,227,758)	(377,261)	0	0
Intragovernmental Net Costs	$ 14,362,070	$ (183,188)	$ 0	$ 0
Gross Costs With the Public	$ 23,897,853	$ 4,792,689	$ 0	$ 0
(Less: Earned Revenue From the Public)	(1,036,745)	0	0	0
Net Costs With the Public	$ 22,861,108	$ 4,792,689	$ 0	$ 0
Net Program Cost	$ 37,223,178	$ 4,609,501	$ 0	$ 0
Procurement				
Intragovernmental Gross Costs	$ 3,968,352	$ (1,545)	$ 0	$ 0
(Less Intragovernmental Earned Revenue)	(886,743)	103	0	0
Intragovernmental Net Costs	$ 3,081,609	$ (1,442)	$ 0	$ 0
Gross Costs With the Public	$ 13,395,399	$ 1,111,662	$ 0	$ 0
(Less: Earned Revenue From the Public)	(310,683)	0	0	0
Net Costs With the Public	$ 13,084,716	$ 1,111,662	$ 0	$ 0
Net Program Cost	$ 16,166,325	$ 1,110,220	$ 0	$ 0
Research, Development, Test & Evaluation				
Intragovernmental Gross Costs	$ 993,892	$ 0	$ 0	$ 0
(Less Intragovernmental Earned Revenue)	(237,506)	0	0	0
Intragovernmental Net Costs	$ 756,386	$ 0	$ 0	$ 0
Gross Costs With the Public	$ 11,418,578	$ 0	$ 0	$ 0
(Less: Earned Revenue From the Public)	(4,122)	0	0	0
Net Costs With the Public	$ 11,414,456	$ 0	$ 0	$ 0
Net Program Cost	$ 12,170,842	$ 0	$ 0	$ 0

Department of Defense
Department of the Navy
CONSOLIDATING STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	Combined Total	Eliminations	2003 Consolidated	2002 Consolidated
Program Costs				
Military Personnel				
Intragovernmental Gross Costs	$ 12,135,559	$ 0	$ 12,135,559	$ 5,070,720
(Less Intragovernmental Earned Revenue)	(69,149)	0	(69,149)	(209,189)
Intragovernmental Net Costs	$ 12,066,410	$ 0	$ 12,066,410	$ 4,861,531
Gross Costs With the Public	$ 24,509,847	$ 0	$ 24,509,847	$ 25,061,634
(Less: Earned Revenue From the Public)	(281,482)	0	(281,482)	(68,080)
Net Costs With the Public	$ 24,228,365	$ 0	$ 24,228,365	$ 24,993,554
Net Program Cost	$ 36,294,775	$ 0	$ 36,294,775	$ 29,855,085
Operations and Maintenance				
Intragovernmental Gross Costs	$ 16,783,901	$ 0	$ 16,783,901	$ 20,573,858
(Less Intragovernmental Earned Revenue)	(2,605,019)	0	(2,605,019)	(824,786)
Intragovernmental Net Costs	$ 14,178,882	$ 0	$ 14,178,882	$ 19,749,072
Gross Costs With the Public	$ 28,690,542	$ 0	$ 28,690,542	$ 15,215,208
(Less: Earned Revenue From the Public)	(1,036,745)	0	(1,036,745)	(1,031,092)
Net Costs With the Public	$ 27,653,797	$ 0	$ 27,653,797	$ 14,184,116
Net Program Cost	$ 41,832,679	$ 0	$ 41,832,679	$ 33,933,188
Procurement				
Intragovernmental Gross Costs	$ 3,966,807	$ 0	$ 3,966,807	$ 4,107,978
(Less Intragovernmental Earned Revenue)	(886,640)	0	(886,640)	(100,053)
Intragovernmental Net Costs	$ 3,080,167	$ 0	$ 3,080,167	$ 4,007,925
Gross Costs With the Public	$ 14,507,061	$ 0	$ 14,507,061	$ 24,291,643
(Less: Earned Revenue From the Public)	(310,683)	0	(310,683)	(463,320)
Net Costs With the Public	$ 14,196,378	$ 0	$ 14,196,378	$ 23,828,323
Net Program Cost	$ 17,276,545	$ 0	$ 17,276,545	$ 27,836,248
Research, Development, Test & Evaluation				
Intragovernmental Gross Costs	$ 993,892	$ 0	$ 993,892	$ 26,807
(Less Intragovernmental Earned Revenue)	(237,506)	0	(237,506)	(1,734)
Intragovernmental Net Costs	$ 756,386	$ 0	$ 756,386	$ 25,073
Gross Costs With the Public	$ 11,418,578	$ 0	$ 11,418,578	$ 10,376,773
(Less: Earned Revenue From the Public)	(4,122)	0	(4,122)	(53,676)
Net Costs With the Public	$ 11,414,456	$ 0	$ 11,414,456	$ 10,323,097
Net Program Cost	$ 12,170,842	$ 0	$ 12,170,842	$ 10,348,170

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	Navy	Marine Corps	Marine Corps Component Level	DON Component Level
Program Costs				
Military Construction/Family Housing				
Intragovernmental Gross Costs	$ 204,387	$ 0	$ 0	$ 0
(Less Intragovernmental Earned Revenue)	(124,381)	0	0	0
Intragovernmental Net Costs	$ 80,006	$ 0	$ 0	$ 0
Gross Costs With the Public	$ 1,370,505	$ 0	$ 0	$ 0
(Less: Earned Revenue From the Public)	(369,889)	0	0	0
Net Costs With the Public	$ 1,000,616	$ 0	$ 0	$ 0
Net Program Cost	$ 1,080,622	$ 0	$ 0	$ 0
Other				
Intragovernmental Gross Costs	$ (2,083)	$ 0	$ 0	$ 0
(Less Intragovernmental Earned Revenue)	(26,447)	0	0	0
Intragovernmental Net Costs	$ (28,530)	$ 0	$ 0	$ 0
Gross Costs With the Public	$ 112,352	$ 0	$ 0	$ 0
(Less: Earned Revenue From the Public)	(10,133)	0	0	0
Net Costs With the Public	$ 102,219	$ 0	$ 0	$ 0
Net Program Cost	$ 73,689	$ 0	$ 0	$ 0
Total Program Costs				
Intragovernmental Gross Costs	$ 31,731,104	$ 2,351,359	$ 1,672,422	$ (398,483)
(Less Intragovernmental Earned Revenue)	(3,573,048)	(376,094)	14,563	533,783
Intragovernmental Net Costs	$ 28,158,056	$ 1,975,265	$ 1,686,985	$ 135,300
Gross Costs With the Public	$ 66,036,061	$ 14,572,824	$ (1,777,548)	$ 2,337,446
(Less: Earned Revenue From the Public)	(2,013,054)	0	93,358	0
Net Costs With the Public	$ 64,023,007	$ 14,572,824	$ (1,684,190)	$ 2,337,446
Net Program Cost	$ 92,181,063	$ 16,548,089	$ 2,795	$ 2,472,746
Costs Not Assigned to Programs	0	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0	0
Net Cost of Operations	$ 92,181,063	$ 16,548,089	$ 2,795	$ 2,472,746

Department of Defense
Department of the Navy
CONSOLIDATING STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	Combined Total	Eliminations	2003 Consolidated	2002 Consolidated
Program Costs				
Military Construction/Family Housing				
Intragovernmental Gross Costs	$ 204,387	$ 0	$ 204,387	$ 62,054
(Less Intragovernmental Earned Revenue)	(124,381)	0	(124,381)	(73,804)
Intragovernmental Net Costs	$ 80,006	$ 0	$ 80,006	$ (11,750)
Gross Costs With the Public	$ 1,370,505	$ 0	$ 1,370,505	$ 647,686
(Less: Earned Revenue From the Public)	(369,889)	0	(369,889)	(69,133)
Net Costs With the Public	$ 1,000,616	$ 0	$ 1,000,616	$ 578,553
Net Program Cost	$ 1,080,622	$ 0	$ 1,080,622	$ 566,803
Other				
Intragovernmental Gross Costs	$ (2,083)	$ 0	$ (2,083)	$ 69,673
(Less Intragovernmental Earned Revenue)	(26,447)	0	(26,447)	(367)
Intragovernmental Net Costs	$ (28,530)	$ 0	$ (28,530)	$ 69,306
Gross Costs With the Public	$ 112,352	$ 0	$ 112,352	$ 43,076
(Less: Earned Revenue From the Public)	(10,133)	0	(10,133)	(36,348)
Net Costs With the Public	$ 102,219	$ 0	$ 102,219	$ 6,728
Net Program Cost	$ 73,689	$ 0	$ 73,689	$ 76,034
Total Program Costs				
Intragovernmental Gross Costs	$ 35,356,402	$ 213,828	$ 35,142,574	$ 29,911,090
(Less Intragovernmental Earned Revenue)	(3,400,796)	(213,828)	(3,186,968)	(1,209,933)
Intragovernmental Net Costs	$ 31,955,606	$ 0	$ 31,955,606	$ 28,701,157
Gross Costs With the Public	$ 81,168,783	$ 0	$ 81,168,783	$ 75,636,020
(Less: Earned Revenue From the Public)	(1,919,696)	0	(1,919,696)	(1,721,649)
Net Costs With the Public	$ 79,249,087	$ 0	$ 79,249,087	$ 73,914,371
Net Program Cost	$ 111,204,693	$ 0	$ 111,204,693	$ 102,615,528
Costs Not Assigned to Programs	0	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0	0
Net Cost of Operations	$ 111,204,693	$ 0	$ 111,204,693	$ 102,615,528

Department of Defense
Department of the Navy
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	Navy	Marine Corps	Component Level
Cumulative Results of Operations			
Beginning Balances	$ 39,580,404	$ 4,589,268	$ 0
Prior period adjustments (+/-)	152,557,286	0	0
Beginning Balances, as adjusted	$ 192,137,690	$ 4,589,268	$ 0
Budgetary Financing Sources:			
Appropriations Received	$ 0	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0
Appropriations used	117,288,658	16,720,086	2,472,746
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	48,973	2,794	(2)
Imputed financing from costs absorbed by others	452,189	57,530	0
Other (+/-)	0	0	0
Total Financing Sources	$ 117,789,820	$ 16,780,410	$ 2,472,744
Net Cost of Operations (+/-)	$ 92,181,063	$ 16,550,884	$ 2,472,746
Ending Balances	$ 217,746,447	$ 4,818,794	$ (2)
Unexpended Appropriations			
Beginning Balances	$ 61,818,979	$ 2,955,349	$ 0
Prior period adjustments (+/-)	0	0	0
Beginning Balances, as adjusted	$ 61,818,979	$ 2,955,349	$ 0
Budgetary Financing Sources:			
Appropriations Received	$ 104,816,344	$ 17,316,344	$ 0
Appropriations transferred in/out (+/-)	1,367,327	442,961	0
Other adjustments (rescissions, etc) (+/-)	(1,277,509)	(177,125)	(1)
Appropriations used	(117,288,658)	(16,720,086)	(2,472,746)
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
Total Financing Sources	$ (12,382,496)	$ 862,094	$ (2,472,747)
Net Cost of Operations (+/-)	$ 0	$ 0	$ 0
Ending Balances	$ 49,436,483	$ 3,817,443	$ (2,472,747)

Department of Defense
Department of the Navy
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	Combined Total	Eliminations	2003 Consolidated	2002 Consolidated
Cumulative Results of Operations				
Beginning Balances	$ 44,169,672	$ 0	$ 44,169,672	$ 74,443,852
Prior period adjustments (+/-)	152,557,286	0	152,557,286	(27,802,492)
Beginning Balances, as adjusted	$ 196,726,958	$ 0	$ 196,726,958	46,641,360
Budgetary Financing Sources:				
Appropriations Received	$ 0	$ 0	$ 0	0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	136,481,490	0	136,481,490	99,612,676
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
Other Financing Sources:				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	51,765	0	51,765	5,871
Imputed financing from costs absorbed by others	509,719	0	509,719	525,294
Other (+/-)	0	0	0	0
Total Financing Sources	$ 137,042,974	$ 0	$ 137,042,974	100,143,841
Net Cost of Operations (+/-)	$ 111,204,693	$ 0	$ 111,204,693	102,615,528
Ending Balances	$ 222,565,239	$ 0	$ 222,565,239	$ 44,169,673
Unexpended Appropriations				
Beginning Balances	$ 64,774,328	$ 0	$ 64,774,328	$ 61,982,518
Prior period adjustments (+/-)	0	0	0	1,553,324
Beginning Balances, as adjusted	$ 64,774,328	$ 0	$ 64,774,328	$ 63,535,842
Budgetary Financing Sources:				
Appropriations Received	$ 122,132,688	$ 0	$ 122,132,688	$ 99,524,458
Appropriations transferred in/out (+/-)	1,810,288	0	1,810,288	2,727,308
Other adjustments (rescissions, etc) (+/-)	(1,454,635)	0	(1,454,635)	(1,363,575)
Appropriations used	(136,481,490)	0	(136,481,490)	(99,649,705)
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
Other Financing Sources:				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	0	0
Total Financing Sources	$ (13,993,149)	$ 0	$ (13,993,149)	$ 1,238,486
Net Cost of Operations (+/-)	$ 0	$ 0	$ 0	$ 0
Ending Balances	$ 50,781,179	$ 0	$ 50,781,179	$ 64,774,328

Department of Defense
Department of the Navy
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Navy	Marine Corps	Component Level	2003 Combined	2002 Combined
BUDGETARY RESOURCES					
Budget Authority:					
Appropriations Received	$ 104,853,084	$ 17,316,344	$ 0	$ 122,169,428	$ 99,561,202
Borrowing Authority	0	0	0	0	0
Contract Authority	739	0	0	739	0
Net transfers (+/-)	1,254,747	407,395	0	1,662,142	2,676,247
Other	0	0	0	0	0
Unobligated Balance:					
Beginning of period	11,642,091	266,892	0	11,908,983	13,835,828
Net transfers, actual (+/-)	109,980	35,566	0	145,546	51,061
Anticipated Transfers Balances	0	0	0	0	0
Spending Authority from Offsetting Collections:					
Earned					
Collected	6,244,971	547,585	0	6,792,556	6,489,962
Receivable from Federal sources	(1,040,041)	(171,491)	0	(1,211,532)	(263,453)
Change in unfilled customer orders					
Advances received	(59,842)	0	0	(59,842)	1,286
Without advance from Federal sources	154,071	154,211	0	308,282	186,518
Anticipated for the rest of year, without advances	0	0	0	0	0
Transfers from trust funds	0	0	0	0	0
Subtotal	$ 5,299,159	$ 530,305	$ 0	$ 5,829,464	$ 6,414,313
Recoveries of prior year obligations	$ 5,011,529	$ 1,997,810	$ 0	$ 7,009,339	$ 2,286,834
Temporarily not available pursuant to Public Law	0	0	0	0	0
Permanently not available	(1,275,449)	(177,125)	0	(1,452,574)	(1,399,956)
Total Budgetary Resources	$ 126,895,880	$ 20,377,187	$ 0	$ 147,273,067	$ 123,425,529

Department of Defense
Department of the Navy
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Navy	Marine Corps	Component Level	2003 Combined	2002 Combined
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred:					
Direct	$ 105,844,310	$ 18,653,640	$ 0	$ 124,497,950	$ 99,307,751
Reimbursable	6,943,352	1,136,529	0	8,079,881	12,208,795
Subtotal	$ 112,787,662	$ 19,790,169	$ 0	$ 132,577,831	111,516,546
Unobligated balance:					
Apportioned	$ 13,240,876	456,125	$ 0	$ 13,697,001	10,590,567
Exempt from apportionment	0	0	0	0	0
Other available	0	0	0	0	0
Unobligated Balances Not Available	867,342	130,893	0	998,235	1,318,416
Total, Status of Budgetary Resources	$ 126,895,880	$ 20,377,187	$ 0	$ 147,273,067	$ 123,425,529
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:					
Obligated Balance, Net-beginning of period	$ 53,464,877	$ 2,635,309	$ 0	$ 56,100,186	$ 52,333,850
Obligated Balance transferred, net (+/-)	0	0	0	0	0
Obligated Balance, net-end of period:					
Accounts Receivable	(835,725)	(62,117)	0	(897,842)	(2,109,374)
Unfilled customer order from Federal sources	(2,215,181)	(120,295)	0	(2,335,476)	(2,027,193)
Undelivered Orders	62,972,743	3,096,354	(2,650,097)	63,419,000	55,633,755
Accounts Payable	(583,582)	1,268,697	2,650,097	3,335,212	4,603,000
Outlays:					
Disbursements	102,788,724	16,262,309	0	119,051,033	105,540,310
Collections	(6,185,129)	(547,585)	0	(6,732,714)	(6,491,249)
Subtotal	$ 96,603,595	$ 15,714,724	$ 0	$ 112,318,319	99,049,061
Less: Offsetting receipts	(246,802)	0	0	(246,802)	(213,345)
Net Outlays	$ 96,356,793	$ 15,714,724	$ 0	$ 112,071,517	$ 98,835,716

Department of Defense
Department of the Navy
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Navy	Marine Corps	Component Level	2003 Combined	2002 Combined
Resources Used to Finance Activities:					
Budgetary Resources Obligated					
Obligations Incurred	$ 112,787,662	$ 19,790,169	$ 0	$ 132,577,831	$ 111,516,546
Less: Spending Authority from offsetting collections and recoveries (-)	(10,310,688)	(2,528,115)	0	(12,838,803)	(8,701,148)
Obligations net of offsetting collections and recoveries	$ 102,476,974	$ 17,262,054	$ 0	$ 119,739,028	$ 102,815,398
Less: Offsetting receipts (-)	(246,802)	0	0	(246,802)	(213,345)
Net obligations	$ 102,230,172	$ 17,262,054	$ 0	$ 119,492,226	$ 102,602,053
Other Resources					
Donations and forfeitures of property	0	0	0	0	0
Transfers in/out without reimbursement (+/-)	48,973	2,794	(2)	51,765	0
Imputed financing from costs absorbed by others	452,189	57,530	0	509,719	525,294
Other (+/-)	0	0	0	0	0
Net other resources used to finance activities	$ 501,162	$ 60,324	$ (2)	$ 561,484	$ 525,294
Total resources used to finance activities	$ 102,731,334	$ 17,322,378	$ (2)	$ 120,053,710	$ 103,127,347
Resources Used to Finance Items not Part of the Net Cost of Operations:					
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided					
Undelivered orders (-)	$ (4,989,987)	$ (696,179)	$ 2,472,746	$ (3,213,420)	$ (10,676,267)
Unfilled Customer Orders	94,229	154,211	0	248,440	187,805
Resources that fund expenses recognized in prior periods	(28,643)	(2,641)	0	(31,284)	(620,162)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0	0	0	0
Resources that finance the acquisition of assets	(26,444,222)	0	0	(26,444,222)	7,487,846
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations					
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0	0	0	0
Other (+/-)	0	0	0	0	0
Total resources used to finance items not part of the Net Cost of Operations	$ (31,368,623)	$ (544,609)	$ 2,472,746	$ (29,440,486)	$ (3,620,778)
Total resources used to finance the Net Cost of Operations	$ 71,362,711	$ 16,777,769	$ 2,472,744	$ 90,613,224	$ 99,506,569

Department of Defense
Department of the Navy
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Navy	Marine Corps	Component Level	2003 Combined	2002 Combined
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 Periods:					
Increase in annual leave liability	$ 0	$ 0	$ 0	$ 0	$ 263,070
Increase in environmental and disposal liability	0	0	0	0	595,543
Upward/Downward reestimates of credit subsidy expense	0	0	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0	0	0
Other (+/-)	392,738	35,606	0	428,344	117,595
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 392,738	$ 35,606	$ 0	$ 428,344	$ 976,208
Components not Requiring or Generating Resources:					
Depreciation and amortization	$ 16,832,811	$ 103,665	$ 0	$ 16,936,476	$ 916,360
Revaluation of assets and liabilities (+/-)	3,578,020	(374,291)	0	3,203,729	(1,684,365)
Other (+/-)	14,786	8,134	0	22,920	2,900,757
Total components of Net Cost of Operations that will not require or generate resources	$ 20,425,617	$ (262,492)	$ 0	$ 20,163,125	$ 2,132,752
Total components of Net Cost of Operations that will not require generate resources in the current period	$ 20,818,355	$ (226,886)	$ 0	$ 20,591,469	$ 3,108,960
Net Cost of Operations	$ 92,181,066	$ 16,550,883	$ 2,472,744	$ 111,204,693	$ 102,615,529

Department of the Navy

Required Supplementary Stewardship Information

MILITARY EQUIPMENT

Narrative Statement
The Federal Accounting Standards Advisory Board (FASAB) revised the Statement of Federal Financial Accounting Standards No. 6 to require the capitalization and depreciation of military equipment (formerly National Defense Property, Plant and Equipment/ND PP&E) for fiscal years (FY) 2003 and beyond, and encouraged early implementation. Therefore, RSSI reporting of military equipment has been terminated.

HERITAGE ASSETS

For Fiscal Year Ended September 2003

(a)	(b) Measurement Quantity	(c) As of 10/30/02	(d) Additions	(e) Deletions	(f) As of 9/30/03
Museums	Each	21	0	0	21
Monuments & Memorials	Each	507	5	10	502
Cemeteries	Sites	57	0	0	57
Archeological Sites	Sites	23,283	2	23	23,262
Buildings and Structures	Each	9,099	9	16	9,092
Major Collections (See Supplemental Reporting)	Each				

Narrative Statement:

The Department of the Navy (DON) is required to report Heritage Assets in accordance with the following public laws:
- 10 USC 2721
- USC 483(b)
- Antiquities Act of 1906
- Historic Sites Act of 1935
- USC 470 National Historic Preservation Act of 1966
- National Environmental Policy Act of 1969
- American Indian Religious Freedom Act of 1978
- Archeological Resources Protection Act of 1979
- Native American Graves Protection & Repatriation Act of 1990
- Presidential Memorandum for Heads of Executive Departments and Agencies:
  Government to Government Relations with Native American Tribal Governments Act of 1994
- 36 CFR 79 – Curation of Federally Owned and Administered Archeological Collections

In general, the DON defines Heritage Assets as items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic importance; or significant architectural characteristics.

Explanation for adjustments, additions, and deletions. For the DON historic buildings and structures, cemeteries, monuments, and memorials a new Heritage Assets data element series (DE 410) has been added to the internet Naval Facilities Asset Data Store (iNFADS). The DON staff is working to assess the availability of installation inventory and the technical ease of verifying and when necessary recording items in iNFADS that are not already recorded. Therefore, balances will change as the DON staff works to reconcile installation records for historic buildings, structures, cemeteries, monuments and memorials with those in iNFADS.

For Archaeological sites and artifacts, the DON has established a web-based data repository to collect archaeological site and artifact information by installation, and will coordinate database population efforts in FY 2004. Archaeological site data provided for FY 2003 was derived through data collection effort within the heritage asset community.

The Department of the Navy Heritage Assets Management System (DONHAMS) has been implemented across the DON to improve and unify the collections management process that includes archival items, artwork, and historical artifacts are derived from DONHAMS. When implementing DONHAMS, data that was captured electronically was converted and place into DONHAMS. The balances for the aforementioned items will change as DON museum and archive staffs continue to evaluate, accession and catalogue items for inclusion into DONHAMS.

The DON recognizes that there are items that it owns that may be classified as Heritage Assets as the items are evaluated, accessioned and catalogued.

Process used to establish assets as Heritage Assets. The processes used to establish items as having heritage significance varies between categories and type of assets being evaluated. Subject matter experts play a significant role in addition to other criteria such as listing on the National Register of Historic Places. In all cases, a myriad of federal statutes, service regulations, and other guidelines mandate heritage significance or provide guidance in its determination.

Multi-Use Heritage Assets. Per DoD FMR Volume 6B, Multi-Use Heritage Assets are reported both as Heritage Assets and on the Balance Sheet.

Information Pertaining to the Condition of DON Heritage Assets. 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.

Museums
Museums are buildings, places, or institutions devoted to the acquisition, conservation, study, exhibition, and educational interpretation of objects having scientific, historical, or artistic value.

Monuments and Memorials
Monuments and Memorials have significant monetary and/or historical value to the DON.

The FY 2002 ending balance of 483 was adjusted upward by 24 resulting in an FY 2003 beginning balance of 507. This adjustment was the result of the DON beginning to utilize the iNFADS to collect heritage asset information by installation.

Cemeteries
Cemeteries are government owned burial grounds located on the DON Installations. The FY 2002 ending balance of 55 was adjusted upward by 2 resulting in an FY 2003 beginning balance of 57. This adjustment was a result of adding two existing cemeteries to iNFADS.

Archeological Sites
Archeological Sites are lands on which items of significance are located.

Buildings and Structures
Buildings and Structures are listed on or determined eligible for listing on the National Register of Historic Places, including Multi-use Heritage Assets. Criteria for evaluating National Register eligibility of these sites may be referenced at 36 CFR 60.4.

Supplemental Reporting. In addition to the data presented in the table above, the following supplemental information was reported as of 9/30/03:

Category	Measurement Quantity	As of 10/1/02	Additions	Deletions	As of 9/30/03
Archeological Artifacts	Cubic Feet	13,711	39	0	13,749
Archival	Linear Feet	122,575	4,054	3	126,626
Artwork	Item	37,556	335	511	37,380
Historical Artifacts	Item	1,115,628	7,344	8,565	1,114,407

Archeological Artifacts
The FY 2002 ending balance of 13,700 was adjusted upward by 11 resulting in an FY 2003 beginning balance of 13,711. This adjustment was the result of a reclassification of some items from artifacts to archival records.

Archival
The FY 2002 ending balance of 61,957 was adjusted upward by 60,618 resulting in an FY 2003 beginning balance of 122,575. This adjustment was the result of a reclassification of some items from artifacts to archival records.

Artwork
The FY 2002 ending balance of 30,620 was adjusted upward by 6,936 resulting in an FY 2003 beginning balance of 37,556.

Historical Artifacts
The FY 2002 ending balance of 1,058,255 was adjusted upward by 57,373 resulting in an FY 2003 beginning balance of 1,115,628. This adjustment was the result of a reclassification of some items from artifacts to archival records.

Stewardship Land

For Fiscal Year Ended September 30, 2003
(Acres in Thousands)

(a) Land Use	(b) As of 10/1/02	(c) Additions	(d) Deletions	(e) As of 9/30/03
1. Mission	2,021	0	0	2,021
2. Parks & Historic Sites	0	0	0	0
Totals	2,021	0	0	2,021

Narrative Statement:
The DON followed the definition of Stewardship Land per DoD Guidance to include Public Domain, Land Set Aside, and Donated Land. The iNFADS was used to derive acres for Stewardship Land. Within the definition of Stewardship Land, land can be further defined as improved, semi-improved and other categories of land.

Non-Federal Physical Property

The Department of the Navy does not fund this type of Activity.

Investments in Research and Development

Yearly Investment in Research and Development
For Fiscal Years 1999 through 2003
(In Millions of Dollars)

(a) Categories	(b) FY99	(c) FY00	(d) FY01	(e) FY02	(f) FY03
1. Basic Research	$344	$345	$383	$378	$399
2. Applied Research	510	538	597	647	743
3. Development					
Advanced Technology Development	532	607	738	779	836
Advanced Component Development And Prototypes	2,234	2,216	2,418	2,415	2,536
System Development and Demonstration	2,019	2,225	2,086	2,836	4,200
Research, Development, Test, and Evaluation Management Support	709	750	782	838	797
Operational Systems Development	1,696	2,047	2,266	2,417	2,385
Total	$8,044	$8,728	$9,270	$10,310	$11,896

Narrative Statement

Investments in Research and Development
Investment values included in this Report are based on Research and Development (R&D) outlays (expenditures). Outlays are used because current DoD systems are unable to capture and summarize costs in accordance with FASAB standards.

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 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 above major category.

Light Emitting Devices
The first-generation display based on polymers that conduct electric current and emit light is being produced and distributed for evaluation. These polymers called "organic light-emitting diodes" or OLEDs are self-emissive, by eliminating the need for background lighting that is used in conventional liquid-crystal displays, yet producing a crisp, sharp image. The OLEDs also support moving images and offer wider viewing angles without image inversion or loss of contract ratio. Products using this type of technology has the potential of producing such items as computer displays, lighted faces of cell phones, and personal digital assistants (PDAs).

Designer Proteins

Proteins designed to follow marching orders are the latest in the new field of "synthetic biology," where scientists can create certain organisms to perform specific tasks. A new technology that is being developed would enable plants to change color in the presence of chemical and biological agents. A new computational method for designing sensor proteins is the key. Plants that detect groundwater pollution around chemical facilities, for example, and react by changing color, could be feasible in the near future. A variety of uses are possible from this research such as a TNT-sensing protein to assist the U.S. Navy's underwater robots with locating and disarming explosion devices.

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 a 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 above major category.

Abrupt Wing Stall

For the past 50 years, all aircraft that can operate at velocities near the speed of sound, and angles of attack near maximum lift, have experienced some form of uncommanded lateral motion or abrupt wing stall. The aircraft undergoes a one-sided or side-to-side upset from the intended direction of flight. At the very least, it causes loss of advantage. At its worst, it could result in a loss of the aircraft. The question that this project researched was the following: why did the F/A-018E/F jet fighters experience abrupt wing stall (AWS) when the F/A-18C/D jet fighters did not? A team of scientists and engineers conducted high-speed wind tunnel tests, performed hundreds of computational fluid dynamics calculations, and conducted both piloted and un-piloted simulations of AWS models. An AWS simulation model was developed and flown on a flight simulator. Both qualitative and quantitative simulation data were compared with actual flight test results. The team successfully developed new tools and procedures for an early assessment of an aircraft's susceptibility to AWS. These tools and procedures include experimental, computational, simulation, and flight test figures of merit that can indicate if a new aircraft design will be vulnerable to AWS anywhere in its flight envelope.

Naval-Commercial Test Kit (NACTEK) Water Test Kits

The NACTEK water test kits to improve the Department of the Navy's water-quality program. This effort sets an example of how the Operational Forces, Naval Research Science and Technology Action Team, Office of Naval Research program staff, and research scientists can work together as a team to develop a process that made use of commercial-off-the-shelf products rather than a Navy-developed system that would require extended development.

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 defined below:

1. Advance 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 producibility rather than the development of hardware for service use. 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 Prototype 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 development testing.

4. RDT&E 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 R&D program.

5. Operational Systems Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development, which have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

The following are two representative program examples for the above major category.

Submarine Acoustic Warfare Development
A submarine Defensive Warfare System (SDWS) is being developed to improve the effectiveness and survivability of all classes of naval submarines. Acoustic Interception consist of developing a new acoustic sensor, the Sparsely Populated Volumetric Array (SPVA), that will improve the performance of acoustic intercept systems. It will also provide a ranging capability for submarines through Acoustic Rapid commercial-off-the-shelf Insertion and Advanced Process build software improvements. Next Generation Countermeasures are also part of this effort.

SSN-688 and Trident Modernization
Under this program the Department of the Navy scientists continued the design and integration efforts of the Common Submarine Radio Room (CSRR) in support of the OHIO class submarines. In addition, they began the CSRR conversion of the TRIDENT Land-Based Evaluation Facility into a CSRR configuration, which will support all classes of submarines. The scientists also completed environmental and qualification testing consisting of airborne/structure borne noise, TEMPEST, humidity, overpressure, temperature, shock, inclination, and drip in support of Multifunctional Crypto System (MCS).

DEPARTMENT OF THE NAVY

GENERAL FUND
REQUIRED SUPPLEMENTARY INFORMATION

Department of Defense
Department of the Navy
DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

	Other	Research, Development, Test & Evaluation	Operation and Maintenance	Procurement
BUDGETARY FINANCING ACCOUNTS				
BUDGETARY RESOURCES				
Budget Authority				
Appropriations Received	$ 443,688	$ 13,866,785	$ 42,354,227	$ 27,744,961
Contract Authority	739	0	0	0
Net transfers (+/-)	(255,507)	(77,869)	1,209,710	594,260
Other	0	0	0	0
Unobligated Balance:				
Beginning of period	37,538	1,116,137	942,066	9,053,880
Net transfers, actual (+/-)	0	(44,039)	94,010	54,139
Anticipated Transfers Balances	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned	0	0	0	0
Collected	0	269,635	4,459,542	1,027,974
Receivable from Federal sources	0	(28,007)	(1,163,010)	169,349
Change in unfilled customer orders	0	0	0	0
Advances received	0	0	(59,948)	0
Without advance from Federal sources	0	(157,683)	555,920	(161,081)
Anticipated for the rest of year, without advances	0	0	0	0
Transfers from trust funds	0	0	0	0
Subtotal	$ 0	$ 83,945	$ 3,792,504	$ 1,036,242
Recoveries of prior year obligations	$ 1,246	$ 562,512	$ 4,183,221	$ 1,267,960
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	(1,441)	(167,654)	(709,857)	(326,598)
Total Budgetary Resources	$ 226,263	$ 15,339,817	$ 51,865,881	$ 39,424,844
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred				
Direct	$ 125,130	$ 13,574,331	$ 45,257,714	$ 27,185,912
Reimbursable	598	342,630	5,749,577	1,017,120
Subtotal	$ 125,728	$ 13,916,961	$ 51,007,291	$ 28,203,032
Unobligated balance				
Apportioned	$ 98,427	$ 1,397,290	$ 65,967	$ 11,185,410
Unobligated Balances Not Available	2,109	25,565	792,623	36,401
Total, Status of Budgetary Resources	$ 226,264	$ 15,339,816	$ 51,865,881	$ 39,424,843
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:				
Obligated Balance, Net-beginning of period:	$ 99,094	$ 5,057,690	$ 10,003,721	$ 37,496,560
Obligated Balance transferred, net (+/-)	0	0	0	0
Obligated Balance, net-end of period:				
Accounts Receivable	$ 0	$ (2,127)	$ (313,178)	$ (389,937)
Unfilled customer order from Federal sources	0	(19,659)	(1,842,209)	142,971
Undelivered Orders	95,085	6,109,572	17,493,978	39,732,271
Accounts Payable	7,658	47,501	466,561	(1,812,407)
OUTLAYS:				
Disbursements	$ 120,833	$ 12,462,543	$ 41,629,728	$ 26,750,467
Collections	0	(269,635)	(4,399,594)	(1,027,974)
Subtotal	$ 120,833	$ 12,192,908	$ 37,230,134	$ 25,722,493
Less: Offsetting receipts	0	0	(246,802)	0
Net Outlays	$ 120,833	$ 12,192,908	$ 36,983,332	$ 25,722,493

Department of Defense
Department of the Navy
DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

	Military Personnel	Military Construction/Family Housing	2003 Combined	2002 Combined
BUDGETARY FINANCING ACCOUNTS				
BUDGETARY RESOURCES				
Budget Authority				
Appropriations Received	$ 35,955,150	$ 1,804,617	$ 122,169,428	$ 99,561,202
Contract Authority	0	0	739	0
Net transfers (+/-)	230,763	(39,215)	1,662,142	2,676,247
Other	0	0	0	0
Unobligated Balance:				
Beginning of period	127,311	632,051	11,908,983	13,835,828
Net transfers, actual (+/-)	81,691	(40,255)	145,546	51,061
Anticipated Transfers Balances	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned	0	0	0	0
Collected	521,105	514,301	6,792,556	6,489,962
Receivable from Federal sources	(170,474)	(19,390)	(1,211,532)	(263,453)
Change in unfilled customer orders	0	0	0	0
Advances received	0	106	(59,842)	1,286
Without advance from Federal sources	(1,682)	72,808	308,282	186,518
Anticipated for the rest of year, without advances	0	0	0	0
Transfers from trust funds	0	0	0	0
Subtotal	$ 348,949	$ 567,825	$ 5,829,464	$ 6,414,313
Recoveries of prior year obligations	$ 957,070	$ 37,332	$ 7,009,339	$ 2,286,834
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	(225,608)	(21,415)	(1,452,574)	(1,399,956)
Total Budgetary Resources	$ 37,475,326	$ 2,940,940	$ 147,273,067	$ 123,425,529
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred				
Direct	$ 36,881,447	$ 1,473,416	$ 124,497,950	$ 99,307,751
Reimbursable	416,471	553,485	8,079,881	12,208,795
Subtotal	$ 37,297,918	$ 2,026,901	$ 132,577,831	$ 111,516,546
Unobligated balance				
Apportioned	$ 83,776	$ 866,132	$ 13,697,001	$ 10,590,567
Unobligated Balances Not Available	93,632	47,905	998,235	1,318,416
Total, Status of Budgetary Resources	$ 37,475,326	$ 2,940,938	$ 147,273,067	$ 123,425,529
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:				
Obligated Balance, Net-beginning of period:	$ 1,738,394	$ 1,704,726	$ 56,100,186	$ 52,333,850
Obligated Balance transferred, net (+/-)	0	0	0	0
Obligated Balance, net-end of period:				
Accounts Receivable	$ (99,555)	$ (93,046)	$ (897,842)	$ (2,109,374)
Unfilled customer order from Federal sources	954	(617,533)	(2,335,476)	(2,027,193)
Undelivered Orders	505,517	2,132,674	63,419,000	55,633,755
Accounts Payable	1,693,723	282,078	3,335,212	4,603,000
OUTLAYS:				
Disbursements	$ 36,150,759	$ 1,936,704	$ 119,051,033	$ 105,540,310
Collections	(521,105)	(514,406)	(6,732,714)	(6,491,249)
Subtotal	$ 35,629,654	$ 1,422,298	$ 112,318,319	$ 99,049,061
Less: Offsetting receipts	0	0	(246,802)	(213,345)
Net Outlays	$ 35,629,654	$ 1,422,298	$ 112,071,517	$ 98,835,716

DON GENERAL PROPERTY, PLANT, AND EQUIPMENT

Real Property Deferred Annual Sustainment and Restoration Tables
As of September 30, 2003
($ in Millions)

Annual Sustainment F Y 2003			
	Required	Actual	Difference
Navy			
Marine Corps			
Building, Structures, and Utilities	1,857	1,511	346

Annual Deferred Sustainment Trend				
	FY 2000	FY 2001	FY 2002	FY 2003
Navy				
Marine Corps				
Building, Structures, and Utilities	-	501	40	346

Restoration and Modernization Requirements			
	End FY 2002	End FY 2003	Change
Navy			
Marine Corps			
Building, Structures, and Utilities	-	-	-

Narrative Statement:

Navy General Fund Facilities transitioned from Real Property Maintenance to Facility Sustainment in FY 2003 via use of the new OSD Facility Sustainment Model (FSM). This is the second financial statement utilizing this methodology. The methodology in the DoD Financial Management Regulation, Volume 6B, Chapter 12, July 2002 was utilized to calculate the deferred amounts. In FY 2003, facility investments were programmed and budgeted using FSM version 3.0.

The quality of data used in the Facility Sustainment Model continued to undergo quality checks in FY 2003, resulting in a more accurate accounting of deferred sustainment requirements.

Presently, a separate breakout between the Navy and Marine Corps sustainment amounts cannot be provided. Due to this limitation, information in the Real Property Deferred Annual Sustainment and Restoration Tables are presented as overall totals for the Department of the Navy (DON).

The Facility Sustainment Model calculates facility sustainment investment based on the DON property inventory, facility type, key units of measure, geographic location and industry standards. These variables are constantly being examined to reduce errors and eliminate disconnects for unique DON facility requirements.

The DON General Fund has no material amounts of deferred sustainment for General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

Military Equipment
Deferred Maintenance Amounts
As of September 30, 2003
($ in Thousands)

Major Type	Amount
1. Aircraft	$ 148,154
2. Ships	49,533
3. Missiles	65,125
4. Combat Vehicles	3,726
5. Other Weapons Systems	139,194
6. Total	$ 405,732

Narrative Statement:

Aircraft Deferred Maintenance
There are four sub-categories that 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 executable unfunded requirements, which represent aircraft that failed Aircraft Service Period Adjustment (ASPA) 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. Generally, component repair deferred maintenance cost represents the difference between requirement and funding. Aircraft deferred maintenance reflects only executable deferred maintenance. Unexecutable deferred maintenance is not reported in the Exhibit OP-30, nor is it collected.

The Depot maintenance is currently being performed under both the Standard Depot Level Maintenance (SDLM) and Integrated Maintenance Concept (IMC) programs. Currently, the E-2, E-6, F/A-18, H-1, 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, with smaller work packages, reducing out of service time. The goal of this program is to improve readiness while reducing operating and support costs. Commander, Naval Air Systems Command's (COMNAVAIRSYSCOM) Industrial Strategy in the downsizing environment is to maintain only the minimum level of organic capacity, consistent with force levels, that is necessary to sustain peacetime readiness and was fighting surge capability. COMNAVAIRSYSCOM will work in partnership with private industry to make maximum use of industry's production capabilities and for non-CORE related aviation depot level maintenance.

Ship Deferred Maintenance
Deferred Ship Maintenance data was provided by Fleet Type Commanders. Data was 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 has been provided in this report. This includes maintenance actions that were deferred from actual depot maintenance work packages as well as maintenance that was deferred prior to inclusion in a work package due to either fiscal, operational, or capacity constraints. Although there is a significant amount of deferred maintenance actions, there are no ships that 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.

Ship deferred maintenance decreased from $243,615 thousand in FY 2002 to $49,533 thousand in FY 2003. This is due to the DON's funding a higher percentage of ship maintenance requirements in FY 2003.

Missile 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 (reworked) annually.

Combat Vehicles
The combat vehicles category is for vehicle overhaul for the active and reserve Marine Corps.

Other Weapons Systems
The "Other Weapons Systems" 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 repairables. 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 requirements and funding.

Software Maintenance
Software maintenance requirements and deferred maintenance for aircraft, missiles and other equipment are determined using the same methodology and, therefore will not be addressed separately for each Military Equipment Deferred Maintenance reporting categories. 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). The deferred maintenance reported for the execution year are those requirements below the funding threshold and up to, but not exceeding, the capacity of the Software Support Activity (SSA) in that particular fiscal year. There may be deferred requirements that exceed the capacity of the SSA, but these are not reported in the Exhibit OP-30 for the execution year, but rather identified as an out year requirement.

Schedule, Part A DoD Intra-governmental Asset Balances ($ Amounts in Thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Executive Office of the President	11		$16,430			
Department of Agriculture	12		1,141			
Department of the Interior	14		8,959			
Department of Justice	15		10,173			
Department of Labor	16		71			
Department of State	19		14,207			
Department of the Treasury	20	$78,414,877	12		$ 9,801	
Army General Fund	21		12,315			$ 325
Federal Trade Commission	29		2,839			
Department of Veterans Affairs	36		3			
Government Printing Office	4		189			
General Service Administration	47		239			
Air Force General Fund	57		16,940			6,006
Federal Emergency Management Agency	58		33			
Department of Transportation	69		384			
Small Business Administration	73		4			
Department of Health and Human Services	75		317			
National Aeronautics and Space Administration	80		293			
Department of Housing and Urban Development	86		10,233			
Department of Energy	89		15,023			
US Army Corps of Engineers	96		507			
Other Defense Organizations General Funds	97		148,300			
Other Defense Organizations Working Capital Funds	97-4930		88,138			43,852
Army Working Capital Fund	97-4930.001					95
Navy Working Capital Fund	97-4930.002		145,038			130,165
Air Force Working Capital Fund	97-4930.003		4,974			7,422
The General Fund of the Treasury	99					
Homeland Security			100			
	Totals:	**$78,414,877**	**$496,862**		**$9,801**	**$187,865**

Note: Totals might not match the amounts shown on the Principal Statements.

Schedule, Part B DoD Intra-governmental Entity Liabilities ($ Amounts in Thousands)	Treasury Index	Accounts Payable	Debts/Borrowings From Other Agencies	Other
Department of Labor	16			$613,067
Department of the Treasury	20			561,277
Army General Fund	21	$ 48,294		
Office of Personnel Management	24			47,073
Air Force General Fund	57	18,746		
US Army Corps of Engineers	96	2,170		
Other Defense Organizations General Funds	97	13,860		2,228
Other Defense Organizations Working Capital Funds	97-4930	512,262		
Army Working Capital Fund	97-4930.001	8,817		
Navy Working Capital Fund	97-4930.002	420,647		
Air Force Working Capital Fund	97-4930.003	10,240		
The General Fund of the Treasury	99			2,636,268
	Totals:	**$1,035,036**	**$0**	**$3,859,913**

Note: Totals might not match the amounts shown on the Principal Statements.

Schedule, Part C DoD Intra-governmental revenue and related costs ($ Amounts in Thousands)	Treasury Index	Earned Revenue
Executive Office of the President	11	$ 19,401
Department of Agriculture	12	311
Department of Commerce	13	481
Department of the Interior	14	658
Department of Justice	15	12,773
Department of Labor	16	204
Department of State	19	7,927
Department of the Treasury	20	30,590
Army General Fund	21	226,067
Nuclear Regulatory Commission	31	738
Department of Veterans Affairs	36	7,156
Government Printing Office	4	1,106
General Service Administration	47	6,338
National Science Foundation	49	41
Air Force General Fund	57	133,437
Federal Emergency Management Agency	58	3,918
Railroad Retirement Board	60	25
Department of Transportation	69	6,698
Small Business Administration	73	10
Department of Health and Human Services	75	230
National Aeronautics and Space Administration	80	6,482
Department of Housing and Urban Development	86	2,019
Department of Energy	89	37
US Army Corps of Engineers	96	836
Other Defense Organizations General Funds	97	1,737,114
Other Defense Organizations Working Capital Funds	97-4930	346,529
Army Working Capital Fund	97-4930.001	4,571
Navy Working Capital Fund	97-4930.002	505,386
Air Force Working Capital Fund	97-4930.003	6,488
The General Fund of the Treasury	99	-
Homeland Security		119,397
	Total:	**$ 3,186,968**

Note: Totals might not match the amounts shown on the Principal Statements.

Schedule, Part E DoD Intragovernmental non-exchange revenues ($ Amounts in Thousands)	Treasury Index	Transfers In	Transfers Out
Air Force General Fund	57	$ 6,589	
US Army Corps of Engineers	96		$ 40
Other Defense Organizations General Funds	97	42,352	
Other Defense Organizations Working Capital Funds	97-4930		10,660
Navy Working Capital Fund	97-4930.002	13,526	
	Totals:	**$ 62,467**	**$ 10,700**

Note: Totals might not match the amounts shown on the Principal Statements.

Department of the Navy

General Fund Other Accompanying Information

Appropriations, Funds, and Accounts Included in the Principal Statements

Entity Accounts:
General Funds

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing, Navy and Marine Corps (Operations and Maintenance)
17X0810	Environmental Restoration, Navy
17 1105	Military Personnel, 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 1205	Military Construction, Navy
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 1405	Reserve Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17 1611	Shipbuilding and Conversion, Navy
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement, Navy

Revolving funds

17 4557	National Defense Sealift Fund, Navy

Trust funds

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

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

Non Entity Accounts:
Special funds (Receipt Accounts)

17 3041	Recoveries Under the Foreign Military Sales Program
17 3210	General Fund Proprietary Receipts, Defense Military, Not Otherwise Classified

Deposit funds

17X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy
17X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy
17X6025	Pay of the Navy, Deposit Fund
17X6026	Pay of the Marine Corps

17X6050	Employee Payroll Allotment Account (U.S. Bonds)
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
17X6275	Withheld State and Local Income Taxes
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 (fiscal year)
17X6850	Housing Rentals, Navy
17X6875	Suspense, Navy
17X6999	Accounts Payable, Check Issue Underdrafts, Navy

Department of the Navy

Navy Working Capital Fund Principal Statements

PRINCIPAL STATEMENTS

The FY 2003 Navy Working Capital Fund Principal Financial 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, 2003, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2002.

The following statements are included in 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
- Combined Statement of Financing

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, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 1,827,646	$ 1,709,680
Non-Entity Seized Iraqi Cash	0	0
Non-Entity - Other	0	0
Investments (Note 4)	0	0
Accounts Receivable (Note 5)	582,773	525,240
Other Assets (Note 6)	10,392	266
Total Intragovernmental Assets	$ 2,420,811	$ 2,235,186
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0
Accounts Receivable (Note 5)	111,775	80,901
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	18,256,128	17,655,864
General Property, Plant and Equipment (Note 10)	4,323,910	4,190,837
Investments (Note 4)	0	0
Other Assets (Note 6)	868,808	1,140,654
TOTAL ASSETS	$ 25,981,432	$ 25,303,442
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 313,786	$ 434,772
Debt (Note 13)	615,648	750,725
Environmental Liabilities (Note 14)	0	0
Other Liabilities (Note 15 & Note 16)	289,268	177,808
Total Intragovernmental Liabilities	$ 1,218,702	$ 1,363,305
Accounts Payable (Note 12)	$ 2,102,870	$ 1,799,671
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,409,853	1,325,926
Environmental Liabilities (Note 14)	0	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	3,113,177	2,807,834
Debt Held by Public (Note 13)	0	0
TOTAL LIABILITIES	$ 7,844,602	$ 7,296,736
NET POSITION		
Unexpended Appropriations (Note 18)	$ 0	$ 0
Cumulative Results of Operations	18,136,830	18,006,706
TOTAL NET POSITION	$ 18,136,830	$ 18,006,706
TOTAL LIABILITIES AND NET POSITION	$ 25,981,432	$ 25,303,442

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
Program Costs		
Intragovernmental Gross Costs	$ 5,422,250	$ 5,382,324
(Less: Intragovernmental Earned Revenue)	(21,871,864)	(20,916,260)
Intragovernmental Net Costs	$ (16,449,614)	$ (15,533,936)
Gross Costs With the Public	$ 17,656,253	18,837,402
(Less: Earned Revenue From the Public)	(766,709)	(862,692)
Net Costs With the Public	$ 16,889,544	$ 17,974,710
Total Net Cost	$ 439,930	$ 2,440,774
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0
Net Cost of Operations	$ 439,930	$ 2,440,774

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	Cumulative Results of Operations 2003 Consolidated	Cumulative Results of Operations 2002 Consolidated
Beginning Balances	$ 18,006,706	$ 17,718,572
Prior period adjustments (+/-)	0	1,952,397
Beginning Balances, as adjusted	$ 18,006,706	$ 19,670,969
Budgetary Financing Sources:		
Appropriations Received	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (recissions, etc) (+/-)	0	0
Appropriations used	40,200	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	312,060
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(13,527)	(1,138)
Imputed financing from costs absorbed by others	543,381	465,589
Other (+/-)	0	0
Total Financing Sources	$ 570,054	$ 776,511
Net Cost of Operations (+/-)	$ 439,930	$ 2,440,774
Ending Balances	$ 18,136,830	$ 18,006,706

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	Unexpended Appropriations 2003 Consolidated	Unexpended Appropriations 2002 Consolidated
Beginning Balances	$ 0	$ 0
Prior period adjustments (+/-)	0	0
Beginning Balances, as adjusted	$ 0	$ 0
Budgetary Financing Sources:		
Appropriations Received	$ 40,200	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (recissions, etc) (+/-)	0	0
Appropriations used	(40,200)	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ 0	$ 0
Net Cost of Operations (+/-)	$ 0	$ 0
Ending Balances	$ 0	$ 0

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined Budgetary Financing Accounts	2002 Combined Budgetary Financing Accounts
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations Received	$ 40,200	$ 0
Borrowing Authority	0	0
Contract Authority	558,144	818,950
Net transfers (+/-)	0	0
Other	0	0
Unobligated Balance:		
Beginning of period	4,117,221	3,106,657
Net transfers, actual (+/-)	(30,200)	0
Anticipated Transfers Balances	0	0
Spending Authority from Offsetting Collections:		
Earned	0	0
Collected	25,585,547	24,242,264
Receivable from Federal sources	(432,227)	(478,538)
Change in unfilled customer orders	0	0
Advances received	178,239	58,673
Without advance from Federal sources	1,964,175	773,407
Anticipated for the rest of year, without advances	0	0
Transfers from trust funds	0	0
Subtotal	$ 27,295,734	$ 24,595,806
Recoveries of prior year obligations	$ 0	$ 0
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(204,140)	(417,232)
Total Budgetary Resources	$ 31,776,959	$ 28,104,181
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	$ 0	$ 0
Reimbursable	27,263,631	23,986,959
Subtotal	$ 27,263,631	$ 23,986,959
Unobligated balance:		
Apportioned	$ 4,632,115	$ 4,117,221
Exempt from apportionment	0	0
Other available	2	1
Unobligated Balances Not Available	(118,789)	0
Total, Status of Budgetary Resources	$ 31,776,959	$ 28,104,181

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined Budgetary Financing Accounts	2002 Combined Budgetary Financing Accounts
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net-beginning of period	$ 2,985,762	$ 2,421,105
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, Net-end of period:		
Accounts Receivable	(341,097)	(773,326)
Unfilled customer order from Federal sources	(8,756,130)	(6,791,954)
Undelivered Orders	7,998,442	7,327,957
Accounts Payable	4,372,899	3,223,082
Outlays:		
Disbursements	25,443,332	23,127,436
Collections	(25,763,785)	(24,300,937)
Subtotal	$ (320,453)	$ (1,173,501)
Less: Offsetting receipts	0	0
Net Outlays	$ (320,453)	$ (1,173,501)

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined	2002 Combined
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 27,263,631	$ 23,986,959
Less: Spending Authority from offsetting collections and recoveries (-)	(27,295,734)	(24,595,806)
Obligations net of offsetting collections and recoveries	$ (32,103)	$ (608,847)
Less: Offsetting receipts (-)	0	0
Net obligations	$ (32,103)	$ (608,847)
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(13,527)	0
Imputed financing from costs absorbed by others	543,381	465,589
Other (+/-)	0	0
Net other resources used to finance activities	$ 529,854	$ 465,589
Total resources used to finance activities	$ 497,751	$ (143,258)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	$ (703,528)	$ (3,023,627)
Unfilled Customer Orders	2,142,413	832,078
Resources that fund expenses recognized in prior periods	0	(46,725)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	8	0
Resources that finance the acquisition of assets	(1,899,644)	5,167,247
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations		
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0
Other (+/-)	0	0
Total resources used to finance items not part of the Net Cost of Operations	$ (460,751)	$ 2,928,973
Total resources used to finance the Net Cost of Operations	$ 37,000	$ 2,785,715

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund
COMBINED STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined	2002 Combined
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 Periods:		
Increase in annual leave liability	$ 0	$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	83,927	0
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 83,927	$ 0
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 243,755	$ 210,490
Revaluation of assets and liabilities (+/-)	74,973	(555,394)
Other (+/-)	275	(41)
Total components of Net Cost of Operations that will not require or generate resources	$ 319,003	$ (344,945)
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 402,930	$ (344,945)
Net Cost of Operations	$ 439,930	$ 2,440,774

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE NAVY

NAVY WORKING CAPITAL FUND
NOTES TO THE PRINCIPAL STATEMENTS

Note 1. Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Navy Working Capital Fund (NWCF), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act of 1994, and other appropriate legislation. The financial statements have been prepared from the books and records of the NWCF in accordance with the Department of Defense (DoD) Financial Management Regulation, Office of Management and Budget (OMB) Bulletin No. 01-09, "Form and Content of Agency Financial Statements," and to the extent possible Federal Generally Accepted Accounting Principals (GAAP). The accompanying financial statements account for all resources for which the NWCF is responsible except that information relative to classified assets, programs, and operations has been excluded from the statement or otherwise aggregated and reported in such a manner that it is no longer classified. The NWCF financial statements are in addition to the financial reports also prepared by the NWCF pursuant to OMB directives that are used to monitor and control the NWCF use of budgetary resources.

The NWCF is unable to fully implement all elements of Federal GAAP and OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. Reported values and information for NWCF major asset and liability categories are derived in part from nonfinancial feeder systems, such as inventory systems and logistic systems. These were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with Federal GAAP. The NWCF continues to implement process and system improvements addressing the limitation of its financial and nonfinancial feeder systems. A more detailed explanation of these financial statement elements is provided in the applicable note.

B. Mission of the Reporting Entity

The overall mission of the Department of the Navy (DON) is to organize, train, and equip forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies. The NWCF provides goods, services, and infrastructure to DON and other DoD customers to help ensure our military forces are mobile, ready, and have the most advanced technology.

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

The NWCF financial statements include all activities previously financed through the Navy Industrial Fund and DON Stock Fund. DoD converted these activities to the Defense Business Operations Fund (DBOF) in October 1991. In December 1996, Under Secretary of Defense (Comptroller) replaced the DBOF with four working capital funds, one of which is the NWCF. This action did not change the previous organizational reporting structure.

C. Appropriations and Funds

The DON's appropriations and funds are divided into the general, working capital (revolving funds), trust, special, and deposit funds. These appropriations and funds are used to fund and report how the resources have been used in the course of executing the DON's missions.

The NWCF (a revolving fund) received its initial working capital through an appropriation or a transfer of resources from existing appropriations or funds and used those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders. The NWCF operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision making process. The activities provide goods and services on a reimbursable basis. Receipts derived from operations generally are available in their entirety for use without further congressional action.

D. Basis of Accounting

The NWCF generally records transactions on an accrual accounting basis as required by Federal GAAP. However, some of the NWCF's financial and nonfinancial feeder systems and processes are not designed to collect and record financial information on the full accrual accounting basis. The NWCF has undertaken efforts to determine the actions required to bring all of its financial and nonfinancial feeder systems and processes into compliance with all elements of Federal GAAP.

In addition, the NWCF identifies programs based upon the major appropriation groups provided by Congress. The NWCF is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statements of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," with the need to keep the financial statements from being overly voluminous.

E. Revenues and Other Financing Sources

Revenue is recognized according to the percentage of completion method for depot maintenance activities. Research and Development activities recognized revenue according to the percentage of completion method or as actual costs are incurred and billed. Revenue is recognized when an inventory item is sold for supply management activities and at the time service is rendered for base support activities. Revenue for the transportation activity group is recognized on either a reimbursable or per diem basis, that is revenue is recognized when earned. The preponderance of per diem projects are billed and collected in the month services are rendered. In the case of reimbursables, some per diems, and point-to-point voyages, the revenue is accrued in the month services are rendered and collection is made the following month.

The NWCF does not include non-monetary support provided by U.S. Allies for common defense and mutual security in its list of other financing sources that appears in the Statement of Financing. The U.S. has agreements with foreign countries that include both direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port. DoD is reviewing these types of financing and cost reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the financial statements in accordance with generally accepted accounting principles. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

F. Recognition of Expenses

For financial reporting purposes, the DoD policy requires the recognition of operating expenses in the period incurred. However, because the NWCF's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and contracts. Expenditures for capital and other long-term assets are not recognized as expenses in the NWCF's operations until depreciated in the case of Property, Plant, and Equipment (PP&E) or consumed in the case of Operating Materials and Supplies (OM&S). Net increases or decreases in unexpended appropriations are recognized as a change in the net position.

Operating expenses were adjusted as a result of the elimination of balances between DoD Components. See Note 19.I Intra-governmental Expenses and Revenue, for disclosure of adjustment amounts.

G. Accounting for Intro-governmental Activities

The NWCF, as an agency of the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the NWCF as though the agency was a stand-alone entity.

The DON's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related costs are not apportioned to federal agencies. The NWCF's financial statements, therefore, do not report any portion of the federal government public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

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

The NWCF's civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement Systems (FERS), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The NWCF funds a portion of the civilian and military pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The NWCF recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the Statement of Net Cost; and recognizes corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

To prepare reliable financial statements, transactions occurring between components or activities within the NWCF must be eliminated. However, the NWCF cannot accurately identify all intra-governmental transactions by customer. The Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions between components or activities of the NWCF. For FY 1999 and beyond, seller entities within the Department provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records have been adjusted to recognize unrecorded costs and accounts payable. Intra-DoD intra-governmental balances were then eliminated.

The Department of the Treasury, Financial Management Service is responsible for eliminating transactions between the Department and other federal agencies. In September 2000, the Financial Management Service issued the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide." The Department was not able to fully implement the policies and procedures in this guide related to reconciling intra-governmental assets, liabilities, revenues, and expenses for non-fiduciary transactions. The NWCF, however, was able to implement the policies and procedures contained in the "Intra-governmental Fiduciary Transactions Accounting Guide," as updated by the "Federal Intra-governmental Transactions Accounting Policies and Procedures Guide," issued October 2002, for reconciling intra-governmental transactions. These transactions pertain to investments in federal securities, borrowings from the United States (U.S.) Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the OPM.

H. Transactions with Foreign Governments and International Organizations

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of this Act, DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or loss to the U.S. Government. Customers may be required to make payments in advance.

I. Funds with the U.S. Treasury

The NWCF's financial resources are maintained in U.S. Treasury accounts. Cash collections, disbursements, and adjustments are processed worldwide at the DFAS, Military Services, and the U.S. Army Corps of Engineers (USACE) disbursing stations, as well as the Department of State financial service centers. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers and deposits.

In addition, the DFAS sites and the USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury then records this information to the applicable Fund Balance with Treasury (FBWT) account maintained in the Treasury's system. Differences between the NWCF's recorded balance in the FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled. Material disclosures are provided at Note 3. Differences between accounting offices' detail-level records and Treasury's FBWT accounts are disclosed in Note 21.B, specifically, differences caused by in-transit disbursements and unmatched disbursements (which are not matched in the accounting offices' detail-level records).

J. Foreign Currency
Not Applicable.

K. Accounts Receivable
As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. DoD does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims against another federal agency are to be resolved between the agencies. Material disclosures are provided in Note 5.

L. Loans Receivable. As Applicable.
Not Applicable.

M. Inventories and Related Property
Effective October 1, 2002, Statement of Federal Financial Accounting Standards No.23, Eliminating the Category National Defense Property, Plant, and Equipment, revises accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). The standard renames National Defense Property, Plant, and Equipment to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. Likewise, military equipment (previously referred to as National Defense Property, Plant, and Equipment) also includes items which will now be classified as Operating Materials and Supplies. Military equipment is reported on the books of the Department of the Navy General Fund.

The majority of the NWCF inventories are reported at approximate historical cost using Latest Acquisition Cost (LAC) adjusted for holding gains and losses, the remaining inventory is valued using Moving Average Cost (MAC).

The NWCF uses the LAC method because its inventory systems were designed for material management rather than accounting. The systems provide accountability and visibility over inventory items. They do not maintain the historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Neither can they directly produce financial transactions using the United States Government Standard General Ledger (USSGL), as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). DoD is transitioning to a MAC methodology for valuing inventory that when fully implemented will allow the NWCF to comply with SFFAS No. 3.

SFFAS No. 3 distinguishes between "inventory held for sale" and "inventory held in reserve for future sale." There is no management or valuation difference between the two USSGL accounts. Further, the DoD manages only military or government-specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD material management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DoD holds material based on military need and support for contingencies.

Related property includes Operating Materials and Supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The NWCF uses various methods of accounting for OM&S.

The DoD implemented new policy in FY 2002 to account for condemned material (only) as “Excess, Obsolete, and Unserviceable.” The net value of condemned material is zero, because the costs of disposal are greater than the potential scrap value. Material that can be potentially redistributed, presented in previous years as “Excess, Obsolete, and Unserviceable,” is included in the “Held for Use” or “Held for Repair” categories according to its condition.

In August 2003, DoD adopted the use of an allowance to reflect impaired assets, i.e. Inventory Held for Repair. Previously, the DoD financial statements have presented its impaired assets at other than historical cost. The NWCF will implement the allowance method in conjunction with the transition to MAC.

In addition, past audit results identified uncertainties about the completeness and existence of quantities used to produce the reported values. Material disclosures related to Inventory and Related Property are provided at Note 9.

N. Investments in U.S. Treasury Securities

Not Applicable.

O. General Property, Plant and Equipment

Effective October 1, 2002, Statement of Federal Financial Accounting Standards No. 23, Eliminating the Category National Defense Property, Plant, and Equipment, revises accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). The standard renames National Defense Property, Plant, and Equipment to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. Military equipment is reported on the books of the Department of the Navy General Fund.

General PP&E assets and any improvements to the asset are capitalized at historical acquisition cost when the asset has a useful life of two or more years, and when the acquisition cost equals or exceeds the DoD capitalization threshold of $100 thousand. Improvement costs over the DoD capitalization threshold of $100 thousand for General PP&E are required to be capitalized. All General PP&E, other than land, is depreciated on a straight-line basis. Land is not depreciated.

Effective February 20, 2003, Public Law 108-7, the Consolidated Appropriations Resolution, 2003, Section 106 increased the expense/investment unit value threshold from $100 thousand to $250 thousand. FMR, Volume 2B, Chapter 9, eludes to the fact that if the expense/investment threshold changes, the capitalization threshold changes. The revised threshold is not applicable to FY 2002 and other prior fiscal year appropriations. Since the NWCF receives their funds through the Capital Purchases Program (CPP) the threshold remains at $100 thousand for FY 2003.

General PP&E has been capitalized and reported on the NWCF financial statements using the following DoD capitalization thresholds: FY 1996 though FY 2003 - $100 thousand; FY 1995 - $50 thousand; FY 1994 - $25 thousand; and FY 1993 - $15 thousand.

For NWCF activities, all PP&E used in the performance of their mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E categories. Military Equipment, Heritage Assets and Stewardship Land owned or maintained on a NWCF installation are reported in the Supplemental Stewardship Report of the applicable Military Department. To prevent duplicative reporting of the same Heritage Assets within DON, the total number of DON-wide Heritage Assets are reported in the Required Supplementary Stewardship Information of the Annual Audited Financial Statements of the DON General Funds (Treasury Index 17).

Material disclosures are provided at Note 10.

P. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

Q. Leases

Generally, lease payments are for the rental of equipment and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) the NWCF records the applicable asset and liability if the value equals or exceeds the current DoD capitalization threshold. The NWCF records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair value. The NWCF deems the use of estimates for these costs as adequate and appropriate due to the relatively low dollar value of capital leases. Imputed interest was necessary to reduce net minimum lease payments to present value calculated at the incremental borrowing rate at the inception of the leases. In addition, the NWCF classifies leases that do not transfer substantially all of the benefits or risks of ownership as operating leases and records payment expenses over the lease term.

R. Other Assets

The NWCF conducts business with commercial contractors under two primary types of contracts - fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, the NWCF provides financing payments. One type of financing payment that the NWCF makes, for real property, is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as construction in process and are reported on the General PP&E line and in Note 10, General PP&E, Net.

In addition, based on the provision of the Federal Acquisition Regulation (FAR), the NWCF makes financing payments under fixed price contracts that are not based on a percentage of completion. The NWCF reports these financing payments as advances or prepayments in the "Other Assets" line item. The NWCF treats these payments as advances or prepayments because the NWCF becomes liable only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the NWCF is not obligated to reimburse the contractor for its costs and the contractor is liable to repay the NWCF for the full amount of the advance.

The DoD has completed a review of all applicable federal accounting standards; applicable public laws on contract financing FAR Parts 32, 49, and 52; and the OMB guidance in 5 Code of Federal Regulations Part 1315, "Prompt Payment." The DoD has concluded that SFFAS No. 1 does not fully or adequately addresses the subject of progress payment accounting and is considering what further action is appropriate.

S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the NWCF. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when a past event or exchange transaction has occurred, a future loss is probable and the amount of loss 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 that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The NWCF's loss contingencies arising as a result of pending or threatened litigation or claims and assessments occur due to events such as vehicle accidents; property damages; and contract disputes.

T. Accrued Leave
Civilian annual leave that has been accrued and not used as of the balance sheet date is reported as a liability. The liability reported at the end of the fiscal year reflects the current pay rates.

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

CRO for the NWCF represents the excess of revenues over expenses less refunds to customers and returns to the U.S. Treasury since fund inception.

V. Treaties for Use of Foreign Bases
The DoD Components have the use of land, buildings, and other facilities, which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. The DoD capital assets overseas are purchased with appropriated funds; however, title to land and improvements is retained by the host country. Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Department. Therefore, in the event treaties or other agreements are terminated whereby use of the foreign bases is no longer allowed, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the U.S. and the host country have been concluded to determine the amount to be paid the U.S. for such capital investments.

W. Comparative Data
The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2003. Financial statement fluctuations greater than 2 percent of total assets on the Balance Sheet and/or greater than 10 percent between FY 2002 and FY 2003, are explained within the Notes to the Financial Statements.

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

NOTE 2. NONENTITY AND ENTITY ASSETS

As of September 30,	2003 Nonentity	2003 Entity	2003 Total	2002 Nonentity Assets
(Amounts in thousands)				
1. Intra-governmental Assets:				
A. Fund Balance with Treasury	$ 0	$ 1,827,646	$ 1,827,646	$ 0
B. Investments	0	0	0	0
C. Accounts Receivable	0	582,773	582,773	0
D. Other Assets	0	10,392	10,392	0
E. Total Intra-governmental Assets	$ 0	$ 2,420,811	$ 2,420,811	$ 0
2. Non-Federal Assets:				
A. Cash and Other Monetary Assets	$ 0	$ 0	$ 0	$ 0
B. Accounts Receivable	11,617	100,158	111,775	0
C. Loans Receivable	0	0	0	0
D. Inventory & Related Property	0	18,256,128	18,256,128	0
E. General Property, Plant and Equipment	0	4,323,910	4,323,910	0
F. Investments	0	0		0
G. Other Assets	0	868,808	868,808	0
H. Total Non-Federal Assets	$ 11,617	$ 23,549,004	$ 23,560,621	$ 0
3. Total Assets:	$ 11,617	$ 25,969,815	$ 25,981,432	$ 0
4. Other Information:				

Information Related to Non-entity and Entity Assets:

Definitions

Asset accounts are either categorized as entity or nonentity. Entity accounts consist of resources that the agency has the authority to use, or where management is legally obligated to use funds to meet entity obligations, e.g., accounts payable. Non-entity accounts are assets that are held by an entity, but are not available for use in the operations of the entity, for example, interest, penalties and fines, as an agent of the Department of Treasury.

Composition of Non-entity Assets

The $11,617 thousand included in non-entity non-federal accounts receivable represents interest, penalties, fines, & administrative fees. These fees do not belong to the Navy Working Capital Fund and will be submitted to the Department of Treasury. In FY 2002, these amounts were reported in entity non-federal Other Assets.

Other Disclosures Related to Non-entity Assets

No further disclosures required.

Note Reference

For additional line item discussion, see Note 3, Fund Balance with Treasury; Note 5, Accounts Receivable; Note 6, Other Assets; Note 9, Inventory and Related Property; and Note 10, General Property, Plant, and Equipment.

For regulatory discussion on Non-entity and Entity Assets, See Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1004.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30,	2003	2002
(Amounts in thousands)		
1. Fund Balances:		
A. Appropriated Funds	$ 0	$ 0
B. Revolving Funds	1,827,646	1,709,680
C. Trust Funds	0	0
D. Other Fund Types	0	0
E. Total Fund Balances	$ 1,827,646	$ 1,709,680
2. Fund Balances Per Treasury Versus Agency:		
A. Fund Balance per Treasury	$ 1,827,646	$ 1,709,680
B. Fund Balance per Agency	1,827,646	1,709,680
C. Reconciling Amount	$ 0	$ 0

3. Explanation of Reconciliation Amount: None

4. Other Information Related to Fund Balance with Treasury:

Fluctuations and/or Abnormalities None.

Composition of Fund Balance with Treasury

The Fund Balance with Treasury of $1,827,646 thousand reflects the FY 2002 ending balance of $1,709,680 thousand plus FY 2003 collections, disbursements, and other cash transactions recorded in the Navy Working Capital Fund (NWCF) Treasury sub-limit 97X4930.002. The following table details the amounts recorded as of September 30, 2003.

Collections	$ 25,654,152
Disbursements	(25,443,357)
Other Cash Transactions, Net	(92,830)

The following table provides a breakout of Other Cash Transactions, Net:
(Amounts in thousands)

Activity		
Supply Management, Navy	Appropriation Received	$40,200
Transportation	Principal Payment to FFB	(133,030)
Total		($92,830)

A direct appropriation was provided to the Defense Working Capital Fund in the Department of Defense (DoD) Appropriations Act, 2003, P.L. 107-248. Program Budget Decision 624, dated December 3, 2002 allocated $40.2 million to the NWCF Supply Management activity group to augment inventory levels.

The principal payment to the Federal Financing Bank relates to an outstanding debt principal amount reported by the Transportation Activity Group. See Note 6 for additional disclosures.

Intra-governmental Payment and Collection (IPAC)
IPAC differences are reconcilable differences that represent amounts recorded by Treasury but not reported by the organization. IPAC differences for the Department of the Navy can not be differentiated between NWCF and General Funds, therefore no IPAC differences are being reported for the NWCF. All amounts if applicable will be reported on the Department of the Navy General Fund statement.

Other Disclosures Related to Fund Balance with Treasury
No further disclosures required.

Note Reference
See Note Disclosure 1.I., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Funds with the U.S. Treasury.

For regulatory discussion on Fund Balance with Treasury, See Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 100501.

Note 4. Investments
Not Applicable.

Note 5. Accounts Receivable

As of September 30,	2003			2002
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
(Amounts in thousands)				
1. Intra-governmental Receivables:	$ 582,773	N/A	582,773	$ 525,240
2. Non-Federal Receivables (From the Public):	$ 111,764	$ 11	$ 111,775	$ 80,901
3. Total Accounts Receivable:	$ 694,537	$ 11	$ 694,548	$ 606,141

4. Other Information:

Fluctuations and/or Abnormalities
The balance in the Allowance for Estimated Uncollectibles is abnormal due to a posting logic flaw in the Material Financial Control System (MFCS) for the Supply Management business area. The problem should be corrected for the First Quarter, FY 2004.

Intra-governmental Accounts Receivable increased $57,536 thousand, 11 percent, from FY 2002 to FY 2003. The increase is primarily a result of an increase in sponsor reimbursable billing associated with the prepositioning ship program in support of the war effort by the Transportation activity group.

Non-federal Accounts Receivable increased $30,874 thousand, 38 percent, from FY 2002 to FY 2003. The increase can be attributed to the recording of interest, penalties, fines and administrative fees in non-entity non-federal accounts receivable. In FY 2002, these amounts were recorded in entity non-federal other assets.

Allowance Method

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

Allocation of Undistributed Collections

The DoD policy is to allocate supported undistributed collections between federal and non-federal categories based on the percentage of federal and non-federal accounts receivable. Supported undistributed collections in the amount of $758,605 thousand were applied against accounts receivable. Unsupported undistributed collections should be recorded in United States Standard General Ledger account 2400, Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections. The NWCF followed this allocation procedure. This is necessary because the potential exists that some of these unsupported undistributed collections do not belong to the NWCF and will have to be paid to the appropriate fund holder.

Trading Partner Data

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

Accounts Receivable Greater than 180 days

The amount of non-federal and intra-governmental receivables over 180-days old is $52,992 thousand and $80,832 thousand, respectively.

Non-federal Refunds Receivable

The total amount of non-federal refund receivables does not exceed 10 percent of the non-federal accounts receivable, net amount on the Balance Sheet. No further disclosures required.

Other Disclosures Related to Accounts Receivable

Supply Management, Navy had several activities that reported financial data from the Financial Inventory Reporting (FIR) system during FY 2003. In that system, cash sales were posted to current year collections instead of being recorded directly as an accounts receivable. This process resulted from the FIR system inability to report accounts receivable data. As of September 30, 2003, all FIR system users have been converted to the Material Financial Control System (MFCS). As a part of the conversion process any required adjustments were made within the year-end closing process. MFCS will enable these activities to properly record cash sales as accounts receivable rather than influencing the balance of accounts receivable through undistributed collections.

Note Reference

For additional discussion on financial reporting requirements and DoD policies governing Trading Partner Data and Accounts Receivable, see Notes 1.G. and 1.K, Significant Accounting Policies, respectively.

For regulatory discussion on Accounts Receivable, See Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1007.

NOTE 6. OTHER ASSETS

As of September 30,	2003		2002	
(Amounts in thousands)				
1. Intra-governmental Other Assets:				
A. Advances and Prepayments	$	10,392	$	266
B. Other Assets		0		0
C. Total Intra-governmental Other Assets	$	10,392	$	266
2. Non-Federal Other Assets:				
A. Outstanding Contract Financing Payments	$	0	$	0
B. Other Assets (With the Public)		868,808		1,140,654
C. Total Non-Federal Other Assets	$	868,808	$	1,140,654
3. Total Other Assets:	$	879,200	$	1,140,920

4. Other Information Related to Other Assets:

Fluctuations and/or Abnormalities

Intra-governmental Other Assets increased $10,126 thousand, 3806 percent, from FY 2002 to FY 2003. Intra-governmental Advances to Others is overstated $26,300 thousand due to an erroneous cash advance posted to the Base Support activity group. The error resulted from a problem within the Department of Defense Working Capital Fund Accounting System (DWAS) in which the customers' cash advances could not be reversed. Action will be taken to transfer the advances to the proper appropriation during the First Quarter, FY 2004 and to have system changes made to DWAS. This increase (i.e. overstatement) is offset by trading partner adjustments and a concerted effort to ensure that advances were liquidated against the appropriate customer bill.

Non-federal Other Assets decreased $271,846 thousand, 24 percent, from FY 2002 to FY 2003. The decrease is a result of the write-off of credits pending over 90 days by Supply Management, Marine Corps and the FY 2003 reduction of the outstanding debt principal amount reported for the Transportation Activity Group.

Advances and Prepayments

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

Composition of Other Assets (With the Public)

Other Assets (With the Public) includes an amount of $606,250 thousand relating to the outstanding debt principal amount reported for the Transportation Activity Group involving Time Charter arrangements made by Military Sealift Command for the long-term use of the Afloat Prepositioning Force – Navy ships. The outstanding debt principal amount is reported in the Navy Working Capital Fund Balance Sheet Other Assets (With the Public) in order to reconcile with the amount reported by the Federal Financing Bank through the trading partner elimination process. See Note 13 for material disclosures.

Other Assets (With the Public) also includes progress payments made by Supply Management, Navy amounting to $143,388 thousand, revenue earned but not billed by Depot Maintenance, Shipyards amounting to $94,672 thousand and inventory returned to suppliers by Supply Management, Marine Corps with a credit pending in the amount of $1,048 thousand. The remaining amounts of $11,504 thousand, $8,964 thousand, and $2,982 thousand represents deferred charges, advances, and unallocated costs, respectively.

Other Disclosures Related to Other Assets
Assets awaiting disposal in the amount of $3,549 thousand is currently reported in General Property, Plant, & Equipment Other. This amount was reported in Other Assets (With the Public) in FY 2002.

In FY 2002, included in Other Assets were amounts that represented interest, penalties, fines, & administrative fees. For FY 2003, these amounts are reported in non-entity accounts receivable. These fees do not belong to the Navy Working Capital Fund and will distributed directly to the Department of Treasury.

Note Reference
See Note 1.R., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Other Assets.

For regulatory discussion on Other Assets, See Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1008.

NOTE 7. CASH AND OTHER MONETARY ASSETS

Not Applicable.

NOTE 8. DIRECT LOANS AND LOAN GUARANTEES, NONFEDERAL BORROWERS

Not Applicable.

NOTE 9. INVENTORY AND RELATED PROPERTY

As of September 30,	2003	2002
(Amounts in thousands)		
1. Inventory, Net (Note 9.A.)	$ 17,519,382	$ 17,012,566
2. Operating Materials & Supplies, Net (Note 9.B.)	736,746	643,298
3. Stockpile Materials, Net (Note 9.C.)	0	0
4. Total	$ 18,256,128	$ 17,655,864

NOTE 9.A. INVENTORY, NET

As of September 30,	2003			2002	
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
(Amounts in thousands)					
1. Inventory Categories:					
A. Available and Purchased for Resale	$ 20,190,933	$ (16,871,638)	3,319,295	$ 4,456,193	O
B. Held for Repair	14,593,725	(1,350,791)	13,242,934	11,796,119	O
C. Excess, Obsolete, and Unserviceable	438,650	(438,650)	0	0	SP
D. Raw Materials	0	0	0	0	
E. Work in Process	957,153	0	957,153	760,254	AC
F. Total	$ 36,180,461	$ (18,661,079)	17,519,382	$ 17,012,566	

Legend for Valuation Methods:

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

2. Other Information:

Information Related to Inventory:

Fluctuations and/or Abnormalities

Inventory Available and Purchased for Resale decreased $1,136,897 thousand, 26 percent, from FY 2002 to FY 2003. The decrease is a result of the inventory valuation model adjustments being posted to the inventory allowance account thereby increasing inventory allowance and decreasing inventory. The posted adjustments can be predominately attributed to the reclassification of Cost of Goods Sold (COGS) prior period adjustments in the amount of $773,196 thousand that are no longer authorized.

Inventory Held for Repair increased $1,446,814 thousand, 12 percent, from FY 2002 to FY 2003. The increase can be attributed to inventory bought to support Iraqi freedom.

Work in Process increased $196,900 thousand, 26 percent, from FY 2002 to FY 2003. The increase is due to system implementation problems at the Naval Air Warfare Center (NAWC). These system problems impeded the ability of the NAWCs from fully billing their customers, which generated an increase in the work in process account. Corrective actions are underway and expected to be completed First Quarter, FY 2004. This increase is offset by decreases in Base Support and Depot Maintenance activity groups stemming from increased emphasis on resolving unbilled accounts.

Changes from Prior-Year's Accounting Methods

Supply Management, Navy implemented SMART, an Enterprise Resource System (ERP) system. The inventory capitalized into ERP is valued at Moving Average Cost (MAC). Under the MAC inventory valuation method, the "per item" inventory value can change upon each new purchase. In FY 2003, 2,472 National Item Identification Number (NIINs) supporting two weapon systems – E-2C Hawkeye Aircraft and LM-2500 Gas Turbine Engine- were converted from legacy systems to ERP. This material, while held at standard price in legacy system, was valued at $1.426 billion and represented 3.7 percent of total inventory. When transferred to ERP and recorded under MAC, the inventory value decreased to $810 million, a difference of $616 million.

<u>Valuation Methods</u>

The valuation method O (Other) included in the numeric note table above for inventory categories Available and Purchased for Resale and Held for Repair were provided because the amounts reported are valued at both Latest Acquisition Cost (LAC) and MAC. A breakout of these amounts by valuation method is as follows:

(Amounts in thousands)	
Inventory Available and Purchased for Resale, Net	
Latest Acquisition Cost	$2,773,673
Moving Average Cost	545,623
Total	$3,319,296
Inventory Held for Repair, Net	
Latest Acquisition Cost	$12,751,034
Moving Average Cost	491,900
Total	$13,242,934

<u>Restrictions of Inventory Use, Sale, or Disposition</u>

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

<u>Composition of Inventory</u>

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

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

Inventory Available and Purchase for Resale includes consumable spare and repair parts and repairable items owned and managed by the DON. In some cases, the consumable and repairable items are managed by other Military Services, such as the Defense Logistics Agency or the General Services Administration. Material available and purchased for resale includes material held due to a managerial determination that it should be retained to support military or national contingencies. Federal Accounting Standards requires disclosure of the amount of Inventory Held for "Future Sale". The Navy Working Capital Fund estimates that $733,374 thousand of the Inventory Held for Sale, Net will be for future sale. There is no management or valuation difference between the two categories.

Included in Line 1.A., Inventory Available and Purchased for Resale, are War Reserve Material for Supply Management, Navy and Supply Management, Marine Corps in the amount of $171,373 thousand and $33,000 thousand, respectively.

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

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

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

Inventory Work in Process

Work in process at Depot Maintenance activities and Research and Development activities of approximately $287,851 thousand and $411,025 thousand is included as inventory Work in Process in Note 9.A because the U.S. Government Standard General Ledger (USSGL) does not include an account for Work in Process that is not inventory. This amount represents work that has been completed, expenses incurred, and waiting to be billed to the customer.

Other Disclosures Related to Inventory

The general ledger values in the accounting system do not reconcile with the supporting detail records in the Navy segment of the Supply Management Activity logistics system. Supply Management, Navy has determined that program changes must be made to the Material Financial Control System to correct systemic posting problems, which contribute to a reconciling difference between the systems. A System Change Request has been prepared and submitted, once approved and executed final adjustments will be made to inventory and financial systems to align the data.

Note Reference

See Note 1.M., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

For regulatory discussion on Inventory, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1011.

Note 9.B. Operating Materials and Supplies, Net

As of September 30,	2003			2002	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
(Amounts in thousands)					
1. OM&S Categories:					
A. Held for Use	$ 736,746	$ 0	$ 736,746	$ 643,298	O
B. Held for Repair	0	0	0	0	
C. Excess, Obsolete, and Unserviceable	0	0	0	0	
D. Total	$ 736,746	$ 0	$ 736,746	$ 643,298	

Legend for Valuation Methods:

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

NRV = Net Realizable Value

O = Other

SP = Standard Price

AC = Actual Cost

Information Related to Operating Materials & Supplies (OM&S):

Fluctuations and/or Abnormalities

OM&S increased $93,448 thousand, 15 percent, from FY 2002 to FY 2003. The increase is due to increased material and supplies for the Depot Maintenance activity group to support the reduced cycle time for aircraft and accelerated production of J52 and F404 engines in support of the war effort. As well as, acceleration of Senior Readiness Oversight Committee components and start up associated with new requirements of the H1 platform.

Restrictions on OM&S

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

Composition of OM&S

OM&S Held for Use represents property that is consumed during normal operations and includes consumable spare and repair parts for use on customer work by various activities. The items are recorded using different methodologies including actual, weighted-average and historical cost. Federal Accounting Standards requires disclosure of the amount of OM&S Held for "Future Use". The Navy Working Capital Fund estimates that $10,928 thousand of the OM&S Held for Use, Net will be for future use. There is no management or valuation difference between the two categories.

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

Generally, the values of the NWCF's GFM and CAM in the hands of contractors is not included in the OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to annually collect and report required information without duplicating information already in other existing logistics systems.

Other Disclosures Related to OM&S

No further disclosures required.

Note Reference

See Note 1.M., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Inventory and Related Property.

For regulatory discussion on OM&S, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 101107.

NOTE 9.C. STOCKPILE MATERIALS, NET

Not Applicable.

NOTE 10. GENERAL PP&E, NET

As of September 30,	2003								2002	
	Depreciation/ Amortization Method	Service Life	Acquisition Value		(Accumulated Depreciation/ Amortization)		Net Book Value		Prior FY Net Book Value	
(Amounts in thousands)										
1. Major Asset Classes:										
A. Land	N/A	N/A	$	63,711		N/A	$	63,711	$	63,773
B. Buildings, Structures, and Facilities	S/L	20 Or 40		6,711,260	$	(4,214,367)		2,496,893		2,441,271
C. Leasehold Improvements	S/L	lease term		302		(134)		168		199
D. Software	S/L	2-5 Or 10		288,844		(181,910)		106,934		92,263
E. Equipment	S/L	5 Or 10		3,308,036		(2,386,054)		921,982		948,910
F. Assets Under Capital Lease [1]	S/L	lease term		0		0		0		0
G. Construction-in-Progress	N/A	N/A		730,673		N/A		730,673		644,421
H. Other				3,549		0		3,549		0
I. Total General PP&E			$	11,106,375	$	(6,782,465)	$	4,323,910	$	4,190,837

[1] Note 15.B for additional information on Capital Leases

Legend for Valuation Methods:

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

2. Other Information:

Fluctuations and/or Abnormalities

Leasehold Improvements decreased $31 thousand, 15 percent, from FY 2002 to FY 2003. The decrease is due to the annual depreciation of leasehold assets by the Transportation Activity group.

Software increased $14,671 thousand, 16 percent, from FY 2002 to FY 2003. The increase is a result of the reclassification of capital purchase software projects from Assets under Development (AUD) to their corresponding GPP&E. Capital purchases are recorded in an AUD account while they are under development. Upon completion of the project, the total value is moved to GPP&E. Two of the projects that were completed this year were the Configuration Management Information System and the Naval Air Depot Maintenance System.

Construction in Progress increased $86,251 thousand, 13 percent, from FY 2002 to FY 2003 primarily as a result of Supply Management, Navy modifications to existing computer space to accommodate Navy and Marine Corps Intranet (NMCI).

GPP&E Other increased $3,549 thousand or 100 percent from FY 2002 to FY 2003 as a result of the inclusion of assets awaiting disposal. Prior to FY 2003, these amounts were reported in Other Assets (With the Public).

Military Equipment

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

Fully Depreciated Assets

The acquisition value of fully depreciated assets included in the table above and reported in the Balance Sheet amount to $3,124,055 thousand as of September 30, 2003.

Outside of the Continental United States (OCONUS) GPP&E

Included in the Major Asset Classes disclosed in Note 10 are assets totaling $351,414 thousand located OCONUS.

Contractor Held GPP&E

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

Other Disclosures Related to GPP&E

For the Naval Supply Systems Command the value of GPP&E is overstated. Implementation of the Defense Property Accounting System (DPAS) has recorded all plant, property, and equipment since its inception in October 1999. However, lack of an interface between DPAS and the financial system caused a disconnect allowing only one activity to update their GPP&E subsidiary ledger with DPAS data. Additionally, the GPP&E that was resident in the Central Data Base (CDB) prior to October 1999 remains in the CDB. The amounts reported in the CDB appear on the balance sheet, but overstates the true value of the GPP&E. This deficiency has been noted in the FY04 Qualified Opinion Financial Statement Plan. Corrective action will be initiated in FY 2004 to develop an interface between DPAS and the CDB using the Defense Business Management System.

Note Reference

See Note 1.O., Significant Accounting Policies, for additional discussion on financial reporting requirements and the Department of Defense (DoD) policies governing GPP&E.

For regulatory discussion on GPP&E, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1012.

NOTE 10.A. ASSETS UNDER CAPITAL LEASE

Information Related to Assets Under Capital Lease:

The Navy Working Capital Fund has no assets under capital lease.

Other Disclosures Related to Assets Under Capital Lease

No further disclosures required.

Note References

See Note 1.Q., Significant Accounting Policies, for additional discussion on financial reporting requirements and the DoD policies governing Leases.

NOTE 11. LIABILITIES NOT COVERED AND COVERED BY BUDGETARY RESOURCES

As of September 30,	2003			2002
(Amounts in thousands)	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	Not Covered by Budgetary Resources
1. Intra-governmental Liabilities:				
A. Accounts Payable	$ 313,786	$ 0	$ 313,786	$ 0
B. Debt	615,648	0	615,648	0
C. Environmental Liabilities	0	0	0	0
D. Other	277,651	11,617	289,268	0
E. Total Intra-governmental Liabilities	$ 1,207,085	$ 11,617	$ 1,218,702	$ 0
2. Non-Federal Liabilities:				
A. Accounts Payable	$ 2,102,870	$ 0	$ 2,102,870	$ 0
B. Military Retirement Benefits and Other Other Employment-Related Actuarial Liabilities	0	1,409,853	1,409,853	1,325,926
C. Environmental Liabilities	0	0	0	0
D. Loan Guarantee Liability	0	0	0	0
E. Other Liabilities	3,113,177	0	3,113,177	0
F. Total Non-Federal Liabilities	$ 5,216,047	$ 1,409,853	$ 6,625,900	$ 1,325,926
3. Total Liabilities:	$ 6,423,132	$ 1,421,470	$ 7,844,602	$ 1,325,926

4. Other Information:

Definitions

Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date.

Included in the Non-Federal Other Liabilities Not Covered by Budgetary Resources is an amount of $11,617 thousand representing interest, penalties, fines & administrative fees. These fees do not belong to the Navy Working Capital Fund and will be distributed directly to the Department of Treasury.

Liabilities Covered by Budgetary Resources are 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. Available budgetary resources include the following:

- 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
- Borrowing authority or 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.

Other Disclosures Related to Liabilities Not Covered by Budgetary Resources
No further disclosures required.

Note Reference
For additional line item discussion, see Note 12, Accounts Payable; Note 13, Debt; Note 15, Other Liabilities; Note 16, Commitments and Contingencies; and Note 17, Military Retirement Benefits and Other Employment Related Actuarial Liabilities.

NOTE 12. ACCOUNTS PAYABLE

As of September 30,	2003			2002
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intra-governmental Payables:	$ 313,786	N/A	$ 313,786	$ 434,772
2. Non-Federal Payables (to the Public):	$ 2,102,870	$ 0	$ 2,102,870	$ 1,799,671
3. Total	$ 2,416,656	$ 0	$ 2,416,656	$ 2,234,443

4. Other Information:

Fluctuations and/or Abnormalities
Intra-governmental Accounts Payable decreased $120,986 thousand, 28 percent, from FY 2002 to FY 2003. Intra-governmental Accounts Payable for the Supply Management and Transportation business areas increased as a result of increased purchases and services in support of the war effort, however this increase was offset by undistributed disbursements and the continual clearing of residual accounts for the Ordnance business area.

Non-federal Accounts Payable increased $303,199 thousand, 17 percent, from FY 2002 to FY 2003. The increase is a result of change in guidance for unsupported undistributed collections in FY 2003. In FY 2002, unsupported undistributed disbursements were netted against unsupported undistributed collections and posted to Accounts Payable – Disbursements in Transit whereas in FY 2003 the entire unsupported undistributed collections amount is applied to other liabilities. Additionally, the Supply Management business area realized an increase in non-federal accounts payable due to increased war effort support.

Definitions
Intra-governmental accounts payable consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Interest, penalties, and administrative fees are not applicable to intra-governmental payables. Non-Federal payables are payments to non-federal government entities (to the public).

Undistributed Disbursements
Undistributed disbursements are the difference between disbursements/collections recorded at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury via the reconciled DD1329 and DD1400. The total undistributed disbursement amounts displayed in this note should agree with the undistributed amounts reported on the accounting reports (SF133/ AR(M)1307). In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to each entity's outstanding accounts payable balance at year-end. Accounts Payable were adjusted downward in the amount of $198,886 thousand for these payments.

Composition of Undistributed Disbursements

The majority of the undistributed disbursements represent Mechanization of Contract Administration Services (MOCAS) payments, which have not been liquidated. MOCAS payments represent those payments made to contractors for materials or services that are greater than $2,500 dollars. Accruals are made when the service is performed and remains in this account until the provider submits an invoice for payment. Therefore, if a copy of the invoice is not received by the NWCF activity prior to the Defense Finance and Accounting Service making payment, the payment will go to undistributed disbursements. The amounts accrued to cover the anticipated materials and services are captured as Contract Accruals on the Other Accrued Expense line (Note 15.A., Other Liabilities, Non-federal: Other Liabilities) and are not considered an accounts payable.

Allocation of Undistributed Disbursements

The Department of Defense (DoD) policy is to allocate supported undistributed disbursements between federal and nonfederal categories based on the percentage of Federal and Nonfederal Accounts Payable. Supported undistributed disbursements in the amount of $1,690,497 thousand have been applied against accounts payable. Unsupported undistributed disbursements should be recorded in United States Standard General Ledger account 2120, Disbursements in Transit. The Navy Working Capital Fund (NWCF) followed this allocation policy.

Trading Partner Data

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

Eliminating Adjustments

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

Other Disclosures Related to Accounts Payable

No further disclosures required.

Note Reference

See Note 1.G., Significant Accounting Policies, for additional discussion on financial reporting requirements and DoD policies governing Trading Partner Data and Eliminating Adjustments.

NOTE 13. DEBT

As of September 30, (Amounts in thousands)	2003 Beginning Balance	2003 Net Borrowings	2003 Ending Balance	2002 Ending Balance
1. Public Debt:				
A. Held by Government Accounts	N/A	N/A	N/A	N/A
B. Held by the Public	N/A	N/A	N/A	N/A
C. Total Public Debt	N/A	N/A	N/A	N/A
2. Agency Debt:				
A. Debt to the Treasury	$ 0	$ 0	$ 0	$ 0
B. Debt to the Federal Financing Bank	750,725	(135,077)	615,648	750,725
C. Debt to Other Federal Agencies	0	0	0	0
D. Total Agency Debt	$ 750,725	$ (135,077)	$ 615,648	$ 750,725
3. Total Debt:	$ 750,725	$ (135,077)	$ 615,648	$ 750,725
4. Classification of Debt:				
A. Intra-governmental Debt			$ 615,648	$ 750,725
B. Non-Federal Debt			N/A	N/A
C. Total Debt			$ 615,648	$ 750,725

5. Other Information

<u>Fluctuations and/or Abnormalities</u>

Intra-governmental Debt decreased $135,077 thousand, 18 percent, from FY 2002 to FY 2003 as a result of FY 2003 reduction of the outstanding debt principal amount reported for the Transportation Activity Group.

<u>Other Information Related to Debt</u>

The Afloat Prepositioning Force – Navy (APF-N) program, with Congressional approval, provides ships for Time Charter to meet requirements not available in the marketplace. These ships are built or converted by private Interim Vessel Owners using private, non-government financing obtained from various banking institutions. There were no payments made by the government during the building/conversion phase. APF-N Time Charters are for five years with four option renewal periods of five years each, for a total of 25 years. At the end of the contract, each ship returns to the vessel's owner.

The Federal Financing Bank (FFB) is one of the institutions that provided loans to the vessel owners. The FFB is reporting a debt in the amount of $615,647 thousand, which represents an outstanding principal balance of $606,250 thousand and accrued interest payable of $9,397 thousand, for the Transportation activity group. This information is being presented in error as the transportation activity group does not owe this debt to the FFB. This debt is a public debt owed by the private vessel owners. In order to simplify the payments to the FFB and to meet their requirements, the FFB cross-disburses the semi-annual principal and interest payments directly from the Navy Working Capital Fund (NWCF). This is done instead of having the Military Sealift Command (MSC) make Capital Hire payments to the vessel owners, who would in turn make its loan obligation payments to the FFB.

The direction of the vessel owner to have the government make payments directly to a bank, in this case the FFB, is not an uncommon practice, and mirrors other Time Charters where payment is assigned directly to a bank. This occurred when the ownership of these vessels was transferred to private vessel owners; however, the FFB when establishing the loan coded the loan as a government debt.

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

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

Note References
See Note 3, Fund Balance with Treasury and Note 6, Other Assets, for additional discussion on the Debt to the Federal Financing Bank.

For regulatory discussion on Debt, Net, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1015.

NOTE 14. ENVIRONMENTAL LIABILITIES AND DISPOSAL LIABILITIES
Not Applicable.

NOTE 15.A. OTHER LIABILITIES

As of September 30,	2003			2002
(Amounts in thousands)	Current Liability	Noncurrent Liability	Total	Total
1. Intra-governmental:				
A. Advances from Others	$ 239,595	$ 0	$ 239,595	$ 141,318
B. Deferred Credits	0	0	0	0
C. Deposit Funds and Suspense Account Liabilities	0	0	0	0
D. Resources Payable to Treasury	0	0	0	0
E. Disbursing Officer Cash	0	0	0	0
F. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
G. Accounts Payable-- Cancelled Appropriations	0	0	0	0
H. Judgement Fund Liabilities	0	0	0	0
I. FECA Reimbursement to the Department of Labor	0	0	0	0
J. Capital Lease Liability	0	0	0	0
K. Other Liabilities	49,763	0	49,763	36,490
L. Total Intra-governmental Other Liabilities	$ 289,268	$ 0	$ 289,268	$ 177,808

As of September 30, (Amounts in Thousands)	2003 Current Liability	2003 Noncurrent Liability	2003 Total	2002 Total
2. Non-Federal:				
A. Accrued Funded Payroll and Benefits	$ 726,494	$ 0	$ 726,494	$ 710,275
B. Advances from Others	194,779	0	194,779	138,650
C. Deferred Credits	0	0	0	0
D. Loan Guarantee Liability	0	0	0	0
E. Liability for Subsidy Related to Undisbursed Loans	0	0	0	0
F. Deposit Funds and Suspense Accounts	235,588	0	235,588	0
G. Temporary Early Retirement Authority	0	0	0	0
H. Nonenvironmental Disposal Liabilities:				
(1) National Defense PP&E (Nonnuclear)	0	0	0	0
(2) Excess/Obsolete Structures	0	0	0	0
(3) Conventional Munitions Disposal	0	0	0	0
(4) Other	0	0	0	0
I. Accounts Payable--Cancelled Appropriations	0	0	0	0
J. Accrued Unfunded Annual Leave	0	0	0	0
K. Accrued Entitlement Benefits for Military Retirees and Survivors	0	0	0	0
L. Capital Lease Liability	0	0	0	0
M. Other Liabilities	1,956,316	0	1,956,316	1,958,909
N. Total Non-Federal Other Liabilities	$ 3,113,177	$ 0	$ 3,113,177	$ 2,807,834
3. Total Other Liabilities:	$ 3,402,445	$ 0	$ 3,402,445	$ 2,985,642

Fluctuations and/or Abnormalities

Intra-governmental Other Liabilities increased $111,460 thousand, 63 percent, from FY 2002 to FY 2003. The increase is due to an increase in Advances from Others for Depot Maintenance Shipyards and the Naval Air Warfare Center (NAWC), a Research and Development activity.

The NAWC increase is associated with the conversion from the Department of Defense Industrial Financial Management System to SIGMA, an Enterprise Resource Planning System. The conversion of funding produced a reclassification between Intra-governmental and Public, which now ensures the proper posting of this account. Also, program problems encountered in the billing area have hampered the ability to bill certain customers. Once the bills are produced, the appropriate customer advances will be liquidated.

Depot Maintenance Shipyards growth is attributable to Advances for Revenue Recognition, which have been cross-walked within the Department of Defense Reporting System to Advances from Others. Specified projects at the Naval Shipyards are funded using fixed price vice the reimbursable method. This amount actually represents the difference between what the activity billed the customer and that which it actually earned as determined by what was physically accomplished on the job. It is believed this amount would be more appropriately posted to Progress Payments - Work in Progress. A review of this account will be included in the Department of Navy Mid-Range Financial Management Plan.

Non-federal Other Liabilities increased $305,343 thousand, 11 percent, from FY 2002 to FY 2003. The increase is a result of the inclusion of unsupported undistributed collections of $235,588 thousand in Non-federal Deposit Funds and Suspense Account Liabilities. Prior to FY 2003, these amounts were offset against unsupported undistributed disbursements and posted to Accounts Payable – Disbursements in Transit. The increase can also be attributed to an increase for accrual of contractual services for the Research and Development activities.

Composition of Other Liabilities

Intra-governmental Other Liabilities represents liabilities of $49,673 thousand for fringe benefits and the Voluntary Separation Incentive Program.

Non-federal Deposit Funds and Suspense Account Liabilities include amounts for unsupported undistributed collections.

Non-federal Other Liabilities includes amounts that are significant portions of the total liabilities presented in the Navy Working Capital Fund (NWCF) Balance Sheet. A breakout of the major components of Non-federal Other Liabilities follows:

Title	Amount (in thousands)
Accrual of Contractual Services	$ 2,030,953
Other Liabilities	(1,485,750)
Depot Level Repairable Carcass Return Liability	1,409,155
Contract Holdback	1,958
Total, Nonfederal Other Liabilities	$ 1,956,316

The Accrual of Contractual Services of $2,030,953 thousand represents an accrued liability for direct work performed by contractors or material and supplies purchased for a direct order in which a request for payment has not been received. The accrual is based on the level of effort performed for the direct order on a monthly basis.

The Other Liabilities amount of $(1,485,750) thousand includes a $(1,044,715) thousand allocation of unsupported undistributed disbursements. This allocation was based on a the Defense Finance and Accounting Service memorandum dated October 10, 1997 which directed the allocation of undistributed disbursements to the DoD Military Services from their Defense Working Capital Fund corporate account. As this allocation is not supported by specific transactional information, which would identify the value as belonging to the NWCF, the allocation continues to remain on the books at the Navy Component level.

In addition, the Other Liabilities amount includes $(627,404) thousand for Property Furnished by Others Liability. The Liability for Property Furnished by Others account is being inappropriately used by the Material Financial Control System (MFCS) to record intra-fund transfers of assets when such transfers are between activities with different reporting systems (e.g. Financial Inventory Reporting activities transfer assets with Transactions Item Reporting activities).

The remainder of the Other Liabilities amount consists of Progress Payments, which are maintained to show the balance of payments taken for accrued costs charged to Work in Process or the value of material procured and held for specific orders received from customers within the DoD.

The Depot Level Repairable Carcass Return Liability of $1,409,155 thousand represents the value of returned depot level repairable carcasses that have been received by an accountable activity from an end-use activity but for which an issue has not yet been processed.

Intra-governmental Reconciliation for Fiduciary Transactions with Department of Labor (DOL)

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

Other Disclosures Related to Other Liabilities

No further disclosures required.

Note References

See Note 1.G., Significant Accounting Policies, for additional discussion on financial reporting requirements and the DoD policies governing Contingencies and Other Liabilities.

NOTE 15.B. CAPITAL LEASE LIABILITY

Information Related to Capital Lease Liabilitity:
The NWCF has no capital lease liability.

Other Disclosures Related to Capital Lease Liability
No further disclosures required.

Note Reference
See Note 1.Q., Significant Accounting Policies, for additional discussion on financial reporting requirements and the DoD policies governing Leases.

For regulatory discussion on Capital Lease Liability, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1017.

NOTE 16. COMMITMENTS AND CONTINGENCIES

Information Related to Commitments and Contingencies:
None.

Other Disclosures Related to Commitments and Contingencies
No further disclosures required.

Note Reference
See Note 1.S., Significant Accounting Policies, for additional discussion on financial reporting requirements and the Department of Defense (DoD) policies governing Commitments and Contingencies.

For regulartory discussion on Commitments and Contingencies, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1018.

NOTE 17. MILITARY RETIREMENT BENEFITS AND OTHER EMPLOYMENT RELATED ACTUARIAL LIABILITIES

As of September 30, (Amount in Thousands)	2003				2002
	Actuarial Present Value of Projected Plan Benefits	Assumed Interest Rate	(Less: Assets Available to Pay Benefits)	Unfunded Actuarial Liability	Unfunded Actuarial Liability
1. Pension and Health Benefits:					
A. Military Retirement Pensions	$ 0		$ 0	$ 0	$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Benefits	$ 0		$ 0	$ 0	$ 0
2. Other					
A. FECA	$ 1,409,853		$ 0	$ 1,409,853	$ 1,325,926
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Educational Benefits Fund	0		0	0	0
E. Total Other	$ 1,409,853		$ 0	$ 1,409,853	$ 1,325,926
3. Total Military Retirement Benefits and Other Employment Related Actuarial Liabilities:	$ 1,409,853		$ 0	$ 1,409,853	$ 1,325,926

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

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

Assumptions: The projected annual benefit payments are discounted to the present value using the OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost-of-living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. The interest rate assumptions used in the discount calculations were as follows as of September 30, 2003:

3.84 percent in year 1,
4.35 percent in year 2 and thereafter

Market Value of Investments in Market-based and Marketable Securities: Not Applicable.

NOTE 18. UNEXPENDED APPROPRIATIONS

Not Applicable.

Note 19.A. General Disclosures Related to the Statement of Net Cost

Information Related to the Statement of Net Cost:

Fluctuations and/or Abnormalities
The overall change on the Statement of Net Cost results from an increase in both the intra-governmental costs and earned revenue from other government sources offset by a decrease in both the gross costs and revenue from public sources. The goal of the Net Cost of Operations is to maintain an income and expense account that comes close to break even. It is not the goal of the U.S. Government to make a profit. This goal has been met. The changes in the various accounts that make up the Statement of Net Cost exceeds the 2 percent of total assets reported on the Balance Sheet.

The increase of $955,604 thousand, 5 percent, of intra-governmental revenue is attributable to increased work related to efforts to support the on-going war efforts, such as the War on Global Terrorism and Iraqi Freedom. As additional income is generated, additional costs associated with these efforts comes hand in hand, thus the increase of $39,925 thousand, 1percent, in intra-governmental costs. Increased intra-governmental net costs were offset by a decrease in the revenue and costs associated with the Public.

Gross costs with the Public decreased $1,181,144 thousand, 6 percent, as labor, materials and services required to support the public workload were decreased from the prior period. During FY 2003 workload focused almost totally on government sources and the ability to support public requests were minimized, which is attributable to the decrease of $95,982 thousand, 11 percent, in revenue from the public.

Composition of Statement of Net Cost
The Navy Working Capital Fund (NWCF) generally records transactions on an accrual basis as required by federal generally accepted accounting principles. Information presented on the Statement of Net Cost represent the net result of post-closing adjustments and eliminating entries made in compiling and consolidating the NWCF financial statements. These entries significantly affected the reported amounts of Intra-governmental Program Cost, Program Cost with the Public, Earned Revenue and Net Program Cost. The post-closing adjustments were made in order to increase or decrease certain NWCF account balances reported as of September 30, 2003 to ensure agreement with related balances reported by other Department of Defense (DoD) and other federal reporting entities. Eliminating entries are required adjustments made as part of the financial process. This process enables the matching of trading partner data recorded at each financial statement consolidation level -- the NWCF, DoD and Federal Government levels.

Other Disclosures Related to the Statement of Net Cost
The Statement of Net Cost was impacted by the recording of Prior Period Adjustments, other than the inventory valuation model, in the amount of $540,335 thousand as current year transactions.

Note 19.B. Gross Cost and Earned Revenue by Budget Functional Classification
Not Applicable.

Note 19.C. Gross Cost to Generate Intra-governmental Revenue and Earned Revenue (Transactions with Other Federal—Non-DoD—Entities) by Budget Functional Classification
Not Applicable.

NOTE 19.D. IMPUTED EXPENSES

As of September 30, (Amount in thousands)	2003	2002
1. Civilian (e.g.,CSRS/FERS) Retirement	$ 270,127	$ 205,147
2. Civilian Health	272,241	259,494
3. Civilian Life Insurance	1,013	948
4. Military Retirement Pension	0	0
5. Military Retirement Health	0	0
6. Judgment Fund	0	0
7. Total Imputed Expenses	$ 543,381	$ 465,589

8. Other Information

Information Related to Imputed Expenses:

The NWCF financial statements have recognized an imputed expense for civilian employee pensions, life insurance, and health benefits in the Statement of Net Cost. Imputed expenses for employee benefits were calculated using cost factors provided by the Office of Personnel Management applied against gross basic pay for all categories of civilian service employees. The gross basic pay amounts were extracted directly from the Defense Civilian Pay System.

Judgment Fund claims are reported in the Navy General Fund statements and notes.

Other Disclosures Related to Imputed Expenses
No further disclosures required.

NOTE 19.E. BENEFIT PROGRAM EXPENSES
Not Applicable.

NOTE 19.F. EXCHANGE REVENUE

Information Related to Exchange Revenue:

Definition
Exchange revenue arises when a government entity provides goods and services to the public or to another Government entity for a price, “earned revenue”. Exchange revenue includes most user charges other than taxes, i.e., regulatory user charges.

Other Disclosures Related to Exchange Revenue
No further disclosures required.

Note Reference
For regulatory discussion on Exchange Revenue, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 102120.

Note 19.G. Amounts for Foreign Military Sales (FMS) Program Procurements from Contractors

Not Applicable.

Note 19.H. Stewardship Assets

Not Applicable.

Note 19.I. Intra-governmental Revenue and Expense

Information Related to Intergovernmental Revenue and Expense:

Intra-governmental Revenue

The NWCF accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the NWCF was unable to reconcile intra-governmental revenue balances with the majority of their trading partners. Action has been taken to reconcile some of the smaller accounts manually. Through an ongoing Business Management Modernization Program, the DoD intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations.

Intra-governmental Operating Expenses

The NWCF operating expenses were adjusted based on a comparison between the NWCF's accounts payable and the DoD summary level seller accounts receivables. Adjustments were posted to accounts payable and operating expenses to reflect the following reported balances: other trading partners; Federal Financing Bank payments for debt; interest, penalties, fines & administrative fees data call; and resolution of abnormal accounts payables in accordance with current guidance. The operating expenses of the NWCF were adjusted downwards in the net amount of $959,303 thousand.

The Office of Management and Budget (OMB) has established a working group to review the current business practices in place to capture the data exchanged between federal agencies; and to determine what changes need to be incorporated. The Department of the Navy has representation on the Office of the Under Secretary of Defense (Comptroller) group which is working directly with OMB to ensure that all aspects (e.g., financial, logistics and security) of the DoD are given full consideration. Based on the large volume of intra-governmental transactions that occur this project is a major undertaking and will take several years to complete with the ultimate goal of having this process totally automated.

Other Disclosures Related to Exchange Revenue

No further disclosures required.

Note 19.J. Suborganization Program Costs

Not Applicable.

NOTE 20. DISCLOSURES RELATED TO THE STATEMENT OF CHANGES IN NET POSITION

As of September 30,	Cumulative Results of Operations 2003	Unexpended Appropriations 2003	Cumulative Results of Operations 2002	Unexpended Appropriations 2002
(Amounts in thousands)				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance:				
A. Changes in Accounting Standards	$ 0	$ 0	$ 0	$ 0
B. Errors and Omissions in Prior Year Accounting Reports	0	0	1,952,397	0
C. Other Prior Period Adjustments	0	0	0	0
D. Total Prior Period Adjustments	$ 0	$ 0	$ 1,952,397	$ 0
2. Imputed Financing:				
A. Civilian CSRS/FERS Retirement	$ 270,127	$ 0	$ 205,147	$ 0
B. Civilian Health	272,241	0	259,494	0
C. Civilian Life Insurance	1,013	0	948	0
D. Military Retirement Pension	0	0	0	0
E. Military Retirement Health	0	0	0	0
F. Judgment Fund	0	0	0	0
G. Total Imputed Financing	$ 543,381	$ 0	$ 465,589	$ 0

Information Related to Statement of Net Position:

Fluctuations and/or Abnormalities

Prior Period Adjustments, Errors and Omissions decreased 100 percent from FY 2002 to FY 2003. The entire change is due to Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) direction to remove prior period adjustments generated in the inventory valuation model.

Composition of Statement of Net Position

A direct appropriation was provided to the Defense Working Capital Fund in the Department of Defense Appropriations Act, 2003, P.L. 107-248. Program Budget Decision 624, dated December 3, 2002. This appropriation allocated $40.2 million to the Navy Working Capital Fund (NWCF) Supply Management to augment inventory levels. All funds have been obligated and expended.

Reclassified to current year operations were prior period adjustments generated in the Navy Activity accounting systems in the amount of $540,335 thousand. These amounts were reclassified as their individual values did not meet the materiality threshold outlined in the (OUSD(C)) memo of 8 June 2003.

Based on OUSD(C) direction, amounts generated as prior period adjustments within the Cost of Goods Sold model were moved to inventory allowance accounts. The amounts are as follows:

Amount in thousands	
Supply Management, Navy	($ 951,964)
Supply Management, Marine	$ 178,768

Imputed Financing

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

Other Disclosures Related to the Statement of Net Position

Included in the NWCF's Net Position, Cumulative Results of Operations (CRO) are amounts that were approved by OUSD(C) as a deferral for recovery from, or return to, customers in later fiscal years' billing rates. As of September 30, 2003, the total NWCF amount of CRO-Deferred was ($522,620) thousand. This amount primarily consists of system development costs incurred during FY 1992-1998 totaling ($389,533) thousand by the Joint Logistics Service Center (JLSC). With the closure of JLSC, OUSD(C) directed in August 1998 that this JLSC system development cost be deferred from cost recovery. As instructed by the OUSD(C), the Department of the Navy distributed this amount among affected NWCF activities. It also includes the write-off of liabilities from a Pilot Program at Naval Shipyard Pearl Harbor in FY 2002 in the amount of ($116,306) thousand.

Note Reference

For regulatory disclosure related to the Statement of Changes in Net Position, see Department of Defense Financial Management Regulation, Volume 6B, Chapter 10, paragraph 1022.

NOTE 21.A. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

As of September 30,	2003	2002
(Amounts in thousands)		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 8,043,629	$ 7,340,100
2. Available Borrowing and Contract Authority at the End of the Period	5,880,543	5,394,300
3. Other Information:		

Information Related to the Statement of Budgetary Resources:

The Statement of Budgetary Resources (SBR) is an image of the monthly Report on Budget Execution (Standard Form (SF) 133). These reports should be produced using budgetary accounts. However, the Navy Working Capital Fund (NWCF) uses proprietary accounts because its financial accounting systems were not designed to produce budgetary accounting data. The Department of the Navy and the Defense Finance and Accounting Service continue with the implementation of new accounting systems designed to produce both proprietary and budgetary reports and use the U.S. Standard General Ledger. The Defense Industrial Financial Management System (DIFMS) has been fully implemented at all Research and Development (R&D) activities that were scheduled for conversion. R&D activity Space and Naval Warfare Systems Center, San Diego has successfully implemented the Enterprise Resource Planning (ERP) pilot program (Project Cabrillo) thus moving off DIFMS. Also, the Naval Air Warfare Centers (NAWC's) have moved from DIFMS to their ERP pilot program "SIGMA". The ERP's are programmed to complete the SBR at the activity level. The Defense Working Capital Fund Accounting System (DWAS) implementation continues to be implemented at the Base Support Activities and is currently ahead of schedule. DWAS implementations should be completed by year-end FY 2004. Once the legacy systems have been replaced, the capability to produce the SBR and SF133 should be accomplished.

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

For the SBR, Supply Management's revenue is defined as gross sales less credit returns. For the balance sheet, revenue does not include credit returns because the inventory valuation model considers credit returns as inventory allowances. The difference in "meanings" causes variances in the reports.

On these budgetary reports, the net outlays (collections and disbursements) year to date are reported based on the amounts reported to U.S. Treasury from the Cash Accountability System and Centralized Expenditures/Reimbursement Processing System. As of September 30, 2003, the differences between the U.S. Treasury and the NWCF activity ledgers have been minimal, and the cause is related to timing or the type of transactions. The differences are recorded as undistributed disbursements and collections on the departmental reports.

While there may be no impact upon the U.S. Treasury balance, the above differences have created distortions in the accounts receivable and accounts payable from a budgetary reporting perspective on the SBR. Also, problems with undistributed collections and disbursements have created abnormal balances for accounts receivable and accounts payable on the SBR.

Intra-entity Transactions

The SBR does not include intra-entity transactions because the statements are presented as combined and combining.

Apportionment Categories

OMB Bulletin No. 01-09, section 9.27, requires disclosure of the amount of direct and reimbursable obligations incurred against amounts apportioned under categories A, B and exempt from apportionment. These amounts are as follows:

Obligations Incurred – Direct	Line 8A	$	0
Obligations Incurred – Reimbursable	Line 8B	$	27,263,631K
Exempt from apportionment -	Line 9B	$	0

Undelivered Orders

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

Spending Authority from Offsetting Collections

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

Other Disclosures Related to the Statement of Budgetary Resources

No further disclosures required.

NOTE 21.B. DISCLOSURES RELATED TO PROBLEM DISBURSEMENTS, IN-TRANSIT DISBURSEMENTS AND SUSPENSE/BUDGET CLEARING ACCOUNTS

As of September 30, (Amounts in thousands)	September 2001	September 2002	September 2003	(Decrease)/Increase from 2002 to 2003
1. Total Problem Disbursements				
A. Absolute Unmatched Disbursements	$ 204,317	$ 166,500	$ 88,748	$ (76,752)
B. Negative Unliquidated Obligations	0	0	0	0
2. Total In-transit Disbursements, Net	$ 0	$ 0	$ 0	$ 0

3. Other Information Related to Problem Disbursements and In-transit Disbursements :

Absolute Unmatched Disbursements
A Unmatched Disbursement (UMD) occurs when a payment is not matched to a corresponding obligation in the accounting system. For FY 2003, the NWCF has $88,748 thousand (absolute value) in UMDs, which is a decrease of $76,752 thousand since FY 2002. NWCF problem disbursements continue to decrease from the prior years largely due to improving system functionality and business processes. Additional emphasis on further reducing NWCF problem disbursements has resulted in corresponding efforts to analyze and improve processes, and determine solutions to reduce current inflow and their root causes. Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign (plus or minus).

Negative Unliquidated Obligations
A Negative Unliquidated Obligations occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These problem disbursements represent the absolute value of funds that have been reported by a disbursing station to the Department of the Treasury, but have not yet been precisely matched against the specific source obligation that gave rise to the disbursements. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

In-transit Disbursements
In transits represents the net value of disbursements and collections made by a Department of Defense disbursing activity on behalf of an accountable activity but not yet posted in an accounting system.

Other Disclosures Related to Problem Disbursements and In-transit Disbursements
No further disclosures required.

Information Related to Suspense/Budget Clearing Accounts:

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

NOTE 22. DISCLOSURES RELATED TO THE STATEMENT OF FINANCING

Information Related to the Statement of Financing:

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

The Defense Finance and Accounting Service (DFAS) Navy Working Capital Fund (NWCF) accounting systems include budgetary accounts however some of the legacy NWCF accounting systems do not. As a result, the Statement of Budgetary Resources (SBR) is generated by DFAS using data extracted from the proprietary accounts. The detailed level of information required to appropriately complete the SBR is in the process of being developed for those activities that cannot provide the data due to system deficiencies. Due to the system deficiencies, the Statement of Financing line, Resources that Finance the Acquisition of Assets, was adjusted upward by $1,803,706 thousand. Therefore, the data presented on the Statement of Financing may not meet the intent of the Department of Defense Financial Management Regulation.

Intra-entity transactions have not been eliminated because statements are presented as combined and combining.

<u>Other Disclosures Related to the Statement of Financing</u>
In FY 2003, the Naval Air Warfare Center (NAWC), a Research and Development activity group, was unable to fully bill its customers due to system implementation problems. The NAWCs inability to bill customers had an impact on the unfilled customer orders balance. Corrective actions are underway and are expected to be complete by First Quarter, FY 2004.

During FY 2003, accounts that populated line items on the Statement of Financing were re-mapped within the Defense Departmental Reporting System thereby, affecting the readers' ability to made a useful comparison between FY 2002 and FY 2003.

NOTE 23. DISCLOSURES RELATED TO THE STATEMENT OF CUSTODIAL ACTIVITY

Not Applicable.

NOTE 24.A. OTHER DISCLOSURES: LEASES

Entity As Lessee - Operating Leases

As of September 30, (Amounts in thousands)	2003				2002
B. Future Payments Due:	Buildings	Equipment	Other	Total	Total
Fiscal Year					
2004	$ 511	$ 0	$ 0	$ 511	$ 1,100
2005	0	0	0	0	0
2006	0	0	0	0	0
2007	0	0	0	0	0
2008	0	0	0	0	0
After 5 Years	0	0	0	0	0
Total Future Lease Payments Due	$ 511	$ 0	$ 0	$ 511	$ 1,100

Fluctuations and Abnormalities
None.

Definitions
Lessee – A person or entity who receives the use and possession of leased property (e.g. real estate or equipment) from a lessor in exchange for a payment of funds.

Operating Lease - A lease which does not transfer substantially all the benefits and risk of ownership. Payments should be charged to expense over the lease term as it becomes payable.

Land and Building Leases consist of:

Description of Leases:
The Military Sealift Command has an existing operating lease for a corporate data center, which commenced December 1, 1999 for a lease period of one year with three option years. The final lease payment in the amount of $1,100 thousand was made December 1, 2002 (FY 2003) and the final option to buy the equipment will be exercised December 2003 (FY 2004) in the amount of $511 thousand.

Equipment Leases consist of:
None.

Other Leases consist of:
None.

NOTE 24.B. OTHER DISCLOSURES

No further disclosures required.

Department of the Navy

Navy Working Capital Fund Supporting Consolidating/Combining Statements

Navy Working Capital Fund Supporting Consolidating/Combining Statements

Department of Defense
Navy Working Capital Fund
CONSOLIDATING BALANCE SHEET
As of September 30, 2003 and 2002
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps	Ordnance
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	$ 484,764	$ 86,232	$ (28,830)	$ 73,709
Non-Entity Seized Iraqi Cash	0	0	0	0
Non-Entity - Other	0	0	0	0
Investments (Note 4)	0	0	0	0
Accounts Receivable (Note 5)	9,889	143,792	20,183	825
Other Assets (Note 6)	0	0	10	0
Total Intragovernmental Assets	$ 494,653	$ 230,024	$ (8,637)	$ 74,534
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0	$ 0
Accounts Receivable (Note 5)	273	318	152	120
Loans Receivable (Note 8)	0	0	0	0
Inventory and Related Property (Note 9)	226,169	658,386	56,072	284
General Property, Plant and Equipment (Note 10)	684,737	361,592	53,531	140
Investments (Note 4)	0	0	0	0
Other Assets (Note 6)	96,551	3,448	0	711
TOTAL ASSETS	$ 1,502,383	$ 1,253,768	$ 101,118	$ 75,789
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$ 26,380	$ 270,352	$ 5,906	$ (113,819)
Debt (Note 13)	0	0	0	0
Environmental Liabilities (Note 14)	0	0	0	0
Other Liabilities (Note 15 & Note 16)	137,352	5,565	4,435	0
Total Intragovernmental Liabilities	$ 163,732	$ 275,917	$ 10,341	$ (113,819)
Accounts Payable (Note 12)	$ 45,799	$ 28,685	$ 5,511	$ 8,416
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	0	0	23,068	0
Environmental Liabilities (Note 14)	0	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0	0
Other Liabilities (Note 15 and Note 16)	239,124	528,872	3,718	13,600
Debt Held by Public (Note 13)	0	0	0	0
TOTAL LIABILITIES	$ 448,655	$ 833,474	$ 42,638	$ (91,803)
NET POSITION				
Unexpended Appropriations (Note 18)	$ 0	$ 0	$ 0	$ 0
Cumulative Results of Operations	1,053,728	420,294	58,480	167,592
TOTAL NET POSITION	$ 1,053,728	$ 420,294	$ 58,480	$ 167,592
TOTAL LIABILITIES AND NET POSITION	$ 1,502,383	$ 1,253,768	$ 101,118	$ 75,789

Department of Defense
Navy Working Capital Fund
CONSOLIDATING BALANCE SHEET
As of September 30, 2003 and 2002
($ in thousands)

	Transportation	Base Support	Research & Development	Supply Management
ASSETS (Note 2)				
Intragovernmental:				
Fund Balance with Treasury (Note 3)				
Entity	$ 256,819	$ 212,906	$ 773,480	$ 314,590
Non-Entity Seized Iraqi Cash	0	0	0	0
Non-Entity - Other	0	0	0	0
Investments (Note 4)	0	0	0	0
Accounts Receivable (Note 5)	143,258	166,029	(9,110)	222,038
Other Assets (Note 6)	0	0	0	0
Total Intragovernmental Assets	$ 400,077	$ 378,935	$ 764,370	$ 536,628
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0	$ 0
Accounts Receivable (Note 5)	105	25,502	16,280	(4,875)
Loans Receivable (Note 8)	0	0	0	0
Inventory and Related Property (Note 9)	35,100	28,666	689,220	16,562,231
General Property, Plant and Equipment (Note 10)	37,390	695,015	1,994,358	497,147
Investments (Note 4)	0	0	0	0
Other Assets (Note 6)	607,606	1,766	13,903	144,823
TOTAL ASSETS	$ 1,080,278	$ 1,129,884	$ 3,478,131	$ 17,735,954
LIABILITIES (Note 11)				
Intragovernmental:				
Accounts Payable (Note 12)	$ 45,370	$ 44,850	$ (178,326)	$ 489,521
Debt (Note 13)	615,648	0	0	0
Environmental Liabilities (Note 14)	0	0	0	0
Other Liabilities (Note 15 & Note 16)	1,634	6,437	128,453	55,888
Total Intragovernmental Liabilities	$ 662,652	$ 51,287	$ (49,873)	$ 545,409
Accounts Payable (Note 12)	$ 420,415	$ 155,099	$ 870,638	$ 444,678
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	0	0	0	0
Environmental Liabilities (Note 14)	0	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0	0
Other Liabilities (Note 15 and Note 16)	37,786	180,305	2,102,959	831,076
Debt Held by Public (Note 13)	0	0	0	0
TOTAL LIABILITIES	$ 1,120,853	$ 386,691	$ 2,923,724	$ 1,821,163
NET POSITION				
Unexpended Appropriations (Note 18)	$ 0	$ 0	$ 0	$ 0
Cumulative Results of Operations	(40,575)	743,193	554,407	15,914,791
TOTAL NET POSITION	$ (40,575)	$ 743,193	$ 554,407	$ 15,914,791
TOTAL LIABILITIES AND NET POSITION	$ 1,080,278	$ 1,129,884	$ 3,478,131	$ 17,735,954

Department of Defense
Navy Working Capital Fund
CONSOLIDATING BALANCE SHEET
As of September 30, 2003 and 2002
($ in thousands)

	Component Level	Combined Total	Eliminations
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	$ (346,024)	$ 1,827,646	$ 0
Non-Entity Seized Iraqi Cash	0	0	0
Non-Entity - Other	0	0	0
Investments (Note 4)	0	0	0
Accounts Receivable (Note 5)	(114,131)	582,773	0
Other Assets (Note 6)	10,382	10,392	0
Total Intragovernmental Assets	$ (449,773)	$ 2,420,811	$ 0
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0	$ 0
Accounts Receivable (Note 5)	73,900	111,775	0
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property (Note 9)	0	18,256,128	0
General Property, Plant and Equipment (Note 10)	0	4,323,910	0
Investments (Note 4)	0	0	0
Other Assets (Note 6)	0	868,808	0
TOTAL ASSETS	$ (375,873)	$ 25,981,432	$ 0
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	$ (276,448)	$ 313,786	$ 0
Debt (Note 13)	0	615,648	0
Environmental Liabilities (Note 14)	0	0	0
Other Liabilities (Note 15 & Note 16)	(50,496)	289,268	0
Total Intragovernmental Liabilities	$ (326,944)	$ 1,218,702	$ 0
Accounts Payable (Note 12)	$ 123,629	$ 2,102,870	$ 0
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,386,785	1,409,853	0
Environmental Liabilities (Note 14)	0	0	0
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	(824,263)	3,113,177	0
Debt Held by Public (Note 13)	0	0	0
TOTAL LIABILITIES	$ 359,207	$ 7,844,602	$ 0
NET POSITION			
Unexpended Appropriations (Note 18)	$ 0	$ 0	$ 0
Cumulative Results of Operations	(735,080)	18,136,830	0
TOTAL NET POSITION	$ (735,080)	$ 18,136,830	$ 0
TOTAL LIABILITIES AND NET POSITION	$ (375,873)	$ 25,981,432	$ 0

Department of Defense
Navy Working Capital Fund
CONSOLIDATING BALANCE SHEET
As of September 30, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	$ 1,827,646	$ 1,709,680
Non-Entity Seized Iraqi Cash	0	0
Non-Entity - Other	0	0
Investments (Note 4)	0	0
Accounts Receivable (Note 5)	582,773	525,240
Other Assets (Note 6)	10,392	266
Total Intragovernmental Assets	$ 2,420,811	$ 2,235,186
Cash and Other Monetary Assets (Note 7)	$ 0	$ 0
Accounts Receivable (Note 5)	111,775	80,901
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	18,256,128	17,655,864
General Property, Plant and Equipment (Note 10)	4,323,910	4,190,837
Investments (Note 4)	0	0
Other Assets (Note 6)	868,808	1,140,654
TOTAL ASSETS	$ 25,981,432	$ 25,303,442
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 313,786	$ 434,772
Debt (Note 13)	615,648	750,725
Environmental Liabilities (Note 14)	0	0
Other Liabilities (Note 15 & Note 16)	289,268	177,808
Total Intragovernmental Liabilities	$ 1,218,702	$ 1,363,305
Accounts Payable (Note 12)	$ 2,102,870	$ 1,799,671
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,409,853	1,325,926
Environmental Liabilities (Note 14)	0	0
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	3,113,177	2,807,834
Debt Held by Public (Note 13)	0	0
TOTAL LIABILITIES	$ 7,844,602	$ 7,296,736
NET POSITION		
Unexpended Appropriations (Note 18)	$ 0	$ 0
Cumulative Results of Operations	18,136,830	18,006,706
TOTAL NET POSITION	$ 18,136,830	$ 18,006,706
TOTAL LIABILITIES AND NET POSITION	$ 25,981,432	$ 25,303,442

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Total	Eliminations	2003 Consolidated	2002 Consolidated
Program Costs				
Base Support				
Intragovernmental Gross Costs	$ 1,008,827	$ 0	$ 1,008,827	$ 1,634,739
(Less: Intragovernmental Earned Revenue)	(1,584,722)	0	(1,584,722)	(1,627,848)
Intragovernmental Net Costs	$ (575,895)	$ 0	$ (575,895)	$ 6,891
Gross Costs With the Public	$ 560,902	0	560,902	19,753
(Less: Earned Revenue From the Public)	0	0	0	(64,086)
Net Costs With the Public	$ 560,902	$ 0	$ 560,902	$ (44,333)
Net Program Cost	$ (14,993)	$ 0	$ (14,993)	$ (37,442)
Component Level				
Intragovernmental Gross Costs	$ (5,267,415)	$ 0	$ (5,267,415)	$ (12,661,671)
(Less: Intragovernmental Earned Revenue)	3,370,279	0	3,370,279	2,152,034
Intragovernmental Net Costs	$ (1,897,136)	$ 0	$ (1,897,136)	$ (10,509,637)
Gross Costs With the Public	$ 1,763,338	0	1,763,338	12,335,314
(Less: Earned Revenue From the Public)	(750,905)	0	(750,905)	1,272
Net Costs With the Public	$ 1,012,433	$ 0	$ 1,012,433	$ 12,336,586
Net Program Cost	$ (884,703)	$ 0	$ (884,703)	$ 1,826,949
Depot Maintenance, Aviation				
Intragovernmental Gross Costs	$ 1,333,506	$ 0	$ 1,333,506	$ 2,146,371
(Less: Intragovernmental Earned Revenue)	(2,355,599)	0	(2,355,599)	(1,973,128)
Intragovernmental Net Costs	$ (1,022,093)	$ 0	$ (1,022,093)	$ 173,243
Gross Costs With the Public	$ 945,884	0	945,884	43,155
(Less: Earned Revenue From the Public)	(12,226)	0	(12,226)	(50,214)
Net Costs With the Public	$ 933,658	$ 0	$ 933,658	$ (7,059)
Net Program Cost	$ (88,435)	$ 0	$ (88,435)	$ 166,184
Depot Maintenance, Marine Corps				
Intragovernmental Gross Costs	$ 21,757	$ 0	$ 21,757	$ 208,091
(Less: Intragovernmental Earned Revenue)	(224,548)	0	(224,548)	(207,825)
Intragovernmental Net Costs	$ (202,791)	$ 0	$ (202,791)	$ 266
Gross Costs With the Public	$ 222,057	0	222,057	3,620
(Less: Earned Revenue From the Public)	(3,578)	0	(3,578)	(4,327)
Net Costs With the Public	$ 218,479	$ 0	$ 218,479	$ (707)
Net Program Cost	$ 15,688	$ 0	$ 15,688	$ (441)

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Total	Eliminations	2003 Consolidated	2002 Consolidated
Program Costs				
Depot Maintenance, Shipyards				
Intragovernmental Gross Costs	$ 1,019,640	$ 0	$ 1,019,640	$ 2,726,318
(Less: Intragovernmental Earned Revenue)	(2,750,642)	0	(2,750,642)	(2,534,914)
Intragovernmental Net Costs	$ (1,731,002)	$ 0	$ (1,731,002)	$ 191,404
Gross Costs With the Public	$ 1,650,127	0	1,650,127	107,251
(Less: Earned Revenue From the Public)	0	0	0	(16,895)
Net Costs With the Public	$ 1,650,127	$ 0	$ 1,650,127	$ 90,356
Net Program Cost	$ (80,875)	$ 0	$ (80,875)	$ 281,760
Ordnance				
Intragovernmental Gross Costs	$ 71	$ 0	$ 71	$ (56,748)
(Less: Intragovernmental Earned Revenue)	(926)	0	(926)	0
Intragovernmental Net Costs	$ (855)	$ 0	$ (855)	$ (56,748)
Gross Costs With the Public	$ 512	0	512	0
(Less: Earned Revenue From the Public)	0	0	0	(604)
Net Costs With the Public	$ 512	$ 0	$ 512	$ (604)
Net Program Cost	$ (343)	$ 0	$ (343)	$ (57,352)
Transportation				
Intragovernmental Gross Costs	$ 1,299,609	$ 0	$ 1,299,609	$ 1,383,045
(Less: Intragovernmental Earned Revenue)	(1,844,089)	0	(1,844,089)	(1,516,715)
Intragovernmental Net Costs	$ (544,480)	$ 0	$ (544,480)	$ (133,670)
Gross Costs With the Public	$ 489,538	0	489,538	4,103
(Less: Earned Revenue From the Public)	0	0	0	(1,950)
Net Costs With the Public	$ 489,538	$ 0	$ 489,538	$ 2,153
Net Program Cost	$ (54,942)	$ 0	$ (54,942)	$ (131,517)
Research & Development				
Intragovernmental Gross Costs	$ 5,822,619	$ 0	$ 5,822,619	$ 9,030,982
(Less: Intragovernmental Earned Revenue)	(9,585,868)	0	(9,585,868)	(9,119,274)
Intragovernmental Net Costs	$ (3,763,249)	$ 0	$ (3,763,249)	$ (88,292)
Gross Costs With the Public	$ 3,750,586	0	3,750,586	127,598
(Less: Earned Revenue From the Public)	0	0	0	(351,023)
Net Costs With the Public	$ 3,750,586	$ 0	$ 3,750,586	$ (223,425)
Net Program Cost	$ (12,663)	$ 0	$ (12,663)	$ (311,717)

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF NET COST
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Total	Eliminations	2003 Consolidated	2002 Consolidated
Program Costs				
Supply Management				
Intragovernmental Gross Costs	$ 183,636	$ 0	$ 183,636	$ 971,197
(Less: Intragovernmental Earned Revenue)	(6,895,749)	0	(6,895,749)	(6,088,590)
Intragovernmental Net Costs	$ (6,712,113)	$ 0	$ (6,712,113)	$ (5,117,393)
Gross Costs With the Public	$ 8,273,309	0	8,273,309	6,196,608
(Less: Earned Revenue From the Public)	0	0	0	(374,865)
Net Costs With the Public	$ 8,273,309	$ 0	$ 8,273,309	$ 5,821,743
Net Program Cost	$ 1,561,196	$ 0	$ 1,561,196	$ 704,350
Total Program Costs				
Intragovernmental Gross Costs	$ 5,422,250	$ 0	$ 5,422,250	$ 5,382,324
(Less: Intragovernmental Earned Revenue)	(21,871,864)	0	(21,871,864)	(20,916,260)
Intragovernmental Net Costs	$ (16,449,614)	$ 0	$ (16,449,614)	$ (15,533,936)
Gross Costs With the Public	$ 17,656,253	0	17,656,253	18,837,402
(Less: Earned Revenue From the Public)	(766,709)	0	(766,709)	(862,692)
Net Costs With the Public	$ 16,889,544	$ 0	$ 16,889,544	$ 17,974,710
Net Program Cost	$ 439,930	$ 0	$ 439,930	$ 2,440,774
Costs Not Assigned to Programs	0	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0	0
Net Cost of Operations	$ 439,930	$ 0	$ 439,930	$ 2,440,774

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps	Ordnance
Cumulative Results of Operations				
Beginning Balances	$ 947,968	$ 347,908	$ 66,559	$ 168,016
Prior period adjustments (+/-)	(4,957)	0	0	(767)
Beginning Balances, as adjusted	$ 943,011	$ 347,908	$ 66,559	$ 167,249
Budgetary Financing Sources:				
Appropriations Received	$ 0	$ 0	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	0	0	0	0
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
Other Financing Sources:				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	29,841	(16,050)	0	0
Imputed financing from costs absorbed by others	0	0	7,609	0
Other (+/-)	0	0	0	0
Total Financing Sources	$ 29,841	$ (16,050)	$ 7,609	$ 0
Net Cost of Operations (+/-)	$ (80,875)	$ (88,435)	$ 15,688	$ (343)
Ending Balances	$ 1,053,727	$ 420,293	$ 58,480	$ 167,592
Unexpended Appropriations				
Beginning Balances	$ 0	$ 0	$ 0	$ 0
Prior period adjustments (+/-)	0	0	0	0
Beginning Balances, as adjusted	$ 0	$ 0	$ 0	$ 0
Budgetary Financing Sources:				
Appropriations Received	$ 0	$ 0	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	0	0	0	0
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
Other Financing Sources:				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	0	0
Total Financing Sources	$ 0	$ 0	$ 0	$ 0
Net Cost of Operations (+/-)	$ 0	$ 0	$ 0	$ 0
Ending Balances	$ 0	$ 0	$ 0	$ 0

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	Transportation	Base Support	Research & Development	Supply Management
Cumulative Results of Operations				
Beginning Balances	$ (95,093)	$ 677,090	$ 512,075	$ 16,610,137
Prior period adjustments (+/-)	0	(30)	0	5,885
Beginning Balances, as adjusted	$ (95,093)	$ 677,060	$ 512,075	$ 16,616,022
Budgetary Financing Sources:				
Appropriations Received	$ 0	$ 0	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	33,049	0
Appropriations used	0	0	0	40,200
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
Other Financing Sources:				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	(425)	51,141	(3,379)	819,764
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	0	0
Total Financing Sources	$ (425)	$ 51,141	$ 29,670	$ 859,964
Net Cost of Operations (+/-)	$ (54,942)	$ (14,993)	$ (12,663)	$ 1,561,196
Ending Balances	$ (40,576)	$ 743,194	$ 554,408	$ 15,914,790
Unexpended Appropriations				
Beginning Balances	$ 0	$ 0	$ 0	$ 0
Prior period adjustments (+/-)	0	0	0	0
Beginning Balances, as adjusted	$ 0	$ 0	$ 0	$ 0
Budgetary Financing Sources:				
Appropriations Received	$ 0	$ 0	$ 0	$ 40,200
Appropriations transferred in/out (+/-)	0	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0	0
Appropriations used	0	0	0	(40,200)
Nonexchange revenue	0	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Other budgetary financing sources (+/-)	0	0	0	0
Other Financing Sources:				
Donations and forfeitures of property	0	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0	0
Imputed financing from costs absorbed by others	0	0	0	0
Other (+/-)	0	0	0	0
Total Financing Sources	$ 0	$ 0	$ 0	$ 0
Net Cost of Operations (+/-)	$ 0	$ 0	$ 0	$ 0
Ending Balances	$ 0	$ 0	$ 0	$ 0

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	Component Level	Combined Total	Eliminations
Cumulative Results of Operations			
Beginning Balances	$ (1,227,954)	$ 18,006,706	$ 0
Prior period adjustments (+/-)	(131)	0	0
Beginning Balances, as adjusted	$ (1,228,085)	$ 18,006,706	$ 0
Budgetary Financing Sources:			
Appropriations Received	$ 0	$ 0	$ 0
Appropriations transferred in/out (+/-)	0	0	0
Other adjustments (rescissions, etc) (+/-)	(33,049)	0	0
Appropriations used	0	40,200	0
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	(894,419)	(13,527)	0
Imputed financing from costs absorbed by others	535,772	543,381	0
Other (+/-)	0	0	0
Total Financing Sources	$ (391,696)	$ 570,054	$ 0
Net Cost of Operations (+/-)	$ (884,703)	$ 439,930	$ 0
Ending Balances	$ (735,078)	$ 18,136,830	$ 0
Unexpended Appropriations			
Beginning Balances	$ 0	$ 0	$ 0
Prior period adjustments (+/-)	0	0	0
Beginning Balances, as adjusted	$ 0	$ 0	$ 0
Budgetary Financing Sources:			
Appropriations Received	$ 0	$ 40,200	$ 0
Appropriations transferred in/out (+/-)	0	0	0
Other adjustments (rescissions, etc) (+/-)	0	0	0
Appropriations used	0	(40,200)	0
Nonexchange revenue	0	0	0
Donations and forfeitures of cash and cash equivalents	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Other budgetary financing sources (+/-)	0	0	0
Other Financing Sources:			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	0	0	0
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
Total Financing Sources	$ 0	$ 0	$ 0
Net Cost of Operations (+/-)	$ 0	$ 0	$ 0
Ending Balances	$ 0	$ 0	$ 0

Department of Defense
Navy Working Capital Fund
CONSOLIDATING STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Consolidated	2002 Consolidated
Cumulative Results of Operations		
Beginning Balances	$ 18,006,706	$ 17,718,572
Prior period adjustments (+/-)	0	1,952,397
Beginning Balances, as adjusted	$ 18,006,706	19,670,969
Budgetary Financing Sources:		
Appropriations Received	$ 0	0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	40,200	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	312,060
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	(13,527)	(1,138)
Imputed financing from costs absorbed by others	543,381	465,589
Other (+/-)	0	0
Total Financing Sources	$ 570,054	776,511
Net Cost of Operations (+/-)	$ 439,930	2,440,774
Ending Balances	$ 18,136,830	$ 18,006,706
Unexpended Appropriations		
Beginning Balances	$ 0	$ 0
Prior period adjustments (+/-)	0	0
Beginning Balances, as adjusted	$ 0	$ 0
Budgetary Financing Sources:		
Appropriations Received	$ 40,200	$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	(40,200)	0
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	$ 0	$ 0
Net Cost of Operations (+/-)	$ 0	$ 0
Ending Balances	$ 0	$ 0

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations Received	$ 0	$ 0	$ 0
Borrowing Authority	0	0	0
Contract Authority	0	0	0
Net transfers (+/-)	0	0	0
Other	0	0	0
Unobligated Balance:			
Beginning of period	421,463	640,385	63,188
Net transfers, actual (+/-)	0	0	0
Anticipated Transfers Balances	0	0	0
Spending Authority from Offsetting Collections:			
Earned	0	0	0
Collected	2,655,831	2,342,024	215,430
Receivable from Federal sources	(586)	34,541	10,600
Change in unfilled customer orders	0	0	0
Advances received	65,403	2,281	1,075
Without advance from Federal sources	608,638	88,350	84,948
Anticipated for the rest of year, without advances	0	0	0
Transfers from trust funds	0	0	0
Subtotal	$ 3,329,286	$ 2,467,196	$ 312,053
Recoveries of prior year obligations	$ 0	$ 0	$ 0
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	(38,900)	(17,973)	0
Total Budgetary Resources	$ 3,711,849	$ 3,089,608	$ 375,241

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred:			
Direct	$ 0	$ 0	$ 0
Reimbursable	2,431,161	2,112,126	255,736
Subtotal	$ 2,431,161	$ 2,112,126	$ 255,736
Unobligated balance:			
Apportioned	$ 1,280,688	977,482	119,505
Exempt from apportionment	0	0	0
Other available	0	0	0
Unobligated Balances Not Available	0	0	0
Total, Status of Budgetary Resources	$ 3,711,849	$ 3,089,608	$ 375,241
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:			
Obligated Balance, Net-beginning of period	$ 279,894	$ 160,824	$ (16,419)
Obligated Balance transferred, net (+/-)	0	0	0
Obligated Balance, net-end of period:			
Accounts Receivable	(8,730)	(141,440)	(20,336)
Unfilled customer order from Federal sources	(1,506,419)	(911,219)	(133,756)
Undelivered Orders	598,499	174,417	35,339
Accounts Payable	311,824	827,871	19,570
Outlays:			
Disbursements	2,707,828	2,200,432	242,952
Collections	(2,721,235)	(2,344,305)	(216,504)
Subtotal	$ (13,407)	$ (143,873)	$ 26,448
Less: Offsetting receipts	0	0	0
Net Outlays	$ (13,407)	$ (143,873)	$ 26,448

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Ordnance	Transportation	Base Support
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations Received	$ 0	$ 0	$ 0
Borrowing Authority	0	0	0
Contract Authority	0	0	340
Net transfers (+/-)	0	0	0
Other	0	0	0
Unobligated Balance:			
Beginning of period	265,628	176,443	207,122
Net transfers, actual (+/-)	0	0	0
Anticipated Transfers Balances	0	0	0
Spending Authority from Offsetting Collections:			
Earned	0	0	0
Collected	1,025	1,796,663	1,652,496
Receivable from Federal sources	(135)	47,626	(15,269)
Change in unfilled customer orders	0	0	0
Advances received	(68)	0	30,142
Without advance from Federal sources	(2,553)	123,097	(9,705)
Anticipated for the rest of year, without advances	0	0	0
Transfers from trust funds	0	0	0
Subtotal	$ (1,731)	$ 1,967,386	$ 1,657,664
Recoveries of prior year obligations	$ 0	$ 0	$ 0
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	0	(134,684)	0
Total Budgetary Resources	$ 263,897	$ 2,009,145	$ 1,865,126

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Ordnance	Transportation	Base Support
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred:			
Direct	$ 0	$ 0	$ 0
Reimbursable	53,569	1,798,511	1,627,419
Subtotal	$ 53,569	$ 1,798,511	$ 1,627,419
Unobligated balance:			
Apportioned	$ 210,328	210,634	237,707
Exempt from apportionment	0	0	0
Other available	0	0	0
Unobligated Balances Not Available	0	0	0
Total, Status of Budgetary Resources	$ 263,897	$ 2,009,145	$ 1,865,126
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:			
Obligated Balance, Net-beginning of period	$ (36,110)	$ 241,275	$ 105,108
Obligated Balance transferred, net (+/-)	0	0	0
Obligated Balance, net-end of period:			
Accounts Receivable	(826)	(143,258)	(144,004)
Unfilled customer order from Federal sources	(15,027)	(158,231)	(252,069)
Undelivered Orders	6,318	(17,495)	170,814
Accounts Payable	(91,803)	514,603	347,565
Outlays:			
Disbursements	121,486	1,673,444	1,635,195
Collections	(957)	(1,796,663)	(1,682,638)
Subtotal	$ 120,529	$ (123,219)	$ (47,443)
Less: Offsetting receipts	0	0	0
Net Outlays	$ 120,529	$ (123,219)	$ (47,443)

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Research & Development	Supply Management	Component Level
BUDGETARY RESOURCES			
Budget Authority:			
Appropriations Received	$ 0	$ 40,200	$ 0
Borrowing Authority	0	0	0
Contract Authority	0	557,804	0
Net transfers (+/-)	0	0	0
Other	0	0	0
Unobligated Balance:			
Beginning of period	1,199,702	711,212	432,078
Net transfers, actual (+/-)	10,501	(10,505)	(30,196)
Anticipated Transfers Balances	0	0	0
Spending Authority from Offsetting Collections:			
Earned	0	0	0
Collected	9,766,600	6,842,601	312,877
Receivable from Federal sources	(145,480)	(50,647)	(312,877)
Change in unfilled customer orders	0	0	0
Advances received	78,047	1,359	0
Without advance from Federal sources	967,075	104,325	0
Anticipated for the rest of year, without advances	0	0	0
Transfers from trust funds	0	0	0
Subtotal	$ 10,666,242	$ 6,897,638	$ 0
Recoveries of prior year obligations	$ 0	$ 0	$ 0
Temporarily not available pursuant to Public Law	0	0	0
Permanently not available	(12,583)	0	0
Total Budgetary Resources	$ 11,863,862	$ 8,196,349	$ 401,882

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	Research & Development	Supply Management	Component Level
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred:			
Direct	$ 0	$ 0	$ 0
Reimbursable	10,828,358	8,158,986	(2,235)
Subtotal	$ 10,828,358	$ 8,158,986	$ (2,235)
Unobligated balance:			
Apportioned	$ 1,035,503	156,152	404,116
Exempt from apportionment	0	0	0
Other available	1	0	1
Unobligated Balances Not Available	0	(118,789)	0
Total, Status of Budgetary Resources	$ 11,863,862	$ 8,196,349	$ 401,882
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:			
Obligated Balance, Net-beginning of period	$ 52,929	$ 3,343,567	$ (1,145,306)
Obligated Balance transferred, net (+/-)	0	0	0
Obligated Balance, net-end of period:			
Accounts Receivable	13,750	(217,164)	320,911
Unfilled customer order from Federal sources	(4,813,043)	(966,366)	0
Undelivered Orders	2,243,490	4,787,060	0
Accounts Payable	2,703,194	914,048	(1,173,973)
Outlays:			
Disbursements	9,912,300	6,931,297	18,398
Collections	(9,844,646)	(6,843,960)	(312,877)
Subtotal	$ 67,654	$ 87,337	$ (294,479)
Less: Offsetting receipts	0	0	0
Net Outlays	$ 67,654	$ 87,337	$ (294,479)

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	2003 Combined	2002 Combined
BUDGETARY RESOURCES		
Budget Authority:		
Appropriations Received	$ 40,200	$ 0
Borrowing Authority	0	0
Contract Authority	558,144	818,950
Net transfers (+/-)	0	0
Other	0	0
Unobligated Balance:		
Beginning of period	4,117,221	3,106,657
Net transfers, actual (+/-)	(30,200)	0
Anticipated Transfers Balances	0	0
Spending Authority from Offsetting Collections:		
Earned	0	0
Collected	25,585,547	24,242,264
Receivable from Federal sources	(432,227)	(478,538)
Change in unfilled customer orders	0	0
Advances received	178,239	58,673
Without advance from Federal sources	1,964,175	773,407
Anticipated for the rest of year, without advances	0	0
Transfers from trust funds	0	0
Subtotal	$ 27,295,734	$ 24,595,806
Recoveries of prior year obligations	$ 0	$ 0
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(204,140)	(417,232)
Total Budgetary Resources	$ 31,776,959	$ 28,104,181

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF BUDGETARY RESOURCES
For the years ended September 30, 2003 and 2002
($ in thousands)

BUDGETARY FINANCING ACCOUNTS

	2003 Combined	2002 Combined
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	$ 0	$ 0
Reimbursable	27,263,631	23,986,959
Subtotal	$ 27,263,631	23,986,959
Unobligated balance:		
Apportioned	$ 4,632,115	4,117,221
Exempt from apportionment	0	0
Other available	2	1
Unobligated Balances Not Available	(118,789)	0
Total, Status of Budgetary Resources	$ 31,776,959	$ 28,104,181
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net-beginning of period	$ 2,985,762	$ 2,421,105
Obligated Balance transferred, net (+/-)	0	0
Obligated Balance, net-end of period:		
Accounts Receivable	(341,097)	(773,326)
Unfilled customer order from Federal sources	(8,756,130)	(6,791,954)
Undelivered Orders	7,998,442	7,327,957
Accounts Payable	4,372,899	3,223,082
Outlays:		
Disbursements	25,443,332	23,127,436
Collections	(25,763,785)	(24,300,937)
Subtotal	$ (320,453)	(1,173,501)
Less: Offsetting receipts	0	0
Net Outlays	$ (320,453)	$ (1,173,501)

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations Incurred	$ 2,431,161	$ 2,112,126	$ 255,736
Less: Spending Authority from offsetting collections and recoveries (-)	(3,329,287)	(2,467,195)	(312,052)
Obligations net of offsetting collections and recoveries	$ (898,126)	$ (355,069)	$ (56,316)
Less: Offsetting receipts (-)	0	0	0
Net obligations	$ (898,126)	$ (355,069)	$ (56,316)
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	29,841	(16,050)	0
Imputed financing from costs absorbed by others	0	0	7,609
Other (+/-)	0	0	0
Net other resources used to finance activities	$ 29,841	$ (16,050)	$ 7,609
Total resources used to finance activities	$ (868,285)	$ (371,119)	$ (48,707)
Resources Used to Finance Items not Part of the Net Cost of Operations:			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered orders (-)	$ (7,452)	$ 38,944	$ (7,252)
Unfilled Customer Orders	674,041	90,631	86,022
Resources that fund expenses recognized in prior periods	0	0	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0	0
Resources that finance the acquisition of assets	81,564	122,835	(18,899)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations			
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0	0
Other (+/-)	0	0	0
Total resources used to finance items not part of the Net Cost of Operations	$ 748,153	$ 252,410	$ 59,871
Total resources used to finance the Net Cost of Operations	$ (120,132)	$ (118,709)	$ 11,164

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Depot Maintenance, Shipyards	Depot Maintenance, Aviation	Depot Maintenance, Marine Corps
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 Periods:			
Increase in annual leave liability	$ 0	$ 0	$ 0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0
Other (+/-)	0	0	959
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 0	$ 0	$ 959
Components not Requiring or Generating Resources:			
Depreciation and amortization	$ 39,256	$ 30,273	$ 3,564
Revaluation of assets and liabilities (+/-)	0	0	0
Other (+/-)	0	0	0
Total components of Net Cost of Operations that will not require or generate resources	$ 39,256	$ 30,273	$ 3,564
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 39,256	$ 30,273	$ 4,523
Net Cost of Operations	$ (80,876)	$ (88,436)	$ 15,687

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Ordnance	Transportation	Base Support
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations Incurred	$ 53,569	$ 1,798,511	$ 1,627,419
Less: Spending Authority from offsetting collections and recoveries (-)	1,730	(1,967,386)	(1,657,664)
Obligations net of offsetting collections and recoveries	$ 55,299	$ (168,875)	$ (30,245)
Less: Offsetting receipts (-)	0	0	0
Net obligations	$ 55,299	$ (168,875)	$ (30,245)
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	0	(425)	51,141
Imputed financing from costs absorbed by others	0	0	0
Other (+/-)	0	0	0
Net other resources used to finance activities	$ 0	$ (425)	$ 51,141
Total resources used to finance activities	$ 55,299	$ (169,300)	$ 20,896
Resources Used to Finance Items not Part of the Net Cost of Operations:			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered orders (-)	$ 5,289	$ 48,047	$ 69,090
Unfilled Customer Orders	(2,621)	123,097	20,437
Resources that fund expenses recognized in prior periods	0	0	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0	0
Resources that finance the acquisition of assets	(58,311)	(62,812)	(141,549)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations			
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0	0
Other (+/-)	0	0	0
Total resources used to finance items not part of the Net Cost of Operations	$ (55,643)	$ 108,332	$ (52,022)
Total resources used to finance the Net Cost of Operations	$ (344)	$ (60,968)	$ (31,126)

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Ordnance	Transportation	Base Support
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 Periods:			
Increase in annual leave liability	$ 0	$ 0	$ 0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0
Other (+/-)	0	0	0
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 0	$ 0	$ 0
Components not Requiring or Generating Resources:			
Depreciation and amortization	$ 0	$ 6,025	$ 16,135
Revaluation of assets and liabilities (+/-)	0	0	0
Other (+/-)	0	0	0
Total components of Net Cost of Operations that will not require or generate resources	$ 0	$ 6,025	$ 16,135
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 0	$ 6,025	$ 16,135
Net Cost of Operations	$ (344)	$ (54,943)	$ (14,991)

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Research & Development	Supply Management	Component Level
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations Incurred	$ 10,828,358	$ 8,158,986	$ (2,235)
Less: Spending Authority from offsetting collections and recoveries (-)	(10,666,242)	(6,897,638)	0
Obligations net of offsetting collections and recoveries	$ 162,116	$ 1,261,348	$ (2,235)
Less: Offsetting receipts (-)	0	0	0
Net obligations	$ 162,116	$ 1,261,348	$ (2,235)
Other Resources			
Donations and forfeitures of property	0	0	0
Transfers in/out without reimbursement (+/-)	(3,379)	819,764	(894,419)
Imputed financing from costs absorbed by others	0	0	535,772
Other (+/-)	0	0	0
Net other resources used to finance activities	$ (3,379)	$ 819,764	$ (358,647)
Total resources used to finance activities	$ 158,737	$ 2,081,112	$ (360,882)
Resources Used to Finance Items not Part of the Net Cost of Operations:			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			
Undelivered orders (-)	$ (283,624)	$ (531,309)	$ (35,261)
Unfilled Customer Orders	1,045,122	105,684	0
Resources that fund expenses recognized in prior periods	0	0	0
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	0	0	8
Resources that finance the acquisition of assets	(1,072,496)	(178,443)	(571,533)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations			
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)	0	0	0
Other (+/-)	0	0	0
Total resources used to finance items not part of the Net Cost of Operations	$ (310,998)	$ (604,068)	$ (606,786)
Total resources used to finance the Net Cost of Operations	$ (152,261)	$ 1,477,044	$ (967,668)

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	Research & Development	Supply Management	Component Level
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 Periods:			
Increase in annual leave liability	$ 0	$ 0	$ 0
Increase in environmental and disposal liability	0	0	0
Upward/Downward reestimates of credit subsidy expense	0	0	0
Increase in exchange revenue receivable from the public (-)	0	0	0
Other (+/-)	0	0	82,968
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 0	$ 0	$ 82,968
Components not Requiring or Generating Resources:			
Depreciation and amortization	$ 139,599	$ 8,903	$ 0
Revaluation of assets and liabilities (+/-)	0	74,973	0
Other (+/-)	0	275	0
Total components of Net Cost of Operations that will not require or generate resources	$ 139,599	$ 84,151	$ 0
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 139,599	$ 84,151	$ 82,968
Net Cost of Operations	$ (12,662)	$ 1,561,195	$ (884,700)

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

		2003 Combined		2002 Combined
Resources Used to Finance Activities:				
Budgetary Resources Obligated				
Obligations Incurred	$	27,263,631	$	23,986,959
Less: Spending Authority from offsetting collections and recoveries (-)		(27,295,734)		(24,595,804)
Obligations net of offsetting collections and recoveries	$	(32,103)	$	(608,845)
Less: Offsetting receipts (-)		0		0
Net obligations	$	(32,103)	$	(608,845)
Other Resources				
Donations and forfeitures of property		0		0
Transfers in/out without reimbursement (+/-)		(13,527)		0
Imputed financing from costs absorbed by others		543,381		465,589
Other (+/-)		0		0
Net other resources used to finance activities	$	529,854	$	465,589
Total resources used to finance activities	$	497,751	$	(143,256)
Resources Used to Finance Items not Part of the Net Cost of Operations:				
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided				
Undelivered orders (-)	$	(703,528)	$	(3,023,627)
Unfilled Customer Orders		2,142,413		832,080
Resources that fund expenses recognized in prior periods		0		(46,725)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations		8		0
Resources that finance the acquisition of assets		(1,899,644)		5,167,247
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations				
Less: Trust or Special Fund receipts related to exchange in the entity's budget (-)		0		0
Other (+/-)		0		0
Total resources used to finance items not part of the Net Cost of Operations	$	(460,751)	$	2,928,975
Total resources used to finance the Net Cost of Operations	$	37,000	$	2,785,719

Department of Defense
Navy Working Capital Fund
COMBINING STATEMENT OF FINANCING
For the years ended September 30, 2003 and 2002
($ in thousands)

	2003 Combined	2002 Combined
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 Periods:		
Increase in annual leave liability	$ 0	$ 0
Increase in environmental and disposal liability	0	0
Upward/Downward reestimates of credit subsidy expense	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	83,927	0
Total components of Net Cost of Operations that will require or generate resources in future periods	$ 83,927	$ 0
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 243,755	$ 210,489
Revaluation of assets and liabilities (+/-)	74,973	(555,389)
Other (+/-)	275	(41)
Total components of Net Cost of Operations that will not require or generate resources	$ 319,003	$ (344,941)
Total components of Net Cost of Operations that will not require or generate resources in the current period	$ 402,930	$ (344,941)
Net Cost of Operations	$ 439,930	$ 2,440,774

Department of the Navy

Navy Working Capital Fund
Required Supplementary Information

Navy Working Capital Fund
General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and Restoration Tables
As of September 30, 2003
($ in Millions)

Annual Sustainment F Y 2003			
	Required	Actual	Difference
Navy			
Marine Corps			
Building, Structures, and Utilities	1,360	1,360	0

Annual Deferred Sustainment Trend				
	FY 2000	FY 2001	FY 2002	FY 2003
Navy				
Marine Corps				
Building, Structures, and Utilities	0	72	0	0

Restoration and Modernization Requirements			
	End FY 2002	End FY 2003	Change
Navy			
Marine Corps			
Building, Structures, and Utilities	0	0	0

Narrative Statement:

In FY 2003, Navy Working Capital Fund facilities transitioned to OSD's Facility Sustainment Model for calculating deferred sustainment and restoration.

The quality of data used in the Facility Sustainment Model continued to undergo quality checks in FY 2003, resulting in a more accurate accounting of deferred sustainment requirements.

Presently, a separate breakout between the Navy and Marine Corps sustainment amounts cannot be provided. Due to this limitation, information in the Real Property Deferred Annual Sustainment and Restoration Tables are presented as overall Totals for the Department of the Navy (DON).

The Facility Sustainment Model calculates facility sustainment investment based on the DON property inventory, facility type, key units of measure, geographic location and industry standards. The variables are constantly being examined to reduce errors and disconnects for unique DON facility requirements.

The NWCF has no material amounts of deferred sustainment for General Property, Plant, and Equipment category of Personal Property.

Schedule, Part A DoD Intra-governmental ($ Amounts in Thousands)	Treasury Index	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
Department of Agriculture	12		$5			
Department of Commerce	13		182			
Department of the Interior	14		91			
Department of Justice	15		286			
Navy General Fund	17		420,647			
United States Postal Service	18		6			
Department of State	19		320			
Department of the Treasury	20	$1,827,646	35			
Army General Fund	21		17,241			
Nuclear Regulatory Commission	31		10			
Department of Veterans Affairs	36		255			
General Service Administration	47		60			
National Science Foundation	49		5			
General Accounting Office	5		1,504			
Air Force General Fund	57		10,108			
Federal Emergency Management Agency	58		15			
Environmental Protection Agency	68		374			
Department of Transportation	69		12,131			
Agency for International Development	72		13			
Department of Health and Human Services	75		348			
National Aeronautics and Space Administration	80		267			
Department of Energy	89		437			
Department of Education	91		79			
US Army Corps of Engineers	96		394			
Other Defense Organizations General Funds	97		82,406			
Other Defense Organizations Working Capital Funds	97-4930		27,041			
Army Working Capital Fund	97-4930.001		1,141			$933
Air Force Working Capital Fund	97-4930.003		4,323			9,458
DoD Medicare-Eligible Retiree Health Care Fund			3,050			
	Totals:	**$1,827,646**	**$582,774**	**$ -**	**$ -**	**$10,391**

Note: Totals might not match the amounts shown on the Principal Statements.

Schedule, Part B DoD Intra-governmental Entity Liabilities ($ Amounts in Thousands)	Treasury Index	Accounts Payable	Debts / Borrowings From Other Agencies	Other
Executive Office of the President	11			$397
Department of Agriculture	12			3,429
Department of Commerce	13			2,215
Department of the Interior	14			1,918
Department of Justice	15			26,561
Navy General Fund	17	$145,038		130,165
United States Postal Service	18			10,095
Department of State	19			2,144
Department of the Treasury	20		$615,648	1,051
Office of Personnel Management	24			38,056
Social Security Administration	28			185
Nuclear Regulatory Commission	31			98
Smithsonian Institution	33			1,396
Department of Veterans Affairs	36			209
General Service Administration	47			88
National Science Foundation	49			19,058
Securities and Exchange Commission	50			38
Air Force General Fund	57	236		133
National Foundation on the Arts and Humanities	59			195
Environmental Protection Agency	68			1,652
Department of Transportation	69			8,423
Agency for International Development	72			264
Small Business Administration	73			5
Department of Health and Human Services	75			2,868
National Aeronautics and Space Administration	80			12,969
Department of Housing and Urban Development	86			4
Department of Energy	89			1,805
Department of Education	91			4,630
US Army Corps of Engineers	96	3		
Other Defense Organizations General Funds	97	2,193		10
Other Defense Organizations Working Capital Funds	97-4930	145,115		
Army Working Capital Fund	97-4930.001	9,085		
Air Force Working Capital Fund	97-4930.003	12,118		
The General Fund of the Treasury	99			11,617
Homeland Security				7,590
	Totals:	**$313,788**	**$615,648**	**$289,268**

Note: Totals might not match the amounts shown on the Principal Statements.

Schedule, Part C DoD Intra-governmental revenue and related costs ($ Amounts in Thousands)	Treasury Index	Earned Revenue
Executive Office of the President	11	$ 4,968
Department of Agriculture	12	5,562
Department of Commerce	13	9,252
Department of the Interior	14	1,135
Department of Justice	15	88,634
Navy General Fund	17	18,912,777
United States Postal Service	18	3,019
Department of State	19	9,534
Department of the Treasury	20	5,794
Army General Fund	21	281,499
Social Security Administration	28	912
Nuclear Regulatory Commission	31	548
Smithsonian Institution	33	66
Department of Veterans Affairs	36	4,217
General Service Administration	47	926
National Science Foundation	49	14,248
General Accounting Office	5	373
Air Force General Fund	57	329,269
Federal Emergency Management Agency	58	190
National Foundation on the Arts and Humanities	59	205
Consumer Product Safety Commission	61	172
Environmental Protection Agency	68	4,020
Department of Transportation	69	36,744
Agency for International Development	72	7,032
Department of Health and Human Services	75	9,410
National Aeronautics and Space Administration	80	41,654
Department of Housing and Urban Development	86	27
Department of Energy	89	33,448
US Army Corps of Engineers	96	2,082
Other Defense Organizations General Funds	97	1,605,987
Other Defense Organizations Working Capital Funds	97-4930	188,156
Army Working Capital Fund	97-4930.001	24,929
Air Force Working Capital Fund	97-4930.003	238,319
The General Fund of the Treasury	99	(11,617)
DoD Medicare-Eligible Retiree Health Care Fund		6,756
	Total:	**$ 21,860,247**

Note: Totals might not match the amounts shown on the Principal Statements.

Schedule, Part E DoD Intragovernmental non-exchange revenues ($ Amounts in Thousands)	Treasury Index	Transfers In	Transfers Out
Navy General Fund	17		$ 13,526
	Totals:	**$ -**	**$ 13,526**

Note: Totals might not match the amounts shown on the Principal Statements.

Department of the Navy

Navy Working Capital Fund
Other Accompanying Information

Navy Working Capital Fund
Other Accompanying Information

APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE FINANCIAL STATEMENTS

REPORTING ENTITY
Navy Working Capital Fund

Fund/Account Treasury Symbol and Title:
97X4930 002

Navy Working Capital Fund Activity Group Treasury Symbol and Title:

97X4930.NA1*	Depot Maintenance-Shipyards
97X4930.NA2*	Depot Maintenance-Aviation
97X4930.NA4*	Depot Maintenance- Other (Marine Corps)
97X4930.NA3* a	Ordnance
97X4930.ND*	Transportation
97X4930.NE* *	Base Support
97X4930.NH**	Research and Development
97X4930.NC**	Supply Management

Notes

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

a - 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.

Department of the Navy

Audit Opinions

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

December 3, 2003

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

SUBJECT: Independent Auditor's Report on the Department of the Navy General Fund Fiscal Year 2003 Principal Financial Statements (Report No. D-2004-030)

The Chief Financial Officers Act of 1990, as amended, requires the Inspector General of the Department of Defense to audit the accompanying Consolidated Balance Sheet of the Department of the Navy General Fund as of September 30, 2003 and 2002, and the related Consolidated Statements of Net Cost and Changes in Net Position, the Combined Statements of Financing, the Combined Statements of Budgetary Resources, and the Statements of Custodial Activity for the fiscal years then ended. These financial statements are the responsibility of the 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. In addition to our disclaimer of opinion on the financial statements, we are including the required reports on internal control and compliance with laws and regulations.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies in the Navy General Fund financial statements still exist. Therefore, we did not perform auditing procedures to support material amounts on the financial statements. In addition, other auditing procedures were not performed because Section 1008(d) of the FY 2002 National Defense Authorization Act requires the Inspector General of the Department of Defense to perform only the audit procedures required by generally accepted government auditing standards consistent with the representations made by management. The material deficiencies also affect the reliability of certain information contained in the accompanying Management's Discussion and Analysis and certain other information—much of which is taken from the same data sources as the principal financial statements.[1] These deficiencies would have precluded an audit opinion. As described above, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

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[1] Other information includes the Supporting Consolidating and Combining Financial Statements, the Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. —Constitution of the United States, Article I, Section 9

Summary of Internal Control

In planning and performing our audit, we considered the Department of the Navy's internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance because previously identified reportable conditions,[2] all of which are material, continue to exist in the following areas: accounting and financial management systems, policies, and procedures; internal control structure; and compliance with laws and regulations. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that noncompliance, misstatements, or losses that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Management has acknowledged that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level, as required under the Federal Financial Management Improvement Act (FFMIA) of 1996. Therefore, we did not determine whether the Department of the Navy was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

In order for DoD to comply with statutory reporting requirements and applicable financial systems requirements, the Under Secretary of Defense (Comptroller)/Chief Financial Officer is developing the DoD-wide Business Enterprise Architecture. The DoD anticipates developing and implementing the Business Enterprise Architecture by 2007. Until the architecture is fully developed and implemented, the Department of the Navy will be unable to fully comply with the statutory reporting requirements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to express an opinion on compliance with applicable laws and regulations.

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[2] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 are met;
- ensuring that the Department of the Navy's financial management systems substantially comply with FFMIA of 1996 requirements; and
- complying with applicable laws and regulations.

Paul J. Granetto

Paul J. Granetto, CPA
Director
Defense Financial Auditing
Service

Attachment:
As stated

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. —Constitution of the United States, Article I, Section 9

Reports on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data is accumulated, recorded, and reported properly; and that assets are safeguarded. We did not perform tests of internal control over financial reporting for the Department of the Navy, and we did not obtain sufficient evidence to support or express an opinion on internal control. We limited our audit tests because previously identified reportable conditions, all of which are material, continue to exist. These material internal control weaknesses significantly impair the ability of the Department of the Navy to detect and prevent fraud or theft of assets. A high risk of material misstatements will continue to exist until the internal control deficiencies are corrected. Reportable conditions exist in the following areas.

- **Accounting and Financial Management Systems.** The Department of the Navy financial systems deficiencies include the inability to implement elements of Generally Accepted Accounting Principles (GAAP), and inadequate implementation of the U.S. Government Standard General Ledger.

- **Policies and Procedures.** The Department of the Navy financial reporting is not accurate because of inadequate guidance and lack of standard operating procedures. Additionally, reconciliations are not adequately completed and valuation of Inventory and Operating Materials and Supplies does not comply with GAAP.

- **Efficiency and Effectiveness of Operations.** The Department of the Navy legacy systems do not maintain the historical cost data necessary to comply with Statement of Federal Financial Accounting Standard No. 3, "Accounting for Inventory and Related Property;" the accuracy and reliability of financial data is adversely affected by non-financial feeder systems and journal voucher adjustments; and problem disbursements cause data errors and unreliable obligation data.

Compliance with Laws and Regulations

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

The Department of the Navy is required to comply with financial management systems reporting requirements. For example, the Federal Financial Management Improvement Act of 1996 requires the Department of the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In addition, the Federal Managers' Financial Integrity Act of 1982 requires the Department of the Navy to evaluate the systems and to annually report whether those systems are in compliance with applicable requirements. The Chief Financial Officers Act of 1990 requires DoD to prepare a 5-year Financial Management Plan describing activities that DoD will conduct during the next 5 years to improve financial management.

The Department of the Navy acknowledged that many of its critical financial management and feeder systems do not comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In an attempt to comply with statutory reporting requirements and applicable financial systems requirements, DoD is developing a DoD-wide Business Enterprise Architecture. The architecture is intended to provide a "blueprint" of the Department's financial management systems and processes to initiate a comprehensive financial management reform effort. Until the architecture is fully developed, the Department of the Navy will be unable to fully comply with the statutory reporting requirements. Therefore, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on October 22, 2003, that the Department of the Navy General Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. As a result, we were unable to obtain adequate evidential matter to form or express an opinion on the financial statements, internal control, and compliance with laws and regulations.

We did not conduct audit followup work related to deficiencies identified during previous audits of the Department of the Navy.

In addition, we did not perform audit tests of the Department of the Navy compliance with the Antideficiency Act, the Prompt Payment Act, and the Federal Credit Reform Act.

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.

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

December 3, 2003

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 Fiscal Year 2003 Principal Financial Statements (Report No. D-2004-031)

The Chief Financial Officers Act of 1990, as amended, requires the Inspector General of the Department of Defense to audit the accompanying Consolidated Balance Sheet of the Department of the Navy Working Capital Fund as of September 30, 2003 and 2002, and the related Consolidated Statements of Net Cost and Changes in Net Position, the Combined Statements of Financing, the Combined Statements of Budgetary Resources, and the Statements of Custodial Activity for the fiscal years then ended. These financial statements are the responsibility of the 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. In addition to our disclaimer of opinion on the financial statements, we are including the required reports on internal control and compliance with laws and regulations.

Disclaimer of Opinion on the Financial Statements

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us that material deficiencies in the Navy Working Capital Fund financial statements still exist. Therefore, we did not perform auditing procedures to support material amounts on the financial statements. In addition, other auditing procedures were not performed because Section 1008(d) of the FY 2002 National Defense Authorization Act requires the Inspector General of the Department of Defense to perform only the audit procedures required by generally accepted government auditing standards consistent with the representations made by management. The material deficiencies also affect the reliability of certain information contained in the accompanying Management's Discussion and Analysis and certain other information—much of which is taken from the same data sources as the principal financial statements.[1] These deficiencies would have precluded an audit opinion. As described above, we are unable to express, and we do not express, an opinion on the financial statements and the accompanying information.

[1] Other information includes the Supporting Consolidating and Combining Financial Statements, Required Supplementary Information, and Other Accompanying Information.

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. —Constitution of the United States, Article I, Section 9

Summary of Internal Control

In planning and performing our audit, we considered the Department of the Navy's internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance but not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance because previously identified reportable conditions,[2] all of which are material, continue to exist in the following areas: accounting and financial management systems, policies, and procedures; internal control structure; and compliance with laws and regulations. A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that noncompliance, misstatements, or losses that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

Summary of Compliance with Laws and Regulations

Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Management has acknowledged that critical financial management and feeder systems do not comply with Federal financial systems requirements, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level, as required under the Federal Financial Management Improvement Act (FFMIA) of 1996. Therefore, we did not determine whether the Department of the Navy was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

In order for DoD to comply with statutory reporting requirements and applicable financial systems requirements, the Under Secretary of Defense (Comptroller)/Chief Financial Officer is developing the DoD-wide Business Enterprise Architecture. The DoD Chief Financial Officer anticipates developing and implementing the Business Enterprise Architecture by 2007. Until the architecture is fully developed and implemented, the Department of the Navy will be unable to fully comply with the statutory reporting requirements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to express an opinion on compliance with applicable laws and regulations.

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[2] Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

Management Responsibility

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 are met;
- ensuring that the Department of the Navy's financial management systems substantially comply with FFMIA of 1996 requirements; and
- complying with applicable laws and regulations.

Paul J. Granetto, CPA
Director
Defense Financial Auditing
Service

Attachment:
As stated

A regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. —Constitution of the United States, Article I, Section 9

Reports on Internal Control and Compliance with Laws and Regulations

Internal Control

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data is accumulated, recorded, and reported properly; and that assets are safeguarded. We did not perform tests of internal control over financial reporting for the Department of the Navy, and we did not obtain sufficient evidence to support or express an opinion on internal control. We limited our audit tests because previously identified reportable conditions, all of which are material, continue to exist. These material internal control weaknesses significantly impair the ability of the Department of the Navy to detect and prevent fraud or theft of assets. A high risk of material misstatements will continue to exist until the internal control deficiencies are corrected. Reportable conditions exist in the following areas.

- **Accounting and Financial Management Systems.** The Department of the Navy financial systems deficiencies include the inability to implement elements of Generally Accepted Accounting Principles (GAAP) and inadequate implementation of the U.S. Government Standard General Ledger. Also adjusting entries were needed to correct errors caused by differences between accounting systems.

- **Policies and Procedures.** The Department of the Navy financial reporting is not accurate because of inadequate guidance and lack of standard operating procedures. Additionally, reconciliations are not adequately completed; and valuation of Inventory does not comply with GAAP.

- **Efficiency and Effectiveness of Operations.** The existence, location, and condition of Property, Plant, and Equipment are not adequately maintained and reported; the accuracy and reliability of financial data is adversely affected by non-financial feeder systems and journal voucher adjustments; and problem disbursements cause data errors and unreliable obligation data.

Compliance with Laws and Regulations

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

The Department of the Navy is required to comply with financial management systems reporting requirements. For example, the Federal Financial Management Improvement Act of 1996 requires the Department of the Navy to establish and maintain financial management systems that comply substantially with the Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In addition, the Federal Managers' Financial Integrity Act of 1982 requires the Department of the Navy to evaluate the systems and to annually report whether those systems are in compliance with applicable requirements. The Chief Financial Officers Act of 1990 requires DoD to prepare a 5-year Financial Management Plan describing activities that DoD will conduct during the next 5 years to improve financial management.

The Department of the Navy acknowledged that many of its critical financial management and feeder systems do not comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. In an attempt to comply with statutory reporting requirements and applicable financial systems requirements, DoD is developing a DoD-wide Business Enterprise Architecture. The architecture is intended to provide a "blueprint" of the Department's financial management systems and processes to initiate a comprehensive financial management reform effort. Until the architecture is fully developed, the Department of the Navy will be unable to fully comply with the statutory reporting requirements. Therefore, we did not perform tests of compliance for these requirements.

Audit Disclosures

The Assistant Secretary of the Navy (Financial Management and Comptroller) acknowledged to us on October 22, 2003, that the Department of the Navy Working Capital Fund financial management systems cannot provide adequate evidence supporting various material amounts on the financial statements. As a result, we were unable to obtain adequate evidential matter to form or express an opinion on the financial statements, internal control, and compliance with laws and regulations.

We did not conduct audit followup work related to deficiencies identified during previous audits of the Department of the Navy.

In addition, we did not perform audit tests of the Department of the Navy compliance with the Antideficiency Act, the Prompt Payment Act, and the Federal Credit Reform Act.

This report does not include recommendations to correct the material internal control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.