Audit Report

INSPECTOR GENERAL, DOD, OVERSIGHT OF THE NAVAL AUDIT SERVICE AUDIT OF THE NAVY WORKING CAPITAL FUND FINANCIAL STATEMENTS FOR FYs 1997 AND 1996

Report Number 98-106 April 7, 1998

Office of the Inspector General
Department of Defense

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Acronyms

GAO	General Accounting Office
IG	Inspector General
NAS	Naval Audit Service

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

April 7, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Inspector General, DoD, Oversight of the Naval Audit Service Audit of the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996 (Report No. 98-106)

We are providing this audit report for your information and use and for transmittal to the Director, Office of Management and Budget. It includes our endorsement of the Naval Audit Service (NAS) disclaimer of opinion on the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996, along with the NAS Audit Report, "Fiscal Years 1997 and 1996 Consolidated Financial Statements of the Department of the Navy Working Capital Fund." An audit of the Navy Working Capital Fund Financial Statements is required by the "Chief Financial Officers Act of 1994," as amended by the "Federal Financial Management Act of 1994." Since this report contains no findings or recommendations, written comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard Bird, Audit Program Director, at (703) 604-9175 (DSN 664-9175, e-mail rbird@dodig.osd.mil) or Mr. Joel K. Chaney, Audit Project Manager, at (216) 522-6091, extension 235, e-mail jchaney@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-106 **April 7, 1998**
(Project No. 7FI-2035)

Inspector General, DoD, Oversight of the Naval Audit Service Audit of the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996

Executive Summary

Introduction. An audit of the Navy Working Capital Fund Financial Statements is required by Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. We delegated the audit of the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996 to the Naval Audit Service. This report provides our endorsement of the Naval Audit Service disclaimer of opinion on the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996, along with the Naval Audit Service Report, "Fiscal Years 1997 and 1996 Consolidated Financial Statements of the Department of the Navy Working Capital Fund."

Audit Objective. Our objective was to determine the accuracy and completeness of the Naval Audit Service audit of the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996. See Appendix C for a discussion of the audit process.

Audit Results. The Naval Audit Service report, "Fiscal Years 1997 and 1996 Consolidated Financial Statements of the Department of the Navy Working Capital Fund," February 27, 1998, stated that the Naval Audit Service was not able to express an opinion on the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996. We concur with the Naval Audit Service disclaimer of opinion; our endorsement of that disclaimer is at Appendix A. The Naval Audit Service report is at Appendix B.

Internal Control Structure and Compliance With Laws and Regulations. The Naval Audit Service issued reports on internal controls and compliance with laws and regulations in the Navy. Those reports are included in the Naval Audit Service report.

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Appendix A. Inspector General, DoD, Endorsement Memorandum

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

February 27, 1998

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER) AND CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Endorsement of the Disclaimer of Opinion on the FY 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements (Project No. 7FI-2035)

The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires financial statement audits by the Inspectors General. Before FY 1992, DoD operated a significant number of its commercial and industrial facilities under a revolving fund concept. In FY 1992, the revolving funds were consolidated to form the Defense Business Operations Fund (DBOF). On December 11, 1996, the Under Secretary of Defense (Comptroller) restructured DBOF into separate working capital funds. The Inspector General, DoD, was responsible for auditing both the DBOF financial statements and working capital fund financial statements. On January 16, 1997, we delegated to the Naval Audit Service (NAS) the audits of the Navy Working Capital Fund financial statements.

Summarized below are the NAS disclaimer of opinion on the FYs 1997 and 1996 financial statements and the results of our review of the work conducted by the NAS. We endorse the disclaimer of opinion expressed by NAS (see the Enclosure).

Disclaimer of Opinion. The NAS disclaimer of opinion on the FYs 1997 and 1996 Navy Working Capital Fund Consolidated Financial Statements, dated February 27, 1998, states that the NAS was unable to express an opinion on the statements. We concur with the NAS disclaimer of opinion for the reasons summarized below.

o Navy Working Capital Fund activities and the Defense Finance and Accounting Service did not provide sufficient information to evaluate management's assertions and the fair presentation of the September 30, 1997, financial statements.

o The NAS did not observe the taking of the physical inventories reported as of September 30, 1996, and could not verify inventory quantities by other auditing procedures.

Internal Controls. Internal controls did not ensure that the FYs 1997 and 1996 Navy Working Capital Fund Consolidated Financial Statements contained no material misstatements. Procedural and compliance problems also contributed to the lack of accurate financial reporting. The Department of the Navy and the Defense Finance and Accounting Service have recognized these weaknesses and reported them in their FY 1997 Annual Statements of Assurance. Details on these matters and on compliance with laws and regulations will be discussed in a separate report.

Compliance With Laws and Regulations. The NAS also identified areas of noncompliance with laws and regulations. Under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 93-06, Addendum 1, "Audit Requirements

Compliance With Laws and Regulations. The NAS also identified areas of noncompliance with laws and regulations. Under the Federal Financial Management Improvement Act of 1996 and OMB Bulletin No. 93-06, Addendum 1, "Audit Requirements for Federal Financial Statements," January 16, 1998, the NAS work disclosed that financial management systems did not comply with Federal financial management system requirements; applicable Federal accounting standards; and the United States Government Standard General Ledger at the transaction level.

Review of Naval Audit Service Work. To fulfill our responsibilities for determining the accuracy and completeness of the independent work conducted by the NAS, we reviewed the approach and planning, and monitored the progress at the key points. We also performed other procedures necessary to determine the accuracy and reliability of the approach and conclusions.

We conducted our review of the NAS work of the FYs 1997 and 1996 Navy Working Capital Fund Consolidated Financial Statements from August 27, 1997, to February 27, 1998, in accordance with generally accepted Government auditing standards. We found no indication that we could not rely on the NAS disclaimer of opinion or its related evaluations of internal controls and compliance with laws and regulations.

David K. Steensma

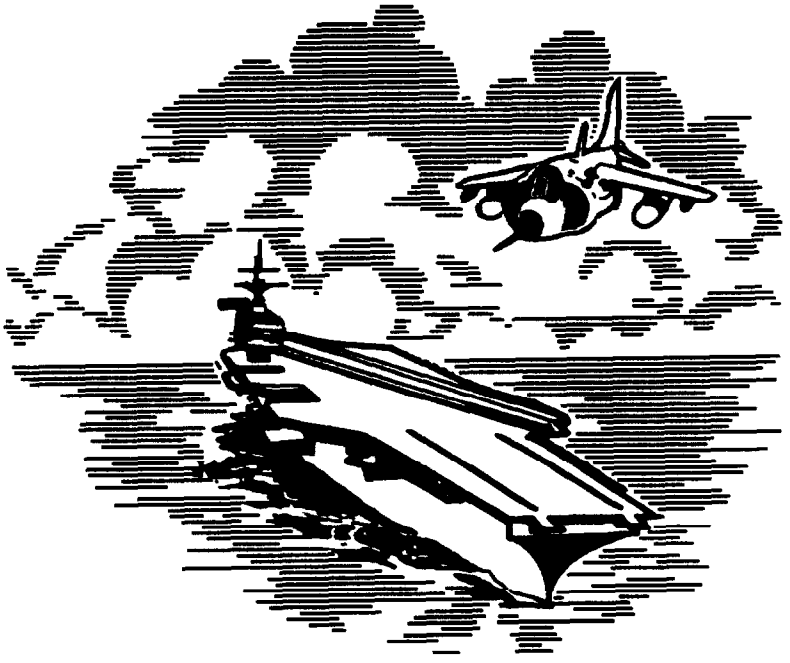
David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosure

Appendix B. Naval Audit Service Report

Naval Audit Service
NAVAUDSVC P-7520.1

Audit Report



Fiscal Years 1997 and 1996 Consolidated Financial Statements of the Department of the Navy Working Capital Fund

024-98

27 February 1998

DEPARTMENT OF THE NAVY
AUDITOR GENERAL OF THE NAVY
5611 COLUMBIA PIKE
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FALLS CHURCH, VA. 22041-5080

7540/97-0003
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27 Feb 98

From: Auditor General of the Navy

Subj: **FISCAL YEARS 1997 AND 1996 CONSOLIDATED FINANCIAL STATEMENTS OF THE DEPARTMENT OF THE NAVY WORKING CAPITAL FUND (024-98)**

Ref: (a) Public Law 101-576, "Chief Financial Officers Act," 15 Nov 90
(b) SECNAV Instruction 7510.7E, "Department of the Navy Internal Audit"

1. We conducted an audit of the Fiscal Years 1997 and 1996 Consolidated Financial Statements of the Department of the Navy Working Capital Fund and attempted to issue an opinion, in accordance with reference (a). Audit results were discussed with the designated representatives of the Department of the Navy and Department of Defense.

2. Our primary objective was to determine the accuracy of the information presented in the Statement of Financial Position and the related Statement of Operations and Changes in Net Position, and Statement of Cash Flows, for the Consolidated Financial Statements of the Department of the Navy Working Capital Fund for the years ended as of 30 September 1997 and 1996.

3. The following account balances were audited to determine the accuracy of the information presented in the Consolidated Financial Statements: Fund Balance with Treasury; Accounts Receivable, Net, Federal; Advances and Prepayments, Federal; Accounts Receivable, Net, Non-Federal; Advances and Prepayments, Non-Federal; Inventory, Net; Work in Process; Operating Materials/Supplies, Net; Property, Plant, and Equipment, Net; Other Entity Assets; Other Non-Entity Assets; Accounts Payable, Federal; Debt, Federal; Other Federal (Intragovernmental) Liabilities; Accounts Payable, Non-Federal; Accrued Payroll and Benefits; Other Non-Federal (Governmental) Liabilities; Invested Capital; Cumulative Results of Operations; Other (Net Position); and Future Funding Requirements. We performed limited audit work on the Statement of Operations and Changes in Net Position accounts of: Other Revenues and Financing Sources, and Depreciation and Amortization. We concluded that the account balances reported on the statements were misstated and we recommended adjustments to the accounts to make the reported balances more representative.

4. This report contains our Independent Auditor's Opinion on the Consolidated Financial Statements for the Fiscal Years 1997 and 1996 Department of the Navy Working Capital Fund in which we were unable to issue an opinion, as well as our

Subj: **FISCAL YEARS 1997 AND 1996 CONSOLIDATED FINANCIAL STATEMENTS OF THE DEPARTMENT OF THE NAVY WORKING CAPITAL FUND (024-98)**

Report on Internal Control Structure and our Report on Compliance With Laws and Regulations. A separate supporting report will contain details on specific findings, as well as recommended adjustments to the accounts to make the reported balances more representative.

5. Any request for our report under the Freedom of Information Act must be approved or denied by the Auditor General of the Navy, as required by reference (b).

6. We appreciate the cooperation and courtesies extended to our auditors.

JAMES D. WATTS
By direction

Distribution:
Assistant Secretary of the Navy (Financial Management and Comptroller)
Assistant Secretary of the Navy (Research, Development, and Acquisition)
Commander, Naval Supply Systems Command
Commander, Naval Inventory Control Point
Under Secretary of Defense (Comptroller)
Inspector General, Department of Defense
Director, Defense Finance and Accounting Service
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NADEP Cherry Point
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NAVSURFWARCENDIV Crane
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(continued)

Subj: **FISCAL YEARS 1997 AND 1996 CONSOLIDATED FINANCIAL STATEMENTS OF THE DEPARTMENT OF THE NAVY WORKING CAPITAL FUND (024-98)**

NAVUNSEAWARCENDIV Keyport
NAVUNSEAWARCENDIV Newport
SPAWARSYSCEN San Diego
SPAWARSYSCEN Charleston
SPAWARSYSCEN Chesapeake
NRL
NAVAIRWARCENACDIV Patuxent River
NAVAIRWARCENACDIV Trenton
NAVAIRWARCENWPNDIV Point Mugu
NAVAIRWARCENWPNDIV China Lake
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GAO (AFMD)
(AIMD)

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Section A
Introduction

Background

Audit Requirement

The 101st Congress of the United States passed the Chief Financial Officers Act (Public Law 101-576) on 15 November 1990. The Act was passed to improve general and financial management practices within the Federal Government and make Government operations more efficient and effective. The Act requires that financial statements be audited by the Inspector General of the Department of Defense or by an independent external auditor designated by the Inspector General, Department of Defense.

A centralized financial management structure was established within the Office of Management and Budget and in each executive department and agency by statutory provisions of the Act. The Act strengthens internal controls over financial management by requiring that: (1) 5-year financial management systems improvement plans, both Government-wide and in the 23 agencies covered by the Act, be prepared; (2) financial statements and audits for revolving funds, trust funds, and commercial operations of agencies be prepared to hold agency heads accountable for their operations; and (3) the status of general and financial management in the Federal Government be reported annually to the President and Congress..

Reporting agencies are required to prepare financial statements. Pending issuance of final accounting standards, the reporting agencies are to prepare the statements in accordance with those standards contained in agency accounting policies, procedures manuals, and/or related guidance as set forth in "Department of Defense Guidance on Form and Content of Financial Statements for Fiscal Year 1997 Financial Activity." Department of Defense accounting standards are incorporated in the Department of Defense Accounting Manual, DoD 7220.9-M, dated February 1988, in supplemental memorandums, and in the Department of Defense Financial Management Regulation, DoD 7000.14-R.

Department of the Navy Working Capital Fund

The Department of Defense established the Defense Business Operations Fund on 1 October 1991 by combining five industrial funds, four stock funds, and several appropriated fund support activities, including the Defense Finance and Accounting Service and the Defense Commissary Agency, into a single Department of Defense-wide revolving fund. The focus of the Defense Business Operations Fund was to provide a management structure that encouraged Department of Defense business-like support

organizations to provide industrial and commercial-type services at lowest cost. The Fund was designed for activities that provide services that can be charged to customers, just as is done in private industry.

On 11 December 1996, the Under Secretary of Defense (Comptroller) canceled the Defense Business Operations Fund and established four funds: Department of the Army Working Capital Fund, Department of the Navy Working Capital Fund, Department of the Air Force Working Capital Fund, and Defense-Wide Working Capital Fund.

The basic principle of the Department of the Navy Working Capital Fund is to capture all costs of operating an activity group and to reflect the total cost of doing business in stabilized rates charged to customers. For Fiscal Year 1997, the Defense Finance and Accounting Service, with assistance from the Assistant Secretary of the Navy (Financial Management and Comptroller), prepared consolidated financial statements for the Department of the Navy Working Capital Fund and financial statements for each reporting entity. Comparative statements were produced for reporting purposes on the consolidated statements, which included:

- Statement of Financial Position
- Statement of Operations and Changes in Net Position
- Statement of Cash Flows

Copies of these statements for 30 September 1997 are in Section C.

The Department of the Navy Working Capital Fund consists of six primary activity groups. Our audit encompassed all primary groups through statistical sampling techniques, and our audit encompassed four primary activity groups:

Supply Operations. This activity group finances the purchase of material to be held in inventory until issued to end users. The Naval Supply Systems Command has overall responsibility for this activity group. The material is overseen by the Naval Inventory Control Point, which is headquartered in Philadelphia, PA, and also has an office in Mechanicsburg, PA. The material is stored and maintained at Department of the Navy and Department of Defense locations worldwide, aboard selected ships, and at contractor facilities. Supply Management is financially structured into 12 Budget Projects, which delegate responsibility for budgets, funds allocation and execution, and accounting.

Depot Maintenance. Within the Depot Maintenance primary area, we focused on three secondary groups: Shipyards, Aviation, and Ordnance.

Shipyards. Four shipyards 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; and provide services and material to other activities and units as required.

Aviation. Three aviation depots maintain and operate facilities required to perform depot level maintenance and rework operations on airframes, engines, components, weapons systems, accessories, and equipment, in addition to providing engineering and other professional services with respect to aviation maintenance and logistics problems.

Ordnance. Five weapons stations provide all services for explosive outloading of ships; perform retail ammunition management services; provide intermediate and depot maintenance assignments for various weapons systems, engineering functions, and technical logistics support; and provide ordnance packaging, handling, storage, and transport.

Base Support. Nine public works centers provide utilities services, facilities maintenance, family housing services, transportation support, engineering services, and shore facilities planning support required by operating forces and other activities.

Research and Development. Six secondary activity groups within this primary activity group provide engineering support and services for naval weapons, weapons systems, and other systems as required, and conduct research, development, testing, evaluation, and related services for the Department of the Navy and other Department of Defense customers.

The two primary activity groups not included in our review were Transportation and Information Services. These primary activity groups were in the universe included in the multistage selection process used in our statistically based sampling methodology but did not get selected.

Objectives

The objectives of this audit were to determine:

- Whether the Department of the Navy Working Capital Fund Consolidated Financial Statements fairly represented the financial position and results of operation for Fiscal Years 1997 and 1996, in all material respects, in accordance with the appropriate comprehensive basis of accounting other than generally accepted accounting principles.

- Whether the internal controls of the Department of the Navy Working Capital Fund Consolidated Financial Statements were adequate to detect or prevent

errors and misstatements that had a material effect on the financial statement balances.

- Whether the Department of the Navy Working Capital Fund was in compliance with laws and regulations that had a material effect on the financial statement balances.

- Whether known contingencies had been disclosed in the Department of the Navy Working Capital Fund Consolidated Financial Statements.

- The effect, and report conditions, that come to the auditor's attention that impact the Department of the Navy Working Capital Fund Consolidated Financial Statements.

Scope and Methodology

Overall responsibility for auditing Department of Defense financial statements rests with the Inspector General, Department of Defense, as required by the Chief Financial Officers Act of 1990. Our audit of the Department of the Navy Working Capital Fund was accomplished in support of this requirement.

Our audit evaluated selected accounts of the Fiscal Years 1997 and 1996 Department of the Navy Working Capital Fund Consolidated Financial Statements. Of six primary activity groups, four were reviewed as a result of statistical activity selection: (1) Supply Operations; (2) Depot Maintenance (Shipyards, Aviation, and Ordnance); (3) Base Support; and (4) Research and Development.

Our audit focused on transactions and operations for Fiscal Year 1997 that impacted the Department of the Navy Working Capital Fund Consolidated Financial Statements. We also reviewed some transactions from Fiscal Year 1996 and prior years that impacted on the Fiscal Year 1997 statements. We further reviewed reported contingencies in the financial statements to ensure all known contingencies were stated as required, including claims reported in the Department of the Navy Working Capital Fund Legal Representation Letter provided by the Department of the Navy Office of the General Counsel.

We performed our audit work from 1 April 1997 to 27 February 1998 at the Under Secretary of Defense (Comptroller); Under Secretary of Defense (Budget); Defense Finance and Accounting Service (Headquarters, Cleveland, and Columbus); Assistant Secretary of the Navy (Financial Management and Comptroller); Assistant Secretary of the Navy (Financial Management and Comptroller) (Financial Management Operations); Naval Supply Systems Command; Naval Air Systems Command; Naval Sea Systems Command; Naval Facilities Engineering Command; and subordinate activities.

We reviewed internal controls and Management Control Programs at all activities. We also evaluated compliance with laws and regulations, presentation in financial statements, and the consistency of applying the comprehensive basis of accounting other than Federal generally accepted accounting principles. We further reviewed for completeness the deficiencies disclosed in the Management Representation Letter provided by the Assistant Secretary of the Navy (Financial Management and Comptroller) for the Department of the Navy Working Capital Fund. We coordinated the audit with the Inspector General, Department of Defense and the General Accounting Office.

The audit was conducted in accordance with generally accepted government auditing standards. We reviewed applicable laws, policies, procedures, regulations, and directives related to the audited accounts for the Department of the Navy Working Capital Fund Consolidated Financial Statements for Fiscal Years 1997 and 1996.

We examined accounting records and reports, and held discussions with officials at activities visited. We performed various audit steps to enable us to evaluate internal control structures and compliance with applicable laws and regulations. As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems under the Department of the Navy's Management Control Program as to whether there was reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act were achieved. We compared the Department of the Navy Working Capital Fund's most recent Federal Managers' Financial Integrity Act report with the results of the audit we conducted of the Fund's internal controls. We also reviewed the comparative balances for Fiscal Year 1996 on the Fiscal Year 1997 consolidated statements for consistency of reporting.

Section B
Results of Audit Work

Part I:
Independent Auditor's Opinion on the Consolidated Financial Statements for the Fiscal Years 1997 and 1996 Department of the Navy Working Capital Fund

We attempted to audit the Statement of Financial Position of the Consolidated Financial Statements of the Department of the Navy Working Capital Fund as of 30 September 1997 and 1996, and the related Statement of Operations and Changes in Net Position, and Statement of Cash Flows for the years then ended. These financial statements are the responsibility of the Department of the Navy Working Capital Fund management.

The Department of the Navy Working Capital Fund or its accountant, the Defense Finance and Accounting Service, did not provide us sufficient information necessary to evaluate management's assertions contained in the 30 September 1997 and 1996 financial statement presentation. Specific accounts for which sufficient information was not provided included: Accounts Receivable, Net, Federal; Accounts Receivable, Net, Non-Federal; Inventory, Net; Work in Process; Operating Materials/Supplies, Net; Property, Plant, and Equipment, Net; Accounts Payable, Federal; Other Federal (Intragovernmental) Liabilities; Accounts Payable, Non-Federal; Other Non-Federal (Governmental) Liabilities; Invested Capital; Cumulative Results of Operations; and Other (Net Position). Additionally, we did not observe the taking of the physical inventories reported as of 30 September 1996 and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of 30 September 1996 enter into the determination of Excess (Shortage) of Revenues and Financing Sources Over Total Expenses, and Cash Flow, for the fiscal year ended 30 September 1997.

Since the Department of the Navy Working Capital Fund or its accountant, the Defense Finance and Accounting Service, did not provide us with sufficient information necessary to evaluate management's assertions, and we were unable to perform tests necessary to satisfy ourselves as to the fair presentation of the statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these statements.

JAMES D. WATTS
By direction

27 February 1998

Part II:
Report on Internal Control Structure

We attempted to audit the Statement of Financial Position of the Consolidated Financial Statements of the Department of the Navy Working Capital Fund as of 30 September 1997 and 1996 and the related Statement of Operations and Changes in Net Position and the Statement of Cash Flows for the years then ended. We issued our report thereon dated 27 February 1998.

We conducted our audit in accordance with Federal generally accepted auditing standards that are stated in Government Auditing Standards issued by the Comptroller General of the United States, and in Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Financial Position, the Statement of Operations and Changes in Net Position, and the Statement of Cash Flows of the Consolidated Financial Statements of the Department of the Navy Working Capital Fund are free of material misstatements.

In planning and performing our audit of the Statement of Financial Position, the Statement of Operations and Changes in Net Position, and the Statement of Cash Flows, we considered the internal control structure of the following accounts of the Consolidated Financial Statements of the Department of the Navy Working Capital Fund activities as of 30 September 1997: for **Entity Assets**: Fund Balance with Treasury; Accounts Receivable, Net, Federal and Non-Federal; Advances and Prepayments, Federal and Non-Federal; Other Federal (Intragovernmental); Other Non-Federal (Governmental); Inventory, Net; Work in Process; Operating Materials/Supplies, Net; Property, Plant, and Equipment, Net; and Other Entity Assets; for **Non-Entity Assets**: Other; for **Liabilities Covered by Budgetary Resources**: Accounts Payable, Federal and Non-Federal; Debt, Federal; Other Federal (Intragovernmental) Liabilities; Accrued Payroll and Benefits; and Other Non-Federal (Governmental) Liabilities; and **Net Position**: Invested Capital; Cumulative Results of Operations; and Other. The purposes of this consideration were: (1) to determine our auditing procedures for the purpose of expressing an opinion on the Department of the Navy Working Capital Fund Consolidated Financial Statements, and (2) to determine whether the internal control structure meets the objectives identified in the following paragraph.

We obtained an understanding of the internal control policies and procedures and assessed the level of control risk relevant to all significant cycles, classes of transactions, or account balances. For those significant control policies and procedures that have been properly designed and placed in operation, we performed sufficient tests to provide reasonable assurance that the controls are effective and working as designed.

Management of the Department of the Navy Working Capital Fund is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility,

management uses estimates and judgments to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable but not absolute assurance that: (1) obligations and costs are in compliance with applicable laws; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenue and expenditures applicable to agency operations are properly recorded and accounted for so that accounts and reliable financial and statistical reports can be prepared to maintain accountability over assets.

For the purpose of this report, we have classified the significant internal control structure policies and procedures for the accounts reviewed into the following functional areas:

Entity Assets:

Fund Balance with Treasury: (1) collections, (2) disbursements, (3) certifications, (4) reconciliations, and (5) financial reporting.

Accounts Receivable, Net, Federal: (1) revenue cycle, (2) billing cycle, (3) collections cycle, and (4) financial reporting.

Advances and Prepayments, Federal: (1) receipt cycle, (2) billing cycle, (3) expense cycle, (4) disbursement cycle, (5) collections cycle, and (6) financial reporting.

Other Federal (Intragovernmental): (1) asset classification, and (2) financial reporting.

Accounts Receivable, Net, Non-Federal: (1) revenue cycle, (2) billing cycle, (3) collection cycle, and (4) financial reporting.

Advances and Prepayments, Non-Federal: (1) receipt cycle, (2) billing cycle, (3) expense cycle, (4) disbursement cycle, (5) collections cycle, and (6) financial reporting.

Other Non-Federal (Governmental): (1) asset classification, and (2) financial reporting.

Inventory, Net: (1) inventory cycle, (2) financial and inventory accounting cycle, and (3) financial reporting cycle.

Work in Process: (1) revenue cycle, (2) billing cycle, (3) expense cycle, and (4) financial reporting cycle.

Property, Plant, and Equipment, Net; and **Operating Materials/Supplies, Net:** (1) requesting, (2) receiving, (3) issuing/disposal, and (4) financial reporting.

Other Entity Assets: (1) asset classification, and (2) financial reporting.

Non-Entity Assets:

Other: (1) requesting, (2) approving, (3) receiving, (4) disposing, and (5) financial reporting.

Liabilities Covered by Budgetary Resources:

Accounts Payable, Federal and Non-Federal: (1) expense cycle, (2) receipt cycle, (3) disbursement cycle, and (4) financial reporting cycle.

Debt, Federal: financial reporting.

Other Federal (Intragovernmental) Liabilities: (1) billing cycle, (2) production cycle, (3) expense cycle, and (4) financial reporting cycle.

Accrued Payroll and Benefits: (1) personnel liabilities, and (2) financial reporting.

Other Non-Federal (Governmental) Liabilities: (1) expense cycle, (2) receipt cycle, (3) disbursement cycle, and (4) financial reporting cycle.

Net Position:

For **Invested Capital, Cumulative Results of Operations, and Other:** financial reporting.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and Office of Management and Budget Bulletin No. 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to ensure that: (1) obligations and costs are in compliance with applicable law; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are properly recorded and accounted for so that accounts and reliable financial and statistical reports can be prepared in accordance with applicable accounting standards and accountability over assets can be maintained.

The specific reportable internal control conditions are briefly identified below. Details on these conditions are presented in a separate supporting report.

1. Amounts reported as collected and disbursed in support of Fund Balance with Treasury for the 30 September 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements did not agree with individual activity records even after cash reconciliations were performed.

2. Accounts Receivable, Net, Federal was inaccurate because guidance was not followed for revenue recognition, reconciliations, billings, and collection procedures. Additionally, transactions were incorrectly reported and others were not reported.

3. Accounts Receivable, Net, Non-Federal was misstated because transactions were not reported or were incorrectly reported, and because amounts reported as outstanding had already been collected.

4. Advances and Prepayments, Non-Federal was inaccurate because of payment data not being properly registered or recorded, system weaknesses, and previous payment errors not being corrected.

5. Inventory, Net records were inaccurate due to errors in inventory transaction processing and reporting, inadequacies in commercial repair transaction program recognition, and the lack of or questionable transaction reporting by some contractors. In addition, Material-in-Transit was inaccurate due to payment mischarges and various systemic problems.

6. Work in Process was inaccurate because the present revenue recognition policy was incorrectly applied, reconciliations were not performed, misclassifications occurred, and inappropriate costs were included.

7. Operating Materials/Supplies, Net was inaccurate because of improper reconciliation procedures, items being misclassified, noncompliance with material and supplies levels, and unauthorized use of an allowance account. In addition, records for material were inaccurate because of flawed physical inventory techniques, lack of statistical sampling techniques, lack of sightback procedures, and inaccurate reporting of inventory results.

8. Property, Plant, and Equipment, Net was inaccurate because assets were not reported or recorded correctly, other assets were misclassified, depreciation was not correctly reported, leases were not capitalized, and depreciation was not taken for Assets Not-In-Use and misclassified assets.

9. Accounts Payable, Federal was not accurate because of failure to adjust accounting records for paid liabilities, bookkeeping errors, improper reconciliations, and misclassifications.

10. Other Federal (Intragovernmental) Liabilities was inaccurate because of reconciliations not being performed, customer orders being billed in excess of authorized funding, misclassifications, accounting errors, lack of supporting documentation, and premature revenue recognition. Submissions were misstated for Advance Return of Depot Level Repairable Carcasses, due to unique processing transactions and systemic processing problems. In addition, Liabilities for Deposits in Advance of Sales for the Foreign Military Sales Trust Fund and for Ships Stores Profits Transferrable had not been reviewed for validity.

11. Accounts Payable, Non-Federal was misstated due to bookkeeping errors, invalid transactions being included in records, misclassifications, and records not being updated.

12. Other Non-Federal (Governmental) Liabilities was inaccurate due to bookkeeping errors, unrecorded payments, incorrect postings, and misclassifications.

13. Under Net Position, Invested Capital, Cumulative Results of Operations, and Other were inaccurately reported because losses from excess material, assets transferred out to others, and material transferred in from others were posted to incorrect capital accounts.

14. Vulnerability assessments were inaccurate for assessable units related to the accounts reviewed for internal controls on the Fiscal Year 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements.

15. Department of the Navy Working Capital Fund did not include all intrafund eliminating transactions for Accounts Receivable, Unearned Revenue, Accounts Payable, or Advances because systems that would identify intrafund transactions were not fully developed.

16. Financial accounting systems used by Department of the Navy Working Capital Fund activities could not adequately control, distribute, identify, or transfer collections and disbursements because audit trails and internal controls were lacking.

17. Department of the Navy Working Capital Fund activities could not always provide complete and usable transaction-driven databases to support reported financial statement balances.

Based on our comparison of the agency's most recent Federal Managers' Financial Integrity Act report and the results of our audit, we concluded that the agency's Federal

Managers' Financial Integrity Act report was not completely accurate. The Federal Managers' Financial Integrity Act report did not disclose the material internal control weaknesses identified in this audit regarding Accounts Receivable, Net, Non-Federal; Non-Entity Assets; Invested Capital; Cumulative Results of Operation; Other (Net Position); and Financial Accounting Systems. In addition, Department of the Navy Working Capital Fund activities prepared inaccurate vulnerability assessments for assessable units related to the accounts reviewed on the Fiscal Year 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements. We reviewed 118 assessable units and found 76, or 64 percent, were not given an accurate vulnerability assessment by the activities. This means that management rated the assessments either too low or not at all. Of the 76 assessments that were not accurately rated, activities gave no rating for 43. Accurate vulnerability assessments form the basis of a meaningful Management Control Plan that schedules Management Control Reviews and Alternate Management Control Reviews to identify material internal control weaknesses. Inadequate internal control systems increase the vulnerability of assets to fraud, waste, or mismanagement.

We consider these reportable conditions to be material weaknesses. A material weakness is a reportable condition in which the design or operation of specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the Statement of Financial Position being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above.

JAMES D. WATTS
By direction

27 February 1998

Part III:
Report on Compliance With Laws and Regulations

We attempted to audit the Statement of Financial Position of the Consolidated Financial Statements of the Department of the Navy Working Capital Fund as of 30 September 1997 and 1996 and the related Statement of Operations and Changes in Net Position and Statement of Cash Flows for the years then ended. We have issued our report thereon dated 27 February 1998.

We conducted our audit in accordance with Federal generally accepted auditing standards as stated in Government Auditing Standards issued by the Comptroller General of the United States and as stated in Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance that the Statement of Financial Position, Statement of Operations and Changes in Net Position, and Statement of Cash Flows of the Consolidated Financial Statements of the Department of the Navy Working Capital Fund are free of material misstatements.

Compliance with laws and regulations applicable to the Department of the Navy Working Capital Fund activities is the responsibility of the Department of the Navy's management. As part of obtaining reasonable assurance about whether the Statement of Financial Position, Statement of Operations and Changes in Net Position, and Statement of Cash Flows of the Consolidated Statements were free of material misstatement, we tested compliance with laws and regulations that could directly affect the statements and appropriate laws and regulations designated by the Office of Management and Budget, Department of Defense, and the Department of the Navy for the following accounts: for **Entity Assets**: Fund Balance with Treasury; Accounts Receivable, Net, Federal and Non-Federal; Advances and Prepayments, Federal and Non-Federal; Other Federal (Intragovernmental); Other Non-Federal (Governmental); Inventory, Net; Work in Process; Operating Materials/Supplies, Net; Property, Plant, and Equipment, Net; and Other Entity; for **Non-Entity Assets**: Other; for **Liabilities Covered by Budgetary Resources**: Accounts Payable, Federal and Non-Federal; Debt, Federal; Other Federal (Intragovernmental) Liabilities; Accrued Payroll and Benefits; and Other Non-Federal (Governmental) Liabilities; and for **Net Position**: Invested Capital; Cumulative Results of Operations; and Other. Transactions were tested against the following laws and regulations as applicable:

- Public Law 103-356, "Government Management Reform Act of 1994."
- Public Law 103-62, "Government Performance and Results Act of 1993."
- Public Law 101-576, "Chief Financial Officers Act of 1990."
- Public Law 100-496, "Prompt Payment Act of 1988."
- Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982."

- Public Law 96-510, 94 Stat. 2767, "Comprehensive Environmental Response, Compensation, and Liability Act," as amended by Public Law 99-499, 100 Stat. 1613.
- Budget and Accounting Procedures Act of 1950.
- Title 31, "Money and Finance."
- Subtitle II, The Budget Process, of Title 31, U.S. Code, including the Antideficiency Act provisions found in Title 31, U.S. Code, Section 1341, "Limitations on Expending and Obligating Amounts," and Title 31, U.S. Code, Section 1517, "Prohibited Obligations and Expenditures."
- Subtitle III, Financial Management, of Title 31, U.S. Code, including the requirements for accounting and accounting systems and information in Title 31, U.S. Code, Sections 3511, 3512, 3513, and 3514; and the financial statement requirements in Title 31, U.S. Code, Section 3515.
- Title 10, "Working Capital Funds."
- Office of Management and Budget Bulletin 93-06, "Audit Requirement for Federal Financial Statements."
- Office of Management and Budget Bulletin 93-18, "Audited Financial Statements."
- Office of Management and Budget Bulletin 97-01, "Form and Content of Agency Financial Statements."
- Office of Management and Budget Circular No. A-123, "Management Accountability and Control."
- Office of Management and Budget Circular A-125 (Revised), "Prompt Payment."
- Office of Management and Budget Circular No. A-127, "Financial Management Systems."
- Office of Management and Budget Statement of Federal Financial Accounting Concepts Number 1, "Objectives of Federal Financial Reporting."
- Office of Management and Budget Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities."
- Office of Management and Budget Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees."
- Office of Management and Budget Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property."
- Office of Management and Budget Statement of Federal Financial Accounting Standards Number 5, "Accounting for Liabilities of the Federal Government."
- Treasury Financial Manual.
- Federal Financial Management Improvement Act of 1996 (Public Law 104-208).
- Federal Acquisition Regulation, Part 45.
- Department of Defense Appropriations Act of 1993 (Public Law 102-396).
- Department of Defense Instruction 4140.1R, "Materiel Management Regulation."
- Department of Defense Instruction 4140.39, "Storage."
- Department of Defense Manual 7220.9-M, "Department of Defense Accounting Manual."

- Department of Defense Instruction 7000.14, "Department of Defense Financial Management Policy Procedures."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 1, "General Financial Management Information, Systems, and Requirements."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 2B, "Budget Presentation and Formulation."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 4, "Accounting Policy and Procedures."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 5, "Disbursing and Policy Procedures."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 6, "Reporting Policy and Procedures."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 8, "Civilian Pay Policies and Procedures."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 10, "Contract Payment Policy and Procedures."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, "Reimbursable Operations, Policy, and Procedures-Defense Working Capital Fund."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 14, "Administrative Control of Funds and Antideficiency Act Violations."
- Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 15, "Security Assistance Policy and Procedures."
- Department of Defense Directive 5010.38, "Internal Management Control Program."
- Department of Defense Manual 7200.10M, "Report of Survey."
- Department of Defense Directive 4140.31, "Defense Inactive Item Program."
- Defense Finance and Accounting Service - Cleveland Memorandum 7220.1-G, "DFAS-CL Year-End Closing Guidance for Fiscal Year 1997."
- Defense Finance and Accounting Service Memorandums dated 25 June and 19 August 1993, "Update to New Accounts, Data Base Codes and Procedures for Use by Navy Industrial Fund."
- Defense Finance and Accounting Service Memorandum dated 1 August 1997, "Revised Fiscal Year 1997 Factors to Adjust Defense Working Capital Fund Supply Management Inventory Values."
- Under Secretary of Defense (Comptroller) Memorandum dated 31 March 1994, "Negative Unliquidated Balances/Disbursements in Excess of Obligations."
- Under Secretary of Defense (Comptroller) Memorandum dated 30 June 1995, "Obligation of Amounts for Unmatched Disbursements and Negative Unliquidated Obligations."
- Under Secretary of Defense (Comptroller) Memorandum dated 30 June 1995, "New Accounts, Database Codes and Procedures for Use by Obligation of Amounts for Unmatched Disbursements and Negative Unliquidated Obligations."

- Under Secretary of Defense (Comptroller) Memorandum dated 19 August 1994, "Recording Monthly Cash Transactions."
- Secretary of the Navy Instruction 5200.35C, "Department of the Navy Management Control Program."
- Secretary of the Navy Instruction 5212.5C, "Navy and Marine Corps Record Disposition Manual."
- Secretary of the Navy Instruction 7000.18E, "Policy for Development and Control of Accounting Systems in the Department of the Navy."
- Secretary of the Navy Instruction 5500.4F, "Reporting of Missing, Lost, Stolen, or Recovered Government Property."
- Assistant Secretary of the Navy (Financial Management and Comptroller) Memorandum of 6 November 1996, "Procedures for Expensing Problem Disbursements over 180 Days Old in the Defense Business Operations Fund."
- Assistant Secretary of the Navy (Financial Management and Comptroller) Memorandum of 21 October 1997, "Procedures for Expensing Problem Disbursements over 180 Days Old in the Navy Working Capital Fund."
- Chief of Naval Operations Instructions 4440.39 and 4440.23, "Storage."
- Naval Supply Publication 437, "Standard Operating Procedures Manual."
- Naval Supply Systems Command Instruction 4440.179A, "Report of Discrepancy (ROD) Manual."
- Naval Supply Publication 1, "Storage."
- Naval Supply Systems Command Instruction 4440.115G, "Physical Inventory Program."
- Naval Supply Systems Command Instruction 4440.177, "Inventory Accuracy Officer for Inventory Control Points."
- Navy Comptroller Manual, Volume 3, "Appropriation Cost and Property Accounting (Field)."
- Navy Comptroller Manual, Volume 5, "Navy and Marine Corps Industrial Funds."
- Navy Comptroller Manual, Volume 8, "Financial Inventory Accounting, Reporting, and Billing."

As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems under the Department of the Navy's Management Control Program and Financial Management Systems Review and Evaluation Program. Our review focused on whether there was reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act were achieved. We compared the Department of the Navy Working Capital Fund's most recent Integrity Act reports with the evaluation we conducted of the Fund's internal control system. We also reviewed and tested the Fund's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the Overview of the Reporting Entity and Supplemental Financial and Management Information. However, our objective was not to provide an opinion on overall compliance with such provisions.

Material instances of noncompliance are failures to follow requirements and violations of prohibitions contained in laws or regulations that cause us to conclude that: (1) the aggregation of the misstatements resulting from those failures or violations is material to the Statement of Financial Position of the Consolidated Financial Statements of the Department of the Navy Working Capital Fund, or (2) the sensitivity of the matter would cause it to be perceived as significant by others. The results of our tests of compliance disclosed instances of noncompliance, the effects of which have not been corrected in the Fiscal Year 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements.

The specific material instances of noncompliance are briefly described below. Details on these instances are presented in a separate supporting report.

1. Amounts reported as collected and disbursed in support of Fund Balance with Treasury for the 30 September 1997 Department of the Navy Working Capital Fund Consolidated Financial Statements did not agree with individual activity records after cash reconciliations. (Under Secretary of Defense (Comptroller) Memorandum dated 19 August 1994; and Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 54, paragraph B.5.)

2. Accounts Receivable, Net, Federal was inaccurate because guidance was not followed for revenue recognition, reconciliations, billings, and collection policies. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 4, paragraphs 010406 and 030203; Volume 5, paragraph 280203; and Volume 11B, chapter 54, paragraph C.5, and chapter 61, paragraph A.7.)

3. Accounts Receivable, Net, Non-Federal was misstated because transactions were not reported or were incorrectly reported, and because amounts reported as outstanding had already been collected. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 4, paragraphs 010402 and 030201; and Volume 11B, chapter 54, paragraph C.4.)

4. Advances and Prepayments, Non-Federal was inaccurately reported because payment data was not properly registered or recorded, system weaknesses existed, and previous payment errors were not corrected. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 4, paragraph 050309.)

5. Inventory, Net records were inaccurate due to errors in inventory transaction processing and reporting, inadequacies in commercial repair transaction program recognition, and the lack of or questionable transaction reporting by some contractors. In addition, Material-in-Transit was inaccurate due to receipts not being posted or being posted using incorrect prices, and because of payment mischarges. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 55, paragraph G.1; and Federal Acquisition Regulation, Subpart 45.5.)

6. Work in Process was inaccurate because the present revenue recognition policy was incorrectly applied, reconciliations were not performed, misclassifications occurred, and inappropriate costs were included. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 61, paragraph A.7.B; and chapter 63, paragraph F.2.D.)

7. Operating Materials/Supplies, Net was inaccurate because of improper reconciliation procedures, items being misclassified, noncompliance with material and supply levels, and unauthorized use of an allowance account. In addition, material records were inaccurate because of flawed physical inventory techniques, lack of statistical sampling techniques, lack of sightback procedures, and inaccurate reporting of inventory results. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 55, addendum 1, paragraphs a - f.)

8. Property, Plant, and Equipment, Net was inaccurate because assets were incorrectly reported and recorded, other assets were misclassified, depreciation was not correctly reported, leases were not capitalized, and depreciation was not taken for Assets Not-In-Use and misclassified assets. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 58, paragraphs D.6 and D.7; and Addendum 1, paragraph B.1.)

9. War Reserves material was included in Inventory, Net rather than separately as required. (It was stated in the footnotes to the Department of the Navy Working Capital Fund Statement of Financial Position that this condition would be corrected in Fiscal Year 1998.) (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 6, paragraph 061202.A.1.l.)

10. Other Non-Entity Assets included Individual Material Readiness List equipment that should not have been reported on Department of the Navy Working Capital Fund financial statements. These assets did not meet criteria for reporting as Department of the Navy Working Capital Fund assets. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 58, paragraph 7.E.2.)

11. Accounts Payable, Federal was misstated because of failure to adjust accounting records for paid liabilities, bookkeeping errors, improper reconciliations, and misclassifications. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 4, paragraphs 080204, 080301, 080302, and 090201 (A. and B.).)

12. Other Federal (Intragovernmental) Liabilities was misstated because of reconciliations not always being performed, customer orders being billed in excess of authorized funding, misclassifications, accounting errors, lack of supporting documentation, and premature revenue recognition. Submissions were misstated

for Advance Return of Depot Level Repairable Carcasses, due to unique processing transactions and systemic processing problems. In addition, Liabilities for Deposits in Advance of Sales for the Foreign Military Sales Trust Fund and for Ships Stores Profits Transferrable had not been reviewed for validity. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 1, paragraphs 020206, 030602, chapter 3, Addendum 1; Volume 4, chapter 13, paragraphs 080203, 080204, 080310, 130102, and 130303; and Volume 11B, chapter 61, paragraphs A.5, B.2.b, and B.3.)

13. Accounts Payable, Non-Federal was misstated due to bookkeeping errors, invalid transactions being included in records, misclassifications, and records not being updated. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 1, paragraph 020206; Volume 4, paragraph 090205; and Volume 11B, chapter 59, paragraph B.2.)

14. Other Non-Federal (Governmental) Liabilities was misstated due to bookkeeping errors, unrecorded payments, incorrect postings, and misclassifications. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 1, paragraph 020206; Volume 4, paragraph 090205; and Volume 11B, chapter 59, paragraph B.2.)

15. The Net Position accounts of Invested Capital, Cumulative Results of Operations, and Other were inaccurately reported because losses from excess material, assets transferred out to others, and material transferred in from others were posted to incorrect capital accounts. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 56, paragraph E.; and Defense Finance and Accounting Service memorandums dated 25 June and 19 August 1993.)

16. Department of the Navy Working Capital Fund did not include all intrafund eliminating transactions for Accounts Receivable, Unearned Revenue, Accounts Payable, or Advances because systems that would identify intrafund transactions were not fully developed. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 6, chapter 6, paragraph 0616, Appendix AI.)

17. Department of the Navy Working Capital Fund activities did not recognize the financing source and corresponding depreciation expense received from the use of real property assets because personnel did not think it was appropriate for such assets. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 11B, chapter 62, paragraph D.2.)

18. Problem disbursements over 180 days old were not being written off as required. (Under Secretary of Defense (Comptroller) Memorandum of 30 June 1995.)

19. General Ledger Account 2270, Accrued Expenses - Other was being reported in Other Non-Federal (Governmental) Liabilities rather than in Accounts Payable, Federal as required. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 6, paragraph 061205.)

20. The Defense Industrial Financial Management System did not comply with Federal Financial Management Systems requirements. (Federal Financial Management Improvement Act of 1996, PL 104-208, Section 803; and Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 1, paragraph 020204-B.)

21. Department of the Navy Working Capital Fund activities could not always provide complete and usable transaction-driven databases to support reported financial statement balances as required. (Department of Defense Financial Management Regulation, DoD 7000.14-R, Volume 6, Chapter 6, paragraphs 060102 and 060701.)

Except as described above, the results of our tests of compliance indicated that, with respect to the items tested, the Department of the Navy Working Capital Fund activities complied, in all material respects, with the provisions referred to in the third paragraph of this auditor's report. With respect to items not tested, nothing came to our attention that caused us to believe that Department of the Navy Working Capital Fund activities had not complied, in all material respects, with those provisions.

JAMES D. WATTS
By direction

27 February 1998

Section C

Overview, Consolidated Principal Statements, and Consolidated Footnotes

Chief Financial Officer Annual Financial Statements FY 1997

Department of the Navy Navy Working Capital Fund

DEPARTMENT OF THE NAVY
NAVY WORKING CAPITAL FUND

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OVERVIEW

DEPARTMENT OF THE NAVY
NAVY WORKING CAPITAL FUND
OVERVIEW

Introduction

These financial statements report on the financial position and results of operations of the Department of the Navy (DON) Navy Working Capital Fund for FY 1997. They are prepared pursuant to the requirements of the Chief Financial Officer's Act of 1990 as amended by the Government Management Reform Act of 1994 and the Department of Defense (DoD) implementing guidance.

The financial statements include all aspects of the DON's supply and industrial operations. They do not include any other appropriated, trust or revolving funds. The principal statements are prepared from the same sources as are reports used to monitor and control budgetary resources. In FY 1996, the DON's financial statements were presented for each primary and select secondary activity groups as well as a consolidated level financial statement. In FY 1997, the DON's financial statements are presented at the consolidated level only in accordance with DoD guidance.

Description and Overview

Working capital funds were created in the DoD by the National Security Act Amendments of 1949. This legislation gave the Secretary of Defense the authority to establish working capital funds to finance inventories of supplies and for industrial activities that provide common services within the Departments and Agencies of the DoD.

Working capital funds can be broadly segregated into two functional areas: industrial operations and supply operations. Working capital funds finance the operating costs of most industrial, manufacturing, and service activities of the DoD. Industrial and service activities are given working capital to finance the cost of producing goods and services ordered by customers and subsequently receive reimbursement by billing, much as a private business does. By using money generated from sales to replenish its working capital, these funds are intended to be self-sustaining; hence the term "revolving fund." Working capital funds also finance the costs of supply operations which hold inventories of parts, subsistence, fuel, and other supplies for sale to military units.

Beginning in FY 1992, the DoD combined five industrial funds and four stock funds, and several appropriated fund support activities, including the Defense Finance and Accounting Service (DFAS) and the Defense Commissary Agency, into a single revolving fund called the Defense Business Operations Fund (DBOF). The primary goal of establishing DBOF was to focus the attention of all levels of DoD management on the total costs of carrying out certain

critical DoD business operations and to manage those costs effectively. Within the Department of the Navy this combining of funds involved the Navy Industrial Fund, the Marine Corps Industrial Fund, and the Department of the Navy Stock Fund.

The Office of the Secretary of Defense (Comptroller) centrally managed the cash balance of the DBOF. On 1 February 1995, DoD returned the management of the DBOF's cash balance to the military service and DoD component level to more appropriately align cash management with the operating entities. This action made each individual DoD component directly accountable for its respective cash balance since it was their management decisions that directly affected cash.

A further evolution of the fund occurred on 11 December 1996, when the Under Secretary of Defense (USD) (Comptroller) canceled the DBOF and established four funds: the Army Working Capital Fund, the Navy Working Capital Fund (NWCF), the Air Force Working Capital Fund, and the Defense-wide Working Capital Fund. This decision reinforced the role the DoD components by clearly establishing the component's responsibility to manage. Collectively, these four funds are known as the Defense Working Capital Funds.

The NWCF is a business-type financial operation which distinguishes between capital and operating costs using standard accounting principles. A basic principle of the NWCF, like the DBOF, is to capture all the costs of operating an activity group and to reflect the total cost of doing business in stabilized prices charged to customers. It operates on a break-even basis over the long term. Profits, when they occur, are returned to customers through lower rates in subsequent years. Similarly, losses are recouped through an increase in rates in subsequent years.

The DON has historically operated a large number of its supply and industrial facilities under revolving fund concepts. Effective 1 October 1996, the Department merged the Logistics Support Activities activity group into the Supply Management activity group, and transferred the Defense Automated Printing Service activity group to the Defense Logistics Agency, thereby reducing the number of activity groups reported in FY 1997. There are six diverse primary activity groups remaining in the DON, covering about fifty reporting entities. These six activity groups are (1) Supply Management, (2) Depot Maintenance, (3) Research & Development, (4) Base Support, (5) Information Services, and (6) Transportation.

Three of the six primary activity groups include operations so extensive as to warrant smaller "secondary" activity groups that correspond to the Department of the Navy systems command structure. For example, the activity group of Depot Maintenance consists of four secondary activity groups. Generally, the primary and secondary activity groups can also be categorized by the type of functions performed for its customers, i.e., supply, industrial, or services. The DON also has Component-level activity group that represents a "corporate-level" holding area for financial transactions (primarily collections and disbursements) which are pending identification to a specific activity group. A brief synopsis of the primary and associated secondary NWCF activity groups categorized by these three functions is provided below.

Supply

Supply Management - This primary activity group of Supply Management consists of two secondary activity groups, Supply Management-Navy and Supply Management-Marine Corps, which perform inventory management functions for shipboard, aviation, and amphibious reparable and consumable spare parts and commodities. In FY 1996, the Navy Distribution Depot activity group, which provided management of overseas Fleet Industrial Supply Centers, merged with Supply Management-Navy, and in FY 1997, the Logistics Support Activities activity group, which provided support functions for ashore and afloat commanders, merged into Supply Management-Navy.

Industrial

Depot Maintenance - This primary activity group of Depot Maintenance consists of the following four secondary activity groups: (1) Ordnance with five activities; (2) Shipyards with four activities; (3) Aviation with three activities; and (4) the Marine Corps with two activities. The functions associated with Depot Maintenance are maintenance, repair, manufacturing, overhaul, refit and restoration, and engineering services for design and development.

Services

Transportation - This primary activity group provides service-unique vessels such as Naval Fleet Auxiliary Force vessels, Special Mission Ships, and Afloat Prepositioning Force ships for sea transportation, logistics forces, and special missions. The Military Sealift Command manages these vessels from eight commands around the world.

Research and Development - This primary activity group consists of the following six secondary activity groups: (1) Air Warfare Center, (2) Surface Warfare Center, (3) Undersea Warfare Center, (4) Command, Control, and Ocean Surveillance Center, (5) Naval Research Laboratory, and (6) Facilities Engineering Service Center. These activities perform a wide range of research, development, test, evaluation and engineering support functions.

Information Services - This primary activity group consists of three secondary activity groups which provide regional automated information systems services and design support, and design, development, maintenance, and environmental support for information technology systems used by the DON, other DoD activities, and Federal agencies.

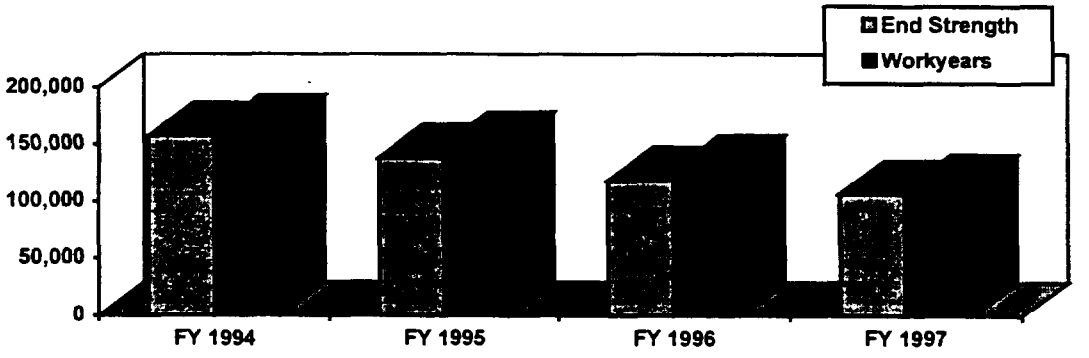
Base Support - This primary activity group is comprised of nine public works centers which support facilities maintenance, environmental services, and utilities for the operating forces and other activities throughout the world.

Performance Measures

All NWCF activity groups use performance measures as tools in determining management and operations effectiveness. Performance measures may include cost per direct labor hour, cost per unit of sales or product, operating costs and results, capital investments, current assets, financial obligations, financial conditions, and asset management. Performance measures and information discussed below, representing an aggregation of all NWCF activity groups include the civilian and military workforce, revenue, operating results, cash, fill rate for supply items, and activity accomplishments.

Personnel Resources

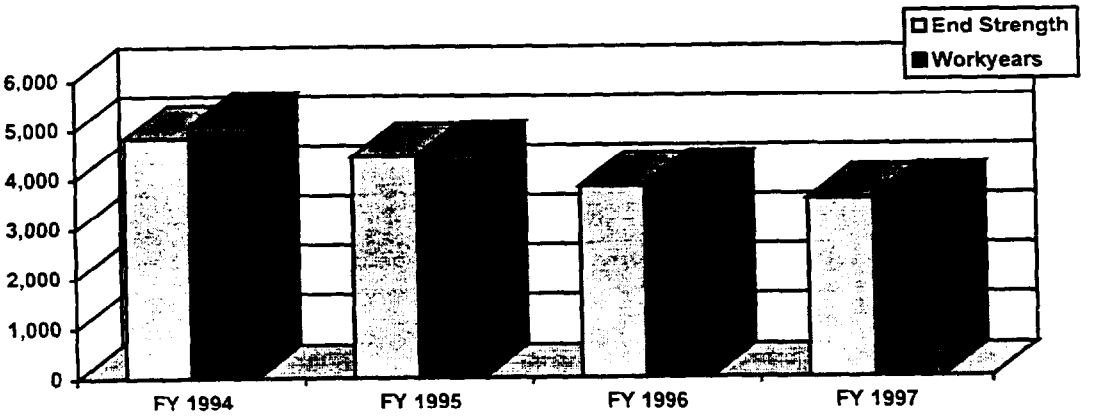
Trend Analysis of Civilian End Strength and Workyears FYs 1994-1997



Civilian Resources:	*FY 1994*	*FY1995*	*FY 1996*	*FY 1997*
End Strength	*157,117*	*138,034*	*118,318*	*106,652*
Workyears	*163,601*	*149,178*	*128,321*	*112,129*

Civilian personnel levels in the DON are at the lowest level since before World War II. FY 1997 reflects the continued downward trend of the civilian work force as a result of base closures, reductions in force structure, decreasing workload, and management efficiency. About 49% of the DON's civilians work at NWCF activities supporting depot level maintenance and repair of ships, aircraft, and associated equipment, development of enhanced warfighting capabilities at the Warfare Centers of Excellence, supply, and public works support. Decreases are anticipated beyond FY 1997 reflecting continued base closure actions, workload decline, and continued efforts of competition, outsourcing, and regionalization.

Trend Analysis of Military End Strength and Workyears FYs 1994-1997

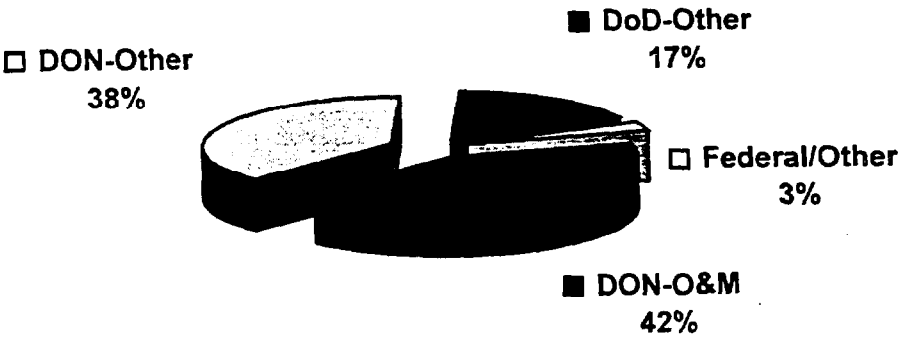


Military Resources:	*FY 1994*	*FY 1995*	*FY 1996*	*FY 1997*
End Strength	*4,827*	*4,443*	*3,837*	*3,573*
Workyears	*5,074*	*4,477*	*3,875*	*3,601*

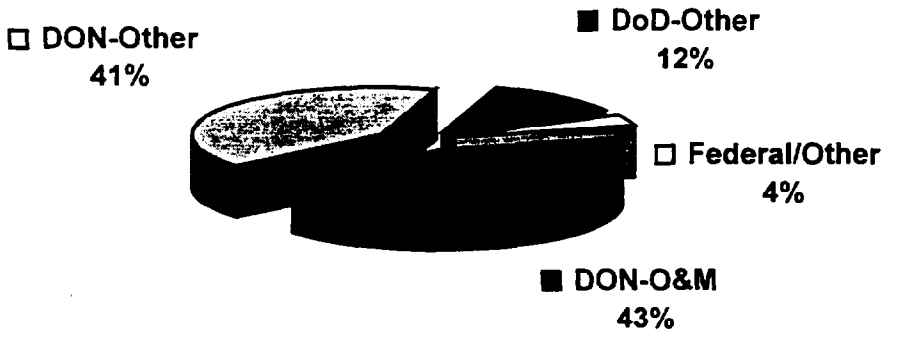
Military personnel levels at NWCF activities reflect the same downward trend seen in the civilian workforce resulting from base closures, reductions in force structure, decreasing workload, and management efficiencies. Decreasing levels are anticipated beyond FY 1997 with further base closures and workload declines.

Revenue by Customer and Provider

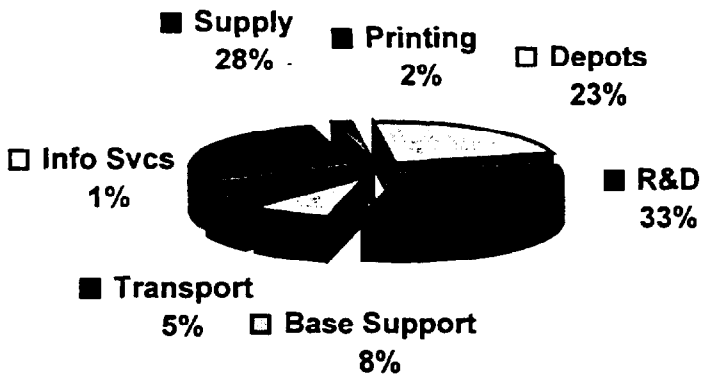
FY 1996 Revenue by Customer



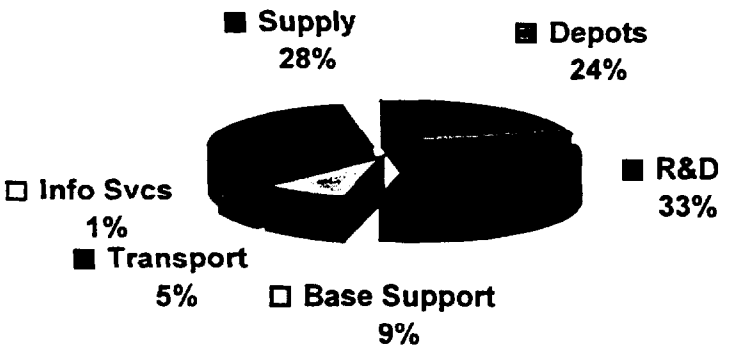
FY 1997 Revenue by Customer



FY 1996 Revenue by Provider

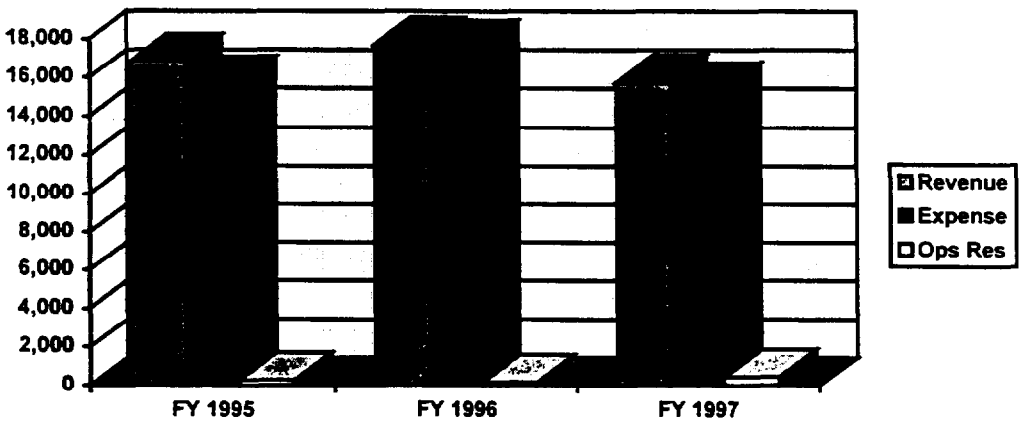


FY 1997 Revenue by Provider



The total revenue base and thus the volume of goods and services provided to NWCF customers in FY 1997 was $21,921 million. When compared to FY 1996 revenues of $24,378 million, this represented over a ten percent decline in FY 1997 due primarily to an overall decline in workload. As the pie charts indicate, the DON Operation and Maintenance (O & M) appropriation is the largest customer of the NWCF, followed by the aggregation of other DON appropriations which include various procurement accounts, Research, Development, Test and Evaluation, Shipbuilding and Conversion, and others. The major activity group providers of goods and services are Research and Development, Supply Management, and Depot Maintenance. These activity groups satisfy over 85 percent of the needs of the NWCF customers and remains almost unchanged from FY 1996. In FY 1997, the Defense Automated Printing Service (DAPS) was transferred from the NWCF under DON management to the Defense Working Capital Fund (DWCF) under the management of the Defense Logistics Agency (DLA). DAPS generated approximately $400 million in revenues per annum.

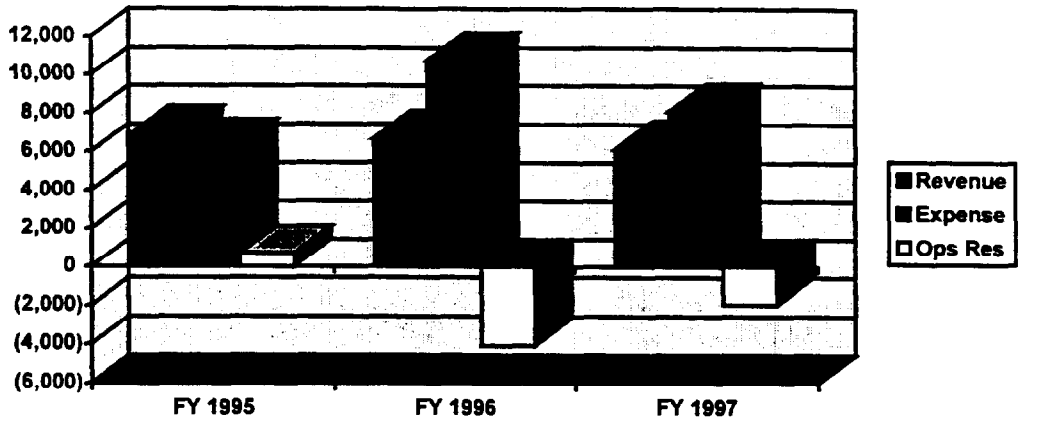
Industrial/Services



Industrial/Services: ($000)	*FY 1995*	*FY 1996*	*FY 1997*
Revenue	***16,821***	***17,691***	***15,759***
Expenses	***16,549***	***17,536***	***15,324***
Operating Results	***272***	***155***	***435***

The Industrial and Services activity groups have shown positive operating results over the past three fiscal years. However, FY 1997 includes revenues of $511 million that Congress directed to replenish the NWCF cash balance. After adjusting for these revenues, the FY 1997 operating results were negative $76 million. Although negative, this reflects a trend of continual improvement in NWCF execution against plan. This was possible because of fewer variations in planned customer workload versus actual customer workload and through the continued efforts of NWCF managers to control costs and adapt to those changes in customer workload that did occur.

Supply



Supply: ($000)	*FY 1995*	*FY 1996*	*FY 1997*
Revenue	***6,935***	***6,687***	***6,162***
Expenses	***6,253***	***10,764***	***8,118***
Operating Results	***682***	***(4,077)***	***(1,956)***

The Supply Management activity group recorded significant operating losses in FY 1996 and FY 1997. These values, resulting from the implementation of the Federal Accounting Standards Advisory Board (FASAB) inventory valuation accounting standard, are not considered representative of the operating results of the Supply Management activity group. The FASAB standard is implemented in the DoD Financial Management Regulation (FMR) 7000.14-R, Volume 11B and was recently modified by the accounting policy staff of the USD (Comptroller). The standard requires the use of the latest acquisition cost method for valuing inventory and also requires the establishment and use of inventory holding gain and loss accounts and a Cost of Goods Sold from Inventory calculation.

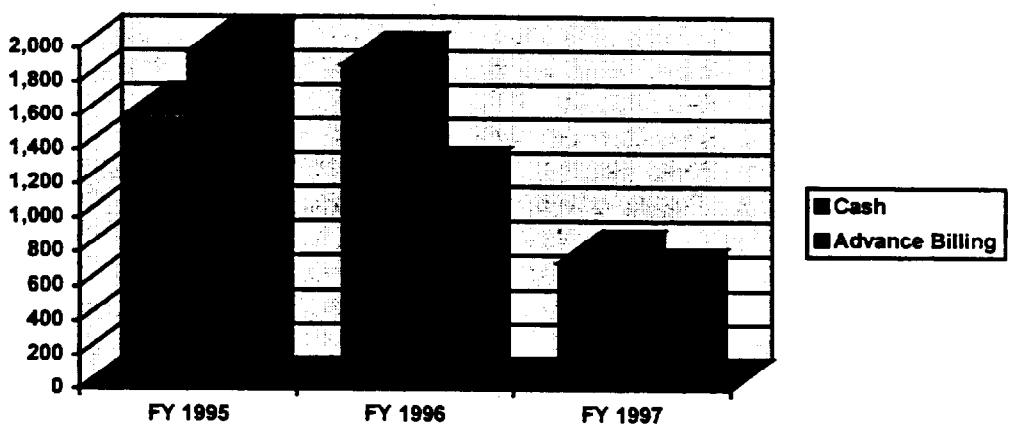
The calculations required to produce the FY 1997 operating results revealed an error in the FY 1996 operating results. Correction of the FY 1996 error produces a FY 1996 operating result of about negative $1.9 billion versus the negative $4.1 billion reported. Notwithstanding this error, the operating results of negative $1.9 billion in both FY 1996 and FY 1997 were still not considered representative values for the Supply Management activity group. The USD (Comptroller) , DFAS, and DON continue to review the calculation methodology.

Cash Management

Cash management is the process by which managers maintain a sufficient supply of cash to meet day-to-day business needs while maintaining a reasonable allowance for emergencies. Cash management consists of developing cash plans, monitoring the execution of this cash plan,

analyzing collections, disbursements and non-expenditure transfers, identification and correction of errors, and maintaining an appropriate cash balance to meet liabilities and prevent a violation of the Anti-Deficiency Act. The USD policy requires each WCF to maintain a cash balance equal to seven to ten days of operating program cash disbursements plus six months of capital program cash disbursements. For the NWCF this equates to a cash balance in the range of $750 million to $1,100 million. The following chart displays the NWCF cash balance for the past three fiscal years.

Cash Balance versus Advance Billings
FY 1995 – FY 1997
($000)



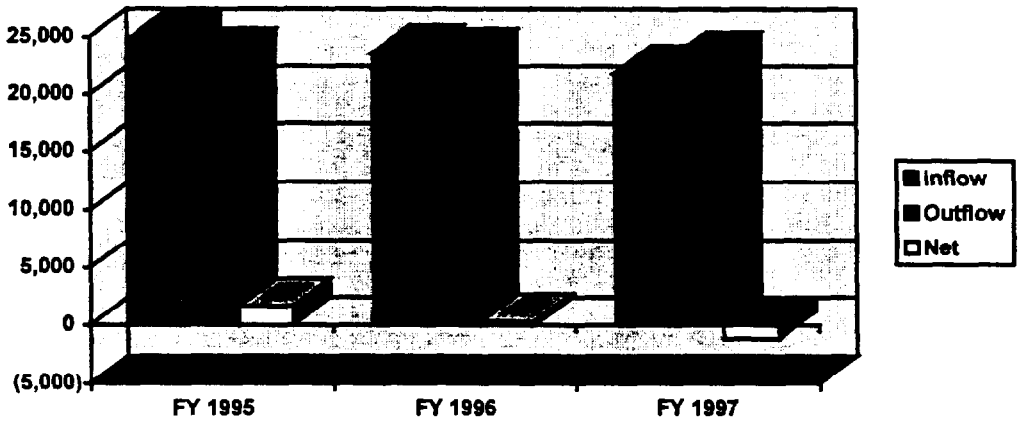
The cash balance has been at or above the minimum level for the last three fiscal years. In addition to the cash balance, the above chart displays the unliquidated advance billings balances remaining at the end of each fiscal year. Advance billing is the practice of having the customer pay for agreed upon before completion of the task. Advance billing does not change the scheduled accomplishment of the work or its cost; it does increase short-term cash availability.

Large scale advance billings began in FY 1993 while DBOF cash was under the management of USD. When cash management was returned by USD to the DoD components in February 1995, the DON received $442 million, less than the required minimum level. Additionally, the advance billing liability of $2,190 being carried in the DON segment of the DBOF at the time of the transfer greatly exceeded the cash received. These two conditions necessitated additional advance billings to ensure solvency and avoid an Anti-Deficiency Act violation.

The above chart displays the downward trend of the advance billing balance and an improving trend when compared to the cash balance. The DON has taken actions to eliminate the need for further advance billings and liquidate the advance billing liability. The DON has

included specific factors in prices charged to customers to generate additional cash of about $500 million in FY 1998 and $150 million in FY 1999. In addition, Congress authorized a transfer of funds into customer accounts of the NWCF in FY 1997 to pay for increased surcharges levied by the NWCF to replenish the cash balance. These actions are anticipated to eliminate the advance billing balance by the end of FY 1999 and establish the minimum cash balance required by the NWCF. Advance billings may be necessary during this "replenishment" time period to ensure solvency.

Cash Flows
FY 1995 – FY 1997
($000)



The cash inflows and outflows of the NWCF represent over $44 billion in throughput to the cash balance. This combination of collections and cash transfers-in of $21,826 million and disbursements and cash transfers-out of $22,986 million represents a flow of about $170 million each business day. The greatest cash flows occur in the Depot Maintenance, Supply Management, and Research and Development activity groups. The significant net outflow of cash in FY 1997 resulted from the liquidation of about $600 million in advance billings in the Depot Maintenance and Research and Development activity groups, a net cash outflow in Supply Management of $550 million, and cash transfers-out to finance the Joint Logistics Service Center.

Fill Rate-Supply Management

The primary function of the Supply Management activity group is to sell material to customers. One indicator of how successful it is in satisfying customers is the Fill Rate. The Fill Rate or Supply Material Availability (SMA) as it is called in the DON is calculated as the percent of customer requisitions satisfied from on hand wholesale managed assets. The overall DON goal is 85%. SMA for the Navy segment and the Marine Corps segment of the Supply Management activity group is:

	Navy	Marine Corps
FY 1997	80.4%	79.2% *
FY 1996	79.3%	73.8% *
FY 1995	78.2%	83.1%
FY 1994	80.2%	81.5%

*SMA for depot level repairable items only

For the Navy segment, the upward trend of SMA is attributable to a number of factors. Demand for wholesale managed items is declining and the number of operating units, both aviation and ships, continues to decline. Through these declines, coupled with continued decommissioning of ships and squadrons and efforts to expand asset visibility, more material becomes available from non-traditional sources vice normal procurement. Increased emphasis on fully funding repair of unserviceable assets increases their availability to satisfy the customer requirement. For the Marine Corps segment, the SMA for depot level repairable items has improved over the past fiscal year. Since the majority of consumable items were transferred to the management of the Defense Logistics Agency, they are excluded from the SMA data. Even though the SMA is below the desired goal, the Fleet Marine Force readiness posture is at 91 percent, indicating critical supply parts are available to the customer. Inventory managers continue to monitor SMA and review backorders and repair actions to expedite material to the customer.

Ship Availability-Transportation

The mission of the Transportation activity group is to provide efficient sea transportation, combat ready logistics forces, and reliable special mission ships for the DoD in peace and war. The Military Sealift Command ships are distinct from other U.S. Navy ships in that they are non-combatants, include both government-owned and chartered vessels, and they are crewed by civilian mariners employed by the U.S. Navy and from private operating companies. Ship availability is defined as the measurement of the number of days that ships are actually available to perform the function for which they were contracted, against the number of planned days. The goal is to ensure that the ships are available for the mission to which they were assigned and is expressed as a percentage of meeting the number of planned days. Ship availability for the Naval Fleet Auxiliary Force (NFAF), Afloat Prepositioning Force-Navy (APF-N), and the Special Mission Support (SMS) force are displayed in the following table, in days.

Program	FY	Goal	Actual	Percent
NFAF	1997	11,315	11,937 */**	105.5%
	1996	14,330	13,859	96.7%
APF-N	1997	5,110	5,073 **	99.3%
	1996	5,282	5,258	99.5%

SMS	1997	8,434	8,118 *	96.3%
	1996	4,337	3,933	90.7%

* TAGOS transferred from NFAF to SMS
** Hospital ships transferred from APF-N to NFAF

Activity Accomplishments

The NWCF is composed of six primary activity groups consisting of 17 secondary activity groupings. Facing declining workload, BRAC closings, and organizational changes, the highly skilled workforce at the NWCF activities continue to press for economies and efficiencies in all elements of their organizations. Whether their efforts have been directed at computer systems, combat systems, or the workforce itself, the NWCF activity successes have been unparalleled. The following are just a few of the many important achievements of these groups.

Supply Operations - Inventory investments at all echelons of supply management were reduced from about $32 billion in FY 1989 to about $17 billion in FY 1997 (before adjustment to approximate historical cost). This 47 percent reduction was accomplished, in part, by utilizing technologies to enhance total asset visibility; by reengineering business practices such as satisfying small purchase demand through the Purchase Card and Direct Vender Delivery programs; and by outsourcing SERVMART operations with organizations such as the General Services Administration and the National Industries for the Blind.

The standardization of business practices and the consolidation of resources is being employed in the development of regional partnerships with activities under the Fleet and Industrial Support Centers. These partnerships are designed to reduce the costs of the supply infrastructure, investment in inventories, and transform the supply system into a responsive global network. These partnerships have realized savings of $85 million in labor and non-labor savings through FY 1997.

Depot Maintenance - Naval Shipyards have continued to improve and streamline work processes through the implementation of the Advanced Industrial Management (AIM) system. AIM in an engineering process which improves performance by providing disciplined work planning, estimating, and scheduling functions; delivering simplified and complete work documents to the mechanics; promoting data integration and management; and applying group and zone technology. AIM allows the shipyards to reshape and downsize their organizational structure.

In the Naval Aviation Depots (NADEPs), NADEP North Island won the San Diego Business Journal 1996 Total Excellence In Management award for manufacturing and received the Chief of Naval Operations 1996 Environmental Award for recycling. At NADEP Cherry Point, improved procedures for removing accessory gearboxes from the F405 engine were implemented to prevent damage to engine quill shafts and an intermediate maintenance repair procedure was developed for the T45 Starting System Air Producer insulation blankets.

At the Naval Ordnance Center (NOC), a realignment of the business processes, organizational structure, and staffing of the Inventory Management and Systems Division (IMSD) was activated in FY 1997, thus completing actions begun in FY 1996. Movement of the Ammunition Management Offices of the Atlantic and Pacific Divisions under the IMSD provides a more efficient interface between the Fleet Commanders and inventory managers. Additionally, the engineering and information resource management functions of NOC activities were realigned under the single management of the Naval Warfare Assessment Division, paving the way for the elimination of duplicative efforts and the introduction of standard systems. This was part of the NOC strategic plan to focus management of the weapons stations on the core processes of explosives safety, inventory management, and ordnance distribution.

At the Marine Corps Depot Maintenance Center in Barstow, the Product Team for the High Mobility Multipurpose Wheeled Vehicle became the first team to use the new computerized system for Process Standards. These standards identify each work step required at each workstation. In addition, the system displays plain-language inspection criteria, exploded diagrams, and provides a method for requesting and tracking the usage of parts. One of the more popular features is the "touch screen" which eliminated typing by substituting a simple touch of an appropriate box on the computer screen. Improvements have been seen in predicting parts and labor requirements and providing customers with a more uniform product.

Base Support - At the Navy Public Works Centers various acquisition improvements have been employed. Outsourcing, commitment warranting, and purchase cards have put customers in direct access to suppliers at the point of sale. Integrated teams have been established, involving the fleet commanders, users, and other "stakeholders" in providing innovative contracting tools. Additionally, as the centers implement these contracting tools and improve the delivery of purchases, the time to complete jobs will continue to decline. From a FY 1992 high of 500 days, the turnaround time has declined to 180 days with commensurate improvements in productivity.

Research and Development - In the Naval Surface Warfare Center, Dahlgren Division, successful integration of the Advanced Lightweight Influence Sweep System (ALISS) acoustic subsystem hardware aboard the QST-35A test-bed was completed. The ALISS program was instituted to develop the next generation of mine countermeasures to address emerging threats in shallow and very shallow water. Initial at-sea testing is in progress with the new pulsed power driven spark gap technology and remote control system aboard a target drone craft especially modified to serve as the ALISS demonstration platform.

The Naval Air Warfare Center's (NAWC) accomplishments ranged from the successful lifting of a F/A-18F1 aircraft using an updated Shipboard Aircraft Crash Handling and Salvage Crane as part of the Super Hornet's carrier suitability test, to successfully stopping an unmanned F/A-18E aircraft using a nylon barricade to demonstrate the Super Hornet's compatibility with the emergency barricades used on aircraft carriers. The first Bell Boeing V-22 Osprey built to production standards was delivered to the NAWC Aircraft Division to begin the new flight test phase for the demonstration of its performance and versatility.

The Space and Naval Warfare Systems Center (SSC), San Diego, participated in the Joint Warrior Inter-operability Demonstration 1997 (JWID 97) sponsored by the joint staff. The SSC San Diego managed project COMPASS, the Common Operational Modeling, Planning, and Simulation Strategy, received the JWID Golden Nugget award for its demonstration. SSC San Diego also showcased twelve demonstrations which were key to solutions of inter-operability issues between submarines and joint force commanders.

As a result of amendments to the Clean Air Act, the production of ozone depleting Halon 1301 has been banned. Halon 1301 is a very effective fire suppression agent used in over 2200 shipboard fire suppression systems. The Naval Research Laboratory's (NRL's) efforts are key to the Halon Elimination Program to eliminate Halon in new construction and minimize its existing use. NRL recommended systems have been incorporated in the LPD-17 ship construction drawings. Follow on deliverables are for fire protection for the DD-21 and CV(X) ships. To enhance the Halon replacement performance, NRL invented the Water Spray Cooling System Gaseous Total Flooding Agent Hybrid. A patent is pending for this system which has been adopted by the Army for the protection of their watercraft.

The Naval Facilities Engineering Service Center (NFESC) successfully, demonstrated a new container handler to Naval forces during Exercise Baltic Challenge in Estonia. The container handler is rough-terrain capable and can handle containers weighing up to 50,000 pounds. The demonstration was a joint test and evaluation exercise with the German military and provides an opportunity for joint acquisition through the Naval International Programs Office. The NFESC also developed and successfully employed the modeling and simulation of the Tactical Logistics Distribution Simulation software. This software, developed to support the Maritime Preposition Force and Beyond Wargame, allows the planner to clearly anticipate and detect where technology and capability gaps need to be filled for successful execution of the operation.

The Naval Undersea Warfare Center set a new national submerged speed record with special bullets designed for high performance underwater. In a recent test, the launch velocity of the bullet exceeded the speed of sound. The drag of the bullet is very low due to a phenomenon known as supercavitation in which the high flow speed causes the water near the bullet tip to vaporize. The results of this test are likely to open other areas of unexplored physics.

Information Services - The Naval Computer and Telecommunications Station, Washington, re-engineered the Fleet Modernization Program Management Information System (FMPMIS) from a mainframe system to a fault tolerant client/server architecture which eliminates the need for a costly air-cooled mainframe environment. The FMPMIS facilitates the FMP logistics function for the scheduling of ship overhauls, alterations, and material requirements. The system now enforces the capture of correct data at the time of source data entry and eases data entry through the use of a graphical user interface. Most of the data is now entered using a table of legitimate entries vice manual entry.

The Fleet Material Support Office successfully completed the implementation of the Naval Air Station requirements determination version of the Uniform Automated Data Processing System. This will now provide the capability for all Fleet and Industrial Support Centers, managed in the Supply Management activity group, to establish partnerships with multiple air stations and, thus, facilitate reductions in supply infrastructure and investment in inventory and improve supply system responsiveness.

Systems Accomplishments

Defense Industrial Financial Management System (DIFMS) - DIFMS is the interim migratory finance and accounting system for the NWCF Depot Maintenance and Research and Development activity groups. Through FY 1997, four systems have been consolidated into DIFMS. When this system initiative is completed, a total of 13 systems will have been consolidated into DIFMS. These 13 systems, which have operated on 25 operational data bases, will be collapsed into 7 DIFMS operational data bases.

Defense Working Capital Accounting System (DWAS) - DWAS is the interim migratory finance and accounting system for the NWCF Base Support activity group. An updated software package for this off the shelf system is anticipated for February 1998. The first Base Support Public Work Center (PWC) is to be converted in April 1998 with final completion of all PWCs by FY 2000. Upon completion of all PWCs, two existing systems will have been consolidated into DWAS and 10 operational data bases will have been replaced by one DWAS operational data base.

Corps of Engineers Financial Management System (CEFMS) - CEFMS is an interim migratory finance and accounting system for the NWCF Transportation activity group. The latest projected implementation for CEFMS is June 1998 at which time it will replace the existing Military Sealift Command Financial Management Information System (FMIS). The four operational data bases used for FMIS will be replaced by one CEFMS operational data base.

Material Financial Control System (MFCS) - MFCS is the interim migratory financial system for the NWCF Supply Management activity group to be used in the wholesale and retail segments of the inventory. Two shipboard systems have already been replaced by MFCS. Once conversion is completed, a total of five systems will have consolidated into MFCS. Of the 161 operational data bases for these existing five systems, only three operational data bases will remain under a fully implemented MFCS.

Financial Management Issues

Supply Management Inventory Valuation and Operating Results. The Statement of Federal Financial Accounting Standards Number 3, Accounting for Inventory and Related Property, was issued by the FASAB in October 1993. The standard prescribes inventory be valued at either historical cost or latest acquisition cost. The latest acquisition cost method, which requires the recognition of an allowance account for unrealized holding gains and losses, is used in the NWCF to arrive at an historical cost of inventory. The adjustments made to the

allowance account are a component of the cost of goods sold. The FASAB standard is incorporated in the DoD Financial Management Regulation 7000.14-R, Volume 11B, which also describes procedures for implementation.

The accounting policy and procedures staff from the USD Comptroller and DFAS, with support from the DON staff and the Naval Audit Service (NAS), have been developing a model to calculate the value of inventory and cost of goods sold using the general ledger of the Supply Management activity group. This group has encountered significant difficulties in producing reliable allowance account and cost of goods sold values because (1) the Supply Management general ledger was developed many years ago and, thus, does not conform to the current DoD Standard General Ledger; (2) accounting practices used for depot level repairable inventories were developed over fifteen years ago necessitating the development of work-around methodologies; and (3) information required for the calculation is not resident in the general ledger and must be produced for logistics records; and (4) logistics systems do not produce and pass to the financial systems all transactions envisioned by the latest acquisition cost method.

The inventory value calculated for the Navy segment of the Supply Management activity group for FY 1997 of $12,691,622 thousand is considered representative of the historical cost value. The inventory value of $9,873,757 thousand calculated last year for FY 1996 was not considered representative. However, the subsequent discovery and correction of an error in the FY 1996 valuation calculation resulted in a more representative value for FY 1996 of $13,777,725 thousand.

The cost of goods sold calculated for FY 1997 of $5,026,766 thousand and the total expenses of $7,914,225 thousand are not considered representative values of Supply Management business. When compared to revenues, the resultant net operating results is a negative $1,923,799 thousand. In FY 1996 the net operating results was a negative $4,035,147 thousand. One area under review is the valuation of inventory being transferred to disposal. The value appears to be larger than warranted considering the significant quantities of inventory being returned to the supply system without cost. The USD (Comptroller), DFAS, DON, and NAS group recognizes that additional work must be done in the model to calculate the cost of goods sold and they will be meeting to resolve this issue prior to the FY 1998 CFO report.

Cash Management. The cash position of the NWCF is improving as noted in the charts above. However, the lack of timely reporting of collections and disbursements hampers analysis, error correction, and prevention of violations. As the accounting organization, DFAS is working to improve the accuracy and timeliness of cash reporting.

The DON and DFAS are jointly working in several areas to improve cash management. Through FY 1997 the NWCF cash balance was centralized at the NWCF corporate level. In FY 1998 procedures will be developed toward the goal of establishing cash balances at the activity group and activity level. Consequently, collections and disbursements will no longer be transferred to the corporate level at the end of each fiscal year. Procedures are also being developed to identify non-expenditure transfers of cash to the activity level, Heretofore, these transfers were held at the corporate level, unseen by individual activities. The DON and DFAS

are also reviewing activity level collection and disbursement processing procedures to identify reconciliation problems and develop methods for handling aged and pre-NWCF (i.e., DBOF) transactions.

Undistributed Disbursements and Collections. The NWCF Fund Balance with Treasury represents the value of disbursements, collections, and non-expenditure transfers processed through the DFAS reporting network to the DON NWCF sub-limit in the U.S. Treasury. The DFAS/DON Centralized Expenditure and Reimbursement Processing System (CERPS) is the designated system for reporting disbursement and collection data to the U.S. Treasury. CERPS also provides transaction level disbursement and collection data to the DFAS Operating Locations (OPLOCs) for processing into each individual NWCF activity general ledger.

Significant differences exist between the disbursements and collections reported to the U.S. Treasury and the disbursements and collections recorded in the NWCF activity general ledger. The differences between the U.S. Treasury and activity ledgers are recorded in undistributed disbursement and undistributed collection accounts. Because the activity level values are higher than the U.S. Treasury values, these accounts contain abnormal balances. The DFAS has initiated actions to investigate potential problems with the values reported in CERPS and with activity general ledger processing. Some indications of problems are the pre-posting of transactions into the activity ledgers prior to processing officially through the CERPS. Also, it appears that specific coding in the transactions sent to the U.S. Treasury are causing collections to be processed as negative disbursements, however, the transactions are being corrected when processed into the activity ledgers, but are not being "recycled" through the U.S. Treasury. While there may be no impact upon the Fund Balance with Treasury, this causes distortions between the U.S. Treasury and activity level disbursement and collection values.

Values reported in the undistributed disbursement and collection accounts are normally reflected as reductions to the values being reported for accounts payable and accounts receivable, respectively, to simulate the distribution of the undistributed values. Since the undistributed disbursements and collections accounts contained abnormal values of over $1 billion each, increases of about $1 billion rather than reductions of $1 billion were applied to the accounts payable and accounts receivable, thus overstating the values reported in the DON NWCF CFO for FY 1996. Since significant abnormal balances continue to exist FY 1997, rather than overstate accounts payable and accounts receivable again, undistributed disbursements and undistributed collections are being reported in line 1.a.(6), Other Federal Entity Assets, of the Statement of Financial Position pending the completion of the DFAS investigation.

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations for the Department of the Navy, pursuant to the requirements of the CFO Act of 1990 as amended by the Government Management Reform Act of 1994. While the statements have

been prepared from the books and records of the Department in accordance with the formats prescribed by the Office of Management and Budget, the statements are different from the financial statements used to monitor and control budgetary resources that are prepared from the same books and records.

The statements should be read with the realization that they are for a Federal entity, that unfunded liabilities reported in the financial statement cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

DEPARTMENT OF THE NAVY

NAVY WORKING CAPITAL FUND

CONSOLIDATED

PRINCIPAL STATEMENTS

Department of Defense
Navy Working Capital Fund - Consolidated Navy Working Capital Fund
Statement of Financial Position
As of September 30, 1997
(Thousands)

ASSETS	1997	1996
1. Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	$746,524	$1,905,994
(2) Investments, Net (Note 4)	0	0
(3) Accounts Receivable, Net (Note 5)	1,193,817	2,437,997
(4) Interest Receivable	0	0
(5) Advances and Prepayments	147,792	108,363
(6) Other Federal (Intragovernmental) (Note 6)	49,698	56,461
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments (Note 4)	0	0
(2) Accounts Receivable, Net (Note 5)	285,531	1,610,544
(3) Credit Program Receivables/ Related Foreclosed Property, Net	0	0
(4) Interest Receivable, Net	133	81
(5) Advances and Prepayments	218,225	284,722
(6) Other Non-Federal (Governmental) (Note 6)	1,164,026	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Inventory, Net (Note 8)	13,145,216	10,528,953
e. Work in Process (Note 9)	1,321,327	1,378,813
f. Operating Materials/Supplies, Net (Note 10)	592,074	626,613
g. Stockpile Materials, Net (Note 11)	0	0
h. Seized Property (Note 12)	0	0
i. Forfeited Property, Net (Note 13)	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)	0	0
k. Property, Plant and Equipment, Net (Note 15)	4,623,668	4,534,689
l. War Reserves	0	0
m. Other Entity Assets	58,821	203,617
n. Total Entity Assets	$23,546,852	$23,676,847
2. Non-Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	$0	$0
(2) Accounts Receivable, Net (Note 5)	0	0
(3) Interest Receivable, Net	0	0
(4) Other (Note 6)	393,512	375,620

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Consolidated Navy Working Capital Fund
Statement of Financial Position
As of September 30, 1997
(Thousands)

ASSETS, Continued	1997	1996
2. Non-Entity Assets:		
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Receivable, Net (Note 5)	$0	$0
(2) Interest Receivable, Net	0	0
(3) Other (Note 6)	0	0
c. Cash and Other Monetary Assets (Note 3)	0	0
d. Other Non-Entity Assets	0	0
e. **Total Non-Entity Assets**	$393,512	$375,620
3. Total Assets	$23,940,364	$24,052,467

LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$844,275	$1,844,117
(2) Interest Payable	0	0
(3) Debt (Note 16)	1,164,026	1,225,977
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	1,383,055	3,512,162
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	(33,134)	329,749
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	271,230	368,005
(b) Annual Accrued Leave	461,304	506,741
(c) Severance Pay and Separation Allowance	0	0
(3) Interest Payable	1	0
(4) Liabilities for Loan Guarantees (Note 7)	0	0
(5) Lease Liabilities (Note 18)	0	0
(6) Pensions and Other Actuarial Liabilities (Note 19)	0	0
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	2,941,801	3,060,717
c. **Total Liabilities Covered by Budgetary Resources:**	$7,032,558	$10,847,468

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Consolidated Navy Working Capital Fund
Statement of Financial Position
As of September 30, 1997
(Thousands)

LIABILITIES, Continued	1997	1996
5. Liabilities Not Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	$0	$0
(2) Debt (Note 16)	0	0
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	0	0
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	0	0
(2) Debt (Note 16)	0	0
(3) Lease Liabilities (Note 18)	0	0
(4) Pensions and Other Actuarial Liabilities (Note 19)	1,160,071	0
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	0	0
c. Total Liabilities Not Covered by Budgetary Resources	$1,160,071	$0
6. Total Liabilities	$8,192,629	$10,847,468
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$0	$0
b. Invested Capital	23,516,921	20,695,780
c. Cumulative Results of Operations	(5,793,059)	(6,761,473)
d. Other	(816,056)	(729,308)
e. Future Funding Requirements	(1,160,071)	0
f. Total Net Position	$15,747,735	$13,204,999
8. Total Liabilities and Net Position	$23,940,364	$24,052,467

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Consolidated Navy Working Capital Fund
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
REVENUES AND FINANCING SOURCES		
1. Appropriated Capital Used	$0	$0
2. Revenues from Sales of Goods and Services		
a. To the Public	101,078	236,032
b. Intragovernmental	19,012,895	24,014,812
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 21)	0	0
6. Other Revenues and Financing Sources (Note 22)	924,536	127,669
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	0	0
8. Total Revenues and Financing Sources	$20,038,509	$24,378,513
EXPENSES		
9. Program or Operating Expenses (Note 23)	$1,246,492	$2,581,038
10. Cost of Goods Sold (Note 24)		
a. To the Public	101,078	34,488
b. Intragovernmental	17,510,488	21,780,840
11. Depreciation and Amortization	215,470	239,733
12. Bad Debts and Writeoffs	0	0
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	86,770	0
b. Federal Securities	0	0
c. Other	0	0
14. Other Expenses (Note 25)	2,399,628	3,664,391
15. Total Expenses	$21,559,926	$28,300,490
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	($1,521,417)	($3,921,977)
17. Plus (Minus) Extraordinary Items (Note 26)	(566,412)	477,550
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($2,087,829)	($3,444,427)

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Consolidated Navy Working Capital Fund
Statement of Operations and Changes in Net Position
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
EXPENSES, Continued		
19. Net Position, Beginning Balance, as Previously Stated	$13,204,999	$19,620,121
20. Adjustments (Note 27)	3,031,250	(1,872,621)
21. Net Position, Beginning Balance, as Restated	$16,236,249	$17,747,500
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($2,087,829)	($3,444,427)
23. Plus (Minus) Non Operating Changes (Note 28)	1,599,315	(1,098,074)
24. Net Position, Ending Balance	$15,747,735	$13,204,999

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Consolidated Navy Working Capital Fund
Statement of Cash Flows
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($2,087,829)	($3,444,427)
Adjustments Affecting Cash Flow:		
2. Appropriated Capital Used	0	0
3. Decrease (Increase) in Accounts Receivable	161,060	(188,554)
4. Decrease (Increase) in Other Assets	246,027	3,107,610
5. Increase (Decrease) in Accounts Payable	(296,508)	447,968
6. Increase (Decrease) in Other Liabilities	(2,264,837)	(500,430)
7. Depreciation and Amortization	215,470	239,733
8. Other Unfunded Expenses	(2)	110,456
9. Other Adjustments	2,107,144	1,021,659
10. Total Adjustments	$168,354	$4,238,442
11. Net Cash Provided (Used) by Operating Activities	($1,919,475)	$794,015
CASH FLOWS FROM INVESTING ACTIVITIES		
12. Sale of Property, Plant and Equipment	$0	$1,382
13. Purchase of Property, Plant and Equipment	(240,418)	(176,760)
14. Sale of Securities	0	0
15. Purchase of Securities	0	0
16. Collection of Loans Receivable	0	0
17. Creation of Loans Receivable	0	0
18. Other Investing Cash Provided (Used)	0	0
19. Net Cash Provided (Used) by Investing Activities	($240,418)	($175,378)
CASH FLOWS FROM FINANCING ACTIVITIES		
20. Appropriations (Current Warrants)	$0	$0
21. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	1,522,557	1,170,223
22. Deduct:		
a. Withdrawals	0	0
b. Transfers of Cash to Others	460,183	1,454,714
23. Net Appropriations	$1,062,374	($284,491)

The accompanying notes are an integral part of these statements.

Department of Defense
Navy Working Capital Fund - Consolidated Navy Working Capital Fund
Statement of Cash Flows
For the Period Ended September 30, 1997
(Thousands)

	1997	1996
CASH FLOWS FROM FINANCING ACTIVITIES, Continued		
24. Borrowing from the Public	$0	$0
25. Repayments on Loans to the Public	0	0
26. Borrowing from the Treasury and the Federal Financing Bank	0	0
27. Repayments on Loans from the Treasury and the Federal Financing Bank	(61,951)	(37,382)
28. Other Borrowings and Repayments	0	0
29. Net Cash Provided (Used) by Financing Activities	$1,000,423	($321,873)
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	($1,159,470)	$296,764
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	1,905,994	1,609,230
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	$746,524	$1,905,994

Supplemental Disclosure of Cash Flow Information:	1997	1996
33. Total Interest Paid	$0	$0

Supplemental Schedule of Financing and Investing Activity:	1997	1996
34. Property and Equipment Acquired Under Capital Lease Obligations	$0	$0
35. Property Acquired Under Long-Term Financing Arrangements	$0	$0
36. Other Exchanges of Non-cash Assets or Liabilities	$0	$0

The accompanying notes are an integral part of these statements.

The accompanying notes are an integral part of these statements.

NAVY WORKING CAPITAL FUND

CONSOLIDATED

FOOTNOTES TO THE PRINCIPAL STATEMENTS

Footnotes

NOTES TO THE FISCAL YEAR 1997 PRINCIPAL STATEMENTS
NAVY WORKING CAPITAL FUND
CONSOLIDATED NOTES
PERIOD ENDING 30 SEPTEMBER 1997

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) Navy Working Capital Fund (NWCF), as required by the Chief Financial Officers (CFO) Act of 1990. They have been prepared from the books and records of the DON, in accordance with Department of Defense (DoD) Guidance on Form and Content of Audited Financial Statements (as adopted from Office of Management and Budget (OMB) Bulletin No. 94-01 of 16 November 1993), "Form and Content of Agency Financial Statements" and applicable guidance.

The consolidated statements include the accounts and transactions of the DON NWCF activities. All policies and procedures, unless otherwise noted, are in compliance with the Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN (FM&C)) guidance and the DoD Working Capital Fund guidance implemented by the Defense Finance and Accounting Service (DFAS).

These statements, therefore, are different from the financial reports, also prepared by DON pursuant to DoD, DFAS and Navy directives, that are used to monitor and control DON's use of budgetary resources.

The amounts presented in the financial statements and footnotes (Fiscal Year (FY) 1996 and FY 1997) are rounded to the nearest thousand of dollars.

B. Reporting Entity

FY 1997 represents the seventh year that the DON has prepared financial statements as required by the CFO Act. The CFO Act requires that the DON prepare and have audited, financial statements for each revolving fund and account that performed substantial commercial functions during the preceding fiscal year.

The consolidating NWCF financial statements include all activities and functions previously financed through the Navy Industrial Fund and DON Stock Fund which were converted to the Defense Business Operations Fund (DBOF) on 1 October 1991. The Under Secretary of Defense (Comptroller) (USD(C)) memorandum of 11 December 1996 eliminated the DBOF and established four working capital funds. One of the four working capital funds is the NWCF. Establishment of the NWCF did not change any previous organizational reporting structure.

NWCF CONSOLIDATED NOTES

The following identifies the NWCF primary and secondary activity groups.

Primary Activity Group and Secondary Activity Group
Supply Management
- Navy
- Marine Corps

Depot Maintenance - Aviation
Depot Maintenance - Shipyards
Depot Maintenance - Ordnance
Depot Maintenance - Other (Marine Corps)
Transportation
Base Support
Research and Development
- Naval Surface Warfare Center (NSWC)
- Naval Undersea Warfare Center (NUWC)
- Naval Air Warfare Center (NAWC)
- Naval Research Laboratory (NRL)
- Naval Facilities Engineering Service Center (NFESC)
- Naval Command, Control and Ocean Surveillance Center (NCCOSC)

Information Services
- Naval Computer and Telecommunications Command (NAVCOMTELCOM)
- Naval Reserve Force (COMNAVRESFOR)
- Navy, Fleet Material Support Office (FMSO)

Navy Component

All significant intra-fund balances and transactions have not been eliminated. Data to eliminate intra-agency transactions is not readily available in financial systems supporting the fund.

C. Budgets and Budgetary Accounting

DON NWCF funded activities provide services and materials to DoD components and other federal government agencies through buyer-seller relationships. The buyers, which are the Navy NWCF activities' customers, identify requirements which justify the need for funds from Congress. DON NWCF activities operate under the revolving fund concept whereby customers reimburse the activities' NWCF to cover the cost of services or material provided. The Navy industrial activities financial management systems which operate under NWCF accumulate all cost incurred in various programs or jobs plus overhead which are subsequently billed to the customers. NWCF finances the purchase of consumable and repairable items which are held in inventory at stock activities until issued with charge to the customer and reimbursement to NWCF.

NWCF CONSOLIDATED NOTES

In FY 1996 the Navy Distribution Depots activity group was combined with the Supply Management (Navy) activity group while the Navy Logistics Support Activities activity group was combined with Supply Management (Navy) in FY 1997. The Defense Printing Service transferred from the DON Commander, Naval Supply Systems Command to Defense Logistics Agency (DLA) on 1 October 1996. The general ledger transferred in whole to DLA at that time.

In FY 1997, the DON NWCF recorded an operating loss of $1,521,417 thousand.

NWCF Supply Activities
Sales, Cost of Sales and Expenses, and
Operating Results by Activity Group
(in thousands)

Activity Group	Sales	Cost of Sales and Expenses	Operating Results
Supply Management			
Navy	$5,990,426	$7,914,225	($1,923,799)
Marine Corps	171,881	204,190	(32,309)
Subtotal	$6,162,307	8,118,415	($1,956,108)

NWCF Industrial Activities
Revenues, Expenses, and
Operating Results by Activity Group
(in thousands)

Activity Group	Revenues	Expenses	Operating Results
Depot Maintenance - Aviation	$1,548,306	$1,400,506	$147,800
Depot Maintenance - Shipyards	2,956,223	2,576,933	379,290
Depot Maintenance - Ordnance	539,411	539,112	299
Depot Maintenance - Other (Marine Corps)	160,154	148,861	11,293
Transportation	1,141,101	1,186,425	(45,324)
Base Support	2,016,428	2,013,269	3,159
Research and Development	7,153,684	7,199,504	(45,820)
Information Services	243,444	259,450	(16,006)
Navy Component			
Subtotal	$15,758,751	$15,324,060	$434,691
NWCF Total	$21,921,058*	$23,442,475*	($1,521,417)

*These amounts do not reflect eliminating entries of $2,595,819 thousand for intra-activity revenue and cost of goods and services sold. Also, these amounts do not reflect the Component

NWCF CONSOLIDATED NOTES

level adjusting entries for imputed revenues and expenses of $713,270 thousand for Office of Personnel Management pensions and Other Retirement Benefits (ORB). See also Notes 22, 25, and 29.

This operating loss includes the implementation by the USD(C) and DFAS of DoD Financial Management Regulation (FMR) 7000.14-R, Volume 11B procedures for Supply Management (Navy) inventory valuation and Cost of Goods Sold model. The Navy is considered the prototype in the implementation of this model. The treatment of the Supply Management (Navy) cost of transfers to disposal overstates expenses by assigning a larger cost to disposal than is warranted considering the significant quantities of inventory that are sent to disposal which are received from customers without cost. DFAS, in their implementation of the USD(C) concept of Holding Gains and Losses (as specified in DoD FMR 7000.14-R, Volume 11B) has stated that the issue of how to consider disposal actions needs further study to counter the understatement of costs of sales and the overstatement of expenses. USD(C) has advised that the treatment of disposal actions in the operating results calculations is under review and they are considering applying customer returns without credit as an offset to disposal actions. Additionally, the reported FY 1996 operating results value of ($3,904,937) thousand should have been ($1,724,851) thousand due to a cross check problem encountered by DFAS when preparing the CFO statements. DFAS - Cleveland (CL) has now made corresponding correcting entries to the Cumulative Results of Operations. See Note 27.

D. Basis of Accounting

Transactions are recorded on the accrual basis of accounting. Under this method, revenues are recognized when earned and expenses are recognized when a liability is incurred without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

E. Revenues and Other Financing Sources

Revenue which is earned primarily from providing services, materials and products to DON and others is recognized on a percentage of completion or material issue basis in accordance with NWCF guidance as promulgated by the USD(C). Revenue related to the distribution of inventory and procurement support is recognized at the point of billing for work performed against reimbursable work orders. In August 1996, estimating of Revenues and Funds Collected, and sales, ceased for ships and naval activities in the Supply Management (Navy) activity group.

F. Accounting for Intra-governmental Activities

The DON NWCF activities interact with, and are dependent upon, other financial activities of the Government as a whole. Therefore, these financial statements do not reflect the

NWCF CONSOLIDATED NOTES

results of all financial decisions applicable to the agency as though the agency were a stand alone entity.

1. The DON's proportionate share of the public debt and related expenses of the Federal Government are not included. Debt issued by the Federal Government and the related interest costs are not apportioned to Federal agencies. The 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 issuances of debt instruments or tax revenues.

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

3. NWCF civilian employees participate in the Civil Service Retirement System (CSRS) and 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 are also covered by Social Security. The individual NWCF activity groups fund a portion of pension benefits under these retirement systems but do not disclose the assets or actuarial data on the accumulated plan benefits or unfunded pensions liabilities of its employees. Reporting such amounts is the responsibility of the Office of Personnel Management for CSRS and FERS. The retirement actuarial liabilities for military MRS is reported on the CFO financial statements of the Military Retirement Trust Fund. In FY 1997, the individual NWCF activity groups contributed the following amounts to the retirement plans, Social Security and to the Thrift Savings Plan (TSP).

NWCF CONSOLIDATED NOTES

(in thousands)

Activity Group	CSRS	FERS	MRS	Social Security	TSP	Total
Supply Management (Navy) *	$31,611	$0	$0	$14,695	$0	$46,306
Supply Management (MC) (Not Applicable)						
Depot Maintenance - Aviation	20,043	19,344		12,807	7,103	59,297
Depot Maintenance - Shipyards	49,532	30,014		22,222	11,030	112,798
Depot Maintenance - Ordnance	6,620	8,734		5,609	3,242	24,205
Depot Maintenance - Other (MC)	2,292	4,046		4,254	1,412	12,004
Transportation	7,686	10,099		9,554	3,888	31,227
Base Support	16,411	22,629		16,073	8,488	63,601
Research and Development						
NSWC	30,196	42,132		25,675	16,124	114,127
NUWC	10,029	12,058		7,285	4,759	34,131
NAWC	25,197	39,304		24,277	14,963	103,741
NRL	6,149	9,462		7,994	3,584	27,189
NFESC	766	876		288	362	2,292
NCCOSC	11,524	12,066		7,169	4,780	35,539
Information Services						
NAVCOMTELCOM	2,877	2,183		1,335	835	7,230
COMNAVRESFOR	110	242		140	82	574
FMSO **	3,311			1,272	412	4,995
Total	$224,354	$213,189	$0	$160,649	$81,064	$679,256

*The system (Defense Business Management System) supporting this activity group does not have individual CSRS and FERS contributed amounts.

**Information on contributions related to the identification of specific amounts to CSRS and FERS is not readily available.

4. Most legal actions, other than contract claims, to which the NWCF may be a named party are covered by the provisions of the Federal Tort Claims Act and the provisions of Title 10, United States Code (U.S.C.), Chapter 163, governing military claims. Contingent liabilities under the Tort Claims Act and Chapter 163, Title 10 U.S.C., are $2,500 and $100,000, respectively, per occurrence. Either because payments under these statutes are limited to amounts well below the threshold of materiality for claims payable from the NWCF or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the NWCF operations or financial condition. Additionally, for the Transportation activity group legal action to which the Department is a litigant also include, but are not limited to, the Contract Disputes Act, (CDA), Chapter 9 of Title 441 U.S.C.; Suits in Admiralty Act, Chapter 20, of Title 46 U.S.C.;

NWCF CONSOLIDATED NOTES

and the Public Vessels Act, Chapter 22, of Title 46 U.S.C.. Payments from the Judgment Fund as a result of CDA claims are required to be reimbursed out of agency appropriations, current at the time of entry of the judgment, Title 28 U.S.C. Section 2414.

5. In FY 1997, the NWCF activity groups sold inventories or services to foreign governments under the provisions of the Arms Export Control Act of 1976. Under the provisions of the act, DoD has authority to sell Defense articles and services to foreign countries, generally at no profit or loss to the U.S. Government. Customers are required to make payments in advance to a trust fund maintained by the Department of the Treasury from which the Military Services are reimbursed for the cost of administering and executing the sales. In FY 1997 the NWCF Supply Management activity group sold $107,990 thousand under the Foreign Military Sales (FMS) program. In FY 1997 the NWCF industrial activity groups received reimbursements of $254,184 thousand for assets sold under the FMS program. The following provides the amount of assets and services sold under the FMS program.

(in thousands)

Activity Group	Supply Activity	Industrial Activity
Supply Management (Navy)	$106,956	$0
Supply Management (Marine Corps)	1,034	
Depot Maintenance - Aviation		30,900
Depot Maintenance - Shipyards		5,097
Depot Maintenance - Ordnance		17,192
Depot Maintenance - Other (Marine Corps)		529
Transportation		
Base Support		346
Research and Development		
NSWC		73,743
NUWC		33,687
NAWC		71,553
NRL		484
NFESC		28
NCCOSC		17,538
Information Services		
NAVCOMTELCOM		
COMNAVRESFOR		
FMSO		3,087
Total	$107,990	$254,184

NWCF CONSOLIDATED NOTES

6. The balance for Accounts Payable increased by $25,737 thousand during FY 1997 from FY 1996. The primary reason for the increase is due to problems with the Supply Management (Marine Corps) Accounts Payable function. In the past, the Accounts Payable function had Accounts Payable matched against overstated undistributed disbursements. To correct the problem, outstanding Obligations were validated against receipts. Any receipts that did not have an obligation were written off. The Marine Corps and DFAS have agreed on procedures to guard against future reoccurrence and continue on a monthly basis reviewing Accounts Payable to assure only valid liabilities are recorded and reported properly.

G. Funds with the U. S. Treasury and Cash

In a memorandum dated 5 January 1995, the USD(C) returned management of DBOF cash and its associated anti-deficiency limitations to the DON and other military components effective 1 February 1995. This action effectively merged the component's responsibility for monitoring collection and disbursement transactions as well as taking actions to correct operational problems, with the responsibility for control over the cash balance.

Funds with the U.S. Treasury are managed at the DON level and not in the individual activity groups of NWCF. Fund Balances with Treasury reflected on the financial statements consist of net outlays (disbursements minus collections) and non-expenditure transfers where applicable. Plans are being formulated to move cash management to the activity groups and activity level in the DON during FY 1998. This movement will be contingent upon the development of activity group and activity level cash management procedures by DFAS. See Note 2.

H. Foreign Currency

Not Applicable

I. Accounts Receivable

As presented in the Consolidated NWCF Statement of Financial Position, Accounts Receivable includes accounts, claims and refunds receivable from other entities.

NWCF CONSOLIDATED NOTES

(in thousands)

	Amount	Allowance	Total Net
Accounts Receivable			
Government	$1,194,322	$505	$1,193,817
Public	285,531		285,531
Refunds			
Claims			
Total	$1,479,853	$505	$1,479,348

The financial reporting system for the Supply Management (Navy) activity group was designed to maintain summary level reporting for Accounts Receivable only. At this level, a comparison is made between total Revenue from Sales of Goods and Services and total Funds Collected reported for each month, with the mathematical difference being the change in the Accounts Receivable balance reported for the month. Accounts Receivable is overstated by $10,216 thousand due to reconciliations at the Navy Inventory Control Point (NAVICP) that could not be accomplished prior to year-end closing and payments that have been received but not officially registered by DFAS. The detail Accounts Receivable records for Supply Management (Navy) activities are maintained at the activity level.

J. Loans Receivable

There are no loans receivable recorded.

K. Inventories

Inventory, Net for supply type activities which includes Navy-managed consumable items and repairable items, and Other Service, DLA, and General Services Administration managed items, are carried in the accounting records at Standard Price. Standard Price is composed of the cost of the material plus appropriate surcharges. Inventories for reporting purposes are revalued from Standard Price to utility value using the Latest Acquisition Cost (LAC) method prescribed by the USD(C). This revaluation results in a recognition of unrealized holding gains and losses in the Supply Management (Navy) ending inventory value. Upon adjustment for unrealized holding gains and losses, the LAC method then results in an approximation of historical cost. The FY 1996 and FY 1997 inventory values for Supply Management (Navy) reflect the execution by DFAS of interpreted guidance given by USD(C) which clarified and provided additional instructions to those contained in DoD FMR 7000.14-R, Volume 11B. The execution of this guidance resulted in an inventory at cost for Supply Management (Navy) being portrayed as $9,873,757 thousand for FY 1996 when it should have been $13,777,724 thousand. The error was due to a cross check problem encountered by DFAS when preparing the FY 1996 CFO Statements. The Marine Corps was not able to certify the

NWCF CONSOLIDATED NOTES

Supply Management (Marine Corps) activity group inventories due to business process changes and system problems. See Note 31.B.2, Supply Management (Marine Corps) .

For industrial type activities, Operating Materials and Supplies, Net are held for use on customer work. These inventories are maintained at cost, primarily using a weighted average. (See Note 10).

L. Investments in U.S. Government Securities

There are no investments in U.S. Government Securities in the NWCF activity groups.

M. Property and Equipment

DON NWCF procedures are in accordance with DFAS guidance, which requires property records to be matched with receipt documentation to accurately record and classify assets. Audits of FY 1991 and FY 1992 financial statements have shown that documentation to support the recorded acquisition cost of many older properties is no longer available. Obtaining appraisals for older property for which original acquisition records are no longer available is not cost effective, especially considering the number and age of many of DON's properties. As a reasonable solution to this dilemma, when original records to support the acquisition cost of property are no longer available, recorded valuations of property, or other available information (if the value has not been formally recorded), could be permitted for financial statement purposes when such valuation represents the best available information. The DoD has requested that the Federal Accounting Standards Advisory Board endorse the above policy until such time as other applicable accounting standards are issued by the Board. DON will implement the resulting policy requirements when the DFAS issues the implementing guidance as prescribed in the DoD FMR.

Land, plant property, and equipment are valued at cost. Cost is based upon a specific amount paid or estimated value if a receipt document is not available. The capitalized amount includes the cost of the asset plus any additional costs such as transportation, installation and any internal costs incurred to make the asset ready for use. Based upon the expense/investment criteria, any piece of plant property or equipment with a unit cost of $100,000 or more and a useful life of two years or more is capitalized and depreciated. The expense/investment threshold was $50,000 in FY 1995. Facilities are valued at original cost. Buildings are capitalized when constructed or at the date of acquisition. Improvements to land and buildings costing more than $100,000 are capitalized and depreciated over their remaining useful life. Routine maintenance and repair costs are recorded as an expense when they are incurred.

Property and equipment in inventory prior to 1 October 1991 are depreciated using the straight line method of depreciation under the existing expected service life for each item. New

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property and equipment items introduced into the NWCF since 1 October 1991 are being depreciated using the straight line method under the service life schedule set by DFAS guidance.

Additional information regarding the value of fully depreciated and sponsor owned equipment is provided in Note 15.

The General Accounting Office (GAO) has determined that real property used by the NWCF, but under the jurisdiction of the Military Departments, represents an asset of the NWCF and such property should be reported on the financial statements as an entity asset to show the full costs of all resources and assets used in NWCF operations. Some of the buildings carried on the property records of NWCF primary and secondary activity groups are occupied by other Navy entities (where the NWCF primary and or secondary activity group is the host activity). Based on the GAO determination these assets should not have been included in the values of assets reported on NWCF financial statements. In addition, some of the buildings occupied by NWCF primary and secondary activity group activities are on the property records of the host activity (where the NWCF activity is a tenant activity). Based on the GAO determination these assets should be reported in NWCF financial statements. However, DFAS guidance has not been published to direct a change of property accountability between host and tenant activities, therefore, the current reporting procedure is in accordance with current guidance provided to NWCF activities.

N. Prepaid and Deferred Charges

Payments in advance of the receipt of goods and services are recorded as prepaid charges and reported on Lines 1.a.(5) and 1.b.(5) of the Statement of Financial Position at the time of prepayment and recognized as expenditures and expenses when the related goods and services are received.

O. Leases

The following provides specific disclosure by applicable activity groups.

Transportation - MSC. The Military Sealift Command (MSC) Transportation activity group does not have any capitalized leases. MSC does not report the value of leased ships (Maritime Prepositioning Ships (MPS) and T5 ships) as capital leases under Line 1.k, Entity Assets, Property, Plant, Equipment, Net on the Statement of Financial Position as recommended in Naval Audit Service (NAVAUDSVC) Audit Reports 075-S-92 and 035-96. This NAVAUDSVC recommendation is still being reviewed by higher authority for a determination as to the applicability to MSC. The debt for the outstanding principal balance on these MPS ships is, however, reported on Lines 1.b.(6), Entity Assets, Transactions with Non-Federal(Governmental) Entities, Other Non-Federal (Governmental) and Line 4.a.(3) Liabilities,

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Transactions with Federal (Intragovernmental) Entities, Debt of the Statement of Financial Position.

Base Support. As of 30 September 1997, the Public Works Centers (PWCs) were committed to numerous operating leases and rental agreements. Generally, these leases and agreements were for rental of equipment, space, and operating facilities. Capital leases prior to formation of NWCF were "grandfathered", and continue to be treated as operating leases. Only two long term capital leases remain, and they will both expire within two years.

Research and Development.

NRL. As of 30 September 1997, the NRL is not committed to any significant multiple-year operating leases and rental agreements for rental of equipment, space, and operating facilities. The NRL does rent equipment on annual rental contracts. Total equipment rentals for FY 1997 were $155 thousand.

NFESC. During FY 1997, NFESC was committed to a small number of operating leases for office equipment such as copying machines and mobile trailers used for office space. The dollar values of these leases are immaterial and are recognized as expenses are incurred and not listed as deferred charges.

NCCOSC. As of 30 September 1997, NCCOSC was committed to operating leases and rental agreements. Generally, these leases and agreements were for rental of equipment, space, and operating facilities. All these leases and agreements are either renewable on an annual basis or can be canceled on short notice. Therefore, there is no significant future liability.

Information Services.

NAVCOMTELCOM. Generally, all leases and agreements were for rental of operating equipment. Since these leases are operating in nature, rather than capital, no capital leases are recognized in the Statement of Financial Position.

COMNAVRESFOR. Generally, all leases and agreements were for rental of operating equipment. Since these leases are operating in nature, rather than capital, no capital leases are recognized in the Statement of Financial Position.

FMSO. Generally, all leases and agreements were for rental of operating equipment. Since these leases are operating in nature, rather than capital, no capital leases are recognized in the Statement of Financial Position.

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P. Contingencies

At any given time, DON may be a party to various legal and administrative actions and claims brought against it. These relate primarily to tort claims resulting from aircraft, ship, and vehicle accidents, medical malpractice, property and environmental damages resulting from Departmental activities, and contract disputes. As discussed under Note 1.F.4, most legal claims, other than contract claims, to which the NWCF may be a named party are covered by the provisions of the Federal Tort Claims Act and the provisions of Title 10, U.S.C., Chapter 163 governing military claims. Either because payments under these statutes are limited to amounts well below the threshold of materiality for claims payable from the Department's appropriations or because payments will be from the permanent, indefinite appropriation "Claims, Judgments and Relief Acts" (the Judgment Fund), these legal actions should not materially affect the NWCF's operations or financial condition. The following provides specific disclosure by applicable activity group.

Supply Management (Navy). The ultimate resolution of legal actions will not materially affect the agency's operations or financial condition. Therefore, no contingent liabilities related to legal actions have been recognized in the Statement of Financial Position.

Supply Management (Marine Corps). There are no known contingencies related to the Navy Supply Management (Marine Corps) activity group.

Depot Maintenance - Other (Marine Corps). There are no known contingencies related to the Depot Maintenance - Other activity group.

Transportation - MSC. Contingencies (Reserves) have been established to provide for anticipated accident and damage repairs and estimated value of claims pending. Their values as of 30 September 1997, are $2,223 thousand and $3,570 thousand, respectively. It should be noted that the reserve for accident and damage repairs will be abolished and the remaining value in such account represents funds already obligated. See Note 30.

Base Support. It is estimated that claims for payments and adjudicated claims that will be outstanding as of 30 September 1997, will be approximately $7,000,618 thousand. The ultimate resolution of legal actions still pending will not materially affect the agency's operations or financial condition. Therefore, no contingent liabilities have been recognized in the consolidated Statement of Financial Position. Any settlement of the $7,000,618 thousand should be covered by the Judgment Fund.

As of January 1997, the PWCs were a party to fifteen contract appeals before the Armed Services Board of Contract Appeals. Total value of this appeal is $6,612 thousand which is still in litigation.

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Research and Development.

NRL. The NRL payments during FY 1997 for awards, compromises and settlements resulting from the legal actions were insignificant. As of 30 September 1997, NRL has an outstanding adjudicated claim for $750 thousands. This is expected to be settled for less and is expected to be paid from an appropriation other than NWCF. Since the ultimate resolution of legal actions still pending are not expected to materially affect the NRL's operation or financial condition, no contingent liabilities have been recognized in the Statement of Financial Position.

NCCOSC. At the present time there are some known legal claims which would result in a significant financial impact on NCCOSC's financial position. Therefore, contingent liabilities have been recognized in the NCCOSC Statement of Financial Position. Currently there are three Equal Employment Opportunity complaints for alleged discrimination where an unfavorable Equal decision could result in $2,850 thousand in damages. There are also two contracts under appeal, one with the Armed Services Board of Contract Appeals which could result in a $300 thousand payment and another long standing claim in the amount of $258 thousand which still has not been resolved.

Q. Accrued Leave

Supply Type NWCF Activities.

Navy: Civilian annual leave is earned and the accrued amounts are reduced as leave is taken. The balances for annual leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of non-vested leave are expensed as taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates.

Marine Corps: Civilian annual leave is accrued as earned and the accrued amount is reduced as leave is taken. The balances for civilian annual leave and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current fiscal year fund balances are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick and other types of non-vested leave are expensed as taken. Accruals of leave for civilian employees are reported against the Operations and Maintenance, Marine Corps appropriation.

Industrial Type NWCF Activities. Accrued leave for industrial activities is accrued as it is earned and the accrual is reduced as leave is taken. At least once per year, the balance in the accrued annual leave account is adjusted to reflect current pay rates of cumulative annual leave earned but not taken. Sick and other types of leave are expense as taken.

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R. Equity

Equity for supply type activities consists of invested capital, cumulative results of operations, and unexpended appropriations. Invested Capital represents the DON capital assets valued at acquisition cost or best information available; invested capital of inventory items are valued at the LAC method.

Increases to invested capital are recorded when capital assets are acquired or constructed or when asset valuations increase as a result of increases in average costs. Decreases occur as capital assets depreciate or are consumed in operations, or when average costs decrease.

Cumulative Results of Operations represents the excess of revenues over expenses since inception of DBOF (now NWCF), less refunds to customers and returns to the U.S. Treasury. FY 1996 and FY 1997 Supply Management (Navy) Results of Operations and Invested Capital reflect the implementation of DoD FMR 7000.14-R, Volume 11B as clarified by USD(C) and DFAS. The reported FY 1996 net operating results of ($3,904,937) thousand should have been ($1,724,851) thousand due to a cross check problem encountered by DFAS when preparing the CFO statements. DFAS-CL has now made corresponding correcting entries to the Cumulative Results of Operations.

Equity for industrial type activities consists of invested capital, cumulative results of operations, other equity, and future funding requirements. Invested capital, as presented in the Statement of Financial Position, includes donated capital and represents the value of capital assets as reported at actual cost. Increases to invested capital are recorded when capital assets are acquired. Decreases occur as capital assets are depreciated or retired as surplus. Cumulative results of operations represents revenues minus expenses since fund inception, adjusted for transfers to and from other appropriations and the U.S. Treasury.

S. Aircraft/Ship Crashes

The following provides note disclosure as applicable by activity group.

Depot Maintenance - Aviation. There were no known mishaps.

Transportation - MSC. No ships were destroyed during FY 1997 due to navigation or other mishaps. Any ships damaged due to accidents, were repaired and costs associated with the repair were recorded against reserves for accident and damage.

Research and Development.

NAWC. There were no known mishaps.

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T. Treaties for Use of Foreign Bases

The following provides note disclosure as applicable by activity group.

Transportation - MSC. MSC has 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. Generally, treaty terms allow MSC continued use of these properties until the treaties expire.

Base Support. The Government of Japan is responsible for facility replacement.

Research and Development.

NCCOSC. While some of the NCCOSC operations take place on foreign soil, the operations are performed as tenants to other Naval activities. NCCOSC's only significant presence is in Japan where the NCCOSC Research and Development Division (NRaD) has a detachment located as a tenant to the Naval Ship Repair Facility, Yokosuka. The detachment in Yokosuka employs up to 18 Foreign National Indirect Hire personnel under a Master Labor Contract with Japan. However, Japan now pays the majority of the cost of these employees. The U.S. Government is liable for any shortfall that is borne by the activity for Special Measures Agreement expenses incurred which is approximately $235 thousand. These costs can be for management directed severance obligations, overtime costs or additional schedule pay costs.

U. Comparative Data

Comparative data from FY 1996 CFO financial statements is provided.

The debt for the outstanding principal balance on leased MPS ships is reported on the Statement of Financial Position on Lines 1.b.(6), Entity Assets, Transactions with Non-Federal(Governmental) Entities, Other Non-Federal(Governmental) and Line 4.a.(3) Liabilities, Transactions with Federal (Intragovernmental) Entities, Debt. Prior to FY 1997 this debt for the outstanding principal balance was reported on Lines 1.b.(2), Entity Assets, Transactions with Non-Federal(Governmental) Entities, Accounts Receivable, Net and Line 4.a.(3) of the Statement of Financial Position. The outstanding principal balance, however, represented outstanding loans receivable vice true Accounts Receivable. So as not to distort the true value of Accounts Receivable, DFAS and the DON agreed to reflect the outstanding principal balance on Line 1.b.(6). The FY 1997 presentation on the Statement of Financial Position of the related debt interest payments has also changed. See Note 24.

Financial data for the Information Services - COMNAVRESFOR NWCF activity group was part of the NAVCOMTELCOM for FY 1996 and a portion of FY 1997. This is the first

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submission for the Information Services - FMSO activity group. In FY 1996 FMSO was part of the Supply Management (Navy) activity group.

V. Undelivered Orders

NWCF activities are obligated for goods which have been ordered but not yet received (undelivered orders). As of 30 September 1997 undelivered orders amounted to $3,467,840 thousand for supply type activities and $3,164,146 thousand for industrial type activities for a total of $6,631,986 thousand.

Undelivered Orders

Activity Group	Supply Activities	Industrial Activities
Supply Management (Navy)	3,536,445	
Supply Management (Marine Corps)	(68,605)	
Depot Maintenance - Aviation		214,387
Depot Maintenance - Shipyards		580,401
Depot Maintenance - Ordnance		57,252
Depot Maintenance - Other (Marine Corps)		52,575
Transportation		29,226
Base Support		485,491
Research and Development		
NSWC		681,300
NUWC		141,719
NAWC		491,720
NRL		154,235
NFESC		22,550
NCCOSC		228,329
Information Services		
NAVCOMTELCOM		14,069
COMNAVRESFOR		3,462
FMSO		7,430
Total	$3,467,840	$3,164,146

The Marine Corps was not able to certify the Supply Management (Marine Corps) activity group undelivered orders due to accounting system problems. See Note 31.B.2. The primary reason for the Supply Management (Marine Corps) abnormal balance for undelivered orders is due to problems with the Accounts Payable function. In the past, the Accounts Payable function had Accounts Payable matched against overstated undistributed disbursements. To correct the problem, outstanding obligations were validated against receipts.

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The Marine Corps and the DFAS have agreed on procedures to guard against future reoccurrence and continue on a monthly basis reviewing Accounts Payable. In FY 1998, undelivered orders should be in a normal positive balance.

Note 2. Fund Balances with Treasury (in thousands):

A. Fund and Account Balances:

	Entity Assets				
	Trust Funds	Revolving Funds	Appro-priated Funds	Other Fund Types	Total
Unobligated Balance Available:					
Available	$0	$1,988,427	$0	$0	$1,988,427
Restricted					
Reserve For Anticipated Resources					
Obligated (but not expensed)		3,004,069			3,004,069
Unfunded Contract Authority		(4,245,972)			(4,245,972)
Unused Borrowing Authority					
Treasury Balance	$0	$746,524	$0	$0	$746,524

B. Other Information: One of the many policy changes made with the creation of the DBOF (now NWCF) was to manage Fund Balances with Treasury at the DoD level and not at the individual activity group of the NWCF. However, in FY 1995 Fund Balances with Treasury responsibility was transferred back to DON, but not to the individual activity group level. As a result, the Fund Balances with Treasury represents the net outlays (disbursements minus collections) and non-expenditure transfers where applicable. The Consolidated NWCF Statement of Financial Position reflects the 30 September 1997 NWCF cash balance. Included are non-expenditure cash transfers totaling $909,764 thousand. Transfers of $97,500 thousand have been made to the Joint Logistics Systems Center (JLSC) to finance costs associated with the development of automated systems for the NWCF. The transfers were made from or to the following NWCF activity groups.

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Activity Group	Non-expenditure JLSC Transfers	Other Non-expenditure Transfers	Total Non-expenditure Transfers
Supply Management (Navy)	($39,700)	$22,800	($16,900)
Supply Management (Marine Corps)		1,700	1,700
Depot Maintenance - Aviation	(26,200)		(26,200)
Depot Maintenance - Shipyards	(30,400)		(30,400)
Depot Maintenance - Other (Marine Corps)	(1,200)		(1,200)
Transportation		(61,951)	(61,951)
Navy - Component		1,044,715	1,044,715
Total	($97,500)	$1,007,264	$909,764

The Transportation activity group non-expenditure cash transfer of $61,951 thousand was made to the Federal Financing Bank (FFB) for the principal payment of loans related to APF-N ships. See Note 16. The $1,700 thousand transfer to Supply Management (Marine Corps) activity group from the DLA was made to compensate for items that were transferred to DLA under Consumable Item Transfer. The transfer-in to Supply Management (Navy) was $22,800 thousand. The transfer-in to the Navy Component was $1,044,715 (See Notes 17 and 28).

The Fund Balances with Treasury contains information from financial registers that were not provided to the activity groups. Without these registers, the activity groups can not reconcile their activity's balances to the balance reported to Treasury. Plans are being formulated to move cash management to the activity group level in the DON during FY 1998. This movement will be contingent upon the development of activity group and activity level cash management procedures by DFAS.

The following provides other specific disclosure by activity group:

Supply Management (Navy). The Fund Balances with Treasury was understated in FY 1996 due to the $135,000 thousand duplication of Register 06 disbursements processed by DFAS, subsequently corrected in FY 1997.

Research and Development. NRL's Funds Collected and Funds Disbursed as included here do not agree with NRL books. However, the net fiscal-year-to-date cash balances do agree. As previously documented in the AR (M)1307 certification report, $102,061 thousands of collections were processed in the financial reporting system as "negative" disbursements due to incorrect transaction type codes. Thus, collections and disbursements reported in the Centralized Expenditures/Reimbursement Processing System (CERPS) and herein are each understated by $102,061 thousand.

Information Services - FMSO. The Treasury Fund Balance is derived using a CERPS disbursement figure that was manually adjusted for $11,829 thousand of labor disbursements that

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processed under subhead NC1C vice our subhead NF1F. An additional $3,856 thousand of labor disbursements was discovered to have processed through subhead NC1C vice NF1F. A Journal Voucher Optional Form 1017-G (9-79) was prepared by DFAS - Columbus (CO) and sent to DFAS - Indianapolis (IN) for each of these revisions which should process through Treasury in October 1997. The CFO Statement of Financial Position includes an amount of $14,531 thousand in Liabilities on Line 4. a. (4), Other Federal (Intragovernmental) Liabilities, that can not be verified by FMSO.

Navy Component. The cash in this activity group includes collections and disbursements which are pending identification to another activity group, the initial transfer of $945,875 thousand from the DoD corporate Treasury cash account to the DON corporate Treasury account which was reestablished on 1 February 1995 in accordance with USD(C) memorandum of 5 January 1995, and the transfer of end of FY 1995 and FY 1996 cash balances at the activity group level to the DON NWCF corporate account.

Note 3. Cash, Foreign Currency and Other Monetary Assets (in thousands): Not applicable

Note 4. Investments, Net (in thousands): Not applicable

Note 5. Accounts Receivable, Net (in thousands):

	(1) Gross Amount Due	(2) Allowance For Estimated Uncollectibles	(3) Allowance Method Used	(4) Net Amount Due
A. Entity Receivables:				
Intragovernmental	$1,194,322	$505		$1,193,817
Governmental	285,531			285,531
B. Non-Entity Receivables:				
Intragovernmental	$0	$0		$0
Governmental				

C. Other Information:

Supply Management (Navy). The NAVAUDSVC concluded that the use of estimates in the reporting of Revenue and Funds Collected was not an authorized accounting practice. In their audit report of the FY 1995 DBOF CFO Financial Statements, NAVAUDSVC recommended that estimating processes be discontinued for ships and activities. In August 1996, estimating of Revenue and Funds Collected, and sales, ceased for ships and Naval activities.

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Procedures were developed by DFAS, with NAVSUP and ASN(FM&C) assistance to streamline the shipboard financial reporting process by using satellite communications systems that significantly reduced submission timeframes to DFAS and result in timely reporting.

Supply Management (Marine Corps). At the Supply Management (Marine Corps) activity group level Accounts Receivable are in an abnormal balance because $16.1 million in reversals were done to correct duplicate, error, and wrong price issue transactions.

NWCF Industrial Activities. Included in the Entity Receivables, Governmental line is the value of Navy Account 1543 Undistributed Collections - Unmatched. This is an account with a normal credit balance which represents the value of refunds/collections received which are initially posted as increases to activity level cash, but must be researched in order to determine the appropriate receivable to liquidate.

Depot Maintenance - Aviation. Revenue billing of $38,000 thousand was not processed by Treasury resulting in the large Entity Receivables, Intragovernmental balance.

Transportation - MSC. During FY 1997, MSC did not write off any uncollectible Accounts Receivable in excess of the write off criteria. Prior to FY 1997, Entity Receivables, Governmental, included the outstanding principal balance related to loans from the FFB for the APF-N ships. The principal balance represented outstanding loans receivable vice true Accounts Receivable. So as not to distort the true value of Accounts Receivable, DFAS and the DON agreed to reflect the outstanding principal balance in Line 1.b.(6), Entity Assets, Transactions with Non-Federal (Governmental) Entities, Other Non-Federal (Governmental). See Note 6.

Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets (in thousands):

A. Other Entity Assets:

1. Federal (Intragovernmental)	
(a) Assets Returned for Credits	$50,868
(b) Other	(1,170)
(c)	
Total	$49,698
2. Non-Federal (Governmental)	
(a) FFB Loan Principal for APF-N Ships	$1,164,026
(b)	
(c)	
Total	$1,164,026

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B. Other Information: Included in Line A.2.(a) above is the Transportation activity group outstanding principal balance of $1,164,026 thousand related to loans from the FFB for the APF-N ships. Prior to FY 1997, the principal balance was included in Line 1.b.(2), Entity Assets, Transactions with Non-Federal (Governmental) Entities, Accounts Receivable, Net. So as not to distort the true value of Accounts Receivable, DFAS and the DON agreed to reflect this outstanding principal balance on Line 1.b.(6), Entity Assets, Transactions with Non-Federal (Governmental) Entities, Other Non-Federal (Governmental) of the Statement of Financial Position. See Note 16.

C. Other Non-Entity Assets:

1. Federal (Intragovernmental)	
(a) IMRL Equipment	$393,512
(b)	
(c)	
Total	$393,512
2. Non-Federal (Governmental)	
(a)	$0
(b)	
(c)	
Total	$0

D. Other Information: The $393,512 in Note 6.C.1.(a) reports the FY 1997 gross value of Individual Material Readiness List (IMRL) equipment as requested by the ASN(FM&C). The NAVAUDSVC Audit report 044-95 has questioned the inclusion of IMRL in this section of the Statement of Financial Position. Recommendation 83 recommended USD(C) to prepare and issue clarifying guidance in the area of sponsor provided assets and Non-Entity Assets. Pending USD(C) guidance, DON will continue to report IMRL as Non-Entity Assets at the departmental level only as agreed to in a joint meeting among NAVAUDSVC, DFAS Headquarters, DFAS-CL and DON on 21 July 1995. See Note 15, Depot Maintenance - Aviation and Research and Development activity groups for additional information as to those activity groups reporting IMRL equipment in a statistical account at the activity group level. IMRL equipment is not reported in Note 15 at the activity group level.

Note 7. Loans and Loan Guarantees, Non-Federal Borrowers (in thousands): Not applicable

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Note 8. Inventory, Net (in thousands):

	(1) Inventory Amount	(2) Allowance For Losses	(3) Inventory, Net	(4) Valuation Method
A. Inventory Categories:				
1. Held for Current Sale	$11,222,16	$3,460,705	$7,761,456	LAC
2. Held in Reserve for Future Sale				
3. War Reserve Material	269,22	26,736	242,488	LAC
4. Excess, Obsolete and Unserviceable	103,96		103,960	NRV
5. Held for Repair	7,050,15	2,012,841	5,037,312	
Total	$18,645,49	$5,500,282	$13,145,216	

B. Restrictions on Inventory Use, Sale, or Disposition: Generally, there are no restrictions with regard to the use, sale, or disposition to applicable DoD activities and personnel. Inventory may be sold to foreign, state and local governments, private parties and contractors in accordance with DoD, DFAS, and DON policies and guidance or at the direction of the President.

C. Other Information: Inventory, Net applies to the supply activity group and not to the industrial activity groups. War Reserve Material is included in Note 8 and on Line 1.d, Entity Assets, Inventory, Net and not on Line 1.l, Entity Assets, War Reserves, in accordance with DFAS-HQ guidance. This presentation of War Reserve Material is restricted to the Defense Working Capital Funds (DWCF) and is a departure from the DoD FMR, which requires War Reserve Material to be reported on Line 1.l on the CFO Statement of Financial Position. War Reserve Material presentation will be changed to comply with the DoD FMR for FY 1998 reporting.

Supply Management (Navy). Inventories are carried in the accounting records at Standard Price. Standard Price is used in the day-to-day operations of the fund and is comprised of the cost of material and surcharges to recover operating and inventory costs in managing the Supply Management (Navy) activity group. For reporting purposes inventories are valued using the LAC method. Additionally, an allowance for unrealized holding gains and losses has been established to value inventory to an approximation of historical cost. The valuation is in accordance with DoD FMR 7000.14-R, Volume 11B recently modified by additional guidance from USD(C) and DFAS.

Application of the LAC method requires a series of journal adjustments which (1) remove the surcharge included in the Standard Price; (2) remove the cost to repair from the value of unserviceable inventory; (3) reduce to salvage value inventory, which is not expected to survive the repair process; and (4) reduce to salvage value inventory, which is categorized as Potential Reutilization/Disposal Stocks. These adjustments are applied to the total of the inventory and are considered (along with other computed factors) in the inventory valuation model developed by

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USD(C) and DFAS. The surcharge and estimated cost to repair are variable depending upon the material category being valued. The FY 1997 salvage rate based on current USD guidance at the time of CFO reporting was 2.7 percent. This method reduced Standard Price inventory value by $12,487,682 thousand as follows:

	(in thousands)
Remove surcharge:	$6,416,665
Remove cost to repair:	$2,020,841
Reduce to salvage value:	$4,050,176
Total reduction:	$12,487,682

The reported FY 1996 inventory, net value of $9,873,757 thousand should have been $13,777,724 thousand. The error was due to a cross check problem encountered by DFAS when preparing the FY 1996 Statements.

The necessary adjustment to inventory based on NAVAUDSVC Audit 035-96, Recommendation 13 was made in FY 1996 for a net gain of $2,291 thousand. A similar adjustment to inventory based on NAVAUDSVC Audit 040-97, Finding 1 was made in FY 1997 for a net gain of $12,510 thousand. These actions are completed.

Also, because not all reconciliations could be accomplished prior to year-end closing at NAVICP, the intransit accounts are overstated by $13,662 thousand.

The Supply Management (Navy) activity group does not have sponsor funded inventory.

Supply Management (Marine Corps). Inventories are valued at LAC as required by DoD accounting policies. Generally, these values are based on prices paid for recently acquired items. Gains and losses that result from valuation changes for stock items are recognized in the allowance account. Only the realized gains and losses are reflected in the Cost of Goods Sold.

The Supply Management (Marine Corps) activity group does not have sponsor funded inventory.

Note 9. Work in Process (in thousands):

	(1) Work In Process Amount	(2) Valuation Method
A. Work in Process:		
1. In House	$1,242,813	Actual Cost
2. Contractor	30,245	
3. Other Government Activities	48,269	
4. Government Furnished Materials		
Total	$1,321,327	

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B. Other Information: Work-in-Process at NWCF industrial activities consists of costs incurred for customers, not yet billed. Work-in-Process does not apply to the supply activity group.

Note 10. Operating Materials and Supplies (OM&S), Net (in thousands):

	(1) OM&S Amount	(2) Allowance For Losses	(3) OM&S, Net	(4) Valuation Method
A. OM&S Categories:				
1. Held for Use	$583,686	$27,412	$556,274	Weighted Average and Other
2. Held in Reserve for Future Use	35,800		35,800	
3. Excess, Obsolete and Unserviceable				
Total	$619,486	$27,412	$592,074	

B. Restrictions on operating materials and supplies: None

C. Other Information: Operating Materials and Supplies, Net are held at industrial activity groups for use on customer work. These inventories are maintained at cost, primarily using a weighted average. The following specifics by activity group apply.

Depot Maintenance - Aviation. Inventories are valued using the weighted average method. The majority of inventory is retained for use on customer orders. An allowance for inventory losses has been established to accrue potential inventory shortfalls over the fiscal year. This activity group also manufactures inventory which is later used on customer projects. The cost to produce the manufactured inventory in FY 1997 was $26,328 thousand.

Depot Maintenance - Shipyards. Inventories of operating supplies and non-consumable items, are valued at weighted average. Direct Material Inventory is valued at acquisition cost by line item. Generally, these values are based on prices paid for recently acquired items plus appropriate surcharges.

Depot Maintenance - Ordnance. Inventories of operating supplies and non-consumable items, are valued at weighted average. Direct Material Inventory is valued at acquisition cost by line item. Generally, these values are based on prices paid for recently acquired items plus appropriate surcharges.

Depot Maintenance - Other (Marine Corps). Inventories, including operating supplies and non-consumable items, are valued at Standard Prices. Generally, these prices are based on

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prices paid for recently acquired items plus appropriate surcharges. The Standard Price is updated to reflect the LAC by national stock number every month. No gains or losses resulted from Standard Price changes for NWCF stock items included in the Statement of Operations and Changes in Net Position.

Transportation - MSC.

1. Active: MSC's active inventory consists of consumable supplies, subsistence, fuel, miscellaneous material supplies and MPS equipment. The following is a description of inventory categories:

a. Consumable inventories are frozen inventories for United States Navy Ship (USNS) ships based on the values for a period of three months of actual expenses. Values were examined during FY 1997 and found to be adequate. Also, a 100% actual physical inventory is conducted upon transfer or inactivation of the vessel.

b. Ship subsistence inventories for USNS ships reflect the chief steward's on-hand inventory and is processed at the end of each month using current average unit prices. A 100% actual on board inventory is taken quarterly, in accordance with MSC instructions.

c. For the ships for which fuel inventory are maintained, inventory is based on the bunkers available at month end, as reported by the ship operators.

d. Miscellaneous materials are equipment items stored at Cheatham Annex and Oakland, CA. A 100% physical inventory was taken in April 1997 for Commander, Military Sealift Command, Atlantic and for Commander, Military Sealift Command, Pacific. Equipment items were priced either at their requisition cost or capitalized cost. The latter methodology was used in cases where the original inventory taken had no unit prices. In such cases, cost was established by an outside party who was contracted to perform a physical inventory of these items.

e. MPS/T5 equipment is inventory stored at the contractors' site.

2. Inactive: All OX Cognizance Symbol material was transferred to NAVICP Mechanicsburg and DLA during FY 1994, FY 1995, and FY 1996. The current value is zero.

3. The unallocated cost account - unmatched for ($10,647) thousand was included in the operating material and supplies value.

4. The valuation methods are LAC, Standard Price and other.

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Base Support. These materials are maintained at cost, using a weighted average. An adjustment of $227 thousand was made by DFAS Operating Location (OPLOC) Oakland for PWC Norfolk under Data Base Code 1541, which was entered into the Department of the Navy Industrial Budget Information System, but was not entered into the official accounting system at DFAS-CL. Correction will be made in FY 1998.

Research and Development.

NSWC and NUWC. Inventories of operating supplies and non-consumable items, are valued at weighted average. Direct Material Inventory is valued at acquisition cost by line item. Generally, these values are based on prices paid for recently acquired items plus appropriate surcharges.

NAWC. Inventories are valued using the weighted average method. The majority of inventory is retained for use on customer orders. An allowance for inventory losses account has been established to accrue potential inventory shortfalls over the fiscal year. The NAWC manufacture inventory which is later used on customer projects. The cost to produce the manufactured inventory in FY 1997 was $0. The last triennial physical inventory was performed in FY 1995 for NAWC sites. The acceptable error rate for Material and Supplies is (+/-) 5%. All sites were within this limit.

NRL. $119 thousand of the Operating Materials and Supplies Inventory is material ordered from the General Services Administration and paid for, but which has not yet been received. The Operating Materials and Supplies Inventory is valued using the weighted average method. The NRL conducts an annual wall-to-wall inventory of its Operating Materials and Supplies Inventories. The net adjustments resulting from the wall-to-wall inventories in FY 1997 was a $4 thousand loss. An allowance for inventory losses account has also been established to accrue potential inventory short falls over the fiscal year.

NFESC. NFESC NWCF does not maintain any Operating Material and Supplies. All operating materials needed to perform the mission of NFESC are purchased on an as needed basis preventing inventory build-up and related costs to carry and value inventory.

NCCOSC. The Operating Materials and Supplies inventory in custody control at the end of FY 1997 was zero, and $2,025 thousand in Material-in-Transit (MIT). The MIT will be delivered directly to the organizations performing work for customers and the material will not be held as part of the Operating Materials and Supplies inventory. Inventory was reduced to zero when the shop stores were closed in preparation for the increased usage of the bankcard.

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Information Services.

NAVCOMTELCOM. Inventories are valued using the weighted average method. Materials and supplies physical inventories were taken during the last quarter of FY 1997 using the actual cost method. Resulting inventory adjustments amounted to an increase of $2 thousand. These adjustments are contained in the Financial and Operating Statements.

COMNAVRESFOR. The Average Cost method is currently used to price inventories. Actual physical counts for Materials and Supplies inventories were taken during the last quarter of FY 1997. Resulting inventory adjustments amounted to a gain of $112 thousand. These adjustments are contained in the amounts shown in the Statement of Financial Position.

FMSO. This activity group does not have Operating Materials and Supplies, Net.

The following identifies those industrial activity groups that do not have sponsor funded material and those that have sponsor funded material, which is recorded in a statistical account, but not reported in the Statement of Financial Position or related Note 10.

Activity Group	No Sponsor Funded Material	Sponsor Funded Material	(in thousands) Amount
Depot Maintenance - Aviation	X		$0
Depot Maintenance - Shipyards	X		
Depot Maintenance - Ordnance		X	1,758
Depot Maintenance - Other (Marine Corps)	X		
Transportation	X		
Base Support	X		
Research and Development			
NSWC		X	414,924
NUWC		X	179,422
NAWC	X		
NRL	X		
NFESC	X		
NCCOSC		X	278,164
Information Services			
NAVCOMTELCOM	X		
COMNAVRESFOR	X		
FMSO (Note 10 N/A)			
Total			$874,268

Note 11. Stockpile Materials, Net (in thousands): Not applicable

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Note 12. Seized Property (in thousands): Not applicable

Note 13. Forfeited Property, Net (in thousands): Not applicable

Note 14. Goods Held Under Price Support and Stabilization Programs, Net (in thousands):
Not applicable

Note 15. Property, Plant and Equipment, Net (in thousands):

	(1) Depreciation Method	(2) Service Life	(3) Acquisition Value	(4) Accumulated Depreciation	(5) Net Book Value
Classes of Fixed Assets					
A. Land	N/A	N/A	$137,862	$0	$137,862
B. Structures, Facilities, & Leasehold Improvements	SL	Various	7,380,722	4,312,775	3,067,947
C. Military Equipment					
D. ADP Software	SL	1-5	83,799	58,924	24,875
E. Equipment	SL	Various	3,575,025	2,512,102	1,062,923
F. Assets Under Capital Lease			2,272	925	1,347
G. Other	SL	Various	4,580	482	4,098
H. Natural Resources					
I. Construction-in-Progress	N/A	N/A	324,616		324,616
Total			$11,508,876	$6,885,208	$4,623,668

J. Other Information: See next four pages.

*Keys:

Depreciation Methods	Range of Service Life	
SL - Straight Line	1-5	1 to 5 years
DD - Double-Declining Balance	6-10	6 to 10 years
SY - Sum of the Years' Digits	11-20	11 to 20 years
IN - Interest (sinking fund)	>20	Over 20 years
PR - Production (activity or use method)		
OT - Other (describe)		

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1. The depreciation method is straight line and the Service Life varies by class of fixed asset and activity group as shown below.

	Service Life			
Activity Group	B. Structures, Facilities & Leasehold Improvements	D. ADP Soft-ware	E. Equip-ment	G. Other
Supply Management (Navy)	11-20	N/A	5-20	N/A
Supply Management (Marine Corps)(Note 15 N/A)	N/A	N/A	N/A	N/A
Depot Maintenance - Aviation	>20	1-5	6-10	1-5
Depot Maintenance - Shipyards	>20	N/A	6-10	N/A
Depot Maintenance - Ordnance	>20	1-5	6-10	N/A
Depot Maintenance - Other (Marine Corps)	20	N/A	10	
Transportation	20	5	10	10
Base Support	*20	5	**10	
Research and Development				
NSWC	>20	1-5	6-10	N/A
NUWC	>20	1-5	6-10	N/A
NAWC	>20	1-5	6-10	N/A
NRL	20	5	5-10	N/A
NFESC	*20	N/A	**10	N/A
NCCOSC	>20	N/A	Various	N/A
Information Services				
NAVCOMTELCOM	N/A	1-5	6-10	N/A
COMNAVRESFOR	N/A	N/A	N/A	N/A
FMSO	N/A	N/A	N/A	1-5

*Except for facilities in service prior to FY 1992 for which Service Life was established upon construction based on a variable scale. **Except for General Purpose Vehicles for which depreciation is 5 years.

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2. The following identifies those activity groups that do not have sponsor funded equipment and those that have sponsor funded equipment which is recorded in a statistical account, but not reported in the Statement of Financial Position or related Note 15.

Activity Group	No Sponsor Funded Equipment	Sponsor Funded Equipment	(in thousands) Net Book Value
Supply Management (Navy)	X		
Supply Management (Marine Corps) (Note 15 N/A)			
Depot Maintenance - Aviation (IMRL)		X	$90,700
Depot Maintenance - Shipyards		X	8,523
Depot Maintenance - Ordnance		X	11,323
Depot Maintenance - Other (Marine Corps)	X		
Transportation	X		
Base Support	X		
Research and Development			
NSWC		X	172,993
NUWC		X	133,168
NAWC (IMRL)		X	162,211
NRL		X	78,532
NFESC		X	722
NCCOSC		X	27,948
Information Services			
NAVCOMTELCOM	X		
COMNAVRESFOR	X		
FMSO	X		
Total			$686,120

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3. The following identifies whether or not an activity group has Fixed Assets - Not in Use. It also indicates when the related accumulated depreciation of Fixed Assets - Not in Use continues to be reported under Note 15, because the DFAS-CL Center guidance of 16 October 1997 was received too late by our DFAS-CL OPLOC to implement. When implemented the amount of Accumulated Depreciation - Assets Not in Use will be reported as a contra account to Fixed Assets - Not in Use which is reported on Line 1.m of the Statement of Financial Position.

Activity Group	No Fixed Assets - Not in Use on Line 1.m of Statement of Financial Pos	Note 15 Includes Depreciation Related to Fixed Assets- Not in Use	Assets Not in Use Related Depreciation Included on Line 1.m of Statement of Financial Pos	Assets Not in Use Included in Note 15 But Not Depreciated
Supply Management (Navy)	X			
Supply Management (Marine Corps)(Note 15 N/A)				
Depot Maintenance - Aviation			X	
Depot Maintenance - Shipyards		X		
Depot Maintenance - Ordnance		X		
Depot Maintenance - Other (Marine Corps)				X
Transportation	X			
Base Support		X		
Research and Development				
NSWC		X		
NUWC		X		
NAWC	X			
NRL		X		
NFESC	X			
NCCOSC	X			
Information Services				
NAVCOMTELCOM		X		
COMNAVRESFOR		X		
FMSO	X			

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4. Fully depreciated assets included in the above Note 15 are as follows.

Activity Group	(in thousands) Amount of Fully Depreciated Assets
Supply Management (Navy)	$0
Supply Management (Marine Corps) (Note 15 N/A)	
Depot Maintenance - Aviation	235,349
Depot Maintenance - Shipyards	459,844
Depot Maintenance - Ordnance	193,245
Depot Maintenance - Other (Marine Corps)	17,813
Transportation	10,742
Base Support	Not readily available
Research and Development	
NSWC	418,375
NUWC	84,714
NAWC	1,351,148
NFESC	2,476
NCCOSC	63,588
NRL	183,311
Information Services	
NAVCOMTELCOM	2,415
COMNAVRESFOR	Not readily available
FMSO	Not readily available
Total	$3,023,020

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Note 16. Debt (in thousands):

Liabilities Covered by Budgetary Resources	Beginning Balance	New Borrowings	Repay-ments	Ending Balance	Re-financing
A. Intragovernmental Debt:					
1. Borrowing from the Treasury	$0	$0	$0	$0	$0
2. Borrowing from Federal Financing Bank	1,225,977		61,951	1,164,026	
3. Borrowing from Other Federal Agencies					
Total Intragovernmental Debt	$1,225,977	$0	$61,951	$1,164,026	$0
Liabilities Not Covered by Budgetary Resources					
B. 1. Public Debt:					
a. Held by Government Accounts	$0	$0	$0	$0	$0
b. Held by the public					
c. Total Public Debt	$0	$0	$0	$0	$0
2. Agency Debt:					
a. Held by Government Accounts	$0	$0	$0	$0	$0
b. Held by the public					
c. Total Public Debt	$0	$0	$0	$0	$0
C. Total Liabilities For Debt Not Covered by Budgetary Resources:	$0	$0	$0	$0	$0
D. Total Debt:	$1,225,977	$0	$61,951	$1,164,026	$0

E. Other Information: The $1,164,026 thousand debt represents the Transportation activity group outstanding principal balance on the APF-N ships. See Note 6.

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The APF-N program provided ships for time charter to MSC to meet requirements not available in the marketplace. The program was approved by the Congress. The ships were built/converted by private Interim Vessel Owners using private, non-government financing obtained from various banking institutions. No payments were made by the government during the building/conversion phase.

When each vessel was delivered to MSC for use under the Time Charter Party, the interim financing was replaced by permanent financing, and vessel ownership was transferred to the permanent vessel owners (a trust company acting for the benefit of equity investors). The ships were financed with approximately 30% equity investments and 70% debt borrowings. The debt is in the form of loans from the FFB to the vessel owners. Capital Hire payments under the Time Charter are assigned to FFB to cover the loan obligations, and to the vessel owners to cover the equity obligations.

The Time Charter Party requires MSC to pay Capital Hire twice a year. These payments cover repayment of principal and interest on the FFB loans, and any equity payments due the vessel owners. Separately, Operating Hire is paid twice a month to the vessel operators to cover crew costs, provisions, ship management, etc., and specified reimbursements such as fuel and port expenses are paid to the operators. These expenses are paid from the NWCF. 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, the ships belong to the ship owner. The government does have an option to purchase the ships, if the contract is terminated, at the greater of the fair market value or termination value.

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 NWCF. This is done instead of having MSC make Capital Hire payments to the vessel owners, who would in turn make their loan obligation payments to the FFB. This is very much the same as other Time Charters where payment is assigned directly to a bank. Equity payments, on the other hand, are made by MSC from the NWCF, upon receipt of invoices.

The Time Charters contain a clause requiring payment of stipulated termination penalties in the event the government desires to end the contracts prior to their final expiration (25 years for the APF-N). These penalties apply whether the termination results from a Termination for Convenience by the government, or by mere failure of the government to exercise its five-year renewal options. The contract requires that the ships be sold for the best price obtainable, and, if that is below the applicable termination value, the government makes up the difference. The Time Charters also contain casualty loss values in case of total loss of the ships which would be payable by the government to the vessel owners investors. In case of total loss the Time Charter requires the contractor to maintain casualty insurance sufficient to cover the casualty values due to the vessel owners including the amounts that they would owe to the FFB.

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The DoD Appropriation Act passed in December 1985 required that 10% of the 5th year termination value of the vessels be obligated from Operations and Maintenance, Navy funds. This was done as each vessel was delivered. Also, as required by the Act, MSC records the contingent liability for each current year's Operating Hire in its NWCF financial statement.

Note 17. Other Liabilities (in thousands):

A. Other Liabilities Covered by Budgetary Resources:

	Non-Current Liabilities	Current Liabilities	Total
1. Intragovernmental			
a. Advances-Government	$66,449	$659,594	$726,043
b. Advances-Loans		(1,453)	(1,453)
c. Progress Payments-WIP-In-House		795,505	795,505
d. Progress Payments-Direct Material		5,690	5,690
e. Progress Payments-Other Government			
f. Military Labor		64,668	64,668
g. Incomplete Voyage Revenue			
h. Undistributed Cash Disbursements		(1,256,899)	(1,256,899)
i. Accrued Reserve Revenue		5,817	5,817
j. Miscellaneous Other Liabilities	1,043,684		1,043,684
Total	$1,110,133	$272,922	$1,383,055

	Non-Current Liabilities	Current Liabilities	Total
2. Governmental			
a. Advances-Other	$0	$94,357	$94,357
b. Accrued Expenses-Other		2,803,887	2,803,887
c. Progress Payments-Contractor			
d. Miscellaneous Other Liabilities	(186)	40,173	39,987
e. Claims		3,570	3,570
f. Undistributed Cash Disbursements			
Total	($186)	$2,941,987	$2,941,801

B. Other Information:

Supply Management (Navy). Intragovernmental liabilities is overstated by $41,837 thousand since carcass tracking records at the NAVICP could not be reconciled to financial records prior to year-end closing.

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Transportation - MSC. Other (Intragovernmental) liabilities covered by budgetary resources include Accrued Reserves for Major Ship Maintenance and Repair, Undistributed Cash Disbursements, and Military Labor. Other (Governmental) liabilities covered by budgetary resources consist of claims and MSC's accrued expenses for ship operations inclusive of Capital Hire for the MPS.

Research and Development.

NRL. See Note 31.E.

NCCOSC. Advance billings directed by ASN(FM&C) during FY 1997 amounted to $50,000 thousand, of which $24,573 thousand remain unliquidated. These billings represent charges to customers in advance of performance of work based on projected workloads. The remaining balance of $18,260 thousand represents the amount of money that was received from non-DoD sponsors in advance to authorize the performance of work or services.

Information Services.

FMSO. The Undistributed Cash Disbursements includes $3,856 thousand of labor disbursements discovered to have also processed to subhead NC1C vice NF1F. A Journal Voucher Optional Form 1017-G (9-79) was prepared by DFAS-CO and sent to DFAS-IN for each of these revisions which should process through Treasury in October 1997. The remaining variance of $10,675 thousand can not be validated by FMSO.

Navy Component. The value reported represents the net of collections and disbursements held in this activity group pending identification to another activity group. Included in Line A.1.h above, is an allocation of $1,044,715 thousand of disbursements from the DWCF Corporate account. This allocation was directed by a DFAS-Headquarters (HQ) memorandum of 10 October 1997. This directed allocation was not supported by specific transactional information which would identify the value as belonging to the NWCF. ASN(FM&C) memorandum of 24 November 1997 to DFAS-HQ challenges the validity of this decision and requests the value be reversed.

C. Other Liabilities Not Covered by Budgetary Resources:

	Non-Current Liabilities	Current Liabilities	Total
1. Intragovernmental			
a. Cancelled Budget Authority	$0	$0	$0
b.			
c.			
Total	$0	$0	$0

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2. Governmental	Non-Current Liabilities	Current Liabilities	Total
a. Cancelled Budget Authority	$0	$0	$0
b.			
c.			
Total	$0	$0	$0

D. Other Information: Not applicable

Note 18. Leases (in thousands): Not applicable

Note 19. Pensions and Other Actuarial Liabilities (in thousands):

Major Program Activities	(1) Actuarial Present Value of Projected Plan Benefits	(2) Assumed Interest Rate (%)	(3) Assets Available to Pay Benefits	(4) Unfunded Actuarial Liability
A. Pensions and Health Plans:				
1. Pensions	$0		$0	$0
2. Health Plans				
3.				
Total	$0		$0	$0
B. Insurance/Annuity Programs:				
1.				
2.				
3.				
Total	$0		$0	$0
C. Other:				
1. Workers' Compensation	$1,160,071			$1,160,071
2.				
3.				
Total	$1,160,071		$0	$1,160,071
D. Total Lines A+B+C:	$1,160,071		$0	$1,160,071

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E. Other Information: The Note 19.C.1 value was computed by DFAS-HQ. Future workers' compensation (FWC) figures are provided by the Department of Labor. The liability for FWC benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is detemined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ulimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's June 10, 1997 economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

1997
6.24% in year 1
5.82% in year 2
5.60% in year 3
5.45% in year 4
5.40% in year 5 and thereafter

Note 20. Net Position (in thousands):

	Revolving Funds	Trust Funds	Appropriated Funds	Total
A. Unexpended Appropriations:				
1. Unobligated,				
a. Available	$0	$0	$0	$0
b. Unavailable				
2. Undelivered Orders				
B. Invested Capital	23,516,921			23,516,921
C. Cumulative Results of Operations	(5,793,059)			(5,793,059)
D. Other	(816,056)			(816,056)
E. Future Funding Requirements	(1,160,071)			(1,160,071)
F. Total	$15,747,735	$0	$0	$15,747,735

G. Other Information:

Supply Management (Navy). The value included in Invested Capital of $11,840,672 thousand is influenced by $3,957 thousand of Transfers-In Without Reimbursement resulting from Fleet and Industrial Supply Center (FISC)/Naval Shipyard (NSY) material transfer partnerships that occurred in FY 1997. DFAS-CL: Invested Capital and the Cumulative Results of Operations have been influenced by the Cost of Goods Sold model produced by members of the USD(C) and DFAS-HQ.

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Depot Maintenance - Aviation. Note 20.D, Other includes ($72,886) thousand balance which is the amount of assets transferred out to another Depot, other government agencies, or to the public.

Depot Maintenance - Shipyards. Included in Other is ($631,059) primarily attributed to the four closed NSYs which reflect ($613,000) thousand. This reduction in capital is a result of transferring closed NSYs assets to various entities without reimbursement.

Transportation - MSC. Invested Capital includes the FY 1997 principal payment of $61,951 thousand for loans related to the APF-N ships.

Base Support. Note 20.D Other includes the transfer/retiring of equipment by PWC, San Francisco in FY 1997.

Research and Development.

NAWC. The Note 20.D Other ($5,436) thousand includes the amount of plant property fixed assets transferred out to other government agencies.

NCCOSC. (1) Unexpended Appropriations is not applicable. (2) Invested Capital decreased in value by $65,362 thousand from FY 1996 to FY 1997. $61,115 thousand was due to transfer of cash balances from the NWCF activity level books to the corporate level; and a decrease of $4,247 thousand occurred in the value of Contributed Fixed Assets due to adjustments in asset valuations. (3) The change in Cumulative Operating Results from FY 1996 to FY 1997 was $4,972 thousand. The net operating results were reduced $1,369 thousand for a variance generated by military labor (see Note 26) and $77 thousand for a prior period adjustment (see Note 27).

Information Services.

NAVCOMTELCOM. The Invested Capital amount of ($69,377) thousand is the total of General Ledger Accounts (GLA) 2922, 2924, 2927, and 2961. The largest amount being ($93,747) thousand in GLA 2961, Net Treasury Balance - NWCF.

FMSO. FMSO is a new CFO entity, therefore, in order to bring FMSO in line with the other industrial activities, it was necessary to zero out the prior-to FY 1997 cash balance. Because GLA 1100, Undistributed, was a significant number, the result is the abnormal Net Position of ($25,708) thousand at the activity group level.

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Navy Component. The Invested Capital represents the initial transfer of cash from the DoD corporate account to reestablish a DON corporate cash balance, the transfer of end of FY 1995 and FY 1996 cash balances at the activity group level to the DON NWCF corporate account, and those collections and disbursements being held by this activity group pending identification to another activity group.

Note 21. Taxes (in thousands): Not applicable

Note 22. Other Revenues and Financing Sources (in thousands):

	1997	1996
A. Other Revenues and Financing Sources:		
1. Other Revenue	$211,266	$127,669
2. OPM Pension Plan Imputed Financing	713,270	
3.		
Total	$924,536	$127,669

B. Other Information: Other Revenues and Financing Sources Note 22.A.1 applies only to Supply Management (Navy). The use of the Property Clearance Account to reflect revenue is questionable. The value in this account represents timing differences between the receipt of material in the inventory accounting system and the related Accounts Payable posting for material receipt. Until the inventory accounting system and the allotment accounting system are integrated in a single system these timing differences will continue. The Note 22.A.2 value was computed by DFAS-HQ as follows:

Imputed Pension and ORBs

CSRS/FERS Retirement	$554,974
Health	157,861
Life Insurance	435
Total	$713,270

The $713,270 represents the imputed financing for pensions and ORBs. The Office of Personnel Management (OPM) is the administrative entity for pensions and ORBs. OPM accounts for and reports the pension liability in their financial statements while the employer discloses the imputed financing. OPM actuaries provide the normal cost rates which are used to calculate the imputed financing (see Note 25).

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Note 23. Program or Operating Expenses (in thousands):

	1997	1996
A. Operating Expenses by Object Classification:		
1. Personal Services and Benefits	$476,645	$487,028
2. Travel and Transportation	103,104	109,680
3. Rental, Communications and Utilities	25,340	25,768
4. Printing and Reproduction	5,851	8,157
5. Contractual Services	526,519	555,448
6. Supplies and Materials	58,842	68,790
7. Equipment not Capitalized	20,475	26,963
8. Grants, Subsidies and Contributions	806	712
9. Insurance Claims and Indemnities	17,089	25,835
10. Other (describe):		
(a) Repair Expense	11,821	1,272,657
(b)		
(c)		
11. Total Expenses by Object Class	$1,246,492	$2,581,038

B. Operating Expenses by Program:	1997	1996
1.	$0	$0
2.		
3.		
4. Unallocated Expense		
Total	$0	$0

C. Other Information: Program or Operating Expenses applies to the supply activity group and not to the industrial activity groups. The significant change between FY 1996 and FY 1997, in the Supply Management (Navy) activity group, is the exclusion of estimated repair expenses in FY 1997 which is now included in the Cost of Goods Sold, Note 24.

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Note 24. Cost of Goods Sold (in thousands):

A. Cost of Services Sold:		
1. Beginning Work-in-Process		$1,378,812
2. Plus: Operating Expenses		15,017,149
3. Minus: Ending Work-in-Process		1,321,327
4. Minus: Completed Work for Activity Retention		41,119
Cost of Services Sold		$15,033,515*
B. Cost of Goods Sold from Inventory (using Latest Acquisition Cost):		
1. Beginning Inventory - L.A.C.		$18,813,666
2. Less: Beginning Allowance for Unrealized Holding Gains (Losses)		8,284,713
3. Plus: Purchases at Cost		3,696,391
4. Plus: Customer Returns - Credit Given		505,855
5. Plus: DLR Exchange Credits		(180,538)
6. Less: Inventory Losses Realized		1,681,590
7. Less: Ending Inventory - L.A.C.		18,645,497
8. Plus: Ending Allowance for Unrealized Holding Gains (Losses)		5,500,283
9. Less: Equity Transfers of Inventory to Others		611,414
10. Plus: Equity Transfers of Inventory from Others		1,038,368
11. Plus: Other		5,023,059
a. Repair Cost Adjustment	$1,119,092	
b. Beginning Allowance Adjustment from Prior Year	3,903,967	
12. Equals: Cost of Goods Sold from Inventory		$5,173,870*
C. Cost of Goods Sold from Inventory (using Historical Cost):		
1. Beginning Inventory		
a. Plus: Purchases at Cost		$0
b. Plus: Inventory Gains		
c. Minus: Inventory Losses		
2. Less: Ending Inventory		
Cost of Goods Sold		$0

* These amounts do not reflect eliminating entries of $2,595,819 thousand for intra-activity cost of goods or services sold. See Note 19.

D. Other Information: Note 24.A applies to industrial activity groups and Note 24.B applies to the supply activity group.

Supply Management (Navy). The Cost of Goods Sold calculation identified in the CFO Act guidance has been prepared in accordance with DoD FMR 7000.14R, Volume 11B, which provides a new Cost of Goods Sold policy as clarified by USD(C). Additionally, the values

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portrayed as Costs of Goods Sold is calculated using percentages and adjustments from the Allowance Account for Holding Gains and Losses.

Transportation - MSC. This includes the costs of MSC government owned and government operated ships, exclusive of salaries and related costs; and virtually all costs of government owned, contractor operated ships; and contractor owned, contractor operated ships. FFB interest payments of $86,770 thousand are excluded from the Note 24.A Cost of Goods Sold calculation in FY 1997 and included on Line 13.a Expenses, Interest, Federal Financing Bank/Treasury Borrowing of the Statement of Operations and Changes in Net Position.

Research and Development. The NRL Cost of Services Sold does not include depreciation expense of $10,103 thousand.

Note 25. Other Expenses (in thousands):

	1997	1996
A. Other Expenses:		
1. Inventory Losses-Physical	$4,380,983	$7,500,945
2. Incoming Shipment Losses		
3. Stock Account DLR Program Losses		
4. Shrinkage, Fire, Theft, Losses, etc.	93,228	62,419
5. Major Disaster Losses	653	628
6. Accounting Adjustments		
7. Material Returns Without Credit	143,187	(32,685)
8. Assembly/Disassembly Losses		
9. DLR Carcass Price Reduction		
10. Inventory Control Point Adjustments		
11. Discounts on Material Returns		
12. DLR Advance Credit	(61,023)	
13. JLSC Surcharge Reserve		1,100
14. Summation of USD(C) model entries	(2,870,670)	(3,868,016)
15. OPM Pension Plan Imputed Expense	713,270	
Total	$2,399,628	$3,664,391

B. Other Information: In FY 1996 and 1997 Other Expenses was reported by the Supply Management activity group, except $1,100 thousand was reported in the FY 1996 Depot Maintenance - Other (Marine Corps) activity group. In FY 1997 Note 25, Line 15 was computed by DFAS-HQ as follows:

Imputed Pension and ORBs

CSRS/FERS Retirement	$554,974
Health	157,861
Life Insurance	435
Total	$713,270

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The $713,270 represents the imputed expense for pensions and ORBs. The OPM is the administrative entity for pensions and ORBs. OPM accounts for and reports the pension liability in their financial statements while the employer discloses the imputed expenses. OPM actuaries provide the normal cost rates which are used to calculate the imputed financing (see Note 22).

Supply Management (Navy). DFAS-CL: Note 25.A, Lines 1, 4, 5 and 7 values are transcribed from the FY 1997 Trial Balance report produced using the model developed by members of the USD(C) and DFAS-HQ. Those values are attributed to GLAs. Note 25.A, Line 14 is a summation of entries to adjust that portion of the FY 1997 Trial Balance report. Those adjusting entries are also to be found within the model produced by members of the USD(C) and DFAS-HQ.

Depot Maintenance - Other (Marine Corps). In FY 1995 and FY 1996, transfers to JLSC were recorded as expenses and reported in Note 25.A, Line 13. In FY 1997, $1,200 thousand was transferred to JLSC and recorded as a non-operating transfer.

Note 26. Extraordinary Items (in thousands):

A. Extraordinary Items:

1. Surcharges	($566,585)
2. Extraordinary Current Year Expense	3,864
3. Reserve Balancing	(1,969)
4. Fixed Asset Adjustments	
5. Passthroughs	
6. Refunds	
7. ACP Cumulative 1/12 Surcharge	(54)
8. Redistribution	
9. Transfers	
10. Excess ACP Write-off	
11. Military Labor/Variance	(1,668)
Total	($566,412)

B. Other Information: In FY 1997 Extraordinary Items were reported by the industrial activity groups and not by the supply activity group.

Depot Maintenance - Aviation. $135,190 thousand represents the cash collected in FY 1997 to fund a cash surcharge of $112,628 thousand and the JLSC of $22,562 thousand. The reserve balancing includes $428 thousand of cash collected in FY 1997 associated with the FY 1996 surcharge to fund the JLSC.

Depot Maintenance - Shipyards. Includes a surcharge of $380,254 thousand.

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Depot Maintenance - Ordnance. Includes a surcharge of $51,195 thousand.

Research and Development.

NRL. Extraordinary adjustments in the amount of $2,261 thousand are the result of aged Accrued Expenses written off as a result of review and validation of accounts in accordance with Navy Comptroller Manual, Volume 5, paragraph 054922 and DoD 7000.14R, FMR, Volume 4, Chapter 8.

NCCOSC. A military labor variance of $1,369 thousand was generated when NCCOSC was required to pay for more military labor than was actually worked, thus creating a decrease to the accumulated operating expenses in that amount. NCCOSC does not agree with the recording of the military labor variance as an extraordinary expense. DoD FMR (DoD 7000.14-R), Volume 11B, Chapter 62, paragraph B.4.c.(3) provides guidance for reporting the military labor variance on the Statement of Operations as a non-recoverable/deferred amount.

Information Services - COMNAVRESFOR. Transfers amount of $4,314 thousand was the activity's portion of the Cumulative Results of Operations at the time of the transfer from NAVCOMTELCOM to COMNAVRESFOR. Military costs imposed by headquarters were significantly higher than the actual costs causing this variance. COMNAVRESFOR NWCF activity does not have any military billets.

Note 27. Prior Period Adjustments (in thousands):

A. Prior Period Adjustments:

1. USD(C) Model Prior Period AOR Adjustment	$2,131,132
2. Accounts Payable Transfer to Equity	(52,974)
3. Prior Period AOR Adjustment	951,392
4. Other Fund Transfer	1,700
Total	$3,031,250

B. Other Information:

Supply Management (Navy). DFAS-CL: Note 27.A, Lines 1 and 3 are products of the model developed by members of the USD(C) and DFAS-HQ for the Cost of Goods Sold presentation and Inventory Valuation. Navy: Note 27.A Line 3 is included to accommodate the transfer of FMSO from the Supply Management (Navy) activity group to the Information Services activity group.

Depot Maintenance - Other (Marine Corps). In FY 1997, adjustments were made to Accounts Receivable and the inventory accounts to balance the general ledger to subsidiary

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accounts during the implementation of the Naval Air Systems Command Industrial Financial Management System.

Research and Development.

NRL. Prior Period Adjustments in the amount of ($38) thousand are the result of correcting costs erroneously charged to a direct job order in FY 1996.

NCCOSC. A Prior Period Adjustment was approved by the ASN(FM&C) in the amount of $77 thousand. This adjustment is the second part of corrections that are being made by NCCOSC's In-Service Engineering East Coast Division (NISE East) after a COMSPAWARSYSCOM Inspector General (IG) investigation completed in FY 1996 revealed that during NISE East's conversion to DBOF numerous accounting errors had been made in FY 1994 and FY 1995. This adjustment was made to correct those errors. See Note 31 for additional information.

Information Services - FMSO. An adjustment of $7,090 thousand was made to transfer FMSO from the Supply Management (Navy) activity group to the Information Services activity group during FY 1997.

Note 28. Non-Operating Changes - (Transfers and Donations) (in thousands):

	1997	1996
A. Increases:		
1. Transfers-In:		
a. Transfers-Without Reimbursement-NWCF	$1,410,875	$541,720
b. Transfers-Without Reimbursement-Capital NWCF	13,148	2,441
c.		
2. Unexpended Appropriations		
3. Donations Received		
4. Other Increases	3,156,714	719,570
5. Total Increases	$4,580,737	$1,263,731

	1997	1996
B. Decreases:		
1. Transfers-Out:		
a. Transfers to Govt. Agency Without Reimbursement	$2,111,824	$795,842
b. Transfers to All Others Without Reimbursement	9,439	233,708
c. Transfers to Others Without Reimbursement-NWCF	162,684	103,107
d. Transfers to Others Without Reimbursement-Capital	226,493	126,627
2. Donations		
3. Other Decreases	470,982	1,102,521
4. Total Decreases	2,981,422	$2,361,805
C. Net Non-Operating Changes (Transfers):	$1,599,315	($1,098,074)

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D. Other Information:

Depot Maintenance - Ordnance. Note 28.B.3 Other Decreases of ($31,773) thousand is primarily due to a cash surcharge collection of $51,195 thousand to GLA 2910. This increase was partially offset by the transfer of the prior year activity cash balance to Net Treasury Balance - NWCF GLA 2961.

Depot Maintenance - Other (Marine Corps). Note 28.B.1.a Transfers to Government Agency Without Reimbursement represents the JLSC surcharge for FY 1997 of $1,200 thousand.

Base Support. Note 28.B.3 Other Decreases represents the transfer/retiring of equipment by PWC, San Francisco in FY 1997.

Research and Development.

NSWC. Note 28.B.3 Other Decreases ($260,901) thousand is due to the transfer of the negative prior year activity cash of ($208,995) thousand to Net Treasury Balance (GLA 2961). In addition there was an increase of $60,933 thousand in Assets Capitalized - Contributed Fixed Assets (GLA 2922).

NAWC. The Note 28.B.3 Other Decreases ($284,007) thousand is attributable to a close out of FY 1996 NWCF Treasury Cash and a large amount of assets capitalized.

NRL. Note 28.B.3 Other Decreases consist of the change to non-operating equity accounts. The largest portion of these changes in FY 1997 is $3,288 thousand of the NRL cash was transferred to Net Treasury Balance - NWCF. Total cash transfers now equal $132,352 thousand.

NFESC. Note 28.B.3 Other Decreases ($10,691) represents the FY 1997 year-end Net Treasury Balance less assets capitalized prior to NWCF.

NCCOSC. The changes reflected in this note are for changes in Invested Capital as discussed in Note 20. The largest portion of these changes occurred when $61,115 thousand of NCCOSC cash was transferred to Net Treasury Balance – NWCF

Information Services - NAVCOMTELCOM. OPLOC Pensacola reported that the Note 28.A.1 ($2,326) thousand Transfers-Without Reimbursement-NWCF reflects prior year leave adjustments made in GLA 2941. However, GLA 2923, Liabilities Assumed is the appropriate GLA for those adjustments and that amount was moved to GLA 2923 in October 1997.

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Navy Component. The FY 1997 Transfer-In represents the transfer of end of FY 1996 cash balances of $281,026 thousand at the activity group level to the DON NWCF corporate account, the FY 1997 gross value of IMRL of $393,512 thousand and a non-expenditure cash transfer of $1,044,715 thousand from the DWCF Corporate account. The latter cash transfer was directed by a DFAS-HQ memorandum of 10 October 1997. This cash transfer was made concurrently with an allocation of $1,044,715 thousand of disbursements from the DWCF Corporate account. The allocation of disbursements was not supported by specific transactional information which would identify the value as belonging to the NWCF. ASN(FM&C) memorandum of 24 November 1997 to DFAS-HQ challenges the validity of this allocation. The FY 1996 Transfer-In represents the transfer of end of FY 1995 cash balances of $713,054 thousand at the activity group level to the DON NWCF corporate account and an offsetting Transfer-Out of $33,961 thousand representing a DON payment of prior year DFAS services. The FY 1997 Other Decreases consists of $1,160,071 thousand actuarial workers' compensation liability. DFAS-HQ guidance requires that changes in the unfunded liability for workers' compensation be reported on Line 23 of the Statement of Operations and Changes in Net Position. Workers' compensation liability was not reported in FY 1996.

Note 29. Intrafund Eliminations (in thousands):

Schedule A: General Fund Sales to the General Fund
Not applicable to NWCF.

Schedule B: NWCF Sales to NWCF

Selling Activity:

	Column A Accounts Receivable	Column B Revenue	Column C Unearned Revenue	Column D Collections
Navy Working Capital Fund				
Supply Management	$0	$754,782	$0	$754,782
Industrial activities		1,841,037		1,841,037
Total	$0	$2,595,819	$0	$2,595,819

Customer Activity:

	Column A Accounts Payable	Column B Expenses	Column C Advances	Column D Disbursements
Navy Working Capital Fund				
Supply Management	$0	$795,097	$0	$795,097
Industrial activities		1,800,722		1,800,722
Total	$0	$2,595,819	$0	$2,595,819

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Schedule C: NWCF Sales to DoD Entities

Selling Activity:

	Column A Accounts Receivable	Column B Revenue	Column C Unearned Revenue	Column D Collections
Navy Working Capital Fund	$0	$15,798,978	$0	$15,798,978
Unearned Revenues				
Total	$0	$15,798,978	$0	$15,798,978

Customer Activity:

	Column A Accounts Payable	Column B Expenses	Column C Advances	Column D Disbursements
Department of the Army GF	$0	$128,095	$0	$128,095
Department of the Navy GF		13,925,412		13,925,412
Department of the Air Force GF		247,100		247,100
Army WCF		$44,702		$44,702
Air Force WCF		102,927		102,927
Defense WCFs		(20,950)		(20,950)
National Defense Stockpile				
U.S. Army Corps of Engineers				
Defense Security Asst Agency				
Other Defense Organizations		1,371,692		1,371,692
Advances				
Total	$0	$15,798,978	$0	$15,798,978

Schedule D: NWCF Sales to U.S. Government Entities

Selling Activity:

	Column A Accounts Receivable	Column B Revenue	Column C Unearned Revenue	Column D Collections
Navy Working Capital Fund	$0	$646,614	$0	$646,614
Unearned Revenue				
Total	$0	$646,614	$0	$646,614

Customer Activity:

	Column A Accounts Payable	Column B Expenses	Column C Advances	Column D Disbursements
General Services Administration	$0	$149,423	$0	$149,423
State Department		254,445		254,445
Department of Transportation		242,746		242,746
Advances				
Total	$0	$646,614	$0	$646,614

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E. Other Information: In the absence of standard USD(C) policy and procedures for intrafund eliminating entries, each DFAS Center was tasked by DFAS-HQ to evaluate the Center's capability to produce from existing systems the seller data for the numeric portion of Note 29.

The data disclosed for industrial type activities revenues has been developed from field level revenue classifications reports. The data disclosed for supply type activities revenues has been developed from the DD Form 1400 (S) "Statement of Inter-Fund Transactions" which is a departmental report representing billings made via Interfund billings only. The values reported herein from the DD Form 1400 are considered at the summary level to be representative of revenues reported in the General Ledger Account for Interfund billings during FY 1997. The supporting individual primary and secondary activity group Note 29 data is not readily available in the financial systems supporting this Fund.

Until standard USD(C) DBOF policy for the treatment of intrafund elimination transactions is issued and DFAS implementing procedures and controls are provided, the data disclosed may not meet the intent of the DoD Guidance on Form and Content of Financial Statements for FY 1997 Financial Activity.

Under Schedule D, Customer Activity, Column B, General Services Administration: the $149,423 thousand represents Other Federal and non-DoD transactions including General Services Administration which can not be broken out individually for the categories shown.

Note 30. Contingencies: The following provides specific activity group disclosure.

Transportation - MSC. Contingencies (Reserves) have been established to provide for anticipated accident and damage repairs and estimated value of claims pending. Their values as of 30 September 1997, are $2,223 thousand and $3,570 thousand, respectively. It should be noted that the reserve for accident damage repairs will be abolished and the remaining value in such account represents funds already obligated. MSC has not provided a reserve to cover the potential total loss of any ship. Funding for any necessary replacement assets would have to be obtained from sources outside MSC.

Research and Development. The NRL has obligation balances totaling $101 thousand on canceled appropriations.

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Note 31. Other Disclosures:

A. Supply Management (Navy).

1. Year-end Financial Processing: NWCF activities are required to include all transactions through 30 September of the reporting fiscal year in their financial reports to higher levels. Current reporting due dates require all activities to close their "books" prior to 30 September in order to be included in year-end reports. Delays resulting from ADP scheduling and processing constraints will be encountered and result in some transactions being excluded from year-end reports. Also, financial processing will preclude some measure of transactions from processing to accounting records. These transactions are output to exception files and are reviewed, reconciled, and reprocessed to accounting records. Financial reporting deadlines provide insufficient time to effect corrections and, thus, corrections are processed and reported in subsequent reporting periods. Therefore, financial information presented in the financial statements of this activity group are not as of 30 September 1997. This is not considered material when viewing and drawing conclusions from these financial statements.

2. Financial Adjustments Due to Audit Findings:

a. The necessary adjustment to the Accounts Payable, Federal Account of $6,620 thousand (reduction) based on NAVAUDSVC Audit 035-96, Recommendation 32 was made in FY 1996. This action is completed.

b. The necessary adjustment to the Accounts Payable, Non-Federal Account of $564 thousand (reduction) based on NAVAUDSCV Audit 035-96, Recommendation 38 was made in FY 1996. This action is completed.

c. The necessary adjustment to the Other Federal (Intragovernmental) Liabilities Account of $19,065 thousand (reduction) based on NAVAUDSVC Audit 035-96, Recommendation 34 was made in FY 1996. This action is completed.

d. The necessary adjustment to the Advances and Prepayments, Non-Federal Account of $21,463 thousand (reduction) based on NAVAUDSVC Audit Report 035-96, Recommendation 9 was made in FY 1996. This action is completed.

3. Adjustments Due to Undistributed Disbursements: Federal and Non-Federal Accounts Payable were adjusted for undistributed disbursements based on percentages computed from current relationships between the two accounts. The total value of Accounts Payable was not changed. Additionally, Accounts Payable is overstated by approximately $33,100 thousand due to processing problems at DFAS payment offices.

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4. The FY 1997 Prepayment Standard General Ledger 1452 is overstated by approximately $18,900 thousand due to processing problems at DFAS payment offices.

B. Supply Management (Marine Corps).

1. Changes in the Reporting Entity: Line 3A (Earned) of the SF-133 Report should match the CFO Statement of Operations and Changes in Net Position Line 2b, Revenue from Sales of Goods and Services, Intragovernmental. Discrepancy is due to new guidance from the Secretary of Defense dated 20 April 1995, which makes Line 2b reflect Gross Sales instead of Net Sales. This change is to nullify adjustments to Gross Sales for credit given for material returns and Depot Level Repairables (DLR) exchanges.

2. Other Disclosures:

a. The Marine Corps representatives can not validate the Supply Management (Marine Corps) activity group FY 1997 CFO Financial Statements and Notes. The Supply Management (Marine Corps) activity group continues to have problems with inventory values on financial accounting reports. Many of these problems originated with business process changes associated with the consolidating of DLRs in DBOF as of 1 October 1993. The business practices included co-mingling NWCF and Procurement, Marine Corps (PMC) owned repairables on the same inventory records. Existing financial systems are not able to accommodate this methodology.

b. The Marine Corps staff noted that a more effective and efficient management approach was needed in regards to the current business practice. In March, 1997 the Marine Corps advised DFAS that the Marine Corps is changing current policy on funding repairables. These changes included the capitalization of Critical Low Density (CLD) and War Reserve Material repairables (currently PMC) under the NWCF management umbrella, on 1 October 1997. In FY 1997 with the changed business process, those problems associated with co-mingling NWCF and PMC owned repairables should be resolved. This repairable business practice change alone will not resolve all the problems DON has with data on Supply Management (Marine Corps) financial reports.

c. The Marine Corps personnel continue to address the system and financial problems with DFAS, as appropriate. The accuracy of the future financial data and reports will depend on the successful replacement/interface of existing financial systems with the Standard Accounting Budgeting, and Reporting Systems. In March 1997, the Marine Corps and DFAS established an Integrated Processing Team (IPT) to coordinate and implement the new business practices and new financial systems. The IPT meets monthly to update the process and discuss any existing system or financial problems. There has been tremendous progress on establishing creditable accounting data. Marine Corps personnel plan to coordinate with DFAS representatives to produce certifiable financial data for FY 1998 year-end financial reports.

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d. Supply Management (Marine Corps) activity group was not audited during FY 1996 and FY 1997.

C. Transportation - MSC.

1. Non Compliance with Existing DFAS Guidance: Since the September Industrial Fund Centralized Disbursement Reimbursement System was not available until 15 October 1997, detailed treasury cash transactions by others were not processed against MSC's activity cash account. Instead, a summary amount was processed in activity cash by debiting the unallocated cost account - unmatched and crediting the cash account.

2. Other Financial Statement Disclosures:

a. It should be noted that Line 4.b.(2).b Liabilities, Transactions with Non-Federal (Governmental) Entities, Accrued Payroll and Benefits, Annual Accrued Leave of the Statement of Financial Position includes shore leave for civilian mariners in the amount of $9,763 thousand.

b. The figures for 1996 and 1997 on the CFO financial statements are not comparable. The FY 1996, DBC 1520 (Travel Advances) was included in the Statement of Financial Position on Line 1.a.(5) Entity Assets, Transactions with Federal (Intragovernmental) Entities, Advances and Prepayments vice Line 1.b.(5) Entity Assets, Transactions with Non Federal (Governmental) Entities, Advances and Prepayments. It is included in Line 1.b.(5) for FY 1997. The FY 1996, DBC 1545 (Undistributed Summary Register) was included in the Statement of Financial Position on Line 4.b.(1) Liabilities, Transactions with Non-Federal (Governmental) Entities, Accounts Payable vice Line 4.a.(1) Liabilities, Transactions with Federal (Intragovernmental) Entities, Accounts Payable. It is included in Line 4.a.(1) for FY 1997. The FY 1996, FFB interest is included in the Statement of Operations and Changes in Net Position on Line 10.b., Expenses, Cost of Goods Sold, Intragovernmental vice Line 13.a Expenses, Interest, Federal Financing Bank/Treasury Borrowing. It is included in Line 13.a for FY 1997.

D. Base Support.

1. Cost Sharing Agreement: Per DFAS-IN Center's 30 October 1997 memorandum, PWC Yokosuka receives payment from the Government of Japan under a cost sharing agreement. This funding is treated as a reduction to expenses for accurate unit costing, rather than a revenue source.

2. PWCs Rates: PWCs charge annual published rates for services/products provided in the year of execution, regardless of the fiscal year the work is actually accepted.

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3. Cash Impacts: Cash impacts for this activity group include transactions for two activities that are not currently active. PWC Charleston is charged with net transactions of $2 thousand; however, PWC Charleston was never activated. The net transaction is clearly in error. PWC Cubic Bay has been closed for four years. Financial closet of contingencies continue for this activity group.

4. Audits: PWC Great Lakes added $12,839 thousand to Class 1 property and $6,754 thousand to Class 2 property as a result of NAVAUDSVC Audit 97-003 March 1997.

5. General Ledger: PWC Pearl Harbor is experiencing difficulty reconciling accounts since the transfer of accounting responsibilities to DFAS-OPLOC Oakland. PWC Guam understated Unmatched Disbursements by $2,700 thousand and overstated Undistributed Disbursements - Unmatched by the same amount. PWC Guam erroneously posted a $942 thousand credit to Undistributed Disbursements - Unmatched and an equal debit to Undistributed Collections - Unmatched.

E. Research and Development.

1. NRL. In Accordance with DFAS policy, in FY 1997 undistributed disbursements of $7,115 thousand were adjusted to Liabilities, Transactions with Federal (Intragovernmental) Entities, Accounts Payable, Line 4.a.(1) on the Statement of Financial Position. These disbursements have not been distributed in detail registers to NRL through the Industrial Fund Centralized Disbursement Reimbursement System. These net disbursements were recorded only in summary registers at the appropriation/subhead level and have not been identified by detail register, amount, or document to validate that they are NRL transactions. Unmatched disbursements of $28,496 thousand were adjusted to Liabilities, Transactions with Non-Federal (Governmental) Entities, Accounts Payable, Line 4.b.(1) and unmatched collections of $3,272 thousand were adjusted to Entities Assets, Transactions with Non-Federal (Governmental) Entities, Accounts Receivable, Net, Line 1.b.(2) on the Statement of Financial Position. These disbursements and collections were made by external Disbursing Offices and are reported in the "unmatched" accounts because they are either not identifiable or have not yet been matched to specific payable or accrual transactions; some may have been charged to NRL in error. Many, once identified, will liquidate Liabilities, Transactions with Non-Federal (Governmental) Entities, Other Non-Federal (Governmental) Line 4.b.(7) on the Statement of Financial Position. See also Note 17.

2. NCCOSC.

a. As part of the BRAC process ongoing consolidations are continuing throughout NCCOSC. The transfer of NCCOSC east coast operations from St. Inigoes, MD to Charleston, SC was completed at the end of FY 1997. The final transfer of east coast operations, from Portsmouth, VA to Charleston, SC, will be completed by the end of FY 1998. NCCOSC

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headquarters was consolidated with its management command, the COMSPAWARSYSCOM; and COMSPAWARSYSCOM operations moved from Arlington, VA to San Diego, CA during FY 1997. While these consolidations are expected to result in lower overall overhead costs, they are not expected to have a significant impact on NCCOSC's overall cost of operations or the assets and liabilities of NCCOSC's NWCF accounts. Costs related to the above BRAC actions are funded by BRAC appropriations made available for those purposes and will be reported in the NWCF financial statements as appropriate.

b. During FY 1996, the COMSPAWARSYSCOM IG investigated (at NISE East's request) financial management practices believed to be irregular. Areas were reviewed and reconciled where it was believed that mishaps had occurred. As a result of the investigation it was determined that approximately $3,000 thousand was charged incorrectly. All mischarges had occurred as a result of NISE East's conversion to DBOF effective FY 1994. All items that were from the current year have been completed. As indicated in Note 27, $77 thousand has been written off in FY 1997 as a prior period adjustment. The remaining $782 thousand of mischarges are part of the Capital Program, and require reprogramming of funds and ASN (FM&C) approval. This request was forwarded to ASN (FM&C) on 26 November 1996. Procedures have been put into place to avoid this situation in the future.

F. Information Services.

1. NAVCOMTELCOM. Cost overruns were not a major problem during FY 1997. NAVCOMTELCOM has directed subordinate activities to effect timely renegotiation before cost of performance has exceeded 75 percent of the funded amount for cost reimbursable orders. When renegotiation failed and funding is exhausted, services have been terminated. The customer and its management command were notified in writing of the planned work stoppage.

2. COMNAVRESFOR. COMNAVRESFOR claimancy acquired the NWCF activity group financial responsibilities on 1 February 1997. All fund balances were transferred over as of this date. Cost overruns were not a major problem during FY 1997. COMNAVRESFOR has directed subordinate activities to effect timely renegotiation before cost of performance has exceeded 75 percent of the funded amount for cost reimbursable orders.

G. Depot Maintenance - Other (Marine Corps).

1. Changes in Reporting Entity. Line 3A (Earned) of the SF 133 Report should match the CFO Statement of Operations and Changes in Net Position Line 2.b Revenue from Sales of Goods and Services, Intragovernmental. Discrepancy is due to new guidance from the Secretary of Defense dated 20 April 1995 which makes Line 2.b reflect Gross Sales instead of Net Sales. This change is to nullify adjustments to Gross Sales for credit given for material returns. Line 14 d. on the SF 133 does not match the Principal Statement's accounts payable because the SF 133 accounts payable includes accrued liabilities.

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2. Other Disclosures:

a. Marine Corps representatives cannot validate the Depot Maintenance - Other (Marine Corps) activity group 1997 Financial Statements and Notes due to inaccuracies reported for Accounts Payable, Other Liabilities, and Net Operating Position on Year-end Closing Statements (FMS 2108), Report on Budget Execution (SF Form 133), and 30 September 1997 NWCF Accounting Report (AR 1307).

b. Depot Maintenance - Other (Marine Corps) activity group was not audited in FY 1996 or FY 1997.

H. Unmatched Disbursements, Negative Unliquidated Obligations, and Aged In-Transit Disbursements.

(in thousands)

Treasury Index Appropriation 4930	September 1997	September 1996	Change	Percent Change
Unmatched Disbursements	$289,887	$424,344	($134,457)	(31.7%)
Negative Unliquidated Obligations	Not Applicable	Not Applicable	-	-
Aged In-Transit Disbursements	$928,225	$1,955,671	($1,027,446)	(52.5%)
Totals	$1,218,112	$2,380,015	($1,161,903)	(48.8%)

NWCF CONSOLIDATED NOTES

Section D

Department of the Navy
Working Capital Fund
Management Representation Letter

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON, D.C. 20350-1000

27 FEB 1998

MEMORANDUM FOR AUDITOR GENERAL OF THE NAVY

Subj: MANAGEMENT REPRESENTATION LETTER FOR FISCAL YEAR 1997 FINANCIAL STATEMENTS OF THE DEPARTMENT OF THE NAVY WORKING CAPITAL FUND (97-0003)

Encl: (1) Identified Procedural and Systemic Deficiencies

This representation letter is submitted in connection with your audit of the Department of the Navy (DON) Navy Working Capital Fund (NWCF) financial statements as of 30 September 1997 and for the year then ended. For the purpose of expressing an opinion on whether the financial statements are presented fairly, in all material respects, in conformity with Federal Financial Accounting Standards, the Department of Defense (DoD) Financial Management Regulation (FMR), or component accounting policy and guidance, we confirm, to the best of our knowledge and belief, the following representations made to the Naval Audit Service (NAVAUDSVC) during their audit:

a. We are responsible for the fair presentation in the Statement of Financial Position, Statement of Operations and Changes in Net Position, and Statement of Cash Flows in conformity with Federal Financial Accounting Standards, the DoD FMR, or component accounting policy and guidance. We are also responsible for the fair presentation of performance measures in accordance with Office of Management and Budget (OMB) requirements.

b. Except as noted, we have made available to the NAVAUDSVC all financial records and related data, including all reports submitted to Department of Treasury and OMB and performance measurement records prepared by the Defense Finance and Accounting Service (DFAS) and Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN(FM&C)). The NAVAUDSVC was precluded from performing substantive testing in various accounts because data was not provided or not provided in a timely manner by DON and DFAS activities.

c. There have been no known:

(1) Irregularities involving management or employees who have significant roles in the internal control structure;

(2) Irregularities involving other employees that could have a material effect on the financial statements or performance measures;

(3) Communications from regulatory, investigative, or other oversight agencies concerning noncompliance with, or deficiencies in, financial reporting practices that could have a material effect on the financial statements or performance measures.

d. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities as reflected in the financial statements.

e. The following have been properly recorded or disclosed in the financial statements:

(1) Related party transactions and related accounts receivable or payable, including assessments, loans, and guarantees;

(2) Arrangements with the Department of Treasury and OMB regarding restrictions on cash balances;

(3) Contingent liabilities;

(4) Unmatched disbursements; and

(5) Other restricted amounts.

f. There are no known:

(1) Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency;

(2) Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by the Statement of Financial Accounting Standards, Number 5, Accounting for Contingencies; or

(3) Material unasserted claims or assessments that our legal representatives have advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards, Number 5, Accounting for Contingencies.

g. All known material transactions have been properly recorded in the accounting records and reflected in the financial statements, except for

(1) There were no pre-utilization discussions of the Fiscal Year (FY) 1997 audit report (97-0003) regarding reported material weaknesses affecting the presentation of the financial statements. There are a number of policy issues raised in previous audits which still have not been addressed by Under Secretary of Defense (Comptroller) (USD(C)). Therefore, DON did not make any adjustments to the FY 1997 column on the FY 1997 NWCF Consolidated Statements.

(2) Values of Military Equipment assets (ships) and accumulated depreciation for assets used by the Transportation activity group, but not owned by the NWCF were not included in the FY 1997 NWCF financial statements. The NAVAUDSVC has previously recommended that USD(C) provide policy and procedures on whether or not Military Equipment should be included in the financial statements of NWCF. The fixed asset value for Military Equipment assets (ships) and accumulated depreciation value of $6,562,370,000 and $1,557,629,000, respectively were disclosed in the Transportation activity group footnotes which support the FY 1997 NWCF Consolidated Financial Statements. The ships are statistically recorded by the Transportation activity group, but not included in their financial statements in accordance with DFAS guidance. This footnote disclosure was inadvertently not included in the footnotes to the FY 1997 NWCF Consolidated Financial Statements.

(3) Meetings among the USD(C), DFAS, NAVAUDSVC and ASN(FM&C) Office of Financial Operations were held to reexamine the procedures used to calculate the inventory value, holding gains and losses, cost of goods sold, and operating results related to the Supply Management activity group. As a result of this reexamination, the financial statements were revised to use the jointly developed procedures. We all recognize that additional work must be done to further refine the procedures used to calculate the cost of goods sold and operating results for the standardization throughout DoD.

h. Provision, when material, has been made to reduce accounts receivable to their estimated net realizable value.

i. Provision, when material, has been made to reduce excess or obsolete inventories in the supply system to their estimated net realizable value. Operating material and supplies held by industrial activities determined to be excess or obsolete have not been reduced to their estimated net realizable value.

j. The NWCF has satisfactory title to all assets and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.

Subj: MANAGEMENT REPRESENTATION LETTER FOR FISCAL YEAR 1997 FINANCIAL STATEMENTS OF THE DEPARTMENT OF THE NAVY WORKING CAPITAL FUND (97-0003)

k. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

l. DFAS is responsible for establishing and maintaining the internal control structure of accounting operations and systems and DON is responsible for internal control of DON feeder systems and funds administrator processes and procedures. There have been no changes to the internal control structure subsequent to 30 September 1997, or other factors that might significantly affect it.

m. We have assessed the effectiveness of the DON's internal control over safeguarding of assets against unauthorized acquisition, use, or disposition, compliance with laws and regulations, and financial reporting, based upon control criteria established under the Federal Manager's Financial Integrity Act of 1982 and the OMB Circular A-123.

n. We are responsible for the DON's compliance with applicable laws and regulations, as promulgated by USD(C) and DFAS.

o. All material intra-governmental transactions and activities have been appropriately recorded and disclosed.

p. There are no known material events or transactions that occurred subsequent to 30 September 1997 that have not been properly adjusted for or disclosed in the notes to the financial statements.

q. We have identified in enclosure (1) significant material deficiencies in: (1) accounting and financial management systems, policies and procedures; (2) internal control structure; and (3) noncompliance of laws and regulations identified during audits of the NWCF.

r. We have responded fully to all inquiries made to us by the auditors during the audit.

Gladys J. Commons

GLADYS J. COMMONS
Assistant Secretary of the Navy
(Financial Management and Comptroller)
Acting

IDENTIFIED PROCEDURAL AND SYSTEMIC DEFICIENCIES

Part 1. Deficiencies In Accounting And Financial Management Systems, And Departures From Published Accounting Policies And Procedures

A. General Ledger Control/Lack Of Uniform Accounting Systems. For the Fiscal Year (FY) 1997 financial statements, preparers had to crosswalk general ledger accounts to the DoD uniform chart of accounts, then crosswalk the Department of Defense (DoD) accounts to the account classifications on the financial statements. This condition exists because the U.S. Government Standard General Ledger accounts have not been incorporated into the Defense Finance and Accounting Service (DFAS) accounting systems.

B. Inadequate Coding Structure. The DoD coding structure within the accounting and financial management systems employed by the Defense Working Capital Fund (DWCF) activities have not been developed to capture and report adequately the data necessary for preparing DWCF financial statements. For example, a coding structure does not exist to capture and report on intrafund eliminations within Department of the Navy's (DON) NWCF primary and secondary activity groups. Also see Part 3, paragraph D below.

C. Lack Of General Ledger Account For Accrued Expenses Other - Federal. Accrued Expenses Other reported under Other Non-Federal (Governmental) Liabilities includes both Non-Federal and Federal liabilities because there is no general ledger account established for Accrued Expenses Other - Federal.

D. Invalid Material-in-Transit (MIT) And Advances And Prepayments, Non-Federal. Invalid MIT and progress payments are created because receipts and disbursements are being posted by different criteria. However, work around procedures are in place to match disbursements recorded at the Contract Line Item Number (CLIN) level with receipts recorded at the CLIN/Subcontract Line Item Number (SLIN) level. New software modules of the Material Financial Control System, Allotment Reporting (PX02) and Expenditure Reporting (PX04) are under development for use to correct the systemic generation of these invalid MIT and progress payments. Additionally, DFAS is responsible for developing a method to provide a detailed payment record by CLIN/SLIN.

E. Lack Of Coding Structure For The Revaluation Of Excess Operating Materials/Supplies, Net. DFAS has been requested by DON to prepare and coordinate the financial and accounting procedures for operating activities and accounting systems to implement the DoD FMR policy regarding the revaluation of excess

Operating Materials and Supplies to its estimated net realizable value. Additionally, the procedures should recognize the NWCF Corporate Board finalization of their review of the policy statement for Miscellaneous and Extraordinary Gains and Losses. Also see Part 3, paragraph B below.

F. Lack Of Coding Structure For Reporting Other Revenues And Financing Sources And Depreciation. DON has requested DFAS to coordinate the financial and accounting procedures for operating activities and accounting systems to provide for the reporting of finance source and expense associated with the use of real property assets not acquired with NWCF resources. DON needs to work with DFAS to resolve this deficiency. Also see Part 3, paragraph C below.

G. Lack Of Coding Structure For Accountability of Stock-in-Transit (SIT). DON is pursuing a system that will provide for accountability of SIT issues and receipts of material pertaining to repair contractors which are non-reporters.

Part 2. Internal Controls

A. Inaccurate Reporting Of Plant, Property And Equipment, Net. Procedures and controls are not adequate to ensure that the value of plant, property and equipment are reported accurately in the financial statements. Plant, property and equipment were not capitalized as required, were not properly depreciated, were missing, and included unsupported costs. Documentation to support the recorded acquisition cost of many older properties is no longer available.

B. Inadequate Accounting For Receivables And Payables. Procedures and controls are not adequate to ensure that required reconciliations, whether performed by DFAS solely or with DON's assistance, are being performed to assure that only valid transactions are recorded and reported. Accounts Receivable for one activity group is based on a computation performed at the summary level using the net of sales and collections, however, there are unofficial subsidiary records held at the activity level.

C. Inaccurate Reporting Of Accrued Expenses Other Reported Under Other Non-Federal (Governmental) Liabilities. Procedures and controls are not adequate to ensure that required reconciliations are being performed to assure that only valid transactions are recorded and reported.

D. Inaccurate Reporting Of Operating Materials/Supplies, Net. Procedures and controls are not adequate to ensure that the MIT balances are accurate; physical inventories are conducted; physical inventories are completed; unused material returned to the appropriate inventory account; excess material disposed of timely; and stock levels reviewed for excesses.

E. Inadequate Accounting For Advances and Prepayments, Non-Federal. DON's procedures and controls are not adequate to ensure accuracy of the Advances and Prepayments, Non-Federal account with regard to performing actual contract reviews to validate account balances. DFAS procedures and controls are not adequate to ensure proper contract close-out, retention of payment vouchers in contract files, and proper recording of progress payment liquidation transactions.

F. Inaccurate Reporting Of Work-in-Process (WIP). Procedures and controls are not adequate to ensure that fixed price order cost overruns are expensed in the period incurred and not retained in WIP.

G. Inadequate Cash Management Controls. Procedures and controls may not be sufficient within DON and DFAS to ensure adequate cash management controls exist to avoid Antideficiency violations. Since some functions having significant impact on cash management (such as recording and reconciling disbursements and collections) are performed by DFAS, DON and DFAS are working together to strengthen cash management controls. Prior to 1 February 1995, the Defense Business Operations Fund (DBOF) cash management and its associated Antideficiency limitations was held at the DoD level. In a memorandum dated 5 January 1995, the USD(C) delegated DBOF cash management responsibilities and its associated Antideficiency limitations to the DoD components composing the Fund. This action effectively merged the component's responsibility for monitoring collection and disbursement transactions and taking actions to correct operational problems with the responsibility for control over the cash balance resulting from the transactions and actions. Cash is managed at the DON level and not in the individual activity groups of the NWCF. Plans are being formulated to record and account for cash at the activity group and activity level during FY 1998. This movement will be contingent upon the development of activity group and activity level accounting/entries by DFAS.

H. Inadequate DoD Guidance For Reporting Sponsored Provided Equipment And Material. Procedures and controls are not adequate to ensure capitalization, prevent duplicative reporting of sponsor provided assets and ensure proper financial presentation by either the sponsor or the NWCF activity. Activities did not capitalize or report these assets because they were not procured

with their fund. DoD guidance concerning reporting of property held for others is not sufficiently clear and is subject to interpretation. DoD Guidance on Form and Content of Financial Statements For FY 1994/1995 and subsequent guidance requires activities to report assets that are held but are not available to the activity as Non-Entity Assets. However, USD(C) directed DON to report a class of sponsor provided equipment as Non-Entity Assets although this equipment was used by the NWCF activities. The definition of Non-Entity Assets in the DoD Guidance on Form and Content of Financial Statements For FY 1994/1995 and subsequent guidance is not clear and conflicts with other guidance. Non-Entity Assets could be interpreted as all assets in the custody of the activity that were not classified as Entity. Additionally, if an item does not meet the characteristics of an asset, as defined by DoD, the item may be financially reportable on the sponsors records which conflicts with the DoD Guidance on Form and Content of Financial Statements For FY 1994/1995 and subsequent guidance. Draft DoD guidance has been provided for review and comment.

I. Inaccurate Financial Statements. The Marine Corps is still experiencing accounting/reporting problems in the Marine Corps segment of the Supply Management activity group. Many of these problems originated with business process changes associated with the consolidation of depot level repairable items in DBOF as of 1 October 1993. The business practices included the co-mingling of NWCF owned and Procurement, Marine Corps (PMC) owned depot level repairable items on the same inventory records. The existing financial systems were not able to accommodate this practice and resulted in distortions in the NWCF reported data. The Marine Corps is addressing this problem by transferring the PMC owned depot level repairable items to the NWCF. In March 1997, the Marine Corps and the DFAS established an Integrated Processing Team to discuss and resolve other financial problems and coordinate and implement new business practices and financial systems. Because of the uncertainty in the inventory and other account balances, the Supply Management (Marine Corps) activity group financial statements and notes could not be validated. In addition, problems with account balances are also being experienced in the Marine Corps segment of the Depot Maintenance activity group. As a result of discrepancies in the balances between activity level data, Accounting Report 1307, and Report on Budget Execution (SF-133), the financial statements for this activity group could not be validated. The Marine Corps and the DFAS are working these problems to ensure certifiable statements and reports in FY 1998.

J. Inadequate DoD Guidance For Reporting Undistributed Disbursements And Undistributed Collections. Values reported in the undistributed disbursement and collection accounts are normally reflected as reductions to the values being reported for Accounts Payable and Accounts Receivable, respectively, to simulate the distribution of the undistributed values. Since the undistributed disbursements and collections accounts contained abnormal values of over $1 billion each, increases of about $1 billion rather than reductions of $1 billion were applied to the Accounts Payable and Accounts Receivable, thus overstating the values reported in the DON NWCF Consolidated Statements for FY 1996. Since significant abnormal balances continue to exist in FY 1997, rather than overstate Accounts Payable and Accounts Receivable again, undistributed disbursements and undistributed collections were reported in Line 1.a.(6), Other Federal Entity Assets, of the Statement of Financial Position pending the completion of the DFAS investigation.

Part 3. Compliance With Laws And Regulations

A. Procedures Not Followed In Financial Statements. Financial statement account balances were overstated or understated because: plant, property and equipment are not always capitalized as required or properly depreciated; DFAS general ledger reconciliations of Accounts Receivable, Accounts Payable and Accrued Expenses Other to subsidiary and source documentation (with DON participation as appropriate) are not always performed; and physical inventories of Operating Materials/Supplies are not conducted or when conducted are incomplete, unused materials are not returned to the appropriate inventory account, and stock levels are not adequately reviewed to determine excesses.

B. Procedures Not Followed For Reporting Excess Operating Materials/Supplies, Net. The financial statements are overstated because excess Operating Materials/Supplies, Net are not reduced to their estimated net realizable value. Also see Part 1, paragraph E above.

C. Procedures Not Followed For Reporting Other Revenues And Financing Sources And Depreciation. The financial statements are understated because the financing source and corresponding depreciation expense received from the use of real property assets are not being recognized. Also see Part 1, paragraph F above.

D. Improper Reporting Of Intrafund Transactions. Intrafund transactions have been identified and eliminated from the NWCF Consolidating Financial Statements for FY 1997. Intrafund transactions have also been eliminated from the NWCF Consolidated

Financial Statements for FY 1997. Intrafund transactions, however, have not been identified and eliminated from the supporting individual primary and secondary activity group financial statements because data is not readily available in the financial systems supporting the NWCF. There is footnote disclosure that until standard USD(C) DWCF policy for the treatment of intrafund elimination transactions is issued and DFAS implementing procedures and controls are provided, the data disclosed may not meet the intent of the DoD Guidance on Form and Content of Financial Statements for FY 1997 Financial Activities. DoD is pursuing the development of techniques to eliminate the impact of intrafund transactions in the financial reports, but does not anticipate that the capability will be available soon. Also see Part 1, paragraph B above.

E. Cut-off Dates. Financial information presented in the financial statements is not as of 30 September for all activity groups. The current reporting due dates require virtually all supply activities to close their "books" prior to 30 September. Financial reporting deadlines provide insufficient time to effect corrections and, therefore corrections are processed and reported in subsequent reporting periods.

Section E

Department of the Navy
Working Capital Fund
Legal Representation Letter

GENERAL COUNSEL OF THE NAVY
WASHINGTON, D.C. 20350-1000

January 21, 1998

MEMORANDUM FOR THE AUDITOR GENERAL OF THE NAVY

Subj: LEGAL REPRESENTATION LETTER FOR THE FISCAL YEAR 1997 YEAR-END DEPARTMENT OF THE NAVY WORKING CAPITAL FUND FINANCIAL AUDIT

Ref: (a) Auditor General of the Navy ltr 7540/97-0003 dtd 31 Oct 97

Encl: (1) DoN AGC (Litigation) memo dtd 15 Jan 98 with encl
(2) Office of Counsel, NAVFAC memo dtd 15 Jan 98
(3) Acting Counsel, NICP, memo dtd 9 Jan 98 w/encl

This responds to your request in reference (a) for a legal representation letter for use by auditors to corroborate information furnished by management with respect to litigation, claims, assessments and contingencies in connection with your examination of the Fiscal Year 1997 Department of the Navy Working Capital Fund Financial Statements.

As General Counsel of the Department of the Navy, I have general supervision of the legal affairs of the Office of the Navy General Counsel. In this capacity, I have completed a review of litigation and claims threatened or asserted involving the fund to which Office of the General Counsel lawyers devoted substantial attention in the form of legal consultation or representation. This review reflects a threshold of materiality of $100 million applied to individual and aggregate claims, litigation, assessments, or contingencies arising out of a single event or series of events, and includes matters that existed at 30 September 1997, and from that date through the present.

Subject to the foregoing and to the last paragraph of this memorandum, I advise you that during the period specified above, neither I, nor any of the lawyers over whom I exercise general legal supervision, have given substantive attention to, or representation, involving the fund in connection with material loss contingencies coming within the scope of clause (a) of paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, **except for the matters reported in enclosures (1), (2) and (3).**

The information set forth herein is as of the date of this memorandum and covers matters that existed through the period stated, and I disclaim any undertaking to advise you of changes which thereafter may be brought to my attention or to the attention of the lawyers over whom I exercise general legal supervision.

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975). Without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of paragraph 6 of the ABA Statement of Policy, this will confirm as correct the Department's understanding that whenever, in the course of performing legal services for the Department with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, I have formed a professional conclusion that the Department of the Navy must disclose, or consider disclosure, concerning such possible claim or assessment, then I, or one of the lawyers over whom I exercise general legal supervision, as a matter of professional responsibility to the Department of the Navy, will consult with the Department's managers concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.

Steven S. Honigman

Copy to:

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

Appendix C. Audit Process

Audit Work Performed. To fulfill our responsibilities under Public Law 101-576, the "Chief Financial Officers Act of 1990," as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," we performed oversight of the independent audit conducted by the Naval Audit Service (NAS) of the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996. Our purpose was to determine whether we could rely on the NAS audit. We reviewed the NAS audit approach and planning and monitored the the progress of the audit at key points, which included reviewing key working papers and summaries supporting the Naval Audit Service conclusions.

Reviewing the NAS Audit Approach. We used the "Federal Financial Statement Audit Manual," January 1993, issued by the President's Council on Integrity and Efficiency, and the "Financial Audit Manual," December 12, 1997, issued by the General Accounting Office, as the criteria for reviewing the NAS audit approach. We reviewed the notification letter, formulation of strategy, entity profile, general risk analysis, cycle memorandums, and audit plans and programs. Statisticians in the Quantitative Methods Division, Office of the Assistant Inspector General for Auditing, DoD, reviewed and approved the NAS sampling plan for the Navy Working Capital Fund Financial Statements for FYs 1997 and 1996. The plan called for statistical sampling of 9 line items and analytical review of 14 line items at 42 statistically selected activities of the Navy Working Capital Fund We also participated in NAS conferences that included audit planning and formulation of strategy, as well as presentations on issues that developed during the NAS work.

Monitoring Audit Progress. Through the DoD Financial Statement Executive Steering Committee and Integrated Audit Process Team, we provided a forum for a centrally managed exchange of guidance and information leading to a focused DoD-wide audit of the DoD Consolidated Financial Statements, including the supporting financial statements of major DoD Components. We performed on-site reviews of the implementation of the NAS audit program for the nine statistically sampled line items at five audit locations. As much as possible, we performed the audit along with the NAS auditors to ensure that the audit steps for each sample item were accurately executed. We also reviewed and commented on NAS draft audit reports, including the audit opinion report. We reviewed additional documentation, including working papers and summaries of NAS audit results and conclusions. Observations from our oversight and field work were traced to the draft audit report to ensure the accurate compilation of audit results.

Audit Period and Standards. We performed this financial statement audit from August 27, 1997, through February 27, 1998, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Statisticians in the Quantitative Methods Division, Office of the Assistant Inspector General for Auditing, DoD,used statistical sampling procedures to identify the sites where we performed oversight.

Contacts During the Audit. We visited or contacted individuals and organizations in the DoD audit community. Further details are available on request.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
  Director, Defense Finance and Accounting Service Cleveland Center

Non-Defense Federal Organizations and Individuals

Inspector General, Department of Education
Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information and Technology, Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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