DEPARTMENT OF THE NAVY

ANNUAL FINANCIAL REPORT

FISCAL YEAR 1997

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

February 1998

MESSAGE FROM THE SECRETARY OF THE NAVY

During the past year, Navy and Marine Corps forces were heavily involved in providing presence worldwide and responding to a variety of crises. We expect little diminution in the level of activity for the foreseeable future. At the same time, the Department of the Navy must prepare to meet the challenges of the next century. The high tempo of current operations places a premium on recruiting and retaining high quality Sailors and Marines and maintaining a high level of force readiness. On the other hand, developing and procuring the numbers and types of forces and capabilities we require for the future requires increases in funding for research, development, and acquisition. To do both within anticipated spending levels, we must reduce the costs of all our operations and of the infrastructure that supports them.

The Department of the Navy has an aggressive program to reduce costs on all fronts. Within our operating forces, initiatives such as the Navy's "Smart Ship" program are designed to rapidly identify labor-saving technologies which will reduce maintenance requirements, manning and operating costs. The Marine Corps Warfighting Lab and the Navy's at-sea Fleet Battle Experiments explore future concepts and doctrine that will make our forces more efficient, effective, and capable. The cost of operating shore bases is being reduced through the application of technology in the "Smart Base" initiative and the elimination of redundancy and excess capacity through regionalization of base management and maintenance operations. Business processes such as civilian personnel management are being reengineered for greater efficiency. Headquarters staffs are being streamlined. Acquisition reform is reducing the cost of acquiring new systems. We are leveraging our resources by partnering with the private sector to provide family housing.

The Financial Management community plays two key roles in these efforts. First, managers throughout the Navy and Marine Corps depend on financial information to assist them in making sound decisions that will reduce the cost of operations and free funds for modernization and readiness. Second, the cost of financial operations themselves must be reduced. In partnership with the Defense Finance and Accounting Service (DFAS), the Department is taking steps to meet both challenges. These changes also will enable us to meet the reporting requirements of the Chief Financial Officers' Act and to produce accurate financial statements for our external stakeholders, but their most important contribution will be the information they enable us to provide to managers within the Department.

Much remains to be done to reach the goals of government-wide financial management reform. We are committed to staying the course, however, and we have made considerable progress in the past year. I solicit the support and understanding of Congress and the public for the steps necessary to complete the process.

John H. Dalton

John H. Dalton

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

February 1998

MESSAGE FROM THE ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT & COMPTROLLER)

This is the second year that the Department of the Navy (DON) has prepared financial statements for its general funds to meet requirements of the Chief Financial Officers' (CFO) Act . As I noted last year, when we began efforts to meet CFO Act requirements, we knew we would be unable to comply fully for several years. Many long-standing deficiencies in accounting and feeder systems and in management controls have to be eliminated. This year, in partnership with the Defense Finance and Accounting Service (DFAS), the DON has made progress on all fronts.

<u>Accounting Systems</u>. We completed movement of the Navy's general funds to our interim migratory system—Standard Accounting and Reporting System, Field Level—from the legacy systems supporting the Operating Forces, activities in Europe, and Major Commands. As a result, the Department will have virtually all appropriated funds accounted and reported in a single system by the end of Fiscal Year 1998. All appropriated funds provided to the Marine Corps were accounted for in their interim migratory system, the Standard Accounting, Budget, and Reporting System. Future efforts are focused on making these systems compliant with the Federal Financial Management Improvement Act of 1996.

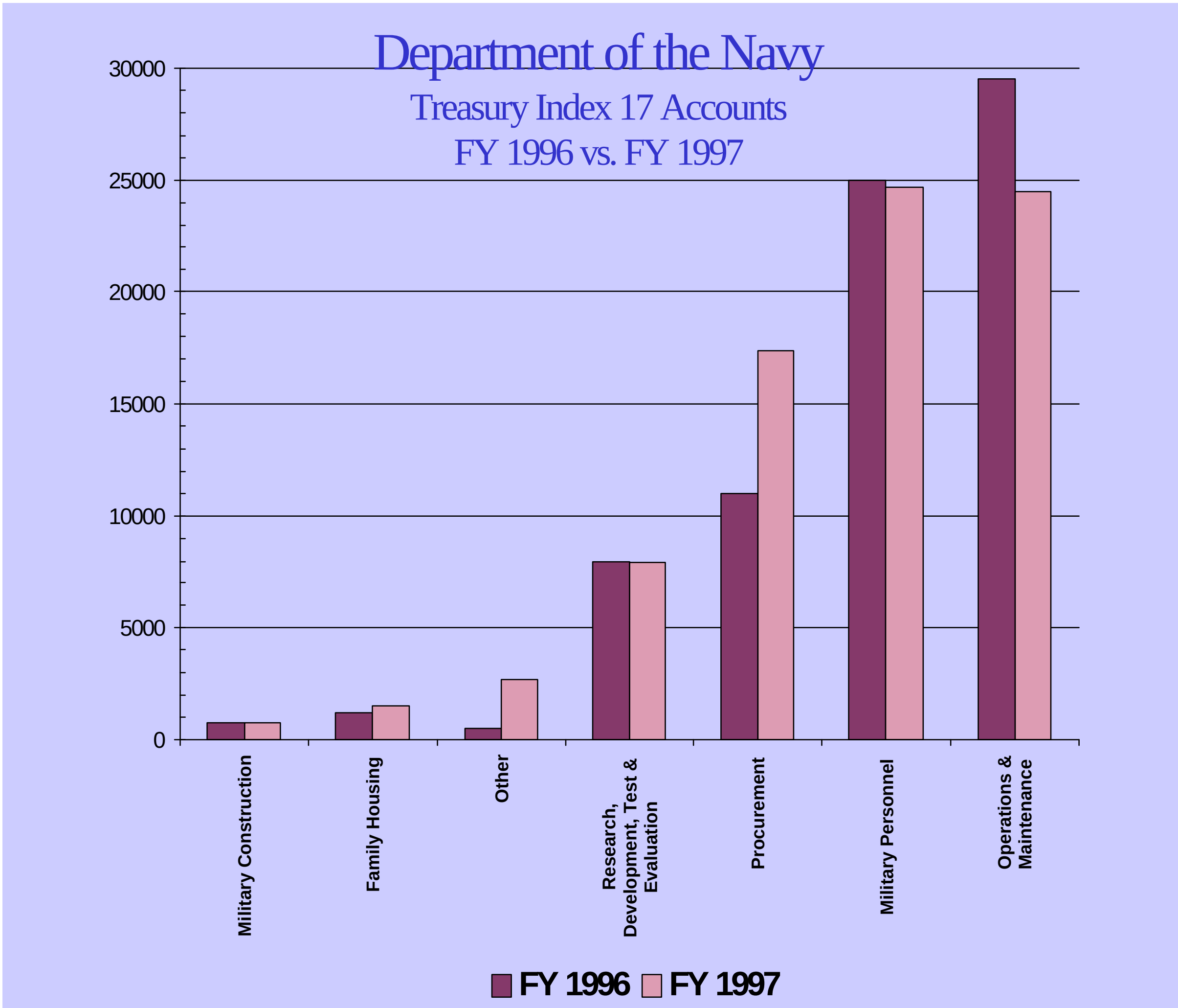
<u>Feeder Systems</u>. The DON made significant progress in identifying the mission essential feeder systems, which must interface with the Department's interim migratory accounting systems. Future efforts are directed towards defining the information required from these systems and developing the necessary interfaces to have a fully compliant general ledger based system.

<u>Management Controls</u>. This year, the Department focused on improving the accuracy, timeliness, and utility of financial and management information. For example, the Installation Management Accounting Project will provide Commanding Officers base support cost data for making resource allocation decisions. The Department is eliminating paper from its processes through initiatives such as increasing the number of users on FASTDATA, a system which increases the accuracy and timeliness of recording financial events in the accounting system. In conjunction with use of the Government purchase card, the Department is deploying a card management system that permits cardholders to record their purchases, transmit obligation and payment information electronically, and perform account reconciliation more efficiently.

Managers throughout the DON recognize the importance of financial information both for reporting to Congress and the American people and to permitting efficient operations. The financial management community is committed to providing timely, accurate and complete information to both customers.

Deborah P Christie

Deborah P. Christie



The above chart represents the amounts expended for the Department of the Navy appropriations listed below.

	Treasury Account Number					
Military Construction	1205	1235				
Family Housing	0703					
Other	0380	1236	3980			
Research Development Test and Evaluation	1319					
Procurement	1109	1506	1507	1508	1611	1810
Military Personnel	1105	1108	1405	1453		
Operations and Maintenance	1106	1107	1804	1806		

DEPARTMENT OF THE NAVY

OVERVIEW

"NAVAL POWER: *PROJECTED FORWARD DEPLOYED* AROUND THE WORLD"

Introduction

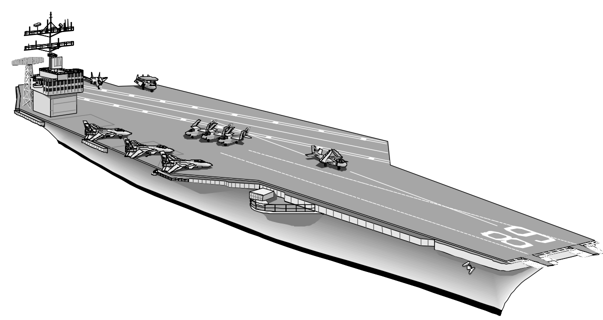
This year marks the Department of the Navy's (DoN) second year for developing its annual financial report for general funds, in compliance with the Chief Financial Officers' (CFO) Act. The Department was proud to have undertaken and completed this task in a timely manner for the first time last year. It was because of the combined effort and joint interest demonstrated by the Navy and Marine Corps, that this undertaking was a success. We continue with the same resolve this year, and the content of this report reflect the teamwork exhibited by the competent people who work in the financial departments within these organizations.

The Annual Financial Statements and Supplemental information provide the financial condition and operating results of the Department's major programs. The Overview section provides a narrative discussion with charts/graphs to highlight actual FY 1997 performance of these programs in the critical mission areas of readiness, recapitalization, people, quality of life and technology. In May 1997, the Quadrennial Defense Review (QDR) was published in compliance with the Military Force Structure Review Act, addressed in the National Defense Authorization Act for Fiscal Year 1997. The Department of Defense designed the QDR to be a fundamental and comprehensive examination of America's defense needs into the next century, addressing potential threats, strategy, force structure, readiness posture, military modernization programs, infrastructure, and other elements of the defense program. The QDR is intended to provide a blueprint for a strategy-based, balanced, and affordable defense program. The QDR identifies DoD corporate goals that will help shape future mission areas and performance measures to be reported in subsequent Department of the Navy Annual Financial Statements.

HIGHLIGHTS OF THE DEPARTMENT OF THE NAVY MISSION AND PROGRAM PERFORMANCE

The Navy Department was established by an act of Congress on April 30, 1798 (I Stat. 553; 5 U.S.C. 411-12). The act provided for the office of the Secretary of the Navy and for the office of the accountant of the Navy, subordinate to the Secretary. A corps of Marines having its headquarters in the Navy Department under the Secretary was authorized by an act of Congress on July 11, 1798. Historically, it was the Continental Congress which actually established both the first Navy as the *Continental Navy*, and two battalions of Marines as the *Continental* M*arines* in 1775. The Congress set up a Naval Committee and later a Marine Committee, to administer naval affairs and to build and equip warships.

During this early colonial period, the Navy's mission was conducted aboard warships known as *privateers*, which were privately owned vessels usually operating on independent missions. Eventually, the Navy grew from a few sailing ships in the Revolutionary War to the greatest fleet ever to sail the seas. Its history recounts the changes from sails and cannon to nuclear powered ships and guided missiles. It blazes with the achievements of such historic ships as USS *Bonhomme Richard*, *Constitution*, *Monitor*, *Olympia*, *Enterprise* and the *Nautilus*, the world's first nuclear-powered warship.



By 1776, the *Continental Marines* were ready for their first expedition, when 277 Marines sailed under the command of Captain Samuel Nicholas, from Philadelphia to New Providence Island (Nassau) in the Bahamas. Captain Nicholas landed his battalion, took the British fort, and captured powder and arms for General George Washington's army. Over the span of 222 years, the Marine Corps has never failed to answer the Nation's call. Its Battle Colors call to mind the glory, sacrifice and accomplishments of Marines in Tripoli, Belleau Wood, Tarawa, Iwo Jima, Inchon, Vietnam and Desert Storm. It is this unbroken legacy of honor, courage and commitment that has produced our nation's unwavering confidence in the famous dispatch, "The Marines have landed and the situation is well in hand."

Naval history tells of John Paul Jones, whose battle cry, "I have not yet begun to fight," established the Navy's fighting traditions. It includes the achievements of James Lawrence, who rallied his men with the historical words, "Don't give up the ship!" It reflects the deeds of David G. Farragut, the Navy's first hispanic admiral, who reportedly bellowed, "Damn the torpedoes! Full speed ahead!" It includes leaders such as Chester W. Nimitz, who directed the Pacific fleet in its sweep from Pearl Harbor to Tokyo Bay, and who said of the Marine members of the Naval warfighting team on Iwo Jima, "Uncommon valor was a common virtue."

The Department of the Navy, as authorized by the National Security Act of 1947, is composed of the "… the Department of the Navy at the seat of government; the headquarters, United States Marine Corps; the entire operating forces of the United States Navy… and the reserve components of such forces; all field activities, and functions under the control or supervision of the Department of the Navy…" The broad missions of the Navy and Marine Corps are set forth in the Act as follows:

> The Navy, as a component of the Department of the Navy, "shall be organized, trained, and equipped primarily for prompt and sustained combat incident to operations at sea. It is responsible for the preparation of naval forces necessary for the effective prosecution of war except as otherwise assigned and is generally responsible for naval reconnaissance, antisubmarine warfare and protection of shipping."
>
> The Marine Corps, as a component of the Department of the Navy, "shall be organized, trained and equipped to provide fleet marine forces of combined arms, together with supporting air components, for service with the fleet in the seizure or defense of advance naval bases and for the conduct of such land operations as may be essential to the prosecution of a naval campaign. In addition, the Marine Corps shall provide security detachments for the protection of naval property at naval stations and bases, and shall perform such other duties as the President may direct."
>
> The Secretary of the Navy, as the head of the Department of the Navy, "is responsible for the policies and control of the Department of the Navy, including its organization (except as otherwise prescribed in law), its administration, operation and efficiency."

The Secretary exercises his authority, direction, and control, through the Chief of Naval Operations and the Commandant of the Marine Corps, of their forces not specifically assigned to the combatant commanders. This administrative control provides for the preparation of naval forces and their administration and support, unless such responsibilities are specifically assigned by the Secretary of Defense to another component of the Department of Defense. Thus, the authority vested in the Secretary of the Navy in the performance of his role to organize, train, equip and provide forces runs from the President through the Secretary of Defense through the Secretary of the Navy and to the Chief of Naval Operations and the Commandant of the Marine Corps.

DEPARTMENT OF DEFENSE CORPORATE GOAL

Provide a flexible, ready and sustainable military force structure capable of conducting joint operations to execute the national military strategy.

FORWARD FROM THE SEA

Today's Navy and Marine Corps Team is capable of projecting U.S. policy forward from the sea anytime, anywhere, with an inventory of 358 battle force ships at the end FY 1997 and over a half-million people on active duty and in the reserves. Approximately 50 percent (178) of those ships are underway; and 33 percent (117 ships and 60,422 personnel) of ships underway are forward deployed. Similarly, approximately 23,300 Marines (23% of the Fleet Marine Forces) are forward deployed at any given time. Naval forces are on station and ready, in a fully joint and combined manner, to lead and participate in unilateral, bilateral and fully combined operations whenever and wherever our Nation requires them. Because we are forward deployed, our Nation can call upon these ships, aircraft and personnel without the need for surge from the United States and without the need for permission to base them on foreign soil. Rapid response, significant force, visible presence - these are all important contributions of Naval forces, Navy and Marines, positioned forward. They provide ready examples of America's power and America's character, reassuring other nations without firing a shot. Contingency operations continue to demonstrate our ability to respond to a major crisis on short notice and underscore the benefits of a forward deployed presence.

The Department of the Navy continues to support U.S. Government efforts to reduce supply of illicit drugs entering the country. Regular and reserve Navy and Marine Corps aircraft, ships and unique sensors contributed to detection and monitoring missions in the transit zone. During FY 1997, naval forces assisted the U.S. Coast Guard with interdiction operations and provided a wide range of domestic support that included training and the use of facilities, equipment and personnel.

Overview

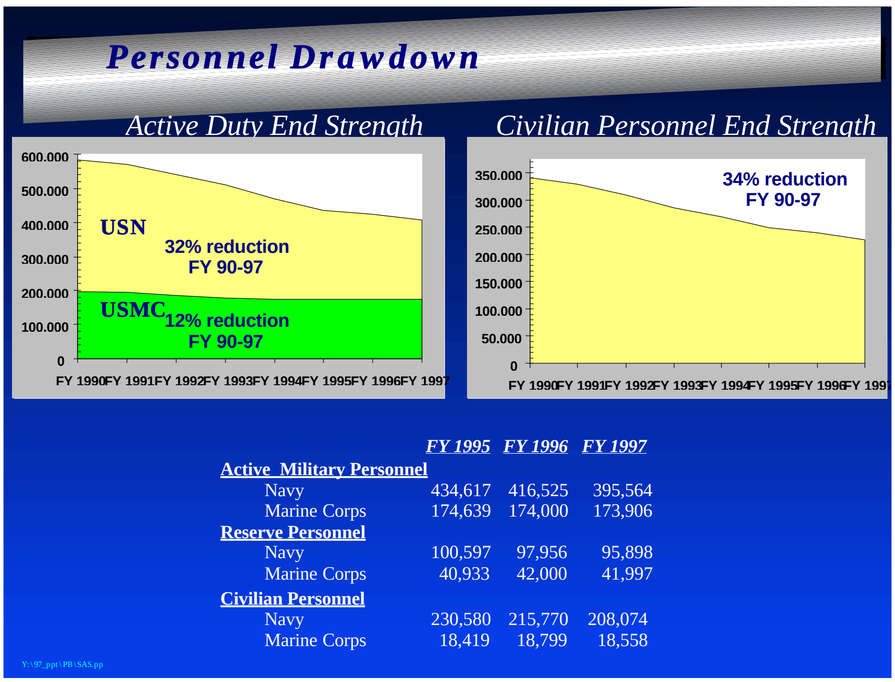
In addition, regular and reserve Marine Corps units provided operational support to the combatant commanders-in chief and drug enforcement agencies participating in counterdrug forces throughout the Continental U.S. as well as the Caribbean.

In recent times, Naval units have conducted humanitarian missions in the countries of Bosnia-Herzegovina, Cuba, Liberia, Somalia, Haiti, Rwanda and Kenya. These operations provided humanitarian support, noncombatant evacuations, relief efforts and in the instances such as Haiti, restored democracy and rebuilt that nation. For many people in these countries, the sight of Navy and Marine Corps personnel was a beacon from the sea. For example, during FY 1997, the USS Kearsarge (LHD 3), transporting Sailors and the 22nd Marine Expeditionary Unit, successfully conducted an evacuation of 2,500 civilians from 40 different nations in Sierra Leone (including more than 360 Americans), in *Operation Noble Oblelisk*.

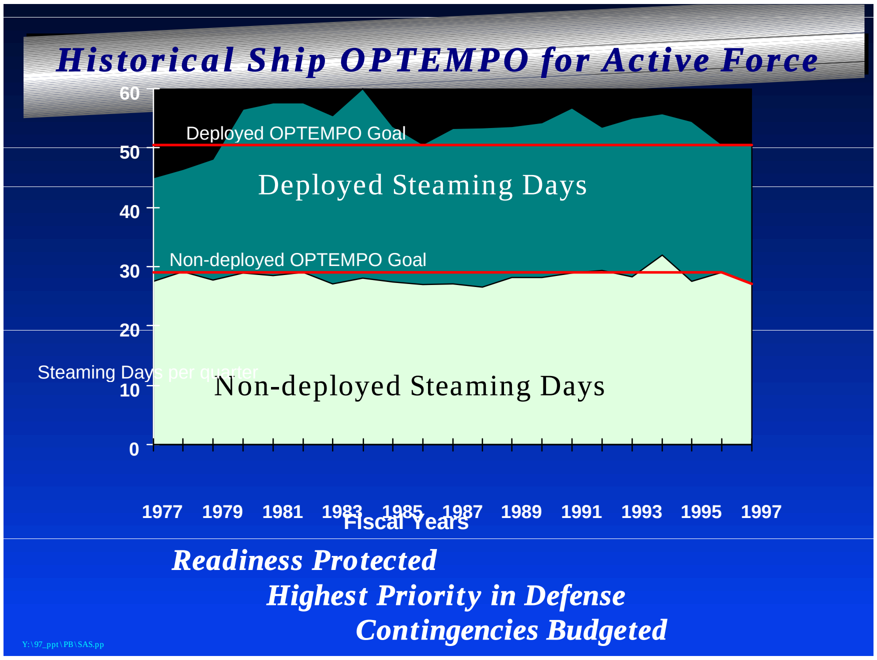
Shaping The Force

During 1997, the Navy and Marine Corps' active end strength kept in line with previously specified downsizing goals for the forces. The force size of the Navy at the end of FY 1997 of 395,564 in active duty personnel represents 56,297 Officers, 335,267 Enlisted, and 4,000 Midshipmen; and the total Navy Reserve personnel was 95,898, which consists of selected and individual reservists. The current force of 173,906 active duty Marines and 41,997 Marine Corps Reserve end strength is already at a steady state.

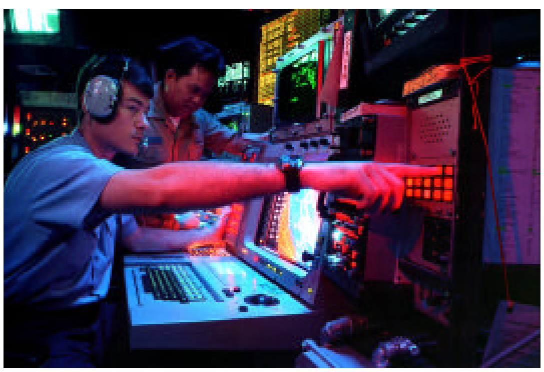
Department of the Navy civilian staffing continues to keep pace with overall rightsizing objectives, with an actual end strength decline from 234,569 in FY 1996 to 209,410 at the end of FY 1997. Civilian employees represent about 26 percent of our total work force end strength. Forty-nine percent of the Department's civilians work at Navy Working Capital Fund activities supporting depot level maintenance and repair of ships, aircraft, and associated equipment, development of enhanced warfighting capabilities at the Warfare Centers of Excellence, and direct fleet communications, supply, and public works support. Personnel transactions of Navy Working Capital Fund civilian personnel are reflected in the Navy Working Capital Fund's annual report. A significant number of civilians funded directly by operations and maintenance appropriations provide direct fleet support at Navy and Marine Corps bases and stations world-wide. The balance provide essential support in functions such as training, medical care, and the engineering, development and acquisition of weapons systems, all of which are necessary for long-range readiness and achieving recapitalization.



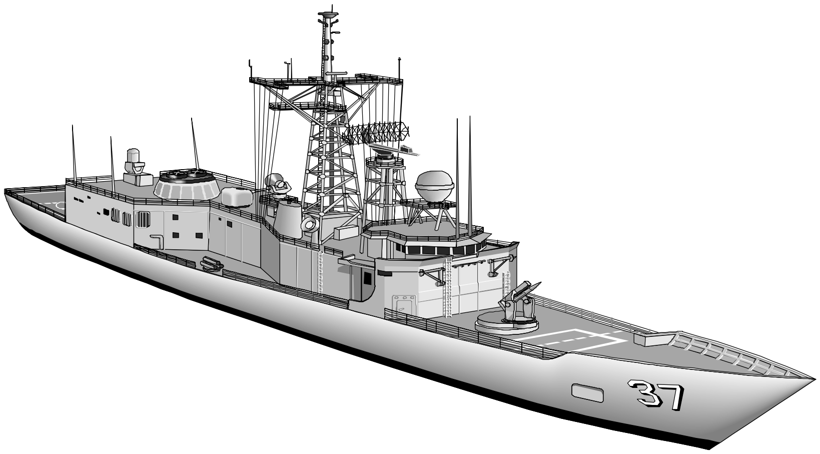
Ship and Aircraft OPTEMPO



Ship operations underway time is budgeted and measured by ship operating tempo (OPTEMPO). Ship OPTEMPO represents the average number of underway days per quarter for ships operating in the deployed (5th Fleet, 6th Fleet and 7th Fleet) operating areas and the non-deployed (2nd Fleet and 3rd Fleet) operating areas. The Department OPTEMPO performance measure goal for ships is 50.5 underway days per quarter for deployed forces and 28 underway days per quarter for non-deployed forces. The actual days deployed for ships during FY 1997 were 53.8 and 28.4 for non-deployed. Deployed operations are budgeted to maintain highly ready forces,

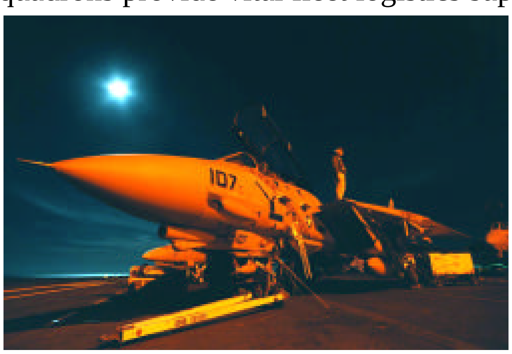


prepared to operate jointly to perform the full spectrum of military activities , and to meet forward deployed operational requirements and overseas presence commitments in support of the National Military Strategy. Non-deployed fleet OPTEMPO provides primarily for the training of fleet units when non deployed, including participation in individual unit training exercises, multiunit exercises, joint exercises, refresher training and various other training evolutions. Non-deployed Fleet OPTEMPO levels are considered the minimum required for maintaining a combat ready and rapidly deployable force.



The Naval Reserve provides an extensive inventory of manpower and equipment that augment active force operations. Ship, aircraft and individuals integrate into the active force for exercises and contingencies, thereby relieving active units and personnel from these commitments. Reserve ships and aircraft, especially at the dedicated E-2 reserve surveillance squadron, perform critical counter-narcotics operations.

Naval aviation is divided into three primary categories: tactical air (TACAIR), fleet air support and fleet readiness squadrons. Fleet Navy and Marine Corps tactical aircraft squadrons conduct strike operations against a wide range of threats identified in the national strategy and provide long range and local protection against airborne and surface threats. Fleet air support squadrons provide vital fleet logistics support. Fleet readiness squadrons provide the necessary training to allow pilots to become proficient in a specific type of aircraft prior to fleet operations. The TACAIR/antisubmarine warfare (ASW) requirement for active flying hours is based on the number of crews assigned to a squadron. Each crew is funded at a specific level of primary mission readiness (PMR) to achieve the overall active Navy goal of 85% PMR with an additional 2% of PMR achieved through simulator usage.



Department of the Navy Flying Hour Program	**(Actual) FY 1996**	**(Actual) FY 1997**
Active		
TACAIR Primary Mission Readiness (%) 1/	85%	75%
Fleet Readiness Squadrons (%)	97%	89%
Fleet Air Support (%)	92%	81%

1/ Includes 2% simulator contribution		
	FY 1996	**FY 1997**
Reserve		
Primary Mission Readiness (%) 1/	87%	85%
1/ Includes 0.25% simulator contribution		

Mission Capable Rates		
	1996	**1997**
Aircraft:		
Navy and Marine Corps Tactical/Antisubmarine Warfare	70.6%	*68.6%
Ships:		
Battle Forces	67.1%	*69.3%
Support Forces	93.7%	*92.3%

Objective: For tactical aircraft, attain mission capable rates of 73%; for ships, attain the specified percentage of operating time free of C-3/C-4 casualty reports.
Measure: Percent of time that naval aircraft and ships are mission capable.
Definition: For tactical aircraft, number of mission capable hours in the year, divided by the total in-service hours for tactical aircraft. An aircraft is mission capable if it can perform at least one of its assigned primary missions. For ships, the amount of equipment percentage of operating time free of C-3/C-4 casualty reports in the year, divided by the total amount of equipment operating time for these ships. Battle forces include aircraft carriers, surface combatants, combat logistics force ships, amphibious ships, and mine warfare ships. Support forces include mobile logistics and fleet support ships. Percentage of operating time free measures the amount of time during a fiscal year that ships did not report any critical mission degrading equipment casualty reports. Material casualty reports indicate degradation to equipment and systems which cannot be repaired in a timely manner by ship's force due to a lack of onboard spares or the inability to effect repairs because of ongoing operations, ship repair capability, or lack of technical expertise.
* Rates are actual numbers for 3/4 of FY 1997. Fourth quarter data was unavailable as of report date.

Equipment Readiness Indicators	1996	1997
Navy Deployed Units	92%	93.7%
Marine Corps (Ground)	92.3%	93.9%

Navy

Objective: Maintain deployed units at either C-1 or C-2 in the equipment resources area for 90% of the time they are deployed

Measure: Percent of time deployed units were C-1 or C-2 in the equipment resources area.

Definition: Percent of time for deployed units that total combat essential equipment on-hand and combat ready exceeded 70% of prescribed wartime requirements , major end items of equipment on-hand and combat ready exceeded 70% of prescribed wartime requirement and total aircraft on-hand and operationally ready exceeded 60% of prescribed wartime

Marine Corps

Objective: Attain 94% "R" rating (equipment on hand that is mission capable). For Marine Corps, percentages are calculated for all Fleet Marine Force (FMF) units (to include active, reserve, and newly active units) on all ground equipment listed in a Marine Corps bulletin, 3000 series. This equipment provides a realistic portrayal of a unit's capability to perform its

Measure: Percent of equipment in readiness condition.

Definition: Equipment possessed minus equipment deadlined, divided by equipment possessed.

Training Readiness Indicators - Navy (Actual)	1996	1997
Navy Deployed Units	95%	94.8%

Objective: Maintain deployed units at either C-1 or C-2 in the training resource area 90% of the time they are deployed

Measure: Percent of time deployed units were C-1 or C-2 in the training resource area.

Definition: Percent of time for deployed units that less than four weeks training was required to fulfill type commander requirements and the percent of assigned aircrews that were combat ready and available exceeded 70% of aircrews and the percent of unit training completed exceeded 70% of type commander requirements.

Overview

Marine Corps Readiness

The Marine Corps is organized as a "force-in-readiness" to support national needs. It is divided into three broad categories: Operating Forces; Reserves; and Supporting Establishment. Operating Forces, considered the heart of the Marine Corps, constitute the forward presence, crisis response and fighting power available to the combatant commanders-in-chief. The primary objective of the Marine Corps, as a Naval expeditionary force, is to provide combatant commanders-in-chief with an effective means of dealing with existing and future threats, providing as it does forward-deployed units that are inherently balanced, sustainable, flexible, responsive, expandable and credible. Marine Corps operating forces are the nation's "cocked pistol--the force that remains ready to fight Tuesday's battle, on Tuesday, with Tuesday's forces." Marine Air-Ground Task Forces (MAGTFs) are the organization through which Marine forces are tailored to meet specific operational requirements. Depending upon the mission for which they are structured, they may include a wide range of combat power, including infantry, tanks, amphibious assault vehicles, light armored vehicles, artillery and aircraft. Marine Air-Ground Task Forces range in size from small special purpose units to large Marine expeditionary forces. Each Marine Air-Ground Task Force is an integrated combined-arms team, and regardless of size is composed of a command element, a ground combat element, an aviation combat element and a combat service support element.

Overall Unit Status Indicators - Marine Corps		
Overall C(*) Level Assessments -	**1996**	**1997**
Marine Corps (Marine Expeditionary Units/Unit Deployment Plan)	100%	100%
*(C ratings = combat rating)		
Objective: Attain 100% of deployed units (Marine Expeditionary Units/Unit Deployment Program) at C-1 or C-2. Measure: Percent of deployed units that are at C-1 or C-2 at time of deployment. Definition: Number of deployed units (Marine Expeditionary Units/Unit Deployment Program) at C-1 or C-2, divided by the total number of deployed units.		

In addition to active forces, force expansion is also augmented by the activation of the Marine Corps Reserve, which, like the active forces, consists of combined arms forces with balanced ground combat, aviation combat and combat service support units. The reserve provides the individuals and specific units to augment and reinforce active capabilities.

Significant Manpower Factors-	1996	1997
Active MILPERS (End Year)	**(590,735)**	**(568,470)**
Navy	416,525	395,564
Marine Corps	174,883	173,906
Reserve MILPERS (End Year)	**(140,189)**	**(137,895)**
Navy	*98,112	*95,898
Marine Corps	42,077	41,997

Objective: Attain planned force structure and military personnel
Measure: Size of force structure and level of military personnel
Definition: Compare actual numbers to the planned requirements, and determine the difference.

* Actual numbers for FY 96 & FY 97. Does not include NROTC numbers.

Significant Force Factors- (end of FY 1997)	1996	1997
Battle Force Ships	**(357)**	**(358)**
Aircraft Carriers	11	11
Reserve Operational Carriers	1	1
Fleet Ballistic Missile Submarines	17	17
Surface Combatants	115	115
Nuclear Attack Submarines	80	80
Amphibious Ships	40	41
Combat Logistics Ships	41	41
Patrol/Support/Mine Warfare	35	35
Reserve Ships	17	17
Strategic Sealift Ships	**(18)**	**(18)**
Prepositioning Ships	1	1
Maritime Prepositioning Force	13	13
Aviation Logistics Support Ships (T-AVB)	2	2
Hospital Ships (T-AH)	2	2
Tactical Air Forces	**(13/2)**	**(13/2)**
Aircraft Wings (Active/Reserve) - USN	10/1	10/1
Aircraft Wings (Active/Reserve) - USMC	3/1	3/1
Tactical Aircraft*	**(1808/375)**	**(1796/375)**
Aircraft (Active/Reserve) - USN	962/190	962/190
Aircraft (Active/Reserve) - USMC	846/185	834/185
*(Total average operating aircraft)		
Marine Corps Divisions	**4**	**4**
Active	3	3
Reserve	1	1

Strategic Surge Capability - Prepositioned Material Ashore -	1996	1997
Marine Corps		
Number of Sites	6	6
Short Tons	26,160	26,160

Objective: Meet or exceed the Prepositioned material at the FY 1994
Measure: Level of Prepositioned material maintained.
Definition: The Prepositioned material for the fiscal year, divided by the Prepositioned material in FY 1994.

Strategic Sealift Capability		
Sealift Capacity (SqFt in millions)-	**1996**	**1997**
Navy:		
Afloat Prepositioning Program	4.0	4.0
Current Prepositioning Program	3.0	3.0

Objective: Meet the Sealift capacity in the mobility requirements study (MRS) and MRS Bottom Up Review (BURU).
Measure: Percent of strategic Sealift capacity achieved, compared to the requirements established by the MRS and MRS BURU.
Definition: Compare the actual or projected program capacity to the required capacity for the given category in the given fiscal year.

Amphibious Shipping Capability -		
Marine Expeditionary Brigades (Lift	**1996**	**1997**
Troops	2.55	2.74
Vehicle Squared	1.88	2.05
Cargo Cubed	3.09	3.33
Air Spots	2.78	3.03
LCAC Spots	3.25	3.38

Objective: Meet or exceed the 2.5 Marine Expeditionary Brigade (MEB) goal in all five lift categories for active amphibious lift.
Measure: Percent of active amphibious shipping versus the 2.5 MEB
Definition: Divide the MEBs of lift in each category by 2.5.

DEPARTMENT OF DEFENSE CORPORATE GOAL

Recruit and retain well qualified military and civilian personnel and provide them with equal opportunity and a high quality of life.

QUALITY PEOPLE

The Department's readiness depends on the ability to attract and retain high quality people. While challenging, 1997 was a highly successful year for Navy and Marine Corps recruiting. Navy and Marine Corps recruiters achieved 100 percent of their enlisted accession goal through targeted marketing. The strategy successfully procured qualified individuals for particular skill areas needed most in the Fleet and Fleet Marine Forces, while achieving significant progress in recruiting minorities. Minority accessions will be the most representative in the Department's history. Although low national unemployment and other changes in demographics combined to create a tough recruiting environment, the academic quality of enlisted recruits remained high; 95 percent possessed a high school diploma and more than 66 percent scored in the upper half of the Armed Forces Qualification Test.

Officer recruitment was also successful, with nearly all programs attaining 100 percent of their goal. Medical recruiting accepted 36 percent more physicians and dentists than a year ago. Similar increases were achieved for pilots and Naval flight officers.

For the Marine Corps, the propensity to enlist remained constant. This was largely attributable to an effective advertising program. An increase in the direct mail budget realized a 25 percent rise in contacts. The Internet also proved to be a useful low cost source of leads and contacts. Continued improvements include an expanded and enhanced area canvassing effort through event partnerships with youth oriented programs. Maintaining a quality force is a key element of overall readiness, and retention of our Sailors and Marines is a critical component. We have many tools available to accomplish this, such as special pays and bonuses which are targeted for those skills most costly to replace. For example, the Selective Reenlistment Bonus (SRB) program is the Navy and Marine Corps' most cost effective tool for increasing or maintaining the retention of high quality people and highly technical skills. The Special Duty Assignment Pay (SDAP) has been used to attract high quality volunteers into the most demanding and responsible billets. These bonuses, special pays and other programs such as Nuclear Officer Incentive Special Pay, Aviation Continuation Pay, and Medical Officer Incentive Special Pay, are also essential tools for ensuring our future inventory of Navy and Marine Corps officers will meet diverse and highly technical requirements.

Enlisted Reenlistments (Actual)		
First Term Reenlistments - FY 1997	**1996**	**1997**
Navy	11,954	12,311
Marine Corps	4,300	4,615
Career Reenlistments - FY 1997	**1996**	**1997**
Navy	27,172	27,254
Marine Corps	9,461	8,871

Objective: Attain 100% of planned enlisted first term and career reenlist.
Measure: Number of enlisted first term and career reenlistment versus plan.
Definition: Compare the number of enlisted first term and career reenlistment to the plan, and determine the difference.

Enlisted Accessions-FY 1997 (Actual)		
	1996	**1997**
Navy:		
Active	48,206	50,135
Reserve	16,820	16,820
Marine Corps:		
Active	33,495	34,548
Reserve	10,513	10,744

Objective: 100% of planned enlisted accessions.
Measure: Number of enlisted accessions versus planned budget year.
Definition: Compare the number of enlisted accessions to the planned budget year , and determine the difference.

Nonprior Service Recruits			
Active Duty Nonprior Service Recruits - FY 1997		**1996**	**1997**
With High School Diploma	Navy	95.1%	95.1%
	Marine Corps	96.3%	96.3%

Objective: Maintain a 95% rate of high school graduates from the top half aptitude segment (Categories I-IIIU) in the nonprior service recruiting category.

Measure: Percent of nonprior service recruits that are high school graduates and are classified in the top half aptitude segment of American youth (Armed Forces Qualification Test Categories I-IIIU).

Definition: Number of nonprior service recruits with high school diplomas who are Category I-IIIU, divided by the total number of nonprior service recruits.

Overview

Maintaining Quality of Life

The most vital resource of the Navy-Marine Corps team is our people—active, reserve, and civilian. The intense demands of a modern, high technology naval force operating in a complex foreign littoral environment requires highly motivated, well-trained and responsibly-led Sailors and Marines. The daily sacrifices of our people, who are deployed around the globe to ensure the security of the United States, deserve the best possible career and family support. Wise investment of resources in people and their families will maintain the Navy-Marine Corps team as the world's preeminent naval force and will ensure the Department of the Navy enters the 21st century on a solid foundation.

While it is imperative that our Naval forces are well trained and equipped, it is equally important that we maintain the highest possible quality of life for our personnel and their families. We continue to use private sector assets to the greatest extent possible to house our personnel. This allows us to build housing in areas without adequate private sector developments. In 1996, Congress passed the Family Housing Revitalization Act, which authorized public/private venture authority. This authority allows the Department of Defense to contract with the private sector for construction of housing. The Department of the Navy has benefited from this legislation with construction of housing units at Corpus Christi, Texas, Brownsville, Texas, and Everett, Washington.

We are also committed to meeting the needs of our single Navy and Marine Corps member. Funding has been earmarked specifically for single members' programs such as pier-side laundry facilities and secure parking and storage for deployed personnel.

Another critical workforce issue is quality child care at affordable prices. We have reviewed several options to meet the growing child care demand such as contracting for spaces in qualifying off-base civilian centers, expanding Family Child Care to include off-base residences, enhancing our Resource and Referral Program, encouraging school-age care partnerships, and obtaining wrap-around contracts with local providers.

We are also committed to providing a full range of community and family support services for our family members. These services help prepare family members for the challenges of frequent relocations, major life transitions, employment opportunities, deployments and mobilizations. One of the most important facets of individual and family support continues to be the spiritual services supplied by our Chaplain Corps for numerous religious and counseling programs.

Child Care - Navy			
Child Care Spaces - FY 1997	**Potential Need***	**Goal***	**Actual****
Child Development Centers (ages 0-5)	-------	-------	13,972
Family Child Care (ages 0-5)	-------	-------	12,426
Out-sourced (Civilian Contracts)			633
School Age Care (ages 6-12)	-------	-------	12,006
Total	**74,197**	**48,228**	**39,037**

Objective: Attain 100% of the goal (65% of potential need).
Measure: Number of child care spaces available versus what is planned for the fiscal year.
Definition: Compare the number of child care spaces to the plan, and determine the difference.

*Goal/Potential Need for children ages 0-5 is determined by the total program, and not broken out by child development centers/family child care (36,421/56,032).
*Goal/Potential Need for school age care (6-12) is determined by the total program, and not broken out by centers/family child care (11,807/18,160).
**Actual figures are based on the most recent NC15 submission (97).

Child Care - Marine Corps			
Child Care Spaces - FY 1997	**Potential Need**	**Goal**	**Actual****
Marine Corps Child Care Spaces			
Child Development Centers Spaces			4,923
School Age Spaces			593
Total			**5.516**
Family Child Care Spaces			-------
On-base (other than Centers)			4,494
Resources and Referral Spaces in off-base facilities			216
Total	**23,400**	**15,210**	**4,710**

Objective: Attain 100% of the goal. (65% of potential need)
Measure: Number of child care spaces available versus what is planned for the fiscal year.
Definition: Compare the number of child care spaces to the plan, and determine the difference.
**"Actual" is derived from the Quarterly Summary of Child Development Program Operation report.

Meeting Medical Needs

The Department of the Navy is committed to providing the highest quality health care to active duty, family members and retired service members and their families in support of its primary mission of readiness. This means keeping people on the job, at sea and ashore, by providing medical services close to operations and by moving information-instead of patients-whenever possible. Navy medicine's strategic plan, Journey to Excellence: Meeting the Challenges of the Future, will help guide us in meeting our primary mission of readiness. This strategic plan describes the means for reengineering the approach to medicine and health care services, particularly through the development of measurable data. Navy medicine is developing performance indicators that are specific, measurable, accountable, realistic, and time-phased. The annual planning process aligns the department with the Government Performance and Results Act; supports TRICARE (the Department of Defense's managed health care system) and makes strategic planning a part of our culture.

The need to keep faith with the armed forces' retired community with regard to medical benefits requires constant vigilance. We are also continuing to work with the Department of Defense in support of the recently enacted legislation which authorizes a three year subvention demonstration project that permits a limited number of dual-eligible Medicare beneficiaries to enroll in TRICARE Prime at selected military treatment facilities.

Supporting Equal Opportunity

The Department of the Navy is fully committed to ensuring our personnel are provided a working environment which promotes success. Through leadership, training, education, and mentoring, the Department offers all hands the opportunity to succeed by providing an environment that recognizes the dignity and unique qualities of all. The Navy equal-opportunity vision statement is a foundation of this environment, supplemented by our increased emphasis on our core values of honor, courage and commitment. Leadership is the key, and through several initiatives, we are providing policy guidance to assist leaders in identifying and eliminating discrimination, as well as in removing artificial barriers to advancement. This includes the Navy and Marine Corps' Equal Opportunity Manuals, various equal opportunity conferences and a stern warning by the Secretary of the Navy against naval personnel involvement in extremist or supremacist group activities.

The Department has continued in its efforts to identify and eliminate sexual misconduct by supporting a top-level standing committee on military and civilian women. We have added more fleet equal-opportunity billets and have provided command-managed equal opportunity officers or equal opportunity advisors to all commands. Toll-free advice lines, as well as victim/witness assistance programs, have been established at installations, offering full access to counseling, advocacy, and other community support services. We will continue developing and refining our policies and initiatives in order to eliminate discrimination and sexual harassment from our ranks.

Table 1: Overall Department of the Navy Numbers (as of 9/97)

	Women	**Men**	**Total**
Active-duty Personnel	54,879	379,608	**434,487**
Enlisted Personnel	46,835	327,867	**374,702**
Officers	8,044	51,741	**59,785**
Reserve Personnel	17,221	80,735	**97,956**
Enlisted Personnel	13,806	63,570	**77,376**
Officers	3,415	17,165	**20,580**

Recent changes have opened many new positions to women. More than 94 percent of all Navy billets and 93 percent of all Marine Corps occupational specialties are now available to women.

Overview

Today, the most senior women in the active-duty military, enlisted and officer, are Marines. The Department of the Navy also is continuing its support of the "Enhanced Opportunities for Minorities Initiative (12/12/5)" , to achieve cultural diversity within the Navy and Marine Corps. The goal is to reach an accession level of 12% African American, 12% Hispanic, and 5% other minorities by the year 2005. This would create an officer corps that is reflective of American society and our enlisted force by the year 2025. Although the goals of this initiative will take a number of years to achieve, the impact will have a lasting and positive effect on the future of our Navy, Marine Corps, and the country.

Table 2: Navy Women Aboard Ship (as of 9/97)		
	Women on Ships	**Women on Combatants (including Airwings)**
Officers	847	463
Enlisted Personnel	8107	3614
Personnel on ships	8954	4077

All new Navy surface ships are now designed to incorporate berthing for officer and enlisted women including *USS Benfold (DDG 65),* the first U.S. Navy ship built from the keel up with habitability modifications necessary for full integration of women into the crew.

Table 3: Navy Women in Aviation (as of 6/97)			
Total Women Pilots	229	Student Aviators	0
Total Naval Flight Officers	86	Student Naval Flight Officers	48
Enlisted	9344	Student Pilots	92

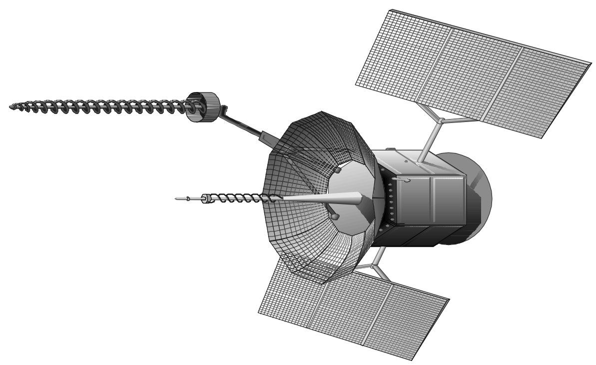
DEPARTMENT OF DEFENSE CORPORATE GOAL

Maintain U.S. qualitative superiority in key warfighting capabilities (e.g., information warfare, logistics).

TECHNOLOGY

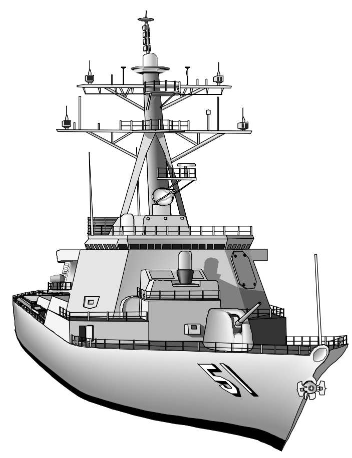
Events of the past year clearly demonstrate we live in an uncertain world that requires naval forces to meet a wide range of contingencies. Through a combination of innovation and modernization, the Department of the Navy is building and maintaining naval forces ready to meet those contingencies. The Department of the Navy is exploiting the explosive changes occurring in high technology to conceive and build new and more capable platforms and weapons systems for the future.

Modernization



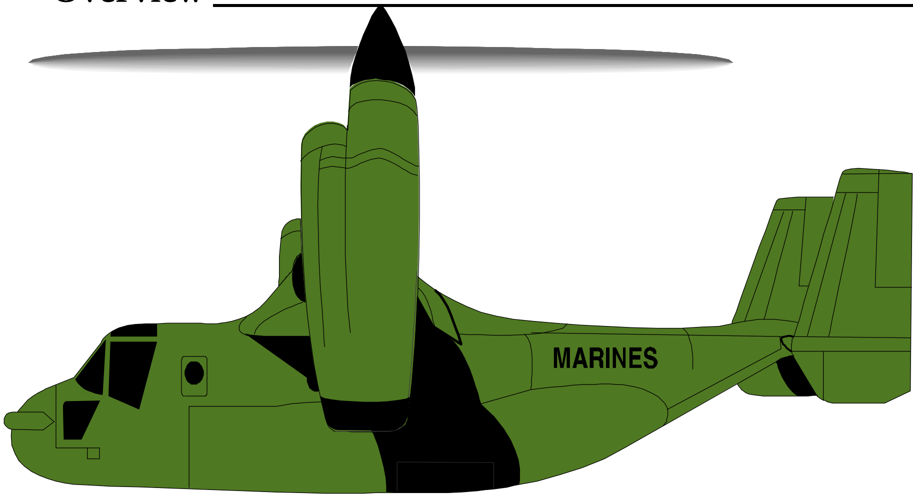
Economic conditions dictate we take advantage of emerging technologies to breathe new life into some of our older systems and platforms or tie together disparate systems to synergize the whole. Capability upgrades to current ships, naval tactical aircraft and various weapons systems all are critical parts of the modernization program. Continued upgrades of our ultra high frequency, super high frequency, extremely high frequency, and commercial satellite communications capabilities are necessary to enhance the support and integration of joint/combined operations.

Acquisition Management



The Department of the Navy is investing today in the platforms, equipment and infrastructure necessary for success in the future. Our approach relies on an acquisition investment strategy that maximizes our scarce procurement dollars without compromising quality or losing critical capabilities. This strategy must capture the cutting edge of technology to guarantee the continued operational primacy of our Navy and Marine Corps team. The Department of the Navy's acquisition investment strategy makes the most of scarce procurement dollars without compromising quality. It also emphasizes that future programs must produce survivable multi-mission platforms and weapons systems - true force multipliers - capable of meeting a great variety of mission requirements. Current programs such as the *USS Arleigh Burke (DDG-51)* - class destroyer, DD/SC21, and others like the CVN-77, LPD 17, the Osprey (MV-22) tilt-rotor aircraft, the Super

Overview



Hornet fighter/attack aircraft (F/A-18E/F) and the Advanced Assault Amphibious Vehicle (AAAV) will help to ameliorate this effect and are critical parts of Navy and Marine Corps future readiness.

Deterrence and Conflict Prevention

Ballistic missile submarine (SSBN) deterrence patrols will continue to be an essential element of U.S. strategy for deterring a wide range of potential threats. SSBNs are central to U.S. nuclear strategy due to their stealth and survivability, the reliability and security of their command and control systems, and the accuracy and flexibility of their weapons.

DEPARTMENT OF DEFENSE CORPORATE GOAL

Reduce costs and eliminate unnecessary expenditures across all DoD missions areas by employing modern management tools and working closely and effectively with other government agencies, Congress and the private sector.

EFFICIENT - EFFECTIVE MANAGEMENT

Initiatives To Improve Efficiency

Today's fiscal realities clearly call for efficient and responsible use of our precious resources. The Department of the Navy (DoN) has been steadfast in its efforts to scrutinize every aspect of our operations, infrastructure, and methodology for efficiencies and cost savings. The DoN is also capitalizing on emerging technologies, employing lessons learned from other successful Defense programs, and implementing acquisition policies that stabilize our out-year procurement funding. These efforts are building a foundation for our future success. In conjunction with the National Performance Review, recommendations from the Commission on Roles and Missions of the Armed Forces and other related activities, the Department of the Navy continues to pursue innovative ideas to increase efficiency. The Department is learning a great deal from private industry and has undertaken several major initiatives, including delegation of waiver authority, designation of reinvention laboratories, reduction of cycle time, acquisition reform and continued implementation of the Government Performance and Results Act.

All these initiatives seek to reengineer key management processes so the nation will receive the best return for invested defense dollars. The Department's overall objective is to provide high quality, cost effective, combat ready forces.

Base Realignment And Closure Strategy

With the Congressional approval of Base Realignment and Closure (BRAC) I through IV, the Department's focus is on implementing all of its BRAC-related efforts. BRAC II costs have been revised and reflect the near completion of the BRAC II program. Of the 36 bases covered by BRAC II, 35 completed operational closure or realignment by the end of FY 1997. To date, 149 of the 178 scheduled closure/realignment actions have been completed. The Department continues its efforts to implement BRAC actions and experience the savings that will become available through the remaining closures and realignments. The prompt and efficient closure of excess shore infrastructure generated savings of approximately $2.114 billion in FY 1997 that can be applied to modernizing naval forces and supporting infrastructure.

Base Realignment and Closure

($ in Millions)

		FY 1996	FY 1997
Costs			
BRAC II		**423.0**	**99.3**
BRAC III		**1,570.0**	**775.7**
BRAC IV		**509.0**	**397.6**
	Total	**$2,502.0**	**$1,272.6**
Savings			
BRAC II		**638.0**	**649.0**
BRAC III		**680.0**	**985.0**
BRAC IV		**559.0**	**480.0**
	Total	**$1,877.0**	**$2,114.0**

Post-Base Closure Strategy

Beyond the significant savings to be attained through closure and realignment of bases, additional efficiencies are targeted in operation of the remaining bases. The key to this is the comprehensive integration of shore requirements with new business practices and improved organizational approaches. Shore infrastructure requirements have been carefully analyzed to ensure that remaining shore capacity is used to best support current and projected force structure.

FINANCIAL MANAGEMENT ISSUES AND ACCOMPLISHMENTS

Consolidation of Finance and Accounting Operations

- With the establishment of the Defense Finance and Accounting Service (DFAS) in January 1991, the functions of finance and accounting were capitalized and transferred from the Departments of the Army, Navy, Air Force, Defense Logistics Agency and other related organizations, into a single Department of Defense agency. In May 1994, DFAS initiated its plans to streamline finance and accounting operations by consolidating over 300 field activities into 17 DFAS Operating locations and the five DFAS Centers. During fiscal year 1997, both the Navy and Marine Corps consolidation of finance and accounting operations for their field activities were completed in the months of March and August respectively .

Consolidation of Accounting Systems

- In the Department of the Navy, we have made significant strides in consolidating the number of inventoried systems and data bases that support of finance and accounting. The results are as follows:

  STARS-FL (Standard Accounting & Reporting System - Field Level)
  We have consolidated 11 appropriated field accounting systems into a single system i.e., STARS-FL. During fiscal year 1998, consolidation of 2 remaining systems and their associated appropriations (Reserve Personnel, Navy and Military Construction) will complete the original DFAS consolidation plan for general fund appropriations.

  STARS-HCM (Standard Accounting & Reporting System - Headquarters Claimant Module)
  During fiscal year 1997, 1 system was consolidated into STARS-HCM. By mid fiscal year 1998, 2 additional systems which are scheduled to be consolidated into STARS-HCM will increase the number to 3 systems. These 3 systems, which have run on at least 11 operational data bases, will be reduced to only 1 operational data base in STARS-HCM.

Strengthening Financial Accounting Systems

- Reduction of Problem Disbursements - The Department of the Navy continues on a downward trend to reduce the number of problem disbursements over 180 days old . Problem disbursements consist of specific disbursements such as in-transits, unmatched disbursements and negative unliquidated obligations, that have not correctly matched with corresponding obligations, or have exceeded the amount of recorded obligations. From a starting value of $9.6B back on 30 September 96 to $6.1B by 30 September 1997, the Department has seen nearly a 40% reduction in its overaged problem disbursements. Several key factors attributing to the overall reduction of problem disbursements in the Department of the Navy include such things as implementing prevalidation procedures by the Defense Finance and Accounting Cleveland Center for high dollar invoices and/or 97 contract fiscal years in STARS-

HCM, and for reimbursable payments in STARS-FL. In addition, through the means of automated system routines, STARS-HCM can obligate up to $1K of major command's available funds in order to quickly eliminate low dollar but high volume negative unliquidated obligation transactions; and unmatched problem disbursement transactions are recycled through STARS-FL at the end of the month to clear out those which can be properly matched . Further, the Department issued revised guidance for its fund holders to record obligations in the applicable accounting system and/or to report accounting corrections to Defense Finance and Accounting Service for overaged problem disbursements. Fundholders were also encouraged to utilize discontinuance of research procedures for their problem disbursements in cases where research efforts have failed due to the lack of documentation or if it has been determined additional research would not be cost effective.

- The Fund Administration and Standardized Document Automation (FASTDATA) System - FASTDATA is a tool used by many Navy activities in conjunction with STARS-FL to manage their source data and funding at the lowest levels of their organizations. These activities experience fewer difficulties with problem disbursements because it captures source data when the transactions are initiated and submits that source data to STARS-FL. Since FY 1996 when ASN(FM&C) assumed sponsorship for FASTDATA from DFAS, the Navy has promoted additional use of this source data system. In FY 1998, implementations are planned within Europe, and the shore operations of the Operating Forces.

Implementation of Electronic Commerce/Electronic Data Interchange

- Card Technology - Throughout the Department of the Navy, streamlined procurement of micro-purchases is being achieved by placing government purchase cards in the hands of the end users of goods and services. Purchase cards allow organizations to go directly to vendors rather than going to government procurement offices.

  To assist in monitoring purchases made with the card, automated management and reconciliation systems are being made available to cardholders to allow them to record details of each of their transactions. Within the Navy, the Express Purchase system, developed by the Space and Naval Warfare Systems Center, also includes functionality to electronically transmit obligation and payment information to accounting and bill paying systems. This feature accomplishes several things. It reduces the data entry workload of both Navy financial personnel and DFAS vendor pay staffs by eliminating the need to enter individual accounting lines into these systems. Data entry errors are also reduced, as the accounting lines associated with each cardholder's transactions are coded into Express Purchase when the system is initially deployed. In addition, these interfaces help to reduce delinquent payments to the contractor bank by ensuring that sufficient funds are obligated to meet pre-validation criteria.

DEPARTMENT OF THE NAVY

PRINCIPAL STATEMENTS

PRINCIPAL STATEMENTS

The Department of the Navy's FY 1997 Principal Statements are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6, Chapter 6. The statements present the overall financial position and operating results of the Department for the fiscal year ending September 30, 1997.

The following statements are included in the Department of the Navy's Principal Statements.

- Statement of Financial Position
- Statement of Operations and Changes in Net Position
- Statement of Cash Flows, Revolving Funds only

The principal statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of the Chief Financial Officers Act of 1990 as amended by the Government Management Reform Act.

The footnotes should be considered an integral part of the principal statements.

Limitations of the Financial Statements:

While the statements have been prepared from the books and records of the entity in accordance with the format prescribed by the Department of Defense, the statements are different from the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources 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 Defense
Department of the Navy
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)	$58,009,408	$64,801,567
(2) Investments, Net (Note 4)	8,610	7,532
(3) Accounts Receivable, Net (Note 5)	3,134,834	1,928,010
(4) Interest Receivable		
(5) Advances and Prepayments		66,579
(6) Other Federal (Intragovernmental) (Note 6)		
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Investments, Net (Note 4)		297
(2) Accounts Receivable, Net (Note 5)	2,526,405	4,360,849
(3) Credit Program Receivables/ Related Foreclosed Property, Net (Note 7)		
(4) Interest Receivable, Net		
(5) Advances and Prepayments	4,786,022	202,972
(6) Other Non-Federal (Governmental) (Note 6)		
c. Cash and Other Monetary Assets (Note 3)		51,339
d. Inventory, Net (Note 8)	43	44
e. Work in Process (Note 9)	6,208	5,277
f. Operating Materials/Supplies, Net (Note 10)		27
g. Stockpile Materials, Net (Note 11)		
h. Seized Property (Note 12)		
i. Forfeited Property, Net (Note 13)		
j. Goods Held Under Price Support and Stabilization Programs, Net (Note 14)		
k. Property, Plant and Equipment, Net (Note 15)	334,588,778	340,975,064
l. War Reserves	54,589,962	41,441,075
m. Other Entity Assets		74
n. Total Entity Assets	$457,650,270	$453,840,706
2. Non-Entity Assets:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Fund Balance with Treasury (Note 2)	($327,502)	($572,625)
(2) Accounts Receivable, Net (Note 5)	30,768	117,075
(3) Interest Receivable, Net		
(4) Other (Note 6)		

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
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)	$5,363	($26,673)
(2) Interest Receivable, Net	0	
(3) Other (Note 6)		
c. Cash and Other Monetary Assets (Note 3)	150,956	65,316
d. Other Non-Entity Assets		
e. Total Non-Entity Assets	($140,415)	($416,907)
3. Total Assets	$457,509,855	$453,423,799
LIABILITIES		
4. Liabilities Covered by Budgetary Resources:		
a. Transactions with Federal (Intragovernmental) Entities:		
(1) Accounts Payable	($27,956)	$2,547,156
(2) Interest Payable		
(3) Debt (Note 16)		
(4) Other Federal (Intragovernmental) Liabilities (Note 17)	146,089	302,605
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	3,165,383	6,461,703
(2) Accrued Payroll and Benefits		
(a) Salaries and Wages	1,204,622	250,455
(b) Annual Accrued Leave		
(c) Severance Pay and Separation Allowance	215,959	405,939
(3) Interest Payable		
(4) Liabilities for Loan Guarantees (Note 7)		
(5) Lease Liabilities (Note 18)		
(6) Pensions and Other Actuarial Liabilities (Note 19)		
(7) Other Non-Federal (Governmental) Liabilities (Note 17)	40,007	40,253
c. Total Liabilities Covered by Budgetary Resources:	$4,744,104	$10,008,111

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
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	$210,920	$0
(2) Debt (Note 16)		
(3) Other Federal (Intragovernmental) Liabilities (Note 17)	6,070,000	
b. Transactions with Non-Federal (Governmental) Entities:		
(1) Accounts Payable	2,301,880	
(2) Debt (Note 16)		
(3) Lease Liabilities (Note 18)		
(4) Pensions and Other Actuarial Liabilities (Note 19)	1,476,455	$2,161,377
(5) Other Non-Federal (Governmental) Liabilities (Note 17)	1,178,739	1,148,870
c. Total Liabilities Not Covered by Budgetary Resources	$11,237,994	$3,310,247
6. Total Liabilities	$15,982,098	$13,318,358
NET POSITION (Note 20)		
7. Balances:		
a. Unexpended Appropriations	$59,026,537	$60,976,097
b. Invested Capital	393,702,842	382,395,684
c. Cumulative Results of Operations	14,656	(12,421)
d. Other	21,716	56,328
e. Future Funding Requirements	(11,237,994)	(3,310,247)
f. Total Net Position	$441,527,757	$440,105,441
8. Total Liabilities and Net Position	$457,509,855	$453,423,799

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
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	$62,037,966	$56,535,616
2. Revenues from Sales of Goods and Services		
a. To the Public	905,244	54,478
b. Intragovernmental	4,215,988	6,645,888
3. Interest and Penalties, Non-Federal	703	616
4. Interest, Federal	566	580
5. Taxes (Note 21)		
6. Other Revenues and Financing Sources (Note 22)	910,190	4,426
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	703	
8. Total Revenues and Financing Sources	$68,069,954	$63,241,604
EXPENSES		
9. Program or Operating Expenses (Note 23)	$62,025,670	$56,466,260
10. Cost of Goods Sold (Note 24)		
a. To the Public	835,391	48,515
b. Intragovernmental	4,215,988	6,672,509
11. Depreciation and Amortization		176
12. Bad Debts and Writeoffs	71,728	78,600
13. Interest		
a. Federal Financing Bank/Treasury Borrowing		
b. Federal Securities		
c. Other	8,745	237
14. Other Expenses (Note 25)	6,978,812	
15. Total Expenses	$74,136,334	$63,266,297
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	($6,066,380)	($24,693)
17. Plus (Minus) Extraordinary Items (Note 26)		
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($6,066,380)	($24,693)

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
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	$440,105,441	$443,232,471
20. Adjustments (Note 27)	0	(1)
21. Net Position, Beginning Balance, as Restated	$440,105,441	$443,232,470
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(6,066,380)	(24,693)
23. Plus (Minus) Non Operating Changes (Note 28)	7,488,696	(3,102,336)
24. Net Position, Ending Balance	$441,527,757	$440,105,441

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
Statement of Cash Flows (Indirect Method)
For the Period Ended September 30, 1997 (Revolving Funds Only)
(Thousands)

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	$0	$0
Adjustments Affecting Cash Flow:		
2. Appropriated Capital Used	0	0
3. Decrease (Increase) in Accounts Receivable	754,755	(511,597)
4. Decrease (Increase) in Other Assets	(932)	0
5. Increase (Decrease) in Accounts Payable	(490,490)	21,673
6. Increase (Decrease) in Other Liabilities	0	0
7. Depreciation and Amortization	0	0
8. Other Unfunded Expenses	0	0
9. Other Adjustments	0	0
10. Total Adjustments	$263,333	($489,924)
11. Net Cash Provided (Used) by Operating Activities	$263,333	($489,924)
CASH FLOWS FROM INVESTING ACTIVITIES		
12. Sale of Property, Plant and Equipment	$0	$0
13. Purchase of Property, Plant and Equipment	0	0
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	$0	$0
CASH FLOWS FROM FINANCING ACTIVITIES		
20. Appropriations (Current Warrants)	$1,393,480	$1,024,220
21. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	0	0
22. Deduct:		
a. Withdrawals	849,641	954,357
b. Transfers of Cash to Others	0	0
23. Net Appropriations	$543,839	$69,863

The accompanying notes are an integral part of these statements.

Department of Defense
Department of the Navy
Statement of Cash Flows (Indirect Method)
For the Period Ended September 30, 1997 (Revolving Funds Only)
(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	0	0
28. Other Borrowings and Repayments	0	0
29. Net Cash Provided (Used) by Financing Activities	$543,839	$69,863
30. Net Cash Provided (Used) by Operating, Investing and Financing Activities	$807,172	($420,061)
31. Fund Balance with Treasury, Cash, and Foreign Currency, Beginning	1,846,072	2,266,133
32. Fund Balance with Treasury, Cash, and Foreign Currency, Ending	$2,653,244	$1,846,072

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.

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The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE NAVY

NOTES TO THE PRINCIPAL FINANCIAL STATEMENTS

Footnotes

Note 1. Summary of 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, as required by the Chief Financial Officers Act of 1990 expanded by the Government Management Reform Act of 1994 (Public Law 103-356), and other appropriate legislation. This report encompasses the financial activities of both the U.S. Navy and the U.S. Marine Corps herein referred to as the Department of the Navy. The financial statements are prepared from the books and records of the Department in accordance with the Department of Defense Financial Management Regulation Volume 6, Chapter 6, as adopted from the Office of Management and Budget (OMB) Bulletin No. 94-01, "Form and Content of Agency Financial Statements," and the applicable portions of OMB Bulletin 97-01. These statements, therefore, are different from the financial reports, also prepared by the Department of the Navy pursuant to OMB directives, that are used to monitor and control the Department of the Navy's use of budgetary resources.

The Chief Financial Officers Act requires that the Department of the Navy issue consolidated principal financial statements with notes for all departmental funds that they manage. These statements are (1) Statement of Financial Position, and (2) Statement of Operations and Changes in Net Position. A Statement of Cash Flows is also required and provided for the revolving fund.

B. Reporting Entity:

The Department of the Navy was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The Marine Corps and the Navy joined as the Department of the Navy by an act of Congress on July 11, 1798. The overall mission of the Department of the Navy is to organize, train, and equip forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies. Fiscal year 1997 represents the second year that the Department of the Navy has prepared, and had audited, financial statements for all its departmental managed funds as required by the Chief Financial Officers Act and the Government Management Reform Act.

The accompanying financial statements account for all funds for which the Department of the Navy is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The financial statements are presented on the accrual basis of accounting as required by the Department of Defense accounting policies. Financial statements and reports are prepared by the Defense Finance and Accounting Service - Cleveland Center, based upon data provided by financial reporting systems and specialized data calls.

The accounts used to prepare the principal statements are classified as entity/non-entity and by type of fund. Entity accounts consist of resources that the agency has the authority to decide how to use, or where management is legally obligated to use funds to meet entity obligations. Non-entity accounts are assets that are held by an entity but are not available for use in operations.

Footnotes

Entity Accounts:

General funds

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps (fiscal year)
17X0810	Environmental Restoration, Navy (fiscal year)
17 1105	Military Personnel, Marine Corps (fiscal year)
17 1106	Operation and Maintenance, Marine Corps (fiscal year)
17 1107	Operation and Maintenance, Marine Corps Reserve (fiscal year)
17 1108	Reserve Personnel, Marine Corps (fiscal year)
17 1109	Procurement, Marine Corps (fiscal year)
17 1205	Military Construction, Navy (fiscal year)
17 1235	Military Construction, Naval Reserve (fiscal year)
17X1236	Payments to Kaho'Olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
17X1319	Research, Development, Test and Evaluation, Navy
17 1319	Research, Development, Test, and Evaluation, Navy (fiscal year)
17 1405	Reserve Personnel, Navy (fiscal year)
17 1453	Military Personnel, Navy (fiscal year)
17 1506	Aircraft Procurement, Navy (fiscal year)
17 1507	Weapons Procurement, Navy (fiscal year)
17 1508	Procurement of Ammunition, Navy and Marine Corps (fiscal year)
17X1611	Shipbuilding and Conversion, Navy
17 1611	Shipbuilding and Conversion, Navy (fiscal year)
17 1804	Operation and Maintenance, Navy (fiscal year)
17 1806	Operation and Maintenance, Navy Reserve (fiscal year)
17 1810	Other Procurement, Navy (fiscal year)
17X3980	Navy Management Fund

Revolving funds

17X4557	National Defense Sealift Fund, Navy
17 4557	National Defense Sealift Fund, Navy (fiscal year)

Trust funds

17X8008	Naval Historical Center Fund (formerly Office of Naval Records and History Fund)
17X8423	Midshipmen's Store, United States Naval Academy
17X8716	Department of the Navy General Gift Fund
17X8723	Ship's Stores Profits, the Navy
17X8730	United States Naval Academy Museum Fund
17X8733	United States Naval Academy General Gift Fund

Special funds

17X5095	Wildlife Conservation, etc., Military Reservations, Navy
17X5185	Kaho'Olawe Island Conveyance, Remediation, and Environmental Restoration fund, Navy
17X5429	Rossmoor Liquidating Trust Settlement Account
17 5429(001)	Rossmoor Liquidating Trust Settlement Account

Non Entity Accounts

Special funds (Receipt Accounts)

17 3041	Recoveries under the Foreign Military Sales Programs
17 3210	General Fund proprietary Receipts, Defense Military, Not Otherwise Classified
17F3875	Budget Clearing Account (Suspense)
17F3878	Budget Clearing Account (Deposits)
17F3879	Undistributed and Letter of Credit Differences (Suspense)
17F3880	Unavailable Check Cancellations and Overpayments (Suspense)
17F3886	Civilian Thrift Savings Plan

Special funds

17X3885	Undistributed Intra-Governmental Payments, Navy
17X9082	Intra-Budgetary Transactions-Trust Funds National Defense

Deposit funds

17X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy
17X6002	Personal funds of Deceased, Mentally Incompetent or Missing Personnel, Navy
17X6025	Pay of the Navy, Deposit Fund
17X6026	Pay of the Marine Corps, Deposit Fund
17X6050	Employees Payroll Allotment Accounts (U.S. Bonds)
17X6075	Withheld Allotment of Compensation for payment of Employee Organization dues, Navy
17X6083	Withheld Allotment of compensation from Charitable Contributions Navy
17X6134	Amounts Withheld for Civilian Pay Allotments, Navy
17X6275	Withheld State and Local Taxes
17X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
17X6705	Civilian Employees Allotments Account, Navy
17X6706	Commercial Communication Service, Navy
17 6763	Gains and Deficiencies on Exchange Transactions, Navy (fiscal year)
17X6850	Housing Rentals, Navy
17X6875	Suspense
17X6999	Accounts Payable, Check Issue Underdrafts, Navy

C. Budgets and Budgetary Accounting:

The Assistant Secretary of the Navy (Financial Management and Comptroller) is responsible for directing the Department of the Navy's budget and monitoring its execution against funds appropriated by Congress. Funds are distributed by appropriation directors through major commands to activities responsible for accomplishing the diverse missions for which the Department of the Navy is responsible. As missions are performed, activities report obligations and disbursements against the applicable appropriations.

The Department of the Navy funds are divided into various types, i.e. general, revolving, trust, special, deposit and receipt accounts. These accounts are used to fund and report how the resources have been used in the course of executing the Department of the Navy's missions.

General fund accounts are used to record the amounts appropriated by Congress and the financial transactions utilizing the funds. The Department of the Navy manages 24 general fund accounts: eight are funded by current year appropriations, ten are funded by multi-year appropriations, and six are funded by no-year appropriations (appropriation which is available for incurring obligations until exhausted). Current year appropriations received budget authority of $49,393 million in fiscal year 1997. Multi-year appropriations received budget authority of $27,592 million, and no-year appropriations received $10 million. Within the General funds there is a management fund account, Navy Management Fund, which is a working fund account authorized by law to facilitate accounting for administrating intra-governmental activities other than business-type operations. In accordance with the CFO Act (Public Law 101-576), the Navy Management Fund was disestablished effective October 1, 1996, but collections were permitted through December 31, 1996. Once the fund becomes inactive, steps may be taken to return the corpus to the Treasury.

Revolving fund accounts are funds authorized by specific provisions of law to finance a continuing cycle of operations in which expenditures generate receipts and the receipts are available for expenditure without further action by Congress. The National Defense Sealift Fund is the Department's only revolving fund.

Trust fund accounts are used to record the receipt and expenditure of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of a donor, trust agreement, or statute. Trust accounts include funds collected through gifts and bequests, assets held for particular purposes and interest earned in investments. The National Defense Authorization Act for Fiscal Year 1997 (Public Law 104-201) amended Section 7222 of title 10 U.S.C. to the effect of changing the name of former Office of Naval Records and History Fund to that of Naval Historical Center Fund. Additionally, Public Law 104-201 repealed 10 U.S.C Section 6970 and authorized the conversion of the Midshipmen's Store Trust Fund to a non-appropriated fund effective October 1, 1996.

Special fund accounts for receipts are credited with collections from specific sources that can only be used in accordance with specific provisions of law. The Department of the Navy maintains four special fund accounts.

Deposit fund accounts generally are used to 1) hold assets whose distribution awaits legal determination or for which the Department of the Navy acts as agent or custodian, and 2) account for unidentified remittances. The Department of the Navy expressly requires all check collections to pass under the immediate control of one of these deposit funds upon receipt, regardless of source, if the ultimate recipient is unknown. The Department of the Navy maintains 16 deposit funds.

Receipt accounts are used to categorize collections or receipts. Receipts are “Available” or “Unavailable,” meaning an agency may or may not spend its collections depending upon Congressional decisions made during the appropriation process. During fiscal year 1997, the Department of the Navy maintained six special fund receipt accounts and internally processed their activities using the pseudo account number reference “17 0002.”

D. Basis of Accounting:

Transactions are generally recorded on an accrual basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to the actual receipt or payment of cash. Budgetary accounting is accomplished through unique general ledger accounts to facilitate the Department of the Navy’s compliance in meeting both legal and internal control requirements associated with the use of federal funds.

The Department of the Navy’s Chief Financial Officers Act financial statements are prepared from a consolidation of accounting information reported from multiple accounting systems as well as departmental level data input by the Defense Finance and Accounting Service - Cleveland Center. At this time, this consolidated accounting data is maintained in the Navy Headquarters Financial System departmental general ledger located at the Naval Computer and Telecommunications Station, Washington Center.

General ledger account balances have been verified to the year-end departmental budget execution and expenditure reports. Budget execution reports are prepared from activity reports that are certified for accuracy and completeness by activity commanders. Other methods, to include feeder reports and logistic data calls, must be used to verify the accuracy of general ledger balances in those instances where budget execution and expenditure reports do not contain the particular information, for example, “Property, Plant, and Equipment.”

Accounts payable for goods and services are generally recognized upon receipt of a receiving document providing notification of acceptance of goods or services. According to Public Law 101-510, outstanding accounts payable from fiscal year 1991 and prior fiscal years are subject to payment.

E. Revenues and Other Financing Sources:

The Department of the Navy receives the majority of funding required to support its programs through Congressional appropriations. A financing source, “Appropriated Capital Used,” is recognized each fiscal year to the extent that appropriated funds have been consumed. Purchases of capital items and accruals of unfunded liabilities are excluded from the “Appropriated Capital Used” account. Appropriations may also be supplemented, when authorized, by revenues generated by sales of goods or services through a reimbursable order process. Revenue is recognized to the extent the revenue is payable to the Department of the Navy from other federal agencies and the public as a result of costs incurred or services performed on their behalf. Revenue is recognized when earned under the reimbursable process. Other revenues and financing sources include donated revenue. Donations to the Department of the Navy are recognized as a financial source upon acceptance of the donated asset. Revenue is recorded for the value of the increase to the asset account.

F. Accounting for Intra-Governmental Activities:

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

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

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

3. The Department’s civilian employees participate in the Civil Service Retirement System and Federal Employees Retirement System, while military personnel are covered by the Military Retirement System. Additionally, employees and personnel also have varying coverage under Social Security. The Department funds a portion of and discloses the assets or actuarial data on the accumulated plan benefits or unfunded pension liabilities of its employees.

Reporting pension benefits under these retirement systems is the responsibility of the Office of Personnel Management for the Civil Service Retirement System and the Federal Employees Retirement System and the Department of Defense for the Military Retirement System. In fiscal year 1997, the Department contributed the following amounts to the retirement plans and Social Security:

	(in thousands)
Civil Service Retirement System	$341,100
Federal Employees Retirement System	433,839
Military Retirement System	2,911,696
Social Security	298,442
	$3,985,077

The Department also contributed $153.5 million to the Federal Employees Retirement System Thrift Savings Plan on behalf of its participating employees.

The expenses for Pension, Federal Health Benefits, and Federal Employees Life Insurance are represented in the CFO Statement of Operation and Changes in Net Position as net of the employer and employee share of the benefits.

4. Most legal actions, other than contract claims, to which the Department of the Navy may be a named party are covered by the provisions of the Federal Tort Claims Act and the provisions of Chapter 163 of Title 10, United States Code, 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 of the Navy's appropriations or because payments will be from the permanent, indefinite appropriation "Claims, Judgments, and Relief Acts" (Judgment Fund), these legal actions should not materially affect the Department of the Navy's operations or financial condition.

5. In fiscal year 1997, the Navy sold assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Under provisions of the Act, the Department of the Navy 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 trust funds maintained by the Department of the Treasury from which the Military Services are reimbursed for the cost of administering and executing the sales. In fiscal year 1997, the Department of the Navy received reimbursements of $355 million for assets and services sold under the Foreign Military Sales program.

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

The Department of the Navy's funding resources are maintained in Treasury receipt and expenditure accounts. The account "Fund Balance with Treasury" represents the aggregate of all the Department of the Navy appropriations. The Department of the Navy is an agent for the Department of the Treasury for cash on hand. As of September 30, 1997, the Department of the Navy had $58 billion in Fund Balance with Treasury.

H. Foreign Currency:

The Department of the Navy conducts a significant portion of its operations overseas. Gains and losses from foreign currency transactions for four general fund appropriations (Operation and Maintenance, Military Construction, Family Housing Operation and Maintenance, and Family

Housing Construction) are recognized and reported in the statement of operations. The gains or losses are computed as the variance between the current exchange rate at the date of payment and a budget rate established at the beginning of the fiscal year. In fiscal year 1997, the Department recognized a net gain of $14.1 million due to foreign currency transactions for the four appropriations. Similar gains and losses for other appropriations are not recognized in the Statement of Operations. They are absorbed by budgetary transactions in which obligations are increased or decreased to reflect foreign currency fluctuations.

I. Accounts Receivable:

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

(in Thousands)

Division	Amount	Allowance	Total Net
Accounts Receivable			
Government	$3,165,602	$0	$3,165,602
Public	2,603,496	71,728	2,531,768
Refunds	0	0	0
Claims	0	0	0
Total	$5,769,098	$71,728	$5,697,370

Allowances for uncollectible accounts are based upon analysis of collection experience by fund type. During fiscal year 1997, the Department wrote off approximately $71.7 million in uncollectible receivables. Collections of outstanding receivables for fiscal year 1991 and prior fiscal years accounts receivable balances are deposited into a Treasury miscellaneous receipt account.

J. Loans Receivable:

Not applicable

K. Inventories:

Inventories, including operating supplies, nonconsumable items, and war reserve material are valued at latest acquisition cost as required by the Department of Defense accounting policies. Generally, these prices are based on prices paid for recently acquired items plus appropriate surcharges. No gains or losses are recognized in the Consolidated Statement of Operations as a result of changes in valuation for operating materials and supplies. Such changes are reflected in the asset valuation and related invested capital as reported in the Statement of Financial Position. War reserve material, as reported from the Supply System Inventory Report (SSIR), is reported in the fiscal year 1997 CFO Financial Statements line 1.l. as directed by OUSD (C). The total war reserve material amounted to $54,589 million. Additionally, there is a $43 thousand dollar residual of inventory attributed to the trust funds.

L. Investments in U.S. Government Securities:

Investments in U.S. government securities are reported by the Department of the Navy Trust funds at cost, net of unamortized premiums or discounts. Premiums or discounts are amortized into interest income over the term of the investment. The Department of the Navy reported $8.6 million in investments. It is the intent of the Department of the Navy to hold its trust fund investments to maturity unless they are needed to finance claims or otherwise sustain operations. Therefore, no provisions are made for unrealized gains or losses on these securities.

M. Property, Plant, and Equipment:

Property, plant, and equipment consists of tangible assets, including land, that must have estimated useful lives of 2 years or more and meet the threshold requirements as required by the Department of Defense. All fixed assets, including land held in public domain, are valued at acquisition cost. Acquisition cost includes such costs as: purchase price, broker's commissions, fees for examining and recording the title, surveying, razing and removal costs (less salvage proceeds) of structures on the land, transportation, handling and storage, activity, interest, preparation, labor, engineering, appropriate share of the cost of equipment and facilities used in construction, inspections, supervision, legal recording fees, and other related costs of obtaining the property. When the acquisition cost can not be determined, fair market value at the time of acquisition is used.

The various criteria used to establish the fair market value are:

a. Cash realized in transactions involving the same or similar assets,
b. Quoted market prices,
c. Fair market value of other assets or services received in exchange of property, or
d. Independent appraisals.

Current Department of Defense financial capitalization policy requires that assets previously capitalized at lower thresholds - $1,000 prior to FY 85; $5,000 from FY 85-91; $15,000 from FY 92-93; $25,000 in FY 1994; $50,000 in FY 1995; and $100,000 in FY 1996 - remain in the accounts after the threshold is raised.

No gains or losses were recognized in the Statement of Operations for revaluation changes and/or loss of equipment. However, the assets and related investment accounts reflect both pricing and value changes based on periodic updates to the general ledger. Depreciation is recorded for assets financed by trust fund activities, but not for assets financed by general fund appropriations. Routine maintenance and repair costs are expensed when incurred.

Real property comprising land and facilities are valued at cost. Buildings are capitalized when constructed or at the date of acquisition.

N. Prepaid and Deferred Charges:

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenditures/expenses when the related goods and services are received.

O. Leases:

As of September 30, 1997 the Department of the Navy was committed to numerous annual operating leases and rental agreements.

The Department owns substantially all of the facilities and real property used in its domestic operations. Capital assets overseas are purchased with appropriated funds, however, title is retained by the host country.

P. Contingencies:

At any given time, the Department of the Navy 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.

The Department is subject to various asserted contract claims for over $100 million which total approximately $1,739 million as of September 30, 1997. These claims are in various phases ranging from investigation to appeal. While no opinion has been expressed regarding specific claims' likely outcome or possible associated loss, experience indicates that many such claims are settled for less than claimed, dismissed altogether, or the possibility of the contingency materializing is remote.

As of September 30, 1997, the Department of the Navy and its components were a party to approximately 807 contract appeals before the Armed Services Board of Contract Appeals. The total value of these appeals was approximately $994 million. According to management, approximately 80% of appeals are successfully defended by the Department. In fiscal year 1997, contractors recovered about $358 million from resolved claims. Such claims are funded primarily from Department appropriations.

Liabilities for the Department of the Navy's Environmental Program are comprised of cleanup costs at Navy installations. This estimated environmental requirement includes environmental restoration efforts and environmental costs at Base Realignment and Closure sites. The possible fiscal year 1998 cost to completion for these efforts totals $6,070 million. The Department of the Navy resources for these requirements are in the Base Realignment and Closure and the Environmental Restoration, Navy accounts.

Q. Accrued Leave:

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. Accrued leave for the Navy is recorded through automatic postings from the Defense Civilian Payroll System.

R. Equity:

Equity which is reflected as net position on the CFO Financial Statements consists of invested capital, donations, cumulative results of operations, and unexpended appropriations less unfunded liabilities. Unexpended appropriations represent amounts of authority which are unobligated and have not been rescinded or withdrawn and amounts obligated but for which neither legal liabilities for payments have been incurred nor actual payments made. The total department equity is shown as $441.5 billion.

Invested capital, as presented in the consolidated Statement of Financial Position, represents the value of the Department's capital assets which consists of property, plant and equipment and inventory not held for sale. The donated capital and trust fund balances have been included in invested capital.

Cumulative results of operations for working capital funds represent the excess of revenues over expenses since fund inception, less refunds to customers and returns to the U.S. Treasury.

Adjustments to non operating changes were made to correct the fiscal year 1997 net position beginning balance amounted to 3,611.9 million. These adjustments consist of changes in accounting policy, correction of errors, and inclusion of data omitted in fiscal year 1996. Equity balances for fiscal year 1991 and prior fiscal years were not included in the fiscal year 1997 CFO financial statement due to change in accounting policy. In fiscal year 1996 non-entity receipt, suspense, and budget clearing accounts were improperly reported as equity instead of liabilities; this was corrected on the fiscal year 1997 CFO financial statements.

S. Aircraft/Ship Crashes:

An operating loss of $431.5 million has been recognized in fiscal year 1997 for aircraft/ships which were either destroyed or damaged beyond repair due to aviation/navigation mishaps. The loss represents the book value at unit cost of those aircraft/ships that were either destroyed or damaged. No loss has been separately recognized for aircraft/ships which were damaged by accidents but were repairable. Costs associated with repair of such aircraft/ships are recorded as operating expenses and generally funded from operation and maintenance appropriations.

T. Treaties for Use of Foreign Bases:

The Department of the Navy 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 the Department of the Navy continued use of these properties until the treaties expire. Capital investments in buildings, runways, aircraft shelters, and other facilities located on the overseas bases are capitalized. As of September 30, 1997, the Department of the Navy has not financed the cost values of buildings and facilities located in foreign countries. These fixed assets are subject to loss in the event the treaties are not renewed or other agreements are not reached which allow for the continued use by the Department of the Navy. In the event these treaties or agreements are terminated, losses will be recorded for the value of nonretrievable capital assets.

U. Comparative Data:

Comparative data from fiscal year 1996 CFO financial statements is presented in order to provide an understanding of changes in financial position and operations of the Department of the Navy's reporting activities. Navy's financial statements will continue to reflect restatements and reclassifications due to the evolving nature of federal accounting standards and the development of new reporting financial systems. Restatement of lines 1.d. and 1.l. resulted from new DoD guidance relating to reclassification of War Reserves from the "Inventory, Net" line to a new line entitled "War Reserves".

Statement of Financial Position (in Thousands):

FY 1996 Line	FY 1996 Balance	Change	FY 1996 Restated
1.d.	$41,441,119	$41,441,075	$44
1.l.	0	41,441,075	41,441,075

Line 1.l. as it relates to Other Entity Assets in fiscal year 1996 was reclassified to line 1.m. in fiscal year 1997.

Due to a DCFO(AP) policy change in the reporting of Environmental Cleanup Costs, the CFO Statement of Financial Position line 5.a.(3) reflects a material dollar fluctuation between fiscal years 1996 and 1997.

V. Undelivered Orders:

The Department of the Navy activities are obligated for goods which have been ordered but not yet received (undelivered orders). As of September 30, 1997 undelivered orders amounted to $45 billion.

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	$15,362	$490,780	$11,875,262	$38,902	$12,420,306
Restricted			(80,003)		(80,003)
Reserve For Anticipated Resources		(30,684)			(30,684)
Obligated (but not expensed)	905	2,193,148	43,495,356	10,380	45,699,789
Unfunded Contract Authority					
Unused Borrowing Authority					
Treasury Balance	$16,267	$2,653,244	$55,290,615	$49,282	$58,009,408

B. Other Information: Funds Returned to the Treasury. During FY 1997 the Department of the Navy returned $1,537,846 thousand back to the Treasury. This consisted of the FY 1992 program year that went into a canceled/withdrawn status. The Navy returned $1,434,233 thousand and the Marine Corps returned $103,613 thousand.

Non-Entity Fund Balance with Treasury. The negative balance of ($327,502) thousand recorded in the Non-Entity Fund Balance with Treasury resulted from the negative balance recorded in 17F3875, Budget Clearing (Suspense), of ($805,933) thousand which offsets all other Non-Entity accounts which recorded a balance of $478,431 thousand.

Ending Balance 9/30/96	($572,625)
Less Canceling Year and Receipt Accounts	(126,049)
Beginning Balance Restated	$(698,674)
Collected	1,087,655
Disbursed	716,483
Ending Balance	($327,502)

Canceled and Closed Years which have been Reopened. The fund balances for canceled and closed years which have been reopened for the processing of adjustments have not been included in the Fund Balance with Treasury amounts recorded on the Statement of Financial Position. If the fund balances for the reopened years were included in the FY 1997 CFO statements, this would have increased the Fund Balance with Treasury amount by $7,462,131 thousand.

Note 3. Cash, Foreign Currency and Other Monetary Assets (in thousands):

	Entity Assets		Non-Entity Assets	
A. Cash		$0		$132,556
B. Foreign Currency				18,400
C. Other Monetary Assets:				
1. Gold	$0		$0	
2. Special Drawing Rights				
3. U.S. Reserves in the International Monetary Fund				
4. Other				
5. Total Other Monetary Assets	$0	0	$0	0
D. Total Cash, Foreign Currency and Other Monetary Assets		$0		$150,956

E. Other Information: The $150,956 thousand is from the Department of the Navy Consolidated Statement of Accountability (SF 1219) as of September 30, 1997.

Foreign currency has been translated into U.S. Dollars utilizing the Department of the Treasury Prevailing Rate of Exchange. This rate is the most favorable rate that would legally be available to the U.S. Government for the acquisition of foreign currency for its official disbursement and accommodation of exchange transactions.

A decision was made in FY 1997 to report all Cash and Other Monetary Assets as Non-Entity on line 2c on the Statement of Financial Position.

Note 4. Investments, Net (in thousands):

	(1) Cost	(2) Market Value	(3) Amortization Method	(4) Amortized Premium/ (Discount)	(5) Investment Net
A. Intragovernmental Securities:					
1. Marketable	$0	$0		$0	$0
2. Non-Marketable Par Value	8,626		N/A	(16)	8,610
3. Non-Marketable Market Based					
Subtotal	$8,626	$0		$(16)	$8,610
B. Governmental Securities:					
	$0	$0		$0	$0
Subtotal	$0	$0		$0	$0
Total	$8,626	$0		($16)	$8,610

Note 4. Investments, Net (in thousands) (cont'd):

C. Other Information: The Trust Funds have a total net investment of $8,610 thousand. The Trust Funds that have investments are the following; Navy General Gift Fund, Naval Academy Museum Fund, Naval Academy General Gift Fund and Naval Historical Center Fund. These investments are Non-Marketable Par Value securities reported at cost, net of unamortized premiums and discounts. The details for each Trust Fund are the following.

	Cost	Amortized Premium/ (Discount)	Investment Net
Navy General Gift Fund	$1,322	($1)	$1,321
Naval Academy Museum Fund	1,617	(1)	1,616
Naval Academy General Gift Fund	5,235	(14)	5,221
Naval Historical Center Fund	452		452
Total	$8,626	($16)	$8,610

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	$3,134,834	$0		$3,134,834
Governmental	2,598,133	71,728	Percentage	2,526,405
B. Non-Entity Receivables:				
Intragovernmental	$30,768	$0		$30,768
Governmental	5,363			5,363

C. Other Information:

National Defense Sealift Fund. Total Entity Accounts Receivable were $5,661,239 thousand for FY 1997 and $6,379,261 thousand for FY 1996. The National Defense Sealift Fund (NDSF) represents a major portion of the Entity Accounts Receivable balance in both years. NDSF Account Receivable were $1,326,354 thousand in FY 1997 and $2,081,109 thousand for FY 1996.

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

C. Other Information (cont'd):

The purpose of the NDSF is to provide for the construction (including design of vessels), purchase, alteration, and the conversion of Department of Defense (DOD) sealift vessels; operation, maintenance, and lease or charter of DOD vessels for national defense purposes; installation and maintenance of defense features on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; and research and development relating to national defense.

The variance between fiscal years in Accounts Receivable Intragovernmental and Governmental was due to the misclassification of the NDSF receivables. NDSF receivables were misclassified as Governmental in FY 1996, and were classified as Intragovernmental in FY 1997.

Fiscal years' 1993 and 1994 vouchers of the NDSF were misclassified as disbursements rather then collections. This resulted in an overstatement of at least $1,216,340 thousand in FY 1997 and FY 1996. Actions are being taken by the Department of the Navy and DFAS to correct the cause of the overstatement.

Canceled Contract Receivable Balance. Included in the Accounts Receivable from Governmental sources is an advance payment of $1,352,460 thousand made to two contractors. The contract was subsequently canceled. The contract was for the A-12 aircraft program which is still in litigation. On October 7, 1997, DFAS-CL asked the Navy General Counsel for a decision on the feasibility of collecting the entire, partial, or no amount of this advance payment. If it was determined that a partial collection could be made DFAS-CL required a formula which was to determine how the partial amount was derived. DFAS-CL placed the entire amount into Accounts Receivable-Governmental per the recommendation from a 1994 General Accounting Office financial operation audit.

Eliminating Entries. Eliminating entries in the amount of $903,779 thousand were made to the Accounts Receivable Intragovernmental. It is a requirement to eliminate those amounts of accounts receivable which represent intra service transactions (one Navy appropriation selling to another Navy appropriation).

Mechanization of Contract Administration Services (MOCAS) and Defense Debt Management System (DDMS) Accounts Receivable Balance. During FY 1997 DFAS-CL and DFAS-KC included in its Accounts Receivable-Governmental balance refunds receivable from MOCAS and DDMS. The amounts were $3,567 thousand for the MOCAS system debts and $419,304 thousand for the DDMS-Navy. The $419,304 thousand was net of $2,146 thousand which was written off in FY 1997.

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

C. Other Information (cont'd):

Allowance for Bad Debts. The Department of the Navy does not have a Department wide allowance for estimated uncollectibles. Using the Report on Receivables Due from the Public, the overall Department of the Navy allowance was calculated to be 4.64% for FY 1997. In instances where the historical rate exists, the chart below indicates the allowances which were used. This allowance for write-offs is provided by the Department of the Navy.

Appropriation	Allowance
17 1453 - Military Personnel , Navy	27.42%
17 1105 - Military Personnel, Marine Corps	7.72%
17 1108 - Reserve Personnel, Marine Corps	7.70%

FY 1991 and Prior Years. For FY 1997 the FY 1991 and prior year balances were included in the Accounts Receivable balances. The amount of account receivable balance was the following (in thousands):

	Intragovernmental	Governmental
Navy	$271,524	($24,247)
Marine Corps	1,937	3,755
Total	$273,461	($20,492)

Non-Entity Accounts Receivable. Included in the accounts receivable balances are $36,131 thousand in Non-Entity Accounts Receivable. These balances are derived from the canceled/withdrawn program years which contained accounts receivable balances outstanding at the time the program year went into a canceled status.

Abnormal Balances. The abnormal balance in Non-Entity Governmental Accounts Receivable, was reported as such in both the trial balance and on budgetary reports. Further investigation is to be conducted to determine the cause of the abnormal balance.

Note 6. Other Federal (Intragovernmental) and Non-Federal (Governmental) Assets (in thousands): Not applicable

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

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	$43	$0	$43	Actual Cost
2. Held in Reserve for Future Sale				
3. War Reserve Material				
4. Excess, Obsolete and Unserviceable				
5. Held for Repair				
Total	$43	$0	$43	

B. Restrictions on Inventory Use, Sale, or Disposition: None

C. Other Information: The inventory amount represents Naval Academy Museum Fund catalogs of Battle Prints.

In FY 1997, an OUSD(C) decision was made to separately indicate the value for War Reserve material on the Statement of Financial Position on line 1.l. This value is derived by utilizing the Supply System Inventory Report (SSIR) for FY 1997 which was $54,589,962.

Note 9. Work in Process (in thousands):

	(1) Work In Process Amount	(2) Valuation Method
A. Work in Process:		
1. In House	$6,208	Actual Cost
2. Contractor		
3. Other Government Activities		
4. Government Furnished Materials		
Total	$6,208	

B. Other Information: Revolving Funds are the only entities within the General Funds which can have work in process. Currently the National Defense Sealift Fund (NDSF) is the only revolving fund within the General Fund Group.

Note 10. Operating Materials and Supplies (OM&S), Net (in thousands): Not applicable

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

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			$751,743	$0	$751,743
B. Structures, Facilities, & Leasehold Improvements			26,957,039		26,957,039
C. Military Equipment			293,015,265		293,015,265
D. ADP Software					
E. Equipment			8,216,821		8,216,821
F. Assets Under Capital Lease					
G. Other			38,523		38,523
H. Natural Resources			190,000		190,000
I. Construction-in-Progress			5,419,387		5,419,387
Total			$334,588,778	$0	$334,588,778

*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)		

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

J. Other Information: Military Equipment contains $426,282 thousand which represents Progress Payments made for the Navy Shipbuilding and Conversion appropriation.

Within the Military Equipment Line, Government Furnished Property was reported in FY 1996 as $32,668,089 thousand. The amount which should have been reported in FY 1996 was $20,189,218 thousand. This difference was due to amounts reported by the contractors as land, structures, and military property which was already captured by another system or in another line and lead to a duplication of reporting. This problem was identified in the Inspector General, Department of Defense Audit Report No. 97-202 dated August 4, 1997 Financial Reporting of Government Property in the Custody of Contractors. The reported amount for FY 1997 is $17,653,088 thousand.

The Naval Audit Service Audit Report No. 051-97 dated 25 September 1997, Department of the Navy Fiscal Year 1996 Annual Financial Report: Property, Plant, and Equipment, Net contained several recommendations for adjustments in the FY 1996 balance. The Department of the Navy's position was not to adjust the FY 1996 balance but to correctly reflect the balance for FY 1997. The FY 1996 audit report recommended an increase for stricken ship and aircraft of $20,100,000 thousand for the military equipment line, an increase of $81,700 thousand for identified unreported and unrecorded acquisitions and dispositions by activities in the "other line" on the published FY 1996 report but which has been moved to the "equipment" line in FY 1997, and a decrease of $321,700 thousand for construction projects completed but inadvertently not deleted from construction in process. Corrective actions have been taken for correct balances in FY 1997.

Other represents artifacts reported by the United States Naval Academy Museum Fund.

Plant, Property and Equipment. Department of the Navy Plant, Property, and Equipment Accounts, are not subject to depreciation for FY 1997.

Note 16. Debt (in thousands): Not applicable

Note 17. Other Liabilities (in thousands):

A. Other Liabilities Covered by Budgetary Resources:

	Non-Current Liability	Current Liability	Total
1. Intragovermental			
a. Unearned Revenue	$0	$10,274	$10,274
b. Entity Accounts Receivable	271,046		271,046
c. Non-Entity Accounts Receivable	39,162	1,784	40,946
d. Budget Clearing Suspense		(327,502)	(327,502)
e. Disbursing Officer Cash		150,956	150,956
f. Miscellaneous	369		369
Total	$310,577	($164,488)	$146,089

	Non-Current Liability	Current Liability	Total
2. Governmental			
a. Unearned Revenue	$0	($4,246)	($4,246)
b. Entity Accounts Receivable	(24,242)		(24,242)
c. Non-Entity Accounts Receivable	(9,393)	4,209	(5,184)
d. Contract Incentives		73,679	73,679
Total	($33,635)	$73,642	$40,007

B. Other Information:

C. Other Liabilities Not Covered by Budgetary Resources:

	Non-Current Liability	Current Liability	Total
1. Intragovermental			
a. Environmental Cleanup Costs	$5,462,000	$608,000	$6,070,000
Total	$5,462,000	$608,000	$6,070,000

	Non-Current Liability	Current Liability	Total
2. Governmental			
a. Accrued Annual Leave, Civilian	$51,012	$167,423	$218,435
b. Accrued Annual Leave, Military		960,304	960,304
Total	$51,012	$1,127,727	$1,178,739

D. Other Information:

Environment Clean-Up Cost : The amount included in the FY 1998 budget for Environmental Restoration, Navy and BRAC is reported as current liabilities with the balance reported as non-current liabilities.

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	$0		$0	$0
B. Insurance/Annuity Programs:				
	$0		$0	$0
Total	$0		$0	$0
C. Other:				
1. Workers' Compensation	$1,476,455	6.24 %		$1,476,455
Total	$1,476,455		$0	$1,476,455
D. Total Lines A+B+C:	$1,476,455		$0	$1,476,455

E Other Information: The amount of $1,476,455 thousand was provided from the Department of Labor (DOL). The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. 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	Appro-priated Funds	Total
A. Unexpended Appropriations:				
1. Unobligated,				
a. Available	$490,780	$2,203	$11,914,164	$12,407,147
b. Unavailable	(30,684)		1,685,978	1,655,294
2. Undelivered Orders	3,989,127		40,974,969	44,964,096
B. Invested Capital		46,345	393,656,497	393,702,842
C. Cumulative Results of Operations		14,656		14,656
D. Other			21,716	21,716
E. Future Funding Requirements			(11,237,994)	(11,237,994)
F. Total	$4,449,223	$63,204	$437,015,330	$441,527,757

G. Other Information:

Net Position is comprised of the following components:

Unexpended appropriations - amount of budget authority remaining for disbursement against current or future obligations. Unobligated balances are restricted for future use and are not available for current use. "Undelivered Orders" represent those goods and services that have not yet been received/performed. Multi-year appropriations remain available to the DoD for obligation in future periods. However, unobligated balances associated with appropriations expiring at fiscal year end remain available only for obligation adjustments until the account is closed. Generally speaking, accounts close five years after the appropriation expires.

Unexpended Appropriations exceeds Fund Balance With Treasury by $1,017,130 thousand. This is primarily attributed to the overstatement of Accounts Receivable in the National Defense Sealift Fund (NDSF).

Invested capital - Represents the net investment and subsequent appropriations to finance program activities. Also included is the net balance of assets and liabilities that have been transferred in and out to DoD Components or other U.S. Government Agencies without reimbursement.

Cumulative results of operations - represent the cumulative net difference between (1) expenses and losses and (2) financing sources to include appropriations, revenues and gains.

Other - represents other components of net position not specifically identified above.

Note 20. Net Position (in thousands) (cont'd):

G. Other Information (cont'd):

Future Funding Requirements - Accrued expenses such as annual and military leave earned but not taken are not funded in the period the expense is recorded. These future funding requirements are recognized as an offset to "Net Position."

The variance in this balance is attributed to the following (in thousands):

Clean -Up Costs	$6,070,000
FY 1991 and prior years Accounts Payable	2,512,831
Change in Pension Liability	(684,922)
Change in Unfunded Leave	29,838
Total	$7,927,747

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. Commissions - Western Union	$0	$12
2. Gain/Loss dairy herd		(6)
3. Annual donations	1,388	1,884
4. New accounts	1,003	41
5. New facilities		2,477
6. Miscellaneous income		18
7. Imputed Financing Sources	907,799	
Total	$910,190	$4,426

B. Other Information: The $907,799 represents the imputed financing for pensions and other retirements benefits. The Office of Personnel Management (OPM) is the administrative entity for pensions and other retirement benefits (ORB). OPM accounts for and reports the pension liability in the financial statements while the employer discloses the imputed financing. OPM actuaries provide the normal cost rates which are used to calculate the imputed financing.

Imputed Pension and Other Retirement Benefits (ORB)(in thousands):

CSRS/FERS Retirement	$706,331
Health	200,914
Life Insurance	554
Total	$907,799

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

	1997	1996
A. Operating Expenses by Object Classification:		
1. Personnel Services and Benefits	$27,353,819	$26,482,945
2. Travel and Transportation	1,679,432	1,523,958
3. Rental, Communication and Utilities	1,207,887	947,678
4. Printing and Reproduction	65,065	49,906
5. Contractual Services	22,119,298	23,470,785
6. Supplies and Materials	6,026,290	1,129,006
7. Equipment not Capitalized	1,892,534	1,325,230
8. Grants, Subsidies and Contributions	74,158	89,503
9. Insurance Claims and Indemnities	2,671	1,724
10. Other (describe):		
(a) Capital assets	1,192,663	507,945
(b) Purchased services	842,486	674,284
(c) Land and structures	23,797	1,797
(d) Unallocated Expenses	(454,430)	261,499
11. Total Expenses by Object Class	$62,025,670	$56,466,260

B. Operating Expenses by Program: Not Applicable

C. Other Information: Operating Expenses for the Navy were derived from budgetary obligation percentages residing within the Navy Headquarters Financial System (NHFS). Operating expenses for the Marine Corps were provided by DFAS-KC. In FY 1996 the Marine Corps reported Operating Expenses by Program. The Marine Corps restated the FY 1996 Operating Expenses by Object Class. The Marine Corps can provide this information by Program. The total value of Operating Expenses reported by the Marine Corps was $1,528,005 thousand for FY 1997 and $774,718 thousand for FY 1996.

Unallocated expenses represent the total of "undistributed expenses", that are not allocated to any particular program. These transactions are being analyzed by the NULO/UMD team to correctly allocate them there by clearing the undistributed expenses.

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

A. Cost of Services Sold:	
1. Beginning Work-in-Process	$5,277
2. Plus: Operating Expenses	5,052,310
3. Minus: Ending Work-in-Process	6,208
4. Minus: Completed Work for Activity Retention	
Cost of Services Sold	$5,051,379

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

B. Cost of Goods Sold from Inventory (using Latest Acquisition Cost): Not Applicable

C. Cost of Goods Sold from Inventory (using Historical Cost): Not Applicable

D. Other Information: This data represents the cost of providing goods and services to the public or other government entities from reimbursable program resources.

Analysis of the Variance between line 2a, Revenue from the Sale of Goods and Services-Public and line 10a, Cost of Goods Sold-Public. The variance between line 2a, Revenue from the Sale of Goods and Services-Public and line 10a, Cost of Goods Sold-Public is attributed to line 12, Bad Debts and Write-offs for the Navy Appropriations and the Excess of Revenue and Financing Sources Over Total Expenses for the Trust Funds.

Note 25. Other Expenses (in thousands):

	1997	1996
A. Other Expenses:		
1. Pension, Health, and Life Insurance Benefits	$907,799	$0
2. Foreign Currency Transaction Expense	1,013	
3. Environmental Clean-Up	6,070,000	
Total	$6,978,812	$0

B. Other Information: The $907,799 represents the imputed expense for pensions and other retirement benefits. The Office of Personnel Management (OPM) is the administrative entity for pensions and Other Retirement Benefits (ORB). 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 expenses. Environmental Clean-Up represents the estimated costs to complete environmental restoration efforts and environmental costs at Base Realignment and Closure sites.

Imputed Pension and Other Retirement Benefits (ORB)(in thousands):

CSRS/FERS Retirement	$706,331
Health	200,914
Life Insurance	554
Total	$907,799

Note 26. Extraordinary Items (in thousands): Not applicable

Note 27. Prior Period Adjustments (in thousands): Not Applicable

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

	1997	1996
A. Increases:		
1. Transfers-In:		
a. Other New Authority Realized	$0	$1,315
2. Unexpended Appropriations		2,457,819
3. Donations Received		
4. Other Increases	12,019,157	84,433
5. Total Increases	$12,019,157	$2,543,567

	1997	1996
B. Decreases:		
1. Transfers-Out:		
a. Other	$0	$28,181
2. Donations		
3. Other Decreases	4,530,461	5,617,722
4. Total Decreases	$4,530,461	$5,645,903
C. Net Non-Operating Changes (Transfers):	$7,488,696	($3,102,336)

D. Other Information: Section A. 4., Other Increases, contains changes in Worker's Compensation of $684,922 thousand, changes in invested capital of $11,307,158 thousand and changes in cumulative results of operations of $27,077 thousand. Section B.3., Other Decreases, contains the FY 1991 and prior year accounts payable balance of $2,512,831 thousand, changes in Other of $34,612 thousand, changes in Unfunded Accrued Military annual leave balance of $29,869 thousand, and changes in Unexpended Appropriations of $1,949,560 thousand and other changes netting to $3,589 thousand.

Note 29. Intrafund Eliminations (in thousands):

Schedule A

Selling Activity:

	A Column Accounts Receivable	B Column Revenue	C Column Unearned Revenue	D Column Collections
Operation and Maintenance	$426,886	$1,096,330	$0	$1,108,393
Procurement		339		339
Research and Development	3,926	39,135		39,926
Military Construction	(6,743)	1,462		1,920
Other Funds and Accounts	479,710	479,725		667,907
Unearned Revenue				
Total	$903,779	$1,616,991	$0	$1,818,485

Customer Activity:

	A Column Accounts Payable	B Column Expenses	C Column Advances	D Column Disbursements
Operation and Maintenance	$426,886	$1,096,330	$0	$1,108,393
Procurement		339		339
Research and Development	3,926	39,135		39,926
Military Construction	(6,743)	1,462		1,920
Other Funds and Accounts	479,710	479,725		667,907
Advances				
Total	$903,779	$1,616,991	$0	$1,818,485

Schedule B Not Applicable

Schedule C

Selling Activity:

	A Column Accounts Receivable	B Column Revenue	C Column Unearned Revenue	D Column Collections
Department of the Navy	$1,415,621	$3,520,376	n/a	$3,506,396
Unearned Revenue			$3,128	
Total	$1,415,621	$3,520,376	$3,128	$3,506,396

Customer Activity:

	A Column Accounts Payable	B Column Expenses	C Column Advances	D Column Disbursements
Other DoD Components	$1,415,621	$3,520,376	n/a	$3,506,396
Advances			$3,128	
Total	$1,415,621	$3,520,376	$3,128	$3,506,396

Note 29. Intrafund Eliminations (in thousands) (cont'd):

Schedule D

Selling Activity:

	A Column Accounts Receivable	B Column Revenue	C Column Unearned Revenue	D Column Collections
Department of the Navy Unearned Revenue	$523,239	$695,609	$0	$286,440
Total	$523,239	$695,609	$0	$286,440

Customer Activity:

	A Column Accounts Payable	B Column Expenses	C Column Advances	D Column Disbursements
Other US Govt./ Non-Defense Advances	$523,239	$695,609	$0	$286,440
Total	$523,239	$695,609	$0	$286,440

Other Information: The primary source of information to compute the intrafund elimination is the DD 725, Report on Reimbursements. This report breaks down all types of transactions, related to the reimbursable program, by reimbursable source codes (RSC). The RSC can be used to identify, in a broad sense, the types of customers that the reimbursable activity is servicing. The following is the RSC utilized by the DD 725:

RSC 1 Non-Federal Sources
RSC 2 & 3 Trust Funds
RSC 4 Off-Budget Federal
RSC 5 Other Defense Funds
RSC 6 Non-Defense Federal
RSC 7 Intrafund Sources

However, this does present a major shortfall since the Note 29 asks to specifically identify the customer which cannot be accomplished using the DD 725.

DFAS-CL has eliminated balances from both the Statement of Financial Position and the Statement of Operations and Changes in Net Position utilizing Schedule A, Intrafund (Navy to Navy) transactions. The other two schedules C and D are eliminated at higher levels.

During FY 1997 the DFAS-HQ has guidance which classifies the Defense Security Assistance Agency (DSAA) as a Non-Defense Federal Entity (Schedule D) whereas in FY 1996 DSAA was classified as an Other DoD Entity (Schedule C).

Note 30. Contingencies (in Thousands): Liabilities for the Department of the Navy's environmental program are comprised of clean-up costs at Navy installations. The environmental requirement estimate includes environmental restoration efforts and environmental costs at the Base Realignment and Closure Commission (BRAC) sites. The possible FY 1998 cost to completion for these efforts totals $6,070,000 thousand. The Department of the Navy resources for these requirements are in the BRAC and the Environmental Restoration, Navy (ERN) account. For FY 1997 CFO statements this amount was recorded as an Other Federal Liability Not Covered by Budgetary Resources and as a Future Funding Requirement.

The Department is subject to various asserted contract claims for over $100,000 million. Claims which fall within this range total approximately $1,738,600 thousand as of September 30, 1997. These claims are in phases ranging from investigation to appeal. While no opinion has been expressed regarding specific claims, likely outcome, or possible associated loss, experience indicates that many such claims are settled for less then claimed, dismissed, or the possibility of the contingency materializing is remote.

Note 31. Other Disclosures (in thousands): The following table presents unmatched disbursements, negative unliquidated obligations and aged in-transit disbursements. (in thousands)

Navy, Treasury Index 17
Appropriations

	September 1997	September 1996	Change	Percent Change
Unmatched Disbursements	$3,785,805	$6,423,544	($2,637,739)	(41.06%)
Negative Unliquidated Obligations	1,875,842	2,690,246	(814,404)	(30.27%)
Intransit Disbursements	12,750,123	6,798,592	5,951,531	87.54%
Total	$18,411,770	$15,912,382	$2,499,388	15.71%

September 1997 Unmatched Disbursements and Negative Unliquidated Obligations included Marine Corps. September 1996 amounts did not include Marine Corps. The amounts not included in the September 1996 column for the Marine Corps were $164,628 thousand and $107,670 thousand respectively. Intransit Disbursements were not disclosed in the prior year. report.

Other information:

Variations between the Comparative Years

1. Advances and Prepayments. The increase of $4,516,471 thousand from FY 1996 was as a result of the inclusion of Progress Payments in FY 1997 on contracts for the Procurement Appropriations.

Note 31. Other Disclosures (in thousands) (cont'd):

Other Information (cont'd):

2. Advances and Prepayments-Intragovernmental. In FY 1996 the amount reported in the Statement of Financial Position was attributed to the FY 1992 year reporting of $66,000 thousand and $579 thousand in FY 1990 and prior years. For FY 1997 CFO Statements FY 1992 went into a canceled/withdrawn status and no FY 1991 and prior year amount were reported on this line.

3. Advances and Prepayments-Governmental. The large variance of $4,583,050 thousand is attributed mainly to progress payments of $4,139,925 thousand for the Operations and Maintenance appropriations which were included in the FY 1997 Statement of Financial Position but were not included in the FY 1996 statements.

4. War Reserves. The reporting of items held for future use in case of conflict or other emergent need is not clearly addressed in the Statements of Federal Financial Standards (SFFAS). For example, munitions could be reported as operating materials and supplies, as general property, plant and equipment (PP&E), or as National Defense PP&E. Since these items are not held for sale, they will not be reported as inventory. Until the SFFAS is clarified, items held for future use, in case of conflict or other emergent need, will be reported as War Reserves.

The Department of the Navy used the Supply System Inventory Report (SSIR) to capture information reported in the Inventory line of $41,441,075 thousand for FY 1996. This report includes a category titled "War Reserve" with a value of $27,418 thousand and the Department used this amount to separate that category. At this time, the items identified for War Reserve should include all the items in the SSIR.

The comparative total War Reserve as derived from the SSIR for FY 1996 and FY 1997 are $41,441,075 thousand and $54,589,962 thousand respectively. Increases in this account include corrective actions to capture all the information sources as identified in the Naval Audit Service Audit Report No. 048-97 dated 25 September 1997, Department of the Navy Fiscal Year 1996 Annual Financial Report: Ammunition and Ashore Inventory.

5. Accounts Payable-Intragovernmental. The variance of $2,575,112 thousand between FY 1996 and FY 1997 is attributable to the eliminating entry of $903,779 thousand which was made in FY 1997 and $0 in FY 1996. Additionally, the FY 1990 and prior years amount of $24,007 thousand was included in FY 1996 but not in FY 1997.

Note 31. Other Disclosures (in thousands) (cont'd):

Other Information (cont'd):

6. Account Payable-Governmental. The variance of $3,296,320 thousand is attributed to the following:

Adjustment made for military Payrolls. This adjustment was approximately $900,000 thousand which was reported in FY 1997 but not reported in FY 1996. This represents wages which were earned during September 1997 but not paid until October 1997.

FY 1990 and prior years. The amount reported in FY 1996 was $1,828,548 thousand was included on this line in FY 1996 there were no FY 1990 and prior years reported on this line in FY 1997.

The FY 1996 amount contained Accounts Payable for contracts accumulated from Accrued Expenditure Reports produced by the MOCAS system. Accounts Payable for contracts was excluded from FY 1997 amount in accordance with the Naval Audit Service Audit Report (97-0046), recommending the discontinuance of including these amounts.

7. Accrued Payroll and Benefits. Accrued Payroll and Benefits represents civilian and military payroll and benefits earned but not paid as of the end of the accounting month. The amount is accrued in the financial statements as a non-federal liability. FY 1997 amounts accrued for civilian and military personnel were $120,000 thousand and $1,300,500 thousand respectively. Accrued Payroll and Benefits includes severance pay and separation allowances in the amount of $215,900 thousand.

8. Severance Pay and Separation Allowance. This represents the unliquidated liability for the Temporary Early Retirement Authority (TERA) reported in the Military Personnel, Navy (17 1453) and the Reserve Personnel, Navy (17 1405) appropriations. These amounts were $186,094 thousand and $24,473 thousand respectively.

9. Unexpended Appropriations. The variance in Unexpended Appropriations of $1,949,560 thousand between FY 1996 and FY 1997 is mainly due to the inclusion of the FY 1990 and prior year balances of $2,788,972 thousand on the FY 1996 CFO statements.

10. Revenue from the Sale of Goods and Services - Public. The variance of $850,766 thousand can be attributed to the work which was performed to correctly split the revenue between public and government during FY 1997. In FY 1996 all revenue was placed on the intragovernmental line

11. Revenue for the Sale of Good and Services-Intragovernmental. This variance of $2,429,900 thousand can be partially attributed to the intrafund elimination of $1,616,991 thousand. Additionally, a split between revenue from public and governmental sources was performed in FY 1997 and was not done in FY 1996.

Note 31. Other Disclosures (in thousands) (cont'd):

Other Information (cont'd):

12. Interest, Other. This amount is attributed to Prompt Payment Act Interest Expense. The following amounts were reported by Navy and Marine Corps (in thousands):

Navy	$8,054
Marine Corps	691
Total	$8,745

Abnormal Balances. Intragovernmental Accounts Payable contains an abnormal balance of $27,956 thousand, which was affected by the following :

Interfund Eliminations of $903,779 thousand were recorded in FY 1997. Interfund Eliminations were not recorded for FY 1996.

A change in the policy for reporting reopened years for FY 1997 resulted in a $210,920 thousand decrease.

Footnotes

DEPARTMENT OF THE NAVY

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

Financial statement attributes represent core DoD financial performance measures used to analyze financial results and trends affecting the overall health and position of the Department of the Navy's financial programs. Identified are five agency attributes; Operating Cost Attribute, Operating Results Attribute, Financial Obligations Attribute, Financial Condition Attribute, and the Operating Efficiency Attribute which form the focus of our financial statement analysis. Cross-sectional analyses are presented comparing similar attributes for the Department of the Navy's General, Revolving, Trust, and Other Funds.

General Funds contain the bulk of congressional appropriations for the Department of the Navy. These appropriations include the military pay and the operations and maintenance accounts which are used to pay and maintain the functional and administrative support of our operating forces. The research and development funds are used to operate and maintain world-wide facilities which perform ongoing test, evaluation and research of systems to be used in the completion of the Department of the Navy's military missions. Finally, the investment/construction accounts are used for specific purposes approved by Congress for acquiring or construction of weapons systems, property and infrastructures.

The Department of the Navy has one revolving fund, the National Defense Sealift Fund, Navy. This account supports vessels for national defense purposes. These vessels are privately owned and operated and constructed in the United States and are documented under the laws of the United States. This fund also supports research and development relating to national defense sealift. The account deposits receipts from the disposition of national defense sealift vessels, charter of vessels, and the disposition of gifts.

Trust funds are used to record the receipt and outlay of funds held in trust by the government for use in carrying out specific purposes in accordance with the terms of a trust agreement or statute. Trust accounts received through gifts and bequests (as well as interest earned on the investments of some of these gifts) and assets held for particular purposes.

Other funds include special, deposit, and special receipt accounts. Special funds are comprised of receipt and expenditure accounts that can only be used in accordance with specific provisions of law. Deposit funds are generally used to hold assets that are awaiting legal determination or where the Department of the Navy acts as agent or custodian. These accounts may also be used for unidentified remittances.

OPERATING COSTS ATTRIBUTE
(in thousands)

The Operating Costs Attribute represents how much it costs to operate a program. This information is useful for planning, budgeting, and cost control purposes.

FY 1997

	General	Revolving	Trust	Other	Total
Total Costs	$73,887,439	$227,429	$21,298	$168	$74,136,334
Revenue & Reimb	5,779,641	227,429	24,918	0	6,031,988
Net Operating Cost FY 97	$68,107,798	$0	($3,620)	$168	$68,104,346
Net Operating Cost FY 96	$56,537,209	$0	$24,693	($1,593)	$56,560,309
Net Operating Change	$11,570,589	$0	($28,313)	$1,761	$11,544,037
Annual Percentage Change	20.47%	0.00%	-114.66%	110.55%	20.41%

FY 1996

	General	Revolving	Trust	Other	Total
Total Costs	$62,000,845	$741,679	$525,366	($1,593)	$63,266,297
Revenue & Reimb	5,463,636	741,679	500,673	0	6,705,988
Net Operating Cost FY96	$56,537,209	$0	$24,693	($1,593)	$56,560,309
Net Operating Cost FY 95*	N/A	N/A	N/A	N/A	N/A
Net Operating Change					
Annual Percentage Change					

* FY 1996 was the first year that these statements were prepared.

OPERATING RESULTS ATTRIBUTE
(in thousands)

The Operating Results Attribute identifies when a program's operations result in an excess of expenses over revenues and appropriations or vice-versa.

FY 1997

	General	Revolving	Trust	Other	Total
Revenues					
Appropriations Realized	$62,037,798	$0	$0	$168	$62,037,966
Federal Sources	3,988,559	227,429	566	0	4,216,554
Public Sources	883,283	0	21,961	0	905,244
Other Sources	907,799	0	2,391	0	910,190
Total Revenues	$67,817,439	$227,429	$24,918	$168	$68,069,954
Expenses & Losses	73,887,439	227,429	21,298	168	74,136,334
Net Operating Results	($6,070,000)	$0	$3,620	$0	($6,066,380)

FY 1996

	General	Revolving	Trust	Other	Total
Revenues					
Appropriations Realized	$56,537,209	$0	$0	($1,593)	$56,535,616
Federal Sources	5,433,537	741,679	471,252	0	6,646,468
Public Sources	30,099	0	29,421	0	59,520
Total Revenues	$62,000,845	$741,679	$500,673	($1,593)	$63,241,604
Expenses & Losses	62,000,845	741,679	525,366	(1,593)	63,266,297
Net Operating Results	$0	$0	($24,693)	$0	($24,693)

FINANCIAL OBLIGATION ATTRIBUTE
(in thousands)

The Financial Obligation Attribute represents the liabilities that a program incurs in its operations or asset acquisitions. The current ratio indicates the program's ability to pay its obligations that will be due within a year.

FY 1997

	General	Revolving	Trust	Other	Total
Total Current Assets	$64,411,171	$3,985,808	$25,269	$49,282	$68,471,530
Total Current Liabilities	6,664,931	(463,415)	588	785	6,202,889
Current Ratio	9.66	4,449,223	42.97	62.78	11.04
Total Quick Assets	$64,411,171	$3,979,600	$25,226	$49,282	$68,465,279
Total Current Liabilities	6,664,931	(463,415)	588	785	6,202,889
Acid Test Ratio	9.66	4,443,015	42.90	62.78	11.04

FY 1996

	General	Revolving	Trust	Other	Total
Total Current Assets	$108,784,999	$3,932,459	$102,461	$45,649	$112,865,568
Total Current Liabilities	9,758,162	27,075	132,843	0	9,918,080
Current Ratio	11.15	145.24	0.77		11.38
Total Quick Assets	$67,343,924	$3,927,182	$102,390	$45,649	$71,419,145
Total Current Liabilities	9,758,162	27,075	132,843	0	9,918,080
Acid Test Ratio	6.90	145.05	0.77		7.20

FINANCIAL CONDITION ATTRIBUTE
(in thousands)

The Financial Condition Attribute shows the ability to generate financial resources to maintain operations and to meet financial obligations, when they are due, without considering financial assistance.

FY 1997

	General	Revolving	Trust	Other	Total
Sources of Cash	$55,290,615	$2,653,244	$16,267	$49,282	$58,009,408
Future Requirements for Cash	16,444,140	(463,415)	588	785	15,982,098
Cash Surplus (Shortfall)	$38,846,475	$3,116,659	$15,679	$48,497	$42,027,310
Total Assets	$453,410,973	$3,985,808	$63,792	$49,282	$457,509,855
Total Liabilities	$16,444,140	($463,415)	$588	$785	$15,982,098
Assets to Debt Ratio	27.57	4,449,223	108.49	62.78	28.63

FY 1996

	General	Revolving	Trust	Other	Total
Sources of Cash	$62,963,305	$1,846,072	($2,120)	$45,649	$68,852,906
Future Requirements for Cash	13,158,270	27,075	133,013	0	13,318,358
Cash Surplus (Shortfall)	$49,805,035	1,818,997	($135,133)	$45,649	$51,534,548
Total Assets	$449,303,385	$3,932,459	$142,306	$45,649	$453,423,799
Total Liabilities	$13,158,270	$27,075	$133,013	$0	$13,318,358
Assets to Debt Ratio	34.15	145.24	1.07		34.05

OPERATING EFFICIENCY - ASSET MANAGEMENT
(in thousands)

The Operating Efficiency Attribute relates performance of a program in terms of what it accomplished to the resources it consumed.

FY 1997

	Revolving	Trust	Total
Cost of Goods Sold	$227,429	$19,302	$246,731
Average Inventory	$0	$0	$0
Inventory Turn Ratio or in Days	0	0	0
Sales Revenue	$227,429	$21,961	$249,390
Daily Accounts Receivable	$3,684	$0	$3,684
Average Rec. Turn Ratio or in Days	62	0	62
OP Cycle = Inv. Turn Day + Acct. Rec. Turn Day	62	0	62

FY 1996

	Revolving	Trust	Total
Cost of Goods Sold	$741,679	$19,230	$760,909
Average Inventory	$0	$0	$0
Inventory Turn Ratio or in Days	0	0	0
Sales Revenue	$0	$0	$0
Daily Accounts Receivable	$5,871	$2	$5,783
Average Rec. Turn Ratio or in Days	0	0	0
OP Cycle = Inv. Turn Day + Acct. Rec. Turn Day	0	0	0

Consolidating Schedules
Statement of Financial Position
As of September 30, 1997
(Thousands)

ASSETS	General Fund	Revolving Fund	Trust Fund	Other	Eliminating Entries	Total
1. Entity Assets:						
a. Transactions with Federal (Intragovernmental) Entities:						
(1) Fund Balance with Treasury	$55,290,615	$2,653,244	$16,267	$49,282	$0	$58,009,408
(2) Investments, Net	0	0	8,610	0	0	8,610
(3) Accounts Receivable, Net	2,228,973	1,809,640	0	0	(903,779)	3,134,834
(4) Interest Receivable	0	0	0	0	0	0
(5) Advances and Prepayments	0	0	0	0	0	0
(6) Other Federal (Intragovernmental)	0	0	0	0	0	0
b. Transactions with Non-Federal (Governmental) Entities:						
(1) Investments	0	0	0	0	0	0
(2) Accounts Receivable, Net	2,526,056	0	349	0	0	2,526,405
(3) Credit Program Receivables/ Related Foreclosed Property, Net	0	0	0	0	0	0
(4) Interest Receivable, Net	0	0	0	0	0	0
(5) Advances and Prepayments	4,786,020	2	0	0	0	4,786,022
(6) Other Non-Federal (Governmental)	0	0	0	0	0	0
c. Cash and Other Monetary Assets	0	0	0	0	0	0
d. Inventory, Net	0	0	43	0	0	43
e. Work in Process	0	6,208	0	0	0	6,208
f. Operating Materials/Supplies, Net	0	0	0	0	0	0
g. Stockpile Materials, Net	0	0	0	0	0	0
h. Seized Property	0	0	0	0	0	0
i. Forfeited Property, Net	0	0	0	0	0	0
j. Goods Held Under Price Support and Stabilization Programs, Net	0	0	0	0	0	0
k. Property, Plant and Equipment, Net	334,550,255	0	38,523	0	0	334,588,778
l. War Reserves	54,589,962	0	0	0	0	54,589,962
m. Other Entity Assets	0	0	0	0	0	0
n. Total Entity Assets	$453,971,881	$4,469,094	$63,792	$49,282	($903,779)	$457,650,270
2. Non-Entity Assets:						
a. Transactions with Federal (Intragovernmental) Entities:						
(1) Fund Balance with Treasury	($327,502)	$0	$0	$0	$0	($327,502)
(2) Accounts Receivable, Net	30,768	0	0	0	0	30,768
(3) Interest Receivable, Net	0	0	0	0	0	0
(4) Other	0	0	0	0	0	0
b. Transactions with Non-Federal (Governmental) Entities:						
(1) Accounts Receivable, Net	5,363	0	0	0	0	5,363
(2) Interest Receivable, Net	0	0	0	0	0	0
(3) Other	0	0	0	0	0	0
c. Cash and Other Monetary Assets	150,956	0	0	0	0	150,956
d. Other Non-Entity Assets	0	0	0	0	0	0
e. Total Non-Entity Assets	($140,415)	$0	$0	$0	$0	($140,415)
3. Total Assets	$453,831,466	$4,469,094	$63,792	$49,282	($903,779)	$457,509,855

Consolidating Schedules
Statement of Financial Position
As of September 30, 1997
(Thousands)

LIABILITIES	**General Fund**	**Revolving Fund**	**Trust Fund**	**Other**	**Eliminating Entries**	**Total**
4. Liabilities Covered by Budgetary Resources:						
a. Transactions with Federal (Intragovernmental) Entities:						
(1) Accounts Payable	$869,615	$6,208	$0	$0	($903,779)	($27,956)
(2) Interest Payable	0	0	0	0	0	0
(3) Debt	0	0	0	0	0	0
(4) Other Federal (Intragovernmental) Liabilities	146,089	0	0	0	0	146,089
b. Transactions with Non-Federal (Governmental) Entities:						
(1) Accounts Payable	3,150,347	13,663	588	785	0	3,165,383
(2) Accrued Payroll and Benefits						
(a) Salaries and Wages	1,204,622	0	0	0	0	1,204,622
(b) Annual Accrued Leave	0	0	0	0	0	0
(c) Severance Pay and Separation Allowance	215,959	0	0	0	0	215,959
(3) Interest Payable	0	0	0	0	0	0
(4) Liabilities for Loan Guarantees	0	0	0	0	0	0
(5) Lease Liabilities	0	0	0	0	0	0
(6) Pensions and Other Actuarial Liabilities	0	0	0	0	0	0
(7) Other Non-Federal (Governmental) Liabilities	40,007	0	0	0	0	40,007
c. Total Liabilities Covered by Budgetary Resources:	$5,626,639	$19,871	$588	$785	($903,779)	$4,744,104
5. Liabilities Not Covered by Budgetary Resources:						
a. Transactions with Federal (Intragovernmental) Entities:						
(1) Accounts Payable	$210,920	$0	$0	$0	$0	$210,920
(2) Debt	0	0	0	0	0	0
(3) Other Federal (Intragovernmental) Liabilities	6,070,000	0	0	0	0	6,070,000
b. Transactions with Non-Federal (Governmental) Entities:						
(1) Accounts Payable	2,301,880	0	0	0	0	2,301,880
(2) Debt	0	0	0	0	0	0
(3) Lease Liabilities	0	0	0	0	0	0
(4) Pensions and Other Actuarial Liabilities	1,476,455	0	0	0	0	1,476,455
(5) Other Non-Federal (Governmental) Liabilities	1,178,739	0	0	0	0	1,178,739
c. Total Liabilities Not Covered by Budgetary Resources	$11,237,994	$0	$0	$0	$0	$11,237,994
6. Total Liabilities	$16,864,633	$19,871	$588	$785	($903,779)	$15,982,098
NET POSITION						
7. Balances:						
a. Unexpended Appropriations	$54,526,614	$4,449,223	$2,203	$48,497	$0	$59,026,537
b. Invested Capital	393,656,497	0	46,345	0	0	393,702,842
c. Cumulative Results of Operations	0	0	14,656	0	0	14,656
d. Other	21,716	0	0	0	0	21,716
e. Future Funding Requirements	(11,237,994)	0	0	0	0	(11,237,994)
f. Total Net Position	$436,966,833	$4,449,223	$63,204	$48,497	$0	$441,527,757
8. Total Liabilities and Net Position	$453,831,466	$4,469,094	$63,792	$49,282	($903,779)	$457,509,855

Consolidating Schedules
Statement of Operations and Changes in Net Position
As of September 30, 1997
(Thousands)

REVENUES AND FINANCING SOURCES	**General Fund**	**Revolving Fund**	**Trust Fund**	**Other**	**Eliminating Entries**	**Total**
1. Appropriated Capital Used	$62,037,798	$0	$0	$168	$0	$62,037,966
2. Revenues from Sales of Goods and Services						
a. To the Public	883,283	0	21,961	0	0	905,244
b. Intragovernmental	5,122,264	710,715	0	0	(1,616,991)	4,215,988
3. Interest and Penalties, Non-Federal	703	0	0	0	0	703
4. Interest, Federal	0	0	566	0	0	566
5. Taxes	0	0	0	0	0	0
6. Other Revenues and Financing Sources	907,799	0	2,391	0	0	910,190
7. Less: Taxes and Receipts Transferred to the Treasury or Other Agencies	703	0	0	0	0	703
8. Total Revenues and Financing Sources	$68,951,144	$710,715	$24,918	$168	($1,616,991)	$68,069,954
EXPENSES						
9. Program or Operating Expenses	$62,023,506	$0	$1,996	$168	$0	$62,025,670
10. Cost of Goods Sold						
a. To the Public	816,089	0	19,302	0	0	835,391
b. Intragovernmental	5,122,264	710,715	0	0	(1,616,991)	4,215,988
11. Depreciation and Amortization	0	0	0	0	0	0
12. Bad Debts and Writeoffs	71,728	0	0	0	0	71,728
13. Interest						
a. Federal Financing Bank/Treasury Borrowing	0	0	0	0	0	0
b. Federal Securities	0	0	0	0	0	0
c. Other	8,745	0	0	0	0	8,745
14. Other Expenses	6,978,812	0	0	0	0	6,978,812
15. Total Expenses	$75,021,144	$710,715	$21,298	$168	($1,616,991)	$74,136,334
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Extraordinary Items	($6,070,000)	$0	$3,620	$0	$0	($6,066,380)
17. Plus (Minus) Extraordinary Items	0	0	0	0	0	0
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	($6,070,000)	$0	$3,620	$0	$0	($6,066,380)
19. Net Position, Beginning Balance, as Previously Stated	436,144,858	3,905,384	9,293	45,906	0	440,105,441
20. Adjustments		0	0	0	0	0
21. Net Position, Beginning Balance, as Restated	$436,144,858	$3,905,384	$9,293	$45,906	$0	$440,105,441
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(6,070,000)	0	3,620	0	0	(6,066,380)
23. Plus (Minus) Non Operating Changes	6,891,975	543,839	50,291	2,591	0	7,488,696
24. Net Position, Ending Balance	$436,966,833	$4,449,223	$63,204	$48,497	$0	$441,527,757

DEPARTMENT OF THE NAVY

AUDIT OPINION

Audit opinion to be provided by the Naval Audit Service at a later date.

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 General Fund Financial Statements (Project No. 7FI-2033)

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. We delegated to the Naval Audit Service (NAS) the audits of the FYs 1997 and 1996 Navy General Fund consolidated financial statements. Summarized below are the NAS disclaimer of opinion on the FYs 1997 and 1996 Navy General Fund financial statements and the results of our review of the NAS audit. We endorse the disclaimer of opinion expressed by the NAS (see the Enclosure).

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

o The Department of the Navy did not have transaction-driven, standard general ledger accounting systems capable of accurately reporting the value of assets and liabilities, including the status of funds appropriated.

o No subsidiary ledgers existed, which are necessary for maintaining accurate financial records and for providing an audit trail.

Internal Controls. Internal controls did not ensure that the FYs 1997 and 1996 Navy General Fund 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 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 to satisfy ourselves as to the fairness and accuracy of the approach and conclusions.

We conducted our review of the NAS work on the FYs 1997 and 1996 Navy General Fund financial statements from March 11, 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 opinion or its related evaluation of internal controls and compliance with laws and regulations.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosure

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Report on Auditor's Opinion

In accordance with the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994, the Department of the Navy prepared the accompanying Principal Statements for the fiscal years ended 30 September 1997 and 1996. The Government Management Reform Act significantly expanded the statutory audit requirements of the Inspectors General. On 10 May 1995, the Inspector General, Department of Defense, delegated responsibility to the Naval Audit Service for audit of the Department of the Navy's financial statements for Fiscal Year 1996 and beyond. Therefore, this was the second year we were requested to audit the financial statements in accordance with generally accepted government auditing standards. The audit included an evaluation of related internal controls and compliance with laws and regulations.

We are unable to give an opinion on the Department of the Navy's Principal Financial Statements for the fiscal years ended 30 September 1997 and 1996. The primary reason for this disclaimer of opinion is that the Department of the Navy does not have transaction-driven standard general ledger accounting systems that can accurately report the value of assets and liabilities, including the status of funds appropriated. Thus, we cannot ascertain the reliability of the financial statements. Based on work we performed, we identified the following: the $5.7 billion balance in Accounts Receivable, Non-Federal and Federal was materially affected by an invalid $1.4 billion receivable and a $430 million understatement; the War Reserve balance of $54.6 billion was understated by at least $8.5 billion; the $293 billion Property, Plant, and Equipment balance was understated by at least $10.8 billion; and the Accounts Payable, Non-Federal balance of $5.5 billion was overstated by $322 million.

Financial data in the Overview and the Supplemental Financial and Management Information sections of the Department of the Navy's Annual Financial Report was derived from the same sources as the financial statements and, therefore, may not be reliable.

Internal controls did not ensure that the financial statements were free of material misstatements. As a result, the risk of material misstatement is high. Procedural and compliance problems also contributed to the lack of support for financial reporting. Accounting systems represented the foremost compliance problem since these systems did not meet the requirements of the Federal Financial Management Improvement Act of 1996. Specifically, the Department of the Navy's financial management systems do not substantially comply with Federal financial management system requirements, applicable

Federal accounting standards, and the U. S. Government Standard General Ledger at the transaction level. The Department of the Navy and Defense Finance and Accounting Service have recognized these weaknesses and reported them in their Fiscal Year 1997 Assurance Statements on Management Controls.

GREG SINCLITICO
By direction
27 February 1998

The Department of the Navy Fiscal Year 1997 Annual Financial Report was prepared jointly by the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) and the Defense Finance and Accounting Service Center in Cleveland. It is the culmination of the efforts of many dedicated personnel of the Department of Defense.

This report was prepared in accordance with the Chief Financial Officers Act of 1990, as amended, and subsequent guidance.

Questions related to this report should be addressed to:

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