Department of the Navy
Fiscal Year 2021
Agency Financial Report

★ One Navy–Marine Corps Team ★

210421-A-BD272-0497
ARABIAN GULF (April 21, 2021) A multinational group of mine countermeasure ships from the French Marine Nationale, UK Royal Navy, U.S. Navy and a MH-53E Sea Dragon helicopter, attached to the “Blackhawks” of Helicopter Mine Countermeasures Squadron (HM-15), operate in formation during exercise Artemis Trident 21 in the Arabian Gulf, April 21. Artemis Trident 21 is a multilateral mine countermeasures exercise between the UK, Australia, France and U.S., designed to enhance mutual interoperability and capabilities in mine hunting and clearance, maritime security and dive operations, allowing participating naval forces to effectively develop the necessary skills to address threats to regional security, freedom of navigation and the free flow of commerce. (U.S. Army photo by Spc. Theoren Neal)

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MESSAGE FROM THE SECRETARY OF THE NAVY

Seamen of the USS Essex and Soldiers of the 185th Theater Aviation Brigade participate in a joint deck landing qualification exercise in the Persian Gulf Sept. 28. This exercise aims to increase the interoperability and trust between the U.S. forces by having them work together. (Photo by Sgt. David N. Beckstrom, 19th Public Affairs Detachment, USARCENT Public Affairs)

MESSAGE FROM THE SECRETARY OF THE NAVY

I am pleased to present the *Department of the Navy Fiscal Year 2021 Agency Financial Report* (AFR), to give our stakeholders insight on the Department of the Navy's (DON) financial health, performance, and significant challenges. This report is a transparent accounting of the DON management of our resources to the President, Congress, and American taxpayers.

The DON is committed to our enduring priorities of *maintaining maritime dominance in defense of our Nation, improving our people, and strengthening strategic partnerships*. Our success in each of these areas depends on our commitment to sound financial management and stewardship of resources entrusted to the Navy and Marine Corps.

The DON AFR serves as our primary annual report articulating our success in achieving these goals, and areas where we must improve. Accountability and transparency are foundational tenets that drive our financial reporting processes, supported by continued strategic implementation of the DON's financial management transformation initiative to modernize systems, processes, and controls focused on innovation and efficiencies that best support our Sailors, Marines, and civilians. This transformation effort remains critical to optimizing resources and allocating assets to addressing the Nation's most significant threats.

The DON is committed to leveraging financial statement audit findings to improve operational effectiveness and fiscal discipline and transform how we conduct business. We led the Department of Defense in reducing material weaknesses, having downgraded four in the last three years; a fifth is downgraded in the auditor's report contained herein.

While our internal controls over financial reporting and systems must continue to improve, we made significant remediation progress in Fiscal Year 2021, while navigating the constraints of the COVID-19 pandemic. We focused on systems consolidation, budgetary reform, and enhancing business processes, policies, and internal controls. Specifically, the DON significantly consolidated and decommissioned seven financially relevant systems. For the first time, we issued an integrated risk management guidance framework to address financial and non-financial risks.

Our *Audit Roadma*p highlights the interdependencies between business processes and systems improvements. These support the critical path to earning an audit opinion. We remain on track to achieve our roadmap objectives, accelerate remediation, and demonstrate internal controls in the future.

Fundamental to this effort is improved data accessibility, timeliness, and accuracy. Having the right data at the right time enables our leaders to deploy data-driven strategies that support the DON's warfighting capability and readiness. DON financial management data transformation goes hand-in-hand with modernizing the systems environment. By treating data as a strategic asset we will gain efficiencies to optimize resource allocation and ensure our Sailors and Marines have what they need to complete the mission and return home safely.

The entire DON will continue to work as a team in order to maximize our resources and readiness so that we are always prepared to respond wherever and whenever needed by our Nation. We will continue to pursue greater achievements in financial management transformation as a warfighting priority. Thank you for your consideration of this report.

Carlos Del Toro
November 8, 2021

MANAGEMENT'S DISCUSSION AND ANALYSIS

211003-N-BC311-1294-PHILIPPINE SEA (Oct. 3, 2021) British Royal Navy HMS Queen Elizabeth (R08) transits the Philippine Sea with ships from six different nations Oct. 3, 2021. The United Kingdom's carrier strike group led by HMS Queen Elizabeth (R08); Japan Maritime Self-Defense Force Hyuga-class helicopter destroyer JS Ise (DDH 182); Royal Canadian Navy's HMCS Winnipeg (FFH 338); Royal Netherlands Navy's HNLMS Evertsen (F 805); Royal New Zealand Navy's HMNZS Te Kaha (F 77) and U.S. Navy Carrier Strike Groups led by flagships USS Ronald Reagan (CVN 76) and USS Carl Vinson (CVN 70), conducted multiple carrier strike group operations in the Philippine Sea. The integrated at-sea operations brought together more than 15,000 Sailors across five nations to demonstrate an unmatched network of alliances and partnerships in support of a free and open Indo-Pacific. (U.S. Navy photo by Aviation Boastwain's Mate (Handling) Airman George A. Valceanu)

ABOUT THIS REPORT

The purpose of the Agency Financial Report (AFR) is to outline how the Department of Navy[1] (DON) has used Federal resources, highlight accomplishments, and represent the financial position. The DON's financial position includes, but is not limited to, financial statements, notes to the financial statements, and the Independent Public Accountant (IPA) report. This AFR provides high-level performance and management results for two separate sets of financial statements: (1) United States Navy (USN) General Fund (GF) - capturing core USN administrative and operational tasks and (2) DON Working Capital Fund (WCF) – capturing business-like acquisition and repair activities for the USN and United States Marine Corps (USMC) funded through sales revenue, rather than direct Congressional appropriations.

Information for USN GF and DON WCF are combined within the Management's Discussion and Analysis (MD&A) Section and presented separately throughout the remaining sections of this AFR. Although part of the DON, the USMC GF is currently audited as a standalone entity and produces a separate AFR and GF financial statements.

This report satisfies the reporting requirements contained in the following laws and Regulations:

- Chief Financial Officers (CFO) Act of 1990;
- Federal Managers' Financial Integrity Act of 1982 (FMFIA);
- Federal Financial Management Improvement Act of 1996 (FFMIA);
- Government Performance and Results Act of 1993 (GPRA);
- GPRA Modernization Act of 2010;
- Government Management Reform Act of 1994 (GMRA);
- Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Controls (OMB A-123); and
- OMB Circular A-136, Financial Reporting Requirements; and Reports Consolidation Act of 2000 (OMB A-136).

1 When used in this document, DON applies to both the USN and USMC WCF and is not intended to discuss items presented in the USMC GF AFR.

MISSION AND ORGANIZATION

On October 13, 1775, the Continental Congress authorized the creation of the first American naval force, the precursor to the USN. This naval force was disbanded after the Revolutionary War. President John Adams signed a Congressional Act on April 30, 1798 establishing the formation of the DON. In 1834 the USMC was incorporated into the DON. The DON remained its own standalone department until the establishment of the National Security Act of 1947, which unified the military agencies by joining the DON, U.S. Army, and U.S. Air Force as component services under the Department of Defense (DoD). Today, the DON operates under the statutory authority provided by Title 10 United States Code Subtitle C (10 USC Subtitle C).

The DON's core responsibility is to deter aggression and, if deterrence fails, win the nation's wars. The DON employs the global reach and persistent presence of forward stationed and rotational forces to secure the nation from direct attack, assure joint operational access, and retain global freedom of action. Along with global partners, the DON protects the maritime freedom that is the basis for global prosperity and fosters and sustains cooperative relationships with an expanding set of allies and international partners to enhance global security.

MISSION

To recruit, train, equip and organize to deliver combat ready Naval forces to win conflicts and wars while maintaining security and deterrence through sustained forward presence.

VISION

A combat credible Navy and Marine Corps Team focused on rebuilding military readiness, strengthening alliances, and reforming business practices in support of the National Defense Strategy.

Organization

The organization of the Navy is prescribed in 10 USC Subtitle C, Part I. The Secretary of the Navy (SECNAV) is responsible for, and has authority to, conduct all affairs of the DON. The SECNAV oversees the construction, outfitting, and repair of naval ships, equipment, and facilities, and is responsible for the formulation and implementation of policies and programs. Under the purview of the SECNAV are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, General Counsel, Chief Information Officer (CIO), and two key military leaders—the Chief of Naval Operations (CNO) and Commandant of the Marine Corps (CMC) are responsible for the command, operating efficiency and performance of combined forces that consists of approximately 729k active duty (including Officers, Enlisted, and Midshipmen), Reserve and civilian forces.

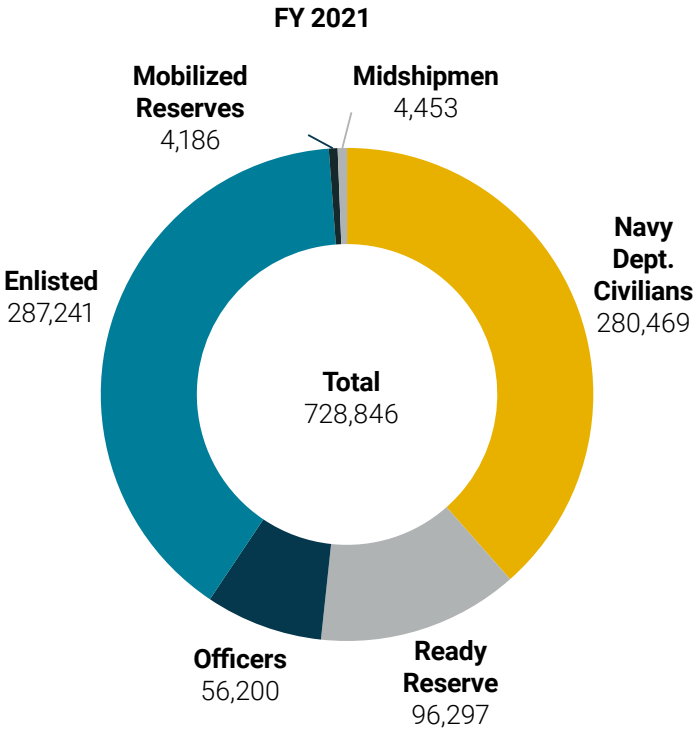
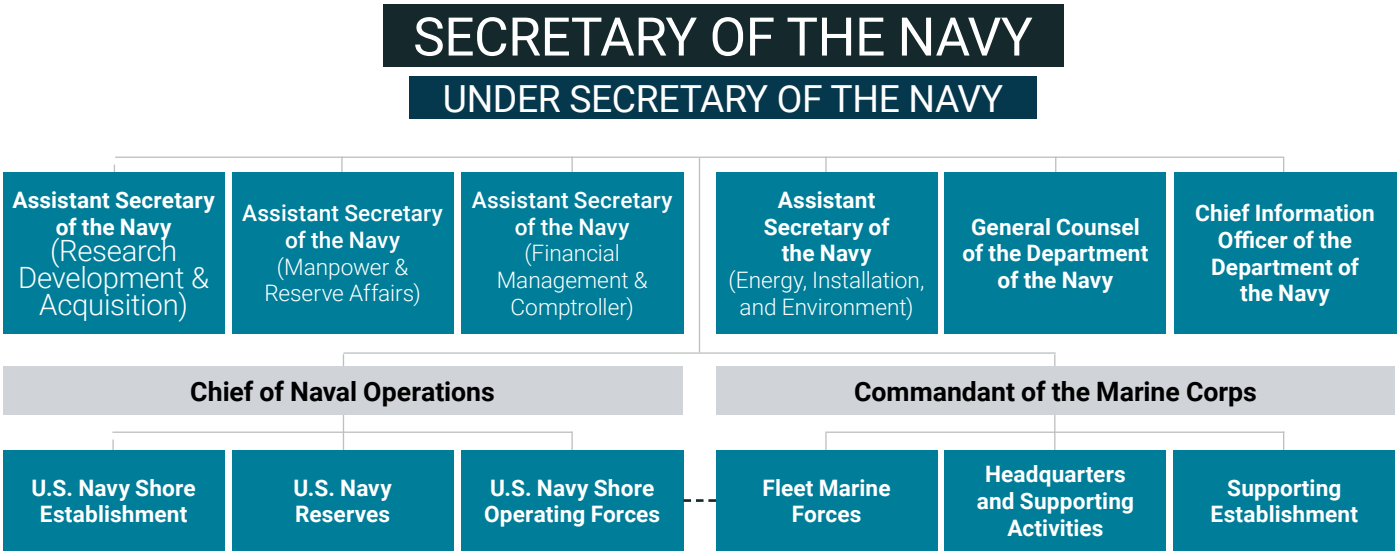


Figure 1: DON Personnel Count

Figure 2: DON Organization Chart



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

Mission Areas

All components of the DON are organized to respond to a broad range of mission priorities that preserve the Nation's freedom and protect U.S. global interests. The Office of the Secretary of the Navy has sole responsibility within the DON for acquisition, audit, environmental protection and conservation, financial and information management, installation and infrastructure support, legislative affairs, personnel recruitment, public affairs, research and development, and safety and occupational health. The CNO is responsible for the command, utilization of resources, and efficiency of operating forces and shore activities assigned by the Secretary of Defense (SECDEF). Like the CNO, the CMC oversees various commands that operate under the authority and responsibility of a commander and typically support a network of subordinate commands. Both Services provide ready forces to support the U.S. joint military commands in conducting worldwide missions.

In support of the DON's mission areas, there are three major CNO components: shore, reserves, and the supporting operations:

U.S. Navy Shore Establishment. Provides the fleet the personnel and resources needed to deter threats and win wars. The USN Shore Establishment support the fleet through the repair of ships, aircraft, weapons, machinery and electronics; communications; naval personnel support; installation and infrastructure support; intelligence, meteorological, and oceanographic support; and legal services.

U.S. Navy Reserves. Delivers strategic and operational capabilities to the Navy and Marine Corps team and Joint forces, in times of peace or war. Reservists seamlessly support and actively aid that mission, all while continuing to lead their own independent lives in the civilian world.

U.S. Navy Operating Forces. Leads the combat and combat support arm of the DON. These operating forces carry out naval operations needed to support the DON's role in upholding and advancing the national policies and interests of the U.S. They have two organizational chains of command - (1) Permanent administrative chain of command through the CNO to the SECNAV, and (2) Operational chain of command through the Unified Combatant Commands (UCCs) to the SECDEF.

These three components carry out naval operations needed to support the DON's role in upholding and advancing the national policies and interests of the U.S. Each component oversees various commands that each have a clearly defined mission in support of the overall DON mission. Within those commands are Budget Submitting Offices (BSO), which are functionally classified across three basic domains: Acquisition, Operating Forces, and Support. Below outlines each domain's purpose and each BSO's distinct mission.

Acquisition BSOs act for and exercise the authority of the Navy Acquisition Executive to manage assigned programs and projects, which generally run the full cycle of requirements development. Except for the Strategic Systems Program, these BSOs are also referred to as systems commands (SYSCOMs). SYSCOMs are the materiel commands of the USN responsible for the design, construction, and maintenance of military systems such as ships, aircraft, and weapons. The USN's Acquisition BSOs are listed below.

Naval Air Systems Command (NAVAIR) is the principal provider for the Naval Aviation Enterprise, which maintains top combat effectiveness by smartly managing precious resources and attack readiness degraders, while collaborating across organization boundaries to deliver ready forces where and when they are needed. NAVAIR provides support to Naval Aviation Program Executive Officers.

Working Capital Fund Operations

NAVAIR operates the Naval Air Warfare Centers (NAWCs) and the Fleet Readiness Centers (FRCs) using a WCF. The portion of NAVAIR's BSO supporting these WCF activities is reported within the DON WCF financial statements. NAVAIR operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Naval Sea Systems Command (NAVSEA) is the largest of the USN's SYSCOMs and is responsible to design, build, deliver, and maintain ships, submarines, and systems reliably, on-time and on-cost for the DON.

Working Capital Fund Operations

NAVSEA operates the Naval Surface Warfare Centers (NSWCs) and the Naval Undersea Warfare Centers (NUWCs) using a working capital fund model and are reported within the DON WCF financial statements. NAVSEA operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Naval Supply Systems Command (NAVSUP) conducts and enables supply chain, acquisition, operational logistics and Sailor & family care activities with our mission partners to generate readiness and sustain naval forces worldwide to prevent and decisively win wars.

Working Capital Fund Operations

NAVSUP operates the Business Systems Centers (BSCs) and Weapons Systems Support (WSS) using a working capital fund. The portion of NAVSUP's BSO supporting these WCF activities is reported within the DON WCF financial statements. NAVSUP operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Naval Information Warfare Systems Command (NAVWAR) identifies, develops, delivers, and sustains information warfare capabilities and services that enable naval, joint, coalition and other national missions operating in war fighting domains from seabed to space; and performs such other functions and tasks as directed.

Working Capital Fund Operations

NAVWAR operates the Naval Information Warfare Centers (NIWCs) using a working capital fund. The portion of NAVWAR's BSO supporting these WCF activities is reported within the DON WCF financial statements. NAVWAR operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Strategic Systems Program (SSP) directs the end-to-end effort of the Navy's Strategic Weapons Systems (SWS) to include training, systems, equipment, facilities and personnel; and fulfill the terms of the U.S./United Kingdom Polaris Sales Agreement.

Marine Corps Logistics Command (MARCORLOGCOM) provides globally responsive ground equipment inventory control and integrated operational-level logistics capabilities in order to maximize Marine Corps materiel readiness and sustainment.

MARCORLOGCOM is a WCF component of the USMC BSO. The USMC GF is reported in the USMC AFR.

Support BSOs support programs such as medical, infrastructure, Science and Technology (S&T), intelligence, and SECNAV and CNO staff office support. The USN's Support BSOs are listed below:

Bureau of Naval Personnel (BUPERS) provides administrative leadership, policy, planning, general oversight, training, and education for all Navy personnel. This includes developing, monitoring, and revising Navy strength plans for all active duty and ready reserve military personnel.

Commander, Navy Installations Command (CNIC) is responsible for worldwide U.S. Navy shore installation management, designing and developing integrated solutions for sustainment and development of Navy shore infrastructure. CNIC also has oversight of Naval Facilities Engineering Command (NAVFAC) which plans, builds, and maintains sustainable facilities.

Bureau of Medicine and Surgery (BUMED) is a global health care network that provides health care support to the USN, USMC, their families, and veterans, through the Defense Health Program (DHP) and coordinated by the Office of Assistant Secretary of Defense (Health Affairs) with support from the Defense Health Agency (DHA).

Office of Naval Research (ONR) sponsors research across a wide array of critical scientific disciplines, working with experts from industry, academia, naval warfare centers, laboratories, and other innovative organizations.

Working Capital Fund Operations

ONR operates the Naval Research Laboratory (NRL) using a working capital fund. The portion of ONR's BSO supporting this WCF activity is reported within the DON WCF financial statements. ONR operations other than the aforesaid activity is general fund operations and consolidated in the USN GF financial statements.

Naval Intelligence Activity (NIA) directs, synchronizes, and manages the Naval Intelligence Enterprise. NIA sets priorities, oversees activities, manages resources, and develops unique talent and capabilities for the Naval Intelligence Enterprise to further U.S. national security objectives and enable the warfighters of today and tomorrow.

Field Support Activity (FSA) establishes, maintains, and provides a system of financial services as a BSO - Principal Administering Office for assigned combatant commands, Navy Headquarters and activities. FSA initiates actions pertaining to the provision of funds and manpower, evaluates the utilization of such resources, and initiates or recommends appropriate corrective actions.

Secretariat Comptroller Division (FMB-7) resides in the Assistant Secretary of the Navy (ASN) Financial Management and Comptroller (FM&C) organization and serves as the Comptroller for the Navy Secretariat comprising four ASNs, one Deputy Under Secretary of the Navy (DUSN), a General Counsel (GC) team and twelve supporting organizations.

Operation forces BSOs support programs and projects once they are fielded and fully operational. The USN's operating forces BSOs are listed below:

U.S. Fleet Forces Command (USFLTFORCOM) trains, certifies and provides combat-ready Navy forces to combatant commanders that can conduct prompt, sustained naval, joint, and combined operations in support of U.S. national interests. USFLTFORCOM also commands and controls subordinate Navy forces and shore activities during the planning and execution of assigned service functions in support of the CNO.

Military Sealift Command (MSC)
USFLTFORCOM also operates the MSC which operates, supplies, and maintains the Naval ships around the world. The portion of USFLTFORCOM's BSO supporting this WCF activity is reported within the DON WCF financial statements. USFLTFORCOM operations other than the aforesaid activity is general fund operations and consolidated in the USN GF financial statements.

Commander, U. S. Pacific Fleet (COMPACFLT) protects and defends the collective maritime interests of the U.S. and its allies and partners in the Asia-Pacific region. COMPACFLT is the world's largest fleet command, encompassing 100 million square miles or more than half the Earth's surface.

Commander, Navy Reserve Force (CNRF) delivers strategic depth and operational capability to the Navy, Marine Corps, and Joint Forces by providing mission-capable units and individuals in support of the full range of operations, from peace to war.

Composition of Support to Unified Combatant Commands

The DON is also supported by UCCs which are DoD commands comprised of forces from at least two military Departments with a broad and continuing mission. These commands are established to provide effective command and control of U.S. military forces to include elements of the DON. UCCs are organized on either a geographical basis (i.e., possessing an area of responsibility) or a functional basis (i.e., providing a capability). The USN maintains operational forces and units that are operationally aligned to UCCs and centrally funded by the DoD and other military service components. Unless otherwise specified, all organizations supporting UCCs are centrally funded by the DoD and not reporting entities under the DON.

Other Reporting Components

The DON also has relationships with Non-Appropriated Funds Instrumentalities (NAFIs) and Federally Funded Research and Development Centers (FFRDCs). Based on the nature of these organizations the DON includes relevant disclosure information in the Notes to the AFR.

Refer to GF Note 1.A "Reporting Entity" and Note 24 "Disclosure Entities and Related Parties" for additional information.

PERFORMANCE GOALS, OBJECTIVES AND RESULTS

In a world more interconnected and interdependent than ever before, a fully integrated and forward maneuverable DON is critical to the security of our Nation and the preservation of rules-based international order. The SECNAV recently issued strategic guidance that articulates his vision to build, train and equip the world's most powerful naval force to meet both today's operational demands and the warfighting needs of the future. It is designed to reinforce and better align service-specific guidance already issued by the CNO and the Commandant of the Marine Corps with the Secretary of Defense's overall direction for the Department. The CNO issued the CNO Navigation Plan 2021, in which the Chief establishes the Navy's strategic priorities: "Our Navy will be manned, trained, and equipped to control the seas and project power. Our fleet will be a potent, formidable force that can decisively win at sea, deter our competitors, and assure our allies and partners. Joining with the Marine Corps and Coast Guard, we will deliver Integrated All-domain Naval Power to prevail in day-to-day competition, in crisis, and in conflict."

The guidance emphasizes the critical balance of maintaining readiness while transforming the fleet. By maintaining forward presence, the DON adds credibility to our national influence abroad and is postured to respond to threats or crises involving our regional allies, to protect freedom of navigation in international waterways, and to otherwise protect our national interests abroad. While maintaining readiness, and within fiscal limitations, the Navy must prioritize in order to deliver the cutting edge capabilities it needs to win against strategic competitors. The explosive rate of technological change complicates this management of force readiness and force modernization efforts. The CNO's guidance emphasizes Sailors, readiness, capabilities, and capacity. The Secretary of the Navy made obtaining the resources to expand the Department's capabilities the top priority. The DON is committed to ensuring sailors, marines and civilian employees have the tools and training they need to succeed, as well as committing to confronting our maintenance backlog, operational requirements, and building our Navy of the future.

Secretary Del Toro recently published his strategic guidance: "One Navy-Marine Corps Team: Strategic Guidance from the Secretary of the Navy", reinforcing and aligning service specific guidance issued by the CNO and CMC with the Secretary of Defense's overall direction for the Department. Selected performance goals, objectives, and results are presented below for areas assessed during FY 2021 that align to the SECNAV's priorities. Due to the recent issuance of the SECNAV strategic guidance, not all goals or priority areas are addressed below; as such, additional measures will be added in the FY 2022 AFR.

SECNAV Priority: Maintaining Maritime Dominance in Defense of Our Nation

The DON will build, train, and equip the world's most powerful naval force, and continue to defend the Nation, its allies, its values, and its interests. This priority necessitates more integration within the Navy, Marine Corps, and Coast Guard, and will require tradeoffs and unpopular choices. The DON will shift investments to capabilities, readiness, and sustainment in those areas necessary to promote force integration and address threats against our national and economic interests.

FY 2021 Results for SECNAV Priority 1:

STRATEGIC OBJECTIVE	SELECTED RESULT(S)
Expand Forward Presence – Expand global posture using the right mix of platforms, capability, and capacity to achieve strategic objectives. Make tough decisions to maximize resources and ensure Naval supremacy.	• Leveraged results from machine learning models to improve SSN Combat Readiness planning and execution, including informing the redistribution of weapons and improving availability and load out of weapons, given current inventory, to increase warfighting readiness. • Began implementation of CNO Navigation Plan strategic objectives to ensure current and future Navy platforms can deliver the appropriate volume and tempo of fires including kinetic, longer-range, higher-speed weapons such as hypersonic missiles, in addition to non-kinetic effects. • Accelerated development of innovative technologies such as long-range fires and unmanned systems through implementation of the CNO's Navigation Plan.
Enhance Warfighting Readiness – Ready to compete, fight, and win wherever and whenever needed. Reduce time offline for maintenance and repairs, and invest in critical readiness infrastructure. Integrate and streamline logistics and supply chains and enhance readiness through investments in training, ranges, and facilities.	• Sustained 558 mission ready F/A-18 E/F Super Hornets during COVID, an increase from 250 over the previous decade. • Increased maintenance on-time completion by >20%, reducing overall days of maintenance delay from over 7,000 days to less than 1,200 days. Saw steady increases in the number of ships completing all maintenance requirements during their scheduled availabilities. The percent of surface ships meeting life cycle health requirements increased. • Reduced public shipyard maintenance delays by over 755 days. Implemented predictive scheduling tools better forecast shipyard availability lengths.
Innovate and Modernize – From artificial intelligence and cyber weapons to unmanned platforms, to directed energy and hypersonic weapons, continue to develop technological breakthroughs that will define future conflict. Make investments in key emerging technologies and capabilities to enhance and sustain amphibious battlefield maneuverability, dominance at sea, and information superiority. Treat information as a strategic asset and make cybersecurity a top priority, increasing lethality, improving readiness, and sustaining resilience in cyberspace.	• Developed data-informed dashboard landing pages for leaders to utilize live data in Aviation and Surface performance management and improvement forums to accelerate data-driven decisions to support missions. • Process reforms improved organic depot capacity and repair velocity resulting in substantially reduced turnaround time for F/A-18E/F events from over 100 days to 60 days or less. • Accelerated development and fielding spectrum-dependent systems that are more agile, efficient, and resilient to meet mission requirements and accommodate increasing sharing initiatives such as 5G and beyond. • Established DON Principal Cyber Advisor's Office to provide advisement, oversight, policy, budget support, and coordination of all cyber related matters within the Department. • Progressed accomplishments in remediating cyber vulnerabilities (encryption, cryptography, zero-trust endpoint devices, etc.); building cyber-resiliency for weapon systems and critical infrastructure; and growing a highly trained and competent cyber workforce. • Improved DON facility related control systems through completed inventory of systems, and implementation of plans, processes, and tools to identify, track, respond to and mitigate cyber-related vulnerabilities.

SECNAV Priority: Empowering Our People

A high quality workforce provides a competitive warfighting advantage. The DON will focus on building and sustaining a strong, diverse, and healthy force, ready at all times and focused on warfighting and leadership at all levels. The DON's priority is to reward initiative and creativity, and enhance its reputation as a place to lead, work, grow, and build families.

FY 2021 Results for SECNAV Priority 2

STRATEGIC OBJECTIVE	SELECTED RESULT(S)
Cultivate Talent and Teamwork – Build the strongest possible warfighting force by recruiting, retaining, and promoting the best America has to offer. Cultivate talent and unique insights of individuals from diverse personal, cultural, and professional backgrounds. Continuously identify opportunities for all Sailors, Marines, and Civilians to develop warfighting and leadership skills, and emphasize diversity, equity, and inclusion in every aspect of our force.	• Accelerated implementation of the DON's Human Capital Strategy to better access and curate best in class talent through stand up and execution of the DON's Human Capital Strategy Task Force. • Launched performance improvement plans for MyNavyHR effort to improve the number of sailors at sea and match the best talent to task; developing live data landing page for leadership briefings. • Improved near miss and hazard reporting through increased leveraging of data analytics and deployment and implementation of new system to report and manage these risks • Tested use of two automated and artificial intelligence recruiting tools at 15+ recruiting events to deliver business case with recommendation for DON-wide tool.
Take Care of our People – Review and reform operating procedures and promotion practices to reward Leadership, Warfighting Skills, initiative, applied problem solving, and innovative strategic thinking at every level. Take a personal and hands-on approach to ensure enduring excellence in all aspects of quality of life for our military families.	• Established the DON's Diversity Equity and Inclusion (DE&I) function and developed the DON Diversity Equity & Inclusion Strategy implementation plan and governance structure to monitor execution against the strategy and plan. • Designed an approach to sustain a distributed workforce (post-COVID) that meets mission requirements as well as optimizes the real estate portfolio and facilities investments.

SECNAV Priority: Strengthening Strategic Partnerships

The DON's security cooperation efforts are designed to sustain and enhance the DON's primary missions, as well as nurture allied and friendly naval force capability and capacity for self-defense and multilateral operations. This entails working with allies and partners to collaborate in a variety of areas, including facilitating interoperability with naval forces, ensuring and exercising port access, and providing partner naval forces access to naval capabilities and technologies. The U.S. has a thriving, global constellation of alliances and partnerships that provides an asymmetric advantage no competitor or adversary can match. DON takes that advantage seriously and is dedicated to fostering its growth at every opportunity.

FY 2021 Results for SECNAV Priority 3

STRATEGIC OBJECTIVE	SELECTED RESULT(S)
Modernize Business Systems to Enhance Performance and Affordability – Take action to enforce business systems modernization on an accelerated and integrated path that is resourced and supported. Use data driven decision making to achieve tangible savings while consistently working to become more effective and efficient as a core element of warfighting discipline. Build on the findings from the audit process and other evaluations to foster a culture that encourages innovation, solves problems, and achieves results to get the most out of every dollar entrusted to us by the American people.	• Established Jupiter as the DON's enterprise data and analytics platform. Built dozens of analytic use cases in Jupiter supporting analysis of readiness, COVID-19 impacts, IT Infrastructure, financial investments, acquisition platform testing, performance management, and more. • Accelerated the modernization and transformation of IT capabilities by aggressively identifying and assessing redundant systems and applications across the enterprise in order to ensure that decisions made to sunset or rationalize unneeded, obsolete, unproductive, insecure, and un-auditable IT systems and applications are realized. • Completed a Naval IT infrastructure Portfolio Review to identify and classify legacy networks and focus on reducing redundant IT capabilities. • Re-aligned resource sponsorship to support deployment of enterprise capabilities while minimizing resource obligations for stove-piped or redundant systems. • The DON's audit roadmap—the first and most articulate in DoD—remains a model for aligning audit remediation priorities, resources, policies, requirements, and change management for a cohesive and effective effort.
Strengthen Alliances and Partnerships – Respond with partnership and alliances, standing alongside a global community of nations in defense of our common values. Operationally integrate our allies and partners into strategic and warfighting concepts to deter those that challenge us.	• Synchronized with key Allies to implement policies and operations that enhance operational resources, strengthen cooperative partnerships, and increase naval power in geopolitically significant regions.

FORWARD-LOOKING INFORMATION

The increasingly aggressive world actors that threaten the freedom of the world's waterways, intimidate U.S. allies, and seek a more hostile international order, reinforce the need to maintain a potent, integrated Navy and Marine Corps that maximizes our naval contribution to the joint force. Seapower provides mobile, self-reliant, survivable, and distributable forces perfectly suited to combat the contemporary threats the nation faces. Competition from an ascendant China and a disruptive Russia is spurring a period of rapid transformation in the strategic environment. Such trends necessitate an acceleration of investment by the DON to reverse the erosion of U.S. military advantages from China's and Russia's aggressive naval growth and modernization. We must maintain resolve to compete with, deter, and, if necessary, defeat our adversaries while we accelerate development of a modernized, integrated all-domain naval force for the future.

External factors that challenge DON's ability to achieve its strategic goals include:

- The emergence of China as a great power is the single biggest threat to the United States, its allies, and interests around the world. Though China's navy does not have anywhere near the tonnage of the U.S. Navy, China has surpassed the U.S in the quantity of ships it possesses, having rapidly grown its Navy from 262 to 350 ships. This fleet is supported by the largest missile force in the world. China's navy continues to invest in larger, more capable surface warfare ships, aircraft carriers, and submarines, and they continue to build ships at a faster rate than the U.S. Navy. By 2023, China expects to launch its third aircraft carrier, and continues it development of cutting-edge technologies to include fifth-generation fighter aircraft.
- Russia has been modernizing all facets of its military to include warships, aircraft and missiles. Russia is pushing the technological envelope with its development of hypersonic missiles, tactical nuclear weapons, and modern submarines.
- Both China and Russia have interests in direct conflict with those of the U.S. and its allies, and both countries have in recent years become more aggressive with their threats to the international rules-based order as the growth in their military capabilities have greatly reduced the U.S. military advantage that was once insurmountable to our enemies.
- Other nations such as Iran, North Korea, and non-state actors are exploiting asymmetric capabilities to create instability and uncertainty on the global maritime commons.

The Navy and Marine Corps team is the most lethal and ready forward deployed force in the world and operates in an increasingly complex global security environment. To succeed, DON must remain agile and improve at the speed of relevance. DON will continue to work with partners, including international allies and industry, to become more agile, compete in ways that are more sustainable, and control the high end of the conflict as part of the DoD and alongside our allies and partners.

The DON realigned strategic objectives in FY 2021 to transition performance results and organizational outcomes to three strategic priorities emphasized by the new Secretary of Defense: (1) defending the nation, (2) taking care of people, and (3) succeeding through teamwork. These priorities and specific performance results are also outlined below with the ultimate objective to reform business operations enterprise-wide to generate lasting, institutionalized resources to support strategic reinvestment in warfighting lethality.

- **Defending the Nation.** The DON established the following FY 2022 priorities: (1) Defeating COVID-19, (2) Prioritizing China, (3) Addressing other advanced and persistent threats, including innovation, and (4) Tackling the climate crisis. These priorities require rapid innovation while divesting legacy capabilities to "improve the efficiency of the force and guarantee freedom of action in contested, complex operating environments."
- **Taking Care of Our People.** The priorities related to people are growing talent, building resilience and readiness, and ensuring accountable leadership, embracing diverse backgrounds, experiences, and thought to drive innovative solutions across the enterprise.
- **Succeeding through Teamwork.** In order to succeed, the DON is prioritizing collaboration and joint action with partners and allies to secure our common interests and promote our shared values. Unity is needed within the DoD in order to ensure the greatest success in protecting and defending our Nation.

The Deputy Secretary of Defense (DEPSECDEF) defined requirements to improve performance and create decision advantage at all echelons, and that DoD Components "develop appropriate metrics, visualizations, and insights regarding the strategic priorities, business health, and operations of the Department." To improve the speed and relevance of the information collected, and in response to the above DEPSECDEF requirements, the DON plans to establish a renewed enterprise performance management function that resides under the Chief Management Officer. Navy and Marine Corps Components will manage organizational performance using metrics driven by strategic objectives, backed by authoritative data, and executed in the DON Enterprise Data and Analytics environment, Jupiter. This transformation to an automated and data-reliant process will be a primary aid for DON senior leaders to drive and monitor performance results, identify issues, risks and areas to implement performance improvement initiatives.

The digitally transformed and streamlined performance management capability will create an enterprise performance management framework based on performance outcomes that drive informed decisions and enable the DON to meet the challenges that peer competitors and non-state actors pose to the U.S. This framework shall enable DON leadership to identify and prioritize performance improvement opportunities in alignment with DoD and SECNAV strategic priorities and shall be coordinated among the DON's Secretariat and Services' performance management functions.

When fully executed, this digitally transformed capability will replace the historical method of tracking performance monitoring. Resources are currently being redirected toward evolving the DON's performance management capability to meet the requirements of the new administration and ensure that leadership is able to monitor performance, understand risk trade-offs, make data-driven decisions, and prioritize performance improvement initiatives – all to drive measurable outcomes in alignment with the new administration's strategic priorities.

MANAGEMENT ASSURANCES

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

October 4, 2021

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2021

As Secretary of the Navy, I recognize the importance of managing the Department of the Navy (DON) risks and maintaining effective internal controls to comply with Sections 2 and 4 of the Federal Managers' Financial Integrity Act of 1982. The DON conducted its risk and internal control assessment in accordance with the Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, and the Government Accountability Office (GAO) publication GAO-14-704G, *Standards for Internal Control in the Federal Government*.

The DON led the Department of Defense in the reduction of four financial statement audit material weaknesses in the last three years, with a fifth expected for downgrade this year. While we are not able to fully provide reasonable assurance for internal controls over financial reporting and systems, we made significant progress remediating deficiencies in Fiscal Year (FY) 2021 while navigating challenges originating from the COVID-19 pandemic. We focused on systems consolidation, budgetary reform, and enhancing business processes, policies, and internal controls. Specifically, the DON significantly consolidated and decommissioned seven financially relevant systems as part of the System Consolidation Action Plan. From a policy and process improvement perspective, we issued our integrated risk management guidance and framework to address both financial and non-financial risks. Additionally, the DON developed an Audit Roadmap, underpinned by key requirements and milestones across our business processes and systems, to support our path to an audit opinion. We remain on track to achieve that objective. We will continue to build upon the foundation established by our audit roadmap to accelerate remediation progress and provide reasonable assurance in the future.

Based on the results of the DON Internal Controls Over Reporting - Operations (ICOR-O) assessment, the DON can provide reasonable assurance, except for the six Material Weaknesses (MWs) and one Significant Deficiency (SD) reported in the "Material Weaknesses and Significant Deficiencies" enclosure, that internal controls over operations and compliance were operating effectively as of 30 September 2021. Although these MWs may have impacted efficiency, the DON continues to be able to meet its mission to support the warfighter and remain combat ready.

Based on the results of the DON Internal Controls Over Reporting - Financial Reporting (ICOR-FR) assessment, the DON is unable to provide assurance that controls were operating effectively due to the thirteen MWs and two SDs reported in the "Material Weaknesses and Significant Deficiencies" enclosure as of 30 September 2021 in accordance

with OMB Circular No. A-123, Appendix A. This internal review also included an evaluation of the internal controls around our Security Assistance Accounts activities.

Based on the results of the DON Internal Controls Over Reporting - Financial Systems (ICOR-FS) assessment, the DON is unable to provide assurance that controls were operating effectively due to the three MWs reported in the "Material Weaknesses and Significant Deficiencies" enclosure as of 30 September 2021 in accordance with the Federal Financial Management Improvement Act of 1996 and OMB Circular No. A-123, Appendix D.

The DON assessed the design of Entity Level Controls (ELCs), including fraud controls, in accordance with the Section 10.09 of GAO's, *Standards for Internal Control in the Federal Government* (the "Green Book"), OMB Circular No. A-123, the Payment Integrity Information Act of 2019, and GAO Fraud Risk Management Framework. Based on the results of the assessment, the DON can provide reasonable assurance, except for one MW that ELCs, including fraud controls, are designed effectively as of 30 September 2021.

The DON is hereby reporting two Anti-Deficiency Act violations discovered/identified during our assessments of the applicable processes.

The classified annex has been forwarded to the Office of the Secretary of Defense Classified Office.

My point of contact for any questions regarding the Statement of Assurance for FY 2021 is Ms. Mobola Kadiri, who may be reached at (202) 685-6767 or mobola.kadiri@navy.mil.

Carlos Del Toro

Attachments:
As stated

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ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

Quantifiable financial information, in conjunction with sufficient controls, provides valuable information to complement operational data and promote a greater understanding of process efficiency and resource utilization. FFMIA, FMFIA, and OMB A-123 provide the framework to create an environment, which allows the production of timely, reliable, and accessible financial information; implementation of effective and efficient internal controls; and a risk management process designed to support DON achievement of strategic objectives.

DON management evaluated the system of internal controls in effect during FY 2021 in accordance with OMB A-123 and GAO's Standards for Internal Control in the Federal Government (Green Book).

Below is an abbreviated discussion. For more information, see the full FY 2021 DON Statement of Assurance (SOA).

Corrected and Reassessed Material Weaknesses

In FY 2021, the DON corrected or reassessed the following Material Weaknesses (MWs):

Corrected and Reassessed Prior Year MWs				
Area	**Internal Control Reporting Category**	**Title of Material Weakness**	**Targeted Correction Year**	**Status**
Internal Controls Over Reporting - Operations (ICOR-O)	Comptroller and Resource Management	DON Oversight and Management of Improper Payments	FY 2021	Corrected
ICOR-O	Personnel and Organizational Management	Submission of Criminal Subject Fingerprint Cards and Reporting Disposition of Criminal Charge	FY 2021	Corrected
Internal Controls Over Reporting - Financial Reporting (ICOR-FR)	Acquire-to-Retire	Property, Plant, and Equipment – Utilities	FY 2021	Reassessed as a Significant Deficiency
ICOR-O	Contract Administration	Execution of Husbanding Contracts-Husbanding Service Provider	FY 2021	Reassessed as a Control Deficiency
ICOR-O	Security	Protection of Controlled Unclassified Information	FY 2021	Corrected

Internal Controls Governance

During FY 2021, the DON's Internal Controls program continued to mature and strengthen its alignment with FMFIA and OMB A-123 requirements. A key element in maturing the program in FY 2021 was the DON's continued progress toward implementation of the Integrated Risk Management (IRM) framework. IRM is the DON's approach to integrating its Enterprise Risk Management (ERM) and Internal Control over Reporting (ICOR) programs. The DON ERM Program assumes a top-down perspective to proactively identify and deliberately manage risks to the DON's overall mission and most important enterprise goals and objectives. In contrast, ICOR facilitates risk and internal control assessments from the bottom-up, emphasizing the quality of data and significant reports used to inform leaders about key mission objectives and support the decisions required to effectively execute those objectives. Through collaboration with stakeholders from across the enterprise, the DON developed IRM guidance, training, and tools to initiate the IRM implementation in FY 2022.

The DON established an IRM governance structure to monitor risks, the effectiveness of internal controls, deficiency remediation efforts, and progress reporting. The governance structures encompass three main bodies to support the flow of risk information and recommendations to senior leaders. The governance structure and the roles and responsibilities of each governing body is illustrated in Figure 3.

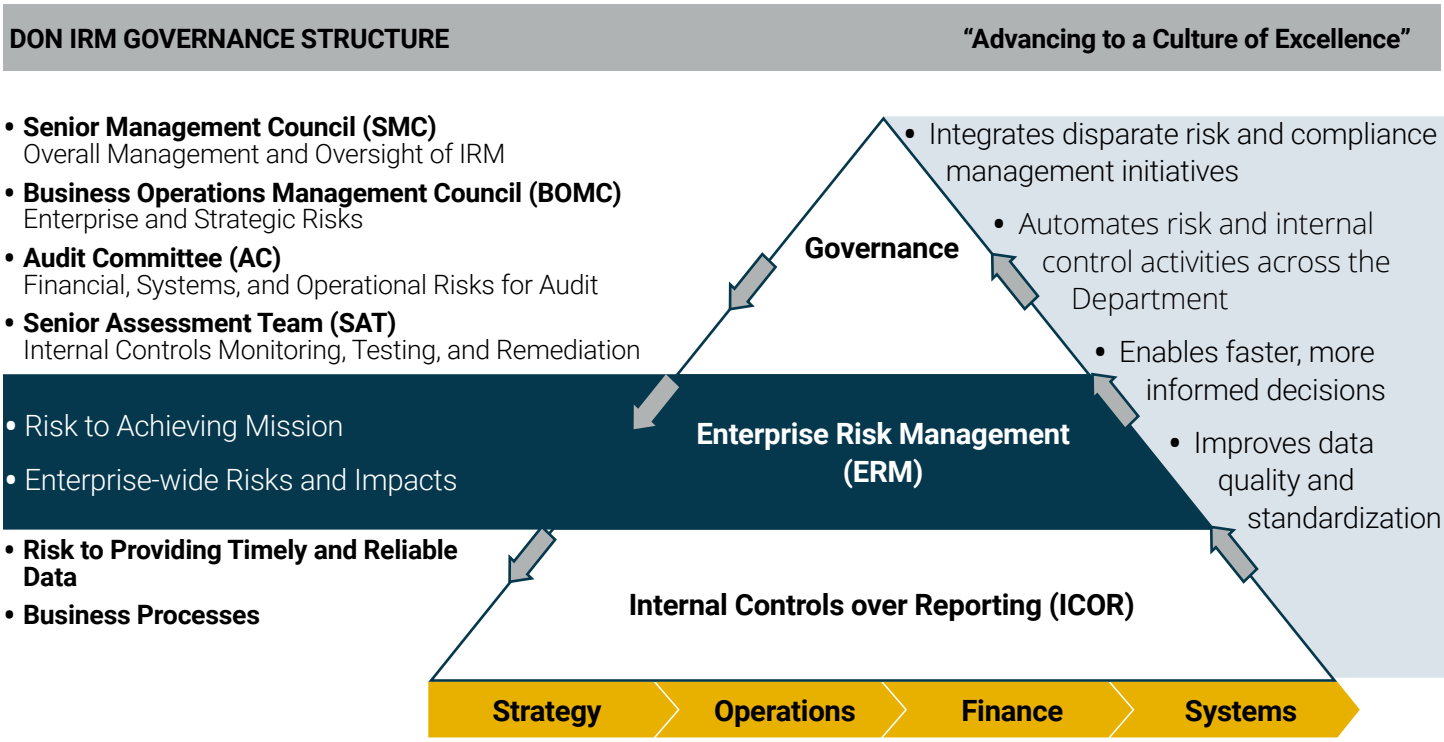


Figure 3: DON Internal Control Governance Structure

- **The DON's Senior Management Council (SMC)**, comprising Senior Executive Service (SES) members and flag officers from each Echelon I command, or major assessable unit (MAU), and is co-chaired by the Principal Deputy ASN (FM&C) and Director of OCMO. The SMC advises the AC on the state of the DON's internal control risk assessment, testing, compliance, corrective action implementation, and reporting. The SMC leads the implementation of the IRM Strategy and enhance OMB A-123 evaluation program across the DON. It will report financial risks to the AC and non-financial, operational risks to the BOMC.

- **The Business Operations Management Council (BOMC)** assesses enterprise-level and strategic risks. The Council is chaired by the Under Secretary of the Navy and includes senior leaders from the Department. It focuses on the early identification of risk from external, strategic, and internal sources.
- **The DON Audit Committee (AC)**, chaired by the Under Secretary of the Navy, representing the DON's senior-level leadership, provides dedicated oversight of internal control compliance, and oversees the annual audit of financial statements, while setting the audit response strategy and aligning its priorities. In July, the SECNAV issued an update to the March 2018 AC memo that assigned end-to-end process owners to lead the DON's functional business process areas, including policy development, implementation, and compliance. SECNAV indicates that functional owners are responsible for oversight, improvement, and standardization of end-to-end business processes and effective enterprise-wide remediation.
- **The DON's Senior Assessment Team (SAT)** is co-chaired by the Deputy Assistant Secretary of the Navy, Financial Operations (DASN(FO)) and the DASN Financial Management Systems (DASN(FMS)) and is responsible for governance over audit priorities and remediation. The SAT reports status of enterprise risk and control evaluations and progress on enterprise-level audit priorities to the SMC and AC.

The governing bodies are further supported by the DON A-123 Annual Certification Statement process. Each of the DON MAUs and BSOs are assigned a MICP Coordinator that serves as the working-level internal control representatives for their organizations. The DON A-123 Program Office provides continuous support and feedback throughout the assessment process including training that focuses on the completion of the annual Certification Statement Memorandum and supporting components (i.e., MICP Plan, Risk Assessment, Internal Controls Evaluation, Material Weakness/Significant Deficiency CAPs, and Significant Accomplishments).

Internal Controls over Operations (FMFIA Section 2)

The DON's MICP is the administrative vehicle for monitoring ICOR-O, ICOR-FR, and ICOR-FS. The DON's ICOR-O program assists in mitigating the risk of fraud, waste, and misuse of DON resources. The evaluation and execution of effective and efficient internal control extends to internal stakeholders and external shared service providers. Responsibility for program execution and reporting resides within a network of 19 MAUs, which includes the CNO, CMC, ASNs, Secretariat Staff Offices, and other entities that report directly to the SECNAV.

Based on the results of the assessment, the DON can provide reasonable assurance, except for the six MWs and one Significant Deficiency (SD) identified below, that internal controls over operations and compliance were operating effectively as of September 30, 2021 (all findings listed are material weaknesses unless denoted as "SD," indicating a significant deficiency).

The DON has developed CAPs to address each of the areas above, which are managed by the appropriate MAUs across the DON. The SMC is responsible for independently monitoring and reviewing the implementation of those CAPs.

Uncorrected ICOR-O Material Weaknesses			
Internal Control Reporting Category	**Title of Material Weakness**	**First Year Reported**	**Targeted Correction Date**
Multiple	Depot Level Maintenance	FY 2016	Q3 FY 2025
Personnel and Organizational Management	Military Pay and Personnel	FY 2016	Q2 FY 2025
Multiple	Data Protection	FY 2017	Q1 FY 2022
Information Technology	Complex Business IT Environment	FY 2018	Q1 FY 2024
Multiple	Property in the Possession of Contractors	FY 2018	Q1 FY 2023
Acquisition	Attenuating Hazardous Noise in Acquisition and Weapons System Design (SD)	FY 2017	Q1 FY 2022
Multiple	Oversight and Monitoring	FY 2016	Q1 FY 2026

Internal Controls over Financial Reporting (FMFIA Section 2)

In FY 2021, the DON continued to build upon prior year progress in improving ICOR-FR, maintaining focus on its financial transformation objectives, and building a robust internal control program enabling mission success and program sustainability.

The DON's BSOs define the assessable units within their organization based on those most critical to the BSO's mission and strategic objectives. The BSOs executed their internal control process, which includes a risk assessment, control testing, deficiency identification and subsequent corrective actions, and reporting results in a certification statement.

These certification statements, and their supporting enclosures, combined with insight from IPA findings that shed further light on the nature and significance of the MWs are the primary source documents for the SECNAV's determination that controls are not in place to provide reasonable assurance over the effectiveness of the DON's financial operations and processes.

Based on the results of the assessment, the DON cannot provide reasonable assurance controls were operating effectively due to 13 MWs and two SDs identified below as of September 30, 2021 in accordance with OMB A-123, Appendix A.

Uncorrected ICOR-FR Material Weaknesses			
Internal Control Reporting Category	**Title of Material Weakness**	**First Year Reported**	**Targeted Correction Date**
Acquire-to-Retire	Property, Plant & Equipment Valuation	FY 2006	Q4 FY 2024
Acquire-to-Retire	General Equipment-Remainder—Existence & Completeness	FY 2007	Q2 FY 2023
Multiple	Financial Reporting	FY 2017	Q4 FY 2026
Multiple	Fund Balance with Treasury	FY 2016	Q1 FY 2023
Procure-to-Pay	Accounts Payable	FY 2017	Q4 FY 2023
Budget-to-Report	Traceability and Supportability of Foreign Military Transactions	FY 2015	Q4 FY 2023
Procure-to-Pay	Procure-to-Pay Process	FY 2013	Q1 FY 2026
Plan-to-Stock	Inventory	FY 2005	Q3 FY 2024
Plan-to-Stock	Operating Materials & Supplies – Remainder	FY 2005	Q4 FY 2024
Plan-to-Stock	Operating Materials & Supplies – Ordnance	FY 2005	Q2 FY 2023
Order-to-Cash	Order-to-Cash Process	FY 2009	Q4 FY 2023
Multiple	Budgetary Execution	FY 2012	Q4 FY 2026
Acquire-to-Retire	Environmental and Disposal Liabilities	FY 2021	Q4 FY 2022
Budget-to-Report	Contingent Legal Liabilities (SD)	FY 2020	Q4 FY 2022
Acquire-to-Retire	Property, Plant, and Equipment – Utilities (SD)	FY 2020	Q4 FY 2022

The DON has identified several remediation priority areas. By concentrating resources and management attention on these areas, the DON established a more focused and efficient approach to correcting findings and improving the reliability of its financial information. As a result, the DON expects to reduce material weaknesses in its system of internal controls, increase the accuracy of financial disclosures and, ultimately, achieve a positive audit opinion.

Each of these areas have distinct initiatives that are being worked through various remediation efforts. Significant accomplishments for FY 2021 include:

Oversight and Monitoring: Continued to expand enterprise-wide top-down testing to include compliance with DATA Act and CARES Act. Expanded Entity Level Control assessments and Fraud Risk Assessments for nine areas. Finalized DON's IRM Guidebook and IRM Implementation Instruction to support enterprise wide IRM implementation beginning in FY 2022. Revamped training to allow large number of participants to continue learning.

Government Furnished Property: Provided GFP requirements training to over 1,400 DON personnel. Individuals gained the knowledge of key risks and associated controls to mitigate those risks. Revisions were also made to SECNAV Instruction on GFP accountability and management, and this document along with policies and standard operating procedures were made available across the DON.

Financial Statement Compilation: Developed and documented standardized procedures for financial closing process and began recording of appropriations received into the Navy Enterprise Resource Planning tool which eliminated over 40,000 journal vouchers from the Defense Departmental Reporting System (DDRS). This was as a result of DON and Defense Finance and Accounting Service (DFAS) efforts to eliminate the Program Budget Information System overlay process and feed General Ledger funding balances to DDRS.

Inventory and OM&S: Designed procedures and controls to ensure the existence and completeness of Working Capital Fund inventory including new accountability framework for inventory adjustment; added requirement of an annual wall-to-wall inventory to commercial vendors' statement of work.

Real Property: Inventoried 100% of utility assets and one-third of non-utility assets on Navy installations. Conducted internal analytics, sustainment control testing, and site visit testing at six locations for over 300 assets to validate audit readiness.

Internal Controls over Financial Systems (FMFIA Section 4 and FFMIA)

In conjunction with the Office of the Undersecretary of Defense (Comptroller) and service providers, the DON continues to assess relevant financial system security controls. These include security controls applied to systems during the Risk Management Framework (RMF) /Financial Management (FM) Overlay process to operate within the USN Information Technology (IT) environment and to ensure compliance with the OMB A-123, FMFIA, and FFMIA, Financial Improvement and Audit Remediation guidance, NIST SP 800-53, and DON Enterprise IT Control Standards. DON further assesses IT security controls for key audit-relevant systems via the A-123 program.

Based on the results of the assessment, the DON cannot provide reasonable assurance controls were operating effectively due to the three Material Weaknesses (MWs) identified below as of 30 July 2021. The Internal Control over Reporting – Financial Systems (ICOR-FS) MWs are assigned to the DASN (Financial Systems) and the USMC and have a similar remediation and validation process as ICOR-FR MWs.

Uncorrected ICOR-FS Material Weaknesses			
Internal Control Reporting Category	**Title of Material Weakness**	**First Year Reported**	**Targeted Correction Date**
Interface Controls	Information Systems Interfaces	FY 2016	Q3 FY 2022
Multiple	Information Systems Configuration Management (CM)	FY 2015	Q1 FY 2023
Multiple	Information Systems Access Controls/Segregation of Duties (SOD)	FY 2014	Q4 FY 2024

During FY 2021 reporting period, the DON made considerable progress toward improving ICOR-FS. In Q2 FY 2021, the DON successfully completed remediation and closed the IPA issued enterprise Notice of Finding and Recommendations (NFR), for implementation of RMF over financial systems. The Navy Full Financial Statement Audit (FFSA) identified a combination of Configuration Management (CM) NFRs as a MW. DON CIO has prioritized CM MW related NFRs to downgrade and close the CM MW by Q1 FY 2023 tentatively. DON Office of the Chief of Information Officer (OCIO) continues to support efforts in modernizing many of the DON's business systems that are integral to supporting information management. DON CIO Office of the Chief Digital & Innovation Officer (CDIO) assumed oversight of OCIO initiatives that are integrated into the DON's effort to improve its financial systems in FY 2021. Significant accomplishments for FY 2021 include:

Information Systems Interfaces (IN):

- As of 30 September 2021, a total of 7 (4 MW related) IPA issued IN NFRs were closed during FY 2021.
- DON CIO developed and distributed the Interface Toolkit to define and promote interface documentation requirements containing:
- Interface Memorandum of Agreement (MOA) and Interface Control Agreement templates to outline the controls and procedures that should be documented in accordance with the DON IT Control Standards. The MOA and ICA templates are used by DON system owners to identify gaps and update their documentation.
- Requirements for managing complete and accurate population of interfaces, edit checks & validations, and error handling/reconciliation for greater efficiency and process enforcement.
- DON CIO continued to support FM&C to implement its Application Programming Interfaces (API) strategy to strengthen interface controls through automation.

Configuration Management (CM):

- As of 30 September 2021, a total of 13 (10 MW related) IPA Issued CM NFRs were closed during FY 2021.
- DON CIO continued to promote governance over the logging of configuration management activities performed in DON systems (e.g., direct table updates, defects, changes implemented in production), and develop configuration management templates for documenting change requests, test plans, and test results.

Access Controls and Segregation of Duties (AC/SOD):

- As of 30 September 2021, a total of 36 (22 MW related) IPA issued AC/SOD NFRs were closed during FY 2021.
- DON CIO continued to identify, verify, remediate, or mitigate user cross-application SOD conflicts between Navy ERP and 19 financially significant systems through automated and manual processes.
- The DON developed the Naval Identity Services (NIS) prototype for Identity Credential and Access Management (ICAM). DON CIO, PEO digital and PMW-220 continue to collaborate to integrate NIS with Navy ERP and is expected to be completed in Q1 FY 2022.
- The DON continued to perform SOD Conflict Analysis and monitoring of Navy ERP SOD conflicts that occur over transactional duty through the Access Violation Management (AVM) tool and continued development to integrate the AVM tool with the Command Financial Management System (CFMS) and SABRS with expected completion in Q1 FY 2022.

Biennial Review Fees

The Chief Financial Officers Act of 1990 and OMB Circular A-25, User Charges, requires each agency CFO to review, on a biennial basis, the fees, royalties, rents, and other charges imposed by the agency for services and items of value provided to specific recipients, beyond those received by the general public. The purpose of this review is to periodically adjust existing charges to 1) reflect unanticipated changes in costs or market values, and 2) to review all other agency programs to determine whether fees should be assessed for Government services or the use of Government goods or services. Based on our review, we identified adjustments for fees to achieve full-cost recovery.

Entity-Level Control Assessment

The DON has an established Entity-Level Control (ELC) evaluation process to assess the design of the DON's entity-level controls as outlined in the Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government ("Green Book") as well as determine how well policies, programs, and directives that support ELCs are socialized across the enterprise. FY 2021 results indicated that ELCs are designed to address DON's mission and objectives; however, there are areas that require improvement to support operating effectiveness.

Fraud Assessment

The Payment Integrity Information Act of 2019 (PIIA) requires Federal agencies to establish Fraud Risk Management (FRM) programs to prevent, detect, and respond to fraud. In addition, the Act requires agencies to report on their progress in implementing financial and administrative controls, fraud risk principles from the Government Accountability Office's (GAO) Standards for Internal Control in the Government (Green Book), and leading fraud risk management practices from the Office of Management and Budget (OMB) Circular No. A-123 Management's Responsibility for Enterprise Risk Management and Internal Control. Agencies are required to consider fraud when evaluating risks, use the results of the evaluations to improve fraud prevention and detection, while also incorporating the GAO's Framework for Managing Fraud Risks in Federal Programs (GAO Framework) leading practices into their internal control system.

To meet these requirements and effectively manage fraud risks, the Department of the Navy (DON) has continued to mature its FRM program, which is overseen by the Fraud Risk and Data Analytics (FRDA) Branch within the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN (FM&C)). As part of the FRM Program, in FY 2021, the FRDA Branch conducted an enterprise-wide Fraud Risk Assessment (FRA) to identify mitigating internal controls and assess residual risk across nine high-priority fraud risk areas: Procurement, Information Technology & Security, Asset Safeguards, Payroll (Military Payroll & Civilian Payroll), Beneficiary Payments, Purchase Cards, Travel Cards, Fleet Cards, and Grants. The FY 2021 FRA results indicated the DON has a culture of anti-fraud, and everyone plays a role in fraud detection and prevention. This is exemplified through fraud awareness training at all levels of the enterprise, tone at the top, and accessible reporting channels.

While the DON continues to evolve its FRM program and strengthen its alignment to the Department of Defense (DoD) FRM Strategy, the DON has implemented the following leading practices, procedures, and programs to combat fraud:

- The FRDA Branch executed a training program targeted at strengthening the DON's risk management and internal control environment. The virtual training platform used in FY 2021 allowed for an increased number of participants in each training session, including FRM focused sessions. The DON also conducts FRA Office Hours and a FRM Guest Speaker Series to increase fraud awareness and support an anti-fraud culture.
- The DON assessed the current status and effectiveness of the enterprises' fraud control environment through the completion of the annual Fraud Control Matrix (FCM) issued by Under Secretary of Defense (Comptroller) (OUSD(C)). The FCM identifies existing fraud controls and gaps that require corrective action.
- The Naval Audit Service (NAVAUDSVC) conducts performance and compliance audits of the DON's mission and business operations. These performance audits assess the risk of fraud occurring as outlined in the NAVAUDSVC Handbook, Fraud Risk Matrix, and the Fraud Risk Assessment Checklist.
- Naval Inspector General's (NAVINSGEN) Hotline and investigations division executes the Department of Defense Inspector General (DoD IG) Hotline program. The inspections division conducts process-focused inspections and the results are evaluated regularly to identify trends and problem areas affecting multiple commands, activities, or offices.
- The U.S. Marine Corps (USMC) Inspector General Assistance and Hotline Division maintains the USMC Hotline and ensures allegations of fraud, waste, abuse, mismanagement, misconduct, and whistleblower reprisal are properly recorded and routed for action by the appropriate office or agency.
- The Naval Criminal Investigative Service (NCIS) serves as the primary law enforcement body for the DON, responsible for investigating criminal fraud within the Navy and USMC. NCIS compiles a quarterly Fraud Report by querying the case management system to identify emerging fraud trends and issues an Annual Crime Report that summarizes the crime activities reported throughout the year.

- The Office of the General Council (OGC), Acquisition Integrity Office (AIO) monitors and coordinates criminal, civil, administrative, and contractual remedies for cases of acquisition fraud.
- The Naval Supply Systems Command (NAVSUP) manages the DON's bank card transaction review program to monitor potential improper charges for purchase, travel, and fleet cards. Automated analytic tools managed by the issuing financial institutions will flag potentially fraudulent activity for DON management follow up.
- The Naval Sea Systems Command (NAVSEA) Inspector General (IG) Contract Fraud Risk Assessment and Mitigation (C-FRAM) Division is responsible for establishing, executing, and coordinating NAVSEA acquisition and contract fraud deterrence, detection, and resolution activities and provide investigative support to NAVSEA IG Hotlines and Investigation Division on allegations related to contract improprieties.
- The DON participates in a fraud data analytics pilot with the OUSD(C).

Anti-Deficiency Act Violations

The DON GF reported one ADA violation for fiscal years (FYs) 2013 through 2018 the improperly obligated and expended Operation and Maintenance, Navy (O&MN), funds which was submitted to Congress on March 17, 2021. This violation does not impact the FY 2021 financial statements.

Analysis of Financial Systems

The Office of Financial Management Systems (FMS) is leading the DON's efforts to simplify and consolidate the

Financial Management Information Technology (FM IT) environment to improve auditability, reduce operating costs and minimize cyber vulnerabilities. The DON has implemented a multi-disciplinary approach to consolidate the legacy systems in phases over the next three years. There are seven legacy systems in the Department's inventory that will be retired by FY 2024.

The Department achieved significant progress in FY 2021 to consolidate financial management systems. The FY 2021 accomplishments are illustrated in the table below and provides a comprehensive list of DON GL systems, descriptions, and status as of September 30, 2021:

Legacy System	Status	Target Migration
Standard Accounting, Budgeting, and Reporting System (SABRS)	In Progress	FY 2023
Standard Accounting and Reporting System-Field Level (STARS-FL)	In Progress	FY 2022
Defense Industrial Financial Management System (DIFMS)	In Progress	FY 2022
Military Sealift Command - Financial Management System (MSC-FMS)	Complete	Navy ERP Live
Defense Working Capital Accounting System (DWAS)	Complete	Navy ERP Live
Integrated Management Processing System (IMPS)	Complete	Navy ERP Live
Standard Accounting and Reporting System- Headquarters Claimant Module (STARS-HCM)	Complete	Navy ERP Live

The DON is successfully moving forward with an integrated financial management system strategy that will reduce costs and maximize the benefits of a consolidated ERP system. Integrated technology is an important milestone that demonstrates the DON's ongoing commitment to sound financial reporting and fiscal stewardship of taxpayers' dollars.

ANALYSIS OF FINANCIAL STATEMENTS AND STEWARDSHIP INFORMATION

The accompanying financial statements and related disclosures represent the enduring commitment to fiscal accountability and transparency. The DON has made progress toward improving the quality and timeliness of financial information. However, the DON is currently unable to implement all elements of U.S. generally accepted accounting principles (GAAP) and OMB A-136 due to limitations of financial and non-financial management processes and systems feeding into the financial statements. These limitations prevented the IPA from issuing an opinion on the FY 2021 USN GF and DON WCF financial statements.

For financial reporting purposes, the USN GF and DON WCF financial statements include financial information for appropriations that are administered by BSOs. The sections that follow provides financial conditions and results of operations for USN GF and DON WCF activities.

USN GF

The USN GF supports overall naval operations. Enacted appropriations comprise the majority of the USN GF account structure, which includes six major appropriation groups:

- Operation and Maintenance
- Research, Development, Test, and Evaluation
- Military Personnel
- Family Housing
- Procurement
- Military Construction

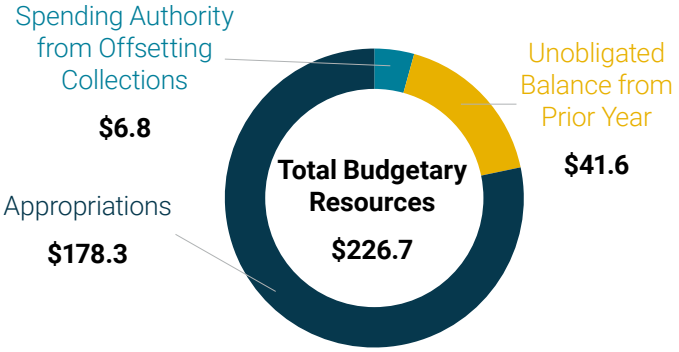
Enacted appropriations flow through OMB to the SECDEF and then to the SECNAV, where funds are allocated to administering offices and commands. The administering offices and commands obligate appropriations to fund operational expenses and capital investments and are required to exercise a system of effective control over financial operations.

Results of Operations

The Combined Statement of Budgetary Resources (SBR) presents Total Budgetary Resources of $226.7 billion that were available to the USN GF through Q4 FY 2021 and the status of those resources at the end of Q4 FY 2021. The enacted appropriations of $178.3 billion represent 78.7% of total budgetary resources. The Navy obligated $191.6 billion of the $226.7 billion total resources through Q4 FY 2021. The remaining $35.1 billion, or 15.5%, of available funding remained unobligated through Q4 FY 2021.

The Statement of Net Cost (SNC) presents Net Cost of Operations of $164.9 billion through Q4 FY 2021. Net Cost of Operations represents gross costs incurred by the USN GF less earned revenue. The SNC is presented with costs and earned revenues in accordance with OMB A-136 requirements.

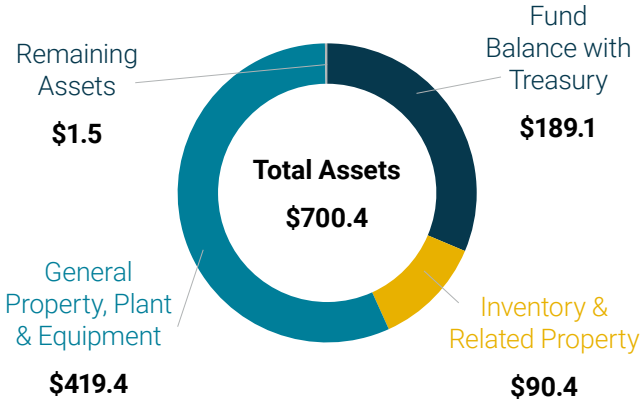
USN GF Sources of Funds ($ in billions)



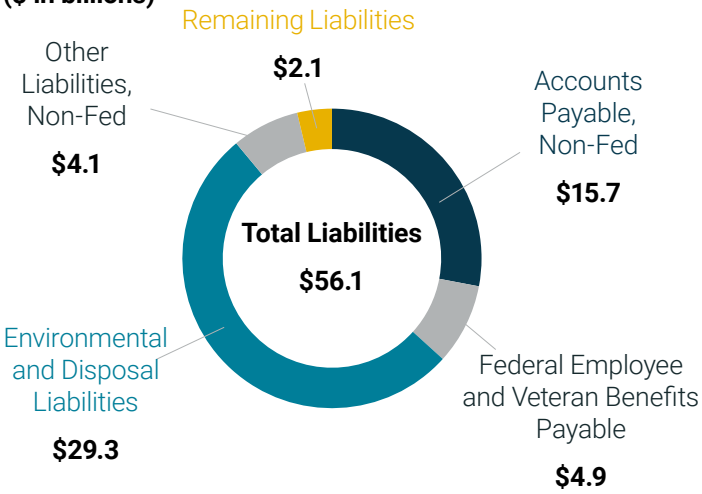
Financial Position

The USN GF continued to report a positive Net Position on its Consolidated Balance Sheet, the difference between Total Assets of $700.4 billion and Total Liabilities of $56.1 billion. As of Q4 FY 2021, Net Position totaled $644.3 billion. The USN is a capital asset-intensive organization, with General Property, Plant, and Equipment (PP&E) representing 59.9% of Total Assets. These assets have significant associated environmental and disposal liabilities (E&DL) of $29.3 billion, or 52.2% of Total Liabilities.

USN GF Total Assets
($ in billions)



USN GF Total Liabilities
($ in billions)



DON WCF

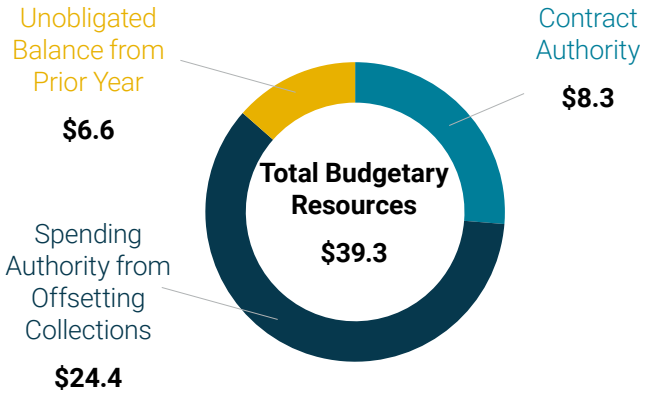
The DON WCF is a revolving fund established to meet the diverse requirements of the USN and USMC operating forces. Under the revolving fund concept, an appropriation, or a transfer of funds finances initial DON WCF operations. The DON WCF then charges amounts necessary to recover the full cost of goods and services provided with the goal to break even over the long term. DON WCF business areas allow the DON to absorb risk in planning investment programs for acquisitions, maintenance, and supply.

Results of Operations

The SBR presents Total Budgetary Resources of $39.3 billion that were available to the DON WCF through Q4 FY 2021. DON WCF budget authority is comprised of Contract Authority and Spending Authority from Offsetting Collections of which the latter accounts for $24.4 billion or 62.1% of total budgetary resources.

The SNC presents net cost of operations of $1.6 billion through Q4 FY 2021. Net Cost of Operations represents gross costs incurred by DON WCF less Earned Revenue. Sources of Earned Revenue include DON, U.S. Army, and U.S. Air Force GF; Defense Working Capital Funds; other Navy and DoD appropriations; and non-DoD fund sources.

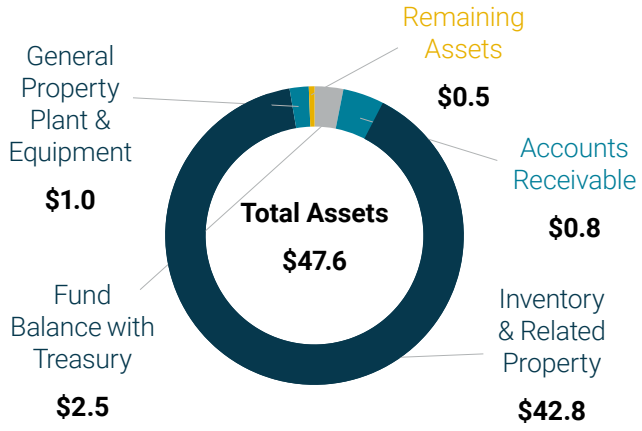
DON WCF Sources of Funds
($ in billions)



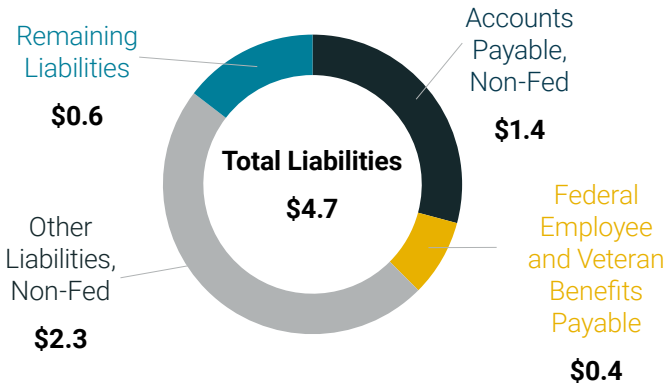
Financial Position

The DON WCF reported a positive Net Position on its Consolidated Balance Sheet. Net Position is the difference between Total Assets of $47.6 billion and Total Liabilities of $4.7 billion. As of Q4 FY 2021, Net Position totaled $42.9 billion.

DON WCF Total Assets
($ in billions)

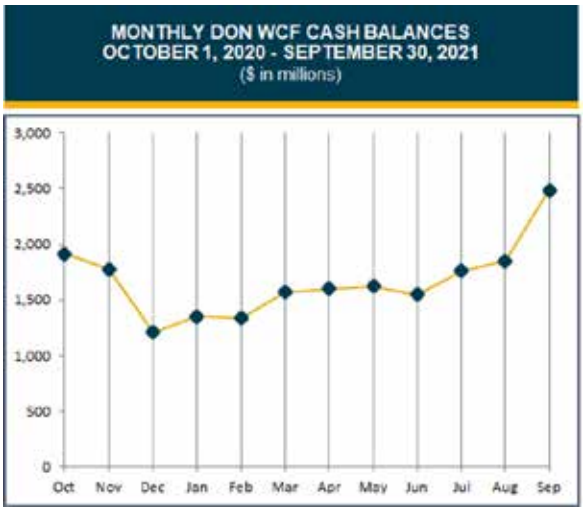


DON WCF Total Liabilities
($ in billions)



Cash Management

The DON WCF manages cash at the departmental level and must maintain a minimum cash balance necessary to meet operations, capital investments, and other justified requirements, as required by the DoD Financial Management Regulation (FMR). The DON WCF has established a high and low cash requirement based on business events and activities relevant to its operations. For the period ended Q4 FY 2021, the high cash requirement was $2.5 billion, and the low cash requirement was $1.2 billion.



Coronavirus Response Funding

On March 11, 2020, the World Health Organization declared the outbreak of coronavirus disease 2019 (COVID-19) a pandemic. In response to societal and economic impacts of COVID-19, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law on March 27, 2020 by the President to assist with preventing the spread and mitigating negative impact of the pandemic on individuals; businesses; and federal, state, local, and tribal government operations. The provisions of the CARES Act (Public Law 116-136) provided $835.3 million to Navy in emergency supplemental funding to prevent, prepare for, and respond to the COVID-19 pandemic. In addition, USN GF received an additional $566.0 million via internal realignment of CARES Act funds transferred in. These funds were provided across Operations and Maintenance (O&M) - Navy and Reserve, Other Procurement, Military Personnel and Revolving Fund appropriation categories.

For the purposes of recording, tracking, and reporting the obligation of these funds, Navy uses the following cost categories to indicate the purpose for which CARES Act resources were obligated:

- DoD Operations: Obligated for increased operations and deployment schedules as well as costs to support social distancing, quarantine requirements, etc.
- IT Equipment/Support: Obligated to procure IT equipment and increased bandwidth to continue operations
- Cleaning Contracts and Non-Medical Supplies/Equipment: Obligated for increased cleaning contracts and biohazard mitigation (disinfectants, sanitizers, cleaning materials)
- Non-Medical PPE: Obligated to procure PPE for first responders, installations, and ships
- Transactions with Non-appropriated Fund Instrumentalities (NAFIs): Coronavirus-related reimbursable transactions with revenue-generating NAFIs

Due to system limitations, Navy does not currently report proprietary accounting transactions related to COVID-19 activity.

Limitations of the Financial Statements

The principal financial statements are prepared to report the financial position, financial condition, and results of operations, pursuant to the requirements of 31 U.S.C. § 3515(b). The statements are prepared from records of Federal entities in accordance with Federal generally accepted accounting principles (GAAP) and the formats prescribed by OMB, except where noted in Note 1, Basis of Presentation and Accounting. Reports used to monitor and control budgetary resources are prepared from the same records. Users of the statements are advised that the statements are for a component of the U.S. Government.

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FINANCIAL SECTION

210424-N-MD713-1032
ARABIAN SEA (April 24, 2021) Sailors conduct flight operations aboard the aircraft carrier USS Dwight D. Eisenhower (CVN 69) in the Arabian Sea, April 24, 2021. The Eisenhower Carrier Strike Group is deployed to the U.S. 5th Fleet area of operations in support of naval operations to ensure maritime stability and security in the Central Region, connecting the Mediterranean and Pacific through the western Indian Ocean and three strategic choke points. (U.S. Navy photo by Mass Communication Specialist 3rd Class Cameron Pinske)

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

Seamen of the USS Essex and Soldiers of the 185th Theater Aviation Brigade participate in a joint deck landing qualification exercise in the Persian Gulf Sept. 28. This exercise aims to increase the interoperability and trust between the U.S. forces by having them work together. (Photo by Sgt. David N. Beckstrom, 19th Public Affairs Detachment, USARCENT Public Affairs)

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

The Department of the Navy (DON) continues to leverage annual financial statement audits as an outstanding tool for improving risk management, strengthening internal controls, and demonstrating financial management (FM) stewardship through robust audit remediation—a necessary trifecta for sound governance of a large and complex enterprise such as the DON. While I am proud of our progress and focused strategy to drive process and system improvements, our Statement of Assurance and the Reports of Independent Auditors highlight challenges we must overcome on our business process and systems transformation journey to achieve an audit opinion. The DON Audit Roadmap is our plan to track accountability and promote transparency towards auditability milestones. The roadmap aligns audit remediation priorities, FM transformation initiatives, resources, policies, and requirements. Indeed, it drove fiscal year 2021 successes, such as:

- Downgrading our Real Property Utilities material weakness (MW); and sustaining the MW downgrades over Contingent Legal Liabilities and Contract Authority;
- Consolidating and/or decommissioning seven financially relevant systems, to shed legacy systems; automate, clean, and standardize data; and shift our efforts from a transactional orientation to high-value analytics;
- Realizing and maintaining the Department of Defense's lowest military pay improper payment rate (less than 1 percent);
- Validating 100 percent accountability of all afloat Trident missiles. We will apply lessons learned from valuing guidance systems to complete the valuation for remaining Trident assets;
- Implementing controls to sustain Uninstalled Aircraft Engines (UAE) accountability, positioning the Navy to assert to the valuation of UAE as early as the next fiscal year;
- Removing cumbersome reporting requirements by expanding the use of streamlined disbursing to vendors;
- Implementing key reconciliations and controls in our Advana data-analytics platform, significantly improving the timeliness and accuracy of our "checkbook" reconciliations with Treasury; and
- Establishing a DON enterprise-wide automation center of excellence and community of practice with over 200 members across the enterprise. To date, 74 bots are deployed; 83,000 labor hours were redirected to value-added analytics; and over 79 bots are in development.

These accomplishments prove what the DON can achieve through focused collaboration. We are committed to following Secretary Del Toro's strategy to maintain maritime dominance in defense of our nation, empower our people, and strengthen strategic partnerships.

Alaleh A. Jenkins
Acting Assistant Secretary of the Navy
(Financial Management and Comptroller)

November 8, 2021

GENERAL FUND

UNITED STATES NAVY GENERAL FUND PRINCIPAL STATEMENTS

180607-N-EH218-0260 WILLAMETTE RIVER, (June 7, 2018) Sailors assigned to the Arleigh Burke-class guided-missile destroyer USS Michael Murphy (DDG 112), man the rails as the ship transits toward Portland, Ore. for Rose Festival Fleet Week. The festival and Portland Fleet Week are a celebration of the sea services with Sailors, Marines, and Coast Guard members from the U.S. and Canada making the city a port of call. (U.S. Navy photo by Mass Communication Specialist 2nd Class Ryan J. Batchelder/Released)

The FY 2021 USN GF principal statements and related notes are presented in the format prescribed by OMB A-136, except as otherwise disclosed. The statements and related notes summarize financial information for individual funds and accounts within the USN GF for the fiscal year ended September 30, 2021 and are not presented on a comparative basis.

The following section is comprised of the USN GF principal statements and related notes:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources
- Related Notes
- Required Supplementary Information

US NAVY GENERAL FUND

Consolidated Balance Sheet
As of September 30, 2021

($ IN THOUSANDS)	UNAUDITED 2021
ASSETS (Note 2):	
Intragovernmental:	
Fund Balance with Treasury (Note 3)	$189,120,194
Accounts Receivable, net (Note 5)	175,318
Other Assets (Note 9)	788,116
Total Intragovernmental	**$190,083,628**
Other than intragovernmental/With the public:	
Cash and Other Monetary Assets (Note 4)	100,279
Accounts Receivable, Net (Note 5)	82,702
Inventory and Related Property, Net (Note 6)	90,387,635
General Property, Plant and Equipment, Net (Note 7)	419,433,061
Other Assets (Note 9)	299,231
Total Other than intragovernmental/With the public:	**$510,302,908**
TOTAL ASSETS	**$700,386,536**
STEWARDSHIP PP&E (Note 8)	
LIABILITIES (Note 10)	
Intragovernmental:	
Accounts Payable	$1,421,686
Other Liabilities (Note 13 & 15)	646,685
Total Intragovernmental	**$2,068,371**
Other than intragovernmental/With the public:	
Accounts Payable	15,686,061
Federal Employee and Veteran Benefits Payable (Note 11)	4,932,410
Environmental and Disposal Liabilities (Note 12)	29,325,184
Other Liabilities (Note 13 & 15)	4,101,883
Total Other than intragovernmental/With the public:	**$54,045,538**
TOTAL LIABILITIES	**$56,113,909**
COMMITMENTS AND CONTINGENCIES (NOTE 15)	
NET POSITION	
Unexpended Appropriations - Funds from other than Dedicated Collections	$169,251,928
Total Unexpended Appropriations (Consolidated)	**$169,251,928**
Cumulative Results of Operations - Funds from Dedicated Collections (Note 16)	54,474
Cumulative Results of Operations - Funds from other than Dedicated Collections	474,966,225
Total Cumulative Results of Operations (Consolidated)	**$475,020,699**
TOTAL NET POSITION	**$644,272,627**
TOTAL LIABILITIES AND NET POSITION	**$700,386,536**

The accompanying notes are an integral part of these statements.

US NAVY GENERAL FUND

Consolidated Statement of Net Cost
For the Fiscal Year Ended September 30, 2021

($ IN THOUSANDS)	UNAUDITED 2021
GROSS PROGRAM COSTS (Note 17)	
Gross Costs:	
Military Personnel	$38,773,171
Operations Readiness & Support	70,310,957
Procurement	28,568,503
Research, Development, Test & Evaluation	31,235,410
Family Housing & Military Construction	887,965
Less: Earned Revenue	(4,896,054)
NET COST OF OPERATIONS	**$164,879,952**

The accompanying notes are an integral part of these statements.

US NAVY GENERAL FUND

Consolidated Statement of Changes in Net Position
For the Fiscal Year Ended September 30, 2021

($ IN THOUSANDS)				UNAUDITED 2021
	Funds From Dedicated Collections (Consolidated Totals) (Note 16)	All Other Funds (Consolidated Totals)	Eliminations	Consolidated Total
Unexpended Appropriations:				
Beginning Balances	$ -	$169,289,997	$ -	$169,289,997
Budgetary Financing Sources:				
Appropriations Received	-	178,869,199	-	178,869,199
Appropriations Transferred in/out	-	291,013	-	291,013
Other Adjustments	-	(2,616,149)	-	(2,616,149)
Appropriations Used	-	(176,582,132)	-	(176,582,132)
Total Budgetary Financing Sources	**$ -**	**$(38,069)**	**$ -**	**$(38,069)**
Total Unexpended Appropriations	**$ -**	**$169,251,928**	**$ -**	**$169,251,928**
Cumulative Results From Operations:				
Beginning Balances	58,182	451,519,215	-	451,577,397
Changes in Accounting Principles	-	2,145,984	-	2,145,984
Beginning Balances, as Adjusted	**$58,182**	**$453,665,199**	**-**	**$453,723,381**
Budgetary Financing Sources:				
Other Adjustments	-	(14,697)	-	(14,697)
Appropriations Used	-	176,582,133	-	176,582,133
Non-exchange Revenue	33			33
Donations and Forfeitures of Cash and Cash Equivalents	26,084	-	-	26,084
Other Financing Sources (Non-Exchange):				
Transfers In/Out without Reimbursement	-	(1,025,263)	-	(1,025,263)
Imputed Financing	-	762,812	-	762,812
Other	-	9,846,168	-	9,846,168
Total Financing Sources	**$26,117**	**$186,151,153**	**$ -**	**$186,177,270**
Net Cost of Operations (Note 17)	29,825	164,850,127	-	164,879,952
Net Change	**$(3,708)**	**$21,301,026**	**$ -**	**$21,297,318**
Cumulative Results of Operations	**$54,474**	**$474,966,225**	**$ -**	**$475,020,699**
NET POSITION	**$54,474**	**$644,218,153**	**$ -**	**$644,272,627**

The accompanying notes are an integral part of these statements.

US NAVY GENERAL FUND

Combined Statement of Budgetary Resources
For the Fiscal Year Ended September 30, 2021

($ IN THOUSANDS)	UNAUDITED 2021
BUDGETARY RESOURCES:	
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$41,547,945
Appropriations (discretionary and mandatory)	178,343,533
Spending Authority from Offsetting Collections (discretionary and mandatory)	6,789,622
TOTAL BUDGETARY RESOURCES	**$226,681,100**
STATUS OF BUDGETARY RESOURCES:	
New Obligations and Upward Adjustments (total)	$191,618,157
Unobligated Balance, End of Year:	
Apportioned, Unexpired Accounts	$31,505,377
Exempt from Apportionment, Unexpired Accounts	83,935
Unapportioned, Unexpired Accounts	1
Unexpired Unobligated Balance, End of Year	**$31,589,313**
Expired Unobligated Balance, End of Year	3,473,630
Unobligated Balance, End of Year (total)	**$35,062,943**
TOTAL BUDGETARY RESOURCES	**$226,681,100**
OUTLAYS, NET, AND DISBURSEMENTS, NET	
Outlays, Net (total) (discretionary and mandatory)	$173,746,426
Distributed Offsetting Receipts (-)	(218,564)
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$173,527,862**

The accompanying notes are an integral part of these statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.A. Reporting Entity

The DON is a complex organizational entity comprised both of subordinate organizations, as well as other entities, which are administratively aligned to the USN mission, but funding for those operations is provided by external reporting entities.

For financial reporting purposes, the DON is organized into two reporting entities: the USN GF and the DON WCF. The DON WCF includes financial information for both the Navy and the Marine Corps. Each reporting entity has a separate set of financial statements and related disclosures. This section of the AFR specifically applies to the USN GF, as a result, it does not disclose information related to the DON WCF or the USMC.

Refer to the MD&A Section – "Mission and Organization" for additional information.

The USN GF has relationships with Non-Appropriated Funds Instrumentalities (NAFIs) and Federally Funded Research and Development Centers (FFRDCs) that meet certain control elements regarding risk of loss or expectation of benefits. However, the USN GF does not meet enough control elements to consider them consolidating entities.

Refer to Note 24, "Disclosure Entities and Related Parties" for additional information.

1.B. Basis of Presentation and Accounting

These single-year financial statements reflect both proprietary and budgetary accounting transactions and are comprised of the consolidated balance sheet, consolidated statement of net cost, consolidated statement of changes in net position, and the combined statement of budgetary resources of the USN GF. USN GF does not show comparative financial statements because financial statement line-item values are changing due to remediation efforts and any comparison could be misleading to the reader. These financial statements have been prepared from the accounting records of the USN GF in accordance with, to the extent possible, U.S. GAAP promulgated by the Federal Accounting Standards Advisory Board (FASAB), OMB Circular A-136, Financial Reporting Requirements, Revised (August 2021) and the DoD, Financial Management Regulation (FMR).

Accounting standards require all reporting entities to disclose that certain presentations and disclosures can be modified, if needed, to prevent the disclosure of classified information.

The USN GF is unable to implement all elements of GAAP, OMB A-136, and FFMIA due to limitations of financial and non-financial management processes and systems that support the financial statements. These limitations are noted throughout the AFR as applicable.

The USN GF derives reported values and information for major asset and liability categories from both financial and non-financial systems. The non-financial systems were designed primarily to support reporting requirements for maintaining accountability over assets rather than preparing financial statements in accordance with GAAP. The USN GF continues to implement process and system improvements to address these limitations.

The financial statements are compiled from the underlying financial data and trial balances of the USN GF's general ledger accounting systems. The underlying data is largely derived from budgetary transactions (e.g., obligations, disbursements, and collections), non-financial feeder systems, and accruals made for major items (e.g., payroll expenses, accounts payable, Federal Employees' Compensation Act [FECA] Liabilities, and E&DL) and prior period adjustments. Some of the general ledger trial balances may reflect abnormal balances resulting largely from faulty business and system processes and may not be evident within the financial statements. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated / combined level.

The USN GF is not in full compliance with the following authoritative accounting guidance to include Statement of Federal Financial Accounting Standards (SFFAS), Treasury Financial Manual (TFM) and GMRA:

- SFFAS 1, "Statement of Federal Financial Accounting Standards, "Accounting for Selected Assets and Liabilities"
- SFFAS 3, "Accounting for Inventory and Related Property"
- SFFAS 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government"
- SFFAS 5, "Accounting for Liabilities of the Federal Government"
- SFFAS 6, "Accounting for Property, Plant, and Equipment"
- SFFAS 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting"
- SFFAS 10, "Accounting for Internal Use Software"
- SFFAS 15, "Management's Discussions and Analysis"
- SFFAS 21, "Reporting of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources"
- SFFAS 29, "Heritage Assets and Stewardship Land"
- SFFAS 44, "Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use"
- SFFAS 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials"
- SFFAS 50, "Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35"
- SFFAS 53, "Budget and Accrual Reconciliation"
- SFFAS 55, "Amending Inter-entity Cost Provisions"
- TFM
- FFMIA of 1996
- GMRA of 1994
- Navy is evaluating the applicability of SFFAS 51, "Insurance Programs" and impact to the USN GF financial statements.

Certain disclosures related to the DoD Component Reporting Entity (CRE) are not presented, including those required by the Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010 and the Improper Payments Elimination and Recovery Improvement Act of 2012; Section 3 of the OMB Memorandum M-12-12, "Promoting Efficient Spending to Support Agency Operations"; and the OMB Management Procedures Memorandum 2016-04, "Grants Oversight and New Efficiency (GONE) Act Reporting of Unclosed Grant and Cooperative Agreement Awards for Which the Period of Performance Has Expired More Than Two Years." These disclosures are presented in the DoD AFR on behalf of the USN.

1.C. Appropriations and Funds

The USN GF receives appropriated and non-appropriated funds to include general, revolving, trust, special deposit funds, and funds from dedicated collections. The USN GF uses these funds to execute its missions and subsequently report resource usage.

- **General Funds** are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, family housing, and military construction.

- **Revolving Fund** accounts are funds authorized by specific provisions of law, financed by a corpus through an appropriation or a transfer, to perform a continuing cycle of operations through the sales of goods and services without fiscal year limitations. The NDSF is the USN GF's only revolving fund. This unique fund receives annual appropriations expiring after five years and the revenues generated from the sales of goods and services do not expire.
- **Trust Fund** accounts contain receipts and expenditures of funds held in trust by the government for specific purposes or for carrying out or programs in accordance with the terms of the USN GF, trust agreement, or statute.
- **Special Fund** accounts are used to record receipts reserved for a specific purpose, such as funds from dedicated collections.
- **Deposit Fund** accounts are used to record monies held temporarily, where the USN GF is acting as an agent or a custodian for funds awaiting distribution to the appropriate government or public entity. These deposit funds are not USN GF funds, and as such, are not available for the USN GF's operations.
- **Funds from Dedicated Collections** are financed by specifically identified revenues, often supplemented by other financing sources that are originally provided to the federal government by a non-federal source, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the federal government's general revenues.

Refer to Note 16, "Funds from Dedicated Collections" for additional information.

1.D. Use of Estimates

Preparation of the financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Significant estimates underlying the accompanying financial statements include, but are not limited to, plant replacement values for real property, general equipment including depreciation, OM&S, environmental liabilities, allowance for doubtful accounts (AFDA), payroll expenses, Accounts Payable, bulk obligations, Contingent Legal Liabilities, and unbilled revenue. Estimates may not be reasonable or supportable, as indicated in the note disclosures.

1.E. Revenues and Other Financing Sources

The USN GF recognizes revenue generated by the sales of goods and/or services and the costs incurred to provide those goods and services to other DoD entities, other federal agencies, and the public. Full-cost pricing is the USN GF's standard policy for services provided. The USN GF recognizes revenue when earned within the constraints of its current system capabilities. In many instances, revenue is recognized when bills are issued and not when revenue is earned.

The USN GF does not include non-monetary support provided by U.S. allies for common defense and mutual security in the amounts reported in the SNC and Note 22, "Reconciliation of Net Cost to Net Outlays." The U.S. has cost-sharing agreements with countries that have a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in port.

The USN GF records donations in trust funds and special funds as Donations and Forfeitures of Cash and Cash Equivalents, and records the interest earned on those donated assets as non-exchange revenue. Donations and Forfeitures of Cash and Cash Equivalents and Non-exchange revenue are recognized by the USN GF when assets or a specifically identifiable, legally enforceable claim to another party's assets are obtained without providing value in return.

Donations and Forfeitures of Cash and Cash Equivalents and Non-exchange revenue are not considered to reduce the cost of USN GF operations and are therefore reported in the SCNP as financing sources. In certain instances, the USN GF's operating costs are paid out of funds appropriated to other federal entities. For example, by law, certain costs of retirement programs are paid by the Office of Personnel Management (OPM) and certain legal judgments against the USN GF are paid from the Judgment Fund maintained by Bureau of Fiscal Service (Fiscal Service), Treasury. When costs are identifiable to the USN GF, directly attributable to the USN GF's operations, and paid by other agencies, the USN GF recognizes these amounts as imputed costs within the SNC and as an imputed financing source on the SCNP.

1.F. Recognition of Expenses

The USN GF utilizes a combination of financial transactions within its accounting system and data calls to obtain and record financial amounts, including some expenses, which results in the untimely recording of some expense activity. Current financial and non-financial feeder systems were not designed to collect and record financial information on a full accrual accounting basis.

For OM&S, operating expenses are not always recognized when the items are consumed. Efforts are underway to transition to the consumption method to properly recognize expenses. Due to system limitations, the use of OM&S in constructing capital and other long-term assets may be recognized as operating expenses. The USN GF is implementing process and system improvements to correct these limitations.

1.G. Accounting for Intragovernmental Activities

Intragovernmental transactions are business activities conducted between two different federal entities. Transactions with the public are transactions in which either the buyer or the seller of the goods or services is a non-federal entity. The USN GF cannot accurately identify intragovernmental transactions (e.g., revenues, expenses, accounts receivable, accounts payable, and non-expenditure transfers) by customer to properly eliminate intra-entity and trading partner activity and balances from the financial statements. The USN GF's systems do not track buyer and seller data at the transaction level; thereby increasing the risk that all eliminating entries have not been recorded. Generally, seller entities within the USN GF provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with the USN GF's seller-side balances and are then eliminated. The USN GF continues to implement process and system improvements to address these limitations that will enable the USN GF to correctly report, reconcile, and eliminate intragovernmental balances.

The USN GF reconciles balances pertaining to investments in federal securities, borrowings from the Treasury and the Federal Financing Bank, FECA transactions with the Department of Labor (DOL), and benefit program transactions with the OPM.

1.H. Entity and Non-Entity Assets

Assets are classified as either entity or non-entity assets. Entity assets are those that the USN GF has authority to use for its operations. Non-entity assets are those held by the USN GF but not available for use in its operations. Non-entity assets are offset by liabilities to third parties and have no impact on net position. The USN GF combines its entity and non-entity assets on the balance sheets and discloses its non-entity assets in the notes.

Refer to Note 2, "Non-Entity Assets" for additional information.

1. I. Fund Balance with Treasury

Fund Balance with Treasury includes amounts available to pay current liabilities and finance authorized purchases, as well as funds restricted until future appropriations are received. The USN GF's monetary resources are maintained in Treasury accounts. The USN GF generally does not maintain cash in commercial bank accounts. The disbursing offices of the DFAS, USN GF, other military departments, and Department of State (State) financial service centers process the majority of the USN GF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports for the Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits. The disbursing station monthly reports are consolidated at the disbursing office level for financial reporting purposes. In FY 2021, the USN in partnership with DFAS, expanded the use of Treasury Direct Disbursing (TDD) for vendor payments. TDD is the process of utilizing Treasury as a service provider to process disbursements, thereby eliminating the requirements for disbursing stations to prepare monthly reports for Treasury to report fund balance activity. Implementation of TDD results in USN having a blended disbursing environment, where both Non-Treasury Disbursed and TDD processes support the generation of disbursement transactions affecting fund balance.

In addition, DFAS and the U.S. Army Corps of Engineers (USACE) Finance Center submit reports to the Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The Treasury records these transactions to the applicable FBwT account. On a monthly basis, the USN GF's FBwT is reviewed and adjusted at the Department level within the DoD's Defense Departmental Reporting System-Budgetary (DDRS-B). FBwT variances identified after the GL systems have closed each month are addressed through adjustments entered during the financial reporting process in DDRS to record undistributed disbursements and collections. These adjustments, if required, help to ensure the USN GF's financial statements agree with the Treasury accounts.

Refer to Note 3, "Fund Balance with Treasury" for additional information.

1. J. Cash and Other Monetary Assets

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

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

The USN GF conducts a significant portion of its operations overseas with business conducted in foreign currency. The primary source of the amounts is reported on the Disbursing Officers Statement of Accountability. The USN GF reports gains and losses from foreign currency transactions in the Gains and Deficiencies on Exchange Transactions account for the following general fund appropriations: (1) operations and maintenance; (2) military personnel; (3) military construction; (4) family housing operation and maintenance; and (5) family housing construction. The USN GF accounts for foreign currency fluctuations related to other appropriations by adjusting the original obligation amount at the time of payment. The USN GF does not separately identify currency fluctuation transactions.

1. K. Accounts Receivable

Accounts Receivable, inclusive of claims receivable and refunds receivable, consists of amounts owed to the USN GF by other federal agencies and the public. The USN GF estimates losses due to uncollectible non-federal amounts based on Accounts Receivable debt type and delinquency age. The USN GF uses non-intragovernmental

data to age receivables based on an analysis of field-level accounts receivable detail reports to determine collectability of each aging category that is less than 150 days delinquent. Additionally, the USN GF recognizes an allowance for all non-intragovernmental accounts receivable that are 150 days delinquent.

Gross receivables must be reduced to net realizable value by an allowance for doubtful accounts. FASAB Technical Bulletin 2020-1 clarifies that SFFAS 1 standards, including recognition of losses, apply to receivables from federal and non-federal entities. Currently, the USN GF is not fully compliant with the aforementioned authoritative guidance. The USN GF does not calculate an intragovernmental receivables loss allowance.

Refer to Note 5, "Accounts Receivable, Net" for additional information.

1.L. Inventory and Related Property

All inventory held for sale is funded and reported under the DON WCF financial statements. The USN GF does not maintain inventory for sale. Due to long standing business processes and financial system deficiencies, the USN GF is unable to make an unreserved assertion for OM&S opening balances. The USN GF primarily accounts for OM&S-R using the consumption method of accounting, with the purchases method of accounting used on an exception basis.

The USN GF values OM&S assets held for use, held in reserve for future use, and OM&S in development using multiple valuation methods: moving average cost (MAC), historical cost, and latest acquisition cost (LAC). Excess, obsolete, and unserviceable (EOU) OM&S is valued using a net realizable value (NRV) of zero pending development of an effective means of valuing such material. Adjustments for repair costs under the allowance method are made only to UAE; valuation adjustments pertaining to repair costs are not currently calculated for Ordnance, Tridents missiles, nor Remainder. OM&S materials held for repair are reported under held in reserve for future use.

The LAC method is used for OM&S accounted for in legacy logistics systems that were designed specifically for material management rather than for accounting purposes. The USN GF is in the process of transitioning to a MAC valuation methodology. The valuation methods for OM&S cannot be supported.

Refer to Note 6, "Inventory and Related Property, Net" for additional information.

1.M. Investments and Related Interest

The USN GF reports investments in Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments using the effective interest rate method, or another method obtaining similar results. The USN GF's intent is to hold investments to maturity unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities. The USN GF invests in non-marketable and market-based Treasury securities, issued to federal agencies by the Treasury's Bureau of the Fiscal Service. These securities are not traded on any financial exchange but are priced consistently with publicly traded Treasury securities. Accrued interest represents the amount of interest accrued on investment securities, but not received as of the date of the financial statements.

Refer to Note 9, "Other Assets" for additional information.

1.N. General PP&E

Due to long standing business process and financial system deficiencies, the USN GF is unable to make an unreserved assertion for GPP&E opening balances. The USN GF continues to implement sustainable go-forward GAAP-compliant processes.

Currently, the USN GF uses actual costs for valuing aircraft placed in service after FY2020 and vessels placed in service after FY2019. In FY2021, USN developed and implemented Indirect cost methodology for both aircraft and vessels and Research, Development, Test and Evaluation (RDT&E) methodology for vessels in accordance with SFFAS 6 using actual costs for RDT&E costs as of FY2020. Additionally, aircraft capital improvements baseline was established in accordance with SFFAS 50. To establish a baseline, the USN GF accumulated information relating to program funding and associated equipment, equipment useful life, program acquisitions, and disposals. The equipment baseline was updated using expenditure, acquisition, and disposal information.

- **Ships, submarines, aircraft, and satellites:** The USN GF procures and owns all ships (including those operated by the Military Sealift Command), submarines, aircraft (including aircraft that are operated by USMC) and satellites. USN GF valued baseline assets by establishing deemed costs using appropriations for ships and submarines, budgetary estimates for aircraft, and contracts supported by invoices and cost of similar assets for ships, submarines, aircraft, and satellites.
- **General equipment – remainder:** The USN GF values remaining assets based on historical cost or the cost of select similar assets at the time of acquisition. The Navy has not fully implemented SFFAS 50 with respect to the general equipment – remainder category.
- **Equipment held by contractors:** The USN GF provides government property to contractors to complete contract work. The USN GF owns such property and either provides it to the contractor or it is purchased directly by the contractor on behalf of the government. The Federal Acquisition Regulation (FAR) requires the USN GF to maintain information on all property furnished to contractors in the USN GF property systems. The USN GF reports such property when the value of contractor- procured General Equipment meets or exceeds the USN GF capitalization threshold (which applies to both assets and capital improvements) and is reported on the Balance Sheet. The USN GF is not in compliance with the FAR or federal accounting standards and is in the process of implementing business process and system improvements to do so.
- **Land and land rights:** The USN GF has elected to exclude its land and land rights from the GPP&E opening balance. Future land and land rights will be expensed. Acreage for land will be disclosed in Note 7, "General Property, Plant and Equipment".
- **Real property:** The USN GF values its buildings, structures, and linear structures (including utilities) at Plant Replacement Valuation (PRV). PRV represents an estimate of the replacement cost in current year dollars to design and construct a facility to replace an existing facility at the same location. Since PRV is an estimate of current cost for the same or similar assets, it is deflated or discounted for inflation since the time of acquisition to more accurately reflect the current cost.
- **Construction-in-Progress:** Construction in Progress (CIP) reflects the resources expended to construct PP&E that have not been placed in service as of the end of the fiscal year.

The USN GF uses several capitalization thresholds for its GPP&E dependent upon date of asset capitalization. For general equipment assets acquired or developed after June 30, 2013, the USN GF uses a $1.0 million threshold. For general equipment assets acquired/developed prior to June 30, 2013, an in depth analysis was performed to look back using presidential budget data and was determined too immaterial to be applied retroactively. The USN GF uses a $1.0 million capitalization threshold for all its real property. Due to business process and system limitations, the USN GF does not currently report accurate values related to CIP and internal use software (IUS).

Partial asset impairment is not a common occurrence in the USN GF, as assets are either repaired to restore lost utility or removed from service. However, the USN GF will recognize impairments for classes of assets or locations in the case of major events, (e.g., natural disasters) or if the impairment affects an entire class of assets (e.g., technological changes or obsolescence impacting an entire type/model/series of aircraft). In FY21, the Navy impaired 34 inactive Nonfuctional Linear Structure Utilities assets with a Net Book Value (NBV) of $163M.

The USN GF records GPP&E transferred from another DOD Component or federal agency at the current value of the asset on the transferring entity's general ledger, net of any accumulated depreciation at the time of transfer. If the USN cannot reasonably ascertain the net book value, the cost of the asset shall be its fair market value at the time of transfer. The USN GF records GPP&E acquired through an exchange between the USN and a nonfederal entity at the fair value of the GPP&E at the time of exchange.

The USN GF capitalizes GPP&E at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization thresholds. The USN GF capitalizes improvements to existing GPP&E if the improvement equals or exceeds the USN GF's capitalization threshold, extends the useful life of the underlying asset, or increases asset size, efficiency, or capacity. The USN GF depreciates all GPP&E, other than land, on a straight-line basis.

Refer to Note 7, "General Property, Plant and Equipment, Net" for additional information.

1.O. Stewardship PP&E

The USN GF is a large-scale owner of historic buildings, structures, districts, historical artifacts, art, ships, sunken ships, aircraft, archeological sites, installation and stewardship land, and other cultural resources. The USN GF does not capture information relative to Heritage Assets separately and distinctly from normal operations due to business process and system limitations.

The USN GF is unable to identify, separately and distinctly, the cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets from normal operations.

Refer to Note 8, "Stewardship PP&E" for additional information.

1.P. Leases

The USN GF classifies its leases as operating. Payments for operating leases are expensed over the lease term as they become payable. Currently, the USN GF does not classify any leases as capital leases.

Refer to Note 14, "Leases" for additional information.

1.Q. Other Assets

Other assets include advances and prepayments, military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on the USN GF's Balance Sheet. For advance payments recorded as assets, the DON expenses or capitalizes assets when the related goods and services are received.

When making payments in advance of the receipt of goods and services is permitted by law, legislative action, or Presidential authorization, the USN GF's policy is to record advances or prepayments as an asset on the Balance Sheet. Upon receipt of the related goods and services, the USN GF's policy is to reduce the advances and prepayments and properly classify the assets.

Financing payments allow the USN GF to alleviate the potential financial burden that long-term contracts can cause to a contractor. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on costs, and interim payments under certain cost-reimbursement contracts.

Contract financing payments do not include invoice payments, payments for partial deliveries, or lease and rental payments. Progress payments are only authorized based on a percentage or stage of completion and only for construction of real property; shipbuilding; and ship conversion, alteration, or repair. Progress payments based on percentage or stage of completion are reported as CIP. Due to system configuration limitations with certain entitlement systems, the USN GF incorrectly records Mechanization of Contract Administration Services estimated future contract financing payments as other assets, and those transactions have been reclassified to CIP and expenses.

1.R. Liabilities

Liabilities represent actual and estimated amounts to be paid as a result of transactions or events that have already occurred. Liabilities are classified as covered by budgetary resources if budgetary resources are available to pay them. Liabilities are classified as not covered by budgetary resources when congressional action is needed before they can be paid. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities. Liabilities not requiring appropriated budgetary resources include those related to deposit funds.

1.S. Environmental and Other Contingent Liabilities

A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity. Contingent liabilities are recognized when a past event or exchange transaction has occurred, and a future outflow of resources is probable and measurable. A contingency is considered probable when the future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, a contingency is considered probable when the future confirming event or events are likely to occur. A contingency is disclosed in the Notes to the Financial Statements if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. A contingency is considered reasonably possible when the chance of the future confirming event or events occurring is more than remote but less than probable. A contingency is not recognized as a contingent liability and an expense nor disclosed in the Notes to the Financial Statements when the chance of the future event or events occurring is remote. A contingency is considered remote when the chance of the future event or events occurring is slight.

Contingent Legal Liabilities are calculated based on a predetermined estimation methodology. In legal cases where estimated loss or reasonable loss range is not provided by legal offices, the methodology estimates liability amounts based on historical payment to claim ratio. Navy Office of Financial Operations (FMO) leverages OGC and Office of the Judge Advocate General (OJAG) attorney's likelihood assessment to categorize the cases for appropriate accounting treatment. The estimation methodology is based on the OGC and OJAG attorney's claim amount assessments and historical payout data applied to specific claim amounts.

Refer to Note 15, "Commitments and Contingencies" for additional information.

Environmental and Disposal Liabilities (E&DL) are estimates for anticipated environmental clean-up or disposal costs. The USN GF reports E&DL by estimating environmental clean-up (i.e., environmental restoration) or disposal costs for hazardous waste associated with future closure of GPP&E assets. Based on DoD FMR Volume 4 Chapter 13 (April 2018) and Title 40 Code of Federal Regulations, Environmental Protection Agency, Section 266.202, the USN GF does not report the environmental estimation and reporting of active ranges including the disposal of unexploded ordnance. The USN GF will recognize an environmental liability if hazardous waste is found to be migrating or has migrated off the range, or a formal decision is made to close the range.

The other accrued environmental restoration costs do not include the costs of environmental compliance, pollution prevention, conservation activities, contamination, or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations.

There are Environmental Liabilities accrued in Accounts Payable for work conducted but not paid, these amounts are not included in Note 12 Environmental and Disposal Liabilities disclosure.

Refer to Note 12, "Environmental and Disposal Liabilities" for additional information.

1.T. Accrued Leave

The USN GF reports unused military, compensatory, and civilian annual leave as accrued liabilities as it is earned. The accrued balance is adjusted annually to reflect current pay rates and unused hours of leave. The balance of the liabilities for annual leave and other leave (compensatory time and credit hours), including fringe benefit costs associated with the leave, must be assessed and, as needed, adjusted to reflect all pay increases and unused leave balances at least quarterly for financial statement purposes. Any portions of the accrued leave for which funding is not available, are recorded as unfunded liabilities. Sick leave for civilians is expensed as taken. Annual leave earned but not taken, within established limits, is funded from future financing sources.

1.U. Net Position

Net position consists of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations represent the amount of budget authority that is unobligated and has not been rescinded or withdrawn, as well as amounts obligated for which a legal liability for payment has not been incurred.

Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources including appropriations, revenue, and gains, since inception. The Cumulative Results of Operations also include donations and transfers in and out of assets that were not reimbursed.

1.V. Treaties for Use of Foreign Bases

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

1.W. Parent-Child Reporting

The USN GF is a party to allocation transfers with other federal agencies as a transferring "parent" entity or receiving "child" entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the Treasury as a subset of the parent fund account for tracking and reporting purposes. Generally, all financial activity related to these allocation transfers (e.g., budgetary resources, obligations incurred, gross costs, and outlays, gross) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and OMB apportionments are derived.

The USN GF also receives allocation transfers from Security Assistance (SA) programs and the U.S. Forest Service. The SA programs, Foreign Military Financing Program and the International Military Education and Training Program, meet the OMB exception for Executive Office of the President (EOP) funds, but they are reported separately from the USN GF's financial statements. The SA programs are executed by the DoD Components on behalf of the Executive Office of the President and the Department of State. The related Security Assistance Accounts (SAA) is a significant reporting entity, and in accordance with SFFAS 47 "Reporting Entity", its stand-alone financial statements are consolidated directly into the U.S. Government-wide financial statements. The U.S. Forest Service activities are also reported separately from the USN financial statements and reported to the parent. Conversely, as the parent, the USN GF provides allocation transfers to the Federal Highway Administration; all related activity is reported in the USN GF's financial statements.

Refer to Note 24, "Disclosure Entities and Related Parties" for additional information.

1.X. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections recorded in the general ledger and those reported by the Treasury. Due to the nature of these disbursements and collections, there is a possibility both supported and unsupported adjustments may have been made to USN GF Accounts Payable and Accounts Receivable prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the USN GF generally cannot determine whether undistributed disbursements and collections should be applied to federal or non-federal Accounts Payable or Accounts Receivable at the time accounting reports are prepared. The USN GF records undistributed disbursements against non-federal Accounts Payable and undistributed collections against federal Accounts Receivable. Unsupported undistributed disbursements and collections are applied to reduce Accounts Payable and Accounts Receivable accordingly.

Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.Y. Fiduciary Activities

Fiduciary activities are the collection or receipt, management, protection, accounting, investment and disposition by the federal government of cash or other assets in which non-federal individuals or entities have an ownership interest that the federal government must uphold. Fiduciary activities are not recognized on the entity's proprietary financial statements, but they are required to be disclosed on schedules in the notes to the financial statements. Fiduciary activities may involve a variety of transactions including, but are not limited to, cash, investments, other assets, liabilities, inflows, and outflows.

Refer to Note 21 "Fiduciary Activities" for additional information.

1.Z. Federal Employee and Veteran Benefits

Federal Employee and Veteran Benefits consist of FECA and other benefits, including military retirement. For financial reporting purposes, the USN GF's actuarial liability for worker's compensation benefits is developed by DOL and provided to the USN GF at the end of each fiscal year. Military retirement is accounted for in the audited financial statements of the Military Retirement Fund. As such, the USN GF does not record any liabilities or obligations for pensions or healthcare retirement benefits.

1.AA. Tax Exempt Status

As an agency of the federal government, the USN GF is exempt from all income taxes imposed by any governing body whether it is a federal, state, commonwealth, local, or foreign government.

1.BB. Investments in Public-Private Partnerships

The USN GF discloses Public-Private Partnerships (P3s) in accordance with SFFAS 49. The USN GF adopted guidance for P3s which establishes principles for disclosure. USN GF considers certain partnerships as P3 arrangements, defined as risk-sharing arrangements or transactions lasting more than five years between public and private sector entities.

Refer to Note 23, "Public-Private Partnerships" for additional information.

NOTE 2. NON-ENTITY ASSETS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Intragovernmental Assets	
Fund Balance with Treasury	$264,327
Accounts Receivable	93
Total Intragovernmental Assets	**$264,420**
Non-Federal Assets	
Cash and Other Monetary Assets	100,279
Accounts Receivable	140,346
Total Non-Federal Assets	**$240,625**
Total Non-Entity Assets	**$505,045**
Total Entity Assets	**$699,881,491**
TOTAL ASSETS	**$700,386,536**

Non-entity assets are not available for use in USN GF's normal operations. The USN GF has stewardship accountability and reporting responsibility for non-entity assets.

Intragovernmental FBwT is primarily comprised of amounts in the USN GF's fiduciary deposit accounts. During FY 2021, the use of Navy deposit accounts is to record Navy civilian payroll withholdings transitioned to using Treasury Index (TI) 97 deposit fund accounts. This was implemented as a Department of Defense (DoD) reporting process change to use TI97 deposit accounts to record deposits and remittances for civilian payroll withholdings. DoD will maintain the capability to link deposit fund activity to individual employees and their associated agency Line of Accounting. As the remaining deposit accounts used by Navy are non-entity, they do not represent USN GF fund balance, liabilities, or budget, rather they represent public funds that DoD is responsible for remitting at a future time. Due to financial system limitations, the USN GF performs manual reconciliations after the period-end close to categorize these adjustments as supported and unsupported.

Refer to Note 1.W "Undistributed Disbursements and Collections" for additional information.

Non-Federal Cash and Other Monetary Assets are disbursing officers' cash, foreign currency, and undeposited collections as reported on the Disbursing Officer's Statement of Accountability. These assets are held by USN GF disbursing officers' on behalf of other agencies and are not available for the USN GF's use in normal operations.

Non-Federal Accounts Receivable are primarily contractor debts owed to cancelled general fund accounts. The balance also includes out-of-service employee debts owed to cancelled general fund accounts, and interest, penalty, and administrative charges for all other public debts that will be remitted to the Treasury Miscellaneous Receipts account.

NOTE 3. FUND BALANCE WITH TREASURY

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Status of Fund Balance with Treasury	
Unobligated Balance:	
Available	$31,589,312
Unavailable	3,474,915
Total Unobligated Balance	**$35,064,227**
Obligated Balance not yet Disbursed:	**$157,837,469**
Non-Budgetary FBWT:	
Clearing Accounts	1,549
Deposit Funds	264,327
Total Non-Budgetary FBWT	**$265,876**
Non-FBWT Budgetary Accounts:	
Investments-Treasury Securities	(4,958)
Unfilled Customer Orders without Advance	(4,103,929)
Receivables and Other Accounts	61,509
Total Non-FBWT Budgetary Accounts	**$(4,047,378)**
TOTAL FUND BALANCE WITH TREASURY	**$189,120,194**

The Status of FBwT reflects the budgetary resources to support the FBwT and is a reconciliation between budgetary and proprietary accounts. The balances reflect the budgetary authority remaining for disbursement against current and future obligations.

Unobligated Balances are classified as available or unavailable and represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Certain unobligated balances may be restricted for future use and are not apportioned for current use. The Navy has not identified any such restricted balances.

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

Non-Budgetary FBwT is comprised of accounts that do not have budgetary authority but affect FBwT. This includes non- fiduciary deposit funds, budget clearing "suspense" account balances, and non-entity fund balance.

Non-FBwT Budgetary Accounts are required to reconcile the budgetary status to non-budgetary FBwT as reported in the balance sheet. Non-FBwT budgetary accounts create budget authority and unobligated balances, but do not post to FBwT as there has been no receipt of cash or direct budget authority, such as appropriations. The Non-FBwT budgetary accounts are comprised of investments in U.S. Treasury securities, unfilled customer orders without advance, and reimbursements receivable.

Other Additional Information

The USN GF field-level general ledger accounting systems may not include all Treasury collection and disbursement activity for reasons such as timing differences, transaction distribution errors, and disbursements made by other DoD agencies on behalf of the USN GF. Thus, the fund balance per USN GF includes undistributed disbursements and collections, representing the difference between disbursement and collections recorded with Treasury and those balances recorded within the USN GF general ledgers. The USN GF recorded $1.1 billion in undistributed disbursements and $76.0 million in undistributed collections as of September 30, 2021.

In FY21, the Navy transferred $1.9 billion in unused funds to the Department of Treasury, Miscellaneous Receipts account from General Fund Treasury Account Symbols that cancelled on September 30, 2021.

NOTE 4. CASH AND OTHER MONETARY ASSETS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Cash	$45,097
Foreign Currency	55,182
TOTAL CASH AND OTHER MONETARY ASSETS	**$100,279**

Refer to Note 1.J, "Cash and Other Monetary Assets" for additional information

NOTE 5. ACCOUNTS RECEIVABLE, NET

AS OF SEPTEMBER 30 ($ IN THOUSANDS)			UNAUDITED 2021
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$203,356	$(28,038)	$175,318
Non-federal Receivables (From the Public)	121,672	(38,970)	82,702
TOTAL ACCOUNTS RECEIVABLE	**$325,028**	**$(67,008)**	**$258,020**

Accounts Receivable, Net represents the USN GF's claim for payment from federal and non-federal sources. Claims with other federal agencies are resolved in accordance with the business rules published in Appendix 5 of Treasury Financial Manual, Volume 1, Part 2, Chapter 4700.

Intragovernmental Receivables primarily represent amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Seller-side accounts receivable are adjusted to agree with inter-/intra-agency buyer-side's accounts payable through the USN GF's elimination process when buyer- side balances are deemed more reliable.

Non-federal Receivables (With the Public) are balances due from individuals and organizations. Examples include Accounts Receivable for out of service debts and military housing. These balances, once collected, may be used by the collecting agency based upon nature of Accounts Receivable.

Restitution receivables and associated payments are pursued by the courts handling those cases. DON establishes the receivables based on the court documents received and posts payments received through the courts. At two years delinquent, criminal restitution receivables are considered 100 percent uncollectible; however, the DON is only authorized to write off or close accounts with approval from the Department of Justice.

Refer to Note 1.K, "Accounts Receivable" for additional information.

NOTE 6. INVENTORY AND RELATED PROPERTY, NET

Operating Materials and Supplies, Net

AS OF SEPTEMBER 30 ($ IN THOUSANDS) **UNAUDITED 2021**

OM&S Categories	Gross Value	Revaluation Allowance	Net	Valuation Method
Held for Use:				
Ordnance	$32,405,687	$ -	$32,405,687	MAC
Uninstalled Aircraft Engines	2,664,445	-	2,664,445	LAC, HC
Remainder	19,281,757	-	19,281,757	LAC, MAC
Total Held for Use	**$54,351,889**	**-**	**$54,351,889**	
Held in Reserve for Future Use:				
Ordnance	13,910,180	-	13,910,180	MAC
Trident Missiles	10,346,461	-	10,346,461	LAC
Uninstalled Aircraft Engines	4,443,318	(924,280)	3,519,038	LAC, HC
Remainder	7,421,242	-	7,421,242	LAC, MAC
Total Held in Reserve for Future Use	**$36,121,201**	**$(924,280)**	**$35,196,921**	
In Development:				
OM&S in Development	838,825	-	838,825	LAC, MAC
Total In Development	**$838,825**	**-**	**$838,825**	
Excess, Obsolete, and Unserviceable:				
Ordnance	904,793	(904,793)	-	NRV
Uninstalled Aircraft Engines	1,322,802	(1,322,802)	-	NRV
Remainder	83,623	(83,623)	-	NRV
Total Excess, Obsolete, and Unserviceable	**$2,311,218**	**$(2,311,218)**	**$ -**	
TOTAL	**$93,623,133**	**$(3,235,498)**	**$90,387,635**	

Legend for Valuation Methods:
HC = Historical Cost LAC = Latest Acquisition Cost MAC = Moving Average Cost NRV = Net Realizable Value

The USN GF's OM&S consists of tangible personal property to be consumed in normal operations or as part of a larger asset assembly. The USN GF classifies its OM&S into four categories based on purpose or condition: held for use, held in reserve for future use, in development, and EOU.

OM&S designation is determined based on condition codes assignment, as defined by the Defense Logistics Manual 4000.25-2, and subsequent alignment to account categories as directed in the DoD Financial Management Regulation 7000.14-R, Volume 4, Chapter 4 paragraph 040304.

Held for Use consists of serviceable materials and supplies ready for issue as part of normal operations.

Held in Reserve for Future Use consists of OM&S stocks that may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations. OM&S held in reserve for future use are valued using the same basis as OM&S held for use in normal operations. OM&S materials held for repair are reported under held in reserve for future use.

In Development are costs incurred in developing the OM&S or the value of tangible personal property that will be consumed in normal operations upon completion of development.

Excess, Obsolete, and Unserviceable materials include damaged assets that are more economical to dispose of than repair. Materials are defined as follows; "Excess OM&S" are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable future and that do not meet management's criteria to be held in reserve for future use. "Obsolete OM&S" are operating materials and supplies that are no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable OM&S" are operating materials and supplies that are physically damaged and cannot be consumed in operations.

The USN GF has no restrictions on the use of OM&S.

NOTE 7. GENERAL PP&E, NET

AS OF SEPTEMBER 30 ($ IN THOUSANDS)					UNAUDITED 2021
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes:					
Land	N/A	N/A	$ -	$ -	$ -
Buildings, Structures, Linear Structures	S/L	35, 40 or 45	52,454,947	(28,420,386)	24,034,561
Utilities	S/L	35 or 40	6,852,896	(3,684,014)	3,168,882
Leasehold Improvements	S/L	Lease Term	6,530	(6,530)	-
Software	S/L	2-5 or 10	242,958	(12,589)	230,369
General Equipment:					
Vessels	S/L	20-50	342,436,861	(170,427,631)	172,009,230
Aircraft	S/L	15-30	199,170,499	(107,700,103)	91,470,396
Satellites	S/L	10-15	4,304,454	(3,119,495)	1,184,959
General Equipment-Remainder	S/L	Various	22,048,489	(16,294,152)	5,754,337
Total General Equipment			**$567,960,303**	**$(297,541,381)**	**$270,418,922**
Construction-in-Progress	N/A	N/A	121,310,559	-	121,310,559
Other	S/L	35, 40 or 45	479,529	(442,183)	37,346
Utilities	S/L	35 or 40	382,586	(150,164)	232,422
TOTAL GENERAL PP&E			**$749,690,308**	**($330,257,247)**	**$419,433,061**

Legend for Depreciation/Amortization Method:
N/A = Not Applicable S/L = Straight Line

The USN GF's GPP&E is comprised of unique asset lifecycle-based categories: real property (buildings, structures, linear structures, and utilities); IUS; GE and, CIP (real property and GE). The USN GF further identifies GE by major acquisition- based segments: vessels (ships and submarines), aircraft, satellites, and GE remainder (e.g., all other capitalized assets not specifically identified, including operation support equipment, small boats and service craft, maintenance support equipment). Other GPP&E consists of "caretaker" real property. Caretaker real property is unutilized, meaning it is not occupied for current USN GF program purposes. The USN GF provides minimal maintenance to caretaker real property to ensure its safety and security only. Caretaker property is often awaiting disposal action but can also be returned to active use.

The USN GF has interest in 2,248 thousand acres of land as of September 30, 2021. The USN GF uses land, buildings, and other overseas facilities obtained through various international treaties and agreements negotiated by the State. Generally, treaty terms allow the USN GF continued use of these properties until the treaties expire. There are no other known restrictions on GPP&E.

Refer to Note 1.N, "General Property, Plant and Equipment" for additional information.

The USN GF values all its real property at Plant Replacement Valuation (PRV) as reflected in the Acquisition Value above. PRV valuation methodology, calculated using the latest DoD Facility Pricing Guide, is applied to and then deflated (discounted) for all the USN GF's real property assets with the exception of assets associated with an open

construction project. Those real property assets with open construction projects are reported at acquisition cost and will continue to do so until their associated projects are complete.

The USN GF establishes the useful life of 2-5 or 10 years during the planning phase of an IUS's development based on the length of time it is expected to have economic benefit or service potential to the USN.

As of FY 2020, Navy implemented the Office of the Secretary of Defense (OSD) Real Property Financial Reporting Responsibilities (FRO) Policy Update, dated March 15, 2019. The policy requires the USN GF financial statements to recognize all real property assets (i.e., buildings, land, structures, and linear structures) located and aligned to Navy installations, including all DON WCF real property assets located and aligned to Navy installations. This includes the recognition of any capital improvements associated with DoD-owned assets. The DON WCF will continue to report to USN GF instances that they are the installation host, real property assets that are on other federal agency installations or land or private property sites, and leased facilities and the associated improvements that are not on DoD land, if applicable.

As of September 30, 2021 Navy is assessing any property damage within the Kings Bay Naval Base in Kings Bay, Georgia, US due to Hurricane Elsa, as well as property damage within both the Naval Air Station Joint Reserve Base New Orleans, New Orleans, US and Vera Cruz Naval Air base in Vera Cruz, Mexico due to Hurricanes Ida and Grace.

Research and Development costs of new classes of vessels and the various systems thereon are considered part of the capitalizable cost of vessels. Under our SFFAS 6 approach such costs are capitalized from the point a new class of vessels is determined feasible and likely to proceed to the production phase and allocated to all the vessels in the class approved for construction. The cost of vessels put into service prior to October 1, 2019 have been assigned an estimated value under SFFAS 50 using gross budget obligations. The cost of vessels completed after that date have been valued with a SFFAS 50 method that involves a more precise estimate of cost incurred for each vessel using actual costs for SCN funded construction costs and a budget-based estimate for RDT&E costs. However, it was determined that the process had excluded an allocation of the related research and development costs. During 2021 an analysis was conducted to complete a one-time SFFAS 50 valuation estimate to capture Research, Development, Test & Evaluation (RDT&E) costs for the population of USN vessels under construction as of October 1, 2019. That analysis resulted in a valuation adjustment for ships completed subsequent to that date or still under construction to incorporate $12,279,869,678 of RDT&E costs. USN utilized an appropriations based approach in this analysis to determine the allocable percentage of a budget line based on the RDT&E program's total percentage of that line. Certain portions of the estimate have not yet been fully supported and USN will refine the values further once the documentation has been received and a further adjustment may be required after September 30, 2021. Following this baseline effort, all applicable other vessels under construction will receive RDT&E Funds in accordance with an SFFAS 6 compliant approach.

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
General PP&E, Beginning of year	$394,036,341
Capitalized Acquisitions	38,802,686
Dispositions	(781,764)
Transfers in/(out) without reimbursement	(197,345)
Revaluations (+/-)	6,119,217
Depreciation Expense	(20,474,629)
Other (+/-)	1,928,555
GENERAL PP&E, BALANCE AT END OF YEAR	**$419,433,061**

NOTE 8. STEWARDSHIP PP&E

Heritage Assets

AS OF SEPTEMBER 30, 2021 **UNAUDITED 2021**

Heritage Asset Categories	Beginning Balance	Additions	Deletions	Ending Balance
Building and Structures	239	-	14	225
Archaeological Sites	-	-	-	-
Museum Collection Items (Objects, Not Including Fine Art)	489,930	5,543	94	489,379
Museum Collection Items (Objects, Fine Art)	34,176	130	251	34,055

The USN's policy is to preserve its heritage assets, which are items of historical, cultural, educational, or artistic importance.

The overall mission of the USN is to control and maintain freedom of the seas, project power beyond the sea, and influence events and advance U.S. interests across the full spectrum of military operations. The USN is a large-scale owner of historic buildings, structures, districts, historical artifacts, art, ships, sunken ships, aircraft, archeological sites, installation and stewardship land, and other cultural resources. Protection of these components of the nation's heritage assets and stewardship land is an essential part of USN's mission. The USN is committed to responsible heritage asset and cultural resources stewardship.

Heritage assets can be acquired in a number of ways to include, but not limited to purchase, gain by inventory, donation, and transfer from DoD/other federal agency. The disposal of heritage assets can be done in the same manner as acquisition.

Heritage assets receive such designation, and have such designation withdrawn, through the accessioning and deaccessioning procedures for USN GF collections, or through evaluation in compliance with the National Historic Preservation Act. Designation is in accordance with the standards articulated with the collection scopes and collecting plans, or by application of the criteria of the National Register of Historic Places.

Heritage assets within the USN GF consist of buildings, structures, archaeological sites and museum-type collections. The USN GF defines these as follows:

Buildings and Structures: Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including multi-use heritage assets. This also includes sunken military craft, as defined by the Sunk Military Craft Act, which are managed as heritage assets. As of September 30, 2021, there are 225 items classified as buildings and structures.

Archaeological Sites: Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Historical Places in accordance with Section 110 of the National Historical Preservation Act.

Museum-type Collection Items: Art and artifacts that have been formally accessioned into a USN GF collection for the purpose of display or exhibition. As of September 30, 2021, there are 523,434 museum-type collection items, consisting of 34,055 objects (fine art) and 489,379 objects (not including fine arts).

Stewardship Land

AS OF SEPTEMBER 30, 2021 **UNAUDITED 2021**

Facility Code	Facility Title	Beginning Balance	Additions	(Deletions)	Ending Balance
9120	Withdrawn Public Land	1,371	14	-	1,385
9140	Public Land	5	1	-	6
	Grand Total	**1,376**	**15**	**-**	**1,391**
	TOTAL STEWARDSHIP LAND	**1,376**	**15**	**-**	**1,391**

Stewardship Land is land and land rights owned by the federal government but not acquired for or in connection with items of GPP&E. Examples of stewardship land include land used as forests and parks, and land used for wildlife and grazing.

NOTE 9. OTHER ASSETS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Intragovernmental Other Assets	
Advances and Prepayments	$783,112
Investments, Net (including accrued interest)	5,004
Total Intragovernmental Other Assets	**$788,116**
Non-Federal Other Assets	
Outstanding Contract Financing Payments	137,895
Advances and Prepayments	161,304
Other Assets (With the Public)	32
Total Non-Federal Other Assets	**$299,231**
TOTAL OTHER ASSETS	**$1,087,347**

Intragovernmental Advances and Prepayments are cash outlays made by a federal entity to cover all or part of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity will receive. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.

Intragovernmental Investments, Net represent USN GF Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the Navy General Gift Fund. These investments are nonmarketable, market-based Treasury securities reported at cost, net of amortized premiums and discounts. Additionally, USN GF Trust Funds are reported as funds from dedicated collections.

Non-Federal Outstanding Contract Financing are authorized disbursements of monies to a contractor prior to the acceptance of supplies or services.

Non-Federal Advances and Prepayments. In efforts to improve the financial reporting of other asset balances, the USN GF recorded a reclassification of the OCFP balance to CIP and expense. The USN GF will continue to record this reclassification until the financial systems are able to accurately record these balances.

Non-Federal Other Assets (With the Public) consists of advance pay to USN GF military personnel, travel advances to military and civilian personnel, and miscellaneous advances to contractors that are not considered outstanding contract financing payments.

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Intragovernmental Liabilities	
Accounts Payable	$20,155
Other	269,265
Total Intragovernmental	**$289,420**
Non-Federal Liabilities	
Accounts Payable	316,326
Federal Employee and Veteran Benefits	4,631,401
Environmental and Disposal Liabilities	29,325,184
Other	56,433
Total Non-Federal Liabilities	**$34,329,344**
Total Liabilities Not Covered by Budgetary Resources	**$34,618,764**
Total Liabilities Covered by Budgetary Resources	**$21,495,145**
TOTAL LIABILITIES	**$56,113,909**

Accounts Payable consists of accounts payable related to appropriations that have cancelled, which if paid, will be disbursed using current year funds.

Other Intragovernmental Liabilities primarily consists of unfunded FECA liabilities due to the DOL and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

Federal Employment and Veteran Benefits consist of unfunded FECA actuarial liabilities not due and payable during the current fiscal year.

Refer to Note 11, "Federal Employee and Veteran Benefits," for additional information.

Environmental and Disposal Liabilities are estimates related to future events and consist of liabilities related to cleanup or disposal of active installations, and equipment and weapons programs.

Refer to Note 12, "Environmental and Disposal Liabilities," for additional information.

Other Non-Federal Liabilities includes estimated legal contingent liabilities, and cancelled accounts payable as impacted by undistributed adjustments, and the disposal of excess structures that are not currently budgeted for but will become funded as future events occur. The USN GF continues to partner with its service provider to research and correct undistributed transactions to reduce the impact on the accounts payable balance.

Liabilities Not Covered by Budgetary Resources require future congressional action whereas liabilities covered by budgetary resources reflect prior congressional action. Regardless of when the congressional action occurs, when the liabilities are liquidated, Treasury will finance the liquidation in the same way that it finances all other disbursements, using some combination of receipts, other inflows, and borrowing from the public (if there is a budget deficit).

Liabilities Covered by Budgetary Resources includes Accounts Payable amounts owed to federal and non-federal entities for goods and services received by the USN GF.

The USN GF's systems do not track intragovernmental accounts payable transactions by customer. As a result, in the intragovernmental eliminations process, buyer-side accounts payables are adjusted to agree with inter/intra-agency seller-side accounts receivables. The USN GF's methodology for adjusting Accounts Payables consist of (1) reclassifying amounts between federal and non-federal accounts payable and (2) applying both supported and unsupported undistributed disbursements at the reporting entity level. The USN GF is continuing to record accrual entries ($13.6 billion at the end of Q4 FY 2021) to account for non-federal accounts payable. These accrual entries are completed to record the estimated amount of cost incurred and goods or services received but not invoiced.

Refer to Note 1.X, "Undistributed Disbursements and Collections" for additional information.

Due to existing system limitations, Navy is not consistently performing receipt and acceptance activities that would record Accounts Payables in the General Ledger (GL) systems or accruing for goods or services received but not invoiced or paid. As such, the Navy executes an Accounts Payable estimation accrual methodology to estimate the final Accounts Payable balance at the end of each quarter.

NOTE 11. FEDERAL EMPLOYEE AND VETERAN BENEFITS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)			UNAUDITED 2021
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits:			
FECA	$1,328,622	$ -	$1,328,622
Unfunded Annual Leave	3,302,779	-	3,302,779
Other	301,009	(301,009)	-
TOTAL FEDERAL EMPLOYEE AND VETERAN BENEFITS	**$4,932,410**	**$(301,009)**	**$4,631,401**

Federal Employee and Veteran Benefits consist of FECA, unfunded annual leave, and other benefits including Medicare liabilities and FICA taxes payable. Military retirement and other federal employment benefits are accounted for in the audited financial statements of the Military Retirement Fund.

FECA amounts consist of amounts for federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. The USN GF reports an actuarial liability for the FECA. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. FECA is administered by the Office of Workers' Compensation Programs. The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the DoD consolidated level.

Unfunded annual leave represents the amount recorded for unpaid Annual Leave earned but not taken by employees that will be funded by a current or future financing source.

Actuarial Cost Method Used and Assumptions
The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims.

DOL calculates the future workers' compensation liability using wage inflation factors (e.g., cost of living adjustment or COLAs) and medical inflation factors (e.g., consumer price index medical (CPIM)). The actual rates for these factors for charge back year (CBY) 2021 were also used to adjust the methodology's historical payments to current year constant dollars.

To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Year over year changes in the liability were also examined, with any significant agency-level differences inspected in greater detail. DOL concluded that the model has been stable and has projected each agency's actual payments well.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the U.S. Department of the Treasury's Yield Curve for Treasury Nominal Coupon Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.23% was assumed for year one and years thereafter. An interest rate for medical benefits of 2.06% was assumed for year one and years thereafter.

Other represents additional post-employment benefits, which can include, but not limited to, salary continuation, severance benefits, counseling, training, funded unemployment liability for federal employees, funded FECA liability, and the current portion of veterans' disability compensation benefits.

NOTE 12. ENVIRONMENTAL AND DISPOSAL LIABILITIES

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
ACCRUED ENVIRONMENTAL RESTORATION LIABILITIES:	
Active Installations - Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$4,140,397
Active Installations - Military Munitions Response Program (MMRP)	2,374,392
BASE REALIGNMENT AND CLOSURE INSTALLATIONS:	
Installation Restoration Program	1,612,347
Military Munitions Response Program	96,718
Environmental Corrective Action/Closure Requirements	5,318
ENVIRONMENTAL DISPOSAL FOR MILITARY EQUIPMENT / WEAPONS PROGRAMS:	
Nuclear Powered Military Equipment / Spent Nuclear Fuel	16,977,616
Other Weapons Systems	361,563
OTHER ACCRUED ENVIRONMENTAL LIABILITIES - NON-BRAC:	
Environmental Corrective Action	1,424
Environmental Closure Requirements	304,266
Asbestos	3,451,143
TOTAL ENVIRONMENTAL AND DISPOSAL LIABILITIES	**$29,325,184**

An environmental liability is a probable and reasonably estimable future outflow or expenditure of resources that exists as of the financial reporting date for environmental cleanup costs resulting from past transactions or events. The USN GF is required to clean up contamination resulting from past waste disposal practices, leaks, spills, and other past activity, which has created a public human health or environmental risk.

The USN GF reports the estimated environmental clean-up or disposal costs for hazardous waste associated with future closure of GPP&E assets and consist of liabilities related to accrued environmental restoration liabilities (ERN), Base Realignment and Closure (BRAC), environmental disposal for military equipment/weapons programs (disposal) and other accrued environmental liabilities (OEL) Non-BRAC.

Applicable Laws and Regulations for Cleanup, Closure and Disposal Requirements
The following is a list of significant laws that affect the USN GF's conduct of environmental policy and regulations:

- Resource Conservation and Recovery Act of 1976, as amended by the Hazardous and Solid Waste Amendments of 1984
- Superfund Amendments and Reauthorization Act (SARA)
- Clean Water Act
- Safe Drinking Water Act
- Clean Air Act
- Atomic Energy Act
- Nuclear Waste Policy Act
- Low Level Radioactive Waste Policy Amendments Act
- Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
- Medical Waste Tracking Act

- Toxic Substances Control Act
- DoD FMR Volume 4, Chapter 13: "Environmental and Disposal Liabilities"
- SFFAS 5, "Accounting for Liabilities of the Federal Government"
- SFFAS 6, "Accounting for Property, Plant, and Equipment"
- Department of the Defense Environmental Restoration Program (DERP) Manual
- DoD FMR, Volume 6B, Chapter 10: "Notes to the Financial Statements"
- FASAB Technical Release (TR) 2, Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government Page 2 of 27
- FASAB TR 10, Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment
- FASAB TR 11, Implementation Guidance on Cleanup Costs Associated with Equipment
- FASAB TR 14, Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment
- FASAB Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Cost, amended by FASAB under Technical Bulletin 2011-2, Extended Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos- Related Cleanup Costs

Types of Environmental Liabilities and Disposal Liabilities Identified

The USN GF does not report environmental liabilities for cases in which another DoD entity serves as the DoD lead agent or executive agent. The following DoD entities serve as the DoD lead or executive agent and are responsible for identifying funding requirements as well as disclosing financial information regarding the progress of programs: the United States Army Corps of Engineers is the lead agent for Formerly Used Defense Sites at active installations, the Department of the Army is the executive agent for the Chemical Weapons Disposal Program and Unexploded Ordnance.

Accrued Environmental Restoration Liabilities

Active Installations - DERP funded activities may be conducted at operating installations under the Installation Restoration Program (IRP) and at closed, transferred, and transferring munitions ranges under the Military Munitions Response Program (MMRP). These remedial actions may address CERCLA (e.g., hazardous substances, pollutants, and contaminants), RCRA (e.g., hazardous waste or hazardous constituents), military munitions (e.g., Unexploded Ordnance (UXO) or Waste Military Munitions (WMM)), or demolition and removal of unsafe buildings and structures at facilities or sites. Cleanup costs ineligible for DERP funding are reported as Other Accrued Environmental Liabilities – Non-BRAC (OEL). Developing a cleanup cost estimate relies on several factors that include: the current cost basis, the anticipated actions required to complete the cleanup, and applicable legal and or regulatory requirements. In addition, program management, environmental corrective action, and support costs are also included. The estimate produced is based on site-specific information. The cost estimates are developed and maintained in the Normalization of Data System database. Such cost estimates are based on the current technology available. MMRP liabilities are specific to the identification, investigation, removal, and remedial actions to address environmental contamination for munitions specific sites. The contamination may include munitions, chemical residues from military munitions, and munitions scrap at ranges on active installations that pose a threat to human health or the environment.

Cost to complete (CTC) is not estimated until there is sufficient site-specific data available to estimate the total CTC. However, in cases where sufficient site-specific data is unavailable, USN GF uses the cost of the study as the estimate until the study is completed. As of September 30, 2021, the USN GF estimated and reported $6.5 billion for environmental restoration liabilities. This amount is comprised of $4.1 billion in active installations-IRP liabilities and $2.4 billion in Active Installations- MMRP liabilities.

Navy tracks, funds, and executes site remediation for the Department of the Navy and as such, the environmental estimate recorded on the Navy's GF also includes sites on USMC installation. These amounts encompass environmental restoration liability remediation at 192 USMC and 938 USN sites across 17 USMC and 113 Navy installations. The Environmental Liability associated with Navy sites/installations is $5.8B and $685 million for the USMC, however the Navy records the entire amount on its financial statements as the executive agent as well as all Program Management Fees.

Other Accrued Environmental Liabilities

The OEL segment prepares accounting estimates for the unique clean-up costs that will be incurred when USN GF GPP&E assets are decommissioned. The estimate is only prepared for those assets determined to have unique non-routine cleanup costs associated with hazardous waste or materials at the time of decommissioning. This includes estimates of environmental cleanup costs upon asset closure, addressing hazardous waste, and asbestos, in addition to mandated cleanup of petroleum residuals and lubricants, these estimates are recognized as cleanup costs to current operating procedures. The OEL segment also reports estimated costs to remediate existing environmental damage at active USN GF facilities, when such costs are not eligible for funding from DERP.

The USN GF's estimated recognized environmental cleanup cost for GPP&E totaled $3.8 billion as of September 30, 2021. For closure sites and asbestos-abatement units placed in service after a threshold date, only part of estimated costs is immediately recognized as an environmental liability. The un-accrued portion of such estimates is reported as unrecognized costs. The USN GF's unrecognized environmental cleanup cost for GPP&E totaled $107.8 million. For FY21-Q4, 63 estimates had contingent liabilities totaling $195.5M – of which $195.4M is attributable to uncertainty concerning real property closure costs, and $0.1M to corrective action. The USN transferred all real property assets from the DON WCF to the GF in FY 2021. As a result, the Other Environmental Liabilities for the real property assets, previously reported in the DON WCF, will be reported in the GF.

The USN continues to evaluate its Accountable Property System of Record (APSR) for completeness and accuracy of information. This may result in material changes to the estimate in the future.

Additionally, in FY21 and in coordination with Real Property Existence & Completeness efforts and Financial Reporting Organization transfer policy, it was identified that a building was transferred from another agency to the Navy for financial statement reporting, however the associated environmental liability was not transferred. The Navy is working to develop an environmental closure estimate for this asset, a potential understatement of $18 million was identified regarding the closure of this asset, however additional evaluations will need to be conducted to validate this closure estimate in FY22.

Asbestos-Related Cleanup Costs

The Department maintains structures and facilities that may contain asbestos material in the construction or renovation. Due to asbestos being difficult to identify pre-construction or until demolition occurs the Navy does not conduct separate or distinct estimates for friable and non-friable asbestos. Once identified as containing or believed to contain asbestos, the Navy considers the entire property as requiring asbestos remediation upon demolition and disposal of the property.

Beginning in FY 2021, Navy began estimating asbestos values based on average cost per square foot for facilities built before 1989. Additionally, in FY 2021, Navy began capturing parametric linear asbestos estimates for clean-up and disposal of below ground piping at sites prior to 1981. The Correction of Error resulted in a prior period adjustment to correct the understated liability.

Base Realignment and Closure Installations

Congress commissioned to provide an independent review and analysis of bases and military installations that the DoD recommended be closed and/or operationally realigned and provided their recommendations in the BRAC Commission Final Report to the President. There have been five rounds of BRAC; 1988, 1991, 1993, 1995, and 2005. BRAC environmental sites are environmental sites at USN GF installations that are or will be closed under the congressionally mandated BRAC process. As of September 30, 2021, the USN GF includes $1.7 billion for BRAC funded environmental liabilities. This amount includes $1.6 billion for IRP, $96.7 million for MMRP, and $5.3 million for Compliance.

Navy tracks and executes site remediation for the Department of the Navy and as such, the environmental estimate recorded on the Navy's GF also includes sites on USMC installation. These amounts encompass BRAC remediation at 15 USMC and 206 USN sites across 3 USMC and 40 Navy installations resulting in the split of the environmental liability disclosure of $1.7 billion for Navy and $43.8 million for the USMC, however the Navy records the entire amount on its financial statements as the executive agent as well as all Program Management Fees.

Environmental Disposal for Military Equipment/Weapons Programs

Environmental Disposal for Military Equipment/Weapons Programs estimates represents environmental disposal liabilities related to the final disposition of military equipment. Military equipment is composed of two different areas (1) USN GF vessels which include active and inactive assets, such as weapon systems and other equipment designed to carry out battlefield missions, which include conventional (non-nuclear) and nuclear- powered active and inactive ships, aircraft carriers, submarines, and spent nuclear fuel (SNF), and (2) all USN GF active and nonactive aircraft. Currently, the USN GF does not report a liability for Nuclear Component Weapons (Trident missiles) as the warheads have been identified as the sole responsibility of the Department of Energy, and motors have been identified as OM&S.

As of September 30, 2021, environmental disposal estimates for nuclear powered military equipment and SNF is $17 billion and $361.6 million for other weapons disposal (non-nuclear) in recognized liability. The unaccrued portion of such estimates is reported as unrecognized costs. The USN GF's unrecognized environmental cleanup cost for GPP&E is $3.9 billion for nuclear powered military equipment, and $184 million for other weapons disposal (non-nuclear). The USN GF and the Department of Energy share estimated future costs of disposing high-level radioactive waste. The portion of SNF reflected on the USN GF's Balance Sheet represents the USN GF's portion of the estimated future cost based on historical cost factors, which equates to $2.8 billion in recognized liability and $126.3 million in unrecognized costs.

The Navy has determined to include cost data points that are known by Naval engineering experts to align to certain vessel hull numbers and should be included when conducting the environmental disposal regression analysis, however the documentation to support these cost values may not explicitly identify a specific hull number for direct alignment. The inclusion of these additional data points increase the environmental estimate regarding conventional vessels. The Navy has determined to include these data points and report the more conservative (higher) environmental disposal estimate rather than exclude these cost data factors, which could potentially understate the Navy's Environmental Liability.

The demilitarization and disposal of Nuclear Aircraft Carriers has never been performed before. The hazardous waste disposal estimate related to the current active fleet and one decommissioned vessel amounts to $9.3 billion, which is 32% percent of the Navy's overall recognized E&DL balance and $3 billion in unrecognized E&DL disposal costs. The Navy's Nuclear Carrier fleet has begun its first disposal effort for one Nuclear Carrier. The Navy has conducted preliminary analysis for this first Nuclear Carrier disposal through private enterprise and government research and used that analysis as the basis for a detailed but unproven estimate for that specific carrier and as a broad basis for an estimate of the future disposal cost of the currently active carriers. No decisions have been made as to the actual disposal dates for the remaining classes of active aircraft carriers. The second class of carriers is on schedule for consideration in six years, which aligns with their expected useful life. That class of carriers was designed, when built, to have a 50-year life and the first ship in the class was commissioned in 1975. Due to the unique aspects of demilitarization and disposal of nuclear components for a vessel that large and the lack of any available data related to the costs and techniques to be used in such a disposal, there is a significant risk that the projected estimates for the decommissioned carrier may vary widely from future incurred actual disposal costs. Therefore, the estimates for the remainder of the fleet that are based on that estimate may change materially over the remaining active life of the carriers. The Navy expects that once the first Nuclear Carrier has begun its disposal process this information will allow adjustments of the estimates based on the experience of actual costs, new technology, and other lessons learned in the disposal process. The nuclear aircraft hazardous material disposal estimate will be continuously evaluated and adjusted as this information becomes available.

Methods for Assigning Total Cleanup, Closure, and/or Disposal Costs to Current Operating Periods

Accrued Environmental Restoration Liabilities

DERP represents the liability to correct past releases of hazardous constituents from USN GF GPP&E and to bring the known contaminated sites into compliance with the applicable environmental standards. Currently, the USN GF process is to perform an initial assessment of any contamination before the USN GF purchases a new building or land. Any identified contamination is reported as a liability and an associated cost to complete is conducted on an annual basis; these estimates are recognized as cleanup costs to current operating procedures. Estimates are developed using engineering estimates.

Other Accrued Environmental Liabilities Non-BRAC

The OEL program relies on Internet Naval Facilities Assets Data Store (iNFADS) as the accountable property system of record (APSR) to derive and recognize liabilities associated with real property assets. OEL also conducts field data calls to derive the corrective action site population, these data calls are performed in Q3 and Q4 each fiscal year. Environmental conditions that result from current operations and require immediate cleanup (e.g., oil spills or routine hazardous waste removal) are not considered environmental liabilities and are part of current operating expense, if fully remediated within the current fiscal year. Estimates are developed using engineering estimates.

During FY21Q4, for parametric closure estimates that exceeded $1 million, OEL reported only a study cost as liability. The calculated parametric cost was reported as contingency. This had the effect of reducing liability and increasing contingency compared with prior years. This practice will be discontinued, beginning with FY2022-Q2 financial reports.

In addition, for liability accrual purposes, the useful life classifications described in FMR Vol. 4, Chap. 24, Table 24-1 were substituted for figures previously provided by iNFADS. This increased reported Q4 liability for amortized assets - including post-97 closure and post-2012 asbestos.

During FY21Q4 APSR reconciliation filters were adjusted to assign eligibility to some assets that were previously considered ineligible due to incomplete APSR information. This change resulted in a small increase in the eligible asset population and related parametric costs - despite no change in the APSR record set itself.

Asbestos

In years prior, asbestos estimates were calculated using a range of remediation costs that was reported for several groups of similar facilities – the low end was reported and the median value was reported as a contingent cost. For Parametric non-linear asbestos remediation estimates, these values are now based on the average cost per square foot across the population of similar sites built before 1989. The USN GF also added parametric linear asbestos estimates for clean-up and disposal of below ground piping at sites prior to 1981, which were previously not captured. Additionally, Real Property closure and asbestos estimate accruals were adjusted to begin with the facility construction date rather than the previous allocation based on placed in service date.

During Q3FY21, the USN performed an internal search to identify the presence of abandoned piping. The search consisted of reviews of inFADS record cards which resulted in an immaterial impact to the overall Environmental Liability calculation.

Base Realignment and Closure

Once an installation is closed, the DERP associated liabilities for these sites are transferred to the BRAC program, which may include sites on property USN GF may no longer own, but for which the USN GF has retained clean-up responsibility based on property transfer agreements. BRAC's universe consists of environmental liabilities for environmental restoration program sites at closed USN GF installations; the estimates are recognized as cleanup costs to current operating procedures and are estimated annually.

Environmental Disposal for Military Equipment/Weapons Programs

There are two USN GF commands responsible for estimating environmental disposal liabilities related to military equipment and weapons programs. The estimates are developed based on the population of their respective APSRs. NAVSEA develops quarterly updates and maintains the estimate for vessels and NAVAIR develops quarterly updates and maintains the estimate for all USN GF aircraft. NAVSEA Estimates are developed using parametric and engineering estimates based on historical disposal costs. NAVAIR Estimates are developed using the output of a Cost Estimation Relationship equation. This equation uses physical attributes along with historical disposal data to estimate the number of hours required for disposal, multiplied by the labor rates in a given year to estimate the disposal liability.

Ongoing Corrective Action Impacts

Due to ongoing site studies and implementation of corrective action plans across the OEL program, updates to the estimated liabilities associated with OEL sub-line items for Corrective Actions site are expected to continue. Until full implementation of these programmatic changes are complete, balances and estimation methodologies may fluctuate.

Nature of Estimates and the Disclosure of Additional Information

Estimated environmental liabilities are extremely complex with various input factors. In addition, these input factors are adjusted for new technology, price growth (inflation), increases in labor rates, and materials.

In Q4 it was identified that ERN had double reported environmental liabilities in the amount of $41.6 million, in Q4 FY21 ERN's respective environmental liability was decreased by $41.6 million to correct for this overstatement.

In FY21, the Navy conducted an analytical review of all assets impacting the Navy's E&DL estimates. Based on this evaluation, it was determined that the following asset classes did not represent unique hazardous waste disposal costs or lacked an accounting requirement for inclusion and should be excluded from the E&DL population: Ordnance, Trident Missiles, UAEs, OM&S Remainder, IUS, GE (except for Vessels and Aircraft), Satellites, and Active Ranges.

With respect to general equipment (GE) the Navy determined that the environmental costs incurred at closure were either of a routine nature and therefore not considered a potential liability in accordance with Technical Release 11 (TR-11) or presented an immaterial impact to the Navy's environmental liability.

The DON is continuously reviewing their E&DL population, which may result in changes to the excluded assets. In addition, as regulations change, the DON will be required to review and assess their process and methodology to ensure compliance.

As the E&DL program continues to undergo significant changes to include process, population and control updates the future environmental liability may materially change based on the results of these activities.

In Q4 FY21 due to the significant remedial activities being conducted over the environmental and disposal liabilities processes, it was determined to use the Q3 APSR data to develop the asbestos and real property closure estimates reported on the Other Environmental Liabilities line, as a result future updates to the estimate may materially change based on the use of the updated APSR data.

Environmental Liabilities

The environmental liabilities for USN GF are based on accounting estimates, which require certain judgments and assumptions based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than used for (or) assumed for calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

Emerging Contaminants

Per- and Polyfluoroalkyl Substances (PFAS) are a large class of chemicals found in many consumer products, as well as in a certain firefighting foam called aqueous film forming foam (AFFF). While DoD is only one of many users of AFFF, there is significant attention on DoD's use and the subsequent potential impact to human health and the environment. PFAS are classified as emerging contaminants because they do not have established regulatory standards, but evolving science has identified potential risk to humans and regulatory standards are under consideration. DoD follows the existing federal cleanup law (the Comprehensive Environmental Response, Compensation, and Liability Act) and long-standing EPA regulations for all chemicals in its cleanup program, including PFAS. DoD is conducting assessments for PFAS use or potential release at DoD installations and National Guard locations. At this time, some future costs are not yet estimable. However, as DoD continues these investigations and legislative changes, the cost estimates related to PFAS cleanup are likely to increase as more is known about the sites. The Navy is monitoring these changes and updates to ensure compliance.

NOTE 13. OTHER LIABILITIES

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Intragovernmental:	
Advances from Others	$(904)
Disbursing Officer Cash	101,917
Custodial Liabilities	138,800
Other Liabilities	406,872
Total Intragovernmental	**$646,685**
Other than Intragovernmental/With the Public:	
Accrued Funded Payroll and Leave	1,471,631
Advances from Others	1,076,921
Deposit Funds and Suspense Accounts	264,328
Contract Holdbacks	1,216,731
Contingent Liabilities	56,433
Other Liabilities	15,839
Total Other than Intragovernmental/With the Public	**$4,101,883**
TOTAL OTHER LIABILITIES	**$4,748,568**

Intragovernmental Liabilities:

Intragovernmental Advances from Others represent liabilities for collections received to cover future expenses or acquisitions of assets. The $904k abnormal balance is the result of a trading partner reconciliation with a Federal trading partner that reported an abnormal balance with Navy as of 30 September 2021.

Intragovernmental Disbursing Officer Cash represents liabilities for currency on hand, cash on deposit at designated depositories, cash in the hands of depositories, cash in the hands of deputy disbursing officers, cashiers and agents, negotiable instruments on hand, and other related liabilities.

Intragovernmental Custodial Liabilities represent liabilities for collections reported as non-exchange revenues where the USN GF is acting on behalf of another federal entity. The Statement of Custodial Activity is not required as part of the USN GF's financial statements, as they are reflected on the Balance Sheet.

Intragovernmental Other Liabilities represents liabilities not recognized in any previous category and includes liabilities that are immaterial to the agency.

Non-Federal Liabilities:

Non-Federal Accrued Funded Payroll and Leave represents the estimated liability for salaries and wages of civilians and military members that have been earned but are unpaid and amounts of funded annual leave, sick leave, and other employee benefits that have been earned but unpaid.

Non-Federal Advances from Others represent liabilities for collections received from public to cover future reimbursable expenses.

Non-Federal Deposit Funds and Suspense Accounts represent liabilities for receipts held in suspense temporarily for distribution to others or held as an agent for others and paid at the direction of the owner and liabilities that offset undistributed disbursements.

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Non-Federal Contract Holdbacks consist of amounts withheld from payments to contractors to assure compliance with contract terms, usually expressed as a percentage in the respective contract provisions.

Non-Federal Contingent Liabilities include accrued contingent legal liabilities pertaining to pending legal cases where the OGC and the Office of the Judge Advocate General (OJAG) consider an adverse decision probable and the amount of the loss measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Treasury Judgment Fund.

Refer to Note 15, "Commitments and Contingencies," for additional information.

Non-Federal Other Liabilities primarily consist of accruals for services, accrued liabilities for inventory owned and managed on behalf of foreign governments, and undistributed international tariff receipts.

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NOTE 14. LEASES

All USN GF leases are non-cancellable operating leases. Operating lease amounts are captured by asset category for the next five years and beyond. These future operating lease payments will be funded by future year's budgetary resources. Currently, the USN GF does not have any future payments for cancellable leases. The USN GF is not aware of any lease agreements in which we are the Lessor.

Future Payments Due for Non-Cancelable Operating Leases

AS OF SEPTEMBER 30 ($ IN THOUSANDS)				UNAUDITED 2021
	Asset Category		Totals	
	Land and Buildings	Equipment	Federal	Non Federal
Future Payments Due Fiscal Year				
2022	$226,944	$1,489	$7,531	$220,902
2023	224,713	766	6,941	218,538
2024	229,233	781	7,092	222,922
2025	233,890	795	7,245	227,440
2026	238,651	811	7,402	232,060
After 5 Years	243,536	826	7,562	236,800
TOTAL FUTURE LEASE PAYMENTS	**$1,396,967**	**$5,468**	**$43,773**	**$1,358,662**

NOTE 15. COMMITMENTS AND CONTINGENCIES

Commitments:
Commitments are preliminary actions that will ultimately result in an obligation to the U.S. government if carried through, such as purchase requisitions, estimated travel orders, or unsigned contracts/grants. The USN GF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the USN GF does not have a systemic process by which it captures or assesses these potential contingent liabilities. Therefore, the amounts reported may not fairly present the USN GFs contingent liabilities.

The USN GF's estimate of obligations related to cancelled appropriations for which the USN GF has a contractual commitment for payment is $311.0 million.

Legal Contingencies:
The USN GF is a party to various administrative proceedings, legal actions, and claims for environmental damage, employment matters, tort damages, intellectual property, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The OGC and OJAG conduct reviews of litigation claims involving the USN GF to which the OGC and OJAG attorneys devoted substantial attention in the form of legal consultation or representation. The OGC and OJAG assess the likelihood of an unfavorable outcome as follows: probable, reasonably possible, or remote.

Probable Likelihood of an Adverse Outcome:
As of September 30, 2021, the USN GF has an estimated potential loss of $56 million that is assessed as probable if adverse decisions are made against the Navy. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is probable that an adverse outcome will result. The potential loss is reported as part of the Other Liabilities on the Balance Sheet. For certain claims that are paid by Treasury's Judgment Fund, which Navy does not have to reimburse, an Imputed Financing Source is recognized. However, agencies are required to reimburse the Judgment Fund for payments pursuant to the Contract Disputes Act and the Notification and Federal Employees Antidiscrimination and Retaliation Act of 2002.

Refer to Note 13, "Other Liabilities," for additional information.

Reasonably Possible Likelihood of an Adverse Outcome:
As of September 30, 2021, the USN GF has an estimated potential loss of $293 million that is assessed as reasonably possible if adverse decisions are made against the USN GF. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is reasonably possible that an adverse outcome will result.

The United States and by extension the Department of the Navy, is party to certain international court matters that remain undecided at the time of this report. Some of these matters, if decided against the United States and by extension the Department of the Navy, may result in an outflow of resources material to the financial statements. As of September 30, 2021, these matters are not probable, quantifiable, or certain to occur; therefore, no liability is estimated or included in this note.

Other Contingencies:

As of September 30, 2021, the DON documented internal administrative claims (IACs) within the Office of the Judge Advocate General (OJAG) Code 11 and OJAG Code 15 and assessed their financial statement impact related to Contingent Liability/ Contingent Loss (CL). IACs are analyzed by litigators to determine whether in accordance with applicable guidance they must be disclosed as threatened/unasserted litigation pursuant to the Contingent Legal Liability (CLL) reporting process. IACs that do not qualify as reportable in the CLL context may need to be disclosed as part of DON's broader CL reporting. The DON looked at OJAG Code 11, Code 15 and Judgement Fund Total Annual historical payment data averaged for 5 years to determine the loss from Internal Administrative Claims (IACs). As of September 30, 2021, the USN GF has a potential loss of approximately $8.4 million from administrative tort claims.

NOTE 16. FUNDS FROM DEDICATED COLLECTIONS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Assets:	
Intragovernmental:	
Fund Balance with Treasury	$50,005
Investments, net	5,005
Total Assets	**$55,010**
Liabilities:	
Other Liabilities	536
Total Liabilities	**$536**
Cumulative Results of Operations	54,474
Total Liabilities & Net Position	**$55,010**
Statement of Net Cost:	
Gross Program Costs	29,985
Less: Earned Revenue	(160)
Net Program Costs	**$29,825**
Net Cost of Operations	**$29,825**
Statement of Changes in Net Position:	
Net Position Beginning of the Period	58,182
Net Cost of Operations	(29,825)
Budgetary Financing Sources Other Financing Sources	26,117
Change in Net Position	(3,708)
Net Position End of Period	**$54,474**

The USN GF currently has four funds from dedicated collections: Wildlife Conservation, the DON General Gift, Ship Stores Profit, and the U.S. Naval Academy General Gift fund.

The Wildlife Conservation Fund is a special fund authorized by 16 USC 670b, and provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Proceeds from the sale of fishing and hunting permits are used for these programs at USN GF installations charging such user fees. These programs are carried out through cooperative plans agreed upon by the local representatives of the SECDEF, the Secretary of the Interior, and the appropriate agency of the state in which the installation is located.

The DON General Gift Fund is authorized by 10 USC 2601. Under the provisions of this statute, the SECNAV may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that it be used for the benefit, or in connection with the establishment, operation, or maintenance of a school, hospital, library, museum, cemetery, or other institution under the jurisdiction of USN GF.

The Ships Stores Profit Fund is authorized by 10 USC 7220. Deposits to this fund are derived from profits realized through the operation of ships' stores and from gifts accepted for providing recreation, amusement, and contentment for enlisted members of the Navy and Marine Corps.

The U.S. Naval Academy General Gift Fund is authorized by 10 USC 6973. Under the provisions of this statute, SECNAV may accept, hold, administer, and spend any gift, devise, or bequest of personal property, made on the condition that it be used for the benefit of, or in connection with, the United States Naval Academy, or the Naval Academy Museum, its collections, or its service.

NOTE 17. SUBORGANIZATION PROGRAM COSTS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Military Personnel:	
Gross Costs	$38,773,171
Less: Earned Revenues	(463,492)
Net Program Costs	**$38,309,679**
Operations, Readiness, and Support:	
Gross Costs	70,310,957
Less: Earned Revenues	(3,160,351)
Net Program Costs	**$67,150,606**
Procurement:	
Gross Costs	28,568,503
Less: Earned Revenues	(449,616)
Net Program Costs	**$28,118,887**
Research, Development, Test & Evaluation:	
Gross Costs	31,235,410
Less: Earned Revenues	(360,118)
Net Program Costs	**$30,875,292**
Family Housing and Military Construction:	
Gross Costs	887,965
Less: Earned Revenues	(462,477)
Net Program Costs	**$425,488**
NET COST OF OPERATIONS	**$164,879,952**

The SNC represents the net cost of programs and organizations of the USN GF. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The USN GF's current processes and systems capture costs based on appropriations groups and not major programs in accordance with GPRA, due to system and business process limitations. The USN GF is in the process of reviewing available data and developing a cost reporting methodology to comply with the standard.

Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by USN GF are recognized as imputed cost in the SNC and are offset by imputed revenue in the SCNP. Such imputed costs and revenues relate to business-type activities (if applicable), employee benefits, and claims to be settled by the Treasury Judgement Fund. However, unreimbursed costs of goods and services other than those identified above are not included in our financial statements.

NOTE 18. UNDELIVERED ORDERS AT THE END OF THE PERIOD

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021	
	FEDERAL	NON-FEDERAL
Undelivered Orders, Unpaid	$11,488,554	$126,758,107
Undelivered Orders, Paid	1,200,994	299,200
TOTAL	**$12,689,548**	**$127,057,307**

The USN GF financial accounting systems do not assign Federal and Non-Federal attributes to undelivered orders (UDOs), whether paid or unpaid. This footnote imputes the balances of Federal and Non-Federal paid and unpaid UDOs proportional to the Federal/Non-Federal share of Advances and Prepayments and Accounts Payable, respectively.

NOTE 19. PERMANENT INDEFINITE APPROPRIATIONS

The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of DoD sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the U.S. and documented under the laws of the U.S.; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet, including the acquisition, alteration or conversion of vessels. As of September 30, 2021, reporting, there was one transfer to NDSF for $342.4 million from the Operation and Maintenance, Navy appropriation

The Environmental Restoration, Navy (ER,N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. As of September 30, 2021, reporting, there was two transfers from ER,N for $421.3 million to the Operation and Maintenance, Navy appropriation. Appropriations Received on the SCNP does not agree with Appropriations Received on the SBR due to differences between proprietary and budgetary accounting concepts and reporting requirements.

NOTE 20. EXPLANATION OF DIFFERENCES BETWEEN THE SBR AND THE BUDGET OF THE U.S. GOVERNMENT

The Statement of Budgetary Resources has been prepared to agree with the amounts shown in the Budget of the United States Government. The Budget of the United States Government containing the actual amounts for FY 2021 has not been published at the time these financial statements were prepared. The FY 2022 Budget of the United States Government with the actual FY 2020 amounts was released in April 2021. The FY 2023 Budget of the United States Government with the actual amounts for the current year (FY 2021) will be available at a later date on OMB website at https://www.whitehouse.gov/omb/budget/.

The table below presents the FY 2020 differences between the amounts reported in the FY 2020 SBR and the actual FY 2020 amounts reported in the FY 2022 Budget of the U.S. Government for SBR lines Total Budgetary Resources; New Obligations and Upward Adjustments; Outlays, Net; and Distributed Offsetting (Receipts)/Outlays, Net.

AS OF SEPTEMBER 30, 2020	FISCAL YEAR 2020 ACTUAL			
	Total Budgetary Resources	New Obligations & Upward Adjustments (Total)	Distributed Offsetting Receipts	Net Agency Outlays
FY 2020 Combined Statement of Budgetary Resources	$235.8	$202.0	$ -	$165.4
Reconciling Items:				
Resources related to DON expired accounts not reported in the President's Budget	(3.1)	-	-	-
USMC Appropriations included in the President's Budget Balance	29.7	28.8	-	26.9
USMC shared appropriations with DON included in the SBR but excluded from Navy direct appropriations presented in the President's Budget	(1.3)	(1.2)	-	0.9
Rounding	(0.5)	(0.5)	-	-
Per FY 2022 Budget of the US Government	**$260.5**	**$229.1**	**$ -**	**$193.1**

NOTE 21. FIDUCIARY ACTIVITIES

SCHEDULE OF FIDUCIARY ACTIVITY	
AS OF SEPTEMBER 30 ($ IN THOUSANDS)	**UNAUDITED 2021**
Fiduciary Net Assets, Beginning of Year	$965,784
Contributions	1,014,925
Disbursements to and on Behalf of Beneficiaries	(428,582)
Increase/(Decrease) in Fiduciary Net Assets	586,343
Fiduciary Net Assets, End of Period	**$1,552,127**

SCHEDULE OF FIDUCIARY NET ASSETS	
AS OF SEPTEMBER 30 ($ IN THOUSANDS)	**UNAUDITED 2021**
Fiduciary Assets	
Fund Balance with Treasury	$1,552,127
Total Fiduciary Net Assets	**$1,552,127**

The USN GF fiduciary activity consists of funds in the Savings Deposit Program and Foreign Cooperative Agreements. Service members of the USN GF who are on a permanent duty assignment outside the U.S., or its territories can earn interest at a rate prescribed by the President, not to exceed 10% per year, on up to $10 thousand deposited into the program. This limitation shall not apply to deposits made on or after September 1, 1966, in the case of those members in a missing status during the Vietnam conflict, the Persian Gulf conflict, or a contingency operation. In accordance with 22 USC 2767, the President may enter into a cooperative project agreement with the North Atlantic Treaty Organization or with one or more member countries of that Organization. These agreements are made in an effort to leverage share of costs, contracts and other resources where shared interests exist. The USN currently has four (4) BSOs operating within foreign cooperative agreements: NAVAIR, NAVWAR, NAVSEA, and ONR.

NOTE 22. RECONCILIATION OF NET COST TO NET OUTLAYS

AS OF SEPTEMBER 30, 2021	UNAUDITED 2021		
	Intragovernmental	With the public	Total
Net Cost of Operations (SNC)	$45,918,854	$118,961,098	$164,879,952
Components of Net Cost That are Not Part of Net Outlays:			
General Property, plant, and equipment depreciation expense	-	25,396,719	25,396,719
Increase/(decrease) in assets:			
Account Receivable	(178,790)	37,363	(141,427)
Other assets	(375,192)	(220,549)	(595,741)
(Increase)/decrease in liabilities:			
Accounts Payable	340,457	(2,476,564)	(2,136,107)
Federal employee and veteran benefits payable	-	(218,468)	(218,468)
Environmental and disposal liabilities	-	(4,100,209)	(4,100,209)
Other Liabilities (Unfunded Leave, Unfunded FECA, Actuarial FECA)	40,340	(374,137)	(333,797)
Financing Sources:			
Imputed cost	(762,812)	-	(762,812)
Donated revenue	-	(26,084)	(26,084)
TOTAL COMPONENTS OF NET COST THAT ARE NOT PART OF NET OUTLAYS	**$(935,997)**	**$18,018,071**	**$17,082,074**
Components of Net Outlays That Are Not Part of Net Cost:			
Inventories and related property	-	2,729,315	2,729,315
TOTAL COMPONENTS OF NET OUTLAYS THAT ARE NOT PART OF NET COST	**$-**	**$2,729,315**	**$2,729,315**
Other Temporary Timing Differences			
Distributed offsetting receipts	-	(189,721)	(189,721)
Other	1,027,441	(12,001,199)	(10,973,758)
Total Other Reconciling Items	**$1,027,441**	**$(12,190,920)**	**$(11,163,479)**
Net Outlays	**$46,010,298**	**$127,517,564**	**$173,527,862**
Agency Outlays, Net, Statement of Budgetary Resources			**$173,527,862**
Reconciling Difference			**-**

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position, so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis above illustrates this reconciliation by listing the key differences between net cost and net outlays.

NOTE 23. PUBLIC-PRIVATE PARTNERSHIPS

Background

Congress established the Military Housing Privatization Initiative (MHPI) in 1996 as an alternative method to help the military improve the quality of life for its military members. By using the expertise and tools afforded to private companies Navy military housing improvements occurred more expediently and efficiently than the traditional military construction process would allow. 10 U.S.C. §§ 2871-2885 codified the Service Secretaries' MHPI authority, as modified by Pub. L. 116-92, Title XXX – Military Housing Privatization Reform (now 10 U.S.C. §§ 2871-2894a) and Pub. L. 116-283 (FY2021 National Defense Authorization Act (NDAA)).

The Secretary of the Navy (SECNAV) delegated MHPI authority to the Naval Facilities Engineering Command (NAVFAC), and authorized NAVFAC to enter into agreements with eligible entities from the private sector on behalf of the Navy. NAVFAC selected Partners through a competitive process with the intent to demolish, construct, renovate, maintain, and operate family housing and unaccompanied housing for the Navy.

The Navy possesses the following authorities to assist in the execution of Public Private Partnerships (P3s): direct loans and loan guarantees (10 U.S.C. § 2873), rental guarantees (10 U.S.C. § 2876), differential lease payments (10 U.S.C. § 2877), contributions (10 U.S.C. §§ 2875 and 2883), and the conveyance or leasing of land, housing, and other facilities (10 U.S.C. §§ 2875 and 2878). Based on these authorities and after careful analysis and consideration, the Navy elected to enter MHPI P3s by providing appropriated funds to the Department of Defense (DoD) MHPI program. Navy conveyed real property assets to the selected private partners, entering into long-term leases of the underlying land, contributing cash to the selected partners from the Family Housing Improvement Fund (FHIF) and using direct loans from the DoD FHIF.

Detailed reports to the appropriate committees of Congress on the MHPI projects are required by 10 U.S.C. § 2884 for each project, conveyance, or lease proposed; as a part of the annual budget submission; and as an annual report concerning the status of oversight and accountability. Additionally, the House Report 116-63, Pages 23-24, accompanying H.R. 2745, the Department of Defense Appropriations Bill, 2020, directs the Service Secretaries to submit a report to the congressional defense committees detailing: (1) how the Services monitor privatized facilities at a national level and (2) any planned upgrades to this system to improve transparency.

The expected life of each MHPI arrangement corresponds to the duration of the ground lease (generally 50 years), which generally corresponds to the expected useful life of the housing units. The bulk of Navy arrangements will complete the initial term in the 2050-2056 timeframe. Negotiations between the Navy and the private partners established the duration of the ground lease based on the minimum duration required to ensure project success.

The complete universe of Navy family and unaccompanied housing MHPI arrangements is as follows:

The Navy has two (2) MHPI family housing arrangements comprised of one (1) project each under the FY 1995 10 U.S.C. § 2837 authority which are no longer extant:

- Kingsville I
- Everett I

The Navy has one (1) MHPI family housing arrangement comprised of one (1) project under 10 U.S.C. §§ 2871-2886 authorities which is no longer extant:

- Everett II

The Navy has ten (10) MHPI family housing arrangements with twelve (12) partners under 10 U.S.C. §§ 2871-2894a authorities that continue in operation:

- Kingsville II
- San Diego
- New Orleans
- South Texas
- Hawaii
- Northeast
- Northwest
- Mid-Atlantic
- Midwest
- Southeast

The Navy has two (2) Military Unaccompanied Housing arrangements with two (2) partners under 10 U.S.C. §§ 2871-2885 authorities that continue in operation:

- Hampton Roads Unaccompanied Housing
- San Diego Unaccompanied Housing (Pacific Beacon)

Note: As required by the legal agreements between the Navy and its MHPI partners, in order to protect the business sensitive information contained within those individual arrangements, the Navy has elected to aggregate the financial information herein. In cases where data from a single MHPI is presented, that information is presented without naming the specific entity involved.

Responsibilities

The Non-government Managing Member (also referred to as the Partner) is responsible for the management of the MHPI entity with the goal of providing adequate housing to Navy military members choosing to reside in these facilities for rents set equal to the area housing allowance. In the FY2020 NDAA, Pub. L. 116-62, Title XXX – Military Housing Privatization Reform, Congress provided notional standards and definitions for adequate housing (services' condition assessments shall utilize private sector housing industry construction codes and sizing standards as a basis for assessing inventory adequacy) and initiated the process to establish tenant rights and responsibilities for all DoD MHPI housing. In general, the MHPI entities are to provide services, which include the management, maintenance, and operations of the facilities over the life of the operating agreement. The Partner has sole and exclusive management and control over the MHPI entity. The Navy will not take part in the day-to-day management of the MHPI, however, to protect its interests in certain specific circumstances the Navy has reserved the ability to concur/approve with the Managing Member's decisions/ recommendations (i.e., annual operating budgets, recapitalization plans, incurring additional debt).

Funding

Contributions from the DoD MHPI program and the Partner typically occur at the beginning of any new project and occur as a pre-condition of follow-on phases as required by the Operating Agreement (OA). During Phase I, the initial development phase, the Navy entered into long term ground leases (generally 50 years) and conveyed the then existing associated real property assets (buildings, structures, facilities, and utilities) to the MHPI P3, organized

as a Limited Liability Company (LLC) or Limited Partnership (LP). The Navy provided a nominal amount of funding to DoD Family Housing Improvement Fund (FHIF) or DoD Military Unaccompanied Housing Improvement Fund (MUHIF). Once the Navy funds were in the FHIF or MUHIF, the DoD MHPI program made direct cash contributions and loans to the LLCs/LPs at Navy's request.

Cash contributions to MHPI P3 partners from the DoD FHIF or DoD MUHIF requires Congressional notification (10 U.S.C. § 2883(f)). There are no contractual requirements for additional federal contributions to the LLCs/LPs. The Navy has not made any in kind contributions/services or donations to the MHPI entities.

The Navy is not required to contribute resources to the MHPI P3 beyond the initial contribution, and any subsequent contributions required as a pre-condition to follow on phases, to the FHIF or MUHIF and has not made any such additional capital contributions, loans or loan guarantees to the MHPI P3s.

The limited cash contributions of the Navy at formation were used by the Managing Members to fund start-up costs and initial working capital of the MHPI. A substantial portion of the buildings contributed to the MHPI were demolished or substantially renovated shortly after the projects were formed. The capital necessary to construct or renovate the projects came from the issuance of third-party debt collateralized solely by the projects themselves. Funds to support the operations of the MHPI P3s comes from the rental revenue received from the tenants. The Navy does not guarantee any debts incurred by the MHPI entity.

Military Members, as part of their compensation receive a Basic Allowance for Housing (BAH). BAH is determined by Congress as the market cost of housing for each applicable geographic region as calculated under section 403(b)(3)(A)(i) of the military pay statute in Title 37, U.S.C. It is authorized through the National Defense Authorization Act (NDAA) and appropriated via the Defense Appropriations Act (or Continuing Resolutions) annually. If the Military Member uses MHPI, the associated BAH amount is considered to be an indirect third-party payment from Navy as discussed in SFFAS 49, para 24.c.i.3 and as disclosed below.

Beginning in 2018 Congress enacted several laws to make up for BAH reductions in prior years. These laws require the Navy to supplement the housing allowances of the service members residing in the facilities by making direct payments to the MHPI entities. These direct payments are described and disclosed below:

- From 01 January – 31 December 2018, Pub L. 115-91 § 603 directed that payments to the MHPI entities of 1% of the amount of BAH calculated under section 403(b)(3)(A)(i) of the military pay statute in Title 37, U.S.C. for the area in which the covered housing existed would be made monthly.
- From 01 September 2018 to 31 December 2019, Pub. L.115-232 § 606 directed that payments to the MHPI entities of 5% of BAH as calculated as described above would be made monthly.
- From 01 January 2020 forward, Pub. L.116-92 §§ 3036 and 3037 directs that payments to the MHPI entities of 2.5% of BAH as calculated as described above will occur monthly for all MHPI entities. Additionally, "underfunded" projects may receive up to an additional 2.5% of BAH monthly at the determination of the Chief Housing Officer of the Department of Defense and SECNAV until Congress modifies or rescinds this direction. (Note: The Chief Housing Officer of the Department of Defense promulgated interim guidance for Pub. L. 116-92 §§ 3036 and 3037 on 10 June 2020. The DON has issued implementing guidance for the Navy, and the Navy began Pub. L. 116-92 §§ 3036 and 3037 payments in Q4 FY2020.)

The following table represents the current fiscal year Navy transactions in support of the MHPI Program and LLCs/LPs through 30 September 2021:

FY 2021 Navy Transactions through September 30, 2021 ($TYM)	
Navy cash transfers to DoD FHIF/MUHIF	$ –
Real property contributions to the MHPI LLCs/LPs (value of Real Property Assets (RPA) conveyed, per MHPI audited financial statements)	$ –
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1) (actuals) (Ref. 1)	$ 35.20
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(2) (actuals) (Ref. 2)	$ 33.31
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(3) (actuals (Ref.3)	$ –
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1),(a)(2), and (a)(3) (current liability for invoices received as of 30 September 2021 but not yet paid) (Ref.4)	$ 15.92
Navy estimated indirect third party payments to MHPI LLCs/LPs in FY2021 (Ref.5 and 6)	$ 984.31

Reference 1: Pub. L. 115-91 § 603 and Pub. L. 115-232 § 606 (a)(1).
Reference 2: Pub. L. 115-232 § 606 (a)(2) (as established by Pub. L. 116-92 §§ 3036 and 3037)
Reference 3: Pub. L. 115-232 § 606 (a)(3) (as established by Pub. L. 116-92 §§ 3036 and 3037)
Reference 4: Pub. L. 115-91 § 603 and Pub. L. 115-232 § 606 (a)(1)(a)(2), and (a)(3) (as established by Pub. L. 116-92 §§ 3036 and 3037)
Reference 5: BAH provided under section 403 of title 37 to Military Members living in privatized housing.
Reference 6: The number of military family housing units upon which these estimated payments were made is 30,890 in FY 2021. The number of units of military unaccompanied housing upon which these estimated payments were made is 5,831 in FY 2021 .

The following table represents the cumulative Navy transactions in support of the MHPI Program and LLCs/LPs through 30 September 2021:

Cumulative Navy Transactions through September 30 2021 ($TYM)	
Navy cash transfers to DoD FHIF/MUHIF (Ref. 7)	$ 360.16
Real property contributions to the MHPI LLCs/LPs (value of Real Property Assets (RPA) conveyed, per OMB scoring documents)	$ 2,170.57
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1) (actuals) (Ref.1)	$ 97.80
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(2) (actuals) (Ref.2)	$ 36.00
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(3) (actuals (Ref.3)	$ –
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1),(a)(2), and (a)(3) (current liability for all invoices received as of 30 September 2021 but not yet paid) (Ref.4 and 8)	$ 21.11
Navy indirect third party payments (BAH provided under section 403 of title 37 to members living in privatized housing) to MHPI LLCs/LPs (Ref.9 and 10)	$ UNK

Reference 7: The Navy funding transfers were amounts necessary to establish the program or correct shortfalls in commitments to have housing allowances reflect local market conditions and are not expected to be recovered by the Navy. The real property contributions similarly were fully depreciated or are expected to be fully depreciated over the life of the arrangements and are not expected to have a material book value upon their return at the end of the land lease. Accordingly, no amounts are reflected in the FY2021 Navy General Fund Balance Sheet for the assets transferred to the MHPI P3s.
Reference 8: As provided in SFFAS 49, para 24.b, any potential future payments beyond the current liabilities reflected above are not estimable and are therefore not provided. This is due to there being no contractual requirement to make additional payments and the uncertainty associated with Congressional action in this area over the last two years, and the projected revision to the DoD policy governing Section 606(a)(2) and (3) payment authorizations in FY2022.
Reference 9: As provided in SFFAS 49, para 24.b, the cumulative BAH amounts are not readily available nor supportable, therefore no estimate of the cumulative amount of BAH is provided. This disclosure requirement did not exist until FY2019, and Navy has no way of recreating or estimating BAH payments made to individuals living in MHPI housing from program inception in FY1996 through FY2018. Navy will report annual BAH amounts as a part of this disclosure on a go forward basis.
Reference 10: As provided in SFFAS 49, para 24.b, Navy does not estimate the future amount of BAH to be paid to MHPI entities. This is due to the uncertainties associated with the number of members residing in MHPI housing year over year, the paygrade mix of members residing in MHPI housing, and the potential changes in the BAH rates which occur in the annual National Defense Authorization Acts (NDAAs) and which are implemented through annual appropriations to the Navy. Further, it is a discretionary choice on the part of individual Service Members to live in MHPI housing. Service Members may choose to spend their BAH in MHPI housing, non-MHPI housing, or purchase housing. There is no commitment or guarantee on the part of the Navy to any MHPI entity to ensure a minimum number of military residents in MHPI housing.

The following table represents the current year DoD transactions in support of the Navy MHPI Program and LLCs/LPs through 30 September 2021:

FY 2021 DoD Transactions through September 30, 2021 ($TYM) (Ref. 11)	
DoD cash disbursements from the FHIF/MUHIF to MHPI LLCs/LPs	$ –
DoD government direct loans from the FHIF to MHPI LLCs/LPs	$ –

The following table represents the cumulative DoD transactions in support of the Navy MHPI Program and LLCs/LPs through 30 September 2021:

Cumulative DoD Transactions through September 30, 2021 ($TYM) (Ref. 11)	
DoD cash disbursements from the FHIF/MUHIF to MHPI LLCs/LPs	$ 357.65
DoD government direct loans from the FHIF to MHPI LLCs/LPs	$ 2.50

Reference 11: The financial amounts represented above are presented in the DoD's consolidated financial statement and their respective note disclosures and are not presented within the Navy's financial statements.

Neither the Navy nor the DoD have made or expect to make any additional cash contributions, loans, or conveyance of real property to the LLCs/LPs after July 01, 2021 through the end of the P3 arrangements. However, Navy continuously assesses the housing requirements at all of its installations, and Navy may determine that an additional phase within an existing MHPI arrangement best meets the needs of the Navy members. Should an additional phase be executed, Navy or DoD may provide cash contributions to the arrangement as determined by the pro forma analysis. Any new phases and associated cash contributions would require Congressional approval.

The following table represents the current year MHPI Managing Member (Private Partner) contributions to the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported through 30 September 2021:

FY 2021 MHPI Managing Member Contributions to the MHPI LLC/LP through September 30, 2021 ($TYM)	
Cash contribution to MHPI LLCs/LPs by Managing Member	$ –
Value of real property and land contributed to MHPI LLCs/LPs by Managing Member	$ –

The following table represents the current year transactions of the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported through 30 September 2021:

FY 2021 MHPI LLC/LP Transactions through September 30, 2021 ($TYM)	
Bonds or construction loans obtained by MHPI LLCs/LPs	$ –
Value of real property assets donated to Navy by MHPI LLC/LP	$ –
Cash transferred to Navy by MHPI LLC/LLP	$ –
Govt Direct Loan repayments made by the MHPI LLCs/LPs to DFAS in FY2021	$ 0.13

The following table represents the cumulative MHPI Managing Member (Private Partner) contributions to the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported through 30 September 2021:

Cumulative MHPI Managing Member Contributions to MHPI LLC/LP through September 30, 2021 ($TYM)		
Cash contribution to MHPI LLCs/LPs by Managing Member	$	65.29
Value of real property and land contributed to MHPI LLCs/LPs by Managing Member	$	0.33

The following table represents the current year transactions of the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported through 30 September 2021:

Cumulative MHPI LLC/LP Transactions through September 30, 2021 ($TYM)		
Bonds or construction loans by MHPI LLCs/LPs balance outstanding	$	3,884.93
Value of real property assets donated to Navy by MHPI LLC/LP since 2019	$	51.73
Cash transferred to Navy by MHPI LLC/LLP	$	–
Govt Direct Loan Outstanding Balance	$	1.38
Govt Direct Loan repayments made by the MHPI LLCs/LPs through 30 September 2020 (Ref. 12)	$	1.13

Reference 12: Final loan repayment due May 2032.

There is no requirement for the Private Partners to make any additional contributions after 01 July 2021 through the end of the arrangements (approx. through 2050). However, as discussed above, Navy continuously assesses the housing requirements at all of its installations, and Navy may determine that an additional phase within an existing MHPI arrangement best meets the needs of the Navy members. Should an additional phase be executed, the Private Partners are expected to provide contributions to the arrangement as determined by the pro forma analysis. Any new phase and associated cash contributions would require Congressional approval.

The MHPI entities have not borrowed or invested capital based on the Navy's promise to pay, either implied or explicit.

Risk of Loss and Expectation of Gain

The DoD's risk of loss is the initial cash contribution to the program; the Navy's risk is failure to deliver quality-housing services to Navy Military Personnel. The private partner's risk of loss includes the recovery of the initial cash contributions, inability to repay bonds and/or loans, and the loss of a long-term revenue source. Each MHPI Operating Agreement prescribes revenue flow "waterfall" during the life of the arrangement and upon liquidation of the arrangement. These waterfalls generally allow the managing Partner an opportunity to earn incentives and returns for economic performance after providing a set aside of capital for the maintenance of the facilities. Should monies exist in excess of the required reserves securing or repaying the debt, the required reserves for maintenance of the facilities, and the contractual incentive payments to the managing Partner, the excess would be returned to the FHIF at entity dissolution.

The Private Partner's potential risks are (1) inability to recover their initial cash contributions, (2) inability of the project to repay bonds and/or loans causing a loss or restructure of the project, and (3) loss of a long-term revenue source. The Private Partner is not entitled to the return of its capital contribution, or to be paid interest on its capital contribution other than through profits of the project.

The MHPI Operating Agreements do not explicitly identify risk of loss contingencies.

The MHPI entity cash flow is dependent on Congressional authorization and appropriation of basic allowance for housing, which becomes a third-party payment for rent to the MHPI entity. The Navy can influence but cannot control the authorization and appropriation process. Additionally, because of ongoing congressional review of the MHPI program, there may be changes to the relationship between the Navy and the entity based on Congressional action. If or when action is taken, the Navy will disclose any financial changes or impacts that this may pose / cause. This is potentially a remote impact that is not measurable at this time. Conversely, there is an expectation that the market-based rent to be received by the MHPI P3s will be sufficient to cover operating expenses, debt service, and remuneration of the Managing Partner and any excess return is retained within the individual MHPI entity long-term recapitalization/operational reserve lockbox accounts for future use by the entity.

Several MHPI entities have noted a potential negative impact of the COVID pandemic on their operations. While none of the entities indicated a current impact, they did note it generated some uncertainty with respect to operations and future cash flow. Navy will continue to monitor the MHPI entities for these impacts.

Risk of Termination or Non-Compliance

As noted above, Navy does bear risk in the form of non-performance in that, in some cases failure of an MHPI P3 could leave it with inadequate housing alternatives for its military members. There is no requirement in any of the arrangements for the Navy to repay loans or other obligations of the MHPI P3s. In addition to the ability to dispose of assets not subject to the land leases and the ability to refinance or seek additional debt, the arrangements allow for protections for the lenders and the Navy by allowing the removal of property managers for non-performance. As of this note, from inception to date neither the lenders nor Navy has exercised the right to request removal of property managers or other affiliated parties.

In some instances, the Navy provides utility services to the housing area operated by the LLC. The LLC is contractually and statutorily required to provide reimbursements for utility services provided by the Navy.

As of the date of this report, the one MHPI entity that was distressed completed restructuring in November 2020 and is no longer a going concern issue. Further, final payment of the full balance for utilities in arrears was made to Defense Finance Accounting Service (DFAS) and the matter is closed. As previously discussed, the restructure and DFAS payment were completed without Navy intervention and without either additional Navy or DoD funding or guarantees.

The Department recognizes other risk scenarios may occur, such as Private Partner non-compliance with the MHPI agreements. To address non-compliance risk, the Department performs reviews of compliance, a joint effort between the local military housing office, the Private Partners, Military Department installation commands, and other ranking members of the Military Department. These reviews can include neighborhood tours to view project amenities such as community centers, playgrounds, and pools, all of which are owned, maintained, and operated by the Private Partner companies, as well as exteriors of military housing units. Private Partner performance is measured through a variety of metrics, such as resident satisfaction, maintenance management, project safety, and financial management. The Government Accountability Office Report, GAO-20-280T, Preliminary Observations on DoD's Oversight of the Condition of Privatized Military Housing, provides information about the Department's governance activities, and the National Defense Authorization Act (NDAA) 2020 Sections 3001-3064 prescribes the authoritative guidance which defines the accountability and oversight measures of the MHPI projects, the protections and responsibilities for tenants, and any additional requirements relating to contracts and management of MHPI projects.

There are no additional contractual or other risks of loss to the private entities, or any expected risks to cash flows known at this time.

Other Public Private Ventures:

The Navy conducted a review of agreements, which may have created a Public Private Venture (PPV) / P3. This review encompassed Enhanced Use Leases, Renewable Energy Program Out-leases, Utility Energy Savings Contracts, Power Purchase Agreements, Privatized Utilities, and Energy Savings Performance Contracts. Our analysis supports that these contracts and agreements do not constitute a PPV/P3 and do not require disclosure under SFFAS 47 or SFFAS 49.

NOTE 24. DISCLOSURE ENTITIES AND RELATED PARTIES

The USN GF has relationships which constitute control for NAFIs and FFRDCs as these entities meet the SFFAS 47 "Reporting Entity" control principle regarding risk of loss or expectation of benefits.

The USN GF maintains long-term contractual relationships with the parent organizations of Foreign Military Financing, Special Defense Acquisition Fund, Foreign Military Loan Liquidating Account, Military Debt Reduction Financing Account, Advances, and Foreign Military Sales, Security Assistance programs, the U.S. Forest Service, and the Federal Highway Administration. The USN GF sponsored FFRDCs to meet research or development needs that cannot be met as effectively by existing government or contractor resources. The FFRDCs provide research and development laboratory centers to support the USN. All USN GF funding for FFRDCs work is provided through the Department's contract with the parent organization that operates each FFRDC. FAR Part 35.017 provides federal policy for the establishment and use of FFRDCs.

The USN FFRDC relationships are defined through bi-lateral sponsoring agreement between each USN sponsoring organization and the university or private-sector nonprofit parent organization that operates each FFRDC. While the USN does not control the FFRDCs, the parent organization must agree that the FFRDC will conduct its business in a manner befitting its special relationship with the USN GF, operate in the public interest with objectivity and independence, and be free from organizational conflicts of interest. An FFRDC may be used only for work that is within its purpose, mission, and general scope of effort, as established in the sponsoring agreement.

The USN receives significant benefits from the work of the FFRDCs, which is critical to national security. Congress restricts the amount of support that the Department may receive from USN sponsored FFRDCs through a limitation that it sets annually on the staff years of technical effort that be funded.

The USN GF's NAFIs are fiscal entities supported in whole or in part by NAFs. For the most part, NAFs are generated from sales and user fees. The USN GF's NAFIs are established by DoD policy, and are Morale, Welfare, and Recreation (MWR) entities, intended to enhance the quality of life of members of the uniformed services, retired members, and dependents of such members, and to support military readiness, recruitments, and retention.

The Under Secretary of Defense for Personnel and Readiness (USD(P&R)) exercises overall policy direction for oversight of USN GF NAF activities. The Under Secretary of Defense (Comptroller) and Chief Financial Officer and the DFAS, in coordination with the USD(P&R), are responsible for NAF accounting policy. DoD policy requires the USN to appoint advisory groups for NAFIs. The advisory group ensures the NAFI is responsive to authorized patrons and to the purposes for which the NAFI was created. Additionally, the NAFIs are subject to USN policy requirements for financial reporting to USD(P&R) and financial audits conducted by independent public accounting firms. However, NAFI financial activity is not included in the USN GF financial statements.

Refer to Note 23, "Public-Private Partnerships" for USN GF's PPV/P3s that were identified for disclosure in compliance with SFFAS 47 and SFFAS 49.

NOTE 25. COVID-19 ACTIVITY

Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R 748-240 / Public Law 116-136) to respond to the COVID-19 outbreak and its impact on the economy, public health, state and local governments, individuals, and businesses. USN GF subsequently received $360.3 million in funding related to the CARES Act beginning in Q2 FY 2020.

As of Q4 FY 2021, USN GF received transfers in the amount of $566.0 million, $912 million was obligated for activities related to the CARES Act (refer to the table below for the COVID 19 summary). The remaining unobligated budgetary resources (allotments and commitments) balance of $14.3 million can be used for upward/downward adjustments of prior obligations until those funds cancel.

COVID 19 SUMMARY ($ IN MILLIONS)

TAS - Description	Appropriations Received	Net Transfers	Unpaid Obligations	Paid Obligations	Unobligated Balance
1804 – Operations and Maintenance, Navy	$360.3	$545.9	$119.8	$782.7	$3.7
1810 – Other Procurement, Navy	-	10.8	2.8	1.8	6.1
1806 – Operations and Maintenance, Reserve	-	6.3	(0.4)	4.3	2.4
1453 – Military Personnel	-	3.0	-	1.0	2.1
TOTAL	**$360.3**	**$566.0**	**$122.2**	**$789.8**	**$14.3**

NOTE 26. SUBSEQUENT EVENTS

On October 2, 2021, the USS Connecticut (SSN-22) struck an object while submerged in international waters. On October 7, 2021, the Navy announced in a press release that an investigation is underway to assess any damage sustained.

NOTE 27. NON-CUSTODIAL NON-EXCHANGE REVENUES

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Interest on Non-Exchange Gifts and Donations	$33
TOTAL	**$33**

The USN GF's special funds for Academy and General Gifts hold Treasury securities on which they receive interest. The invested balances of these funds derive predominantly from the funds' non-exchange transactions with the public (i.e., donations and gifts). These balances are not earned in exchange transactions by the entity's operations and, most fundamentally, are not produced by operations in which the entity incurs a cost. Therefore, the interest on Treasury securities is not deducted from the gross costs of these special funds or the USN GF in determining its net cost of operations. As a result, the derived interest revenue should not be classified as exchange revenue and instead has the same non-exchange classification as the predominant source (i.e., non-exchange donations) of the invested balances.

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GENERAL FUND

UNITED STATES NAVY GENERAL FUND REQUIRED SUPPLEMENTARY INFORMATION

210424-N-MD713-1140
ARABIAN SEA (April 24, 2021) An MH-60S Sea Hawk helicopter, attached to the "Dusty Dogs" of Helicopter Sea Combat Squadron (HSC) 7, prepares to land aboard the aircraft carrier USS Dwight D. Eisenhower (CVN 69), while the guided-missile cruiser USS Monterey (CG 61), front, and the guided-missile destroyer USS Mitscher (DDG 57) sails alongside in the Arabian Sea. The Dwight D. Eisenhower Carrier Strike Group is deployed to the U.S. 5th Fleet area of operations in support of naval operations to ensure maritime stability and security in the Central Region, connecting the Mediterranean Sea and Pacific Ocean through the western Indian Ocean and three strategic choke points. (U.S. Navy photo by Mass Communication Specialist 3rd Class Cameron Pinske)

This section provides the Required Supplementary Information to accompany the basic financial statements as prescribed by accounting standards.

Deferred Maintenance and Repair

USN GF conducts large quantity of Equipment Maintenance and Repair that encompasses several assets across the Navy. Aircraft and Ships, considered among the most high-tech in the world, constitute major categories for the Navy's Deferred Maintenance and Repair (DM&R).

Disaggregated Statement of Budgetary Resources

The Combined Statement of Budgetary Resources combines the availability, status, and outlays of USN GF budgetary resources. The Statement of Disaggregated Budgetary Resources provides the Combined Statement of Budgetary Resources disaggregated by USN GF programs for the fiscal year ended September 30, 2021.

US NAVY GENERAL FUND

General Property, Plant, And Equipment
Real Property Deferred Maintenance And Repair
For Fiscal Year Ended September 30, 2021

($ IN MILLIONS)			UNAUDITED 2021
PROPERTY TYPE	**1. Plant Replacement Value**	**2. Required Work (Deferred Maintenance and Repair)**	**3. Percentage**
Active			
Category 1: Enduring Facilities			
Navy (Less: Military Family Housing)	$225,816	$20,419	9.04%
Military Family Housing	9,209	1,443	15.67%
Category 2: Heritage Assets			
Navy (Less: Military Family Housing)	-	-	-
Military Family Housing	-	-	-
Inactive			
Category 3: Excess Facilities or Planned for Replacement			
Navy (Less: Military Family Housing)	$6,334	$624	9.85%
Military Family Housing	217	94	43.32%

Note: In the table above, Navy real property deferred maintenance and repair data represent both USN GF and Change to DON WCF.

General Property, Plant and Equipment

Description of Property Categories:
Category 1 – Buildings, Structures, and Linear Structures that are enduring and required to support an ongoing mission, including multi-use Heritage Assets

Category 2 – Buildings, Structures, and Linear Structures that are Heritage Assets

Category 3 – Buildings, Structures, and Linear Structures that are excess to requirements or planned for replacement or disposal, including Heritage Assets

Description of Property Types:
Building: A roofed and floored facility enclosed by exterior walls and consisting of one or more levels that is suitable for single or multiple functions

Structure: A facility, other than a building or linear structure, which is constructed on or in the land

Linear Structures: A facility whose function requires that it traverse land (such as a road, rail line, pipeline, fence, pavement). Includes distribution systems that provide a common service or commodity to more than one building or structure.

The DM&R information presented relates to all Navy facilities and is not restricted to capitalized assets. The DM&R information excludes assets on Navy installations where a Defense Agency is responsible for maintenance and repair. For these assets, defense agencies are responsible for funding the condition assessment of facilities and reporting a Facility Condition Index (FCI).

M&R Policies

The Navy has migrated and is utilizing the Sustainment Management System (SMS), where applicable, to perform a cyclical assessment of real property facilities and assign a FCI, which considers an asset's key life-cycle attributes such as age and material, as part of a repeatable process that involves field-level condition assessments.

M&R Prioritization

As part of the 'Targeted Facilities Investment Strategy', mission, health and safety considerations are more heavily favored than quality of life, when assigning priority to maintenance needs.

Acceptable Condition Standards

Generally, the Navy considers an asset acceptable when it is in good condition with an assigned FCI of 90% or above.

Capitalization of DM&R

The DM&R information presented relates to all DoD facilities and is not restricted to capitalized assets.

Asset Exclusions

The DM&R information excludes assets on Navy installations where a Defense Agency is responsible for maintenance and repair. For these assets, defense agencies are responsible for funding the condition assessment of facilities and reporting a FCI.

EQUIPMENT DEFERRED MAINTENANCE AND REPAIR

AS OF SEPTEMBER 30, 2021 ($ IN THOUSANDS) **UNAUDITED 2021**

MAJOR CATEGORY*	FY20 PB-61 Amounts	Adjustments**	FY21 Totals**
1. Aircraft	$327,029	$290,177	$617,206
2. Electronics and Communications Systems	4,278	2,531	6,809
3. Missiles	42,297	(6,188)	36,109
4. Ships	132,399	48,280	180,679
5. Ordnance Weapons and Munitions	26,385	(1,391)	24,994
6. All Other Items Not Identified Above	23,585	(7,012)	16,573
Total	**$555,973**	**$326,398**	**$882,371**

Note: The deferred maintenance amounts reported in the Budget Exhibit Depot Maintenance (PB-61) was used as the basis to identify and report amounts in the Equipment Deferred Maintenance.
*Amounts include Overseas Contingency Operations (OCO) funding.
**FY21 values are estimates based on data submitted for BES-21

Equipment Deferred Maintenance and Repair

Deferred Maintenance and Repair (DM&R) is "maintenance and repairs not performed when they should have been or were scheduled to be; therefore, are put off or delayed for a future period." The information applies to both capitalized equipment, such as ships and aircraft, and non-capitalized equipment, such as ordnance, weapons types, and targets. All items requiring maintenance in FY 2021 are included in the data. The Department of Navy has not changed prior year policies. Deferred maintenance increased in FY 2021 primarily due to increases in aircraft and ship maintenance. This was driven by revised airframe workloads, increase in unplanned repairs, and increased requirements for aircraft and ships.

Aircraft

Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), and component repair. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircraft that have reached their Fixed Induction Date (FID), or unplanned maintenance events (i.e. crash damage). The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance is the difference between validated requirements and funding received.

Airframe rework and maintenance (active and reserve) is performed under the Integrated Maintenance Concept (IMC) program. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, but with smaller work packages, thereby reducing out-of-service time. The goal of this program is to improve readiness while reducing operating and support costs. The Naval Air Systems Command's (NAVAIR) Industrial Strategy is to maintain the minimum level of organic capacity consistent with force levels necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR partners with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance.

The increase in aircraft deferred maintenance is primarily due revised Airframes workload and unit cost mix of various aircraft as well as unplanned In Service Repairs (ISR) and an increase to software Capability Defect Packages (CDPs) corrections. Primary Aircraft Authorizations and requirements for Logistics support have increased as additional aircraft have been fielded. Funding levels have not grown commensurately with the requirements; thereby resulting in increased deferred maintenance.

Electronics and Communications Systems

The electronics and communications equipment category consists of maintenance performed on a variety of radar, radio, and wire communications equipment. This category refers to deferred systems maintenance for active and reserve Navy assets. In part, the systems include or are associated with the Surveillance Towed-Array Sensor System (SURTASS), P-8 Beartrap, satellite subsystems, the Multi-Band Deployable Antenna, the Multi-Mode Inter/Intra Team Radio, and a variety of radio and radar sets used within the Navy. The total requirement is the planned quantity of systems and their components that require depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is then the difference between the validated requirements and funding received for that fiscal year.

The increase in FY 2021 electronics and communications systems deferred maintenance is due to Manned Recon, ALQ-99, and Airborne Anti-Submarine Intelligence programs being funded to a lower level of repair in FY21.

Missiles

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

The decrease in FY 2021 missile deferred maintenance is associated with CMBRE, HARPOON, LRASM, Sidewinder AIM-9M, SLAM-ER and SOPGM due to overall increased maintenance funding provided in FY21 for 1D4D weapon system repairs.

Ships

Fleet Type Commanders provide deferred ship maintenance data. Data is collected from the Current Ships' Maintenance Plan (CSMP) database, which captures maintenance actions at all levels (organizational, intermediate, depot) for active ships. Only depot level maintenance is provided in the calculation of ship deferred maintenance. This includes maintenance actions deferred from actual depot maintenance work-packages as well as maintenance deferred before inclusion in a work package due to fiscal, operational, or capacity constraints.

For U.S. Fleet Forces the FY 2020 increase in deferred maintenance is due to requirement increase due to submarine availabilities at public shipyards. The reduction in deferred maintenance for U.S. Pacific Fleet was driven by an overall reduction in Ship Depot Maintenance Non-CNO workload at the shipyards and Continuous Maintenance repairs and I-Level workload at CNSP.

Ordnance Weapons and Munitions

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

The FY 2021 decrease in ordnance weapons and munitions deferred maintenance is associated with CAD/PAD, Countermeasures and Guns due to overall increased maintenance funding provided in FY21 for weapon system repairs.

All Other Items Not Identified Above

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

Decreases in FY 2021 are driven by increased training requirement and OPTEMPO utilization for BQM-177, GQM-163A, and Mobile Land Targets in support of the Aerial Targets program.

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US NAVY GENERAL FUND

Statement of Disaggregated Budgetary Resources
For the Fiscal Year Ended September 30, 2021

($ IN THOUSANDS)			UNAUDITED 2021
	Research, Development, Test & Evaluation	Procurement	Military Personnel
BUDGETARY RESOURCES:			
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$2,827,107	$26,043,548	$704,167
Appropriations (discretionary and mandatory)	19,393,857	58,289,824	38,161,184
Spending Authority from Offsetting Collections (discretionary and mandatory)	687,169	365,337	462,910
TOTAL BUDGETARY RESOURCES	**$22,908,133**	**$84,698,709**	**$39,328,261**
STATUS OF BUDGETARY RESOURCES:			
New Obligations and Upward Adjustments (total)	$20,323,243	$60,244,831	$39,016,591
Unobligated Balance, End of Year:			
Apportioned, Unexpired Accounts	2,243,555	23,702,150	58,889
Exempt from Apportionment, Unexpired Accounts	-	-	-
Unapportioned, unexpired accounts	-	-	-
Unexpired Unobligated Balance, End of Year	2,243,555	23,702,150	58,889
Expired Unobligated Balances, End of Year	341,335	751,729	252,781
Unobligated Balance, End of Year (total)	2,584,890	24,453,879	311,670
TOTAL BUDGETARY RESOURCES	**$22,908,133**	**$84,698,710**	**$39,328,261**
OUTLAYS, NET, AND DISBURSEMENTS, NET			
Outlays, Net	$18,990,260	$55,330,895	$38,103,821
Distributed Offsetting Receipts	-	-	-
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$18,990,260**	**$55,330,895**	**$38,103,821**

The accompanying notes are an integral part of these statements.

US NAVY GENERAL FUND

Statement of Disaggregated Budgetary Resources
For the Fiscal Year Ended September 30, 2021

($ IN THOUSANDS) **UNAUDITED 2021**

	Family Housing & Military Construction	Operations, Readiness & Support	2021 Combined
BUDGETARY RESOURCES:			
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$6,344,552	$5,628,571	$41,547,945
Appropriations (discretionary and mandatory)	2,002,056	60,496,612	178,343,533
Spending Authority from Offsetting Collections (discretionary and mandatory)	357,784	4,916,422	6,789,622
TOTAL BUDGETARY RESOURCES	**$8,704,392**	**$71,041,605**	**$226,681,100**
STATUS OF BUDGETARY RESOURCES:			
New Obligations and Upward Adjustments (total)	$3,937,165	$68,096,327	$191,618,157
Unobligated Balance, End of Year:			
Apportioned, Unexpired Accounts	4,294,721	1,206,062	31,505,377
Exempt from Apportionment, Unexpired Accounts	-	83,935	83,935
Unapportioned, unexpired accounts	1	-	1
Unexpired Unobligated Balance, End of Year	4,294,722	1,289,997	31,589,313
Expired Unobligated Balances, End of Year	472,505	1,655,280	3,473,630
Unobligated Balance, End of Year (total)	4,767,227	2,945,277	35,062,943
TOTAL BUDGETARY RESOURCES	**$8,704,392**	**$71,041,604**	**$226,681,100**
OUTLAYS, NET, AND DISBURSEMENTS, NET			
Outlays, Net	$2,827,687	$58,493,763	$173,746,426
Distributed Offsetting Receipts	-	(218,564)	(218,564)
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$2,827,687**	**$58,275,199**	**$173,527,862**

The accompanying notes are an integral part of these statements.

GENERAL FUND

OFFICE OF THE INSPECTOR GENERAL TRANSMITTAL LETTER

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 8, 2021

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/
CHIEF FINANCIAL OFFICER, DOD
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE NAVY

SUBJECT: Transmittal of the Independent Auditor's Report on the U.S. Navy General Fund Financial Statements and Related Notes for FY 2021 (Project No. D2021-D000FS-0046.000, Report No. DODIG-2022-023)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the U.S. Navy (Navy) General Fund Financial Statements and related notes as of and for the fiscal year ended September 30, 2021. The contract required EY to provide a report on internal control over financial reporting and compliance with provisions of applicable laws and regulations, contracts, and grant agreements, and to report on whether the Navy General Fund's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996. The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018, Volume 1 (Updated, April 2020), Volume 2 (Updated, March 2021), and Volume 3 (Updated, September 2021). EY's Independent Auditor's Report is attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the Navy General Fund Financial Statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the Navy General Fund's FY 2021 Financial Statements and related notes.

EY's separate report, "Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit the Financial Statements

Performed in Accordance with Government Auditing Standards," discusses 16 material weaknesses related to the Navy General Fund's internal controls over financial reporting.* Specifically, EY's report concluded that the Navy did not design or implement effective internal controls to:

- produce reliable financial statements, accompanying notes, and related disclosures;
- reconcile and report Fund Balance With Treasury;
- substantiate the reported balances for Government Property in the Custody of Contractors;
- record receipt, acceptance, maintenance, issuance, and disposal of Operating Materials and Supplies Remainder;
- accurately report Operating Materials and Supplies Ordnance, including ordnance held by third parties;
- implement accounting standards related to valuing Inventory and Related Property – Operating Materials and Supplies;
- record receipt, acceptance, maintenance, issuance, and disposal of Property, Plant, and Equipment – General Equipment Remainder;
- process and record Property, Plant, and Equipment – Construction in Progress;
- identify, detect, and correct inaccurate and incomplete balances for Environmental and Disposal Liabilities;
- substantiate the reported Expense and Accounts Payable balances;
- substantiate the reported Revenue and Unfilled Customer Orders balances;
- substantiate the balances reported on the Statement of Budgetary Resources;

* A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statements in a timely manner.

- address the five components of internal control—an effective control environment, risk assessment, control activities, information and communication, and monitoring activities;
- ensure only authorized users have access to financial management systems and users do not have incompatible functions within a system;
- verify only authorized applications and software programs are placed into production; and
- ensure timely, accurate, and complete processing of information between applications.

EY's additional report, "Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit the Financial Statements Performed in Accordance with Government Auditing Standards," discusses two instances of noncompliance with provisions of applicable laws and regulations, contracts, and grant agreements. Specifically, EY's report describes instances in which the Navy General Fund's financial management systems did not comply with the Federal Financial Management Improvement Act of 1996 and the Federal Managers' Financial Integrity Act of 1982.

In connection with the contract, we reviewed EY's report and related documentation and discussed them with EY's representatives. Our review, as differentiated from an audit of the financial statements and related notes in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the Navy's General Fund FY 2021 Financial Statements and related notes. Furthermore, we do not express conclusions on the effectiveness of internal control over financial reporting, on whether the Navy General Fund's financial systems substantially complied with Federal Financial Management Improvement Act of 1996 requirements, or on compliance with provisions of applicable laws and regulations, contracts, and grant agreements. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached November 8, 2021 report, and the conclusions expressed within the report.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

Lorin T. Venable

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting

Attachment:
As stated

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GENERAL FUND

UNITED STATES NAVY GENERAL FUND INDEPENDENT AUDITORS' REPORT

210424-N-MD713-1122
ARABIAN SEA (April 24, 2021) The guided-missile destroyer USS Thomas Hudner (DDG 116), front, and the guided-missile destroyer USS Laboon (DDG 58), sail in formation alongside the aircraft carrier USS Dwight D. Eisenhower (CVN 69) in the Arabian Sea. The Dwight D. Eisenhower Carrier Strike Group is deployed to the U.S. 5th Fleet area of operations in support of naval operations to ensure maritime stability and security in the Central Region, connecting the Mediterranean Sea and Pacific Ocean through the western Indian Ocean and three strategic choke points. (U.S. Navy photo by Mass Communication Specialist 3rd Class Cameron Pinske)

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Report of Independent Auditors

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the General Fund of the United States Navy (Navy), which comprise the consolidated balance sheet as of September 30, 2021, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended, and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

As described in Note 1, the Navy has not implemented certain accounting standards for the Department of Defense and the Federal government. The effect on the financial statement amounts involved is not currently determinable by the Navy and could be material.

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Basis for Disclaimer of Opinion

The Navy continues to have unresolved accounting issues and material weaknesses in internal controls that cause the Navy to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on the Navy's financial statements as of and for the year ended September 30, 2021.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis and Required Supplementary Information, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Other Information

We were engaged for the purpose of forming an opinion on the financial statements that collectively comprise the Navy's financial statements. The Other Information, as listed in the Table of Contents, is presented for the purposes of additional analysis and is not a required part of the financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 8, 2021 on our consideration of the Navy's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of those reports is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Navy's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the Navy's internal control over financial reporting and compliance.

Ernst + Young LLP

November 8, 2021

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Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements*, the financial statements of the General Fund (GF) of the United States Navy (Navy), which comprise the consolidated balance sheet as of September 30, 2021, the related consolidated statements of net cost and changes in net position, the combined statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2021. Our report disclaims an opinion on such financial statements because the Navy was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered Navy's internal control over financial reporting (internal control) as a basis for designing the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Navy's internal control. Accordingly, we do not express an opinion on the effectiveness of Navy's internal control. We did not consider all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to preparing performance information and ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described below and in Appendix A as items I through XVI to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged

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with governance. We consider the deficiencies described below and in Appendix B as items I through III to be significant deficiencies.

Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the Navy's ability to produce reliable financial statements, accompanying notes, and related disclosures. The Navy's management has not adequately designed financial reporting controls and inappropriately relies on the Navy's financial reporting service provider to execute its responsibilities for the design, performance, and oversight of internal controls over financial reporting. The combination of these deficiencies results in a material weakness. The matters related to Financial Reporting are further described in Appendix A.

II. Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in the Navy's accounts with the U.S. Treasury. Lack of policies, procedures, internal controls, and supporting documentation prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to FBwT are further described in Appendix A.

III. Government Property in the Custody of Contractors

Government Property in the Custody of Contractors includes government furnished equipment and materials and contractor acquired property held by contractors on behalf of the Navy. The Navy lacks adequate policies, procedures, controls, and related documentation over the acquisition, disposal, tracking, and inventory processes, and places inappropriate reliance on third parties over the accountability and reporting of assets. These deficiencies prevent the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Government Property in the Custody of Contractors are further described in Appendix A.

IV. Inventory and Related Property – Operating Materials & Supplies Remainder

Operating Materials & Supplies (OM&S) Remainder (R) is a material subset of Inventory and Related Property. It is composed of spare and repair parts not classified as ordnance, uninstalled aircraft engines (UAE), or trident missiles, and consists of assets that are consumed as part of a major end item. Lack of adequate controls over the life cycle of recording OM&S-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to OM&S-R are further described in Appendix A.

V. Inventory and Related Property – Operating Materials & Supplies Ordnance

OM&S Ordnance is comprised of ammunition, conventional missiles, torpedoes, component parts for end-items, and equipment for specific uses associated with these items, such as fuel, storage, and transportation. Lack of policies, procedures, internal controls, and supporting documentation,

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as well as inadequate oversight and monitoring of ordnance held by third parties, prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to OM&S Ordnance are further described in Appendix A.

VI. Inventory and Related Property – Operating Materials & Supplies Valuation

The Navy's Inventory and Related Property line item consists of OM&S, which the Navy categorizes into the following segments: ordnance (e.g., ammunition, conventional missiles and torpedoes), trident missiles, UAE, and OM&S-R. OM&S consists of tangible personal property to be consumed in normal operations but excludes (a) goods that have been acquired for use in constructing Real Property or in assembling equipment to be used by the entity, (b) stockpile materials, and (c) inventory. Lack of policies, procedures, internal controls, and supporting documentation for valuation prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to OM&S Valuation are further described in Appendix A.

VII. Property, Plant & Equipment – General Equipment Remainder

General Equipment Remainder (GE-R) is primarily comprised of equipment used in research, development, and maintenance. The Navy has failed to implement effective policies and procedures over GE-R and lacks adequate controls over the life cycle of recording GE-R (i.e., receipt, acceptance, maintenance, issuance, and disposal) within an approved system. This prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to GE-R are further described in Appendix A.

VIII. Property, Plant & Equipment – Construction in Progress

Construction in Progress (CIP) reflects the resources expended to construct Property, Plant & Equipment (PP&E) that have not been placed in service as of the end of the fiscal year (FY). The Navy has failed to adequately document policies and procedures over CIP and effectively design key controls to ensure appropriate processing and recording of CIP transactions. This prevents the Navy from substantiating CIP reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to CIP are further described in Appendix A.

IX. Environmental and Disposal Liabilities

The Environmental and Disposal Liabilities (EDL) process includes the estimated costs associated with clean-up or disposal of military equipment/programs, base realignment and closure (BRAC), accrued environmental restoration (ERN) and other accrued environmental liabilities (OEL). The EDL process lacks sufficient internal controls to identify, detect, and correct inaccurate and incomplete balances in the general ledger, which impact the balances reported on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to EDL are further described in Appendix A.

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X. Expenses and Accounts Payable

Expenses are incurred and recognized when the Navy obtains goods and services from the public or other Federal entities. Accounts Payable (AP) represents the amount owed to third parties by the Navy for goods and services received. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Expenses and AP are further described in Appendix A.

XI. Revenue and Unfilled Customer Orders

Revenue and Unfilled Customer Orders includes amounts earned by the Navy and amounts anticipated to be earned based on existing agreements for services provided. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Revenue and Unfilled Customer Orders are further described in Appendix A.

XII. Budget Execution and Undelivered Orders

Budget Execution represents the use of appropriated funds from the time the funds are received through the outlay and reporting of those funds. Undelivered Orders (UDOs) represent the amount of goods and services ordered which have not been received. Lack of adequate policies, procedures, internal controls and related supporting documentation over the Budget Execution process, including the recognition and reporting of UDOs, prevents the Navy from substantiating reported balances on the Statement of Budgetary Resources (SBR) and related notes. The combination of these deficiencies results in a material weakness. The matters related to Budget Execution and UDOs are further detailed in Appendix A.

XIII. Entity Level Controls – Oversight and Monitoring

FMFIA requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Navy has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA, leading to inadequate control environment, risk assessment and monitoring processes. The combination of these deficiencies results in a material weakness. The matters related to Entity Level Controls – Oversight and Monitoring are further described in Appendix A.

XIV. Financial Information Systems – Access Controls/Segregation of Duties

Access Controls involve the protection of application boundaries, user identification and authentication, account management (authorization, periodic review of access, removal of access), protection of financially significant transactions and system resources, and the monitoring of security violations impacting financial reporting activities. Segregation of Duties (SoD) controls involve the identification and authorization of SoD conflicts, prevention of incompatible activities, and monitoring of users with conflicting access (when allowable). We identified access control and SoD related deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material

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weakness. The matters related to Access Controls and SoD and are further described in Appendix A.

XV. Financial Information Systems – Configuration Management

Configuration Management involves the identification and management of an information system at a given point and systematic control over changes to that configuration during the system's life cycle, from the initiation of a change request to the migration of a change to production, the protection of source code, the separation of access provisioned to developers and migrators, and the procedures for monitoring changes made to the production environment. We identified configuration management-related deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Configuration Management are further described in Appendix A.

XVI. Financial Information Systems – Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Specifically, interface controls involve the process for validating the financially significant interfaces to be run, validating if the interface edit checks are working as intended, the timing of the interface processing, validating that data sent and received is reconciled, and how interface processing errors are identified and remediated in a timely manner. We identified deficiencies related to interface processing that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Interface Processing are further described in Appendix A.

Significant Deficiencies

I. Property, Plant & Equipment – Real Property

Real Property includes land, buildings, and structures. The Navy has not completely documented policies and procedures over Real Property or fully implemented controls for the processing and recording of Real Property transactions that will enable the Navy to continue to assert to the existence and completeness of its Real Property. These matters result in a significant deficiency. The matters related to Real Property are further described in Appendix B.

II. Property, Plant & Equipment – Utilities

PP&E Utilities consist of overhead and underground distribution networks for electric, water, steam, and sewage; utility plants; and utility assets such as transformers, substations, and switching stations that are made up of multiple components. In FY20 and FY21, the Navy completed remediation efforts to establish baseline values for existence, completeness, and measurement of utility assets. However, the Navy has not completely documented policies and procedures over utilities or fully implemented controls for the processing and recording of utility transactions that will enable the Navy to continue to assert to the existence and completeness of its utility assets. These matters result in a significant deficiency. The matters related to PP&E Utilities are further described in Appendix B.

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III. Contingent Legal Liabilities

Contingent Legal Liabilities (CLL) represents accrued contingent liabilities pertaining to legal cases where the Office of General Counsel (OGC) or the Office of Judge Advocate General (OJAG) considers an adverse decision probable and the amount of the loss measurable. The CLL process lacks effective controls to ensure the accuracy of the data used to calculate estimates, which impacts the reported balances on the financial statements and notes. These matters result in a significant deficiency. The matters related to CLL are further described in Appendix B.

Management's Response to Findings

The Navy's response to the findings identified in our engagement to audit and relevant comments from the Navy's management are provided in their accompanying letter dated November 8, 2021. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

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November 8, 2021

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Appendix A – Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the Navy's ability to produce reliable financial statements, accompanying notes, and related disclosures. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. According to the Government Accountability Office (GAO) Standards for Internal Control in the Federal Government (commonly referred to as the Green Book) issued under the authority of FMFIA, management is responsible for implementing and evaluating its internal control system, including internal controls to meet reporting objectives related to the preparation of reports for use by the entity, its stakeholders, or other external parties. In addition, according to the GAO Green Book, management may engage third parties to perform certain operational processes for the entity; however, management retains responsibility for monitoring the effectiveness of internal controls over the assigned processes performed by third parties. Despite these requirements, management has not adequately designed financial reporting controls and inappropriately relies on its service provider to execute the Navy's responsibilities for the design, performance, and oversight of internal controls over financial reporting. These control weaknesses, as detailed below, can lead to misstatements on the Navy's financial statements:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the financial reporting process are not accurately or completely documented.
2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.** As noted below, the Navy lacks adequate oversight over financial reporting processes executed across the organization:

   Financial Reporting Process

   - The Navy does not have adequately documented policies and procedures, including internal controls, to properly reconcile their general ledgers to trial balances (TB) submitted to the Navy's financial reporting service provider, the Defense Finance and Accounting Service (DFAS), including defining the role of Assistant Secretary of the Navy (ASN) Financial Management and Comptroller (FM&C) and the Budget Submitting Offices (BSOs) in that process. In addition, Navy Enterprise Resource Planning (ERP) and Navy Standard Accounting, Budgeting, and Reporting System (NSABRS) do not have system controls in place to prevent Journal Vouchers (JVs) that have not been reviewed and approved from being posted directly into Navy ERP and NSABRS. The Navy does not have appropriate controls to track the JVs recorded each month to ensure they are properly reviewed and monitored or approved by ASN FM&C. This has led to recording JVs that are incomplete, inaccurate, or non-compliant with Treasury Financial Manual (TFM) requirements.
   - The Navy lacks appropriate monitoring controls over the financial reporting process. Specifically, the Navy's controls are not designed effectively and are missing comprehensive reviews over journal vouchers, the financial statements, accompanying

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footnotes, and related disclosures. In addition, FMO lacks appropriate controls over general ledger reconciliations.

Navy Standard Accounting, Budgeting, and Reporting System

- The Navy lacks appropriate oversight and controls related to the NSABRS general ledger financial reporting process. Currently, neither the system nor the monitoring controls in place are designed effectively. For example, NSABRS is not sufficiently designed to produce a complete and accurate TB, complete sample document populations, or TFM compliant posting logic. In addition, FMO is not sufficiently or timely reviewing the variances and/or issues noted in monthly reconciliation controls.

3. **Lack of Oversight of Financial Reporting Service Provider.** The Navy lacks appropriate oversight of DFAS related to execution of financial reporting controls. Specifically, we noted the following control weaknesses:

Journal Vouchers

- The Navy does not have adequately designed controls over manual and system generated JVs initiated and recorded by DFAS. Specifically, the review process for JVs is not comprehensive and fails to include attributes such as completeness, compliance with the TFM, and the review of the supporting documentation prior to recordation by DFAS.

Trading Partner Eliminations

- On behalf of the Navy, DFAS records trading partner eliminations that are not supported by transaction details, and therefore are not compliant with accounting standards. The Navy's unsupported trading partner eliminations impact all of the Navy's financial statements. The total amount of trading partner eliminations recorded in FY21 Q4 was $36.6 billion.

Data Processing

- Management relies on DFAS to process financial information through Defense Departmental Reporting System Budgetary (DDRS-B) and Defense Departmental Reporting System-Audited Financial Statements (DDRS-AFS), but has not designed sufficient policies and procedures to reconcile its general ledger information against DDRS-B and DDRS-AFS to include verification of the completeness, accuracy, and validity of the trial balances.

Complementary User Entity Controls

- Complementary User Entity Controls (CUECs) are controls that users of the service organization (i.e., the Navy) should have in place to supplement the service organization's (e.g., DFAS) internal controls. Management has not appropriately designed or implemented CUECs, and therefore, is unable to ensure that controls executed by the service organizations achieve their intended outcome.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.** The Navy lacks adequate financial reporting controls to ensure compliance with applicable accounting standards and regulatory reporting requirements as follows:

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Federal Accounting Standards Advisory Board (FASAB) Standards

- As described in Note 1B, *Basis for Accounting and Presentation*, the Navy is not in compliance with accounting standards established by FASAB. In addition, management lacks policies and procedures over reporting for leases in accordance with accounting standards. Lastly, the Office of the Secretary of Defense (OSD) and Navy have not yet determined a financial reporting policy for Navy's contribution of assets held in the Joint Strike Fighter (JSF) program that meets accounting standards.

Office of Management and Budget (OMB) Circular A-136

- The Agency Financial Report is not in compliance with financial reporting requirements for form and content which includes its financial statements and disclosures as established within OMB Circular A-136, *Financial Reporting Requirements*. For example, activities are not classified appropriately within Note 22 *Reconciliation of Net Cost to Net Outlays,* which reconciles budgetary to proprietary transactions.

Treasury United States Standard General Ledger (USSGL)

- The Navy is not in compliance with Treasury's USSGL at the transaction level as required by the Federal Financial Management Improvement Act of 1996. Examples of significant processes that are not recorded in compliance with the USSGL include: Financial Reporting, Recoveries, Revenue and Unfilled Customer Orders, and Real Property CIP. In addition, per guidance from OSD, the Navy is not properly recording adjustments for corrections of an error versus changes in accounting principle.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls.**
   - Complete a Process Cycle Memorandum (PCM) that documents the end-to-end process for the entire life cycle of Financial Reporting, including the initiation, recording, processing and reporting of financial statement data.
   - The PCM should include all key controls, assertions, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all applicable systems and system-generated reports used for the Financial Reporting process.
   - All process owners should review and sign off on the updated PCM to validate that the PCM is complete and accurate.
2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.**

   Financial Reporting Process

   - Design and implement policies and procedures governing the assessment and documentation of variances identified during the monthly TB reconciliation process which

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includes, but is not limited to, who is responsible for the reconciliations, variance investigation threshold and protocols for timely investigation of variances.

- Design and implement policies and procedures for retention of documentation related to TB reviews and reconciliations.
- Develop a system control to prevent unapproved JVs from being posted.
- Document policies and procedures arising from the development of a new system control, including the monitoring of users with access to oversee the control.
- Perform an analysis over any remaining BSO JVs to identify and correct instances where JVs do not comply with TFM posting logic.
- Design and implement sufficient policies and procedures to ensure any remaining field level JV logs are complete, accurate and reviewed in a timely manner.
- Develop and implement a methodology that allows for complete and accurate disclosure of financial statement footnotes, including the values presented in the footnotes, relationships between presented accounts, and all variances and reconciling items.
- Design controls that timely reconcile detailed transactions to TBs submitted to DDRS and JVs submitted to Data Collection Module.
- Design sufficient controls to ensure the completeness and accuracy of the data used in TB reconciliations.
- Implement and document controls to verify the completeness and accuracy of reports received from DFAS, prior to using them to perform analysis and as JV support.
- Periodically (at least annually) evaluate and update Standard Operating Procedures to ensure that the procedures described are the procedures performed.
- Periodically (quarterly) update Delegations of Authority to reflect personnel changes.
- Implement procedures to remediate system limitations and tie-points causing reconciliation variances.

NSABRS

- Navy should consider whether a system change is required for NSABRS/SABRS to completely and accurately report financial balances.
- Configure the NSABRS GL data to include all key data elements.
- Develop and implement management review controls over posting logic in NSABRS.
- Enhance and implement sufficient management review controls to determine the reasonableness of the explanations provided by DFAS.
- Implement a sufficient management review control to ensure that out of balance conditions identified are researched and resolved in a timely manner for all general ledger system data.
- Evaluate existing policies to ensure that the appropriate procedures are in place to effectively execute a system change without disrupting financial reporting functions.

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3. **Lack of Oversight of Financial Reporting Service Provider.**

Journal Vouchers

- Develop policies and procedures for performing a qualitative review and approval of JVs within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and the potential impact on the financial statements.
- Develop more comprehensive policies and procedures for quantitative review and approval requirements within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and potential impact on the financial statements.
- Do not permit DFAS to support JVs with only detail obtained from DDRS-B and DDRS-AFS. Transactional level support should be provided by the Navy.
- Instruct DFAS to only post JVs for which they are able to support by inspecting transaction level detail.
- Record JVs to the appropriate USSGL accounts that are consistent with the business rationale for the transaction.
- Develop and implement control procedures to review DDRS-B system generated JVs at a more precise level of aggregation so that the procedures performed provide comfort over system generated entries.

Trading Partner Eliminations

- In conjunction with DFAS, coordinate with OSD to address the trading partner eliminations issue at the department level and develop next steps towards remediation, such as updating the Department of Defense (DoD) Financial Management Regulation (FMR).
- Implement document level reconciliations with the Navy's trading partners and develop a process for resolving differences at the document level.

Data Processing

- Instruct DFAS to document policies and procedures governing the performance, documentation, and assessment of management review controls performed by DFAS on the Navy's behalf.
- Enhance management review and analysis procedures to ensure completeness, validity, and accuracy of the information reported to DFAS and subsequently processed by DFAS through the transaction universe reconciliation.
- Implement procedures to remediate system limitations and tie-points causing reconciliation variances.
- Design and implement procedures to research and explain unsupported trial balance amounts, including resolution procedures as needed.
- Design and/or enhance controls surrounding the preparation, recordation and review of general ledger transactions to ensure that balances posted after the established chalk line are accurate and appropriately supported.

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Complementary User Entity Controls

- Evaluate the current System and Organization Controls (SOC) reports and CUECs to determine if they are appropriate to cover the end-to-end business processes.
- Design and implement internal controls that address the CUECs identified in the DFAS SOC 1 reports.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.**
   - Develop and implement policies and procedures that ensure compliance with the applicable accounting authoritative standards.
   - Design and implement policies and procedures to identify, analyze and determine whether leases should be accounted for and reported as capital and operating leases.
   - Develop policies and procedures to review all leasing arrangements and gather the information necessary to support the required disclosure for capital and operating leases in the financial statements, in accordance with OMB A-136.
   - Consider the impact that Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases:* an Amendment of SFFAS 5*, Accounting for Liabilities of the Federal Governmen*t, and SFFAS 6, *Accounting for Property, Plant, and Equipment* will have on these policies when the guidance goes into effect.
   - Work with OSD to develop and implement a consistent policy, across the Department, for accounting and reporting assets related to the JSF.
   - Coordinate with OSD to develop and implement USSGL compliant guidance for recording adjustments for corrections of an error versus changes in accounting principle.

II. Fund Balance with Treasury

FBwT represents the aggregate amount of funds in the Navy's accounts with the U.S. Treasury. Reconciliation of agencies' FBwT general ledger accounts to the balances held at Treasury is a key internal control process which ensures the accuracy of the agencies', as well as the government-wide receipt and disbursement data. TFM Chapter 5100, Section 5125 requires agencies to implement effective and efficient reconciliation processes and perform timely reconciliations. Lack of adequate controls over the FBwT process, including reconciliations, can lead to misstatements to the financial statements as well as reports used by management to control the use of its funds. Inadequate procedures, including oversight, over the FBwT process have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of FBwT Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the FBwT process are not accurately or completely documented. This includes roles, responsibilities, processes, and transactions executed at each of its disbursing stations and the process for reconciling to the U.S. Treasury.

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2. **Lack of Effectively Designed or Implemented Controls in the FBwT Process.** Controls are not designed adequately to ensure suspense, unmatched and interfund transactions are recorded timely and appropriately.

3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.** The Navy's FBwT reconciliation is not adequately designed:

   Unsupported Fund Balance with Treasury Journal Vouchers

   - The reconciliation does not produce a complete population of transactions impacting collections and disbursements. In addition, the Navy does not perform sufficient research and resolution of variances identified during the reconciliation prior to the recording of JVs to agree the Navy's books to Treasury's reported balance.

   Reconciliation Tool

   - The Navy FBwT Tool (NFT) is designed to identify and reconcile differences between collection and disbursement transaction level data recorded in the general ledger systems, and the net disbursement balances reported to Treasury's Central Accounting Reporting System. However, the NFT is not designed to identify the total unsupported undistributed amount that exists between the Navy and the U.S. Treasury, preventing the reconciliation from being complete. In addition, the tool lacks effective Information Technology (IT) controls over access and change management, which are necessary to provide assurance that the results of the reconciliation are valid. In August 2021, the Navy began transitioning from using the NFT to Advana to begin to address the issues identified in this weakness.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of FBwT Policies and Procedures, including Controls.**
   - Finalize a PCM that documents the end-to-end process for the entire life cycle of FBwT including initiating, recording, processing and reporting of cash transactions, and reconciliations.
   - The PCM should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used for the FBwT process.
   - Require all process owners to review and sign off on the updated PCM to validate that the PCM is complete and accurate.
2. **Lack of Effectively Designed or Implemented Controls in the FBwT Process.**
   - Implement control procedures to require timely research and resolution of variances within 60 business days of transaction date.
   - Implement control procedures to monitor compliance and accountability of those responsible for resolving variances.

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3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.**
   - Ensure disbursements and collections are accurately recorded in the general ledger system and financially reported from the general ledger system.
   - Finalize implementation of a single reconciliation tool that supports the Navy's initiative to utilize Treasury Direct Disbursing from the general ledger systems.
   - Identify the necessary data attributes to identify transactions recorded in suspense specific to the Navy and develop an estimate using relevant, sufficient, and reliable information to record the Navy's suspense account balances on the Navy's financial statements.

III. Government Property in the Custody of Contractors

Government Property in the Custody of Contractors includes government furnished equipment and materials and contractor acquired property held by contractors on behalf of the Navy. FMFIA requires federal entities to establish internal controls in accordance with the GAO Green Book. The GAO Green Book states that management may engage third parties to perform certain operational processes for the entity; however, management retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by the third party. Due to lack of adequate policies and procedures, the following control weaknesses exist that can lead to an inability to produce accurate information and data to effectively manage the organization and to misstatements on the financial statements:

1. **Lack of or Inadequate Policies and Procedures, including Controls and Related Documentation.** Policies and procedures do not adequately describe the end-to-end processes to maintain accountability for, or to financially report, property in the custody of contractors.
2. **Inappropriate Reliance on Third Parties for Tridents.** The Navy relies on contractors for the accountability and reporting of assets. Prime contractors are responsible for the accountability and reporting of the inventory for the trident missile program except when the missiles are fully assembled and deployed. In FY21, the Navy launched a pilot SOC 1 effort with one third-party service provider to address some of the challenges with oversight and monitoring. However, the Navy still lacks oversight to validate the existence, completeness, accuracy, valuation, and related reporting of trident assets due to the following control weaknesses:
   - The contractor asset listings were not updated appropriately to reflect disposition and consumption of components.
   - Components are not recorded within a government owned system which inhibits the Navy's ability to have real-time information on the status of the components.
   - The Navy does not perform adequate oversight of contractors, including data provided by the contractor that is used to compile the component listing.
   - The Navy does not perform comprehensive physical inventories of components held by contractors.
3. **Inappropriate Reliance on Third Parties for Ordnance**. The Navy inappropriately relies on contractors for the accountability and reporting of assets. Specifically, the Navy lacks oversight

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to validate the existence, completeness, accuracy and related reporting of ordnance assets due to the following control weaknesses:

- The Navy does not have oversight or monitoring controls, or the results of an independent evaluation (e.g., SOC report), to rely on the physical inventory counts performed by contractors.
- Although the Navy has granted access to the accountable property system of record (APSR) for most of its contractors, the Navy lacks oversight to adequately manage and review transactions recorded in the APSR to verify the accuracy of quantity, condition, and physical location changes. This results in inaccurate property records and a lack of current information for management use.
- Reconciliations are not performed from the quantities noted on hand by contractors to the quantities recorded in the government systems.
- Contractors, for certain missile programs, are required by their contract to record the fully assembled missiles and their component parts in the system at the same time, resulting in double reporting within their accountability records and overstatement of the financial statements.

4. **Inappropriate Reliance on Third Parties for GE-R.** Standard contractual provisions are not utilized to require the reporting of assets acquired by the contractor and owned by the government. As a result, a portion of the Navy assets are not recorded in a government system of record. Additionally, the Navy lacks controls over receipt and acceptance of contractor acquired property, resulting in inaccurate property records and a lack of current information for management use.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Policies and Procedures, including Controls and Related Documentation.**
   - ASN Research, Development and Acquisition (RDA) should develop and require the use of a standard set of contract clauses that require contractors to validate the completeness and accuracy of lists of the Navy-owned property in the possession of prime and subcontractors at least quarterly.
   - ASN RDA should identify property officers who will be responsible for the Navy property in the custody of contractors.
   - ASN RDA should document policies and procedures for government furnished property and contractor acquired property that include monitoring and oversight over key service providers, including Defense Contract Management Agency (DCMA).

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2. **Inappropriate Reliance on Third Parties for Tridents.**
   - Develop and require the use of a standard set of contract clauses that require contractors to validate the completeness and accuracy of lists of the Navy-owned property in the possession of prime and subcontractors at least quarterly.
   - Identify property officers who will be responsible for the Navy property in the custody of contractors.
   - Require timely updates to the Navy's property records for all property in the custody of contractors.
   - Complete a risk assessment by contractor and contract type in order to design appropriate oversight functions based on risk.
   - Implement and utilize a government system to track and account for trident assets.
   - Design and implement standardized processes and procedures to produce an asset listing that reflects on hand inventory.
   - Develop and implement a monitoring control process to verify that contractors perform periodic inventories of Navy assets.
   - Continue and expand SOC 1 pilot efforts to include all contractors.
3. **Inappropriate Reliance on Third Parties for Ordnance.**
   - Develop and implement a process for periodic inventory counts of Navy ordnance held by third parties.
   - Design and implement standard contract clauses for all contracts and service agreements for ordnance held by third parties to include requirements for periodic inventories, causative research when discrepancies are found, and timely updating of the Navy's system.
   - Require and train contractors to timely input all Navy ordnance transactions into the Navy's systems.
   - Design and implement policies, procedures, and internal controls to ensure ordnance transactions are appropriately and timely recorded.
   - Provide training to ordnance custodians at contractor facilities to ensure timely and accurate reporting of transactions.
4. **Inappropriate Reliance on Third Parties for GE-R.**
   - Develop and require the use of a standard set of contract clauses that require contractors to provide current and accurate lists of government-owned property in their possession at least quarterly.
   - Identify the responsible party for oversight and monitoring of property in the custody of contractors.
   - Require timely updates to property records for all property in the custody of contractors.

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IV. Inventory and Related Property – Operating Materials & Supplies Remainder

OM&S-R is a material subset of Inventory and Related Property. It is composed of spare and repair parts not classified as ordnance, UAE, or trident missiles, and consists of assets that are consumed as part of a major end item. In accordance with FMFIA, management is responsible for establishing effective controls to maintain accountability over the assets. There is a lack of adequate controls over the life cycle of recording OM&S-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) leading to inaccuracies within the Navy's systems and financial statements. The Navy is currently executing the Navy Material Accountability Campaign (NMAC), which is designed to establish a baseline population of OM&S-R assets and implement internal controls across the life cycle. While NMAC is not complete, the Navy is actively working remediation in this area. Inadequate procedures, including oversight over the OM&S-R process, have led to the following internal control deficiencies:

1. **Lack of, or Inadequate Documentation of, OM&S-R Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for OM&S-R are not accurately or completely documented. The PCM, in its current state, is not a complete representation of key controls, processes, and procedures performed and is inconsistent with how the BSOs initiate, process, record, and report OM&S-R transactions.

2. **Inability to Identify a Complete Population of OM&S-R Assets and Support Related Transactions.** A complete and accurate population cannot be produced for OM&S-R assets and management has failed to provide supporting documentation to substantiate recorded OM&S-R transactions. As noted below, there is a lack of controls to ensure that OM&S-R assets are recorded in an accurate and timely manner in a system of record:

   Incomplete or Duplicate Data

   - The data submitted by BSOs for financial statement compilation is incomplete and inaccurate. For example, asset listings provided by the BSOs have missing values, negative values, and totals that do not agree to financial records. In addition, management cannot distinguish OM&S-R assets versus PP&E or ordnance. As a result, assets have been duplicated or improperly categorized within populations.

   Variance Resolution

   - Each quarter, material variances are identified between BSOs' property systems and their trial balances. Management is unable to perform causative research in a timely manner to resolve these variances.

   Asset Condition Codes

   - OM&S-R asset condition codes are not standardized or consistently applied across BSOs, leading to inconsistent reporting of the status of assets and preventing management from adequately understanding current asset availability and future asset needs.

Recommendations

Consider the following corrective actions related to the conditions described above:

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1. **Lack of, or Inadequate Documentation of, OM&S-R Policies and Procedures, including Controls.**
   - The Office of the Chief of Naval Operations (OPNAV) Fleet Readiness and Logistics (N4) should implement policies that require consistent application and compliance with generally accepted accounting principles, Navy, and DoD policies and procedures related to OM&S-R asset management, accounting, and reporting. Include policies over the end-to-end acquisition process such as controlling the buying and receipt of OM&S-R.
   - OPNAV N4 should develop comprehensive process documentation that describes all key financial control points as they relate to the transaction life cycle of an OM&S-R asset.
2. **Inability to Identify a Complete Population of OM&S-R Assets and Support Related Transactions.**
   - OPNAV N4 should develop and implement comprehensive policies and procedures to substantiate existence and completeness to include developing a listing of approved systems.
   - OPNAV N4 should reconcile balances recorded in the financial statements to the balances in underlying asset listings. As part of this process:
     - Perform review and validation of data in underlying asset listings.
     - Perform timely reconciliations and require variances be investigated and resolved. If applicable, adjust the financials because of this research.
   - OPNAV N4 should design policies and procedures to ensure OM&S-R balances are classified and presented appropriately in the financial statements.
   - OPNAV N4 should reconcile physical inventory counts to the respective property systems. Document, record, and resolve variances observed in a timely manner to ensure OM&S-R is accurately stated.
   - OPNAV N4 should develop a uniform use of condition codes and ensure this is consistently utilized across all BSOs.

V. Inventory and Related Property – Operating Materials & Supplies Ordnance

The Navy's ordnance is comprised of ammunition, conventional missiles, torpedoes, component parts for these end-items and equipment for specific uses associated with these items such as fuel, storage and transportation. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability for all property and other assets for which the agency is responsible. The Navy lacks adequate controls over the recording of ordnance assets leading to inaccuracies in the financial statements. Specifically, inadequate procedures, including oversight, over the ordnance held by others and financial reporting controls for the ordnance process has led to the following internal control deficiencies:

1. **Lack of Effectively Designed or Implemented Controls in the Ordnance Process.** The Navy has not effectively designed or implemented controls to validate that ordnance transactions are compliant with documented accounting policies and procedures. Controls have

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not been implemented to prevent or detect ordnance transactions which are not compliant with documented accounting policies and procedures. Specifically, for afloat and ashore activities, the Navy failed to timely record transactions in the APSR. In some instances, they completely failed to record the transaction altogether leading to inaccurate reporting of ordnance at the activity level. In addition, the Navy uses inconsistent documentation to record the same type of transaction, which is not compliant with their existing policies and procedures. Also, the Navy does not have effective controls to monitor and investigate the status of in-transit assets.

2. **Lack of Sufficient Oversight and Monitoring of Ordnance Held by Army.** The Navy cannot identify a complete and accurate population of its ordnance assets held by Army. The Navy has developed a reconciliation to identify variances between the Navy APSR and Army system. However, the process is currently in development and is not fully implemented to ensure accurate, timely, and consistent execution to accurately report the Navy-owned ordnance held by the Army. Also, the Navy does not have oversight or monitoring controls, or the results of an independent evaluation (e.g., SOC report), to rely on the results of physical inventory counts performed by the Army.
3. **Inadequate or Lack of Controls over Financial Reporting of Ordnance.** The Navy lacks adequate financial reporting controls over ordnance assets. We noted the inputs used to calculate the ordnance gross ending balance are unsupported and cannot be tied back to transactional level detail.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of Effectively Designed or Implemented Controls in the Ordnance Process.**
   - Design and implement policies and procedures to ensure consistency in the application of internal controls across ashore and afloat facilities managing Navy ordnance.
2. **Lack of Sufficient Oversight and Monitoring of Ordnance Held by Army.**
   - Implement procedures and controls to ensure the accurate, timely, and consistent execution of the reconciliation of the Army's records to the Navy's records.
   - Design and execute physical inventory count procedures over Army-held ordnance or leverage the evaluation results of Army physical inventory controls provided by an independent auditor.
3. **Inadequate or Lack of Controls over Financial Reporting of Ordnance.**
   - Update the current policies and procedures for the calculation of the ordnance gross ending balance each quarter. Specifically, the Navy should ensure the inputs to calculate the ordnance ending balance agree to transactional level data.

VI. Inventory and Related Property – Operating Materials & Supplies Valuation

The Navy's Inventory and Related Property line item consists of OM&S, which the Navy categorizes into the following segments: ordnance, trident missiles, UAE, and OM&S-R assets. The Navy lacks policies and procedures, including internal controls to implement accounting

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standards, causing inaccurate presentation of OM&S on the balance sheet and in the related footnote disclosure. Additionally, as noted below, the lack of controls over OM&S prevent full implementation of SFFAS 48 which prevents management from making an unreserved assertion that its balances comply with SFFAS 3 prospectively and SFFAS 48 retroactively, including accurately recording OM&S under the consumption method. Specifically, we noted the following:

- The Navy's OM&S has not been revalued using one of the acceptable valuation methodologies set forth by SFFAS 3 or SFFAS 48.
- Navy management does not have procedures in place to evaluate whether the use of the purchase method of accounting is permitted and appropriate for the BSOs that are continuing to use this method or to periodically reevaluate the appropriateness of its use.
- The Navy does not have an adequate methodology to support the allowance reported for Held for Repair OM&S assets.
- Navy management is unable to provide adequate support for its current recording of Excess, Obsolete and Unserviceable (EOU) OM&S at a net realizable value (NRV) of zero.
- The annual price update policies and procedures related to OM&S ordnance, performed by the Naval Supply Systems Command, are not designed to ensure complete, accurate, and consistent application of procedures by the program offices.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Prior to implementing and applying the valuation methodologies set forth by SFFAS 3 and SFFAS 48, the Navy should:
  - Decide which alternate valuation method to use for establishing opening balances. Valuation methodologies used should be based on the best available information to arrive at an alternate value.
  - Outline documentation detailing the implementation plan for SFFAS 48.
  - Establish and implement policies and procedures that comply with SFFAS 3 on a go forward basis.
  - Document the decision process (e.g., policies and procedures) which demonstrates steps taken to validate consistent application of the methodology.
- Evaluate all BSOs utilizing the purchase method of accounting to ensure appropriateness and compliance with Navy policy and procedures.
- Develop policies and procedures to support an allowance methodology for the Held for Repair OM&S and establish that allowance.
- Develop policies, procedures, and a methodology to support the NRV valuation used for EOU OM&S assets.
- Design procedures to ensure the consistent application of the annual price update.

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- Design and document key controls around the annual pricing update process to ensure the risks to the Inventory and Related Property line item on the balance sheet are mitigated.

VII. Property Plant & Equipment – General Equipment Remainder

GE-R are assets other than vessels, aircraft, and satellites and are primarily comprised of equipment used in research, development, and maintenance activities. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability of property and other assets. The Navy has not implemented effective policies and procedures over GE-R and lacks adequate controls over the life cycle of GE-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) leading to inaccuracies within its systems and financial statements. Specifically, inadequate procedures, including oversight, over the GE-R process have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of GE-R Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the GE-R process are not accurately or completely documented, including the flow of data through applicable information systems from the initiation of a transaction to reporting in the financial statements, the key stakeholders within the process, or the flow of data between stakeholders.

2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.** DoD FMR, Volume 4, Chapter 25, Section 250303, requires independent verification of the accuracy of equipment records through periodic physical counts of general equipment. The counts must also include reconciling the property systems and other systems with the general ledger accounts. Physical count procedures are not designed or operating effectively. Specifically, the Navy has not corrected previously identified conditions such as errors in the asset listing related to inadequate asset location codes and lack of asset disposal recognition, and lack of recording of existing equipment. Discrepancies identified during physical counts are not resolved within timelines established in the Navy's policy (30 days) and that policy is not in accordance with DoD instructions for resolution of discrepancies which requires resolution within 7 days. As a result, the GE-R balance is misstated in the financial statements and notes.

3. **Lack of Policies and Procedures, including Internal Controls to Effectively Implement Accounting Standards.** There is a lack of policies and procedures, including internal controls in place to implement accounting standards, causing inaccurate presentation of GE-R on the balance sheet and in the related footnote disclosure. Specifically, implementation of the provisions of SFFAS 50 to establish opening balances and SFFAS 6 to value assets on a go forward basis have not been completed or fully developed.

4. **Inadequate Controls over Financial Reporting of GE-R.** Controls have not been implemented to report GE-R transactions in a timely manner. A population of GE-R, that reconciles to their financial records, is unavailable and variances are not investigated and resolved prior to preparing the financial statements and notes.

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Recommendations

Consider the following corrective actions related to the deficiencies identified above:

1. **Lack of or Inadequate Documentation of GE-R Policies and Procedures, including Controls.**
   - Complete the documentation of the end-to-end process for the entire life cycle of GE-R, including initiating, recording, processing and reporting of GE-R transactions, applicable risks, and key controls that address those risks.
   - Process documentation should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used for the GE-R process.
2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.**
   - Establish and implement internal controls to ensure location discrepancies are investigated upon discovery and that the location entered in the system is the physical location of the asset, rather than the primary location of the owning activity.
   - Perform timely updates of all required data elements including location, condition and other necessary elements.
   - Implement policies and procedures to record asset transfers, dispositions and losses in a timely manner.
   - Establish policies and procedures and implement an annual physical inventory of assets, to include verification of property existence, data accuracy and completeness, and require updates of specific information about the asset, such as custodian name and physical location.
   - Reconcile the results to the system of record and make all relevant updates following the performance of physical inventory procedures.
   - Complete system adjustments within a timely manner when assets are found or lost between physical inventory periods.
   - Establish and implement internal controls to validate that the complete population of capital GE-R is accurately recorded and presented in the financial statements and to detect any capital GE-R that is not recorded in the financial statements.
3. **Lack of Policies and Procedures, including Internal Controls to Effectively Implement Accounting Standards.**
   - Design policies and procedures to value the Navy's GE-R in accordance with SFFAS 50 and SFFAS 6.
   - Document a detailed implementation plan for SFFAS 50 and SFFAS 6 which includes a detailed description of the process, as well as the proposed application of SFFAS 50 and SFFAS 6.

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- Exercise oversight and perform reviews of valuation calculations for all asset types to ensure accuracy and compliance with federal accounting standards.

4. **Inadequate Controls over Financial Reporting of GE-R.**
   - Establish and implement internal controls to ensure that all reportable GE-R assets are included in the PP&E balance and the related footnote.
   - Consolidate all GE-R into a single system of record for both accountability and financial reporting.
   - Require that each BSO submit accurate and complete asset populations in a timely manner.
   - Implement policies and procedures to require variances identified be investigated and resolved prior to preparation and reporting of the financial statements and related footnotes.

VIII. Property Plant & Equipment – Construction in Progress

The Navy's CIP represents the cost of construction work, which is not yet placed in service. In accordance with SFFAS 6, management is responsible for capitalizing the cost of acquiring assets as those costs are incurred and recording them as CIP within the financial statements. Due to inadequate policies and procedures, the Navy has control weaknesses associated with CIP that could lead to misstatements on the financial statements. Additionally, as noted below, the lack of controls over CIP prevents full implementation of SFFAS 50 which prevents management from making "an unreserved assertion" that its balances comply with SFFAS 6 prospectively and SFFAS 50 retroactively, including accurately recording capital improvements:

1. **Lack of Controls Over Real Property CIP.** In FY21, the Navy designed and implemented controls over the recording of Real Property CIP. For projects funded by appropriations other than Military Construction (MILCON), the Navy has not developed controls to record CIP assets completely and accurately. For MILCON projects, controls were not in place to ensure that all CIP is properly relieved when buildings are placed in service to prevent double counting of CIP with finished assets, and to ensure that CIP transactions are appropriately reviewed and supported with consistent documentation.

2. **Lack of Controls over General Equipment CIP.** Ineffective controls exist related to CIP for vessels and aircraft. In FY21, the Navy began analyzing Research & Development (R&D) costs that should be capitalized as a part of vessels CIP. This analysis has not been completed as of year-end and portions of the SFFAS 50 valuation estimate remain unsupported. These costs are required to be recorded under SFFAS 6. Navy is unable to provide detailed transactions that reconcile to CIP balances. For aircraft related CIP, Navy is unable to provide a transaction universe that ties to the aircraft CIP balance. For vessels related CIP, Navy is unable to provide supporting documentation for Reimbursable Work Orders (RWO), Military Standard Requisitioning and Issue Procedures (MILSTRIP), Receipt without Procurement, and Price Change transactions.

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Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of Controls Over Real Property CIP.**
   - Implement controls to ensure adequate review and appropriate documentation of Real Property CIP transactions to completely and accurately record assets in iNFADS in a timely manner.
   - Complete analysis of the current Real Property CIP projects to validate the accuracy and completeness of the current balance and determine whether an adjustment is necessary to accurately state the CIP balance.
   - Develop and implement policies and procedures to identify and record all CIP for projects above the capitalization threshold.
   - Develop and implement monitoring policies and procedures over the CIP financial compilation process to ensure the reported balance is complete and accurate.
2. **Lack of Controls over General Equipment CIP.**
   - Develop policies and procedures to account for all elements of capitalized cost under SFFAS 6 including R&D.
   - Develop controls to ensure that quarterly CIP balances reported in the general ledger tie to detailed subledger transactions.
   - Develop monitoring controls and standardized recording processes around RWO, MILSTRIP, Receipt without Procurement, and Price Change transactions to capture costs and apply them to the appropriate assets.

IX. Environmental and Disposal Liabilities

EDL includes the estimated costs associated with clean-up or disposal of military equipment including nuclear and conventional vessels, spent nuclear fuel (SNF), aircraft, BRAC, ERN, and OEL. The OEL Program reports the projected future cost associated with environmental corrective action, environmental closure requirements, and asbestos. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that enable the agency to provide reasonable assurance over obligations and costs. During FY21, the Navy has made progress in updating process documentation and implementing new controls for BRAC, ERN, SNF, aircraft, nuclear vessels and conventional vessels. However, the Navy lacks effective controls over their end-to-end EDL processes which could lead to misstatements in amounts reported within the financial statements and contributed to the following weaknesses in internal controls:

1. **Inadequate Policies, Procedures and Related Controls over OEL.** The end-to-end processes, procedures, and key controls for significant portions of the OEL process are not accurately or completely documented. In addition, the Navy has not finalized their process for estimating OEL nor does the Navy completely reconcile the OEL balance. The Navy has not documented or implemented policies, procedures, or controls to ensure the OEL estimate is

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complete and accurate. Specifically, the Navy's policies, procedures and controls are not sufficient to identify errors in the OEL estimate including inaccurate data used to calculate the OEL estimate. Examples of inaccurate data include incomplete or missing property records, incorrect depreciation rates, and incorrect escalation rates. In addition, manual calculation errors were not identified as part of the execution of OEL controls.

2. **Lack of Effectively Designed or Implemented Controls in the EDL Process.** Controls are not designed adequately to verify the completeness and accuracy of data used in spreadsheets and other internally generated reports. The Navy also lacks effective review controls for BRAC, ERN and aircraft.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Inadequate Policies, Procedures, and Related Controls over OEL.**
   - Complete a PCM that documents the end-to-end process for the entire life cycle of OEL including the initiation, recording, processing, and reporting of OEL estimates.
   - Finalize reconciliation procedures to ensure the OEL estimate population is complete and accurate
   - Finalize OEL process and implement controls at the program level and within FMO designed to ensure each estimate in the population has sufficient and appropriate support for cost inputs and documentation of estimate assumptions.
2. **Lack of Effectively Designed or Implemented Controls in the EDL Process.**
   - Develop and implement internal control testing procedures to monitor effectiveness of the control environment for BRAC, ERN and aircraft estimates.

X. Expenses and Accounts Payable

AP represents the amount owed to third parties by the Navy for goods and services received. Expenses includes all costs that are incurred but not capitalized on the balance sheet. Expenses and AP include key subprocesses from the procure to pay (P2P) business processes, including Contract Vendor Pay (CVP), MILSTRIP, Transportation of People (TOP), Transportation of Things (TOT), and Reimbursable Work Orders – Grantor (RWO-G). In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenses applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The Navy's current policies, procedures, and key controls over its end-to-end expense and AP processes do not address financial reporting risks, leading to misstatements in amounts reported within the financial statements. Specifically, we noted the following issues during our testing:

1. **Lack of Effectively Designed Controls in the Expense and AP Process.** Controls over the expenses and AP process are not properly designed as detailed below:

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Posting of Expenses and AP

- There is a lack of controls to ensure that expenses and AP are posted timely or at the appropriate amount, or to ensure that they are adjusted upward or downward when needed, in both Navy ERP and legacy systems. Specifically, expenses and AP were not posted in a timely manner for the CVP, MILSTRIP, TOP, TOT, and RWO-G processes.

Receipt and Acceptance

- There is a lack of sufficient controls to ensure that goods and services are reviewed, received and accepted prior to payment in both Navy ERP and legacy systems. Specifically, the Navy was unable to provide receipt and acceptance support for CVP, RWO-G, and TOT transactions.

2. **Lack of Sufficient AP Control Environment.** There is a lack of sufficient controls surrounding the AP accrual process. In addition, there is a lack of support surrounding the transaction scoping and appropriation allocation utilized in the current cash regression AP estimation. Further, the AP accrual materiality thresholds and underlying data outlined in the accrual methodology are insufficient and lack precision.

3. **Lack of Effectively Designed System Migration Process.** There is a lack of sufficient and/or consistent training for key financial personnel across migrating commands, leading to misstatements in amounts reported in the general ledger system. Specifically, commands recently migrated to NSABRS have expense and AP balances that are invalid and/or abnormal.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of Effectively Designed Controls in the Expense and AP Process.**

- Assess the system interfaces to determine whether expenses and payables are able to post automatically and develop or fix those interfaces as appropriate.
- Post payables manually that cannot be posted via interface timely.
- Identify the unsupported transactions and determine whether an adjustment is necessary to accurately state the AP and budgetary balances in accordance with the timeline provided by the PCM:
  - Develop and implement procedures to ensure transactions are posted accurately and timely.
  - Develop and implement document retention policies for receipt and acceptance procedures.
- Implement additional monitoring of when the receipt of an order is received to when the receipt is uploaded into the general ledger system to ensure timely recording of the expense and payable:
  - Enhance review over three-way match controls.

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- Increase leadership communication across commands to ensure that controls are executed consistently.

2. **Lack of Sufficient AP Accrual Process.**
   - Design and implement additional policies, procedures and controls around the AP accrual process:
     - Design a lower targeted materiality threshold as the AP accrual model matures to obtain increased precision.
   - Document the basis of the allocation methodologies across general ledger accounts affecting CIP, OM&S, Operating Expense, or any other accounts for the AP accrual, as appropriate.
3. Lack of Effectively Designed System Migration Process:
   - During monthly monitoring, Navy and DFAS should research the cause of abnormal documents and document that research and the resolution of abnormal conditions.
   - Implement necessary system controls to prevent processing errors in the NSABRS system.

XI. Revenue and Unfilled Customer Orders

Revenue and Unfilled Customer Orders includes amounts earned by the Navy and amounts anticipated to be earned based on existing agreements for services provided. The Navy's Revenue and Unfilled Customer Orders falls within the scope of the RWO – Performer (RWO-P) process. This includes all processes involved in recognizing revenue and recording the related budgetary entries including Unfilled Customer Orders. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that revenues applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports and maintain accountability of assets. Inadequate procedures over the RWO-P process have led to the following control weaknesses that could lead to misstatements in agency reports used for the management of the organization as well as the financial statements:

1. **Lack of or Inadequate Documentation of RWO-P Policies and Procedures, including Controls.** The end-to-end processes, procedures, general ledger accounting systems, and related control activities over the RWO-P process are not adequately or completely documented. As a result, the RWO-P process is executed inconsistently across the organization.
2. **Ineffective or Inadequate RWO-P Procedures.** Procedures do not exist outlining the appropriate use of reimbursable agreements, identification and elimination of intra-Treasury Account Fund Symbol transactions and recording and monitoring (including segregation of duties) of reimbursements the Navy receives from the DoD Foreign Military Sales (FMS) program. The lack of adequate procedures has resulted in misstatements on the financial statements.
3. **Lack of Effectively Designed Controls in the RWO-P Process.** Controls over the RWO-P process are not effectively designed. Specifically, the Navy has not:

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- Implemented a comprehensive review over incoming sales order funding documents recorded in the general ledger to determine validity and accuracy prior to acceptance.
- Designed sufficient review controls to review billing files, and correct variances prior to certification by DFAS.
- Designed adequate procedures around RWO-P close-out. Specifically, controls for Unfilled Customer Orders are not designed to ensure that all terms and requirements have been met prior to close out and are not closed-out in a timely manner after the work is completed.
- Designed controls around funds collected to validate collections reconcile back to the performance of work, provision of goods, or are recorded in the period in which the services or goods were provided.
- Designed controls to ensure appropriate reimbursement has been collected when costs are incurred in the performance of services or when goods are provided.
- Designed monitoring and oversight controls for the RWO-P process, increasing the risk that reimbursable agreements are invalid and recorded incorrectly in the general ledger.

4. **Inadequate Controls over Financial Reporting of Revenue.** Navy lacks policies, procedures, and related controls to ensure revenue transactions are in compliance with accounting standards. Specifically, revenue is not recorded when services or goods are provided, but instead, recorded when bills are issued in the general ledger. In addition, advance payments are incorrectly recorded due to posting logic issues and documentation to support recorded transactions was not available.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of RWO-P Policies and Procedures, including Controls.**

   Perform an assessment of the RWO-P end-to-end process to ensure all distinct systems, processes, procedures, and key controls are documented in the PCM. The PCM should include all financial statement assertions, key control process owners, key supporting documentation, and applicable GL systems and data interfaces in the RWO-P process.

   - Develop and implement policies and procedures to validate that the RWO-P process is uniformly and consistently executed.

2. **Ineffective or Inadequate RWO-P Procedures.**

   - Design policies to ensure the appropriate use of reimbursable agreements, including the evaluation of whether there is a more appropriate method for distributing funds within BSOs, such as reprogramming or transferring.
   - Design, document, and implement control procedures to ensure that key aspects of an event are properly segregated amongst personnel when processing an internal FMS RWO. In addition:

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  - Implement non-automated review procedures to ensure the validity of FMS RWO documents and procedures to monitor funding within the budget of each command.
- Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.

3. **Lack of Effectively Designed Controls in the RWO-P Process.**
   - Design, document and implement detailed control procedures in the RWO-P process to require all relevant data elements be included on the reimbursable documentation and entered into the general ledger systems. Additionally, implement appropriate monitoring over the execution of the agreements including the billing, collection and closeout cycles.
   - Develop and implement sufficient review procedures to ensure key controls within the PCM are effectively communicated and consistently adhered to by the BSOs and by the Navy's service providers.
   - Develop automated controls and appropriate system interfaces as a part of the implementation of a system solution for intragovernmental transactions such as Government-Invoicing.
   - Implement comprehensive review controls to validate that policies and procedures for the RWO-P closeout process are being consistently applied across BSOs.
4. **Inadequate Controls over Financial Reporting of Revenue.**
   - Develop and implement policies and procedures to require revenue be recognized timely and in the appropriate period as well as recorded accurately including procedures for revenue accruals and management review controls.
   - Perform a detailed review of RWO-P business processes, including advances from others, and respective posting logic to identify and address all non-compliant processes and posting. In addition:
     - Update system posting logic to comply with appropriate accounting guidance for non-compliant processes.
     - Update policies and procedures to outline the appropriate use of RWO-P transactions as well as how to appropriately account for other types of cash receipts that are not RWO-P.

XII. Budget Execution and Undelivered Orders

Budget execution represents the use of appropriated funds, authorized by Congress and apportioned by OMB, from the time the funds are received through the outlay and reporting of those funds. UDOs represent the amount of goods or services ordered which have not been received. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenditures applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The current procedures over the end-to-end budget execution process, including the recognition and reporting of UDOs and the related execution of funding as performed by the Navy

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Office of Financial Management and Budget, do not address financial reporting and budget management risks and could lead to misstatements in amounts reported within the financial statements as detailed below:

1. **Lack of or Inadequate Documentation of Budget Execution Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the budget execution process are not accurately or completely documented. In addition, there is no enterprise-wide policy and related procedures for recording bulk obligation estimates. Estimates are not reviewed and adjusted as execution data becomes available, leading to the potential loss of resources as unneeded funding cannot be reprogrammed timely. Additionally, the estimates do not have adequate analysis to support their recording.

2. **Lack of or Inadequate Budget Execution Procedures.** The Navy does not have effective policies and procedures in place to ensure that all stakeholders prepare and retain consistent and sufficient supporting documentation to support budget execution transactions. Specifically, the Navy was unable to provide sufficient supporting documentation to justify transactions posted and the associated UDO balances. Additionally, procedures outlining the appropriate use of reimbursable agreements and the identification and elimination of intra-appropriation transactions have not been established. In some cases, the lack of procedures has resulted in misstatements on the financial statements.

3. **Lack of Effectively Designed Controls in the Budget Execution Process.** Controls over the budget execution process are not properly designed as detailed below:

   Posting of Obligations

   - There is a lack of controls to ensure that obligations are posted timely or at the appropriate amount, or to ensure that they are adjusted upward or downward when needed, in both Navy ERP and legacy systems.

   Monitoring of Obligations

   - There is a lack of controls to ensure obligations are monitored appropriately throughout their period of availability, including the execution of funding against obligations.
   - The Navy lacks appropriate review of dormant obligations and does not timely de-obligate when execution against an agreement ends. Specifically, for agreements that have had no execution against them for over 90 days, the Navy was unable to provide sufficient evidence that a review occurred to confirm the validity of the obligation. Lack of timely de-obligation of agreements overstates the obligated balance and understates available funds that can be used by Navy for mission critical expenditures.

   Funds Control

   - The Navy lacks proper controls over budget authority. The Navy does not effectively reconcile budget authority reflected within its general ledger systems against amounts reported on the SBR. In addition, the Navy does not research and reconcile variances identified between the field level budget information and the supporting documentation in timely manner.

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Recommendations

Consider the following corrective actions related to the deficiencies identified:

1. **Lack of, or Inadequate Documentation of Budget Execution Policies and Procedures, including Controls.**
   - Complete the PCM for the budget execution process to document a complete and accurate end-to-end process for the entirety of the life cycle, including the initiation, recording, processing, and reporting of transactions.
     - The PCM should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used.
   - Implement a Navy-wide policy requiring obligation estimates be recorded and documented.
2. **Lack of, or Inadequate Budget Execution Procedures.**
   - Increase communication amongst various P2P stakeholders to ensure sufficient and complete documentation is readily available and consistently provided as part of all documentation requests for the budget execution process.
     - Evaluate, identify, and mitigate key gaps and inconsistencies in current document retention policies and procedures.
   - Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.
3. **Lack of Effectively Designed Controls in the Budget Execution Process.**
   - Evaluate existing controls to ensure that the appropriate monitoring procedures are in place, including record retention policies.
   - Evaluate existing policies and procedures over the UDO process to ensure that the appropriate procedures are in place to ensure timely de-obligation of funds.
   - Focus efforts on monitoring active obligations before they become dormant including the related expenditures. This will increase visibility into funds actually needed for valid business purposes versus funds that can be de-obligated and used for other mission critical needs.
   - Develop and implement procedures to reconcile balances recorded in the field-level general ledger to those reported in the financial statements and to supporting documentation and explain or resolve variances on a timely basis.
   - Ensure that end-to-end process documentation related to the Funds Receipt and Distribution processes includes procedures and considerations about financial reporting for all relevant general ledger accounts in the financial statements.

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XIII. Entity Level Controls – Oversight and Monitoring

DoD Instruction 5010.40 requires DoD entities to comply with the requirements of the FMFIA and OMB Circular A-123 *Management's Responsibility for Enterprise Risk Management and Internal Control*. FMFIA requires federal entities to establish internal controls in accordance with the GAO Green Book. The GAO Green Book defines entity level controls as controls that have a pervasive effect on an entity's internal control. It establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. In accordance with the GAO Green Book, management must effectively design, implement, and operate each of the components of internal control for the components to be effective. The Navy has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book and OMB Circular A-123 requirements as described below:

1. **Inadequate Control Environment.** An entity's control environment provides the discipline and structure to help the entity achieve its objectives. According to the GAO Green Book, a key principle in establishing an adequate control environment is the appropriate documentation of the internal control system including the five components of internal controls. The GAO Green Book further states that this type of documentation provides a means to retain organizational knowledge and mitigate the risk of having that knowledge limited to a few personnel. The documentation also provides a means to communicate, as needed, that knowledge to third parties, such as external auditors. A lack of documentation identifying process controls can lead to inadequate communication to those responsible for control performance, as well as inappropriate execution and monitoring of controls. We noted the following deficiencies in the Navy's control environment:

   Entity Level Controls and Documentation

   - The current control environment is ineffective due to inadequate implementation of entity level controls and lack of proper end-to-end documentation of key business processes including internal controls.

   System Consolidation and Data Migration

   - According to the GAO Green Book, management should document internal controls to meet operational needs. Documentation of controls, including changes to controls, is evidence that controls are identified, documented, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated by the entity. The Navy does not have adequate documentation over the internal controls supporting system consolidations and data migration activities. Due to the lack of adequate documentation and governance, there is insufficient evidence to support the system consolidation and data migration efforts, as well as inadequate monitoring of the activities performed. Specifically, the identified system consolidation and data migration weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

     - Lack of overarching governance (e.g., policies, procedures, and minimum activities), over system consolidations.

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- Lack of overarching legacy system decommissioning procedures and/or guidance across all Navy functional areas have not been developed to manage and verify the appropriate shut-down and decommissioning of legacy systems no longer in use by Navy organizations, Commands, and/or BSOs
- Lack of requirements and/or evidence to demonstrate accounting functions are no longer being performed for migrated BSOs when the legacy system remains in use by other organizations/BSOs.
- Insufficient migration specific project plans governing the migration activities for system consolidation efforts, to include but not limited to, the impacted legacy system, future state system, and BSOs.
- Insufficient pre-migration conversion testing performed to demonstrate data designated to be migrated was converted successfully and without error, or that any errors identified are resolved, retested, and do not pose a risk to the completeness and accuracy of the migration results.
- Inappropriately designed User Acceptance Testing (UAT) process where the testing environment was not verified to appropriately mirror the future-state environment.

2. **Lack of Risk Assessments.** According to the GAO Green Book, management should assess the risks facing the entity as it seeks to achieve its objectives by identifying, analyzing, and responding to risks related to achieving the defined objectives. A comprehensive entity level risk assessment does not exist, nor has the Navy fully identified financial reporting risks for the majority of its key business processes.

3. **Inadequate Monitoring Controls.** According to the GAO Green Book, management should establish and operate activities to monitor the internal control system, evaluate results, and remediate identified internal control deficiencies on a timely basis. In addition, it states that management may engage third parties, such as service organizations, to perform certain operational processes for the entity; however, it retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by service organizations. OMB Circular A-123 requires that management evaluate the effectiveness of internal controls annually using the GAO Green Book. The current control environment lacks adequate monitoring controls to evaluate the effectiveness of the internal controls for the majority of its key business processes. In addition, as noted below, the Navy does not have proper oversight of service organizations and other third parties:

   DFAS

   - DFAS performs key financial reporting controls on management's behalf; however, DFAS procedures are not designed to verify the completeness and accuracy of the data within the reports utilized. Additionally, compensating controls do not exist to mitigate the risks posed by DFAS's control weaknesses.

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DCMA

- DCMA validates existence and completeness of government owned property; however, DCMA's procedures are not sufficiently designed for that purpose. Additionally, compensating controls do not exist to mitigate the risks posed by DCMA's control weaknesses.

Contractors

- The Navy does not have adequate oversight of contractors that hold property on its behalf. In addition, there is inconsistent reporting by contractors regarding the property that they hold, leading to unreliable asset reporting, which can have an impact on the Navy's operations.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Inadequate Control Environment.**

Entity Level Controls and Documentation

- Complete the design and emphasize the importance of an A-123 program at all levels of the organization from Navy leadership. This is necessary to bring visibility, education and support to the program from across the organization and at the highest levels of leadership.
- Identify, document and communicate roles and responsibilities throughout the Navy as they relate to the implementation of an A-123 program. Ensure the proper groups and personnel that are involved are trained at the appropriate levels to produce the most effective results. Integrate financial management (FM) and IT remediation efforts to achieve a more efficient and effective program.
- Develop, document and maintain supporting documentation as a part of an A-123 program and for Enterprise Risk Management to evidence the development of management control plans, performance of risk assessments, ongoing monitoring, development of corrective action plans and tracking of progress towards remediation.

System Consolidation and Data Migration

- Develop, document, and implement policy and procedures that define governance structures, minimum activities, and include an enterprise-wide monitoring program for all system consolidations and data migrations efforts.
- Strengthen the integration and collaboration between IT and FM organizations throughout the system consolidation life cycle to promote a holistic, continuous evaluation, and understanding of risk as part of the development and implementation of the Department-level governance and system consolidation enterprise-wide monitoring program.
- Develop, document, and implement system decommissioning procedures and requirements that effectively manage, control, and verify the appropriate shut-down and decommissioning of legacy systems no longer in use.

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- Develop and implement procedures that effectively verify all financial activities and transactions are no longer being performed or recorded in a legacy system and develop a checklist that can be used to validate that the procedures established have been appropriately executed, effectively demonstrate that the legacy system is no longer performing accounting functionality, and serve as evidence for investigative purposes.
- Include requirements that migration-specific project plans (specific to each migrating/impacted BSO, legacy system, and future state system) are developed, implemented, and adhered to.
- Develop and document procedures for conducting the system consolidation conversion documentation tracker process that includes clearly documenting results of all iterations of all pre-migration conversion testing, analysis performed by appropriate stakeholders in situations where errors are identified, and evidence demonstrating that significant errors identified are resolved and re-tested as needed prior to migration.
- Develop policies and procedures to minimize i) the duration that a command cannot enter transactions in the target system ("black-out" period) and ii) the duration that a command cannot financially report out of either the legacy or target system ("brown-out" period).
- Establish policies, procedures, and controls to ensure that all accounting functions can be performed and recorded in a timely, complete, and accurate manner during system black-outs and brown-outs.

2. **Lack of Risk Assessment.**
   - Develop a policy to include proper detail and guidance for conducting the risk assessment process, including:
     - A process to review all aspects of the risk management processes at least once a year.
     - Review of the previous risks identified with appropriate frequency.
     - Provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed.
3. **Inadequate Monitoring Controls.**

   DFAS/DCMA
   - Assess policies and procedures governing oversight of third-party service providers and identify the appropriate level of oversight and monitoring required to ensure accurate and complete reporting.
   - Design management review controls related to actions performed by DFAS and DCMA that are appropriate and/or develop procedures to mitigate the risks identified. Retention of adequate documentation evidencing the procedures performed during their review should include, but is not limited to:
     - Procedures performed/re-performed.

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– Verification that the data transferred from a system of record to an End User Computing tool, such as Excel, is not lost, added, or changed.

Contractors

- Identify the level of oversight required of contractors that have government property in their custody and develop the appropriate policies and procedures to implement the actions necessary for consistent and effective oversight and monitoring.
- Implement changes to contracts to allow for contractors with property in their custody to accurately report the property in accordance with federal accounting standards. Include in the contracts the actions necessary for government personnel to monitor the reports and data presented for accuracy.

Financial Information Systems

The Navy needs to continue focusing on the implementation of a robust internal control environment and information security program, that is designed, operating effectively, and producing the intended results to mitigate key financial audit risks. Consequently, an integrated, prioritized, risk-driven effort is still necessary to remediate deficiencies in the areas of Access Controls, SoD, Configuration Management, and Interface Processing.

Our assessment of the IT controls and the computing environment focused on a subset of financially significant applications that included general ledger systems, feeder systems and operational systems. Specifically, deficiencies are primarily design level deficiencies at the application layer. As the DON's Management Internal Control Program (MICP) matures, we will assess the operating effectiveness and additional layers such as operating system and network.

The following table outlines the number of deficiencies identified across the 32 systems assessed from FY17, FY18, FY19, FY20, and FY21 for the Navy GF, to include current and prior year findings:

	FY21 Navy Financially Significant Systems – IT Internal Controls Deficiencies				
System Type	**Security Management**	**Access Controls/ Segregation of Duties**	**Configuration Management**	**Interface Processing**	**Totals**
General Ledger Systems	4	35	15	19	73
Feeder and Operational Systems	26	198	85	98	407
Totals	**30**	**233**	**100**	**117**	**480**

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A subset of the deficiencies identified were high-risk, which collectively constitute a material weakness in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate. Based on our review and analysis of the findings in aggregate, we have identified three distinct material weaknesses related to information system controls.

We have outlined the three IT material weaknesses below:

- Access Controls/Segregation of Duties
- Configuration Management
- Interface Processing

Each of the IT material weaknesses are discussed further below.

XIV. Financial Information Systems – Access Controls/Segregation of Duties

Access Controls include those controls related to protecting application boundaries, user identification and authentication, authorization, protecting financially significant transactions and system resources, and the monitoring of security violations. When properly implemented, access controls can validate that critical systems assets are safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed.

The identified access control weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- Complete and accurate system generated populations of users were not consistently available, or evidence to support the population of users was not provided, to include level of access granted (i.e., privileges).
- Identification of financially significant transactions and resources has not been performed and/or lacks financial integration and approval.
- Access provisioning to include initial access provisioning, modification, and removal of access were not performed in accordance with defined requirements, timelines, and with sufficient detail to confirm access granted was commensurate with access approved and required for the users' business responsibilities.
- Access recertification/periodic user access reviews were not performed to consistently evaluate both the need for access and the level of access provisioned.
- Monitoring of sensitive user activities, including activities of privileged users, was not documented, not being performed, or not configured appropriately within systems.
- Audit logging evidence was not protected against unauthorized access and modification, as well as not being retained for the audit period.
- Identification and monitoring of security violations, to include required follow-on actions were not consistently performed.

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An effective control environment guards against a particular user without documented authorization and acceptance of the associated risks from being provisioned to incompatible functions within a system. SoD controls provide policies, procedures, and an organizational structure to prevent individual users from being provisioned a combination of roles or permissions that provide the capability to perform incompatible activities. As a result, an effective control environment thereby reduces the risk of users performing inappropriate or unauthorized activities using their incompatible access permissions.

The identified SoD weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- Cross-application SoD analysis has not been performed across key financial systems to determine the significance and pervasiveness of these types of SoD conflicts. Additionally, cross application SoD are not considered when provisioning user access.
- SoD conflict matrix, or equivalent documentation identifying access roles and permissions requiring separation, was not sufficiently documented, inclusive of all functional roles, and/or not mapped effectively to the system access associated with the functional roles.
- Provisioning conflicting access could not be prevented, and for known conflicts where SoD-related concerns were identified, there was a lack of documentation for business rationale and subsequent monitoring of users with known SoD conflict activities.
- System administrators have the ability to complete an entire business functional process by inputting, processing, and approving transactions.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Systematically generate a complete and accurate population of users with access to financially significant systems.
- Periodically review the on-going need for users with elevated access privileges.
- Monitor the activity of users with elevated access privileges.
- Identify and document the completeness and accuracy of financially significant transactions and resources. Additionally, obtain approval from the appropriate level of IT and financial management to validate the listing of financially significant transactions and resources.
- Establish and consistently follow processes and controls related to user account management and SoD, including the entire life cycle from access provisioning to recertification, modification of access, inactivity restrictions, and termination procedures.
- Segregate conflicting roles. In those limited instances where conflicting roles are required or unavoidable, document and approve the business rationale for the conflict and monitor the activity of users with conflicting roles.
- Evaluate cross-application SoD to identify potential conflicts for users accessing multiple systems.

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- Conduct appropriate analysis to confirm functional user access is aligned to the appropriate logical permissions within the systems and confirm SoD is enforced.
- Define required security violation monitoring procedures, including the frequency for which security violations should be escalated, reviewed and approved.

XV. Financial Information Systems – Configuration Management

Configuration Management involves the identification and management of an information system at a given point-in-time and systematically controls changes to that configuration throughout the system development life cycle. By implementing configuration management controls, Navy can verify only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

The identified configuration management-related weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- Complete and accurate system generated populations of changes made to the production environments are not captured nor available to support internal controls and monitoring. This includes code changes, table structure changes, direct data changes, and configurable settings within the application.
- Logging and monitoring controls have not been implemented to identify unintentional or unauthorized changes made to the application and database.
- Access to production and development environments are not segregated. Additionally, access to source code is not properly controlled.
- Changes are not consistently reviewed, approved, and documented.
- Lack of management review or monitoring of third-party service providers, who perform configuration management functions, to validate compliance with the established configuration management process.
- Inadequate governance and requirements during system conversion/consolidation activities resulted in critical financial reporting discrepancies and risks to the financial statements.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Identify complete and accurate populations of configuration changes.
- Only migrate authorized and approved changes into the production environment.
- Segregate access between the development and production environments.
- Restrict access to source code. Document and approve the business rationale for those users requiring access to source code to perform their roles and responsibilities and monitor the activities of those accessing source code.

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- Monitor third party service providers responsible for configuration management activities over Navy's applications.
- Validate and approve changes to applications and databases.
- Implement governance as it relates to system conversions, such that adequate testing and remediation of known errors is performed by both IT and Financial stakeholders prior to the conversion/go-live.

XVI. Financial Information Systems – Interface Processing

Interface Processing controls consist of those related to the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems.

The identified interface control weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- A complete and accurate population of interfaces, processing Navy transactions.
- Identification and verification that financially relevant edits and validation checks are operating as intended.
- Reconciliations are not being performed between source and target systems to validate completeness and accuracy of financial data processing.
- Logs of interface processing activities are not retained to support subsequent auditing and monitoring activities. Additionally, error reporting for failed interface processing activities has not been implemented in some systems.
- Remediation of identified errors in interface processing are not completed in accordance with defined requirements, timelines and with sufficient detail to confirm remediation.
- Interface files are not consistently protected from unauthorized access and modification prior to processing through the use of secure transmission mechanisms.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Identify and document a complete and accurate listing of system interfaces.
- Validate the completeness and accuracy of interface file processing, inclusive of authorized access controls.
- Identify and document a complete and accurate listing of edit checks and validations, to verify that interface files are appropriately edited and validated.
- Validate that information received from a source application is complete, accurate and consistently received.

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- Log interface activity and monitor these logs to allow for timely remediation of errors associated with the transmission of data used in financial reporting.
- Protect data files transmitted via interfaces from inadvertent or intentional access or modification prior to data processing.

Appendix B – Significant Deficiencies

I. Property, Plant, & Equipment – Real Property

The Navy's Real Property consists of land, buildings, and structures, the latter of which is segmented into linear and non-linear structures. Commander, Navy Installations Command (CNIC) oversees the Naval Facilities Engineering Systems Command (NAVFAC), which manages and financially reports real property assets recorded within the Accountable Property System of Record, internet Navy Facilities Asset Data Store (iNFADS). In accordance with the Federal Managers Financial Integrity Act of 1982 (FMFIA), management is responsible for establishing and maintaining effective controls to achieve proper accountability for all funds, property and other assets for which the agency is responsible. Due to the significance of Real Property, a robust control environment is essential.

The Navy has designed and is currently implementing controls over the life cycle of recording Real Property (i.e., receipt, acceptance, maintenance, issuance, and disposal) and related documentation, which are critical to maintaining the outcomes of that effort in the next fiscal year:

1. **Lack of or Inadequate Documentation of Real Property Policies and Procedures, including Controls.** The Navy's Real Property Process Cycle Memorandum (PCM) failed to adequately document the end-to-end processes, procedures, and key control points for significant areas such as acquisitions and disposals of Real Property and inventory procedures such as asset evaluation and virtual inventory reconciliations. The lack of adequate documentation has led to inconsistencies in the execution of Real Property procedures across the organization.
2. **Inadequate Financial Reporting Controls Over Real Property.** The Navy failed to design or implement effective controls over the Real Property process. Specifically, the Navy has not adequately designed internal controls to ensure Real Property data is accurately and timely recorded in iNFADS.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

1. **Lack of or Inadequate Documentation of Real Property Policies and Procedures, including Controls.**
   - Revise the end-to-end process documentation to ensure that it is comprehensive, complete, and speaks to all key financial control points in the various stages of the transaction life cycle of a Real Property asset, as well as but not limited to: inventory procedures, additions and disposals of Real Property, valuation, impairment, deferred maintenance, calculation of accumulated depreciation and depreciation expense, and financial reporting controls.

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2. **Inadequate Financial Reporting Controls Over Real Property.**

- Implement policies and procedures to ensure the revised process is consistent with field level operations.

II. Property Plant & Equipment – Utilities

The Navy's utilities consist of overhead and underground distribution networks for electric, water, steam, and sewage (commonly referred to as linear utility assets), utility plants, and utility assets such as transformers, substations, and switching stations (commonly referred to as parent assets) that are made up of multiple components (commonly referred to as child assets). In accordance with FMFIA, management is responsible for establishing and maintaining effective controls to achieve proper accountability for property and other assets for which the agency is responsible. In FY21, the Navy focused remediation efforts on validating the existence and completeness of utility assets, as well as the appropriate accounting for private plant assets, making significant progress in these areas.

However, the Navy does not have adequate policies and procedures, including internal controls, or related documentation over its utility assets. Specifically, management has not developed and implemented a consistent methodology for the measurement, composition and recordation of plant and linear utility assets across the organization. For example, child asset listings supporting the measurement of parent utility assets are incomplete, inaccurate, and inconsistently documented across installations. In addition, review controls have not been put in place to detect data discrepancies within iNFADS nor have controls been put in place to ensure proper retention of documentation supporting utility assets.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

- Establish and implement policies and procedures to ensure consistent methodology for the measurement, composition, and recordation of utility assets across the organization. For example, ensuring each installation measures assets the same way from standard data sources and determining which plants belong to Navy or are privately owned.
- Establish and implement policies and procedures to determine and appropriately record plant and linear utility asset ownership in iNFADS.
- Establish and implement policies and procedures to enable the Navy to track and accurately maintain records of child utility assets associated to a single parent utility record in iNFADS.
- Establish and implement policies and procedures to ensure the consistent accounting treatment for nonfunctional utility assets.
- Establish and implement policies and procedures to ensure proper review and retention of documentation supporting all utility assets.
- Implement data analytics to ensure that contradicting iNFADS data elements are identified and investigated in a timely manner and/or update inventory procedures to ensure all data elements effecting financial reporting are reviewed.

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III. Contingent Legal Liabilities

Contingent legal liabilities (CLL) include accrued liabilities pertaining to legal cases where the Office of General Counsel (OGC) or the Office of Judge Advocate General (OJAG) consider an adverse decision probable and the amount of the loss measurable. Also disclosed are those cases in which an adverse decision is determined to be reasonably possible. In accordance with Statement of Federal Financial Accounting Standards (SFFAS) 4 and SFFAS 5 as amended by SFFAS 12, management is responsible for reporting and/or disclosing liabilities related to ongoing legal matters.

During FY21, the OGC and OJAG offices executed a 100% review of case information for accuracy. As a result of that effort, Navy legal counsel updated legal records for financial reporting purposes, including closing cases that were no longer active, providing a likelihood of loss for each case, validating the claim amounts, and providing estimated loss assessments where applicable. However, the Navy's controls are not designed and operating effectively to ensure that the estimates reported and disclosed are based on complete and accurate information. Specifically, review controls are not sufficient to validate that the claim amounts used in the calculation of the estimates are based on accurate and updated information from OGC and OJAG offices. In FY21, the Navy updated their CLL process documentation, but the current process documentation does not reflect the end-to-end procedures for the CLL process as a whole, including the identification and appropriate description of all key controls. The Navy plans to implement updated controls around accuracy of case information at both the legal and FMO levels, which will be critical in maintaining the progress achieved.

Recommendations

Consider the following corrective actions related to the conditions described above:

- In order to determine an appropriate loss assessment or range of loss for reporting purposes, OGC and the OJAGs should refine the quarterly control over the review of their case listings to focus on the key financial reporting elements, validate that case listing information is supported by case documents, and ensure that their review is evidenced. Specifically, evidence of review should include notes from the reviewer annotating any differences identified, amounts and other data validated, and action taken to resolve discrepancies.
- FMO should document procedures and controls that require special consideration of the amounts reported and disclosed for those cases that are individually material, assessed as probable or reasonably possible, inestimable, and/or unique in nature.
- FMO should effectively implement a review control over historical payment data received from OGC and the OJAGs to ensure that the information used in the calculation of the estimates is accurate. FMO should perform procedures to assess the financial statement impact when standard percentages are applied to claim amounts for estimation purposes.

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Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements,* the financial statements of the General Fund of the United States Navy (Navy), which comprise the consolidated balance sheet as of September 30, 2021, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2021. Our report disclaims an opinion on such financial statements because the Navy was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of the Navy, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements as well as the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 21-04, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

Our Report on Internal Control over Financial Reporting dated November 8, 2021, includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, and our recommendations to the specific issues presented.

FFMIA

Under FFMIA, we are required to report whether the Navy's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of tests disclosed instances in which the Navy's financial management systems did not substantially comply with federal financial management systems requirements, applicable federal accounting standards or the USSGL.

(a) Federal financial management system requirements

As referenced in the Fiscal Year (FY) 2021 Department of Navy Statement of Assurance, the Navy identified that financial systems and financial portions of mixed systems do not substantially meet the requirements of FFMIA or OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (Circular A-123) Appendix D.

EY also identified this material weakness as part of the Financial Information Systems material weakness, contained in the Report on Internal Control over Financial Reporting, where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with access controls, segregation of duties, configuration management, and interface processing. These financial system deficiencies prevent the Navy from being compliant with federal financial management system requirements and inhibit the Navy's ability to prepare complete and accurate financial reporting.

(b) Noncompliance with applicable federal accounting standards

As referenced in the FY 2021 Department of Navy Statement of Assurance and Note 1 to the financial statements, the Navy identified that the design of financial and non-financial systems does not allow the Navy to comply with applicable federal accounting standards, including not being able to collect and record financial information on an accrual accounting basis. EY also identified noncompliance with federal accounting standards during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

(c) Noncompliance with USSGL posting logic at the transaction level

As referenced in the FY 2021 Department of Navy Statement of Assurance, the Navy identified that the design of financial systems does not allow the Navy to comply with USSGL at the transaction level. EY also identified noncompliance with USSGL posting logic during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

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FMFIA

Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government* (commonly referred to as the GAO Green Book), issued under the authority of FMFIA, establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. To determine if an entity's internal control system is effective, the Green Book requires management to assess the design, implementation, and operating effectiveness of the five components of the entity's internal control system.

The Navy has not fully implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book requirements, leading to inadequate control environment, risk assessment and monitoring processes.

Management's Response to Findings

Navy's response to the findings identified in our engagement and relevant comments from the Navy's management responsible for addressing the noncompliance are provided in their accompanying letter dated November 8, 2021. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the entity's compliance. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

November 8, 2021

GENERAL FUND

UNITED STATES NAVY GENERAL FUND MANAGEMENT'S RESPONSE TO INDEPENDENT AUDITORS REPORT

210422-N-XX200-5074

PACIFIC OCEAN (April 22, 2021) Sailors move in to place chocks and chains on an MH-60S Sea Hawk, assigned to the Eightballers of Helicopter Sea Combat Squadron (HSC) 8, on the flight deck of the Arleigh Burke-class guided-missile destroyer USS Russell (DDG 59) April 22, 2021. Russell, part of the Theodore Roosevelt Carrier Strike Group, is on a scheduled deployment to the U.S. 7th Fleet area of operations. As the U.S. Navy's largest forward-deployed fleet, 7th Fleet routinely operates and interacts with 35 maritime nations while conducting missions to preserve and protect a free and open Indo-Pacific Region. (U.S. Navy photo by Mass Communication Specialist 3rd Class Erik Melgar)

DEPARTMENT OF THE NAVY
ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

November 8, 2021

Ernst & Young, LLP
Attention: Mr. John F. Short, Partner
1775 Tysons Boulevard
Tysons, VA 22102

Dear Mr. Short:

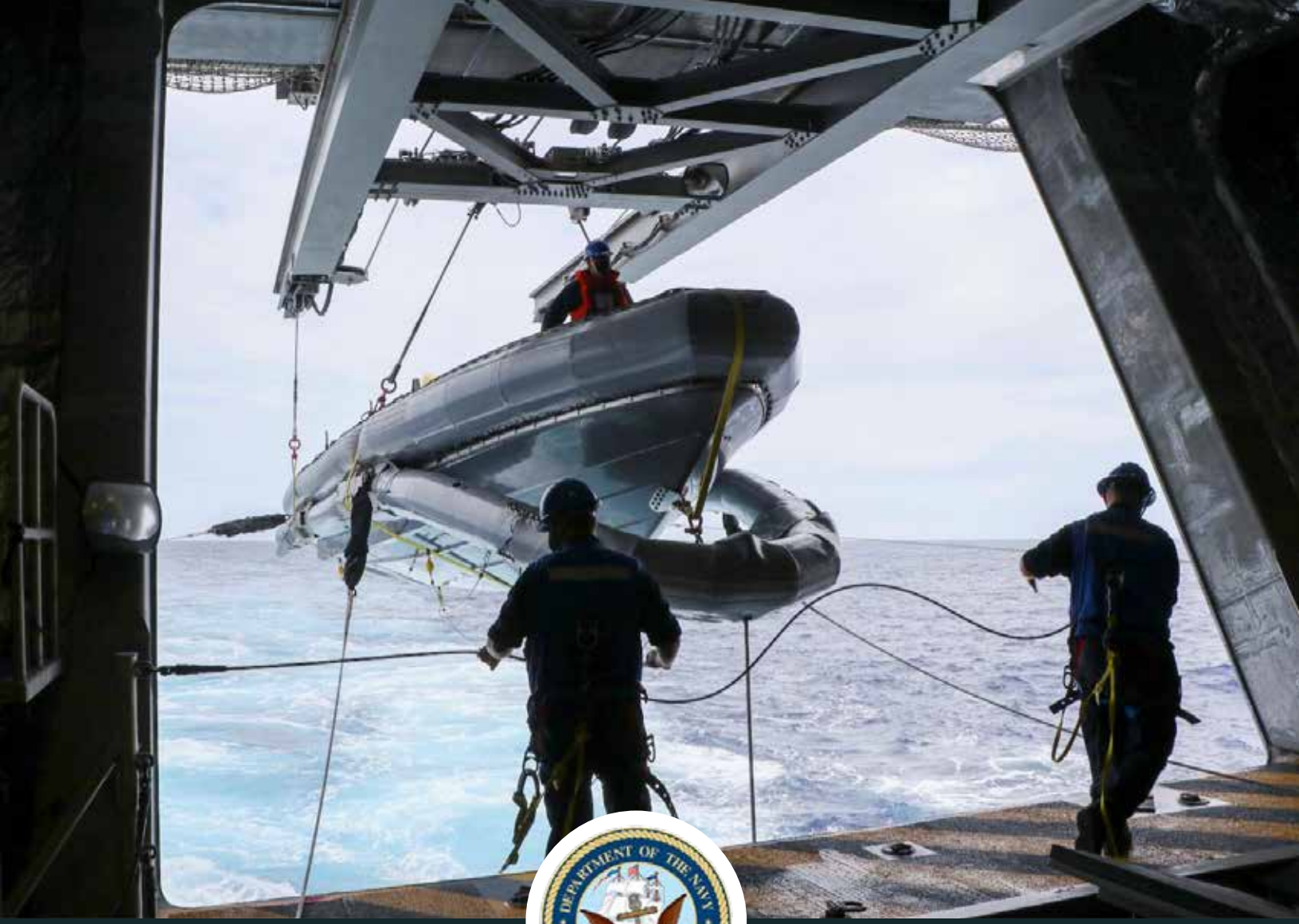
We reviewed the U.S. Navy General Fund Audit Report prepared by Ernst & Young, for the audit of the U.S. Navy General Fund and appreciate the recommendations to continue to improve our financial operations. The Navy acknowledges and concurs with the material weaknesses and the disclaimer of the opinion. Lessons learned from the audit and the recommendations provided in the report will continue to improve our ability to support future audits and improve readiness.

The Navy continues to execute against its Audit Roadmap and address material weaknesses. This integrated strategy keeps us focused on the activities required to meet the long-term goal. In Fiscal Year (FY) 2021, we downgraded our Property, Plant and Equipment – Utilities material weakness. Each year, we will sustain improvements and continue building on milestones achieved. Our FY 2022 priorities include:

- Environmental and Disposal Liabilities – Establish and report accurate environmental and disposal liabilities;
- Fund Balance with Treasury – Sustain progress made to reduce suspense and statement of differences balances, reduce unmatched transactions, support cross-disbursement reconciliations, and reconcile the undistributed population between shared appropriations;
- Information Technology General Controls – Remediate access control, segregation of duties, change management, and interface controls for critical systems;
- Ordnance – Establish existence and completeness;
- Property, Plant and Equipment Valuation – Establish an accurate go-forward valuation process for real property, aircraft, and vessels; and
- Systems Consolidation – Complete migration of all General Fund general ledger accounting systems to the Navy Enterprise Resource Planning system.

We are building on audit findings and fostering a culture that encourages innovation, solves problems, and achieves results to get the most out of every dollar entrusted to us by Congress and the American taxpayer.

Alaleh A. Jenkins
Acting Assistant Secretary of the Navy
(Financial Management and Comptroller)



WORKING CAPITAL FUND

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND PRINCIPAL STATEMENTS

210421-N-WU807-1058
PACIFIC OCEAN (April 21, 2021) Sailors prepare to launch an 11-meter rigid-hull inflatable boat (RHIB) using a twin boom-extendable crane (TBEC) aboard Independence-variant littoral combat ship USS Charleston (LCS 18). Charleston is currently operating in U.S. 3rd Fleet. (U.S. Navy photo by Mass Communication Specialist 3rd Class Adam Butler)

The FY 2021 DON WCF principal statements and related notes are presented in the format prescribed by OMB A-136, except as otherwise disclosed. The statements and related notes summarize financial information for individual funds and accounts within the DON WCF for the fiscal year ended September 30, 2021 and are not presented on a comparative basis.

The following section is comprised of the DON WCF principal statements and related notes:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources
- Related Notes
- Required Supplementary Information

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Consolidated Balance Sheet
As of September 30, 2021

($ IN THOUSANDS)	UNAUDITED 2021
ASSETS (Note 2):	
Intragovernmental:	
Fund Balance with Treasury (Note 3)	$2,458,904
Accounts Receivable, Net (Note 4)	740,729
Other Assets (Note 7)	60
Total Intragovernmental	**$3,199,693**
Other than intragovernmental/With the public:	
Accounts Receivable, Net (Note 4)	18,569
Inventory and Related Property, Net (Note 5)	42,757,036
General Property, Plant and Equipment, Net (Note 6)	1,028,416
Other Assets (Note 7)	603,284
Total Other than intragovernmental/With the public:	**$44,407,305**
TOTAL ASSETS	**$47,606,998**
LIABILITIES (Note 8)	
Intragovernmental:	
Accounts Payable	$211,385
Other Liabilities (Note 11)	445,000
Total Intragovernmental	**$656,385**
Other than intragovernmental/With the public:	
Accounts Payable	1,418,328
Federal Employee and Veteran Benefits payable (Note 9)	399,935
Other Liabilities (Note 11)	2,272,037
Total Other than intragovernmental/With the public:	**$4,090,300**
TOTAL LIABILITIES	**$4,746,685**
COMMITMENTS AND CONTINGENCIES (Note 12)	
NET POSITION	
Unexpended Appropriations - Funds from other than Dedicated Collections	$127,385
Cumulative Results of Operations - Funds from other than Dedicated Collections	42,732,928
TOTAL NET POSITION	**$42,860,313**
TOTAL LIABILITIES AND NET POSITION	**$47,606,998**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Consolidated Statement of Net Cost

For the Fiscal Year Ended September 30, 2021

	UNAUDITED 2021
GROSS PROGRAM COSTS (Note 13)	
Gross Costs:	
Operations Readiness & Support	$40,841,230
Less: Earned Revenue	(39,204,201)
NET COST OF OPERATIONS	**$1,637,029**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Consolidated Statement of Changes in Net Position
For the Fiscal Year Ended September 30, 2021

($ IN THOUSANDS)	UNAUDITED 2021
UNEXPENDED APPROPRIATIONS:	
Beginning Balances	$763,345
Budgetary Financing Sources:	
Appropriations Used	(635,960)
Total Budgetary Financing Sources	**$(635,960)**
Total Unexpended Appropriations	**$127,385**
CUMULATIVE RESULTS FROM OPERATIONS:	
Beginning Balances	40,882,955
Prior Period Adjustments:	
Changes in accounting principles (+/-)	(440,226)
Beginning Balances, as Adjusted	**$40,442,729**
Budgetary Financing Sources:	
Appropriations Used	635,961
Non-exchange Revenue	1,259
Other Financing Sources (Non-Exchange):	
Transfers In/Out without Reimbursement	1,620,812
Imputed Financing	600,871
Other	1,068,325
Total Financing Sources	**$3,927,228**
Net Cost of Operations (Note 13)	1,637,029
Net Change	**$2,290,199**
Cumulative Results of Operations	**$42,732,928**
NET POSITION	**$42,860,313**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Combined Statement of Budgetary Resources
For the Fiscal Year Ended September 30, 2021

($ IN THOUSANDS)	UNAUDITED 2021
BUDGETARY RESOURCES:	
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$6,593,846
Contract Authority (discretionary and mandatory)	8,297,518
Spending Authority from Offsetting Collections (discretionary and mandatory)	24,444,777
TOTAL BUDGETARY RESOURCES	**$39,336,141**
STATUS OF BUDGETARY RESOURCES:	
New Obligations and Upward Adjustments (total)	$33,089,447
Unobligated Balance, End of Year:	
Apportioned, Unexpired Accounts	6,233,008
Exempt from Apportionment, Unexpired Accounts	1,696
Unapportioned, Unexpired Accounts	11,990
Unexpired Unobligated Balance, End of Year	**$6,246,694**
Unobligated Balance, End of Year (total)	**$6,246,694**
TOTAL BUDGETARY RESOURCES	**$39,336,141**
OUTLAYS, NET, AND DISBURSEMENTS, NET	
Outlays, Net (total) (discretionary and mandatory)	$(282,383)
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$(282,383)**

The accompanying notes are an integral part of these statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.A. Reporting Entity

The DON WCF is a complex organizational entity comprised both of subordinate organizations, as well as other entities, which are administratively aligned to the USN mission, but funding for those operations is provided by external reporting entities.

For financial reporting purposes, the DON is organized into two reporting entities: the USN GF and the DON WCF. The DON WCF includes financial information for both the Navy and the Marine Corps. Each reporting entity has a separate set of financial statements and related disclosures. This section of the AFR specifically applies to the DON WCF, as a result, it does not disclose information related to the USN GF.

Refer to the MD&A Section – "Mission and Organization" for additional information.

1.B. Basis of Presentation and Accounting

These single-year financial statements reflect both proprietary and budgetary accounting transactions and are comprised of the consolidated balance sheet, consolidated statement of net cost, consolidated statement of changes in net position, and the combined statement of budgetary resources of the DON WCF. The DON WCF does not show comparative financial statements because financial statement line item values are changing due to remediation efforts and any comparison could be misleading to the reader. These financial statements have been prepared from the accounting records of the DON WCF in accordance with, to the extent possible, U.S. GAAP promulgated by the FASAB, OMB Circular A-136, *Financial Reporting Requirement*s, Revised (August 2021) and the DoD, *Financial Management Regulation (FMR)*.

Accounting standards require all reporting entities to disclose that certain presentations and disclosures can be modified, if needed, to prevent the disclosure of classified information.

The financial transactions are recorded on a proprietary accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recognized when incurred, without regard to the timing of receipt or payment of cash. Whereas, under the budgetary basis, the legal commitment or obligation of funds is recognized in advance of the proprietary accruals and in compliance with legal requirements and controls over the use of federal funds.

The DON WCF is unable to implement all elements of U.S. GAAP, OMB A-136, and FFMIA due to limitations of financial and nonfinancial management processes and systems that support the financial statements. These limitations are noted throughout the financial statements as applicable.

The DON WCF derives reported values and information for major asset and liability categories from both financial and non-financial systems. The non-financial systems were designed primarily to support reporting requirements for maintaining accountability over assets rather than preparing financial statements in accordance with U.S. GAAP. The DON WCF continues to implement process and system improvements to address these limitations.

The financial statements are compiled from the underlying financial data and trial balances of the DON WCF's general ledger accounting systems. The underlying data is largely derived from budgetary transactions (e.g., obligations, disbursements, and collections), non-financial feeder systems, and accruals made for major items (e.g., payroll expenses, accounts payable, and FECA Liabilities). Some of the general ledger level trial balances may reflect abnormal balances resulting largely from faulty business and system processes and may not be evident within the financial statements. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated / combined level.

The DON WCF is not in compliance with the following authoritative accounting guidance:

- SFFAS 1, "Accounting for Selected Assets and Liabilities"
- SFFAS 3, "Accounting for Inventory and Related Property"
- SFFAS 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government"
- SFFAS 5, "Accounting for Liabilities of the Federal Government"
- SFFAS 6, "Accounting for Property, Plant, and Equipment"
- SFFAS 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting"
- SFFAS 10, "Accounting for Internal Use Software"
- SFFAS 15, "Management's Discussions and Analysis"
- SFFAS 21, "Reporting of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources"
- SFFAS 29, "Heritage Assets and Stewardship Land"
- SFFAS 44, "Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use"
- SFFAS 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials"
- SFFAS 50, "Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35"
- SFFAS 53, "Budget and Accrual Reconciliation"
- SFFAS 55, "Amending Inter-entity Cost Provisions"
- Treasury Financial Manual (TFM)
- FFMIA of 1996
- GMRA of 1994

Certain disclosures related to the DoD CRE are not presented, including those required by the Payment Integrity Information Act of 2019, Section 3 of the OMB Memorandum 12-12, Promoting Efficient Spending to Support Agency Operations, and OMB Management Procedures Memorandum 2015-01, the Reduce the Footprint policy implementation guidance; Fraud Reduction Effort; and the OMB Management Procedures Memorandum 2016-04, GONE Act Reporting of Unclosed Grant and Cooperative Agreement Awards for which the period of performance has expired more than two years. These disclosures are presented in the DoD AFR on behalf of the USN.

1.C. Appropriations and Funds

The DON WCF received its initial funding through the establishment of a corpus which was provided through an appropriation. Annually, the DON WCF receives limited appropriated dollars and is primarily funded through contract authority, and spending authority from offsetting collections. Contract authority represents authority that permits the DON WCF to incur obligations. Spending authority from offsetting collection represent authority that permits obligations and outlays to be financed by offsetting collections.

The DON WCF obtains the goods and services sold to customers on a reimbursable basis in order to generate revenue, cover expenses, and maintains the corpus. Reimbursable receipts fund operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the DON WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

Refer to the MD&A Section – "Analysis of Financial Statements and Stewardship Information – DON WCF" for additional information related to the WCF direct appropriations received.

1.D. Use of Estimates

Preparation of the financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Significant estimates underlying the accompanying financial statements include, but are not limited to, plant replacement values for real property, general equipment including depreciation, OM&S, AFDA, payroll expenses, Accounts Payable, bulk obligations, inventory allowance, Contingent Legal Liabilities and unbilled revenue. Estimates may not be reasonable or supportable, as indicated in the note disclosures.

Due to existing system limitations, Navy is not consistently performing receipt and acceptance activities that would record Accounts Payables in the GL systems, or accruing for goods or services received but not invoiced or paid.

1.E. Revenues and Other Financing Sources

The DON WCF recognizes revenue generated by the sales of goods and/or services and the costs incurred to provide those goods and services to other DoD entities, other federal agencies, and the public. Generally, the DON WCF is a revolving fund that relies on sales revenue rather than direct Congressional appropriations to finance its operations.

The DON WCF has four business areas: Depot Maintenance, Research and Development, Transportation, and Supply Management

- **Depot Maintenance** activities recognize revenue according to the percentage of completion method.
- **Research and Development** activities recognize revenue as actual costs are incurred and billed.
- **Transportation** activities recognize revenue on either a reimbursable or per diem basis. The majority of per diem projects are billed and collected in the month services are rendered. The remaining per diem projects recognize revenue in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered.
- **Supply Management** activities recognize revenue from the sale of inventory items.

The DON WCF recognizes revenue when earned within the constraints of its current system capabilities. In many instances, revenue is recognized when bills are issued and not when revenue is earned. The DON WCF does not include non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in the SNC and Note 18, "Reconciliation of Net Cost to Net Outlays." The U.S. has cost- sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in port.

The DON WCF records donations in trust funds and special funds as non-exchange revenue. The DON WCF recognizes non-exchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not receive value in return. Non-exchange revenue is not considered to reduce the cost of the DON WCF operations and is therefore reported in the SCNP as a financing source.

1.F. Recognition of Expenses

The DON WCF utilizes a combination of financial transactions within its accounting system and data calls to obtain and record financial amounts, including some expenses, which results in the untimely recording of some expense activity. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis.

For OM&S, operating expenses are not always recognized when the items are consumed. Efforts are underway to transition to the consumption method to properly recognize expenses. Due to system limitations, the use of OM&S in constructing capital and other long-term assets may be recognized as operating expenses. The USN is implementing process and system improvements to fix these limitations.

1.G. Accounting for Intragovernmental Activities

Intragovernmental transactions are business activities conducted between two different federal entities. Transactions with the public are transactions in which either the buyer or the seller of the goods or services is a non-federal entity. The DON WCF cannot accurately identify intragovernmental transactions (e.g., revenues, expenses, accounts receivable, accounts payable, and non-expenditure transfers) by customer to properly eliminate intra-entity and trading partner activity and balances from the financial statements. The DON WCF's systems do not track buyer and seller data at the transaction level; thereby increasing the risk that all eliminating entries have not been recorded. Generally, seller entities within the DON WCF provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with the DON WCF's seller-side balances and are then eliminated. The DON WCF continues to implement process and system improvements to address these limitations that will enable the DON WCF to correctly report, reconcile, and eliminate intragovernmental balances.

1.H. Non-Entity Assets

Assets are classified as either entity or non-entity assets. Entity assets are those that the DON WCF has authority to use for its operations. Non-entity assets are those held by the DON WCF but not available for use in its operations. Non-entity assets are offset by liabilities to third parties and have no impact on net position. The DON WCF combines its entity and non-entity assets on the balance sheets and discloses its non-entity assets in the notes.

Refer to Note 2, "Non-Entity Assets" for additional information.

1.I. Fund Balance with Treasury

Fund Balance with Treasury includes amounts available to pay current liabilities and finance authorized purchases, as well as funds restricted until future appropriations are received. The DON WCF monetary resources are maintained in Treasury accounts. The DON WCF generally does not maintain cash in commercial bank accounts. The disbursing offices of the DFAS, the DON WCF, other military departments, and Department of State (State) financial service centers process the majority of the DON WCF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports for the Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits. The disbursing station monthly reports are consolidated at the disbursing office level for financial reporting purposes. In Fiscal Year 2020, the USN in partnership with DFAS, implemented TDD for a portion of vendor payments. TDD is the process of utilizing Treasury as a service provider to process disbursements, thereby eliminating the requirements for disbursing stations to prepare monthly reports for Treasury in order to report fund balance activity. Implementation of TDD resulted in USN having a blended disbursing environment, where both Non-Treasury Disbursed and TDD processes support the generation of disbursement transactions affecting fund balance.

In addition, DFAS and the U.S. Army Corps of Engineers (USACE) Finance Center submit reports to the Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The Treasury records these transactions to the applicable FBwT account. On a monthly basis, the DON WCF's FBwT is reviewed and adjusted at the Department level within the DoD's Defense Departmental Reporting System-Budgetary (DDRS-B). FBwT variances identified after the GL systems have closed each month are addressed through adjustments entered during the financial reporting process in DDRS to record undistributed disbursements and collections. These adjustments, if required, help to ensure the DON WCF's financial statements agree with the Treasury accounts.

Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.J. Accounts Receivable

Accounts Receivable, inclusive of claims receivable and refunds receivable, consists of amounts owed to the DON WCF by other Federal agencies and the public. The DON WCF estimates losses due to uncollectible non-federal amounts based on Accounts Receivable debt type and delinquency age. The DON WCF uses non-intragovernmental data to age receivables based on an analysis of field-level Accounts Receivable detail reports to determine collectability of each aging category that is less than 150 days delinquent. Additionally, the DON WCF recognizes an allowance for all non-intragovernmental Accounts Receivable that are 150 days delinquent. Gross receivables must be reduced to net realizable value by an allowance for doubtful accounts. FASAB Technical Bulletin 2020-1 clarifies that SFFAS 1 standards, including recognition of losses, apply to receivables from federal and non-federal entities. Currently, the DON WCF is not fully compliant with the aforementioned authoritative guidance. The DON WCF does not calculate an intragovernmental receivables loss allowance.

Refer to Note 4, "Accounts Receivable, Net" for additional information.

1.K. Inventory and Related Property

The DON WCF categorizes Inventory and Related Property as inventory and OM&S. Due to long standing business processes and financial system deficiencies, the DON WCF is unable to make an unreserved assertion for inventory and OM&S opening balances. The DON WCF accounts for OM&S using a combination of the consumption method and purchases method.

Supply management inventory is tangible personal property that is categorized as available and purchased for resale, held in reserve for future sale, held for repair, in development, and EOU. The DON WCF assigns inventory to categories based upon condition of the inventory item and based upon stage of fabrication.

The DON WCF values available and purchased for resale and held in reserve for future sale inventory using the MAC method. The DON WCF values held for repair inventory at the price of a serviceable item, less estimated repair costs, using the direct method. As the DON WCF completes the repair, the cost of repair is capitalized in the asset account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account. EOU WCF inventory is valued at NRV. The DON estimates an NRV equal to zero ($0) for all EOU WCF inventory assets due to disposition. Disposition of EOU WCF inventory includes DLA Disposition Services (DLADS), donations, and transfers to Government Agencies. The DON's valuation of EOU WCF is not in compliance with SFFAS 3.

Revaluation allowances usually arise from destroyed goods, missing goods, or a decrease in the market value of goods. DON WCF also records revaluation allowances to eliminate unreconciled balances. Currently, DON WCF inventory revaluation allowance is not in compliance with SFFAS 3.

The DON WCF identifies Related Property as OM&S categorized as held for use, held in reserve for future use, held for repair, in development, and EOU. OM&S materials held for repair are reported under held in reserve for future use. The DON WCF holds OM&S based on military/mission need and support for contingencies.

The DON WCF standard valuation method for OM&S is MAC.

1.L. General PP&E

Due to long standing business process and financial system deficiencies, the DON WCF is unable to make an unreserved assertion for GPP&E opening balances accounted for in legacy systems. As the DON WCF continues to implement sustainable go-forward GAAP-compliant processes, the DON WCF is working to establish opening balances for assets.

Currently, the DON WCF uses estimated historical cost for valuing GPP&E. To establish a baseline, the DON WCF accumulated information relating to program funding and associated equipment, equipment useful life, program acquisitions, and disposals. The equipment baseline was updated using expenditure, acquisition and disposal information.

The DON WCF does not yet utilize the account for assets awaiting disposal. Partial asset impairment is not a common occurrence in the DON WCF, as assets are either repaired to restore lost utility or removed from service. However, the DON WCF will recognize impairments for classes of assets or locations in the case of major events, (e.g., natural disasters) or if the impairment affects an entire class of assets.

The DON WCF capitalizes GPP&E at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization threshold of $250k. The DON WCF capitalizes improvements to existing GPP&E if the improvement equals or exceeds the DON WCF's capitalization threshold, extends the useful life of the underlying asset, or increases asset size, efficiency, or capacity. The DON WCF depreciates all GPP&E, on a straight-line basis. Once an asset is identified as capital, it remains on the books even if they do not meet current thresholds. Due to business process and system limitations, the DON WCF does not currently report accurate values related to IUS.

1.M. Other Assets

Other assets include civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on the DON WCF's Balance Sheet.

- **Advances** are cash outlays made by the DON WCF to its employees, contractors, or others to cover part or all the recipients' anticipated expenses. When making payments in advance of the receipt of goods and services is permitted by law, legislative action, or Presidential authorization, the DON WCF's policy is to record advances or prepayments as an asset on the Balance Sheet. Upon receipt of the related goods and services, the DON WCF's policy is to reduce the advances and prepayments and properly classify the assets. The DON WCF has not implemented this policy due to noncompliance with the FFMIA.
- **Civilian pay advances** are payments advanced to full-time DON WCF civilians intended to finance unusual employee expenses associated with oversea assignments that are not otherwise reimbursed and to aid foreign assignment recruitment and retention. Travel advances are disbursed to employees prior to business trips and the travel advance is subsequently reduced when travel expenses are incurred.
- **Financing payments** allow the DON WCF to alleviate the potential financial burden that long-term contracts can cause to a contractor. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on costs, and interim payments under certain cost-reimbursement contracts.
- **Contract financing payments** do not include invoice payments, payments for partial deliveries, or lease and rental payments.
- **Progress payments** are only authorized based on a percentage or stage of completion and only for construction of real property; shipbuilding; and ship conversion, alteration, or repair. Progress payments based on percentage or stage of completion are reported as CIP.

1.N. Liabilities

Liabilities represent actual and estimated amounts to be paid as a result of transactions or events that have already occurred. Liabilities are classified as covered by budgetary resources if budgetary resources are available to pay them. Liabilities are classified as not covered by budgetary resources when congressional action is needed before they can be paid. Although future appropriations to fund these liabilities are likely, it is not certain that appropriations will be enacted to fund these liabilities.

1.O. Environmental and Other Contingent Liabilities

A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity. Contingent liabilities are recognized when a past event or exchange transaction has occurred, and a future outflow of resources is probable and measurable. A contingency is considered probable when the future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, a contingency is considered probable when the future confirming event or events are likely to occur. A contingency is disclosed in the Notes to the Financial Statements if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. A contingency is considered reasonably possible when the chance of the future confirming event or events occurring is more than remote but less than probable. A contingency is not recognized as a contingent liability and an expense nor disclosed in the Notes to the Financial Statements when the chance of the future event or events occurring is remote. A contingency is considered remote when the chance of the future event or events occurring is slight.

Contingent legal liabilities are calculated based on a predetermined estimation methodology. In legal cases where estimated loss or reasonable loss range is not provided by legal offices, the methodology estimates liability amounts based on historical payment to claim ratio. Navy FMO leverages OGC attorney's likelihood assessment to categorize the cases for appropriate accounting treatment. Currently there is no OJAG related cases in the DON WCF. The estimation methodology is based on the OGC attorney's claim amount assessments and historical payout data applied to specific claim amounts.

Refer to Note 12, "Commitments and Contingencies" for additional information.

The USN transferred all real property assets from the DON WCF to the GF in FY 2021. As a result, the Other Environmental Liabilities for the real property assets, previously reported in the DON WCF, will be reported in the GF.

1.P. Accrued Leave

The DON WCF reports compensatory and civilian annual leave as accrued liabilities as it is earned. The accrued balance is adjusted at least quarterly to reflect current pay rates and unused hours of leave. Any portions of the accrued leave for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.Q. Net Position

Net position consists of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations represent the amount of budget authority that is unobligated and has not been rescinded or withdrawn, as well as amounts obligated for which a legal liability for payment has not been incurred. Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources including appropriations, revenue, and gains, since inception. The Cumulative Results of Operations also include donations and transfers in and out of assets that were not reimbursed.

1.R. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections recorded in the general ledger and those reported by the Treasury. Due to the nature of these disbursements and collections, there is a possibility both supported and unsupported adjustments may have been made to the DON WCF Accounts Payable and Accounts Receivable prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the USN generally cannot determine whether undistributed disbursements and collections should be applied to federal or non-federal Accounts Payable or Accounts Receivable at the time accounting reports are prepared. The USN follows the DoD policy to allocate supported undistributed disbursements and collections between federal and non-federal categories based on the percentage of distributed federal and non-federal Accounts Payable and Accounts Receivable. Unsupported undistributed disbursements and collections are applied to reduce Accounts Payable and Accounts Receivable accordingly.

Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.S. Federal Employee and Veteran Benefits

Refer to Note 9, "Federal Employee and Veteran Benefits" for additional information.

1.T. Tax Exempt Status

As an agency of the federal government, the DON WCF is exempt from all income taxes imposed by any governing body whether it is a federal, state, commonwealth, local, or foreign government.

NOTE 2. NON-ENTITY ASSETS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Non-Federal Assets	
Accounts Receivable	$8,846
Total Non-Federal Assets	**$8,846**
Total Non-entity Assets	**$8,846**
Total Entity Assets	**$47,598,152**
TOTAL ASSETS	**$47,606,998**

Non-entity Assets are assets held by the DON WCF but are not available to the DON WCF.

Non-Federal Accounts Receivable with the Public represents interest, penalties, fines, and administrative fees that will be remitted to the Treasury's Miscellaneous Receipts account.

NOTE 3. FUND BALANCE WITH TREASURY

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Status of Fund Balance with Treasury	
Unobligated Balance:	
Available	$6,234,704
Unavailable	11,990
Total Unobligated Balance	**$6,246,694**
Obligated Balance not yet Disbursed:	18,043,959
Non-FBWT Budgetary Accounts:	
Unfilled Customer Orders without Advance	(12,389,428)
Contract Authority	(7,852,626)
Receivables and Other	(1,589,695)
Total Non-FBWT Budgetary Accounts	**$(21,831,749)**
TOTAL FUND BALANCE WITH TREASURY	**$2,458,904**

The Status of FBwT reflects the budgetary resources to support the FBwT and is a reconciliation between budgetary and proprietary accounts. The balances reflect the budgetary authority remaining for disbursement against current and future obligations.

Unobligated Balances are classified as available or unavailable and represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Certain unobligated balances may be restricted for future use and are not apportioned for current use. The Navy has not identified any such restricted balances.

Obligated Balance not yet disbursed represents funds obligated for goods and services but not paid.

Non-FBwT Budgetary Accounts are required to reconcile the budgetary status to non-budgetary FBwT, as reported in the balance sheet. Non-FBwT budgetary accounts create contract authority and unobligated balances, but do not post to FBwT as there is no receipt of cash. The Non-FBwT budgetary accounts are comprised of contract authority, accounts receivable, and unfilled orders without advance from customers.

Other Additional Information

The DON WCF field-level general ledger accounting systems may not include all Treasury collection and disbursement activity for reasons such as timing differences, transaction distribution errors, and disbursements made by other DoD agencies on behalf of the DON WCF. Thus, the fund balance per the DON WCF includes undistributed disbursements and collections, representing the difference between disbursement and collections recorded with Treasury and those balances recorded within the DON WCF general ledgers. The DON WCF recorded $188 million in undistributed disbursements and $247 million in undistributed collections as of September 30, 2021.

NOTE 4. ACCOUNTS RECEIVABLE, NET

AS OF SEPTEMBER 30 ($ IN THOUSANDS)			UNAUDITED 2021
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$753,757	$(13,028)	$740,729
Non-federal Receivables (From the Public)	61,224	(42,655)	18,569
TOTAL ACCOUNTS RECEIVABLE	**$814,981**	**$(55,683)**	**$759,298**

Accounts Receivable, Net represents the DON WCF's claim for payment from federal and non-federal sources.

Intragovernmental Receivables primarily represent amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Seller-side accounts receivable are adjusted to agree with inter-/intra-agency buyer-side's accounts payable through the DON WCF's elimination process when buyer-side balances are deemed more reliable.

Non-Federal Receivables (With the Public) are primarily held with CNIC (NAVFAC) and NAVSUP. These balances, once collected, may be used by the collecting agency based upon nature of Accounts Receivable.

Restitution receivables and associated payments are pursued by the courts handling those cases. DON establishes the receivables based on the court documents received and posts payments received through the courts. At two years delinquent, criminal restitution receivables are considered 100 percent uncollectible; however, the DON is only authorized to write off or close accounts with approval from the Department of Justice.

Refer to Note 1.J, "Accounts Receivable" for additional information.

NOTE 5. INVENTORY AND RELATED PROPERTY, NET

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Inventory, Net	$42,526,345
Operating Material & Supplies, Net	230,691
TOTAL INVENTORY AND RELATED PROPERTY, NET	**$42,757,036**

AS OF SEPTEMBER 30 ($ IN THOUSANDS)				UNAUDITED 2021
Inventory Categories	**Gross Value**	**Revaluation Allowance**	**Net**	**Valuation Method**
Available and Purchased for Resale	$23,399,513	$(163,242)	$23,236,271	MAC
Held in Reserve for Future Sale	622,862	-	622,862	MAC
Held for Repair	17,837,248	-	17,837,248	MAC
In Development	829,964	-	829,964	MAC
Excess, Obsolete, and Unserviceable	4,446	(4,446)	-	NRV
TOTAL	**$42,694,033**	**$(167,688)**	**$42,526,345**	

Legend for Valuation Methods:
MAC = Moving Average Cost NRV = Net Realizable Value

The DON WCF inventory consists of funded and reported materials held for sale or as inventory stock, under the DON WCF. All the USN inventory held for sale is funded and reported on the DON WCF financial statements.

The DON WCF classifies its inventory into five categories based on purpose or condition: available and purchased for resale, held in reserve for future sale, held for repair, in development, and EOU.

Available and Purchased for Resale inventory is defined as inventory held for sale, used in the process of production for sale, or to be consumed in the production of goods for sale or in the provision of services for a fee. Available and purchased for resale inventory includes consumable and repairable spare and repair parts and repairable items owned and managed by the DON WCF. Available and purchased for resale also include items for sale or transfer to entities outside the federal government or other federal entities. The DON WCF recognizes inventory when title passes to the DON WCF or when the goods are delivered to the DON WCF.

As a result of business processes and system limitations, a revaluation allowance is recorded to eliminate unreconciled balances between the USN APSRs and logistics feeder systems.

Held in Reserve for Future Sale inventory consists of additional consumable and repairable items held in reserve for future sale as they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations.

Held for Repair inventory consists of damaged materiel that requires repair to make it usable. With the category of held for repair, the inventory items here are presented at the price of a serviceable item, less estimated repair costs, using the direct method.

In Development consists of partially finished goods still in the production process that has not yet been completed; including direct material, direct labor, applied overhead, and other direct costs.

Excess, Obsolete and Unserviceable inventory consists of items that exceeds the amount expected to be used; is no longer needed because of changes in technology, laws, customs, or operations; or is damaged physically and cannot be consumed in operations.

There are currently no restrictions on the use, sale, or disposition of inventory except in the following situations: 1) distributions without reimbursement are made when authorized by DoD directives; 2) war reserve materiel includes repair items that are considered restricted; and 3) inventory, except for safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

Operating Materials and Supplies, Net

AS OF SEPTEMBER 30 ($ IN THOUSANDS)				UNAUDITED 2021
	Gross Value	Revaluation Allowance	Net	Valuation Method
OM&S Categories				
Held for Use	$223,276	$ -	$223,276	MAC
Held in Reserve for Future Use	1,139	-	1,139	MAC
In Development	6,276	-	6,276	MAC
Excess, Obsolete, and Unserviceable	-	-	-	NRV
Total	**$230,691**	**$ -**	**$230,691**	

Legend for Valuation Methods:

MAC = Moving Average Cost NRV = Net Realizable Value

The DON WCF OM&S consists of tangible personal property to be consumed in normal operations or as part of a larger asset assembly. The DON WCF OM&S classifies its OM&S into four categories based on purpose or condition: held for use, held in reserve for future use, in development, and EOU.

OM&S designation is determined based on condition codes assignment, as defined by the Defense Logistics Manual 4000.25-2, and subsequent alignment to account categories as directed in the DoD Financial Management Regulation 7000.14-R, Volume 4, Chapter 4 paragraph 040304.

Held for Use consists of serviceable materials and supplies ready for issue as part of normal operations.

Held in Reserve for Future Use consists of OM&S stocks that may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations. OM&S held in reserve for future use are valued using the same basis as OM&S held for use in normal operations. OM&S materials held for repair are reported under held in reserve for future use.

In Development are costs incurred in developing the OM&S or the value of tangible personal property that will be consumed in normal operations upon completion of development.

Excess, Obsolete, and Unserviceable materials include damaged assets that are more economical to dispose of than repair. Materials are defined as follows; "Excess OM&S" are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable future and that do not meet management's criteria to be held in reserve for future use. "Obsolete OM&S" are operating materials and supplies that are no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable OM&S" are operating materials and supplies that are physically damaged and cannot be consumed in operations.

The DON WCF has no restrictions on the use of OM&S.

NOTE 6. GENERAL PP&E

AS OF SEPTEMBER 30 ($ IN THOUSANDS)					UNAUDITED 2021
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes:					
Software	S/L	2-5 or 10	$169,691	$(133,959)	$35,732
General Equipment	S/L	Various	3,313,852	(2,800,311)	513,541
Construction-in-Progress	N/A	N/A	479,143	-	479,143
TOTAL GENERAL PP&E			**$3,962,686**	**$(2,934,270)**	**$1,028,416**

Legend for Depreciation/Amortization Method:

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

The DON WCF's GPP&E is comprised of unique asset lifecycle-based categories consisting of IUS; General Equipment; and CIP (real property and general equipment). Other GPP&E consists of assets awaiting disposal.

In FY 2021, the Navy continued to implement the Office of the Secretary of Defense (OSD) Real Property Financial Reporting Responsibilities (FRO) Policy Update, dated March 15, 2019. The policy requires the USN GF financial statements recognize all the DON WCF real property assets (i.e., building, land, structures, and linear structures) located and aligned to Navy installations. This includes the recognition of any capital improvements associated with DoD-owned assets. The DON WCF will continue to report to USN GF instances that they are the installation host, real property assets that are on other federal agency installations or land or private property sites, and leased facilities and the associated improvements that are not on DOD land, if applicable. As a result of the FRO policy, $22M in USMC real property assets were removed from the DON WCF in FY 2021 and as a result, no real property is being reported by the DON WCF as of September 30, 2021.

The USN GF establishes the useful life of 2-5 or 10 years during the planning phase of an IUS's development based on the length of time it is expected to have economic benefit or service potential to the USN.

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

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
General PP&E Beginning of year	$1,022,568
Dispositions	174,819
Transfer in/(out) without reimbursement	(48,858)
Revaluations (+/-)	(27,593)
Depreciation Expense	(140,587)
Other (+/-)	48,067
GENERAL PP&E, BALANCE AT END OF YEAR	**$1,028,416**

Refer to Note 1.L, "General PP&E" for additional information.

NOTE 7. OTHER ASSETS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Intragovernmental Contract Financing Payments	
Advances and Prepayments	$60
Total Intragovernmental Other Assets	**$60**
Non-Federal Other Assets	
Outstanding Contract Financing Payments	72,015
Advances and Prepayments	533,099
Other Assets (With the Public)	(1,830)
Total Non-Federal Other Assets	**$603,284**
TOTAL OTHER ASSETS	**$603,344**

Outstanding Contract Financing Payments consist of contract terms and conditions for certain types of contract financing payments that convey rights to the USN, protecting the contract work from state or local taxation, liens or attachment by contractors' creditors, transfer of property, or disposition in bankruptcy. However, these rights do not mean that ownership of the contractor's work has transferred to the USN. The USN does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DON WCF is not obligated to make payment to the contractor until delivery and acceptance. These cash outlays and payments are made by the DON WCF to contractors, grantees, or others to cover the recipients' anticipated and periodic expenses before those expenses are incurred. OCFP are reduced when goods and services are received, contract terms are met, progress is made on a contract, or prepaid expenses expire.

Advances and Prepayments are cash outlays made by a federal entity to cover a part or all of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity will receive. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.

Other Assets (With the Public) consists of prepayments made to vendors and travel advances made to employees. The abnormal balance is a result of a legacy system migration.

NOTE 8. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Intragovernmental Liabilities	
Other	$75,260
Total Intragovernmental	**$75,260**
Non-Federal Liabilities	
Federal Employee and Veteran Benefits	396,399
Other	2,474
Total Non-Federal Liabilities	**$398,873**
Total Liabilities Not Covered by Budgetary Resources	**$474,133**
Total Liabilities Covered by Budgetary Resources	**$4,272,552**
TOTAL LIABILITIES	**$4,746,685**

Other Intragovernmental Liabilities primarily consist of unfunded FECA liabilities due to DOL and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

Federal Employee and Veteran Benefits consist of various employee actuarial liabilities not due and payable during the current fiscal year.

Refer to Note 9, "Federal Employee and Veteran Benefits," for additional information.

Other Non-Federal Liabilities includes annual leave, estimated legal contingent liabilities, and the disposal of excess structures that are not currently budgeted for but will become funded as future events occur.

Liabilities not Covered by Budgetary Resources require future congressional action whereas liabilities covered by budgetary resources reflect prior congressional action. Regardless of when the congressional action occurs, when the liabilities are liquidated, Treasury will finance the liquidation in the same way that it finances all other disbursements, using some combination of receipts, other inflows, and borrowing from the public (if there is a budget deficit).

Liabilities Covered by Budgetary Resources includes Accounts Payable amounts owed to federal and non-federal entities for goods and services received by the USN. The USN's systems do not track intragovernmental accounts payable transactions by customer. As a result, in the intragovernmental eliminations process, buyer-side accounts payable are adjusted to agree with inter/intra-agency seller-side accounts receivable. The USN's methodology for adjusting Accounts Payables consist of (1) reclassifying amounts between federal and non-federal Accounts Payable and (2) applying both supported and unsupported undistributed disbursements at the reporting entity level.

Refer to Note 1.R, "Undistributed Disbursements and Collections" for additional information.

NOTE 9. FEDERAL EMPLOYEE AND VETERAN BENEFITS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)			UNAUDITED 2021
	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits:			
FECA	$396,399	$ -	$396,399
Other	3,536	(3,536)	-
TOTAL FEDERAL EMPLOYEE AND VETERAN BENEFITS	**$399,935**	**$(3,536)**	**$396,399**

The DON WCF reports an actuarial liability for the FECA. The FECA provides federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation.

FECA amounts consist of amounts for federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. FECA is administered by the Office of Workers' Compensation Programs. The obligations and liabilities for pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

Other represents Medicare liabilities and FICA taxes payable.

Actuarial Cost Method Used and Assumptions

The USN's actuarial liability for workers' compensation benefits is developed by DOL and is provided to the USN only at the end of each fiscal year. The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims.

DOL calculates the future workers' compensation liability using wage inflation factors (e.g., COLAs) and medical inflation factors (e.g., CPIM). The actual rates for these factors for CBY 2021 were also used to adjust the methodology's historical payments to current year constant dollars.

To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Year over year changes in the liability were also examined, with any significant agency-level differences inspected in greater detail. DOL concluded that the model has been stable and has projected each agency's actual payments well.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the U.S. Department of the Treasury's Yield Curve for Treasury Nominal Coupon Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.23% was assumed for year one and years thereafter. An interest rate for medical benefits of 2.06% was assumed for year one and years thereafter.

NOTE 10. ENVIRONMENTAL AND DISPOSAL LIABILITIES

The USN transferred all real property assets from the DON WCF to the GF in FY 2021. As a result, the Other Environmental Liabilities for the real property assets, previously reported in the DON WCF, will be reported in the GF.

NOTE 11. OTHER LIABILITIES

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Intragovernmental:	
Advances from Others	$251,750
Liabilities for Non-entity assets	9,735
Other Liabilities	183,515
Total Intragovernmental	**$445,000**
Other than Intragovernmental/With the Public:	
Accrued Funded Payroll and Leave	$1,331,038
Advances from Others	812,293
Deposit Funds and Suspense Accounts	3,425
Contract Holdbacks	92,708
Contingent Liabilities	2,474
Other Liabilities	30,099
Total Other than Intragovernmental/With the Public	**$2,272,037**
TOTAL OTHER LIABILITIES	**$2,717,037**

Intragovernmental Liabilities:

Intragovernmental Advances from Others represent liabilities for collections received to cover future expenses or acquisition of assets.

Intragovernmental Liabilities for non-entity assets represent liabilities for collections reported as non-exchange revenues where the DON WCF is acting on behalf of another federal entity.

Intragovernmental Other Liabilities primarily consists of unemployment compensation liabilities.

Non-Federal Liabilities:

Non-Federal Accrued Funded Payroll and Leave represents the estimated liability for salaries and wages of civilians that have been earned but are unpaid and amounts of funded annual leave, sick leave, and other employee benefits that have been earned but unpaid.

Non-Federal Advances from Others represent liabilities for collections received from public to cover future reimbursable expenses.

Non-Federal Deposit Funds and Suspense Accounts represent advances or security deposits associated with closed orders in the process of being refunded to customers.

Non-Federal Contract Holdbacks consist of amounts withheld from payments to contractors to assure compliance with contract terms, usually expressed as a percentage in the respective contract provisions.

Non-Federal Contingent Liabilities include accrued contingent legal liabilities pertaining to pending legal cases where OGC consider an adverse decision probable and the amount of the loss measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Treasury Judgment Fund.

Non-Federal Other Liabilities are attributed to improperly record unfunded liability transactions in the field accounting system. The posting issues creating this condition have been documented to support identification and prioritization of corrective action.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Commitments:
Commitments are preliminary actions that will ultimately result in an obligation to the U.S. government if carried through, such as purchase requisitions, estimated travel orders, or unsigned contracts/grants. The DON WCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, the DON WCF does not have a systemic process by which it captures or assesses these potential contingent liabilities. Therefore, the amounts reported may not fairly present the DON WCFs contingent liabilities.

Legal Contingencies:
The DON WCF is a party in various administrative proceedings, legal actions, and claims for environmental damage, employment matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The OGC conducts reviews of litigation claims involving the DON WCF to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation. The OGC assesses the likelihood of an unfavorable outcome as follows: probable, reasonably possible, or remote.

Probable Likelihood of an Adverse Outcome:
As of September 30, 2021, the DON WCF has an estimated potential loss of $2.5 million is assessed as probable if adverse decisions are made against the DON WCF. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is probable that an adverse outcome will result. The potential loss is reported as part of the Other Liabilities on the Balance Sheet. For certain claims that are paid by Treasury's Judgment Fund, which the DON WCF does not have to reimburse, an Imputed Financing Source is recognized. However, agencies are required to reimburse the Judgment Fund for payments pursuant to the Contract Disputes Act and the Notification and Federal Employees Antidiscrimination and Retaliation Act of 2002.

Refer to Note 11, "Other Liabilities," for additional information.

Reasonably Possible Likelihood of an Adverse Outcome:

As of September 30, 2021, the DON WCF has an estimated potential loss of $8.8 million that is assessed as reasonably possible if adverse decisions are made against the DON WCF. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is reasonably possible that an adverse outcome will result.

NOTE 13. SUBORGANIZATION PROGRAM COSTS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021
Operations, Readiness, and Support	
Gross Costs	40,841,230
Less: Earned Revenues	(39,204,201)
Net Program Costs	**$1,637,029**
NET COST OF OPERATIONS	**$1,637,029**

The SNC represents the net cost of programs and organizations of the DON WCF. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The DON WCF's current processes and systems capture costs based on appropriations groups and not major programs in accordance with GPRA, due to system and business process limitations. The DON WCF is in the process of reviewing available data and developing a cost reporting methodology to comply with the standard.

Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by the DON WCF are recognized as imputed cost in the SNC and are offset by imputed revenue in the SCNP. Such imputed costs and revenues relate to business-type activities (if applicable), employee benefits, and claims to be settled by the Treasury Judgement Fund. However, unreimbursed costs of goods and services other than those identified above are not included in our financial statements.

NOTE 14. UNDELIVERED ORDERS AT THE END OF THE PERIOD

AS OF SEPTEMBER 30 ($ IN THOUSANDS)	UNAUDITED 2021	
	FEDERAL	NON-FEDERAL
Undelivered Orders, Unpaid	$1,790,562	$12,014,139
Undelivered Orders, Paid	60	603,335
TOTAL	**$1,790,622**	**$12,617,474**

The DON WCF financial accounting systems do not assign Federal and Non-Federal attributes to undelivered orders (UDOs), whether paid or unpaid. This footnote imputes the balances of Federal and Non-Federal paid and unpaid UDOs proportional to the Federal/Non-Federal share of Advances and Prepayments and Accounts Payable, respectively.

NOTE 15. Available Contract Authority

Contract authority represents authority that permits the DON WCF to incur obligations in advance of an appropriation, offsetting collections, or receipts to make outlays to liquidate the obligations. As of September 30, 2021, there is $39.3 billion in total budgetary resources including $8.3 billion in contract authority.

NOTE 16. EXPLANATION OF DIFFERENCES BETWEEN THE SBR AND THE BUDGET OF THE U.S. GOVERNMENT

The Statement of Budgetary Resources has been prepared to agree with the amounts shown in the Budget of the United States Government. The Budget of the United States Government containing the actual amounts for FY 2021 has not been published at the time these financial statements were prepared. The FY 2022 Budget of the United States Government with the actual FY 2020 amounts was released in April 2021. The FY 2023 Budget of the United States Government with the actual amounts for the current year (FY 2021) will be available at a later date on OMB website at https://www.whitehouse.gov/omb/budget/.

The table below presents the FY 2020 differences between the amounts reported in the FY 2020 SBR and the actual FY 2020 amounts reported in the FY 2022 Budget of the U.S. Government for SBR lines Total Budgetary Resources; New Obligations and Upward Adjustments; Outlays, Net; and Distributed Offsetting (Receipts)/Outlays, Net.

AS OF SEPTEMBER 30 ($ IN BILLIONS)	FISCAL YEAR 2020 ACTUAL			
	Total Budgetary Resources	New Obligations & Upward Adjustments (Total)	Distributed Offsetting Receipts	Net Agency Outlays
FY 2020 Combined Statement of Budgetary Resources	$38.7	$34.6	$ -	$0.8
Budget of the US Government	38.7	34.6	-	0.8
Difference	$ -	$ -	$ -	$ -

NOTE 17. INCIDENTAL CUSTODIAL COLLECTIONS

The DON WCF collected $1.0 million of incidental custodial revenues generated primarily from penalties, fines, and administrative fees. These funds are not available for use by the DON WCF. At the end of each fiscal year, the accounts are closed, and the balances rendered to the Treasury.

NOTE 18. RECONCILIATION OF NET COST TO NET OUTLAYS

AS OF SEPTEMBER 30 ($ IN THOUSANDS)			UNAUDITED 2021
	Intragovernmental	With the public	Total
Net Cost of Operations (SNC)	$(22,666,771)	$24,303,800	$1,637,029
Components of Net Cost That are Not Part of Net Outlays:			
Property, plant, and equipment depreciation	-	5,848	5,848
Increase/(decrease) in assets:			
Account Receivable	571,082	12,675	583,757
Other assets	(4,299)	259,761	255,462
(Increase)/decrease in liabilities:			
Accounts payable	(937,822)	(1,384,240)	(2,322,062)
Environmental and disposal liabilities	-	46,722	46,722
Federal employee and veteran benefits payable	-	(11,073)	(11,073)
Other Liabilities (Unfunded Leave, Unfunded FECA, Actuarial FECA)	61,877	(79,910)	(18,033)
Financing Sources:			
Imputed cost	(600,871)	-	(600,871)
TOTAL COMPONENTS OF NET COST THAT ARE NOT PART OF NET OUTLAYS	**$(910,033)**	**$(1,150,217)**	**$(2,060,250)**
Components of Net Outlays Not Part of Net Cost			
Inventories and related property	-	2,391,009	2,391,009
TOTAL COMPONENTS OF NET OUTLAYS THAT ARE NOT PART OF NET COST	**-**	**$2,391,009**	**$2,391,009**
Miscellaneous Reconciling Items			
Other	(1,086,561)	(506,657)	(1,593,218)
Total Other Reconciling Items	**$(1,086,561)**	**$(506,657)**	**$(1,593,218)**
Net Outlays	**$(24,663,365)**	**$25,037,935**	**$374,570**
Agency Outlays, Net, Statement of Budgetary Resources			**$(282,383)**
Reconciling Difference			**$656,953**

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position, so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis above illustrates this reconciliation by listing the key differences between net cost and net outlays.

Due to the budgetary and financial accounting information differences mentioned above and financial system limitations, there is a $657 million difference between net cost and net outlays. This difference is primarily attributable to variances within non-exchange attribute transactions.

NOTE 19. COVID-19 ACTIVITY

Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R 748-240 / Public Law 116-136) to respond to the COVID-19 outbreak and its impact on the economy, public health, state and local governments, individuals, and businesses. DON WCF subsequently received $475.0 million in funding (appropriated authority) related to the CARES Act beginning in Q2 FY 2020. As of Q4 FY 2021, the entire funding received from the CARES Act remains obligated.

The CARES Act supplemental received helped mitigate DON WCF low cash balances, lost revenue, and unbudgeted costs, such as cleaning, personal protective equipment and administrative leave for high risk personnel for health and safety reasons, related to the coronavirus. The funding received bolstered the DON WCF cash balance, without which, the DON WCF would have experienced an Anti-deficiency Act (ADA) violation.

COVID 19 SUMMARY ($ IN MILLIONS)

TAS - Description	Net Transfers	Paid Obligations
4930 - Defense Working Capital Fund – Navy	$475.0	$475.0
TOTAL	**$475.0**	**$475.0**

WORKING CAPITAL FUND

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND REQUIRED SUPPLEMENTARY INFORMATION

210421-N-UL352-1016

ARABIAN SEA (April 21, 2021) The guided-missile destroyer USS Laboon (DDG 58) conducts a replenishment-at-sea with the Military Sealift Command underway replenishment oiler USNS Arctic (T-AOE 8) in the Arabian Sea, April 21, 2021. Laboon is deployed with the Dwight D. Eisenhower Carrier Strike Group to the U.S. 5th Fleet area of responsibility and conducting naval operations to ensure maritime stability and security in the Central Region, connecting the Mediterranean and the Pacific through the western Indian Ocean and three strategic choke points. (U.S. Navy photo by Mass Communication Specialist Seaman Jeremy R. Boan)

This section provides the Required Supplementary Information to accompany the basic financial statements as prescribed by accounting standards.

Deferred Maintenance and Repair

The DON WCF real property deferred maintenance and repair information for the fiscal year ended September 30, 2021 is reported with the USN GF deferred maintenance and repair. Refer to USN GF Required Supplementary Information.

Disaggregated Statement of Budgetary Resources

The Combined Statement of Budgetary Resources combines the availability, status, and outlays of the DON WCF budgetary resources. The Statement of Disaggregated Budgetary Resources provides the Combined Statement of Budgetary Resources disaggregated by the DON WCF program for the fiscal year ended September 30, 2021.

US DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Statement of Disaggregated Budgetary Resources
For the Fiscal Year Ended September 30, 2021)

($ IN THOUSANDS)		UNAUDITED 2021
	Operations, Readiness & Support	Total
BUDGETARY RESOURCES:		
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$6,593,846	$6,593,846
Contract Authority (discretionary and mandatory)	8,297,518	8,297,518
Spending Authority from Offsetting Collections (discretionary and mandatory)	24,444,777	24,444,777
TOTAL BUDGETARY RESOURCES	**$39,336,141**	**$39,336,141**
STATUS OF BUDGETARY RESOURCES:		
New Obligations and Upward Adjustments (total)	$33,089,447	$33,089,447
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	6,233,008	6,233,008
Exempt from Apportionment, Unexpired Accounts	1,696	1,696
Unapportioned, Unexpired Accounts	11,990	11,990
Unexpired Unobligated Balance, End of Year	**$6,246,694**	**$6,246,694**
Unobligated Balance, End of Year (total)	**$6,246,694**	**$6,246,694**
TOTAL BUDGETARY RESOURCES	**$39,336,141**	**$39,336,141**
OUTLAYS, NET, AND DISBURSEMENTS, NET		
Outlays, Net (total) (discretionary and mandatory)	$(282,383)	$(282,383)
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$(282,383)**	**$(282,383)**

The accompanying notes are an integral part of these statements.

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WORKING CAPITAL FUND

OFFICE OF THE INSPECTOR GENERAL TRANSMITTAL LETTER

210424-N-GA608-1072
PACIFIC OCEAN (April 24, 2021) Sailors oversee the movement of an MV-22 Osprey, assigned to Marine Medium Tiltrotor Squadron 164 (Reinforced), 15th Marine Expeditionary Unit, aboard the amphibious assault ship USS Makin Island (LHD 8). The Makin Island Amphibious Ready Group and the 15th MEU are operating in the U.S. 7th Fleet area of operations as part of a scheduled deployment to the region. As the U.S. Navy's largest forward-deployed fleet, 7th Fleet routinely operates and interacts with 35 maritime nations while conducting missions to preserve and protect a free and open Indo-Pacific Region. (U.S. Navy photo by Mass Communication Specialist 3rd Class Aaron Sperle)

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 8, 2021

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/
CHIEF FINANCIAL OFFICER, DOD
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE NAVY

SUBJECT: Transmittal of the Independent Auditor's Report on the U.S. Department of the Navy Working Capital Fund Financial Statements and Related Notes for FY 2021 (Project No. D2021-D000FS-0047.000, Report No. DODIG-2022-024)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the U.S. Department of the Navy (DON) Working Capital Fund Financial Statements and related notes as of and for the fiscal year ended September 30, 2021. The contract required EY to provide a report on internal control over financial reporting and compliance with provisions of applicable laws and regulations, contracts, and grant agreements, and to report on whether the DON's Working Capital Fund financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996. The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018, Volume 1 (Updated, April 2020), Volume 2 (Updated, March 2021), and Volume 3 (Updated, September 2021). EY's Independent Auditor's Report is attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the DON Working Capital Fund Financial Statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the DON Working Capital Fund FY 2021 Financial Statements and related notes.

EY's separate report, "Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit the Financial Statements Performed in Accordance with Government Auditing Standards," discusses 11 material weaknesses related to the DON Working Capital Fund's internal controls over financial reporting.* Specifically, EY's report concluded that the DON did not design or implement effective internal controls to:

- produce reliable financial statements, accompanying notes, and related disclosures;
- reconcile and report Fund Balance With Treasury;
- substantiate the reported Inventory balances, including inventory held by third parties;
- record receipt, acceptance, maintenance, issuance, and disposal of Property, Plant, and Equipment – General Equipment Remainder;
- substantiate the reported Expense and Accounts Payable balances;
- substantiate the reported Revenue, Accounts Receivable, and Unfilled Customer Orders balances;
- substantiate the balances reported on the Statement of Budgetary Resources;
- address the five components of internal control—an effective control environment, risk assessment, control activities, information and communication, and monitoring activities;
- ensure only authorized users have access to financial management systems and users do not have incompatible functions within a system;
- verify only authorized applications and software programs are placed into production; and
- ensure timely, accurate, and complete processing of information between applications.

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* A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statements in a timely manner.

EY's additional report, "Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit the Financial Statements Performed in Accordance with Government Auditing Standards," discusses two instances of noncompliance with provisions of applicable laws and regulations, contracts, and grant agreements. Specifically, EY's report describes instances in which the DON Working Capital Fund's financial management systems did not comply with the Federal Financial Management Improvement Act of 1996, and the Federal Managers' Financial Integrity Act of 1982.

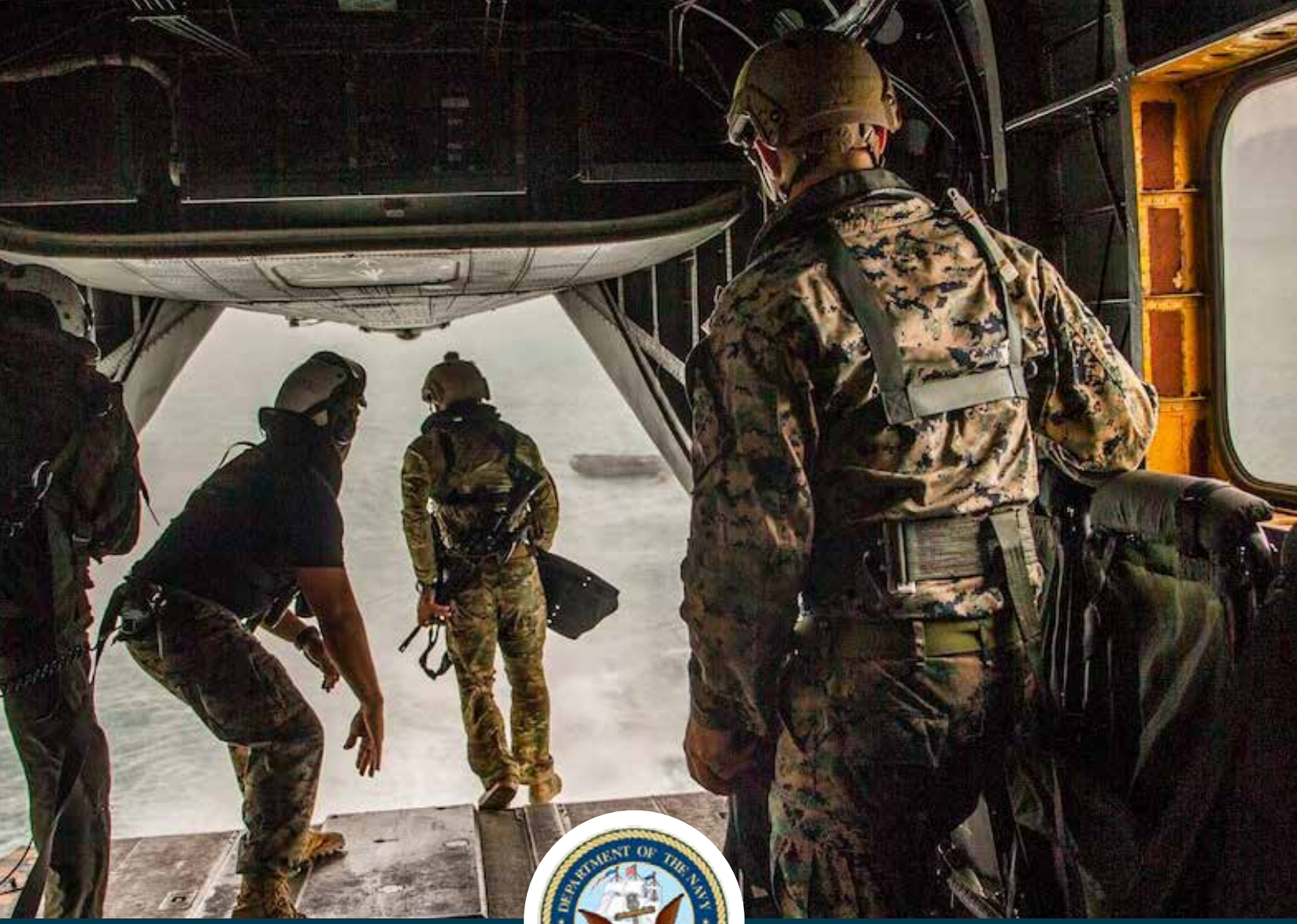
In connection with the contract, we reviewed EY's report and related documentation and discussed them with EY's representatives. Our review, as differentiated from an audit of the financial statements and related notes in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the DON Working Capital Fund FY 2021 Financial Statements and related notes. Furthermore, we do not express conclusions on the effectiveness of internal control over financial reporting, on whether the DON Working Capital Fund's financial systems substantially complied with Federal Financial Management Improvement Act of 1996 requirements, or on compliance with provisions of applicable laws and regulations, contracts, and grant agreements. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached November 8, 2021 report, and the conclusions expressed within the report.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

Lorin T. Venable

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting

Attachment:
As stated



WORKING CAPITAL FUND

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND INDEPENDENT AUDITORS' REPORT

210420-M-VH951-0413
MARINE CORPS BASE HAWAII (April 20, 2021) A U.S. Marine in the Recon Leaders Course jumps out of a CH-53 Sea Stallion helicopter during a helocast training event, Marine Corps Base Hawaii, April 20, 2021. The purpose of the training is to teach Marines how to insert into a body of water from an air asset. (U.S. Marine Corps photo by Lance Cpl. Brandon Aultman)

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Report of Independent Auditors

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Working Capital Fund of the United States Department of the Navy (DON), which comprise the consolidated balance sheet as of September 30, 2021, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended, and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

As described in Note 1, the DON has not implemented certain accounting standards for the Department of Defense and the Federal government. The effect on the financial statement amounts involved is not currently determinable by the DON and could be material.

Basis for Disclaimer of Opinion

The DON continues to have unresolved accounting issues and material weaknesses in internal controls that cause the DON to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on the DON's financial statements as of and for the year ended September 30, 2021.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis and Required Supplementary Information, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Other Information

We were engaged for the purpose of forming an opinion on the financial statements that collectively comprise the DON's financial statements. The Other Information, as listed in the Table of Contents, is presented for the purposes of additional analysis and is not a required part of the financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 8, 2021 on our consideration of the DON's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of those reports is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the DON's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the DON's internal control over financial reporting and compliance.

Ernst & Young LLP

November 8, 2021

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Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund (WCF) of the United States Department of the Navy (DON), which comprise the consolidated balance sheet as of September 30, 2021, the related consolidated statements of net cost and changes in net position, the combined statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2021. Our report disclaims an opinion on such financial statements because the DON was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered the DON's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DON's internal control. Accordingly, we do not express an opinion on the effectiveness of the DON's internal control. We did not consider all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to preparing performance information and ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below and in Appendix A as items I through XI to be material weaknesses.

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Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the DON's ability to produce reliable financial statements, accompanying notes, and related disclosures. The DON's management has not adequately designed financial reporting controls and inappropriately relies on the DON's financial reporting service provider to execute its responsibilities for the design, performance, and oversight of internal controls over financial reporting. The combination of these deficiencies results in a material weakness. The matters related to Financial Reporting are further described in Appendix A.

II. Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in the DON's accounts with the U.S. Treasury. Lack of policies, procedures, internal controls, and supporting documentation prevents the DON from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to FBwT are further described in Appendix A.

III. Inventory

Inventory is comprised of consumable spare parts, repair parts, and repairable items. Inadequate internal controls over the DON's Inventory process, including oversight of third parties, prevents the DON from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Inventory are further described in Appendix A.

IV. Property, Plant, & Equipment – General Equipment Remainder

General Equipment Remainder (GE-R) is primarily comprised of equipment used in research, development, and maintenance. The DON has failed to implement effective policies and procedures over GE-R and lacks adequate controls over the life cycle of recording GE-R (i.e., receipt, acceptance, maintenance, issuance, and disposal) within an approved system. This prevents the DON from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to GE-R are further described in Appendix A.

V. Expenses and Accounts Payable

Expenses are incurred and recognized when the DON obtains goods and services from the public or other Federal entities. Accounts Payable (AP) represents the amount owed to third parties by the DON for goods and services received. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the DON from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Expenses and AP are further described in Appendix A.

VI. Revenue, Accounts Receivable, and Unfilled Customer Orders

Revenue, Accounts Receivable (AR), and Unfilled Customer Orders includes amounts earned by the DON from the sale of goods and services provided to the Navy General Fund (GF), other

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Department of Defense (DoD) and federal agencies, and the public. The DON determines revenue through their stabilized billing rates, established by the individual Budget Submitting Offices (BSOs) and charged to their customers. The bill rates should recoup all amounts necessary to recover the full costs of providing the goods and services. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the DON from determining if bill rates are adequate and from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Revenue, AR, and Unfilled Customer Orders are further described in Appendix A.

VII. Budget Execution and Undelivered Orders

Budget Execution represents the use of appropriated funds from the time the funds are received through the outlay and reporting of those funds. Undelivered Orders (UDOs) represents the amount of goods and services ordered which have not been received. Lack of adequate policies, procedures, internal controls and related supporting documentation over the Budget Execution process, including the recognition and reporting of UDOs, prevents the DON from substantiating the reported balances on the Statement of Budgetary Resources and related notes. The combination of these deficiencies results in a material weakness. The matters related to Budget Execution and UDOs are further described in Appendix A.

VIII. Entity Level Controls – Oversight and Monitoring

FMFIA requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The DON has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA, leading to inadequate control environment, risk assessment and monitoring processes. The combination of these deficiencies results in a material weakness. The matters related to Entity Level Controls - Oversight and Monitoring are further described in Appendix A.

IX. Financial Information Systems – Access Controls/Segregation of Duties

Access Controls involve the protection of application boundaries, user identification and authentication, account management (authorization, periodic review of access, removal of access), protection of financially significant transactions and system resources, and the monitoring of security violations impacting financial reporting activities. Segregation of Duties (SoD) controls involve the identification and authorization of SoD conflicts, prevention of incompatible activities, and monitoring of users with conflicting access (when allowable). We identified access control and SoD related deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Access Controls and SoD are further described in Appendix A.

X. Financial Information Systems – Configuration Management

Configuration Management involves the identification and management of an information system at a given point and systematic control over changes to that configuration during the system's life cycle, from the initiation of a change request to the migration of a change to production, the protection of source code, the separation of access provisioned to developers and migrators, and the procedures for monitoring changes made to the production environment. We identified

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configuration management-related deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Configuration Management are further described in Appendix A.

XI. Financial Information Systems – Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Specifically, interface controls involve the process for validating the financially significant interfaces to be run, validating if the interface edit checks are working as intended, the timing of the interface processing, validating that data sent and received is reconciled, and how interface processing errors are identified and remediated in a timely manner. We identified deficiencies related to interface processing that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Interface Processing are further described in Appendix A.

Management's Response to Findings

The DON's response to the findings identified in our engagement to audit and relevant comments from the DON's management are provided in their accompanying letter dated November 8, 2021. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 8, 2021

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Appendix A – Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the DON's ability to produce reliable financial statements, accompanying notes, and related disclosures. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. According to the Government Accountability Office (GAO) Standards for Internal Control in the Federal Government (commonly referred to as the Green Book) issued under the authority of FMFIA, management is responsible for implementing and evaluating its internal control system, including internal controls to meet reporting objectives related to the preparation of reports for use by the entity, its stakeholders, or other external parties. In addition, according to the GAO Green Book, management may engage third parties to perform certain operational processes for the entity; however, management retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by third parties. Despite these requirements, management has not adequately designed financial reporting controls and inappropriately relies on its service provider to execute the DON's responsibilities for the design, performance, and oversight of internal controls over financial reporting. These control weaknesses, as detailed below, can lead to misstatements on the DON's financial statements:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the financial reporting process are not accurately or completely documented.
2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.** As noted below, the DON lacks adequate oversight over financial reporting processes executed across the organization:

   Financial Reporting Process

   - The DON does not have adequately documented policies and procedures, including internal controls, to properly reconcile their general ledgers to trial balances (TB) submitted to the DON's financial reporting service provider, the Defense Finance and Accounting Service (DFAS), including defining the role of Assistant Secretary of the Navy (ASN) Financial Management and Comptroller (FM&C) and the Budget Submitting Offices (BSOs) in that process. In addition, Navy Enterprise Resource Planning (ERP) does not have system controls in place to prevent Journal Vouchers (JVs) that have not been reviewed and approved from being posted directly into Navy ERP. The DON does not have appropriate controls to track the JVs recorded each month to ensure they are properly reviewed and monitored or approved by ASN FM&C. This has led to recording JVs that are incomplete, inaccurate, or non-compliant with Treasury Financial Manual (TFM) requirements.
   - DON lacks appropriate monitoring controls over the financial reporting process. Specifically, the DON's controls are not designed effectively, and are missing comprehensive reviews over journal vouchers, the financial statements, accompanying

footnotes, and related disclosures. In addition, FMO lacks appropriate controls over general ledger reconciliations.

- The DON lacks the proper controls, capabilities, and knowledge to ensure a comprehensive, critical review is performed on the financial statements as a whole. Specifically, when significant changes are made to the financial statements, the DON does not appropriately consider the potential downstream impact to other accounts when making individual adjustments. In Q4, the DON WCF transferred Real Property (RP) assets to the Navy GF and USMC GF, but did not remove the environmental liabilities associated with those assets. This resulted in a material misstatement on the financial statements that needed to be adjusted outside the financial reporting process.

3. **Lack of Oversight of Financial Reporting Service Provider.** The DON lacks appropriate oversight of DFAS related to the execution of financial reporting controls. Specifically, we noted the following control weaknesses:

Journal Vouchers

- DON does not have adequately designed controls over manual and system generated JVs initiated and recorded by DFAS. Specifically, the review process for JVs is not comprehensive and fails to include attributes such as completeness, compliance with the TFM, and the review of the supporting documentation prior to recordation by DFAS.

Trading Partner Eliminations

- On behalf of the DON, DFAS records trading partner eliminations that are not supported by transaction details, and therefore are not compliant with accounting standards. The DON's unsupported trading partner eliminations impact all of the DON's financial statements. The total amount of trading partner eliminations recorded in FY21 Q4 was $9.8 billion.

Data Processing

- Management relies on DFAS to process financial information through the Defense Departmental Reporting System-Budgetary (DDRS-B) and the Defense Departmental Reporting System-Audited Financial Statements (DDRS-AFS), but has not designed sufficient policies and procedures to reconcile its general ledger information against DDRS-B and DDRS-AFS to include verification of the completeness, accuracy, and validity of the trial balances.

Complementary User Entity Controls (CUECs)

- Complementary User Entity Controls (CUECs) are controls that users of the service organization (i.e., the DON) should have in place to supplement the service organization's (e.g., DFAS) internal controls. Management has not appropriately designed or implemented CUECs, and therefore, is unable to ensure that controls executed by the service organizations achieve their intended outcome.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.** The DON lacks adequate financial reporting controls to ensure compliance with applicable accounting standards and regulatory reporting requirements as follows:

   Federal Accounting Standards Advisory Board (FASAB) Standards

   - As described in Note 1B, *Basis for Accounting and Presentation*, the DON is not in compliance with accounting standards established by FASAB. In addition, management lacks policies and procedures over reporting for leases in accordance with accounting standards.

   Office of Management and Budget (OMB) Circular A-136

   - The Agency Financial Report is not in compliance with financial reporting requirements for form and content which includes its financial statements and disclosures as established within OMB Circular A-136, *Financial Reporting Requirements*. For example, activities are not classified appropriately within Note 18, *Reconciliation of Net Cost to Net Outlays*, which reconciles budgetary to proprietary transactions. In addition, Note 18 includes a $657 million budgetary to proprietary difference that was not researched and reconciled in a timely manner.

   Treasury United States Standard General Ledger (USSGL)

   - The DON is not in compliance with Treasury's USSGL at the transaction level as required by the Federal Financial Management Improvement Act of 1996. Examples of significant processes that are not recorded in compliance with the USSGL include: Financial Reporting, Revenue, Accounts Receivable, and Unfilled Customer Orders. In addition, per guidance from the Office of the Secretary of Defense (OSD), the DON is not properly recording adjustments for corrections of an error versus changes in accounting principle.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls**.

   - Complete a Process Cycle Memorandum (PCM) that documents the end-to-end process for the entire life cycle of Financial Reporting, including the initiation, recording, processing, and reporting of financial statement data.
   - The PCM should include all key controls, assertions, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all applicable systems and system generated reports used for the Financial Reporting process.
   - All process owners should review and sign off on the updated PCM to validate that the PCM is complete and accurate.

2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.**

Financial Reporting Process

- Design and implement policies and procedures governing the assessment and documentation of variances identified during the monthly TB reconciliation process which includes, but is not limited to, who is responsible for the reconciliation, variance investigation threshold and protocols for timely investigation of variances.
- Design and implement policies and procedures for retention of documentation related to TB reviews and reconciliations.
- Develop a system control to prevent unapproved JVs from being posted.
- Document policies and procedures arising from the development of a new system control, including the monitoring of users with access to oversee the control.
- Perform an analysis over any remaining BSO JVs to identify and correct instances where JVs do not comply with TFM posting logic.
- Design and implement sufficient policies and procedures to ensure any remaining field level JV logs are complete and accurate and reviewed in a timely manner.
- Develop and implement a methodology that allows for complete and accurate disclosure of financial statement footnotes including the values presented in the footnotes, relationships between presented accounts, and all variances and reconciling items.
- Design sufficient controls to ensure the completeness and accuracy of the data used in TB reconciliations.
- Implement and document controls to verify the completeness and accuracy of reports received from DFAS, prior to using them to perform analysis and as JV support.
- Periodically (at least annually) evaluate and update Standard Operating Procedures to ensure that the procedures described are the procedures performed.
- Periodically (quarterly) update Delegations of Authority to reflect personnel changes.
- Implement procedures to remediate system limitations and tie-points causing reconciliation variances.
- Design and implement review controls to ensure that, when making a significant adjustment to a single account, the potential downstream impact to other accounts is evaluated for compliance with applicable accounting standards.

3. **Lack of Oversight of Financial Reporting Service Provider.**

Journal Vouchers

- Develop policies and procedures for performing a qualitative review and approval of JVs within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and the potential impact on the financial statements.

- Develop more comprehensive policies and procedures for quantitative review and approval requirements within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and potential impact on the financial statements.
- Do not permit DFAS to support JVs with only detail obtained from DDRS-B and DDRS-AFS. Transactional-level support should be provided by the DON.
- Instruct DFAS to only post JVs which they are able to support by inspecting transaction detail.
- Record JVs to the appropriate USSGL accounts that are consistent with the business rationale for the transaction.
- Develop and implement control procedures to review DDRS-B system generated JVs at a more precise level of aggregation so that the procedures performed provide comfort over system generated entries.

Trading Partner Eliminations

- In conjunction with DFAS, coordinate with OSD to address the trading partner eliminations issue at the department level and develop next steps towards remediation, such as updating the DoD Financial Management Regulation (FMR).
- Implement document-level reconciliations with the DON's trading partners and develop a process for resolving differences at the document level.

Data Processing

- Instruct DFAS to document policies and procedures governing the performance, documentation, and assessment of management review controls performed by DFAS on the DON's behalf.
- Enhance management review and analysis procedures to ensure completeness, validity, and accuracy of the information reported to DFAS and subsequently processed by DFAS through the transaction universe reconciliation.
- Implement procedures to remediate system limitations and tie-points causing reconciliation variances.
- Design and implement procedures to research and explain unsupported trial balance amounts, including resolution procedures, as needed.
- Design and/or enhance controls surrounding the preparation, recordation and review of general ledger transactions to ensure that balances posted after the established chalk line are accurate and appropriately supported.

Complementary User Entity Controls

- Evaluate the current System and Organization Controls (SOC) reports and CUECs to determine if they are appropriate to cover the end-to-end business processes.

- Design and implement internal controls that address the CUECs identified in the DFAS SOC 1 reports.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.**
   - Develop and implement policies and procedures that ensure compliance with the applicable accounting authoritative standards.
   - Coordinate with OSD to develop and implement USSGL-compliant guidance for recording adjustments for corrections of an error versus changes in accounting principle.

II. Fund Balance with Treasury

FBwT represents the aggregate amount of funds in the DON's accounts with the U.S. Treasury. Reconciliation of agencies' FBwT general ledger accounts to the balances held at Treasury is a key internal control process which ensures the accuracy of the agencies', as well as the government-wide, receipt and disbursement data. TFM Chapter 5100, Section 5125 requires agencies to implement an effective and efficient reconciliation process and perform timely reconciliations. Lack of adequate controls over the FBwT process, including reconciliations, can lead to misstatements to the financial statements as well as reports used by management to control the use of its funds. Inadequate procedures, including oversight, over the FBwT process have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of FBwT Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the FBwT process are not accurately or completely documented. This includes roles, responsibilities, processes, and transactions executed at each of its disbursing stations and the process of reconciling to the U.S. Treasury.
2. **Lack of Effectively Designed or Implemented Controls in the FBwT Process.** Controls are not designed adequately to ensure suspense, unmatched and interfund transactions are recorded timely and appropriately.
3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.** The DON's FBwT reconciliation is not adequately designed. The reconciliation does not produce a complete population of transactions impacting collections and disbursements. In addition, the DON does not perform sufficient research and resolution of variances identified during the reconciliation prior to the recording of JVs to agree the DON's books to Treasury's reported balance.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of FBwT Policies and Procedures, including Controls.**
   - Finalize a PCM that documents the end-to-end process for the entire life cycle of FBwT, including initiating, recording, processing, and reporting of cash transactions, and reconciliations.
   - The PCM should include all key controls, assertions, process owners, data interfaces, and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system generated reports used for the FBwT process.
   - Require all process owners to review and sign off on the updated PCM to validate that the PCM is complete and accurate.
2. **Lack of Effectively Designed or Implemented Controls in the FBwT Process.**
   - Implement control procedures to require timely research and resolution of variances within 60 business days of transaction date.
   - Implement control procedures to monitor compliance and accountability of those responsible for resolving variances.
3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.**
   - Ensure disbursements and collections are accurately recorded in the general ledger system and financially reported from the general ledger system.
   - Implement a single reconciliation tool that supports the DON's initiative to utilize Treasury Direct Disbursing from the general ledger systems.
   - Identify the necessary data attributes to identify transactions recorded in suspense specific to the DON and develop an estimate using relevant, sufficient, and reliable information to record the DON's suspense account balances on the DON's financial statements.

III. Inventory

WCF Supply Management – Inventory is comprised of consumable spare parts, repair parts, and repairable items. As of September 30, 2021, inventory is located across over 2,300 plants within and outside of the United States and is comprised of approximately 950,000 unique items – identified through National Item Identification Numbers (NIINs). The Naval Supply Systems Command (NAVSUP) provides program and inventory management for inventory and is the only entity that has financial reporting responsibility for inventory. Inventory is held at DON-managed ashore and afloat sites, Marine Corps Logistic Command (LOGCOM) sites, and third-party managed sites operated by other defense agencies such as the Defense Logistics Agency (DLA), Army, Air Force, and commercial contractors. The DON reports the status of inventory using Navy ERP, which is the system of record for NAVSUP inventory. Until Q2, LOGCOM reported the

status of the DON inventory held in its warehouses using the Stock Control System (SCS). As of September 30, 2021, LOGCOM has not completed its transition from SCS to Navy ERP and is not reporting updated inventory balances. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability for all assets for which the agency is responsible.

Due to the significance of inventory, both operationally and financially, a robust control environment is essential. Lack of adequate controls over the inventory process can lead to misstatements in the financial statements and an inability to produce accurate information and data to effectively manage the inventory process. Inadequate controls, including oversight over the DON inventory process, have led to the following internal control deficiencies:

1. **Lack of Inventory Policies and Procedures, including Controls.** The DON failed to effectively design and document policies, procedures, and controls over inventory transactions:

   Process Cycle Memorandum

   - The end-to-end processes, procedures, and key controls for significant portions of the inventory process are not completely documented. Specifically, the DON failed to document the processes related to inventory managed by LOGCOM, the reclamation of assets from stricken aircraft, processes and procedures related to inventory Held in Reserve for Future Sale, and the condition and associated valuation of inventory Due-In From Maintenance (DIFM).

   NAVSUP Oversight

   - NAVSUP failed to design remediation procedures to research and resolve inventory discrepancies. As of FY21 Q2, NAVSUP wall-to-wall reporting at a specific contractor plant stated 100% accuracy; however, EY observed errors dating back to FY20 that had not been identified or corrected.
   - NAVSUP failed to design sufficient policies and procedures, including oversight controls, related to the accountability of the DON's inventory at both organic and contractor sites. For example, five BSOs (Naval Air Systems Command, Naval Sea Systems Command, NAVSUP, Naval Information Warfare Systems Command, and Strategic Systems Program) asserted that a 100% completed wall-to-wall had been performed as of FY21 Q2; however, not all sites had performed the control. The FY21 Q2 NAVSUP Inventory Accountability Scorecard identified 12 of the 134 baseline organic plants associated to these BSOs as not completing FY21 wall-to-wall procedures.

   Inventory Held by Third Parties

   - The DoD FMR Volume 4, Chapter 4, section 040406 requires that all inventory is counted at least annually, either in a full physical count or through cycle counts to validate perpetual inventory accuracy. The DON failed to develop sufficient annual physical count procedures for inventory held by third parties.

Financial Reporting of Inventory and Accounting Standards

- The DON failed to design policies, procedures, and controls to ensure that inventory balances are appropriately reconciled between the systems and the TB for both NAVSUP and LOGCOM managed inventory. This results in unsupported JVs to agree system balances to the financial statement balance as of September 30, 2021.
- DON failed to design adequate policies and implement sufficient monitoring for the LOGCOM accountable property system of record transition from SCS to Navy ERP. This resulted in stagnant balances reported for Q3 and inaccurate balances reported for Q4. At Q2 FY21, LOGCOM reported approximately $560 million in WCF Inventory.
- The DON failed to design policies, procedures, and controls to effectively implement accounting standards, causing inaccurate presentation of inventory on the balance sheet and in the related footnote disclosure. Specifically:
  - Inventory has not been valued in accordance with FASAB Statement of Federal Financial Accounting Standards (SFFAS) 3 or SFFAS 48.
  - Inventory allowances are not accurate or supported.
  - Excess, obsolete, and unserviceable (EOU) inventory valuation is inaccurate and unsupported.
  - Inventory balances reported under certain condition codes, including suspense codes, are not supported.

2. **Inadequate Inventory Policies and Procedures, including Controls.** Given the control weaknesses noted below, the DON is unable to substantiate the existence, completeness, and condition of its inventory:

Afloat Inventory Physical Counts

- NAVSUP failed to design adequate policies and procedures, including internal controls, to properly document, approve, and record gain/loss transactions resulting from physical inventory counts.
- NAVSUP failed to design adequate policies and procedures, including internal controls, to properly document and approve quarterly inventory counts.

Virtual Plants

- NAVSUP failed to design adequate policies and procedures to ensure inventory transactions reported in virtual plants are appropriate. Virtual plants were created to enable reporting at locations that do not maintain transactions in a feeder system. These transactions should be temporary and should always net to zero. However, due to inadequate processing and oversight, virtual plants erroneously reflect inventory balances at year-end and NAVSUP failed to research and resolve the discrepancies in a timely manner.

Deployed, Sub-custody, or Sub-vendor Assets

- NAVSUP failed to design adequate policies and procedures to ensure that inventory movements for assets in deployed pack-up kits (PUKs) and in sub-custody are recorded in an accurate and timely manner.
- NAVSUP failed to design adequate policies and procedures to ensure that inventory held for repair by sub-vendors is accurately reported by commercial vendors. For example, some items tracked at sub-vendor Fleet Readiness Center East were scrapped over a year prior to EY testing or had already been shipped back to the commercial plant and may have been lost in transit. None of these movements were recorded in the feeder system, thus Navy ERP was also misstated.

3. **Lack of Implementation of Inventory Policies and Procedures, including Controls.** The DON failed to effectively implement controls over inventory transactions. As a result, the DON's inventory records are not complete, accurate, or reliable:

Receipt and Issuance

- NAVSUP failed to implement controls over inventory receipts and issuances to ensure that transactions are recorded in an accurate and timely manner in the inventory feeder systems and Navy ERP. During count procedures, we identified existence and completeness exceptions in 99 sampled NIINs at 24 of 31 sites.

Asset Condition

- NAVSUP failed to implement controls consistently to ensure that asset condition codes assigned to inventory items in the warehouses agree to the condition codes recorded in Navy ERP. Incorrect condition codes not only result in the misstatement of the item values on the financial statements, but also prevent the DON from knowing the correct quantity of ready for issue items available to support operations. During count procedures, we identified condition code exceptions in 48 sampled NIINs at 14 of 31 sites.

Stock in Transit (SIT)

- NAVSUP failed to implement policies and procedures to substantiate inventory items that were recorded as SIT. Specifically, during our testing we noted in-transit items that were recorded in the receiving plant's on hand quantity, but not removed from the plant's open SIT, resulting in the duplicate recording of assets.
- NAVSUP failed to monitor SIT to ensure it is cleared in a timely manner. For example, SIT posted in June 2021 from a virtual plant to a ship in overhaul was not reviewed and corrected by NAVSUP until EY testing in September 2021.

Inventory Held by DLA

- NAVSUP failed to implement a reconciliation of DLA's Distribution Standard System (DSS) and Navy ERP, including root cause analyses of differences identified through the interface, to ascertain the completeness and accuracy of the inventory transactions in Navy

ERP. As of FY21 Q4, NAVSUP records an unsupported JV in Navy ERP to match the unreconciled balance in DSS.

Recommendations

Consider the following corrective actions related to the conditions identified above:

1. **Lack of Inventory Policies and Procedures, including Controls.**

Process Cycle Memorandum

- Document the end-to-end process for the entire life cycle of the Inventory process, including: receiving, distributing, recording, processing and reporting of inventory at all warehouses, including LOGCOM; policies and procedures over the process of reclamation of assets from stricken aircraft; policies and procedures to ensure appropriate reporting of inventory Held in Reserve for Future Sale; and processes and key controls related to the accurate condition and associated valuation of DIFM inventory.

NAVSUP Oversight

- NAVSUP should develop policies and procedures to include timelines for resolution of physical inventory count discrepancies.
- NAVSUP should develop detailed monitoring procedures to ensure that discrepancies and known errors identified during oversight testing are timely corrected.
- NAVSUP should design and implement a management review program in which the DON can monitor the operational activities of the various warehouses to ensure they are in compliance with the DON's inventory policies and procedures such as the NAVSUP Publication 723 (P-723) on the Navy Inventory Integrity Procedures.
- NAVSUP should design and consistently implement inventory count policies and procedures that ensure inventory at organic sites and DON inventory held by commercial contractors is counted at least once annually.

Inventory Held by Third Parties

- NAVSUP should design and implement a management review program in which they monitor the operational activities of the various contractor managed warehouses to ensure the following:
  - Develop inventory count processes for contractor managed warehouses that include a requirement in the agreements between NAVSUP and contractors whereby quantities in the inventory system are supported via physical counts at least once a year either through a wall-to-wall year-end count or adequately designed cycle counts.

Financial Reporting of Inventory and Accounting Standards

- Design policies and procedures to validate the completeness and accuracy of inventory transactions recorded by NAVSUP and LOGCOM to include the following:

  - Implement policies, procedures, and controls to research and resolve identified variances in a timely manner. This should include establishment of a threshold over which the balances will be investigated and corrected for both BSOs.
  - Implement management review controls to ensure adjusting JVs are properly supported and executed, for the accurate amount(s), and in accordance with generally accepted accounting principles (GAAP).
- Prior to implementing and applying the valuation methodologies set forth by SFFAS 3 and SFFAS 48, the DON should:
  - Decide what alternative valuation method to use for establishing opening balances. Valuation methodologies used should be based on the best available information to arrive at an alternate value.
  - Outline documentation detailing the implementation plan for SFFAS 48, which provides a description of the process, as well as the proposed application of SFFAS 48.
  - Implement policies and procedures to value inventory that comply with SFFAS 3 on a go forward basis.
  - Ensure management reviews the implementation methodology to ensure correct application of GAAP.
  - Ensure the DON maintains evidential matter (e.g., policies and procedures) which documents steps taken to ensure consistent application of the selected methodology.
- Develop and implement comprehensive policies and procedures for appropriate use of the Inventory – Allowance account to include the following:
  - Discontinue use of the Allowance account to correct unresolved unreconciled balances.
  - Develop and implement procedures that require periodic performance of causative research to ensure timely resolution of unresolved unreconciled balances.
  - Develop and implement management review controls to ensure that the Inventory - Allowance balance is complete and accurate.
- Develop and implement comprehensive policies and procedures to support the valuation and footnote presentation of EOU inventory:
  - Design and implement controls, policies and procedures to ensure the accurate recording of condition codes for EOU inventory.
  - Design and implement controls, policies and procedures to ensure EOU inventory is valued in accordance with accounting policy.
  - Design and implement management review controls to ensure compliance with policies, procedures, and internal controls.
- Update current policies and procedures for temporary condition codes and consistently implement supply condition codes based on DON policy:

- Develop and implement monitoring procedures for all condition codes to determine whether the field is using the condition codes as defined.
- If condition code definitions need to be updated, work with OSD to ensure that all authoritative policies align.
- Establish expectations for the use of temporary condition codes and design and implement reviews to ensure compliance with the expected timeframes.

2. **Inadequate Inventory Policies and Procedures, including Controls**

Afloat Inventory Physical Counts

- NAVSUP should design consistent policies and procedures to include required documentation and levels of approval for quarterly inventory counts and gain by inventory and loss by inventory transactions.
- NAVSUP should develop and implement oversight procedures to ensure that controls are effectively implemented as designed across the DON.
- NAVSUP should evaluate whether similar actions are needed for ashore and contractor-held inventory.

Virtual Plants

- NAVSUP should design and implement policies, procedures and controls to ensure that the inventory transactions recorded in virtual plants are researched and cleared timely and recorded appropriately.

Deployed, Sub-custody, or Sub-vendor Assets

- NAVSUP should develop and implement policies and procedures to timely capture movement of inventory not physically in custody of the reporting plant.
- NAVSUP should develop and implement documentation requirements to ensure that deployed or sub-custody assets are supported.
- NAVSUP should consider implementing additional plant codes so that the reporting of assets is performed by the physical custodian.
- NAVSUP should identify and analyze how many DON assets are not physically in the custody of known commercial vendors.
- NAVSUP should evaluate whether additional policies need to be implemented or existing contract language needs to be updated to ensure proper accountability of all DON assets, regardless of physical location or custodian.

3. **Lack of Implementation of Inventory Policies and Procedures, including Controls**

Receipt and Issuance

- NAVSUP should develop and implement comprehensive policies and procedures to substantiate existence and completeness to include the following:

- Implement policies, procedures, and controls to record inventory transactions and events in both the inventory feeder systems and Navy ERP in a timely manner.
- Design policies, processes and controls to appropriately account for carcass items.
- Design and implement monitoring and oversight procedures to ensure that plants adhere to the controls documented in the P-723 and Internal Control Aids.

Asset Condition

- NAVSUP should design and implement internal control procedures to ensure that the accurate condition codes are assigned to the appropriate classes of inventory recorded in the ERP general ledger system and recorded on the inventory labels at the warehouse.

Stock in Transit

- NAVSUP should develop and implement comprehensive policies and procedures to substantiate existence of SIT to include the following:
  - Design and implement policies, procedures, and controls to ensure receipt of assets is properly recorded so that SIT items are removed from SIT when received.
  - Design and implement policies, procedures, and controls to ensure that documentation supporting the existence of open in transit items is properly created, utilized, and retained.
  - Design and implement policies, procedures, and controls to research and resolve open SIT records in a timely manner.
  - Design and implement a management review control to validate the SIT receipt and monitoring functions are properly implemented and operating effectively.
  - Perform an analysis at year end to identify known SIT exceptions and quantify the impact to the inventory balance to determine if an adjustment should be recorded.

Inventory Held by DLA

- NAVSUP should design policies and procedures to validate the completeness and accuracy of inventory transactions recorded by DLA to include the following:
  - Implement a reconciliation process between Navy ERP and DLA's DSS to include analysis of differences identified during the process.
  - Configure the system interface between feeder systems including DLA's DSS and Navy ERP to correctly post all movement types within the period to the appropriate general ledger accounts, including the following:
    - Develop an unreconciled balance report that reflects the entire population of unreconciled balances.

- Design and implement policies, procedures, and controls to research and resolve the unreconciled balances in a timely manner. This should include procedures to determine which balances will be investigated and corrected.
- Implement management review controls to monitor and approve the status of the unreconciled balances on a periodic basis as well as the maintenance of evidential matter to support the management review process of the unreconciled balances.

IV. Property, Plant, & Equipment – General Equipment Remainder

GE-R is primarily comprised of equipment used in research, development, and maintenance activities. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability of property and other assets. The DON has not implemented effective policies and procedures over GE-R and lacks adequate controls over the life cycle of recording GE-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) leading to inaccuracies within its systems and financial statements. Specifically, inadequate procedures, including oversight over the GE-R process, have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of GE-R Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the GE-R process are not accurately or completely documented, including the flow of data through applicable information systems from the initiation of a transaction to reporting in the financial statements, the key stakeholders within the process, and the flow of data between stakeholders.
2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.** The DoD FMR, Volume 4, Chapter 25, Section 250303, requires independent verification of the accuracy of equipment records through periodic physical counts of general equipment. The counts must also include reconciling the property systems and other systems with the general ledger accounts. Physical count procedures are not designed or operating effectively. Specifically, the DON has not corrected previously identified conditions such as errors in the asset listing related to inadequate asset location codes, lack of asset disposal recognition, and lack of recording of existing equipment. Discrepancies identified during physical counts are not resolved within timelines established in the DON's policy (30 days) and that policy is not in accordance with DoD instructions for resolution of discrepancies which requires resolution within 7 days. As a result, the GE-R balance is misstated in the financial statements and notes.
3. **Lack of Policies and Procedures, Including Internal Controls to Effectively Implement Accounting Standards.** There is a lack of policies and procedures, including internal controls in place to implement accounting standards, causing inaccurate presentation of GE-R on the balance sheet and in the related footnote disclosure. Specifically, implementation of the provisions of SFFAS 50 to establish opening balances and SFFAS 6 to value assets on a go forward basis have not been completed or fully developed.
4. **Inadequate Controls over Financial Reporting of GE-R.** Controls have not been implemented to report GE-R transactions in a timely manner. A population of GE-R, that

reconciles to the financial records, is unavailable and variances are not investigated and resolved prior to preparing the financial statements and notes.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

1. **Lack of or Inadequate Documentation of GE-R Policies and Procedures, including Controls.**
   - Complete the documentation of the end-to-end process for the entire life cycle of GE-R, including initiating, recording, processing and reporting of GE-R transactions, applicable risks, and key controls that address those risks.
   - Process documentation should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems, and system-generated reports used for the GE-R process.
2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.**
   - Establish and implement internal controls to ensure location discrepancies are investigated upon discovery and that the location entered in the system is the physical location of the asset, rather than the primary location of the owning activity.
   - Perform timely updates of all required data elements including location, condition, and other necessary elements.
   - Implement policies and procedures to record asset transfers, dispositions and losses in a timely manner.
   - Establish policies and procedures and implement an annual physical inventory of assets, to include verification of property existence, data accuracy and completeness, and require updates of specific information about the asset, such as custodian name and physical location.
   - Reconcile the results to the system of record and make all relevant updates following the performance of physical inventory procedures.
   - Complete system adjustments within a timely manner when assets are found or lost in between physical inventory periods.
   - Establish and implement internal controls to validate that the complete population of capital GE-R is accurately recorded and presented in the financial statements and to detect any capital GE-R that is not recorded in the financial statements.
3. **Lack of Policies and Procedures, Including Internal Controls to Effectively Implement Accounting Standards.**
   - Design policies and procedures to value the DON's GE-R in accordance with SFFAS 50 and SFFAS 6.

- Document a detailed implementation plan for SFFAS 50 and SFFAS 6, which includes a detailed description of the process, as well as the proposed application of SFFAS 50 and SFFAS 6.
- Exercise oversight and perform reviews of valuation calculations for all asset types to ensure accuracy and compliance with federal accounting standards.

4. **Inadequate Controls over Financial Reporting of GE-R.**

- Establish and implement internal controls to ensure that all reportable GE-R assets are included in the Property, Plant and Equipment balance and the related footnote.
- Consolidate all GE-R into a single system of record for both accountability and financial reporting.
- Require that each BSO submit accurate and complete asset populations in a timely manner.
- Implement policies and procedures to require that variances identified are investigated and resolved prior to preparation and reporting of the financial statements and related footnotes.

V. Expenses and Accounts Payable

AP represents the amount owed to third parties by the DON for goods and services received. Expenses includes all costs that are incurred but not capitalized on the balance sheet. Expenses and AP include key subprocesses from the procure to pay (P2P) business processes, including Contract Vendor Pay (CVP), Military Standard Requisitioning and Issue Procedures (MILSTRIP), Transportation of People (TOP), Transportation of Things (TOT), and Reimbursable Work Orders – Grantor (RWO-G). In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenses applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The DON's current policies, procedures, and key controls over its end-to-end expense and AP processes do not address financial reporting risks, leading to misstatements in amounts reported within the financial statements. Specifically, we noted the following issues during our testing:

1. **Lack of Effectively Designed Controls in the Expense and AP Process.** Controls over the expenses and AP process are not properly designed as detailed below:

   Posting of Expenses and AP

   - There is a lack of controls to ensure that expenses and AP are posted timely or at the appropriate amount, or to ensure that they are adjusted upward or downward when needed, in both Navy ERP and legacy systems. Specifically, expenses and AP were not posted in a timely manner for the CVP, MILSTRIP, TOP, and TOT processes.

Receipt and Acceptance

- There is a lack of sufficient controls to ensure that goods and services are reviewed, received and accepted prior to payment in both Navy ERP and legacy systems. Specifically, the DON was unable to provide receipt and acceptance support for CVP, RWO-G, and TOT transactions.

2. **Lack of Sufficient AP Control Environment.** The DON is unable to record AP intragovernmental transactions in an accurate, complete, and timely manner. In addition, the DON lacks consistent procedures to monitor outstanding AP. Further, an entity-wide process has not been implemented to calculate an AP accrual for goods and services received prior to receiving an invoice.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of Effectively Designed Controls in the Expense and AP Process.**
   - Assess the system interfaces to determine whether expenses and payables are able to post automatically and develop or fix those interfaces as appropriate.
   - Post payables manually that cannot be posted via interface timely.
   - Identify the unsupported transactions and determine whether an adjustment is necessary to accurately state the AP and budgetary balances in accordance with the timeline provided by the PCM:
     - Develop and implement procedures to ensure transactions are posted accurately and timely.
     - Develop and implement document retention policies for receipt and acceptance procedures.
   - Implement additional monitoring of when the receipt of an order is received to when the receipt is uploaded into the general ledger system to ensure timely recording of the expense and payable:
     - Enhance review over three-way match controls.
2. **Lack of Sufficient AP Control Environment.**
   - Increase leadership communication across commands to ensure that controls are executed consistently.
   - Document policies and procedures to implement an in-depth process to estimate accrued AP and establish monitoring procedures over the AP estimation process.

VI. Revenue, Accounts Receivable, and Unfilled Customer Orders

Revenue, AR, and Unfilled Customer Orders include amounts earned by the DON for the sale of goods and services provided to the Navy GF, other DoD and federal agencies, and the public. The

DON's Revenue, AR, and Unfilled Customer Orders fall within the scope of the Reimbursable Work Order – Performer (RWO-P) process. Revenue is recognized based on rates charged to customers for those goods and services that are developed as a part of the Rate Setting Process. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that revenues applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports and maintain accountability of assets. Per U.S. Code Title 10 section 2208, charges for goods and services provided for an activity through a WCF shall include the amounts necessary to recover the full costs of the goods and services provided for that entity. Inadequate procedures over the RWO-P process have led to the following control weaknesses that could lead to misstatements in agency reports used for the management of the organization as well as the financial statements:

1. **Lack of or Inadequate Documentation of RWO-P Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the RWO-P process are not accurately or completely documented, including the lack of adequate documentation of its methodology for calculating the Allowance for Doubtful Accounts (AFDA) and related write-offs. As a result, the RWO-P process is executed inconsistently across the organization.
2. **Ineffective or Inadequate RWO-P Procedures.** Procedures do not exist, including internal controls over sales orders outsourced to third parties, identification and elimination of intra-Treasury Appropriation Fund Symbol transactions and recording and monitoring (including segregation of duties) of reimbursements the DON receives from the DoD Foreign Military Sales (FMS) program. The lack of adequate procedures has resulted in misstatements on the financial statements.
3. **Lack of Effectively Designed Controls in the RWO-P Process.** Controls over the RWO-P process are not effectively designed. Specifically, the DON has not:
   - Implemented a comprehensive review over incoming sales order funding documents recorded in the general ledger to determine validity and accuracy prior to acceptance.
   - Designed sufficient review controls to review billing files and correct variances prior to certification by DFAS.
   - Designed adequate procedures around RWO-P close-out. Specifically, controls for Unfilled Customer Orders are not designed to ensure that all terms and requirements have been met prior to close out and are not closed-out in a timely manner after the work is completed.
   - Designed controls around funds collected to validate collections reconcile back to the performance of work, provision of goods, or are recorded in the period in which the services or goods were provided.
   - Designed controls to ensure appropriate reimbursement has been collected when costs are incurred in the performance of services or when goods are provided.

- Designed monitoring and oversight controls for the RWO-P process, increasing the risk that reimbursable agreements are invalid and recorded incorrectly in the general ledger.

4. **Inadequate Controls over Financial Reporting of Revenue.** DON lacks policies, procedures, and related controls to ensure revenue transactions are in compliance with accounting standards. Specifically, revenue is not recorded when services or goods are provided, but instead, recorded when bills are issued in the general ledger. In addition, advance payments and unfilled customer order refunds are incorrectly recorded due to posting logic issues and documentation to support recorded transactions is not available.

5. **Lack of or Inadequate Controls over the Rate Setting Process.** Annually, the DON establishes rates that it will charge its customers, in the future, to recover the full costs of the goods and services sold. The DON lacks adequate controls over this manually intensive process. There are no documented policies or procedures including internal controls related to cash management, price updates or the calculation of rates charged to customers. In addition, assumptions used in the development of pricing factors used in the determination of rates are incomplete and/or inadequate, and the methodology for the application of historical and actual costs in the determination of rates is inconsistently applied across the organization.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of RWO-P Policies and Procedures, including Controls.**
   - Perform an assessment of the RWO-P end-to-end process, including AFDA, to ensure all distinct systems, processes, procedures, and key controls are documented in the PCM. The PCM should include all financial statement assertions, key control process owners, key supporting documentation, and applicable general ledger systems and data interfaces in the RWO-P process, including AFDA. The end-to-end AFDA process should include the collection of AR from the field-level accounting systems to the creation of the field-level AR detail, the AR scoping methodology, and the calculation of the AFDA.
   - Develop and implement policies and procedures to validate that the RWO-P process, including AFDA, is uniformly and consistently executed.
     - Develop processes and procedures for AR write-offs and ensure sufficient management review controls are in place to validate entries recorded are appropriate.

2. **Ineffective or Inadequate RWO-P Procedures.**
   - Perform an independent assessment of the Order Fulfillment end-to-end process to ensure all distinct processes, procedures, financial transactions, financial statement assertions and key controls are completely and accurately documented in the PCM:
     - Develop clearly defined roles and responsibilities for monitoring outsourced sales orders to ensure they are appropriately accounted for within Navy ERP as business events occur.

  - Develop and implement a control to review transactions that have been cancelled by a third-party to determine the appropriateness of the transactions and perform follow-up as necessary.
- Design, document, and implement control procedures to ensure that key aspects of an event are properly segregated amongst personnel when processing an internal FMS RWO. In addition:
  - Implement non-automated review procedures to ensure the validity of FMS RWO documents and procedures to monitor funding within the budget of each command.
- Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.

3. **Lack of Effectively Designed Controls in the RWO-P Process.**
   - Design, document and implement detailed control procedures in the RWO-P process to require all relevant data elements be included on the reimbursable documentation and entered into the general ledger systems. Additionally, implement appropriate monitoring over the execution of the agreements including the billing, collection and closeout cycles.
   - Develop automated controls and appropriate system interfaces as a part of the implementation of a system solution for intragovernmental transactions such as Government-Invoicing.
   - Implement comprehensive review controls to validate that policies and procedures for the RWO-P closeout process are being consistently applied across BSOs.
4. **Inadequate Controls over Financial Reporting of Revenue.**
   - Develop and implement policies and procedures to require revenue be recognized timely and in the appropriate period as well as recorded accurately including procedures for revenue accruals and management review controls.
   - Perform a detailed review of RWO-P business processes, including advances from others, and respective posting logic to identify and address all non-compliant processes and posting. In addition:
     - Update system posting logic to comply with appropriate accounting guidance for non-compliant processes.
     - Update policies and procedures to outline the appropriate use of RWO-P transactions as well as how to appropriately account for other types of cash receipts that are not RWO-P.
     - Develop policies and procedures to ensure corrections for customer refunds or credits are timely recorded.

5. **Lack of or Inadequate Controls over the Rate Setting Process.**
   - Perform a detailed assessment of the Rate Setting Process with DON Office of Financial Management and Budget (FMB) and the BSOs to identify and document processes, procedures, systems and data interfaces, system generated reports, process owners, key control points, federal regulations and financial statement risks and relevant assertions. Develop and implement:
     - Oversight procedures to ensure BSOs are properly establishing and charging approved rates to comply with laws and regulations.
     - Policies and procedures for FMB and BSOs to review, assess, and consistently oversee the cash management process.
     - Policies and procedures for the BSOs to review, analyze, and consistently utilize actual cost data in the calculation of the stabilized rates.
     - Procedures to review and evaluate any estimated costs on a timely basis.
     - Monitoring controls to ensure information submitted to DON management is complete and accurate.
   - Perform an analysis to determine the appropriateness of the current assumptions used in the calculation of the pricing factors.

VII. Budget Execution and Undelivered Orders

Budget execution represents the use of funds, authorized by Congress and apportioned by OMB, from the time the funds are received through the outlay and reporting of those funds. UDOs represent the amount of goods or services ordered which have not been received. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenditures applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The current procedures over the end-to-end budget execution process, including the recognition and reporting of UDOs and the related execution of funding as performed by FMB, do not address financial reporting and budget management risks and could lead to misstatements in amounts reported within the financial statements as detailed below:

1. **Lack of or Inadequate Documentation of Budget Execution Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the budget execution process are not accurately or completely documented. In addition, there is no enterprise-wide policy and related procedures for recording bulk obligation estimates. Estimates are not reviewed and adjusted periodically as execution data becomes available, leading to the potential loss of resources as unneeded funding cannot be reprogrammed timely. Additionally, the estimates do not have adequate analysis to support

their recording. The DON also lacks documented policies and procedures over the realignment and reorganization of business units.

2. **Lack of or Inadequate Budget Execution Procedures.** The DON does not have effective policies and procedures in place to ensure that all stakeholders prepare and retain consistent and sufficient supporting documentation to support budget execution transactions. Specifically, the DON was unable to provide sufficient supporting documentation to justify transactions posted and the associated UDO balances. Additionally, procedures outlining the appropriate use of reimbursable agreements and the identification and elimination of intra-appropriation transactions have not been established. In some cases, the lack of procedures has resulted in misstatements on the financial statements.

3. **Lack of Effectively Designed Controls in the Budget Execution Process.** Controls over the budget execution process are not effectively designed as detailed below:

   Posting of Obligations

   - There is a lack of controls to ensure that obligations are posted timely or at the appropriate amount, or to ensure that they are adjusted upward or downward when needed, in both Navy ERP and legacy systems.

   Monitoring of Obligations

   - There is a lack of controls to ensure obligations are monitored appropriately throughout their period of availability, including the execution of funding against obligations.
   - The DON lacks appropriate review of dormant obligations and does not timely de-obligate when execution against an agreement ends. Specifically, for agreements that have had no execution against them for over 90 days, the DON was unable to provide sufficient evidence that a review occurred to confirm the validity of the obligation. Lack of timely de-obligation of agreements overstates the obligated balance and understates available funds that can be used by the DON for mission critical expenditures.

   Funds Control

   - The DON lacks proper controls over budget authority. The DON does not effectively reconcile field-level budget information to supporting documentation and the financial statements. For example, the DON does not reconcile funding authority reflected within its general ledger systems, including legacy systems, to the financial statements. In addition, the DON does not research and reconcile variances identified between the field-level budget information and the supporting documentation in timely manner.

Recommendations

Consider the following corrective actions related to the deficiencies identified:

1. **Lack of or Inadequate Documentation of Budget Execution Policies and Procedures, including Controls.**
   - Complete the PCM for the budget execution process to document a complete and accurate end-to-end process for the entirety of the life cycle, including the initiation, recording, processing, and reporting of transactions.
     - The PCM should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used.
   - Implement a DON-wide policy requiring obligation estimates be recorded and documented.
   - Ensure that relevant stakeholders are consulted on the development of process documentation to timely close abnormal balances as a result of an activity closure or realignment.
   - Develop and implement standard procedures and monitoring controls to ensure accurate and timely identification of abnormal balances so that additional funding can be requested on a timely basis. Controls should monitor and prevent further abnormal balances.
2. **Lack of or Inadequate Budget Execution Procedures.**
   - Increase communication amongst various P2P stakeholders to ensure sufficient and complete documentation is readily available and consistently provided as part of all documentation requests for the budget execution process.
     - Evaluate, identify, and mitigate key gaps and inconsistencies in current document retention policies and procedures.
   - Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.
3. **Lack of Effectively Designed Controls in the Budget Execution Process.**
   - Evaluate existing controls to ensure that the appropriate monitoring procedures are in place, including record retention policies.
   - Evaluate existing policies and procedures over the UDO process to ensure that the appropriate procedures are in place to ensure timely de-obligation of funds.
   - Focus efforts on monitoring active obligations before they become dormant including the related expenditures. This will increase visibility into funds actually needed for valid business purposes versus funds that can be de-obligated and used for other mission critical needs.

- Develop and implement procedures to reconcile balances recorded in the field-level general ledger to those reported in the financial statements and to supporting documentation and explain or resolve variances on a timely basis.
- Ensure that end-to-end process documentation related to the Funds Receipt and Distribution processes includes procedures and considerations about financial reporting for all relevant general ledger accounts in the financial statements.

VIII. Entity Level Controls – Oversight and Monitoring

DoD Instruction 5010.40 requires DoD entities to comply with the requirements of the FMFIA and OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*. FMFIA requires federal entities to establish internal controls in accordance with the GAO Green Book. The GAO Green Book defines entity level controls as controls that have a pervasive effect on an entity's internal control. It establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. In accordance with the GAO Green Book, management must effectively design, implement, and operate each of the components of internal control for the components to be effective. The DON has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book and OMB Circular A-123 requirements as described below:

1. **Inadequate Control Environment.** An entity's control environment provides the discipline and structure to help the entity achieve its objectives. According to the GAO Green Book, a key principle in establishing an adequate control environment is the appropriate documentation of the internal control system including the five components of internal controls. The GAO Green Book further states that this type of documentation provides a means to retain organizational knowledge and mitigate the risk of having that knowledge limited to a few personnel. The documentation also provides a means to communicate, as needed, that knowledge to third parties, such as external auditors. A lack of documentation identifying process controls can lead to inadequate communication to those responsible for control performance, as well as inappropriate execution and monitoring of controls. We noted the following deficiencies in the DON's control environment:

   Entity Level Controls and Documentation

   - The current control environment is ineffective due to inadequate implementation of entity level controls and lack of proper end-to-end documentation of key business processes including internal controls.

   System Consolidation and Data Migration

   - According to the GAO Green Book, management should document internal controls to meet operational needs. Documentation of controls, including changes to controls, is evidence that controls are identified, documented, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated by the entity. The DON does not have adequate documentation over the internal controls

supporting system consolidations and data migration activities. Due to the lack of adequate documentation and governance, there is insufficient evidence to support the system consolidation and data migration efforts, as well as inadequate monitoring of the activities performed. Specifically, the identified system consolidation and data migration weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- Lack of overarching governance (e.g., policies, procedures, and minimum requirements) over system consolidations.
- Lack of overarching legacy system decommissioning procedures and/or guidance across all DON functional areas have not been developed to manage and verify the appropriate shut-down and decommissioning of legacy systems no longer in use by DON organizations, Commands, and/or BSOs.
- Lack of requirements and/or evidence to demonstrate accounting functions are no longer being performed for migrated BSOs when the legacy system remains in use by other organizations/BSOs.
- Insufficient migration specific project plans governing the migration activities for system consolidation efforts, to include but not limited to, the impacted legacy system, future state system, and BSOs.
- Insufficient pre-migration conversion testing performed to demonstrate data designated to be migrated was converted successfully and without error, or that any errors identified are resolved, retested, and do not pose a risk to the completeness and accuracy of the migration results.
- Inappropriately designed User Acceptance Testing (UAT) process where the testing environment was not verified to appropriately mirror the future-state environment.

2. **Lack of Risk Assessments.** According to the GAO Green Book, management should assess the risks facing the entity as it seeks to achieve its objectives by identifying, analyzing, and responding to risks related to achieving the defined objectives. A comprehensive entity level risk assessment does not exist, nor has the DON fully identified financial reporting risks for the majority of its key business processes.

3. **Inadequate Monitoring Controls.** According to the GAO Green Book, management should establish and operate activities to monitor the internal control system, evaluate results, and remediate identified internal control deficiencies on a timely basis. In addition, it states that management may engage third parties, such as service organizations, to perform certain operational processes for the entity; however, it retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by service organizations. OMB Circular A-123 requires that management evaluate the effectiveness of internal controls annually using the GAO Green Book. The current control environment lacks adequate monitoring controls to evaluate the effectiveness of the internal controls for the

majority of its key business processes. In addition, as noted below, the DON does not have proper oversight of service organizations and other third parties:

DFAS

- DFAS performs key financial reporting controls on management's behalf; however, DFAS procedures are not designed to verify the completeness and accuracy of the data within the reports utilized. Additionally, compensating controls do not exist to mitigate the risks posed by DFAS's control weaknesses.

Contractors

- The DON does not have adequate oversight of contractors that hold property on its behalf. In addition, there is inconsistent reporting by contractors regarding the property that they hold, leading to unreliable asset reporting which can have an impact on the DON's operations.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Inadequate Control Environment.**

Entity Level Controls and Documentation

- Complete the design and emphasize the importance of an A-123 program at all levels of the organization from DON leadership. This is necessary to bring visibility, education and support to the program from across the organization and at the highest levels of leadership.
- Identify, document and communicate roles and responsibilities throughout the DON as they relate to the implementation of an A-123 program. Ensure the proper groups and personnel that are involved are trained at the appropriate levels to produce the most effective results. Integrate financial management (FM) and information technology (IT) remediation efforts to achieve a more efficient and effective program.
- Develop, document and maintain supporting documentation as a part of an A-123 program and for Enterprise Risk Management to evidence the development of management control plans, performance of risk assessments, ongoing monitoring, development of corrective action plans and tracking of progress towards remediation.

System Consolidation and Data Migration

- Develop, document, and implement policy and procedures that define governance structures, minimum activities, and include an enterprise-wide monitoring program for all system consolidations and data migrations efforts.
- Strengthen the integration and collaboration between IT and FM organizations throughout the system consolidation life cycle to promote a holistic, continuous evaluation, and understanding of risk as part of the development and implementation of the Department-level governance and system consolidation enterprise-wide monitoring program.

- Develop, document, and implement system decommissioning procedures and requirements that effectively manage, control, and verify the appropriate shut-down and decommissioning of legacy systems no longer in use.
- Develop and implement procedures that effectively verify all financial activities and transactions are no longer being performed or recorded in a legacy system and develop a checklist that can be used to validate that the procedures established have been appropriately executed, effectively demonstrate that the legacy system is no longer performing accounting functionality, and serve as evidence for investigative purposes.
- Include requirements that migration-specific project plans (specific to each migrating/impacted BSO, legacy system, and future state system) are developed, implemented, and adhered to.
- Develop and document procedures for conducting the system consolidation conversion documentation tracker process that includes clearly documenting results of all iterations of all pre-migration conversion testing, analysis performed by appropriate stakeholders in situations where errors are identified, and evidence demonstrating that significant errors identified are resolved and re-tested as needed prior to migration.
- Develop policies and procedures to minimize i) the duration that a command cannot enter transactions in the target system ("black-out" period) and ii) the duration that a command cannot financially report out of either the legacy or target system ("brown-out" period).
- Establish policies, procedures, and controls to ensure that all accounting functions can be performed and recorded in a timely, complete, and accurate manner during system black-outs and brown-outs.

2. **Lack of Risk Assessment.**
   - Develop a policy to include proper detail and guidance for conducting the risk assessment process, including:
     - A process to review all aspects of the risk management processes at least once a year.
     - Review of the previous risks identified with appropriate frequency.
     - Provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed.
3. **Inadequate Monitoring Controls.**

   DFAS
   - Assess policies and procedures governing oversight of third-party service providers and identify the appropriate level of oversight and monitoring required to ensure accurate and complete reporting.
   - Design management review controls related to actions performed by DFAS that are appropriate and/or develop procedures to mitigate the risks identified. Retention of

adequate documentation evidencing the procedures performed during their review should include, but is not limited to:

- Procedures performed/re-performed.
- Verification that the data transferred from a system of record to an End User Computing tool, such as Excel, is not lost, added, or changed.

Contractors

- Identify the level of oversight required of contractors that have government property in their custody and develop the appropriate policies and procedures to implement the actions necessary for consistent and effective oversight and monitoring.
- Implement changes to contracts to allow for contractors with property in their custody to accurately report the property in accordance with federal accounting standards. Include in the contracts the actions necessary for government personnel to monitor the reports and data presented for accuracy.

Financial Information Systems

The DON needs to continue focusing on the implementation of a robust internal control environment and information security program, that is designed, operating effectively, and producing the intended results to mitigate key financial audit risks. Consequently, an integrated, prioritized, risk-driven effort is still necessary to remediate deficiencies in the areas of Access Controls, SoD, Configuration Management, and Interface Processing.

Our assessment of the IT controls and the computing environment focused on a subset of financially significant applications that included general ledger systems, feeder systems and operational systems. Specifically, deficiencies are primarily design level deficiencies at the application layer. As the DON's Management Internal Control Program (MICP) matures, we will assess the operating effectiveness and additional layers such as operating system and network.

The following table outlines the number of deficiencies identified across the 32 systems assessed in FY17, FY18, FY19, FY20, and FY21 for DON WCF, to include current and prior year findings:

	FY21 DON Financially Significant Systems – IT Internal Controls Deficiencies				
System Type	**Security Management**	**Access Controls/ Segregation of Duties**	**Configuration Management**	**Interface Processing**	**Totals**
General Ledger Systems	8	42	11	20	81
Feeder and Operational Systems	25	194	85	87	391
Totals	**33**	**236**	**96**	**107**	**472**

A subset of the deficiencies identified were high-risk, which collectively constitute a material weakness in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate. Based on our review and analysis of the findings in aggregate, we have identified three distinct material weaknesses related to information system controls.

We have outlined the three IT material weaknesses below:

- Access Controls/Segregation of Duties
- Configuration Management
- Interface Processing

Each of the IT material weaknesses are discussed further below.

IX. Financial Information Systems - Access Controls/Segregation of Duties

Access Controls include those controls related to protecting application boundaries, user identification and authentication, authorization, protecting financially significant transactions and system resources, and the monitoring of security violations. When properly implemented, access controls can validate that critical systems assets are safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed.

The identified access control weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- Complete and accurate system generated populations of users were not consistently available, or evidence to support the population of users was not provided, to include level of access granted (i.e., privileges).
- Identification of financially significant transactions and resources has not been performed and/or lacks financial integration and approval.
- Access provisioning to include initial access provisioning, modification, and removal of access were not performed in accordance with defined requirements, timelines, and with sufficient detail to confirm access granted was commensurate with access approved and required for the user's business responsibilities.
- Access recertification/periodic user access reviews were not performed to consistently evaluate both the need for access and the level of access provisioned.
- Monitoring of sensitive user activities, including activities of privileged users, were not documented, not being performed, or not configured appropriately within systems.
- Audit logging evidence was not protected against unauthorized access and modification, as well as not being retained for the audit period.
- Identification and monitoring of security violations, to include required follow-on actions were not consistently performed.

An effective control environment guards against a particular user without documented authorization and acceptance of the associated risks from being provisioned to incompatible functions within a system. SoD controls provide policies, procedures, and an organizational structure to prevent individual users from being provisioned a combination of roles or permissions that provide the capability to perform incompatible activities. As a result, an effective control environment thereby reduces the risk of users performing inappropriate or unauthorized activities using their incompatible access permissions.

The identified SoD weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- Cross-application SoD analysis has not been performed across key financial systems to determine the significance and pervasiveness of these types of SoD conflicts. Additionally, cross-application SoD are not considered when provisioning user access.
- SoD conflict matrix, or equivalent documentation identifying access roles and permissions requiring separation, was not sufficiently documented, inclusive of all functional roles, and/or not mapped effectively to the system access associated with the functional roles.
- Provisioning conflicting access could not be prevented, and for known conflicts where SoD-related concerns were identified, there was a lack of documentation for business rationale and subsequent monitoring of users with known SoD conflict activities.
- System administrators have the ability to complete an entire business functional process by inputting, processing, and approving transactions.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Systematically generate a complete and accurate population of users with access to financially significant systems.
- Periodically review the on-going need for users with elevated access privileges.
- Monitor the activity of users with elevated access privileges.
- Identify and document the completeness and accuracy of financially significant transactions and resources. Additionally, obtain approval from the appropriate level of IT and financial management to validate the listing of financially significant transactions and resources.
- Establish and consistently follow processes and controls related to user account management and SoD, including the entire life cycle from access provisioning to recertification, modification of access, inactivity restrictions, and termination procedures.
- Segregate conflicting roles. In those limited instances where conflicting roles are required or unavoidable, document and approve the business rationale for the conflict and monitor the activity of users with conflicting roles.
- Evaluate cross-application SoD to identify potential conflicts for users accessing multiple systems.
- Conduct appropriate analysis to confirm functional user access is aligned to the appropriate logical permissions within the systems and confirm SoD is enforced.
- Define required security violation monitoring procedures, including the frequency for which security violations should be escalated, reviewed and approved.

X. Financial Information Systems - Configuration Management

Configuration Management involves the identification and management of an information system at a given point-in-time and systematically controls changes to that configuration throughout the system development life cycle. By implementing configuration management controls, DON can verify only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

The identified configuration management-related weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- Complete and accurate system generated populations of changes made to the production environments are not captured nor available to support internal controls and monitoring. This includes code changes, table structure changes, direct data changes, and configurable settings within the application.

- Logging and monitoring controls have not been implemented to identify unintentional or unauthorized changes made to the application and database.
- Access to production and development environments are not segregated. Additionally, access to source code is not properly controlled.
- Changes are not consistently reviewed, approved, and documented.
- Lack of management review or monitoring of third-party service providers, who perform configuration management functions, to validate compliance with the established configuration management process.
- Inadequate governance and requirements during system conversion/consolidation activities resulted in critical financial reporting discrepancies and risks to the financial statements.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Identify complete and accurate populations of configuration changes.
- Only migrate authorized and approved changes into the production environment.
- Segregate access between the development and production environments.
- Restrict access to source code. Document and approve the business rationale for those users requiring access to source code to perform their roles and responsibilities and monitor the activities of those accessing source code.
- Monitor third party service providers responsible for configuration management activities over DON's applications.
- Validate and approve changes to applications and databases.
- Implement governance as it relates to system conversions, such that adequate testing and remediation of known errors is performed by both IT and Financial stakeholders prior to the conversion/go-live.

XI. Financial Information Systems - Interface Processing

Interface Processing controls consist of those related to the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems.

The identified interface control weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- A complete and accurate population of interfaces processing DON transactions.

- Identification and verification that financially relevant edits and validation checks are operating as intended.
- Reconciliations are not being performed between source and target systems to validate completeness and accuracy of financial data processing.
- Logs of interface processing activities are not retained to support subsequent auditing and monitoring activities. Additionally, error reporting for failed interface processing activities has not been implemented in some systems.
- Remediation of identified errors in interface processing are not completed in accordance with defined requirements, timelines and with sufficient detail to confirm remediation.
- Interface files are not consistently protected from unauthorized access and modification prior to processing through the use of secure transmission mechanisms.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Identify and document a complete and accurate listing of system interfaces.
- Validate the completeness and accuracy of interface file processing, inclusive of authorized access controls.
- Identify and document a complete and accurate listing of edit checks and validations, to verify that interface files are appropriately edited and validated.
- Validate that information received from a source application is complete, accurate and consistently received.
- Log interface activity and monitor these logs to allow for timely remediation of errors associated with the transmission of data used in financial reporting.
- Protect data files transmitted via interfaces from inadvertent or intentional access or modification prior to data processing.

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Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 21-04, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund of the United States Department of the Navy (DON), which comprise the consolidated balance sheet as of September 30, 2021, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 8, 2021. Our report disclaims an opinion on such financial statements because the DON was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of the DON, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements as well as the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 21-04, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

Our Report on Internal Control over Financial Reporting dated November 8, 2021, includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, and our recommendations to the specific issues presented.

FFMIA

Under FFMIA, we are required to report whether the DON's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of tests disclosed instances in which the DON's financial management systems did not substantially comply with federal financial management systems requirements, applicable federal accounting standards or the USSGL.

(a) Federal financial management system requirements

As referenced in the Fiscal Year (FY) 2021 Department of Navy Statement of Assurance, the DON identified that financial systems and financial portions of mixed systems do not substantially meet the requirements of FFMIA or OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (Circular A-123) Appendix D.

EY also identified this material weakness as part of the Financial Information Systems material weakness, contained in the Report on Internal Control over Financial Reporting, where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with access controls, segregation of duties, configuration management, and interface processing. These financial system deficiencies prevent the DON from being compliant with federal financial management system requirements and inhibit the DON's ability to prepare complete and accurate financial reporting.

(b) Noncompliance with applicable federal accounting standards

As referenced in the FY 2021 Department of Navy Statement of Assurance and Note 1 to the financial statements, the DON identified that the design of financial and non-financial systems does not allow the DON to comply with applicable federal accounting standards, including not being able to collect and record financial information on an accrual accounting basis. EY also identified noncompliance with federal accounting standards during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

(c) Noncompliance with USSGL posting logic at the transaction level

As referenced in the FY 2021 Department of Navy Statement of Assurance, the DON identified that the design of financial systems does not allow the DON to comply with USSGL at the transaction level. EY also identified noncompliance with USSGL posting logic during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

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FMFIA

Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government* (commonly referred to as the GAO Green Book), issued under the authority of FMFIA, establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. To determine if an entity's internal control system is effective, the Green Book requires management to assess the design, implementation, and operating effectiveness of the five components of the entity's internal control system.

The DON has not fully implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book requirements, leading to inadequate control environment, risk assessment and monitoring processes.

Management's Response to Findings

DON's response to the findings identified in our engagement and relevant comments from the DON's management responsible for addressing the noncompliance are provided in their accompanying letter dated November 8, 2021. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the entity's compliance. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

November 8, 2021

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WORKING CAPITAL FUND

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND MANAGEMENT'S RESPONSE TO INDEPENDENT AUDITORS REPORT

210420-M-HB658-1036

PACIFIC OCEAN (April 20, 2021) The amphibious assault ship USS Essex (LHD 2), left, and the guided-missile destroyer USS Kidd (DDG 100) sail in formation behind the amphibious transport dock ship USS Portland (LPD 27). The Marines and Sailors of the 11th Marine Expeditionary Unit are conducting routine training as part of the Essex Amphibious Ready Group (ARG). Together, the 11th MEU, Amphibious Squadron (PHIBRON) 1, and ships are designated as an ARG. (U.S. Marine Corps photo by Staff Sgt. Donald Holbert)

DEPARTMENT OF THE NAVY
ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT AND COMPTROLLER
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

November 8, 2021

Ernst & Young, LLP
Attention: Mr. John F. Short, Partner
1775 Tysons Boulevard
Tysons, VA 22102

Dear Mr. Short:

We reviewed the Department of the Navy Working Capital Fund Audit Report prepared by Ernst & Young, for the audit of the Department of the Navy Working Capital Fund and appreciate the recommendations to continue to improve our financial operations. The Department of the Navy (DON) acknowledges and concurs with the material weaknesses and the disclaimer of the opinion. Lessons learned from the audit and the recommendations provided in the report, will continue to improve our ability to support future audits and improve readiness.

The DON continues to execute against its Audit Roadmap to address material weaknesses. This integrated strategy keeps us focused on the activities required to meet the long-term goal. In Fiscal Year (FY) 2021, we completed migration of our legacy accounting systems into the Navy Enterprise Resource Planning (ERP) system. Each year, we will sustain improvements and continue building on milestones achieved. Our FY 2022 priorities include:

- Environmental and Disposal Liabilities – Establish and report accurate environmental and disposal liabilities;
- Fund Balance with Treasury – Sustain progress made to reduce suspense and statement of differences balances; reduce unmatched transactions, support cross-disbursement reconciliations, and reconcile the undistributed population between shared appropriations;
- Information Technology General Controls – Remediate access control, segregation of duties, change management, and interface controls for critical systems;
- Inventory – Establish existence and completeness at organic and vendor locations; and
- Systems Consolidation – Migrate remaining organic inventory sites to Navy ERP.

We are building on audit findings and fostering a culture that encourages innovation, solves problems, and achieves results to get the most out of every dollar entrusted to us by Congress and the American taxpayer.

Alaleh A. Jenkins
Acting Assistant Secretary of the Navy
(Financial Management and Comptroller)

OTHER INFORMATION

210419-N-CE622-0141
ATLANTIC OCEAN (April 19, 2021) The guided-missile destroyer USS Winston S. Churchill (DDG 81) fires a MK-45 MOD 4 5-inch 62 caliber lightweight gun as part of a live-fire demo. Winston S. Churchill is operating underway in the 2nd Fleet area of operations in support of naval operations with the aircraft carrier USS Gerald R. Ford (CVN 78). (U.S. Navy photo by Mass Communication Specialist 3rd Class Katie Cox)

The DON has multiple ongoing Financial Management and Reporting corrective action plans. Efforts are being made to continually improve upon the implementation of completed corrective action plans. Additionally, the DON has made significant improvements in the areas of Internal Control design and Implementation to ensure effectiveness.

This section is comprised of:

- Management and Performance Challenges
- Summary of Financial Statement Audit and Management Assurances
- Payment Integrity Information Act Reporting
- Appropriations, Funds and Accounts Included in the Principal Statements

MANAGEMENT AND PERFORMANCE CHALLENGES

DEPARTMENT OF THE NAVY
NAVAL INSPECTOR GENERAL
1254 9TH STREET SE
WASHINGTON NAVY YARD, DC 20374-5006

IN REPLY REFER TO
5040
Ser N00/0107
30 Mar 21

From: Naval Inspector General
To: Department of Defense Office of Inspector General

Subj: SOLICITATION OF INPUT TO THE TOP DOD MANAGEMENT CHALLENGES AND THE FISCAL YEAR 2022 DEPARTMENT OF DEFENSE OFFICE OF INSPECTOR GENERAL OVERSIGHT PLAN

Ref: (a) DoD OIG memo of 12 Feb 21

1. Per reference (a), the Office of the Naval Inspector General (NAVINSGEN) submits the following items to the Department of Defense Office of Inspector General (DoD OIG) for consideration to include in upcoming Fiscal Year 2022 DoD OIG Oversight Plan.

a. Properly Resourcing Oversight Agencies (Inspector General, Audit Service, and Criminal Investigative Service). These Oversight Agencies have significant impact on the stewardship of taxpayer dollars, improving readiness, increasing warfighting ability, and maintaining public trust (e.g., the importance of our work as it impacts fiscal stewardship and health & safety). For example, the Navy Inspector General Senior Officials Investigations has seen a significant increase in case load evidencing the important role oversight agencies play in reducing risk to their departments.

b. Information Technology Benefits, Risks and Inefficiencies. Information technology is a critical element of mission readiness and effectiveness.

c. Ensuring Ethical Conduct. Although ensuring ethical conduct was included in FY20 Top DoD Management Challenges, it is a recurring issue worth including again. This issue relies on sufficient oversight agency resources discussed in issue 1.a.

d. Defense Health Agency Transition. Given the significance of this organizational change and the impact on the health and welfare of service members and their families, it is important to understand its challenges and monitor the implementation and effectiveness of the transition.

e. Foreign Military Vetting Procedures. It is imperative that visiting foreign military members are properly screened and vetted.

2. My point of contact is Ms. Cheryl Miller who can be reached at 202-433-4723 or via e-mail at Cheryl.miller@navy.mil.

SNYDER.RICHARD.PAUL.1041753494 Digitally signed by SNYDER.RICHARD.PAUL.1041753494 Date: 2021.03.30 12:00:17 -04'00'

R. P. SNYDER

SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT
Restatement: No

Areas of Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Balance	General Fund	Working Capital Fund
Financial Reporting	2	0	0	0	2	1	1
Fund Balance with Treasury	2	0	0	0	2	1	1
Government Property in the Custody of Contractors	1	0	0	0	1	1	0
Operating Materials and Supplies – Remainder	1	0	0	0	1	1	0
Operating Materials and Supplies – Ordnance	1	0	0	0	1	1	0
Operating Materials and Supplies - Valuation	1	0	0	0	1	1	0
General PP&E - General Equipment - Utilities	1	0	-1	0	0	0	0
General PP&E - General Equipment - Remainder	2	0	0	0	2	1	1
General PP&E - Construction In Progress	1	0	0	0	1	1	0
Environmental & Disposal Liabilities	1	0	0	0	1	1	0
Expenses and Accounts Payable	2	0	0	0	2	1	1
Revenue and Unfilled Customer Orders	1	0	0	0	1	1	0
Revenue, Accounts Receivable and Unfilled Customer Orders	1	0	0	0	1	0	1
Budget Execution and Undelivered Orders	2	0	0	0	2	1	1
Entity Level Controls - Oversight and Monitoring	2	0	0	0	2	1	1
Inventory	1	0	0	0	1	0	1
Financial Information Systems - Access Controls/ SOD	2	0	0	0	2	1	1
Financial Information Systems - Configuration Management	2	0	0	0	2	1	1
Financial Information Systems - Interface Processing	2	0	0	0	2	1	1
Total Material Weaknesses	28	0	-1	0	27	16	11

TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES

The DON Financial Reporting Material Weaknesses and Corrective Actions

End-to-End Process	Areas of Material Weaknesses	Beginning Balance	New	Recategoriezed	Resolved	Reassessed	Ending Balance	General Fund	Working Capital Fund
Budget-to-Report	Accounts Payable	1	0	0	0	0	1	Yes	Yes
	Financial Reporting	1	0	0	0	0	1	Yes	Yes
	Fund Balance with Treasury (FBwT) Reconciliations	1	0	0	0	0	1	Yes	Yes
	Traceability and Supportability of Foreign Military Sales Transactions	1	0	0	0	0	1	Yes	Yes
Procure-to-Pay	Procure to Pay	1	0	0	0	0	1	Yes	Yes
Order-to-Cash	Order to Cash	1	0	0	0	0	1		Yes
Acquire-to-Retire	General Equipment- Remainder: Existence and Completeness	1	0	0	0	0	1	Yes	Yes
	Property, Plant, & Equipment Valuation	1	0	0	0	0	1	Yes	Yes
Plan-to-Stock	Inventory	1	0	0	0	0	1	Yes	Yes
	Operating Materials & Supplies - Ordnance	1	0	0	0	0	1	Yes	Yes
	Operating Materials & Supplies (OM&S)- Remainder	1	0	0	0	0	1	Yes	Yes
	Property, Plant, & Equipment - Utilities	1	0	0	0	-1	0	Yes	Yes
Multiple End-to-End Processes	Enviornmental and Disposal Liabilities	1	0	0	0	0	1	Yes	Yes
	Budgetary Execution	1	0	0	0	0	1	Yes	Yes
Total Financial Reporting Material Weaknesses		**14**	**0**	**0**	**0**	**-1**	**13**		

The DON Operational Material Weaknesses
Effectiveness of Internal Controls over Non-Financial Operations (FMFIA § 2)

Statement of Assurance: Modified Assurance

Areas of Material Weaknesses	Beginning Balance	New	Recategorized	Resolved	Reassessed	Ending Balance	General Fund	Working Capital Fund
Complex IT Environment	1	0	0	0	0	1	Yes	Yes
Data Protection	1	0	0	0	0	1	Yes	Yes
Depot Level Maintenance	1	0	0	0	0	1	Yes	Yes
DON Oversight and Management of Improper Payments	1	0	0	-1	0	0	Yes	Yes
Execution of Husbanding Contracts – Husbanding Service Providers	1	0	0	0	-1	0	Yes	Yes
Military Pay and Personnel (MILPAY)	1	0	0	0	0	1	Yes	Yes
Oversight and Monitoring	1	0	0	0	0	1	Yes	Yes
Property in the Possession of Contractors	1	0	0	0	0	1	Yes	
Submission of Criminal Subject Fingerprint Cards and Reporting Disposition of Criminal Charges	1	0	0	-1	0	0	Yes	Yes
Total Material Weaknesses	**9**	**0**	**0**	**-2**	**-1**	**6**		
Financial Management Systems Material Weakness/ Nonconformances and Corrective Actions								

Effectiveness of Internal Controls over Financial Systems (FMFIA § 4 and FFMIA)

Statement of Assurance: Controls are not in place to provide Reasonable Assurance

Nonconformances	Beginning Balance	New	Resolved	Recategorized	Reassessed	Ending Balance	General Fund	Working Capital Fund
Financial Management Systems	3	0	0	0	0	3	3	3
Total System Conformance Material Weaknesses	**3**	**0**	**0**	**0**	**0**	**3**		

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)

	Agency	Auditor
1 Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
2 Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
3. USSGL at Transaction Level	Lack of compliance noted	Lack of compliance noted

PAYMENT INTEGRITY INFORMATION ACT REPORTING

In accordance with the Payment Integrity Information Act of 2019 (P. L. 116-117, 31 U.S.C § 3352 and § 3357) and Appendix B of the OMB Bulletin No. 19-03, Audit Requirements for Federal Financial Statements, dated August 27, 2019, DoD reports payment integrity information (i.e., improper payments) at the agency-side level in the consolidated DoD AFR. For detailed reporting on DoD payment integrity, refer to the "Other Information" section of the consolidated DoD AFR at: https://comptroller.defense.gov/ODCFO/afr/.

APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE PRINCIPAL STATEMENTS

General Funds	
017 0199	Miscellaneous Taxes, Not Otherwise Classified
017X0380	Coastal Defense Augmentation, Navy
017X0513	Ship Modernization, Operations and Sustainment Fund, Navy
017 0513	Ship Modernization, Operations and Sustainment Fund, Navy
017 0703	Family Housing, Navy and Marine Corps
017 0730	Family Housing Construction, Navy and Marine Corps
017 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
017X0810	Environmental Restoration, Navy
017 1000	Medicare-Eligible Retiree Health Fund Contribution, Navy
017 1002	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy
017X1205	Military Construction, Navy and Marine Corps
017 1205	Military Construction, Navy and Marine Corps
017 1206	Military Construction – Recovery Act, Navy and Marine Corps
017 1210	Contributions to "Conscience Fund"
017 1235	Military Construction, Naval Reserve
017X1236	Payments to Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
017X1319	Research, Development, Test, and Evaluation, Navy
017 1319	Research, Development, Test, and Evaluation, Navy
017 1320	Research, Development, Test and Evaluation – Recovery Act, Navy
017 1405	Reserve Personnel, Navy
017X1453	Military Personnel, Navy
017 1453	Military Personnel, Navy
017X1506	Aircraft Procurement, Navy
017 1506	Aircraft Procurement, Navy
017X1507	Weapons Procurement, Navy
017 1507	Weapons Procurement, Navy
017 1508	Procurement of Ammunition, Navy and Marine Corps
017X1611	Shipbuilding and Conversion, Navy
017 1611	Shipbuilding and Conversion, Navy
017 1612	National Sea-Based Deterrence Fund, Navy
017X1804	Operation and Maintenance, Navy
017 1804	Operation and Maintenance, Navy
017 1805	Operation and Maintenance – Recovery Act, Navy
017X1806	Operations and Maintenance, Navy Reserve
017 1806	Operation and Maintenance, Navy Reserve
017 1807	Operation and Maintenance – Recovery Act, Navy Reserve
017X1810	Other Procurement, Navy
017 1810	Other Procurement, Navy
Revolving Funds	
017X4557	National Defense Sealift Fund, Navy
017 4557	National Defense Sealift Fund, Navy
Special Funds	
017X5095	Wildlife Conservation, etc., Military Reservations, Navy
017X5185	Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
017 5193	Deposits, Department of Defense Overseas Military Facility Investment Recovery Account for Navy
017X5562	Ford Island Improvement Account
017X5630	Department of Defense World War II Commemoration Fund, Navy
Deposit Funds	
017X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)
017X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)
017X6025	Pay of the Navy, Deposit Fund (T)
017X6050	Employees Payroll Allotment Account, United States Savings Bonds
017X6133	Payment of Unclaimed Moneys, Navy
017X6228	Thrift Savings Fund, Navy
017X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
017X6502	Foreign Cooperative Projects, Navy
017X6505	Title Escrow Amounts, Navy
017X6706	Commercial Communication Service, Navy
017X6705	Civilian Employees Allotment Account, Navy
017X6763	Gains and Deficiencies on Exchange Transactions, Navy
017X6850	Housing Rentals, Navy
017X6950	Disbursing Officer Cash, Department of the Navy
017X6999	Accounts Payable, Check Issue Underdrafts, Navy
Trust Funds	
017X5429	
017X8716	
017X8723	
017X8733	
Working Captial Funds	
097X4930.002	
097 4930.002	

APPENDIX

210418-N-HV010-1087
PACIFIC OCEAN (April 18, 2021) Naval Aircrewman (Helicopter) 2nd Class Daniel Ayres, from Fresno, Calif., assigned to Helicopter Sea Combat Squadron (HSC) 21, operates a GAU-21 .50-caliber machine gun in an MH-60S Sea Hawk during a live-fire exercise with the amphibious assault ship USS Essex (LHD 2). Essex is underway conducting routine operations in U.S. 3rd Fleet. (U.S. Navy photo by Mass Communication Specialist Seaman Sang Kim)

ABBREVIATIONS

Abbreviation	Definition
ADA	Anti-Deficiency Act
AFDA	Allowance for doubtful accounts
AFR	Agency Financial Report
AIO	Acquisition Integrity Office
APSR	Accountable Property System of Record
ASN (FM&C)	Assistant Secretary of the Navy, Financial Management & Comptroller
AVM	Access Violation Management
BAH	Basic Allowance for Housing
BOMC	Business Operations Management Council
BOP	Business Operations Plan
BRAC	Base Realignment and Closure
BSO	Budget Submitting Office
BUMED	Bureau of Medicine and Surgery
BUPERS	Bureau of Naval Personnel
CARES ACT	Coronavirus Aid, Relief, and Economic Security Act
CBY	Charge Back Year
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CFMS	Command Financial Management System
CFO	Chief Financial Officer
CIO	Chief Information Officer
CIP	Construction in Process
CM	Configuration Management
CMC	Commandant of the Marine Corps
CNIC	Commander, Navy Installations Command
CNO	Chief of Naval Operations
CNRF	Commander, Navy Reserve Force
COLA	Cost of Living Adjustment
COMPACFLT	Commander, U.S. Pacific Fleet
COVID-19	Coronavirus disease 2019

Abbreviation	Definition
CPIM	Consumer Price Index Medical
CRE	Component Reporting Entity
CTC	Cost to Complete
DASN	Deputy Assistant Secretary of the Navy
DDRS-B	Defense Departmental Reporting System-Budgetary
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DHA	Defense Health Agency
DHP	Defense Health Program
DLADS	DLA Disposition Services
DM&R	Deferred Maintenance and Repair
DoD	Department of Defense
DoD IG	Department of Defense Inspector General
DOL	Department of Labor
DON	Department of the Navy
DUSN	Deputy Under Secretary of the Navy
E&DL	Environmental and Disposal Liabilities
ELC	Entity-Level Controls
EOP	Executive Office of the President
EOU	Excess, obsolete, and unserviceable
ERM	Enterprise Resource Management
ERN	Environmental Restoration Navy
FAR	Federal Acquisition Regulations
FASAB	Federal Accounting Standards Advisory Board
FBwT	Fund Balance with Treasury
FECA	Federal Employees' Compensation Act
FFMIA	Federal Financial Management Improvement Act
FFRDC	Funded Research and Development Centers
FHIF	Family Housing Improvement Fund

Abbreviation	Definition
FM	Financial Management
FM&C	Financial Management and Comptroller
FMB-7	Secretariat Comptroller Division
FMFIA	Federal Managers' Financial Integrity Act
FMO	Office of Financial Operations
FMR	Financial Management Regulation
FMS	Financial Management Systems
FRA	Fraud Risk Assessment
FRC	Fleet Readiness Centers
FRDAA	Fraud Reduction and Data Analytics Act
FRM	Fraud Risk Management
FRO	Financial Reporting Responsibilities
FSA	Field Support Activity
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GC	General Counsel
GE	General Equipment
GF	General Fund
GLs	General Ledger systems
GPP&E	General Property, Plant, & Equipment
GPRA	Government Performance and Results Act
HQMC	Marine Corps Headquarters
ICOR	Internal Controls Over Reporting
IMC	Integrated Maintenance Concept
iNFADS	Internet Naval Facilities Assets Data Store
IPA	Independent Public Accountant
IPIA	Improper Payments Information Act
IRM	Integrated Risk Management
IRP	Installation Restoration Program
IT	Information Technology
IUS	Internal Use Software
LAC	Latest Acquisition Cost
LLC	Limited Liability Company
LP	Limited Partnership

Abbreviation	Definition
MAC	Moving Average Cost
MARCORLOGCOM	Marine Corps Logistics Command
MAU	Major Assessable Unit
MD&A	Management's Discussion and Analysis
MHPI	Military Housing Privatization Initiative
MMRP	Military Munitions Response Program
MOA	Memorandum of Agreement
MSC	Military Sealift Command
MUHIF	Military Unaccompanied Housing Improvement Fund
MW	Material Weakness
NAFI	Non-Appropriated Funds Instrumentalities
NAVAIR	Naval Air Systems Command
NAVAUDSVC	Naval Audit Service
NAVFAC	Naval Facilities Engineering Command
NAVINSGEN	Naval Inspector General
NAVSEA	Naval Sea Systems Command
NAVSUP	Naval Supply Systems Command
NAVWAR	Naval Information Warfare Systems Command
NAWC	Naval Air Warfare Centers
NCIS	Naval Criminal Investigative Service
NDAA	National Defense Authorization Act
NDS	National Defense Strategy
NDSF	National Defense Sealift Fund
NFR	Notice of Finding and Recommendations
NIA	Naval Intelligence Activity
NIWC	Naval Information Warfare Centers
NRL	Naval Research Laboratory
NRV	Net Realizable Value
NSWC	Naval Surface Warfare Centers
NUWC	Naval Undersea Warfare Centers
O&M	Operations and Maintenance
OA	Operating Agreement
OAD	Office of the Secretary of Defense
OCIO	Office of the Chief of Information Officer

Abbreviation	Definition
OCMO	Office of the Chief Management Officer
OEL	Other accrued environmental liabilities
OGC	Office of General Counsel
OJAG	Office of the Judge Advocate General
OM&S	Operating Materials & Supplies
OMB	Office of Management and Budget
ONR	Office of Naval Research
OPM	Office of Personnel Management
OSD	Office of the Secretary of Defense
OUSD(C)	Office of the Undersecretary of Defense, Comptroller
P3s	Public-Private Partnerships
PPV	Public Private Venture
PRV	Plant Replacement Valuation
RDT&E	Research, Development, Test and Evaluation
RMF	Risk Management Framework
SABRS	Standard Accounting, Budgeting, and Reporting System
SARA	Superfund Amendments and Reauthorization Act
SBR	Statement of Budgetary Resources
SCNP	Statement of Changes in Net Position
SD	Significant Deficiencies
SECDEF	Secretary of Defense
SECNAV	Secretary of the Navy
SES	Senior Executive Service
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Senior Management Council
SMS	Sustainment Management System
SNC	Statement of Net Cost
SOA	Statement of Assurance
SOD	Segregation of Duties
SSP	Strategic Systems Program
SWS	Strategic Weapons Systems
SYSCOMs	System Commands
TDD	Treasury Direct Disbursing
TFM	Treasury Financial Manual

Abbreviation	Definition
TNC	Treasury Nominal Coupon
TR	Technical Release
U.S.	United States of America
UCC	Unified Combatant Command
USACE	U.S. Army Corps of Engineers
USD(P&R)	Under Secretary of Defense for Personnel and Readiness
USFLTFORCOM	U.S. Fleet Forces Command
USMC	United States Marine Corps
USN	United States Navy
WCF	Working Capital Fund

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FOR MORE INFORMATION

Assistant Secretary of the Navy Financial Management and Comptroller
https://www.secnav.navy.mil/fmc/pages/default.aspx

CONTACT US

An electronic copy of this report is available at
https://www.secnav.navy.mil/fmc/fmo/Pages/Financial-Reports.aspx