Lt. Cmdr. Shane Brewer, executive officer of the Freedom-class littoral combat ship USS Milwaukee (LCS 5), gives a tour of the ship to Mexican naval officers from the staff of Mexico’s Secretary of the Navy. (U.S. Navy photo by Mass Communication Specialist 2nd Class Anderson W. Branch/Released)
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Aviation Machinist's Mate 3rd Class Terrence Miller, from Slidell, La., assigned to the "Wolf Pack" of Helicopter Maritime Strike Squadron (HSM) 75, signals a MH-60R Sea Hawk helicopter on the flight deck of the aircraft carrier USS Theodore Roosevelt (CVN 71). (U.S. Navy photo by Mass Communication Specialist Seaman Nicholas V. Huynh/Released)
Today’s dynamic global environment demands a next-generation, integrated naval force as the cornerstone of our competitive advantage. Over the next three years, the Department of the Navy (DON) will relentlessly innovate and adapt to opportunity, aggressively seek out and reform legacy business practices, cultivate a culture of continuous learning and professional development as an essential warfighting capability, and strengthen our global network of allies and partners to guarantee freedom of the seas.

This Agency Financial Report (AFR) reflects the ongoing efforts across the DON to achieve these goals. In an era characterized by the return of great power competition, our adversaries are seeking every opportunity to exploit our inefficiencies and misalignments to close the gap. We cannot respond to this challenge under the banner of “business as usual.”

Every Sailor, Marine and Civilian teammate within our integrated naval force must operate with a sense of urgency, relentlessly seeking ways to increase our efficiency, readiness and lethality, through a mindset of continuous improvement. As we make strategic investments and reinvest in our capabilities, it is imperative that we develop effective ways to measure the cost of achieving our mission, modernizing and sustaining our Fleet, and improving warfighting readiness.

Our ongoing transformation effort is providing improved data and a common vision for the entire enterprise, allowing us to identify opportunities to realign our people, capabilities, and processes to seize opportunities and mitigate risk. Obtaining a clean audit opinion, implementing business reform, and consolidating systems are all mission critical aspects of this effort.

We are accountable for how and where we invest and must understand the readiness and lethality generated by those investments. To aid in our endeavors, we baseline ourselves against best practices and lessons learned in private industry to seek the most efficient, smartest, fastest solutions available and tailor them to the needs of the DON.

Completing our second full financial statement audit demonstrated both the value of our transformation efforts to date and the need for further improvements. As our efforts progress, the processes and mechanisms we establish will focus our resources on improving naval enterprise readiness and increasing lethality. Our success in establishing accountability over our real property inventory will support our infrastructure management program to benefit the talented Sailors, Marines, and Civilian teammates, and families that are key to our success. Our continuing consolidation of financial systems will provide improved data quality and transparency with greater efficiency.

Correcting these inefficiencies and identifying other areas for improvement will require unwavering focus, commitment, and resources. Instilling credibility and demonstrating accountability is vital and achieving our goal of obtaining a clean audit opinion and demonstrating responsibility to the American taxpayer will demonstrate the successful culmination of our transformation efforts.

Naval power is not a choice between readiness and modernization – it requires a balance of both. Fleet readiness must be accelerated to meet the demands of a complex world and fulfill the many missions required of us by the National Defense Strategy. We must all continue to identify, pursue, and rapidly achieve effectiveness and efficiency in all that we do, to protect the American people, maintain the sea lanes of global commerce, and respond wherever there is need. This AFR demonstrates our ongoing efforts to enable the DON to achieve its objective of delivering peak readiness and sustainable operational excellence, so that our warriors always maintain a superior advantage.

Richard V. Spencer
Secretary of the Navy
The purpose of the AFR is to outline how the DON\(^1\) 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 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 is currently audited as a standalone entity and produces a separate AFR and GF financial statements.

\(^1\)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.

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
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 30th, 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) –who are responsible for the command, operating efficiency and performance of their combined Active, Reserve and civilian forces of approximately 720,000 people.

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

Figure 1: DON Organization Chart
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 supporting operations, shore, and the reserves:

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.

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.

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.

BSOs that operate and report on the DON WCF financial statements are identified with an * below.

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.

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

**Naval Supply Systems Command (NAVSUP)** provides supplies, services, and quality-of-life support to the Navy and Joint warfighter. NAVSUP oversees supply chain management for materiel support to Navy, Marine Corps, Joint and coalition partners, supply operations, conventional ordnance, contracting, and quality-of-life issues for DON naval forces.
Naval Information Warfare Systems Command (NAVWAR)* develops, delivers, and sustains advanced information and cyber capabilities for the warfighter. Note: NAVWAR was previously known as Space and Naval Warfare Systems Command (SPAWAR) and was renamed in FY 2019.

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 worldwide, integrated logistics, supply chain, and distribution management; maintenance management; and strategic prepositioning capability in support of the operating forces. 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. ONR has oversight of the Naval Research Laboratory (NRL).

- **Naval Intelligence Activity (NIA)** is the leading provider of maritime intelligence to the USN and joint warfighting forces, as well as national decision makers and other consumers in the Intelligence Community. NIA specializes in the oversight, collection, analysis, production, and dissemination of intelligence information for key consumers worldwide.

- **Field Support Activity (FSA)** establishes, maintains, and provides a system of financial services as the BSO and Principal Administering Office for Navy’s assigned unified command, Navy Headquarters, and the National Defense Sealift Fund (NDSF).

- **Secretariat Comptroller Division (FMB-7)** resides in the Assistant Secretary of the Navy (ASN) Financial Management and Comptroller (F&MC) 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 ten supporting organizations.
U.S. Marines with the 3rd Marine Division, Sailors with the amphibious transport dock ship USS Green Bay (LPD 20) and service members with the Malaysian Armed Forces (MAF) hold an opening ceremony for exercise Tiger Strike 2019. (U.S. Navy photo by Mass Communication Specialist 2nd Class Anaid Banuelos Rodriguez/Released)
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)** supports both the CNO and Combatant Commanders operational and planning efforts worldwide by providing combat-ready, relevant, and sustainable Naval forces. USFLTFORCOM also operates the Military Sealift Command (MSC) which operates, supplies, and maintains the Naval ships around the world.

**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 UCC which is a DoD command 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.
Performance Goals, Objectives, and Results

America’s security depends on the strength and success of the DON and its ability to remain ahead of the competition. The DON set a strategy for restoring readiness, strengthening partnerships and reforming its business practices, centered on three key priorities: people, processes, and capabilities. The focus of these priorities is to restore program balance, sustain global demand for naval forces, continue improving readiness, recapitalize and modernize naval forces, address the competitive operational environment, improve cyber resiliency, and promote responsible military spending. These efforts will enhance capabilities, improve the lives of Sailors and Marines, and increase lethality, resulting in the successful sustainment of our world-class naval force and greater security for the U.S.

In line with the National Defense Strategy, the Navy created the DON Business Operations Plan (BOP) in FY 2018 which established prioritized strategic objectives along with focus areas and specific initiatives to achieve those objectives and support vital integration efforts. The BOP is an agile, guiding tool, not an immovable strategy. Indeed, to be successful, DON objectives and timelines will evolve to reflect changes in the DON’s external environment and capabilities of both partners and adversaries.

One of the Navy’s objectives is to improve business and financial performance that will be affirmed through full financial statement auditability. The DON is committed to promoting a business culture in which all participants understand their respective roles in achieving and sustaining financial auditability, beginning with senior leaders and extending to business managers who support warfighters each day. Given the complexity and scale of the DON’s operating environment, the Navy implemented several long-term transformation initiatives that are designed to integrate, standardize, and modernize enterprise systems; improve visibility and transparency of business data; and institutionalize effective internal controls over business processes. While the transformation effort is ongoing, the audit is proving to be a valuable independent assessment that the DON can leverage to support readiness and lethality. DON is using this information to streamline operations and reimagine how support functions can be modernized.

Finally, the DON BOP aligns with the priorities and initiatives of the Office of the Under Secretary of Defense (Comptroller). All initiatives in the DON BOP fully support reform categories as published in the FY 2020 Budget Book.

The DON Business Operations Management Council (BOMC) and the Office of the Chief Management Officer (OCMO) regularly track performance of initiatives contained within the BOP. The BOMC discusses these initiatives from a risk-based perspective within the context of the National Defense Strategy. The DON uses status reports on each initiative to identify risks to the successful completion of a strategic objective and discusses what resources and authorities may be required to ensure success.

In FY2019, the DON completed 70 BOP initiatives. Some of the most notable successes over the last year include:

• Improved mission capable rates for F/A-18 E/F Super Hornet and EA-18G Growler aircraft from 50% (last year) to 80% (as of September 24, 2019).
• 75% of guided-missile destroyers (DDG) availabilities are on track to complete on time in FY 2020 quarter 1 (Q1) and Q2, above the FY 2019 fleet-wide baseline of 50%.
• Employed agile acquisition strategies to reduce the total cost of the next two aircraft carriers by $2.4 billion.
• Achieved Initial Operating Capability of the Joint Light Tactical Vehicle 10 months early.
• Completed the second full scope audit in our history.
• Achieved an unprecedented 100% baseline review of all USN real property.
• Reduced future maintenance costs by divesting 11.5 million square feet of obsolete USMC facilities.
• Identified over $500 million of inventory that had been maintained outside of an Accountable Property System of Record (APSR).

The DON BOP, now entering its third year, includes 198 initiatives, including 58 that were carried over into FY 2020, and continues to harness the momentum of its successes. The DON BOP was updated in FY 2019 to help articulate the impact each initiative has on the strategic objectives. For FY 2020, new business rules have been established which require initiatives to provide impact in one of three ways: cost savings, investments, or avoidance; manpower or time savings and efficiencies; or as enablers that affect readiness and lethality.
The following discussion and tables provide a high-level overview of the BOP framework and foundation for the DON’s ongoing management agenda, focusing on the three lines of effort, strategic objectives, and sample results. For more information, the DON BOP is available at [https://www.navy.mil/DONBOP](https://www.navy.mil/DONBOP).

**Line of Effort 1: Rebuild Military Readiness as We Build a More Lethal Joint Force**

The pace of wartime and other priority worldwide operational programs has taxed the DON’s capacity to maintain a ready force. Currently however, thanks to sustained support by Congress, the DON is on the path to recovery. The current and planned budgets deliberately prioritize improved readiness and integration of current Fleet and Operational Marine Forces. The DON BOP promotes adjustments to business processes and inserts innovative, more efficient means to assess progress, so that every taxpayer dollar is stewarded effectively in support of DON warfighters. The continued overall improvement of military readiness will take time, and the investments will be more properly balanced across all the dimensions of naval power to consistently meet national strategic objectives.

**Select FY 2019 Results for Line of Effort 1**

<table>
<thead>
<tr>
<th>STRATEGIC OBJECTIVE</th>
<th>SELECTED RESULT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1.A  Fully restore aviation/ship/personnel Readiness to meet missions</td>
<td>Increased public shipyard manning to reduce time and increase throughput of ship repairs</td>
</tr>
<tr>
<td>1.1.B  Restore inventory of weapons and ammunition to meet warfighting requirements</td>
<td>Conducted a Navy gap analysis to determine the number and types of weapons and associated munitions required to support air, surface, subsurface combat missions</td>
</tr>
<tr>
<td>1.2.A  Deliver platforms that possess greater combat power and longer reach in support of Missions across all domains</td>
<td>Developed a Navy Criminal Investigative Service (NCIS) plan to target contractors, subcontractors, and vendors that engage in illegal product substitution and import counterfeit products and parts for improved acquisition</td>
</tr>
<tr>
<td>1.2.B  Deliver innovative technologies that provide greater combat power and longer reach in support of missions across all domains</td>
<td>Strengthened partnerships with law enforcement offices to enhance cyber investigations and operations targeting threat actors who undermine the DON’s capital investment in technology</td>
</tr>
<tr>
<td>1.2.C  Develop and implement a sustainable path to infrastructure modernization</td>
<td>Completed gap analysis, comparing “as-is” operational, test, and training range capabilities compared to current requirements for Operational, Test, and Training Range Effectiveness</td>
</tr>
<tr>
<td>1.3.A  Optimize DON’s information infrastructure (e.g., networks, transport, end-user hardware, spectrum)</td>
<td>Completed a revised technical refresh plan that replaces older equipment allowing the use of higher speed connections for Navy Enterprise Networks Ashore</td>
</tr>
<tr>
<td>1.3.B  Increase DON’s ability to deter, detect, defeat and recover from cyber-attacks</td>
<td>Increased accountability of Defense Industrial Base (DIB) performers and visibility of DIB networks associated with to protection of DON data</td>
</tr>
<tr>
<td>1.4.A  Deliver timely and relevant intelligence, counterintelligence and security support to Sailors and Marines to provide a decisive and dominant advantage</td>
<td>Fielded a secure case management system to synchronize Navy, Marine Corps, and NCIS Counterintelligence activities through a secure, common information and data storage network</td>
</tr>
<tr>
<td>1.5.A  Produce a highly skilled workforce (Sailors, Marines, and civilians) shaped for today and prepared for tomorrow’s needs</td>
<td>Developed and issued DON guidance on “playing the ethical midfield”</td>
</tr>
</tbody>
</table>

Table 1: FY 2019 Results for Line of Effort 1
Line of Effort 2: Strengthen Our Alliances and Attract New Partners

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.

Select FY 2019 Results for Line of Effort 2

<table>
<thead>
<tr>
<th>STRATEGIC OBJECTIVE</th>
<th>SELECTED RESULT</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1.A Implement a more strategic, coordinated approach to security cooperation</td>
<td>Continuing to develop DON policies and tools by DUSN to enable international key leader engagement synchronization</td>
</tr>
</tbody>
</table>

Table 2: FY 2019 Results for Line of Effort 2

Line of Effort 3: Reform the Department’s Business Practices for Greater Performance and Affordability

The DON realigns incentive and reporting structures to increase speed of delivery, enables design tradeoffs in the requirements process, expands the role of warfighters and intelligence analysis throughout the acquisitions process, and utilizes non-traditional suppliers. Prior to defining requirements and using commercial-off-the-shelf systems, the DON uses prototyping and experimentation. Creating a culture of agility, accountability, and continuous learning allows the DON to accomplish business reform objectives. In doing so, the DON is able to build a flatter and faster organization in which data is verified, processes are clear and understood, and business controls lead to informed decisions.

Select FY 2019 Results for Line of Effort 3

<table>
<thead>
<tr>
<th>STRATEGIC OBJECTIVE</th>
<th>SELECTED RESULT</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1.A Increase the use of data analytics and artificial intelligence in DON-wide decision making</td>
<td>Developed a DON Implementation Plan for the DoD Data Strategy focusing on governance, workforce, readiness and tools/technology</td>
</tr>
<tr>
<td>3.1.B Reform business operations enterprise-wide to generate lasting, institutionalized, resources to support strategic reinvestment in lethality</td>
<td>Streamlined environmental compliance through legislative/regulatory relief and improved policy/processes</td>
</tr>
<tr>
<td>3.2.A Reduce redundancies across the enterprise (to include Office of the Chief of Naval Operations (OPNAV), Marine Corps Headquarters (HQMC) and DON Secretariat) to achieve cost savings and improve agility</td>
<td>Developing a new portfolio management construct across the DON, to replace the current Functional Area Management Information Technology (FAM IT)-centric concept</td>
</tr>
<tr>
<td>3.3.A Institutionalize annual audit and remediation, and establish a near term path to a clean opinion</td>
<td>Completed Navy 100% existence and completeness of real property in FY 2019</td>
</tr>
</tbody>
</table>

Table 3 FY: 2019 Results for Line of Effort 3
Looking Forward

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.

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

- Reemergence of long-term, strategic competition, including Russia and China against a resilient, but weakening, post-WWII international order.
- Regional destabilization driven by rogue regimes, including North Korea and Iran, and the continued pursuit of weapons of mass destruction.
- Erosion of DON technological gap through rapid, commercially-driven technological advancements and the changing character of combat.
- Threats from non-state actors, including terrorists, trans-national criminal organizations, cyber hackers, and other malicious non-state actors which target America.
- Increased domestic activity eroding the sanctuary of America, including terrorism, malicious cyber activity, and political and information subversion.
- Economic and labor market changes that impact the availability of a quality workforce to meet DON demands.

To address these risks, the DON BOP identified six strategic priorities aligned to the three key priorities of people, processes, and capabilities:

**People**

- **Invest in human capital.** In FY 2020, develop and implement human capital strategies guaranteeing our military and civilian workforce are the most skilled, innovative, agile, and valued capability in the DON.
- **Prioritize learning as a strategic advantage.** In FY 2020, accelerate the implementation of Education for SeaPower initiatives to advance an institutional culture of learning, innovation, and intellectual preparedness for the DON military and civilian workforce as the core of our sea power advantage.

**Process**

- **Develop a fully integrated Program Objective Memorandum (POM) process.** By the end of FY 2020, develop and implement an integrated DON POM cycle and budgeting process that provides the Secretariat with the holistic understanding of requirements, risks, and strategic decision-points over the FYDP.
- **Modernize business operations.** In FY 2020, continue the aggressive implementation of the initiatives detailed in the DON BOP with a particular emphasis on rationalizing and modernizing the DON's supply chain and logistics operations, systems, financial management, and business process reforms that generate measurable savings across the FYDP.

**Capabilities**

- **Elevate information management.** In FY 2020, establish a fully empowered, mission-oriented CIO implementing structure and strategies that accelerate the whole DON digital transformation while delivering secure, reliable, and resilient warfighting capabilities across the information spectrum.
- **Design an integrated naval structure.** In FY 2020, develop a fully integrated DON and Industrial Base Management Plan for a modern, integrated naval force and supporting infrastructure capable of global projection, interoperable with partner nations and lethal overmatch from warfighting capability and capacity delivered ahead of global business trends.
Management Assurances

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 (FMFIA). 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. Based on the results of this assessment, the DON can provide the following assurance levels as of 30 September 2019:

- **Internal Controls over Operations (ICO)** – Reasonable Assurance, except for nine ICO material weaknesses (MWs) identified and two significant deficiencies (SDs).
- **Internal Control over Financial Reporting (ICOFR)** – No Assurance, due to twelve MWs identified.
- **Internal Controls over Financial Systems (ICOFS)** – No Assurance, due to three MWs identified.
- **Entity-Level Controls (ELCs), including fraud controls** – Reasonable Assurance, except for one MW identified.

Additionally, the annex of classified and Special Access Programs (SAP) MWs has been forwarded through special access to the Office of the Secretary of Defense SAP Classified Office.

RICHARD Y. SPENCER
Secretary of the Navy
**Systems, Controls, and Legal Compliance**

Quantifiable financial information, in conjunction with sufficient controls, provides valuable information to complement operational data and promotes 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 commanders, senior leaders, and managers are obligated to safeguard the integrity of the programs and operations. DON management evaluated the system of internal controls in effect during FY 2019 in accordance with OMB A-123 and GAO’s, Standards for Internal Control in the Federal Government (Green Book). The OMB guidelines were issued in conjunction with the Comptroller General of the U.S., as required by FMFIA.

Below is an abbreviated discussion, for more information; see the full FY 2019 DON Statement of Assurance (SOA).

**Corrected and Reassessed Material Weaknesses**

In FY 2019, DON corrected or reassessed the following prior-year Material Weaknesses (MWs):

<table>
<thead>
<tr>
<th>Area</th>
<th>Internal Control Reporting Category</th>
<th>Title of Material Weakness</th>
<th>Targeted Correction Year</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICO</td>
<td>Force Readiness</td>
<td>Surface Force Incidents</td>
<td>FY 2020</td>
<td>Reassessed as Significant Deficiency (SD)</td>
</tr>
<tr>
<td>ICOFR</td>
<td>Acquire-to-Retire</td>
<td>Real Property E&amp;C</td>
<td>FY 2019</td>
<td>Corrected</td>
</tr>
<tr>
<td>ICOFR</td>
<td>Hire-to-Retire</td>
<td>Military Pay and Personnel (Controls)</td>
<td>FY 2023</td>
<td>Reassessed as SD</td>
</tr>
<tr>
<td>ICOFR</td>
<td>Procure-to-Pay</td>
<td>Retention of Transportation Documents</td>
<td>N/A</td>
<td>Reassessed as Control Deficiency</td>
</tr>
</tbody>
</table>

**Internal Controls Governance**

This year, the DON continued to mature the DON’s Internal Controls program, building upon the existing Managers’ Internal Control Program (MICP) governance structure to align with FMFIA and OMB A-123 requirements. DON also established the Integrated Risk Management Strategy to assist the DON in accomplishing its strategic objectives. It establishes a framework to further elevate existing practices and promote increased connection between enterprise strategies and risk management and the addition of a top-down and bottom-up alignment approach.
The DON’s comprehensive internal control governance structure monitors risks, the effectiveness of internal controls, remediates deficiencies, and reports progress in the annual SOA. The governance structure and the roles and responsibilities of each governing body is illustrated in Figure 2 below.

The DON Audit Committee, 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. In FY 2018, the Audit Committee assigned end-to-end process owners to lead the DON’s functional business process areas, including policy development, implementation, and compliance. Additionally, process owners resolve deficiencies identified through the MICP and other programs.

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, OCMO. The SMC advises SECNAV and the Audit Committee on the state of the DON’s internal control risk assessment, testing, compliance, corrective action implementation, and reporting.

The Senior Assessment Team (SAT) is the governing body that oversees FFMIA compliance activities associated with assessing ICOFR and ICOFS. The SAT is comprised of BSO Comptrollers and is co-chaired by the Deputy Assistant Secretary of the Navy (DASN) (Financial Policy and Systems) and DASN (Financial Operations). The SAT annually assesses the state of the DON’s financial risk and internal controls health within ICOFR and ICOFS. The SAT also determines whether new finance-related deficiencies exist and monitors the remediation status of MW or SD. While the SAT recommends the approval of new (or closure of existing) MWs or SDs, the SMC is responsible for final approval.

Senior Accountable Officials are DON SES members or flag officers that have been assigned a specific deficiency. They are responsible for working with action officers to implement Corrective Action Plans (CAPs) to remediate weaknesses, deficiencies and reporting remediation status to the SMC and SAT.

Each of the DON’s 18 MAUs define the assessable units within their organization based on those most critical to the organization’s mission and strategic objectives. The MAUs execute their internal control process which includes risk assessment, control testing, deficiency identification and subsequent corrective actions, and reporting results in their Certification Statement. These Certification Statements and their supporting enclosures are the primary source documents for the determination of reasonable assurance over the effectiveness of the DON’s non-financial operations and processes.
Internal Controls over Operations (FMFIA Section 2)

The DON’s MICP is the administrative vehicle for monitoring ICO, ICOFR, and ICOFS. The DON’s ICO program mitigates 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 18 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 nine MWs identified below, that internal controls over operations and compliance were operating effectively as of September 30, 2019.

<table>
<thead>
<tr>
<th>Internal Control Reporting Category</th>
<th>Uncorrected ICO Material Weakness</th>
<th>First Year Reported</th>
<th>Targeted Correction Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple</td>
<td>Depot Level Maintenance</td>
<td>FY 2016</td>
<td>Q3 FY 2025</td>
</tr>
<tr>
<td>Personnel and Organizational Management</td>
<td>Military Pay and Personnel</td>
<td>FY 2016</td>
<td>Q1 FY 2023</td>
</tr>
<tr>
<td>Comptroller and Resource Management</td>
<td>DON Oversight and Management of Improper Payments</td>
<td>FY 2015</td>
<td>Q2 FY 2020</td>
</tr>
<tr>
<td>Contract Administration</td>
<td>Execution of Husbanding Contracts – Husbanding Service Providers</td>
<td>FY 2016</td>
<td>Q1 FY 2022</td>
</tr>
<tr>
<td>Multiple</td>
<td>Data Protection</td>
<td>FY 2017</td>
<td>Q1 FY 2020</td>
</tr>
<tr>
<td>Information Technology</td>
<td>Complex Business IT Environment</td>
<td>FY 2018</td>
<td>Q1 FY 2022</td>
</tr>
<tr>
<td>Multiple</td>
<td>Property in the Possession of Contractors</td>
<td>FY 2018</td>
<td>Q4 FY 2021</td>
</tr>
<tr>
<td>Personnel and Organizational Management</td>
<td>Submission of Criminal Subject Fingerprint Cards and Reporting Disposition of Criminal Charges</td>
<td>FY 2018</td>
<td>Q3 FY 2021</td>
</tr>
<tr>
<td>Multiple</td>
<td>Oversight and Monitoring</td>
<td>FY 2016</td>
<td>Q4 FY 2020</td>
</tr>
</tbody>
</table>

The DON 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.

Internal Controls over Financial Reporting (FMFIA Section 2)

In FY 2019, the DON continued to build upon prior year progress in improving ICOFR, 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.

In FY 2019, the DON continued its efforts to improve its process documentation and continues to work with process owners to update Process Cycle Memoranda. This helps to ensure they contain the content necessary to sufficiently document the end-to-end processes and identifying relevant guidance and controls. The DON also continues to evaluate service provider controls through its review of service provider’s System and Organization Controls (SOC 1) reports and identify necessary Complementary User Entity Controls (CUEC). The DON is working with process owners’ internal lexicon to implement CUECs in its end-to-end processes.
The DON tested key internal controls within various business processes, using a variety of testing methodologies, and maintained documentation to support its evaluation and level of assurance. In FY 2019, the DON resolved one ICOFR MW over real property accountability and recategorized or reassessed six MWs, resulting in twelve ICOFR MWs.

Based on the results of the assessment, the DON cannot provide reasonable assurance controls were operating effectively due to the MWs identified below as of September 30, 2019 in accordance with OMB A-123, Appendix A.

<table>
<thead>
<tr>
<th>Uncorrected ICOFR Material Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Internal Control Reporting Category</strong></td>
</tr>
<tr>
<td>Acquire-to-Retire</td>
</tr>
<tr>
<td>Acquire-to-Retire</td>
</tr>
<tr>
<td>Multiple</td>
</tr>
<tr>
<td>Multiple</td>
</tr>
<tr>
<td>Procure-to-Pay</td>
</tr>
<tr>
<td>Budget-to-Report</td>
</tr>
<tr>
<td>Procure-to-Pay</td>
</tr>
<tr>
<td>Plan-to-Stock</td>
</tr>
<tr>
<td>Plan-to-Stock</td>
</tr>
<tr>
<td>Plan-to-Stock</td>
</tr>
<tr>
<td>Order-to-Cash</td>
</tr>
<tr>
<td>Multiple</td>
</tr>
</tbody>
</table>

To address these areas, DON supplemented development of corresponding CAPs with four broader transformation priorities:

**Real Property**: The DON is conducting real property asset existence and completeness inventories and improving end-to-end processes.

**Inventory and Operating Materials and Supplies (OM&S)**: To manage item quantity, condition, and location, the DON is improving oversight procedures, identifying gaps in key controls with a re-engineered process, and establishing baselines for the population of its items.

**Financial Reporting and Fund Balance with Treasury**: The DON is correcting accounting system posting logic and underlying business processes to reduce the number of manual and automated adjustments to financial statements. The DON is also streamlining its processes and transitioning to U.S. Treasury (Treasury) disbursing and collection shared services, starting in FY 2020.

**Budgetary Reform**: The DON is moving funds to where they are used, relieving the need for burdensome documentation and reconciliation requirements at various levels of organizations. The DON is also changing the intragovernmental payment process (with other government agencies) to enforce proper receipt of goods or services before payments are processed.

Each of these areas have distinct initiatives which are identified in the DON BOP and managed under the oversight of ASN (FM&C); ASN (Energy, Installations, and Environment) (EI&E); the Deputy CNO for Fleet Readiness and Logistics; and the USMC Deputy Commandant, Installations and Logistics.

Significant accomplishments for FY 2019 include:

**Real Property**: The USN revised policies and guidance to improve compliance and conducted a 100% physical inventory of all above-ground real property on USN installations. DON used the lessons learned from the event to identify other process improvement opportunities, including below-ground utilities.

**Budgetary Reform**: The DON is successfully improving the transparency and visibility of funds by implementing the
tracking of de-obligations after expiration to identify trends and common issues (i.e., Process to Improve Expenditure Efficiency effort) and developing a Zero-Based Budget approach to attempt to strengthen the link between strategic documents and how funds are spent.

**Inventory and OM&S:** The USN has undertaken a comprehensive effort to begin to identify and properly account for all USN material in order to ensure proper accountability and USN-wide visibility. The effort is focused on identifying all USN material, properly classifying, and determining the appropriate disposition of the material found – either for entry into Navy-wide system for global visibility or disposal through Defense Logistics Agency (DLA). Efforts are underway at select USN sites with Department-wide roll out scheduled for Quarter 1 of FY 2020.

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

During the FY 2019 reporting period, the DON made considerable progress toward improving ICOFS. 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, and NIST 800-53 Rev 4.

The DON updated the FM Overlay in FY 2019 to address enterprise-wide MWs on system interfaces. The updates include the addition of interface-related controls and supplemental requirements (e.g., interface control agreements and configuring data filters). The updated Navy FM Overlay was also deployed to the Enterprise Mission Assurance Support System for the implementation and use by system owners.

The DON Enterprise Continuous Monitoring Program (ECMP) focuses on assessing the IT control posture of financially relevant DON systems. Leveraging the DON’s Enterprise IT Control Standards, the ECMP team performed assessments on financially relevant systems to prepare for the transition to the RMF and future financial statement audits.

In FY 2019, the DON conducted a limited internal review of the effectiveness of internal controls over the financial systems in accordance with FFMIA and OMB A-123, Appendix D- Significant Deficiencies and Material Weaknesses. Based on the results of this assessment, the DON internal controls over financial systems do not fully conform to the objective of FFMIA and OMB A-123, Appendix D. Non-conformance was caused by three items identified below as of September 30, 2019.

ICOFS MWs are assigned to the DASN (Financial Policy and Systems) and the USMC and have a similar remediation and validation process as ICOFR MWs.

<table>
<thead>
<tr>
<th>Uncorrected ICOFS Material Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Control Reporting Category</td>
</tr>
<tr>
<td>Title of Material Weakness</td>
</tr>
<tr>
<td>First Year Reported</td>
</tr>
<tr>
<td>Targeted Correction Date</td>
</tr>
<tr>
<td>Interface Controls</td>
</tr>
<tr>
<td>Interfaces</td>
</tr>
<tr>
<td>FY 2016</td>
</tr>
<tr>
<td>Q3 FY 2022</td>
</tr>
<tr>
<td>Multiple</td>
</tr>
<tr>
<td>Configuration Management</td>
</tr>
<tr>
<td>FY 2015</td>
</tr>
<tr>
<td>Q2 FY 2021</td>
</tr>
<tr>
<td>Multiple</td>
</tr>
<tr>
<td>Information Systems Access Controls/Segregation of Duties (SOD)</td>
</tr>
<tr>
<td>FY 2014</td>
</tr>
<tr>
<td>Q4 FY 2021</td>
</tr>
</tbody>
</table>

The DON financial management IT environment has evolved over decades to the point where DON processed financial transactions on ten general ledgers (GLs). These GLs are supported by a complex and highly customized feeder systems environment necessitating many interfaces and work-arounds resulting in a lack of transactional traceability. In the current state, it is difficult for the DON to produce timely and reliable financial information and statements. This deficiency poses potential risk to informed decision making and efficient operations.
To address the underlying root causes, the Navy embarked on two broad transformation priorities focused on simplifying and consolidating the DON’s financial management environment to increase auditability, reduce operating costs, and minimize cyber vulnerabilities:

**Accounting Systems Consolidation:** The DON is reducing the total number of accounting systems to two Standard Accounting, Budgeting, and Reporting System (SABRS) and Navy Enterprise Resource Planning (NERP) by end of FY 2020 with the ultimate goal of having only one accounting system, NERP. The DON is expanding the financial management functionality in ERP, re-engineering business processes, and enforcing systems compliance with data standards.

**IT General Controls:** By implementing the new RMF within the entire IT acquisition process from beginning to end, the DON is enabling increased oversight, security controls, and interoperability. The DON is leveraging new technologies and retiring legacy systems to accelerate its transition to a modern and more secure system environment.

Each of these areas have distinct initiatives which are identified in the DON BOP and managed under the oversight of ASN (FM&C).

Significant accomplishments for FY 2019 include:

**IT General Controls:** DON initiated an assessment of thirty financially significant DON applications. This assessment included: confirming systems to target; obtaining and reviewing user role extracts and role definitions; mapping roles to business functions; identifying users with access to multiple systems; and identifying potential cross application SOD conflicts based on users with roles in more than one system. Of the thirty financially significant applications assessed, seventeen were selected for analysis based on risk, financial materiality and presence of audit findings. DON mapped system roles for selected systems to function IDs in order to determine which users had potential cross application SOD conflicts and generated an automated cross application SOD conflict report for all seventeen applications to allow for a more timely assessment of potential SOD conflicts. This report allowed the DON to identify a population of four users with potential cross-application SOD issues.

**Accounting System Consolidation:** DON modernized its ERP system by making several changes to improve performance, shifting from an Oracle database to a HANA database, and migrating to a high performance analytic cloud-based platform ten months ahead of schedule, in what is likely the largest ERP cloud migration in North American history. With nearly $70 billion flowing into the U.S. economy annually through NERP, the new cloud platform will provide faster and more capable performance for the 72,000 NERP users across six Navy commands who play a role in managing more than half of the Navy’s finances. DON also continued to make progress in the consolidation of general ledger systems by shutting down a legacy general ledger system and continuing the migration of all other systems to SABRS and NERP.

**Entity-Level Control Analysis and Fraud Assessment**

In FY 2019, the DON assessed ELCs, including fraud controls, in accordance with the Section 10.09 of the GAO Green Book, OMB A-123, Fraud Reduction and Data Analytics Act of 2015, and GAO Fraud Risk Management Framework.

The DON assessed ELCs across twenty MAUs by issuing a comprehensive survey. The survey leveraged GAO’s Internal Control Management and Evaluation Tool to provide examples of control activities and factors to determine if GAO Green Book principles are adequately addressed for each component of internal control (i.e., Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring). MAUs completed the survey from their organization’s perspective by identifying the processes, policies, and guidance in place to address each control activity. Additionally, MAUs were asked to identify DON-wide policy on control activity and describe any additional actions taken to further enforce or implement the policy within their organization. The consolidated survey responses were used to assess the DON’s adherence to GAO requirements and if policies and directives that support ELCs are socialized and implemented across the enterprise.

Based on the analysis of the consolidated FY 2019 ELC survey, MAU responses indicated that core foundational controls supporting the GAO’s Green Book are in place across the organization. Most of the respondents indicated that internal management directives are well-communicated and ELCs exist within the DON’s overall internal control environment. However, responses also indicated that opportunities to improve remain in each internal control area.

The survey results provide the DON with an assessment of its FY 2019 ELC environment and build upon the baseline ELC assessment conducted in FY 2018. The DON is conducting a deep dive analysis leveraging FY 2018 results and FY 2019
assessment results to validate and prioritize observations that indicate potential areas for improved internal controls. The DON will work with process owners (i.e., MAUs) to verify if control gaps exist and to develop actionable next steps for remediation. Using the survey as a tool to conduct assessments in subsequent years will inform DON senior leadership on ELC program trends and progress with corrective actions.

Supplementing the above, the Naval Audit Service (NAVAUDSVC) also conducts performance audits to assess the risk of fraud occurring as outlined in the NAVAUDSVC Handbook, Fraud Risk Matrix, and the Fraud Risk Assessment Checklist. Controls specifically designed to respond to fraud risks and allegations include:

- The Naval Inspector General’s (NAVINSGEN) 24/7 hotline to report fraud, waste, abuse, and mismanagement. The results are considered by NAVINSGEN when developing their inspection plans and special studies scope.
- All criminal fraud allegations are directed to NCIS. Allegations can be reported anonymously and reported via multiple channels. NCIS responds to various types of procurement fraud, including product substitution, general procurement fraud (kickbacks), antitrust, cost mischarging, conflict of interest and bribery.
- The NCIS Economic Crimes Department works to safeguard DON acquisition programs that enhance fleet readiness and respond to allegations of corruption, financial fraud, and illegal product substitution.
- NAVSUP manages a bank card (purchase card, travel card, fleet card, AIR card, SEA card, and SWIPE SEA card) transaction review program. The bank card program managers monitor potential improper charges identified by card issuers. Suspected instances of misuse or abuse are referred to the employee’s supervisor. Penalties for misuse vary but may include reprimand; admonishment; and/or restitution; and separation from government service; or revocation of the employee’s security clearance.
- NAVAUDSVC audits DON activities and programs to determine if internal controls – such as segregating duties among different people to reduce the risk of error or fraud – are in place and operating as intended. Additionally, NAVAUDSVC supports fraud related investigations conducted by various agencies, including NCIS, the Acquisition Integrity Office, and the Naval and Marine Corps IGs as requested.

In FY 2019, the DON established a fraud risk and data analytics program that will evaluate potential mechanisms to monitor fraud trends and improve fraud prevention, detection and response. In addition to overseeing fraud risk management activities, this new program will serve as the repository of knowledge on fraud risks and controls, manage the fraud risk assessment process, coordinate antifraud activities, and lead or assist with trainings and other fraud-awareness activities.

Based on the results of the assessment, the DON can provide reasonable assurance, except for the ICO Oversight and Monitoring MW, that ELCs, including fraud controls, are operating effectively as of September 30, 2019.

**Anti-Deficiency Act Violations**

The DON WCF reported one insignificant Anti-Deficiency Act (ADA) violation for FY 2019: N17-01 (Berry Amendment), which was submitted to Congress on May 7, 2019.
Financial Condition and Results of Operations

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 Revised due to limitations of financial and non-financial management processes and systems feeding into the financial statements. Because of these limitations, the IPA was unable to express an opinion on the FY 2019 USN GF or 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 provide 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
- Military Personnel
- Procurement
- Research, Development, Test, and Evaluation
- Family Housing
- 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 $223.2 billion that were available to the USN GF during FY 2019 and the status of those resources at the end of FY 2019. The enacted appropriations of $169.0 billion represent 75.7% of total budgetary resources. The Navy obligated $180.5 billion of the $223.2 billion total resources in FY 2019. The remaining $42.7 billion, or 19.1%, of available funding remained unobligated as of the end of FY 2019.

The Statement of Net Cost (SNC) presents Net Cost of Operations of $160.1 billion during FY 2019. 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 Revised requirements.

Financial Position

The USN GF continued to report a positive Net Position on its Consolidated Balance Sheet, the difference between Total Assets of $646.0 billion and Total Liabilities of $50.0 billion. As of September 30, 2019, Net Position totaled $596.0 billion. The USN is a capital asset-intensive organization, with General Property, Plant, and Equipment (PP&E) representing 59.5% of Total Assets. These assets have significant associated environmental and disposal liabilities (E&DL) of $25.6 billion, or 51.1% of Total Liabilities.
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 $40.3 billion that were available to the DON WCF during FY 2019. DON WCF budget authority is comprised of Contract Authority and Spending Authority from Offsetting Collections of which the latter accounts for $24.0 billion or 59.5% of total budgetary resources.

The SNC presents net cost of operations of $0.8 billion during FY 2019. 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.
Management's Discussion and Analysis | Fiscal Year 2019 Agency Financial Report

**Financial Position**

The DON WCF reported a positive Net Position on its Consolidated Balance Sheet. Net Position is the difference between Total Assets of $47.7 billion and Total Liabilities of $5.2 billion. As of September 30, 2019, Net Position totaled $42.5 billion.

![DON WCF Total Assets and Liabilities](chart.png)

**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 September 30, 2019, the high cash requirement was $2.4 billion, and the low cash requirement was $1.5 billion.

![MONTHLY DON WCF CASH BALANCES](chart2.png)
Limitations of the Financial Statements

The principal financial statements are prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of 31 USC 3515(b). The statements are prepared from the books and records of the entity in the formats prescribed by OMB. Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. government.
Ensight Collin Long, from Hawthorn Woods, Ill., communicates with the helmsman of the Ticonderoga-class guided-missile cruiser USS Antietam (CG 54) during a replenishment-at-sea with the Henry J. Kaiser-class underway replenishment oiler USNS John Ericsson (T-AO 194). (U.S. Navy photo by Mass Communication Specialist 2nd Class William McCann/Released)
During FY 2019, the Department of the Navy (DON) continued its second year of full financial statement audits while making strides towards achieving its goal of improved and auditable business practices for greater performance and affordability. The audit consists of three parts: The Navy General Fund, Marine Corps General Fund, and the DON Working Capital Fund. As expected, the results of all three audits were disclaimers of opinion. We continued to learn a great deal from this experience as well as from the remediation activities underway to address audit findings. In particular, we are removing excess inventory and operating material and supplies and performing a one hundred percent count of these items while identifying bad business practices and opportunities to reengineer our procurement and logistics processes and systems.

At the start of this year, we used prior year audit results to prioritize our transformation initiatives and establish a roadmap in the DON's Business Operations Plan. The priorities were established based on the impact to operational readiness and the severity of the weakness in our internal control environment. We developed plans and metrics for tracking progress of each initiative and held the responsible stakeholders accountable across the operational and functional communities.

The scope and scale of our transformation initiatives are significant and will continue for several years. This year we successfully completed two major efforts that operationally and financially benefit our readiness and auditability:

- We completed an inventory of real property assets at our installations and corrected all discrepancies between our books and what exists in the field. As a result, we have downgraded a material weakness and improved our ability to account and budget for our real property assets.

- We modernized our DON Enterprise Resource Planning (ERP) system by making several changes to improve performance, shifting from an Oracle database to a HANA database, and migrating to a high performance analytic cloud-based platform 10 months ahead of schedule, in what is likely the largest ERP cloud migration in North American history. With nearly $70B flowing into the U.S. economy annually through Navy ERP, the new cloud platform will provide faster and more capable performance for the 72,000 ERP users across six Navy commands who play a role in managing more than half of the Navy's finances. We also continued to make progress in the consolidation of general ledger systems by shutting down a legacy general ledger system and continuing the migration of all other systems to SABRS and the DON ERP system.

In addition to these accomplishments, we continue to: reform our budget processes for better execution and efficiency, migrate from legacy systems into a modern and standard system environment, and improve controls over receipt and issuance of inventory to ensure we get the right part to the right place at the right time, every time.

The DON’s leadership continues to take this audit seriously. We are committed to resolving the deficiencies in our internal controls and processes with a sense of urgency. We owe the American taxpayers transparency on how we use the resources entrusted to us to buy, build and maintain weapon systems, recruit and develop personnel, and build a secure system environment in support of our mission. The financial audit has fostered a greater awareness of how we can identify opportunities to support and improve readiness and modernization. I look forward to continuing this cadence in the coming year to improve DON’s readiness, lethality, and demonstrate effective stewardship of taxpayer dollars.

THOMAS W. HARKER
Assistant Secretary of the Navy
(Financial Management and Comptroller)
The FY 2019 USN GF principal statements and related notes are presented in the format prescribed by OMB A-136 Revised, 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 ending September 30, 2019, and are not presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2018.

The following statements comprise the USN GF principal statements:

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

The accompanying notes should be considered an integral part of the principal statements.
### US Navy General Fund
Consolidated Balance Sheet
As of September 30, 2019
($ in thousands)

#### ASSETS (Note 2):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intragovernmental:</td>
<td></td>
</tr>
<tr>
<td>Fund Balance with Treasury (Note 3)</td>
<td>$175,335,714</td>
</tr>
<tr>
<td>Accounts Receivable (Note 5)</td>
<td>$230,151</td>
</tr>
<tr>
<td>Other (Note 9)</td>
<td>$969,663</td>
</tr>
<tr>
<td><strong>Total Intragovernmental</strong></td>
<td><strong>$176,535,528</strong></td>
</tr>
<tr>
<td>Cash and Other Monetary Assets (Note 4)</td>
<td>$102,387</td>
</tr>
<tr>
<td>Accounts Receivable, Net (Note 5)</td>
<td>$139,607</td>
</tr>
<tr>
<td>Inventory and Related Property, Net (Note 6)</td>
<td>$84,963,740</td>
</tr>
<tr>
<td>General Property, Plant and Equipment, Net (Note 7)</td>
<td>$384,136,836</td>
</tr>
<tr>
<td>Other (Note 9)</td>
<td>$174,508</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td><strong>$646,052,606</strong></td>
</tr>
</tbody>
</table>

#### LIABILITIES (Note 13)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intragovernmental:</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$2,052,490</td>
</tr>
<tr>
<td>Other (Note 13)</td>
<td>$562,245</td>
</tr>
<tr>
<td><strong>Total Intragovernmental</strong></td>
<td><strong>$2,614,735</strong></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$11,597,370</td>
</tr>
<tr>
<td>Federal Employee and Veteran Benefits (Note 11)</td>
<td>$1,289,343</td>
</tr>
<tr>
<td>Environmental and Disposal Liabilities (Note 12)</td>
<td>$25,551,468</td>
</tr>
<tr>
<td>Accrued Unfunded Annual Leave</td>
<td>$2,401,626</td>
</tr>
<tr>
<td>Other (Note 13)</td>
<td>$6,563,396</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td><strong>$50,017,938</strong></td>
</tr>
</tbody>
</table>

#### Commitments and Contingencies (Note 15)

#### NET POSITION

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unexpended Appropriations - All Other Funds</td>
<td>$157,886,763</td>
</tr>
<tr>
<td>Cumulative Results of Operations - Funds from Dedicated Collections (Note 16)</td>
<td>$54,553</td>
</tr>
<tr>
<td>Cumulative Results of Operations - All Other Funds</td>
<td>$438,093,352</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Position - Funds from Dedicated Collections</td>
<td>54,553</td>
</tr>
<tr>
<td>Net Position - All Other Funds</td>
<td>595,980,115</td>
</tr>
<tr>
<td><strong>TOTAL NET POSITION</strong></td>
<td><strong>596,034,668</strong></td>
</tr>
</tbody>
</table>

#### TOTAL LIABILITIES AND NET POSITION

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOTAL LIABILITIES AND NET POSITION</strong></td>
<td><strong>$646,052,606</strong></td>
</tr>
</tbody>
</table>

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, 2019
($ in thousands)

GROSS PROGRAM COSTS (Note 17)

<table>
<thead>
<tr>
<th>Gross Cost</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Military Personnel</td>
<td>$34,745,852</td>
</tr>
<tr>
<td>Operations, Readiness, &amp; Support</td>
<td>64,558,475</td>
</tr>
<tr>
<td>Procurement</td>
<td>36,586,447</td>
</tr>
<tr>
<td>Research, Development, Test &amp; Evaluation</td>
<td>18,714,894</td>
</tr>
<tr>
<td>Family Housing &amp; Military Construction</td>
<td>14,210,571</td>
</tr>
</tbody>
</table>

Less: Earned Revenue                              | (8,679,444) |

**NET COST OF OPERATIONS**                       | $160,136,795 |

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, 2019

($ in thousands)

<table>
<thead>
<tr>
<th>Funds From Dedicated Collections</th>
<th>All Other Funds</th>
<th>Eliminations</th>
<th>Consolidated Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UNEXPENDED APPROPRIATIONS:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beginning Balances</td>
<td>$</td>
<td>$ 147,921,945</td>
<td>$</td>
</tr>
<tr>
<td><strong>BUDGETARY FINANCING SOURCES:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appropriations Received</td>
<td>-</td>
<td>169,069,290</td>
<td>-</td>
</tr>
<tr>
<td>Appropriations Transferred in/out</td>
<td>-</td>
<td>52,074</td>
<td>-</td>
</tr>
<tr>
<td>Other Adjustments</td>
<td>-</td>
<td>(2,918,014)</td>
<td>-</td>
</tr>
<tr>
<td>Appropriations Used</td>
<td>-</td>
<td>(156,238,532)</td>
<td>-</td>
</tr>
<tr>
<td><strong>TOTAL BUDGETARY FINANCING SOURCES</strong></td>
<td>-</td>
<td>9,964,818</td>
<td>-</td>
</tr>
<tr>
<td><strong>TOTAL UNEXPENDED APPROPRIATIONS</strong></td>
<td>-</td>
<td>157,886,763</td>
<td>-</td>
</tr>
</tbody>
</table>

| **CUMULATIVE RESULTS FROM OPERATIONS:** |
| Beginning Balances (Note 16)       | 47,622         | 412,987,365   | -                  | 413,034,987   |
| Prior Period Adjustments:          |
| Changes in accounting principles (+/-) | -              | 4,528,589     | -                  | 4,528,589     |
| Corrections of Errors              | -              | 7,250,446     | -                  | 7,250,446     |
| **BEGINNING BALANCES, AS ADJUSTED** | 47,622         | 424,766,400   | -                  | 424,814,022   |

| **BUDGETARY FINANCING SOURCES:** |
| Other adjustments (+/-)            | -              | 5,658         | -                  | 5,658         |
| Appropriations Used                | -              | 156,238,532   | -                  | 156,238,532   |
| Non-exchange Revenue               | 128            | (96)          | -                  | 32            |
| Donations and Forfeitures of Cash and Cash Equivalents | 41,715 | - | - | 41,715 |
| Transfers-in/out without reimbursement | -              | (3,586)       | (3,586)            | -             |

| **OTHER FINANCING SOURCES (NON-EXCHANGE):** |
| Transfers In/Out without Reimbursement | -              | (939,801)     | 3,586              | (943,387)     |
| Imputed Financing                  | -              | 803,585       | -                  | 803,585       |
| Other                              | -              | 17,324,543    | -                  | 17,324,543    |
| **TOTAL FINANCING SOURCES**        | 41,843         | 173,428,835   | -                  | 173,470,678   |
| **NET CHANGE**                     | 6,931          | 13,326,952    | -                  | 13,333,883    |

| **CUMULATIVE RESULTS OF OPERATIONS** |
| 54,553                           | 438,093,352   | -                  | 438,147,905 |

| **NET POSITION**             |
| $ 54,553                     | $ 595,980,115 | $                  | $ 596,034,668 |

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, 2019**

($ in thousands)

<table>
<thead>
<tr>
<th>BUDGETARY RESOURCES:</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unobligated Balance from Prior Year, net (discretionary and mandatory)</td>
<td>48,688,347</td>
</tr>
<tr>
<td>Appropriations (discretionary and mandatory)</td>
<td>169,051,374</td>
</tr>
<tr>
<td>Spending Authority from Offsetting Collections (discretionary and mandatory)</td>
<td>5,462,977</td>
</tr>
<tr>
<td><strong>TOTAL BUDGETARY RESOURCES</strong></td>
<td>$ 223,202,698</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>STATUS OF BUDGETARY RESOURCES:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>New Obligations and Upward Adjustments (total)</td>
<td>$ 180,531,329</td>
</tr>
<tr>
<td>Unobligated Balance, End of Y ear:</td>
<td></td>
</tr>
<tr>
<td>Apportioned, Unexpired Accounts</td>
<td>39,450,475</td>
</tr>
<tr>
<td>Exempt from Apportionment, Unexpired Accounts</td>
<td>45,228</td>
</tr>
<tr>
<td>Unexpired Unobligated Balance, End of Y ear</td>
<td>39,495,703</td>
</tr>
<tr>
<td>Expired Unobligated Balance, End of Y ear</td>
<td>3,175,666</td>
</tr>
<tr>
<td>Unobligated Balance, End of Y ear (total)</td>
<td>42,671,369</td>
</tr>
<tr>
<td><strong>TOTAL BUDGETARY RESOURCES</strong></td>
<td>$ 223,202,698</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>OUTLAYS, NET:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Outlays, Net (total) (discretionary and mandatory)</td>
<td>154,062,395</td>
</tr>
<tr>
<td>Distributed Offsetting Receipts (-)</td>
<td>(158,496)</td>
</tr>
<tr>
<td><strong>AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)</strong></td>
<td>$ 153,903,899</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these statements.
NOTE 1. Summary of Significant Accounting Policies

1.A. Reporting Entity and Related Parties

The DON financial results of operations are presented within two separate AFRs: one that presents both the USN GF and the DON WCF and one that presents the USMC GF. This section of the AFR specifically applies to the USN GF, as a result, it does not disclose information related to the USMC. Use of USN within the GF section does not include USMC activities. 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.

Refer to the MD&A Section – “Mission and Organization” for further information.

The USN GF also has relationships which constitute control for Non-Appropriated Funds Instrumentalities (NAFIs) and Federally Funded Research and Development Centers (FFRDCs) given that these entities meet the control principle regarding risk of loss or expectation of benefits.

Refer to Note 22, “Disclosure Entities and Related Parties” for further information.

1.B. Basis of Accounting and Presentation

These financial statements reflect both proprietary and budgetary accounting transactions and have been prepared to report non-comparative consolidated financial position, results of operations, the changes in the financial position, and the combined 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), and the form and content for entity financial statements specified by OMB A-136 Revised.

The USN GF is unable to implement all elements of GAAP, OMB A-136 Revised, 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 and supporting trial balances 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). 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 consolidated USN GF. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

Specifically, the USN GF is not fully in compliance with the following authoritative accounting guidance:


Statement of Federal Financial Accounting Standards (SFFAS) 3, “Accounting for Inventory and Related Property”


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 12, “Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government”

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 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 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, 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 areas are presented in the DoD AFR on behalf of the USN.

Accounting standards require all reporting entities to disclose that accounting standards allow certain presentation disclosures to be modified, if needed, to prevent the disclosure of classified information.

1.C. Appropriations and Funds

The USN GF receives appropriated and NAFs general, revolving, trust, special, deposit, 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.

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 programs and the U.S. Forest Service. The Security Assistance programs, Foreign Military Financing Program and the International Military Education and Training Program, meet the OMB exception for EOP funds, but they are reported separately from the USN GF’s financial statements based on an agreement with OMB. 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.

1.D. Use of Estimates
Preparation of the financial statements 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. As a result, actual results may differ from those estimates. Significant estimates and assumptions include, but are not limited to, plant replacement values for real property, general equipment including depreciation, OM&S, E&DL, allowance for doubtful account (AFDA), Accounts Payable, bulk obligations and Contingent Legal Liabilities.

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.

Significant assumptions used by the DON in making accounting estimates are reasonable and supportable except for estimates related to Contingent Legal Liabilities and Environmental Liabilities.

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 some instances, revenue is incorrectly recognized when bills are issued.

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 20, "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 non-exchange revenue. The USN GF 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 USN GF operations and is therefore reported in the SCNP as a financing source.
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.

In many instances, revenue is recognized when bills are issued and not when revenue is earned. Due to these limitations, the USN GF is not compliant with SFFAS 7.

1.F. Recognition of Expenses

The USN GF performs data calls to obtain and record financial amounts, including expenses, in its financial accounting system, 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. Estimates are made for major items, such as payroll expenses, Accounts Payable, environmental liabilities, FECA liabilities, Contingent Legal Liabilities, and unbilled revenue.

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 fix these limitations.

1.G. Accounting for Intragovernmental Activities

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 consolidated financial statements to prevent overstatement for business with itself. 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 can reconcile 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. The USN GF continues to implement process and system improvements to reconcile intragovernmental transactions with all federal agencies.

1.H. Funds with the Treasury

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 Defense Finance and Accounting Service (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 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.I. 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 nonpurchased 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 is classified as “nonentity” and is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

The USN GF conducts a significant portion of its operations overseas with business conducted in foreign currency. 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.J. 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 depending on 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.

The USN GF does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims for Accounts Receivable against other federal agencies are resolved in accordance with Treasury dispute resolution procedures.

1.K. Inventories 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. USN GF Related Property is comprised of OM&S.

The USN GF previously classified Trident missiles as GPP&E as they were determined to be property whose use in normal operations was to be in service as a nuclear deterrent. During FY 2019, the USN GF determined the consumable nature of Trident missiles supersedes the deterrence characteristic and thus classification of this property as OM&S to be more appropriate. Trident missiles are reported as held for future use only.

Due to long standing business process and financial system deficiencies, the USN GF is unable to make an unreserved assertion for OM&S opening balances accounted for in legacy systems. The USN GF accounts for OM&S using a combination of the consumption method and purchase method. The consumption method is the Navy’s standard method except where an exemption to use the purchases method has been granted. There have been no exemptions granted in any but the “other” OM&S segment.

The USN GF values OM&S assets held for use, held in reserve for future use, and held for repair 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 Direct Method are made only to uninstalled aircraft engines (UAE), held for repair; valuation adjustments pertaining to repair cost are not currently calculated for Ordnance and Remainder.
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 resolving these weaknesses and transitioning to a MAC valuation methodology. The valuation methods for OM&S cannot be supported.

1.1. Investments in Treasury Securities

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 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.

1.1. General Property, Plant, and Equipment

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. As the USN GF continues to implement sustainable go-forward GAAP-compliant processes, the USN GF is working to establish opening balances for assets.

Currently, the USN GF uses estimated historical cost for valuing GPP&E. 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 DON aircraft, to include aircraft that are operated by USMC. USN GF values existing 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 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 from the government based on contract terms. 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 PP&E meets or exceeds the USN GF capitalization threshold 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 real property 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.

The USN GF uses several capitalization thresholds for its GPP&E. For all general fund assets acquired or developed after June 30, 2013, the USN GF uses a $1.0 million threshold for general equipment and $250 thousand for real property and Internal Use Software (IUS). 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 USN GF does not currently report accurate values related to WIP and IUS.

USN GF does not yet utilize the account for assets awaiting disposal. 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.
The USN GF has become 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’s accounting systems generally do not capture information relative to heritage assets separately and distinctly from normal operations. The USN GF is unable to separately identify the cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets.

1.N. Advances and Prepayment

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. Advances and prepayments received are recorded as liabilities. The USN GF has not implemented this policy and properly record the advanced paid or received due to non-compliance with the FFMIA.

1.O. Leases

The USN GF classifies its leases as either operating or capital. 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 further information.

1.P. Other Assets

Other assets include military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on the USN GF’s Balance Sheet.

Advances are cash outlays made by the USN GF to its employees, contractors, or others to cover part or all the recipients’ anticipated expenses.

Military pay advances are advance payments authorized for purposes intended to ease hardships imposed by the lack of regular payments when a military member is mobilized, ordered to duty at distant stations, or deployed aboard ships for more than 30 days. Pay advances may be repaid over 24 months. For pay advances extending into future fiscal years, the USN GF advances future fiscal year pay using fiscal year appropriations current at the time of the advance. In subsequent fiscal years, USN GF transfers appropriations to the prior fiscal year appropriation in the amount of any unliquidated advance payments that remain at the end of such prior fiscal year as required by 37 USC 1006.

Civilian pay advances are payments advanced to full-time USN GF civilians intended to finance unusual employee expenses associated with overseas 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 account is subsequently reduced when travel expenses are incurred.

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 construction in progress (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.Q. Contingencies and Other Liabilities
The USN GF is party to various administrative proceedings, legal actions, and claims. The USN GF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

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

Refer to Note 15, “Commitments and Contingencies” for further information.

Other liabilities also arise as a result of anticipated disposal costs for the USN GF’s assets. Recognition of an anticipated non-environmental disposal liability begins when the asset is placed into service and is only estimated for future vessel and missile motor disposal. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

Refer to Note 13, “Other Liabilities” for further information.

1.R. 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. Any portions of the accrued leave for which funding is not available, is recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.S. 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.T. 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.U. 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 undistributed, 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 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.V. Fiduciary Activities
Fiduciary activities are the collection or receipt, and the management, protection, accounting, 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 cash and other assets are not assets of the federal government and are not recognized in
the USN GF’s financial statements.
Refer to Note 19 “Fiduciary Activities” for additional information.

1.W. Federal Employee and Veteran Benefits
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.X. 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.Y. Investments in Public-Private Partnerships
The USN GF discloses Public-Private Partnerships (P3s) in accordance with SFFAS 49 which became effective June 30, 2019.
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 21, “Public-Private Partnerships” for additional information.
### NOTE 2. NON-ENTITY ASSETS

#### As of September 30 ($ in thousands) | Unaudited 2019
--- | ---
Intragovernmental: |  
Fund Balance with Treasury | $921,344  
Accounts Receivable | 174  
Total Intragovernmental Assets | 921,518

Non-Federal: |  
Cash and Other Monetary Assets | 102,387  
Accounts Receivable | 103,682  
Total Non-Federal Assets | 206,069

Total Non-entity Assets | 1,127,587

Total Entity Assets | 644,925,019

Total Assets | $646,052,606

Non-entity Assets are assets held by the USN GF but are not available for the USN GF.

**Intragovernmental FBWT** is primarily comprised of amounts in the USN GF’s Civilian Employee Allotments Account, Thrift Savings Plan, and Withheld State and Local Taxes Fund. 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.U “Undistributed Disbursements and Collections” for further 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’ 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

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unobligated Balance:</strong></td>
<td></td>
</tr>
<tr>
<td>Available</td>
<td>$39,495,703</td>
</tr>
<tr>
<td>Unavailable</td>
<td>3,176,911</td>
</tr>
<tr>
<td><strong>Total Unobligated Balance</strong></td>
<td>$42,672,614</td>
</tr>
<tr>
<td><strong>Obligated Balance not yet Disbursed</strong></td>
<td>$135,360,448</td>
</tr>
<tr>
<td><strong>Non-Budgetary FBWT:</strong></td>
<td></td>
</tr>
<tr>
<td>Clearing Accounts</td>
<td>$23,328</td>
</tr>
<tr>
<td>Deposit Funds</td>
<td>920,564</td>
</tr>
<tr>
<td><strong>Total Non-Budgetary FBWT</strong></td>
<td>$943,892</td>
</tr>
<tr>
<td><strong>Non-FBWT Budgetary Accounts:</strong></td>
<td></td>
</tr>
<tr>
<td>Investments-Treasury Securities</td>
<td>$(5,399)</td>
</tr>
<tr>
<td>Unfilled Customer Orders without Advance</td>
<td>(3,515,486)</td>
</tr>
<tr>
<td>Receivables and Other</td>
<td>(120,355)</td>
</tr>
<tr>
<td><strong>Total Non-FBWT Budgetary Accounts</strong></td>
<td>$(3,641,240)</td>
</tr>
<tr>
<td><strong>Total Fund Balance with Treasury</strong></td>
<td>$175,335,714</td>
</tr>
</tbody>
</table>
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 $206 million in undistributed collections as of September 30, 2019.

In FY 2019 the Navy transferred $2.4 billion in unused funds to the Department of Treasury, Miscellaneous Receipts account from General Fund Treasury Account Symbols that cancelled on September 30, 2019.

**NOTE. 4. CASH AND OTHER MONETARY ASSETS**

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 55,882</td>
</tr>
<tr>
<td>Foreign Currency</td>
<td>$ 46,505</td>
</tr>
<tr>
<td><strong>Total Cash and Other Monetary Assets</strong></td>
<td><strong>$ 102,387</strong></td>
</tr>
</tbody>
</table>

Cash and other monetary assets are non-entity assets that are not available for the USN GF’s use in normal operations and are restricted in its use.

Cash and Foreign Currency consist primarily of cash held by the USN GF’s Disbursing Officers to carry out their payment, collection, and foreign currency accommodation exchange mission. Foreign currency is also held in overseas banks in support of contingency operations. The primary source of the amounts is reported on the Disbursing Officers Statement of Accountability.

Refer to Note 1.I, “Cash and Other Monetary Assets” for further information on the foreign currency policies.
NOTE 5. ACCOUNTS RECEIVABLE, NET

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Gross Amount Due</th>
<th>Allowance For Estimated Uncollectibles</th>
<th>Accounts Receivable, Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intragovernmental Receivables</td>
<td>230,151 $</td>
<td>- $</td>
<td>230,151 $</td>
</tr>
<tr>
<td>Non-federal Receivables (From the Public)</td>
<td>156,906</td>
<td>(17,299)</td>
<td>139,607 $</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>387,057 $</strong></td>
<td><strong>(17,299)</strong></td>
<td><strong>369,758 $</strong></td>
</tr>
</tbody>
</table>

Accounts Receivable, Net represents the USN GF’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 USN GF’s elimination process when buyer-side balances are deemed more reliable.

**Non-federal Receivables** are balances that include individuals and organizations. Examples include, Accounts Receivable pertaining out of service debts and military housing. These balances, once collected, may be used by the collecting agency based upon nature of Accounts Receivable.

The DON’s gross amount due for Non-federal Receivables (From the Public) for FY 2019 includes criminal restitution orders of $3.2 million monitored by DFAS, of which $0.3 million is determined to be collectible.

Restitution receivables and associated payments are pursued by the courts handling those cases. Receivables are established 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.

Due to limitations of financial and nonfinancial management processes and systems that support the financial statements, the DON is unable to separately identify GF and WCF criminal restitution receivables.

NOTE 6. INVENTORY AND RELATED PROPERTY, NET

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross Value</td>
</tr>
</tbody>
</table>

**Held for Use:**

<table>
<thead>
<tr>
<th>Item</th>
<th>Gross Value</th>
<th>Revaluation Allowance</th>
<th>Net Value</th>
<th>Valuation Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordnance</td>
<td>$31,117,461</td>
<td>$31,117,461</td>
<td></td>
<td>MAC</td>
</tr>
<tr>
<td>Trident Missiles</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uninstalled Aircraft Engines</td>
<td>2,716,226</td>
<td>-</td>
<td>2,716,226</td>
<td>LAC, HC</td>
</tr>
<tr>
<td>Remainder</td>
<td>15,463,800</td>
<td>-</td>
<td>15,463,800</td>
<td>MAC, LAC</td>
</tr>
<tr>
<td><strong>Total Held for Use</strong></td>
<td>49,297,487</td>
<td>-</td>
<td>49,297,487</td>
<td></td>
</tr>
</tbody>
</table>

**Held in Reserve for Future Use:**

<table>
<thead>
<tr>
<th>Item</th>
<th>Gross Value</th>
<th>Revaluation Allowance</th>
<th>Net Value</th>
<th>Valuation Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordnance</td>
<td>3,824,612</td>
<td>-</td>
<td>3,824,612</td>
<td>MAC</td>
</tr>
<tr>
<td>Trident Missiles</td>
<td>13,168,842</td>
<td>-</td>
<td>13,168,842</td>
<td>LAC</td>
</tr>
<tr>
<td>Uninstalled Aircraft Engines</td>
<td></td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remainder</td>
<td>2,791,313</td>
<td>-</td>
<td>2,791,313</td>
<td>LAC, MAC</td>
</tr>
<tr>
<td><strong>Total Held in Reserve for Future Use</strong></td>
<td>19,784,767</td>
<td>-</td>
<td>19,784,767</td>
<td></td>
</tr>
</tbody>
</table>

**Held for Repair:**

<table>
<thead>
<tr>
<th>Item</th>
<th>Gross Value</th>
<th>Revaluation Allowance</th>
<th>Net Value</th>
<th>Valuation Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordnance</td>
<td>7,701,412</td>
<td>-</td>
<td>7,701,412</td>
<td>MAC</td>
</tr>
<tr>
<td>Uninstalled Aircraft Engines</td>
<td>3,792,749</td>
<td>-</td>
<td>3,792,749</td>
<td>LAC, HC</td>
</tr>
<tr>
<td>Remainder</td>
<td>4,387,325</td>
<td>-</td>
<td>4,387,325</td>
<td>LAC, MAC</td>
</tr>
<tr>
<td><strong>Total Held for Repair</strong></td>
<td>15,881,486</td>
<td>-</td>
<td>15,881,486</td>
<td></td>
</tr>
</tbody>
</table>

**Excess, Obsolete, and Unserviceable:**

<table>
<thead>
<tr>
<th>Item</th>
<th>Gross Value</th>
<th>Revaluation Allowance</th>
<th>Net Value</th>
<th>Valuation Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordnance</td>
<td>986,067</td>
<td>(986,067)</td>
<td></td>
<td>NRV</td>
</tr>
<tr>
<td>Uninstalled Aircraft Engines</td>
<td></td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remainder</td>
<td>281,215</td>
<td>(281,215)</td>
<td></td>
<td>NRV</td>
</tr>
<tr>
<td><strong>Total Excess, Obsolete, and Unserviceable</strong></td>
<td>1,267,282</td>
<td>(1,267,282)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Total**

| Gross Value | NRV | $86,231,022 | (1,267,282) | $84,963,740 |

**Legend for Valuation Methods:**

- **LAC** = Latest Acquisition Cost
- **NRV** = Net Realizable Value
- **HC** = Historical Cost
- **MAC** = Moving Average Cost

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, held for repair, 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 040404.

**Held for Use** consists of all other serviceable (ready for issue) material.

**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. These stocks are classified as operating materials and supplies held in reserve for future use. OM&S held in reserve for future are valued using the same basis as operating materials and supplies held for use in normal operations. Such materials and supplies are valued the same as operating materials and supplies held for use in normal operations.

**Held for Repair** consists of damaged or unserviceable material, accounted for in the physical inventory, that is more economical to repair than to dispose.
Excess, Obsolete, and Unserviceable materials are defined as follows; Excess materials are stock items that exceed the anticipated demand in the normal course of operations, which includes scrap materials or assets uneconomical to repair and awaiting disposal. Obsolete materials are items that are no longer needed due to changes in technology, law, or operations. Unsuitable materials are damaged assets that are more economical to dispose of than repair.

The USN GF further identifies OM&S by unique acquisition-based segments: ordnance (e.g., ammunition, conventional missiles and torpedoes), Trident missiles (submarine launched nuclear capable ballistic missiles) centrally managed UAE, and OM&S remainder. OM&S remainder includes, but is not limited to, all non-ordnance materials, uninstalled modification kits, spares and repair parts for major end items (e.g., ships, aircraft, tanks), clothing, textiles, and petroleum products.

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

NOTE 7. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

<table>
<thead>
<tr>
<th>Major Asset Classes:</th>
<th>Depreciation/ Amortization Method</th>
<th>Service Life</th>
<th>Acquisition Value</th>
<th>(Accumulated Depreciation/ Amortization)</th>
<th>Net Book Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>N/A</td>
<td>N/A</td>
<td>$</td>
<td>-</td>
<td>$</td>
</tr>
<tr>
<td>Buildings, Structures, Linear Structures</td>
<td>S/L</td>
<td>35, 40 or 45</td>
<td>145,982,224</td>
<td>(118,602,034)</td>
<td>27,380,190</td>
</tr>
<tr>
<td>Utilities</td>
<td>S/L</td>
<td>35 or 40</td>
<td>5,654,010</td>
<td>(2,140,115)</td>
<td>3,513,895</td>
</tr>
<tr>
<td>Leasehold Improvements</td>
<td>S/L</td>
<td>Lease Term</td>
<td>6,530</td>
<td>(6,530)</td>
<td>-</td>
</tr>
<tr>
<td>Software</td>
<td>S/L</td>
<td>2-5 or 10</td>
<td>177,803</td>
<td>(7,656)</td>
<td>170,147</td>
</tr>
<tr>
<td>General Equipment:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vessels</td>
<td>S/L</td>
<td>20-50</td>
<td>327,916,948</td>
<td>(154,162,424)</td>
<td>173,754,524</td>
</tr>
<tr>
<td>Aircraft</td>
<td>S/L</td>
<td>15-30</td>
<td>175,474,298</td>
<td>(88,524,102)</td>
<td>86,950,196</td>
</tr>
<tr>
<td>Satellites</td>
<td>S/L</td>
<td>7-13</td>
<td>4,304,454</td>
<td>(2,746,353)</td>
<td>1,558,101</td>
</tr>
<tr>
<td>General Equipment-Remainder</td>
<td>S/L</td>
<td>Various</td>
<td>24,070,576</td>
<td>(16,574,601)</td>
<td>7,495,975</td>
</tr>
<tr>
<td><strong>Total General Equipment</strong></td>
<td></td>
<td></td>
<td><strong>$ 531,766,276</strong></td>
<td><strong>(262,007,480)</strong></td>
<td><strong>269,758,796</strong></td>
</tr>
<tr>
<td>Construction-in-Progress</td>
<td>N/A</td>
<td>N/A</td>
<td>82,815,632</td>
<td>-</td>
<td>82,815,632</td>
</tr>
<tr>
<td>Other</td>
<td>M</td>
<td>M</td>
<td>10,541,926</td>
<td>(10,043,750)</td>
<td>498,176</td>
</tr>
<tr>
<td><strong>Total General PP&amp;E</strong></td>
<td></td>
<td></td>
<td><strong>$ 776,944,401</strong></td>
<td><strong>(392,807,565)</strong></td>
<td><strong>384,136,836</strong></td>
</tr>
</tbody>
</table>

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

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 capital assets not specifically identified, including operation support equipment, small boats and service craft, maintenance support equipment). Other GPP&E consists of assets awaiting disposal.
Adjustments to Real Property pertaining to additions of assets found by inventory combined with revaluation adjustments (to remove capital improvement balances previously reported in Real Property segments) resulted in increases to acquisition value and accumulated depreciation of $2.9 billion and $0.7 billion, respectively.

Adjustments to general equipment opening balances for Vessels, Aircraft, and Satellites from application of SFFAS 50 resulted in the following financial statement impact: increased acquisition value of $36.6 billion and increased accumulated depreciation $26.2 billion.

The NRV for USN GF land was adjusted to zero in accordance with accounting standards. The USN GF owns 595 thousand acres of land as of September 30, 2019.

The USN GF reports real property CIP executed using the military construction (MILCON) appropriations for both Navy and USMC projects. The value of CIP associated with MILCON projects was $2.7 billion as of September 30, 2019. This amount includes 506 projects valued at $1.4 billion which will be transferred to USMC upon completion.

Additionally, to improve the financial reporting of other asset balances, the USN GF recorded a reclassification of the Outstanding Contract Financing Payment (OCFP) balance to CIP for $9.5 billion. The USN GF will continue to record this reclassification until the financial systems are able to accurately record the other assets balances.

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.

**NOTE 8. STEWARDSHIP PP&E**

<table>
<thead>
<tr>
<th>Categories:</th>
<th>Measure Quantity</th>
<th>Beginning Balance</th>
<th>Additions</th>
<th>Deletions</th>
<th>Ending Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building and Structures</td>
<td>Each</td>
<td>384</td>
<td>-</td>
<td>20</td>
<td>364</td>
</tr>
<tr>
<td>Archaeological Sites</td>
<td>Each</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Museum Collection Items (Objects, Not Including Fine Art)</td>
<td>Each</td>
<td>479,027</td>
<td>4,802</td>
<td>970</td>
<td>482,859</td>
</tr>
<tr>
<td>Museum Collection Items (Objects, Fine Art)</td>
<td>Each</td>
<td>33,852</td>
<td>236</td>
<td>-</td>
<td>34,088</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>513,263</td>
<td>5,038</td>
<td>990</td>
<td>517,311</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Categories:</th>
<th>Measure Quantity</th>
<th>Beginning Balance</th>
<th>Additions</th>
<th>Deletions</th>
<th>Ending Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stewardship Land (Acres in thousands)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Facility Code</td>
<td>Facility Title</td>
<td>Each</td>
<td>Beginning Balance</td>
<td>Additions</td>
<td>Deletions</td>
</tr>
<tr>
<td>9120</td>
<td>Withdrawn Public Land</td>
<td>1,370</td>
<td>1</td>
<td>-</td>
<td>1,371</td>
</tr>
<tr>
<td>9130</td>
<td>Licensed and Permitted Land</td>
<td>4</td>
<td>-</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>9140</td>
<td>Public Land</td>
<td>1</td>
<td>4</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>Grand Total</td>
<td></td>
<td>1,375</td>
<td>5</td>
<td>3</td>
<td>1,377</td>
</tr>
<tr>
<td>TOTAL - All Other Lands</td>
<td></td>
<td>4</td>
<td>-</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>TOTAL - Stewardship Lands</td>
<td></td>
<td>1,371</td>
<td>5</td>
<td>-</td>
<td>1,376</td>
</tr>
</tbody>
</table>

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, 2019, there are 364 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, 2019, there are 516,947 museum-type collection items, consisting of 482,859 objects (fine art) and 34,088 objects (not including fine arts).

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

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intragovernmental:</strong></td>
<td></td>
</tr>
<tr>
<td>Advances and Prepayments</td>
<td>$ 964,218</td>
</tr>
<tr>
<td>Investments, Net (including accrued interest)</td>
<td>5,445</td>
</tr>
<tr>
<td><strong>Total Intragovernmental Other Assets</strong></td>
<td><strong>969,663</strong></td>
</tr>
<tr>
<td><strong>Non-Federal:</strong></td>
<td></td>
</tr>
<tr>
<td>Advances and Prepayments</td>
<td>172,472</td>
</tr>
<tr>
<td>Other Assets (With the Public)</td>
<td>2,036</td>
</tr>
<tr>
<td><strong>Total Non-Federal Other Assets</strong></td>
<td><strong>174,508</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 1,144,171</strong></td>
</tr>
</tbody>
</table>

**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 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

Intragovernmental Other 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.

Accounts Payable consists of accounts payable related to appropriations that have cancelled.

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

Environmental and Disposal Liabilities are estimates related to future events, and consist of liabilities related to cleanup or disposal of active installations, Base Realignment and Closure (BRAC) sites, and equipment and weapons programs.

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

Accrued Unfunded Annual Leave represents the unfunded portion of accrued leave recorded as an unfunded liability.

Other includes annual leave, estimated legal contingent liabilities, 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 includes liabilities for which congressional action is needed before budgetary resources can be provided to cover the liabilities. These include liabilities resulting from the receipt of goods or services in current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through congressional appropriations or earnings of the entity.

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 ($10.2 billion at the end of FY 2019) to account for nonfederal accounts payable.

As of September 30 ($ in thousands)  Unaudited 2019

<table>
<thead>
<tr>
<th>Intragovernmental:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>$268,620</td>
</tr>
<tr>
<td>Total Intragovernmental</td>
<td>$268,620</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accounts Payable</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Employee and Veteran Benefits</td>
<td>1,281,098</td>
</tr>
<tr>
<td>Environmental and Disposal Liabilities</td>
<td>25,551,468</td>
</tr>
<tr>
<td>Accrued Unfunded Annual Leave</td>
<td>2,401,626</td>
</tr>
<tr>
<td>Other</td>
<td>1,617,306</td>
</tr>
<tr>
<td><strong>Total Liabilities Not Covered by Budgetary Resources</strong></td>
<td><strong>31,143,064</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Liabilities Covered by Budgetary Resources</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$18,606,254</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>$50,017,938</strong></td>
<td></td>
</tr>
</tbody>
</table>
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.U, “Undistributed Disbursements and Collections” for further information.

NOTE 11. FEDERAL EMPLOYEE AND VETERAN BENEFITS

Federal Employee and Veteran Benefits consist of FECA and other benefits. 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.

Actuarial Cost Method Used and Assumptions

The USN GF’s actuarial liability for workers’ compensation benefits is developed by DOL and is provided to the USN GF 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., 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) 2019 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 2.61% was assumed for year one and years thereafter. An interest rate for medical benefits of 2.35% was assumed for year one and years thereafter.

Other represents additional post-employment benefits, which can include 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)

<table>
<thead>
<tr>
<th>Description</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accrued Environmental Restoration Liabilities:</strong></td>
<td></td>
</tr>
<tr>
<td>Active Installations - Installation Restoration Program (IRP) and Building</td>
<td>$ 3,699,609</td>
</tr>
<tr>
<td>Demolition and Debris Removal (BD/DR)</td>
<td></td>
</tr>
<tr>
<td>Active Installations - Military Munitions Response Program (MMRP)</td>
<td>2,315,375</td>
</tr>
<tr>
<td><strong>Base Realignment and Closure Installations:</strong></td>
<td></td>
</tr>
<tr>
<td>Installation Restoration Program</td>
<td>1,652,789</td>
</tr>
<tr>
<td>Military Munitions Response Program</td>
<td>105,043</td>
</tr>
<tr>
<td>Environmental Corrective Action / Closure Requirements</td>
<td>3,683</td>
</tr>
<tr>
<td><strong>Environmental Disposal for Military Equipment / Weapons Programs:</strong></td>
<td></td>
</tr>
<tr>
<td>Nuclear Powered Military Equipment / Spent Nuclear Fuel</td>
<td>17,029,282</td>
</tr>
<tr>
<td>Other Weapons Systems</td>
<td>377,871</td>
</tr>
<tr>
<td><strong>Other Accrued Environmental Liabilities - Non-BRAC:</strong></td>
<td></td>
</tr>
<tr>
<td>Environmental Corrective Action</td>
<td>79</td>
</tr>
<tr>
<td>Environmental Closure Requirements</td>
<td>221,765</td>
</tr>
<tr>
<td>Asbestos</td>
<td>139,442</td>
</tr>
<tr>
<td>Non-Military Equipment</td>
<td>6,530</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 25,551,468</strong></td>
</tr>
</tbody>
</table>

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

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.

### 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:

- Superfund Amendments and Reauthorization Act (SARA)
- Clean Water Act
- Safe Drinking Water Act
- Clean Air Act
- Atomic Energy Act
Description and Liabilities of the Types of Environmental and Disposal Liabilities Identified

**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). 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 SN 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, USN GF uses the cost of the study as the estimate until the study is completed.

As of September 30, 2019, the USN GF estimated and reported $6.0 billion for environmental restoration liabilities. This amount is comprised of $3.7 billion in active installations-IRP liabilities and $2.3 billion in Active Installations-MMRP liabilities.

In addition, there were nine sites which could possibly represent an increase to the liability of approximately $140 million. However, due to the limited environmental assessment information available at the time of the USN GF’s FY 2019 financial statements, these sites are deemed inestimable. These sites will be evaluated and estimated for future cleanup costs in FY 2020.
**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, 2019, the USN GF has estimated and reported $1.8 billion for BRAC funded environmental liabilities. This amount includes $1.7 billion for IRP, $105.0 million for MMRP, and $3.7 million for Compliance.

**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 any Nuclear Component Weapons (Trident missiles) as these have been identified as the sole responsibility of the Department of Energy.

The environmental liability is amortized over the useful life of the asset. As of September 30, 2019, environmental disposal estimates for nuclear powered military equipment and SNF is $17.0 billion and $377.9 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 $4.0 billion for nuclear powered military equipment and $143.0 million for other weapons disposal (non-nuclear).

The USN GF and the Department of Energy share estimated future costs of disposing high-level waste and SNF. 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 $3.4 billion in recognized liability.

As of September 30, 2019, the USN GF was unable to update its estimate regarding E&DL of aircraft. This estimate was carried over from FY18 and equates to $119 million.

**Other Accrued Environmental Liabilities – Non-BRAC**

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 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, asbestos, and lead, 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 $367.8 million as of September 30, 2019. For closure sites, nonmilitary equipment 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 $50.7 million.

For FY 2019, due to environmental estimation uncertainties there is a possibility that environmental liabilities could increase to approximately $469.6 million, of which $460.5 million is attributable to uncertainty concerning asbestos abatement. The remaining possible increase relates to sites for which limited environmental information was available and are deemed inestimable at this time, these sites will be reevaluated in FY 2020.

**Methods for Assigning Total Cleanup Costs to Current Operating Periods**

When the environmental cost estimates are completed, the USN GF complies with accounting standards to assign cost to the current operating period through amortization.
**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 a combination of engineering estimates and model-derived cost from the Remedial Action Cost Engineering Requirements System (RACER).

**Other Accrued Environmental Liabilities Non-BRAC**

The OEL program relied on a historic fence-to-fence survey and currently relies on multiple APSRs to derive and recognize liabilities associated with the decommissioned assets over real property and general equipment-remainder. These APSRs include: Internet Naval Facilities Data Storage System, NERP, and Defense Property Accountability System. On an annual basis, APSRs are reviewed and the estimate is updated to reflect the changes in the inventory. 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 a combination of engineering estimates and cost model derived from the RSMeans engineering software.

**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. Estimates are developed using engineering estimates.

**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. As of September 30, 2019, there are no changes to the environmental liability estimates due to inflation, deflation, changes in laws, regulations, agreements with regulatory agencies, and advances in technology. The USN GF is not aware of any pending changes, but the liability can change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

**Environmental Liabilities**

The environmental liabilities for USN GF are based on accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than 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.
### NOTE 13. OTHER LIABILITIES

<table>
<thead>
<tr>
<th></th>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Non-Current</td>
<td>Current</td>
</tr>
<tr>
<td><strong>Intragovernmental:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances from Others</td>
<td>$</td>
<td>-</td>
</tr>
<tr>
<td>Disbursing Officer Cash</td>
<td>-</td>
<td>103,791</td>
</tr>
<tr>
<td>Judgment Fund Liabilities</td>
<td>-</td>
<td>4,726</td>
</tr>
<tr>
<td>FECA Reimbursement to the Dept of Labor</td>
<td>132,909</td>
<td>109,964</td>
</tr>
<tr>
<td>Custodial Liabilities</td>
<td>-</td>
<td>100,155</td>
</tr>
<tr>
<td>Employer Contribution and Payroll Taxes Payable</td>
<td>-</td>
<td>77,130</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>-</td>
<td>23,324</td>
</tr>
<tr>
<td><strong>Total Intragovernmental</strong></td>
<td>132,909</td>
<td>429,336</td>
</tr>
<tr>
<td><strong>Non-Federal:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued Funded Payroll and Benefits</td>
<td>-</td>
<td>1,344,249</td>
</tr>
<tr>
<td>Advances from Others</td>
<td>-</td>
<td>683,666</td>
</tr>
<tr>
<td>Deposit Funds and Suspense Accounts</td>
<td>-</td>
<td>943,894</td>
</tr>
<tr>
<td>Nonenvironmental Disposal Liabilities</td>
<td>65,890</td>
<td>1,179,196</td>
</tr>
<tr>
<td>Contract Holdbacks</td>
<td>-</td>
<td>1,679,476</td>
</tr>
<tr>
<td>Employer Contribution and Payroll Taxes Payable</td>
<td>-</td>
<td>242,449</td>
</tr>
<tr>
<td>Contingent Liabilities</td>
<td>381,590</td>
<td>-</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>-</td>
<td>42,986</td>
</tr>
<tr>
<td><strong>Total Non-Federal Other Liabilities</strong></td>
<td>447,480</td>
<td>6,115,916</td>
</tr>
<tr>
<td><strong>Total Other Liabilities</strong></td>
<td>$580,389</td>
<td>6,545,252</td>
</tr>
</tbody>
</table>

**Intragovernmental Advances from Others** represent liabilities for collections received to cover future expenses or acquisitions of assets.

**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 Judgment Fund Liabilities** represent the amount due from USN GF, payable to the Treasury Judgment Fund. This is the amount for losses arising from legal cases paid by the Treasury Judgment Fund on USN GF’s behalf, but reimbursable to the Treasury Judgment Fund.

**Intragovernmental FECA Reimbursement to the Dept of Labor** represent the liabilities chargeback amount for payments made by DOL on the behalf of the USN GF.

**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 consist primarily of accrued unfunded annual leave, contingent liabilities, non-environmental disposal liabilities for military equipment, accrued funded payroll and benefits, and advances from others.

**Non-Federal Accrued Funded Payroll and Benefits** 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 liabilities for receipts held in suspense temporarily for...
distribution to another fund or entity or held as an agent for others and paid at the direction of the owner.

Non-Federal Contingent Liabilities include accrued contingent legal liabilities pertaining to pending legal cases where the Office of General Counsel (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 Non-environmental Disposal Liabilities represent liabilities for nuclear, non-nuclear and hazardous waste disposal of vessels and program costs for the disposal of propulsion systems. As of September 30, 2019, the total recognized current portion of non-EDL (other liabilities - current) is $1.2 billion and $65.9 million for unrecognized non-environmental disposal liability (noncurrent). The unaccrued portion of such estimates is reported as unrecognized cost.

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 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.

### NOTE 14. LEASES

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and Buildings</td>
<td>Equipment</td>
</tr>
<tr>
<td>Federal Leases</td>
<td></td>
</tr>
<tr>
<td>Entity as Lessee - Operating Leases:</td>
<td></td>
</tr>
<tr>
<td>Future Payments Due Fiscal Year</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>$42,717</td>
</tr>
<tr>
<td>2021</td>
<td>43,028</td>
</tr>
<tr>
<td>2022</td>
<td>43,973</td>
</tr>
<tr>
<td>2023</td>
<td>44,939</td>
</tr>
<tr>
<td>2024</td>
<td>45,926</td>
</tr>
<tr>
<td>After 5 Years</td>
<td>46,935</td>
</tr>
<tr>
<td>Total Future Lease Payments</td>
<td>$267,518</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and Buildings</td>
<td>Equipment</td>
</tr>
<tr>
<td>Non-Federal Leases</td>
<td></td>
</tr>
<tr>
<td>Entity as Lessee - Operating Leases</td>
<td></td>
</tr>
<tr>
<td>Future Payments Due Fiscal Year</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>159,830</td>
</tr>
<tr>
<td>2021</td>
<td>159,234</td>
</tr>
<tr>
<td>2022</td>
<td>162,410</td>
</tr>
<tr>
<td>2023</td>
<td>165,649</td>
</tr>
<tr>
<td>2024</td>
<td>168,953</td>
</tr>
<tr>
<td>After 5 Years</td>
<td>172,323</td>
</tr>
<tr>
<td>Total Future Lease Payments</td>
<td>$988,399</td>
</tr>
</tbody>
</table>

All USN GF leases are 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.
NOTE 15. COMMITMENTS AND CONTINGENCIES

The USN GF is a party in various administrative proceedings, legal actions, and claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The USN GF accrues contingent legal liabilities for legal actions where the OGC considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Treasury Judgment Fund.

Additional information about the USN GF contingent legal liabilities can be found in Note 13, "Other Liabilities."

The USN OGC and OJAG conduct reviews of litigation and claims threatened or asserted involving 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, remote, and reasonably possible.

As of September 30, 2019, the USN GF has 52 cases with an estimated potential loss of $381.6 million that are assessed as probable for an adverse decision, and 26 out of the 52 cases will potentially be paid out of the Treasury Judgment Fund without reimbursement from the USN GF. The USN GF has 671 cases assessed as reasonably possible with an aggregated potential loss of $1.1 billion.

In addition to legal cases managed by the OGC and OJAG, USN’s Office of Civilian Human Resources (OCHR) manages U.S. Equal Employment Opportunity Commission (EEOC) cases presented against the USN GF. EEOC case liability is not included in the contingent legal liability calculation amount, as the maximum exposure of these cases, individually and collectively, is not significant.

After the period ended September 30, 2019, but before the issuance of this AFR, the USN performed a review of known cases to identify any updates to the cases existed as of September 30, 2019. These updates arise from additional information received based on the progression of legal proceedings for existing cases, including additional claims added to those cases. The changes identified do not have material effects on the contingent legal liability balances recorded or disclosed.

The USN GF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, which may result in a future outflow of budgetary resources. Currently, the USN GF’s automated system processes have limited capability to capture these potential liabilities; therefore, the amounts reported may not fairly present USN GF’s commitments and contingencies.

USN GF’s estimate of obligations related to cancelled appropriations for which the USN GF has a contractual commitment for payment is $291.6 million.
NOTE 16. FUNDS FROM DEDICATED COLLECTIONS

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets:</strong></td>
<td></td>
</tr>
<tr>
<td>Fund Balance with Treasury</td>
<td>$ 49,539</td>
</tr>
<tr>
<td>Investments</td>
<td>5,445</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$ 54,984</td>
</tr>
<tr>
<td><strong>Liabilities:</strong></td>
<td></td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>431</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>$ 431</td>
</tr>
<tr>
<td>Cumulative Results of Operations</td>
<td>54,553</td>
</tr>
<tr>
<td><strong>Total Liabilities &amp; Net Position</strong></td>
<td>$ 54,984</td>
</tr>
</tbody>
</table>

**Statement of Net Cost:**
- Program Costs: $ 35,005
- Less Earned Revenue: (93)
- **Net Cost of Operations**: $ 34,912

**Statement of Changes in Net Position:**
- Net Position Beginning of the Period: $ 47,622
- Net Cost of Operations: 34,912
- Budgetary Financing Sources Other Financing Sources: 41,843
- Change in Net Position: 6,931
- **Net Position End of Period**: $ 54,553

Funds from Dedicated Collections are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. Generally, revenues for USN GF’s funds from dedicated collections are inflows of resources to the Government. The USN GF currently has four funds from dedicated collections: Wildlife Conservation, 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. EXCHANGE REVENUES

<table>
<thead>
<tr>
<th></th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intragovernmental</td>
<td></td>
</tr>
<tr>
<td>Costs</td>
<td>44,912,437</td>
</tr>
<tr>
<td>Nonfederal Costs</td>
<td>123,903,802</td>
</tr>
<tr>
<td>Total Cost</td>
<td>168,816,239</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Intragovernmental</td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>(2,373,821)</td>
</tr>
<tr>
<td>Nonfederal Revenue</td>
<td>(6,305,623)</td>
</tr>
<tr>
<td>Total Intragovernmental Revenue</td>
<td>(8,679,444)</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Net Cost</td>
<td>160,136,795</td>
</tr>
</tbody>
</table>

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 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 the component reporting entity 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. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

<table>
<thead>
<tr>
<th></th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intragovernmental:</td>
<td></td>
</tr>
<tr>
<td>Unpaid</td>
<td>$ 15,073,542</td>
</tr>
<tr>
<td>Prepaid/Advanced</td>
<td>1,417,556</td>
</tr>
<tr>
<td>Total Intragovernmental</td>
<td>16,491,098</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Federal:</td>
<td></td>
</tr>
<tr>
<td>Unpaid</td>
<td>103,694,407</td>
</tr>
<tr>
<td>Prepaid/Advanced</td>
<td>172,472</td>
</tr>
<tr>
<td>Total Non-Federal</td>
<td>103,866,879</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Budgetary</td>
<td></td>
</tr>
<tr>
<td>Resources Obligated</td>
<td></td>
</tr>
<tr>
<td>for Undelivered</td>
<td></td>
</tr>
<tr>
<td>Orders at the End of</td>
<td></td>
</tr>
<tr>
<td>the Period</td>
<td>$ 120,357,977</td>
</tr>
</tbody>
</table>

The SBR includes intra-entity transactions as the statement is presented on a combined basis.
Permanent, Indefinite Appropriations

NDSF is operated under the statutory authority, 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. There were no transfers in or out of NDSF during the fiscal year.

The Environmental Restoration, Navy (ERN) 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 appropriation transferred to. As of September 30, 2019 reporting, there was one transfer from ERN for $365.9 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.

Undelivered Orders – Intragovernmental and Non-Federal

As outlined in OMB A-136 Revised, undelivered orders are to be presented as intragovernmental and non-federal. For FY 2019, the USN GF adopted a methodology to estimate intragovernmental and non-federal undelivered orders based on the total federal and non-federal designation for Accounts Payable, prepaid advances and prepayments.

NOTE 19. FIDUCIARY ACTIVITIES

Schedule of Fiduciary Activity

<table>
<thead>
<tr>
<th>For the Year Ended September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiduciary Net Assets, Beginning of Year</td>
<td>$ 59,362</td>
</tr>
<tr>
<td>Contributions</td>
<td>10,492</td>
</tr>
<tr>
<td>Disbursements to and on Behalf of Beneficiaries</td>
<td>(11,341)</td>
</tr>
<tr>
<td>Increase/(Decrease) in Fiduciary Net Assets</td>
<td>(849)</td>
</tr>
<tr>
<td><strong>Fiduciary Net Assets, End of Period</strong></td>
<td><strong>$ 58,513</strong></td>
</tr>
</tbody>
</table>

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.

The USN GF’s fiduciary activity consists of funds in the Savings Deposit Program. 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.
NOTE 20. RECONCILIATION OF NET COST TO NET OUTLAYS

<table>
<thead>
<tr>
<th>Components of Net Cost that are Not Part of Net Outlays</th>
<th>Intragovernmental</th>
<th>With the public</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant, and equipment depreciation</td>
<td>-</td>
<td>(30,426,239)</td>
<td>(30,426,239)</td>
</tr>
<tr>
<td>Property, plant, and equipment disposal &amp; revaluation</td>
<td>-</td>
<td>(2,029,871)</td>
<td>(2,029,871)</td>
</tr>
<tr>
<td>Other</td>
<td>(6,596)</td>
<td>(5,812,718)</td>
<td>(5,819,314)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Increase/(decrease) in assets:</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>(207,115)</td>
<td>(9,568)</td>
<td>(216,683)</td>
</tr>
<tr>
<td>Investments</td>
<td>5</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>Other assets</td>
<td>99,455</td>
<td>12,285</td>
<td>111,740</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(Increase)/decrease in liabilities:</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>(421,423)</td>
<td>(1,444,845)</td>
<td>(1,866,268)</td>
</tr>
<tr>
<td>Salaries and benefits</td>
<td>(9,218)</td>
<td>(207,457)</td>
<td>(216,675)</td>
</tr>
<tr>
<td>Environmental and disposal liabilities</td>
<td>-</td>
<td>(834,335)</td>
<td>(834,335)</td>
</tr>
<tr>
<td>Other Liabilities (Unfunded Leave, Unfunded FECA, Actuarial FECA)</td>
<td>10,620</td>
<td>(833,160)</td>
<td>(822,540)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other financing sources:</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal employee retirement benefit costs paid by OPM and Imputed to the agency</td>
<td>(722,050)</td>
<td>-</td>
<td>(722,050)</td>
</tr>
<tr>
<td>Other imputed financing</td>
<td>(81,535)</td>
<td>-</td>
<td>(81,535)</td>
</tr>
</tbody>
</table>

Total Components of Net Cost that are Not Part of Net Outlays

<table>
<thead>
<tr>
<th>Total Components of Net Cost that Are Not Part of Net Outlays</th>
<th>Intragovernmental</th>
<th>With the public</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1,337,857)</td>
<td>(41,585,908)</td>
<td>(42,923,765)</td>
</tr>
</tbody>
</table>

Components of Net Outlays That Are Not Part of Net Cost

<table>
<thead>
<tr>
<th>Total Components of Net Outlays That Are Not Part of Net Cost</th>
<th>Intragovernmental</th>
<th>With the public</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(152,062)</td>
<td>37,664,794</td>
<td>37,512,732</td>
</tr>
</tbody>
</table>

Other Temporary Timing Differences

Net Outlays

<table>
<thead>
<tr>
<th>Total Other Temporary Timing Differences</th>
<th>Intragovernmental</th>
<th>With the public</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ 41,048,697</td>
<td>$ 113,677,065</td>
<td>$ 154,725,762</td>
</tr>
</tbody>
</table>

Agency Outlays, Net, Statement of Budgetary Resources

Reconciling Difference

<table>
<thead>
<tr>
<th>Reconciling Difference</th>
<th>$ 153,903,899</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ 821,863</td>
</tr>
</tbody>
</table>

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 some financial system limitations, there is an $821.9 million difference between net cost and net outlays. This difference is primarily attributable to processes relating to purchasing OM&S.
NOTE 21. 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 the condition of Navy military housing improvements occurred more expeditiously and efficiently than the traditional Military Construction, process would allow. 10 U.S.C. §§ 2871-2886 codifies the Service Secretaries’ MHPI authority.

The SECNAV delegated MHPI authority to NAVFAC, which 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 (P3): 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 DoD MHPI program, conveying Navy real property assets to the selected private partners and long-term leases of the underlying land, and the use of direct loans from DoD MHPI.

The expected life of each MHPI arrangement corresponds to the duration of the ground lease (generally 50 years). 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.

Funding
Contributions from the DoD MHPI program and the Partner typically occur at the beginning of any new project, as required by the operating agreement. During Phase I, the initial development phase, the Navy entered into long term ground leases (generally 50 years) and conveyed the associated real property assets (buildings, structures, facilities, and utilities) to the MHPI P3, organized as a Limited Liability Company (LLC). The Navy provided a nominal amount of funding to DoD Family Housing Improvement Fund (FHIF) or DoD Military Unaccompanied Housing Improvement Fund (MUHIF).

The DoD MHPI program made direct cash contributions and loans to the LLCs. 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. 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 to the FHIF or MUHIF. However, the enactment of Pub L. 115-91 § 603, required the Navy to make direct payments to the MHPI entities (lessors) of 1% of the Basic Allowance for Housing (BAH) amount for the period January 1 – December 31, 2018. The amount of BAH was 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.

From September 1, 2018 forward, Pub. L.115-232 § 606 directs that payments to the MHPI entities of 5% of BAH will occur monthly until Congress modifies or rescinds this direction.

The following table represents the aggregated Federal contribution amounts paid to the MHPI Program and LLCs through September 30, 2019:

<table>
<thead>
<tr>
<th>Navy Contributions ($ in millions)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding contributions to DoD MHPI program</td>
<td>$124.9</td>
</tr>
<tr>
<td>Real property contributions to the LLCs (value of Real Property Assets (RPA) conveyed, per OMB scoring documents)</td>
<td>$ 2,170</td>
</tr>
<tr>
<td>Navy direct payments as required by Pub. L. 115-91 § 603 and Pub. L. 115-232 § 606</td>
<td>$ 54.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DoD Contributions*($ in millions)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct cash contributions</td>
<td>$ 357.7</td>
</tr>
<tr>
<td>Direct loans</td>
<td>$ 2.5</td>
</tr>
</tbody>
</table>

*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.
The DoD MHPI program is projected to receive direct loan repayments in the amount of $0.9 million through September 30, 2019 (aggregate) and $125 thousand annually with the final repayment being conducted in May 2032. The USN GF does not receive loan payments from the LLCs.

With respect to indirect third-party payments to MHPI entities, it is estimated that the Navy will pay BAH under section 403 of title 37 to members living in privatized housing in the amount of $930 million in FY 2019. The number of military family housing units upon which these estimated payments will be made is 31,636 in FY 2019. The number of units of military unaccompanied housing upon which these estimated payments will be made is 5,887 in FY 2019. The indirect third-party payments will continue as long as military members reside in MHPI housing.

Neither the Navy nor the DoD are expected to make any additional cash contributions, loans, or conveyance of real property to the LLCs after Oct 01, 2019 through the end of the P3 arrangements. The Navy will continue to make monthly direct payments for 5% of BAH to the MHPI entities for a projected total of $1.5 billion over the remaining life of the OAs, unless this authority is rescinded or modified.

Non-federal funding for the MHPI arrangements generally included direct cash contributions from the private Partner, land contributions upon which new housing was constructed, and either bonds or loans obtained by the LLC.

The following table represents the aggregated contributions by the Private Partner to the LLC through September 30, 2019:

<table>
<thead>
<tr>
<th>Private Partner Contributions* ($ in millions)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct cash contribution</td>
<td>$65.3</td>
</tr>
<tr>
<td>Bonds/Loans contributed</td>
<td>$4,015</td>
</tr>
<tr>
<td>Real property and land contributions</td>
<td>$0.3</td>
</tr>
<tr>
<td>Real Property asset donations to Navy</td>
<td>$51.7</td>
</tr>
</tbody>
</table>

There is no requirement for the private partners to make any additional contributions after October 1, 2019 through the end of the arrangements (approx. through 2050).

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

Risk of Loss

The DoD’s risk of loss is the initial cash contribution to the program; the USN GF’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 a revenue flow “waterfall” which prioritizes payments to “must pay” accounts first. The waterfall is in effect a risk mitigation strategy to the LLC, should unexpected interruptions occur to the revenue stream during project operation.

The MHPI operating agreements do not explicitly identify risk of loss contingencies.

The entity cash flow is dependent on congressional authorization and appropriation of BAH, 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, as a result 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 which is not measurable at this time.
Gains and Losses

The USN GF does not recognize unrealized gains or losses within the MHPI arrangements. Gains or losses will only occur upon the termination of an MHPI arrangement. Upon dissolution, residual cash from the arrangement (i.e. sale of assets or remaining capital improvement funding) reverts to the DoD FHIF or DoD MUHIF, and thus will have no impact to the USN GF financial statement. The USN GF will take ownership of all real property assets left on the leased premises at the end of the lease term (generally 50 years). The USN GF will recognize any gains or losses of RPA valuation at that time.

Risk of Termination or Non-Compliance

The conditions governing the early termination, hand-back, and renewal options vary from MHPI arrangements. If a going-concern, termination, or default occurs, the USN GF will conduct procedures to mitigate risk and to identify an entity to take over the partnership. Each MHPI operating agreement provides processes for dissolution or termination of the arrangement to include the sale of assets not on USN GF land and the transfer of real property assets to the USN GF. The operating agreements also provide processes through which the USN GF can enter into successor arrangements in cases where the current private partner is no longer a member of the MHPI arrangement, thereby avoiding early termination of the project.

The Navy did not receive the FY 2018 audited financial statements for one entity in time to support the development of the Navy’s FY 2019 financial statements. The information contained in this disclosure includes the values for this entity based on their FY 2017 audited financial statements. This information includes immaterial amounts which may impact the financial amount included within the Private Partner Contributions (cash, bonds, loans). The Navy is working with the entity to expedite the delivery of the audited financial statements. If a material adjustment is necessary based on the receipt of the FY 2018 audited financial statements for this entity the Navy will adjust the disclosure to reflect the new information in the quarter following receipt.

In some instances, the USN GF provides utility services to the housing area operated by the LLC. The LLC is contractually required to provide reimbursements for utility services provided by the USN GF. In one instance, payments to the USN GF are overdue and the USN GF is working with the DFAS and the LLC to receive payment.

Additional Disclosure

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 22. 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 21, “Public-Private Partnerships” for USN GF’s PPV/P3s that were identified for disclosure in compliance with SFFAS 47 and SFFAS 49.
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The Office of Naval Research (ONR) leads the Research and Development for the DON and provides technical advice to the Chief of Naval Operations and the Secretary of the Navy.
ONR has been discovering, developing, curating and delivering cutting-edge S&T solutions for U.S. Naval forces for over 70 years.

Congress first established ONR in 1946 “to plan, foster and encourage scientific research in recognition of its paramount importance to the maintenance of future naval power, and the preservation of national security.” Today, ONR leads the Naval Research Enterprise, comprised of ONR Headquarters, the NRL, the Office of Naval Research Global (ONR-G) and PMR-51 (Office of special projects).

In this era of great power competition, technological dominance is essential to national security. Maritime superiority necessitates continuous scientific research robustly resourced and intently focused on the Naval future force. ONR is chartered with that sacred trust: to discover, develop and deliver new technology and capabilities for the Navy and Marine Corps.

Led by the Chief 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. ONR program officers work on everything from long-term (basic) scientific research, through near-term solutions and quick-reaction prototype deliveries.

ONR-led scientific breakthroughs have been many over the years and range from radars to lasers and even the cooling of atoms enabling atomic clocks and GPS. We continue to advance America’s knowledge base on behalf of the naval warfighter. Specific research today includes autonomy, artificial intelligence, biotechnology, quantum computing, hypersonics, big-data analytics and more.
On-top journal vouchers adjusting for prior year transaction recorded as current year activity, due to a mid-year conversion were recorded at a higher level than the disclosure information presented. As a result, large positive and negative amounts are presented. The overall expenses are comparable to prior years and are accurate.

*Bottom line: Maritime superiority begins with Naval S&T.* To learn more about ONR and naval research priorities outlined in the Naval R&D Framework go to: [www.onr.navy.mil](http://www.onr.navy.mil).

**Basic Research Examples:**

**Ice Dynamics in the Arctic**

Predicting sea ice cover and ice dynamics in the Arctic is an emerging critical capability for naval forces and safe ship operations. ONR is pursuing solutions to this challenge leveraging a Multi University Research Initiative (MURI).

Sea ice cover predictions are essential for the strategic and tactical planning of naval operations in the Arctic, as well as for the safe and effective passage of commercial and humanitarian ships in these waters. Increased global socioeconomic activities in Arctic waters will bring with it the challenges of navigation in a dynamic ice-covered ocean.

The observational record shows that the Arctic sea ice cover is undergoing significant changes and the trend suggests this will continue into the future. Notably, the observed reduction in sea ice volume in the Arctic has led to significant areas of open water during summer months and a more dynamic seasonal cycle of ice melt and regrowth.

Current naval models of sea ice lack the complexity to faithfully represent many important processes in sea ice formation, ice motion, and pack ice break-up, inhibiting the ability to predict salient features of the sea ice cover on both short and long-term time scales.

The ONR-funded MURI team includes the Courant Institute of Mathematical Sciences, New York University; University of Wisconsin; California Institute of Technology; Yale University and the University of Washington. Together they are investigating the combination of theoretical physics with data-driven machine learning-based approaches for the development of improved oceanographic and ice cover models over multiple time scales.

This MURI research brings to bear the collaborative and integrated efforts of top minds and laboratories in the fields of artificial intelligence, mathematics, statistics, numerical modelers, and geophysical fluid dynamicists.

What this research will accomplish:

- Next generation Arctic ice prediction models
- Increased access for naval vessels in the Arctic
- Greater safety for naval forces operating in the Arctic region

**Noise Induced Hearing Loss Program**

Exposure to thunderous noise onboard Navy ships—from jet engines, machine rooms, cockpits, firing ranges and other work locations—causes about one in four sailors to experience hearing loss. Throughout the military, hearing loss and tinnitus affect up to 600,000 personnel and cost the Department of Veterans Affairs an estimated $6 billion a year.

Noise-induced hearing loss (NIHL) is a far-reaching and extensive problem for the U.S. Navy. Hearing loss and tinnitus (commonly referred to as ringing in the ears) are among the most frequently cited disability claims. On a mission to help the Navy reduce this problem ONR, has managed the Navy’s NIHL program and delivered numerous solutions for Sailors and Marines who often work in industrial environments for the past 10 years.

High risk of exposure to prolonged noise can produce auditory injuries and impairments, which can compromise safety, quality of life and effectiveness of communication. Extended exposure to high-level noise can kill sensory hair cells found in the inner ear’s cochlea; damage other essential auditory nerves; and alter brain circuits necessary for hearing and speech understanding, which can cause permanent hearing loss.

ONR sponsored research has yielded custom-molded earplugs for more than 6,000 sailors; development of a mobile app on hearing health; quieter, more efficient equipment for abrasive blasting of corrosion and other substances from ship hulls and walls; and a computer-aided modeling technology used to pinpoint the loudest areas of a ship so the Navy can reduce the noise level.
For the modeling technology, ONR commissioned a measuring tool from a company to identify surfaces that produced the loudest reverberations on Navy vessels. The Navy can then coat those “hot spots” with a ceramic-like material to dampen the noise, rather than apply it to whole walls, thus saving weight—a critical need for ships.

Such a coating was used on the aircraft carrier USS Abraham Lincoln, which returned to service in January 2019 following a four-year scheduled maintenance overhaul.

What this research will accomplish:

• Improve warfighter performance
• Increases in warfighting readiness
• Reduce cost of long-term care

Applied Research Examples:

**Network Adaptive Communication Services (NACS)**

“Drowning in data, thirsting for knowledge,” is a common complaint heard from Sailors and Marines in today’s modern naval force. An ever-increasing number of maritime sensors feeding into operational decision systems and tactical applications fuels the Information Warfare (IW) environment. Delivering decisive information to deployed and mobile forces ashore can make the final difference in combat.

NACS is an IW-related research program that began in 2014, is deploying now through 2020, and is realizing its initial operational capability in the Fleet in 2019.

In short, NACS processes software for hand-held devices for U.S. naval forces. These efforts drew on early successes that progressed into the NACS Future Naval Capability program and two other related programs: Actionable Information Tactical Applications (AITA), and Data Conditioning.

Combined, the goal is to optimize how hand-held devices receive and organize data.

NACS, AITA, and Data Conditioning comprise a software platform to improve how warfighters gather, process, and share information for Intelligence, Surveillance and Reconnaissance. The platform is able to trim the “data-to-decisions” timeline down to minutes, if not seconds.

The technology sifts through data faster and more effectively by selecting tactically relevant information, moving it to a special network, and then presents it in an immediately understandable format to battlefield decision-makers.

This research builds on advances in mobile technology and cloud computing to increase operational awareness during tactical missions. Naval warfighters now have better information, to make faster, more-informed decisions with decisive results.

Through such streamlining, this system provides only the most-relevant, real-time data to naval warfighters preventing information overload. Additionally, using their hand-held devices, enhanced mobility enables naval forces to press the fight to the adversary while staying abreast of operational conditions afloat and ashore.

What this research will accomplish:

• Improve tactical decision-making
• Support better, faster coordination across naval forces
• Advance mobile systems and their use in complex, naval environments

**Tactically Reconfigurable Artificial Combat Enhanced Reality (TRACER) Lets Sailors Use Augmented-Reality to Train for Combat**

The ONR teamed with Naval Surface Warfare Center Dahlgren, U.S. Army Combat Capabilities Development Command and industry partners to develop a breakthrough in Augmented Reality (AR) training. The TRACER provides ultra-realistic scenarios for ship boarding, search and seizure afloat, as well as active shooter suppression ashore.

The TRACER system consists of the Magic Leap One Augmented Reality headset, a backpack processor and a state-of-the-art instrumented weapon made by Haptech, Inc. and designed to deliver realistic recoil. More importantly, TRACER leverages and builds upon software developed by Magic Leap Horizons as part of the U.S. Army’s Augmented Reality Dismounted...
Soldier Training project, providing advanced weapons tracking and allowing trainers to create multiple and adaptable simulation scenarios for security personnel to experience.

The training system was built mostly from commercial-off-the-shelf products. All of these technologies combine to deliver an extremely accurate immersive experience. Ultimately, TRACER provides sailors with dynamic, engaging and less predictable training scenarios that would otherwise be too costly or time consuming to create in the real world.

For sailors who often have to train and remain proficient while at sea, flexibility is crucial. The necessary space required to conduct training operations on a ship are limited and the opportunity to conduct training without impeding on regular operations is scarce. TRACER will help mitigate those issues and help increase proficiency and currency in more expansive training scenarios.

What this research will accomplish:
- Improve training and readiness
- Increases availability of training
- Apply training technology to other education needs

**Developmental Research Examples:**

**Sea Hunter Autonomous Ship**

ONR is leading efforts for the U.S. Navy to develop and demonstrate unmanned surface vehicle technology, and test concepts of operation via the Medium Displacement Unmanned Surface Vessel program.

Officially called Sea Hunter, and launched in 2016, it became the first ship to autonomously navigate from San Diego to Pearl Harbor, Hawaii, and back without a single crewmember onboard. Except for short duration boarding by personnel from an escort vessel to check electrical and propulsion systems, the autonomous ship test provided a glimpse into the potential of unmanned surface vessels to augmented and enhance U.S. Naval operations.

Sea Hunter completed the round-trip autonomous voyage in February 2019, covering a total distance of more than 5,000 nautical miles. The test included 20 cumulative days of autonomous sailing underway, during which many valuable lessons learned were harvested about the technology, vessel performance and automation of maritime operations.

The ONR-funded effort is a partnership with Leidos, who designed and built the 132-foot-long Trimaran, which is the first autonomous, unmanned vessel capable of traveling for long periods and executing a variety of missions at a fraction of the cost for a manned ship. This recent achievement is part of an extended test phase, which has been ongoing since the end of 2016.

The Sea Hunter program is leading the world in unmanned, autonomous naval ship design and production. The Hawaii voyage’s long-range mission was the first of its kind and demonstrated to the U.S. Navy that autonomy technology is ready to move from the developmental and experimental stages to advanced mission testing. Sea Hunter will continue long duration and mission package testing throughout 2019.

ONR contracted to develop Sea Hunter II, which is currently under construction. The sister ship will be based upon lessons learned from the first Sea Hunter, evolving mission requirements, and further development of autonomy enhancements.

What this research will accomplish:
- Testing in real-world environment
- Informs future autonomous surface vehicle designs
- Experiment with different concepts of operation
**Solid State Laser Technology Maturation (SSL-TM) Program**

The ONR delivers the most powerful shipboard laser weapon systems in the world. The SSL-TM program is part of the Navy's Laser Family of Systems, which will provide commanders with an array of capabilities to meet evolving threats at a fraction of the cost per shot of current weapons.

Today’s laser weapon systems evolved from research in the 1980’s on high-powered chemical lasers. While these lasers showed promise, the logistics and safety issues of hazardous chemicals in a shipboard environment severely hampered further development or implementation on the Navy’s surface combatants.

Since then, commercial solid-state laser technologies capable of weapons-level effects have matured rapidly. Lessons from the 30kw Laser Weapon System developed by the Office of Naval Research and installed aboard the USS Ponce in the Persian Gulf in 2014 proved extremely valuable and were key to development of the 150kw Laser Weapon System Demonstrator (LWSD).

The 150kw LWSD system will be installed aboard the USS Portland in 2019 and will support demonstrations, experimentation and shipboard operations.

The LWSD implements an open systems architecture design concept that includes government-controlled interfaces. The open system elements provide opportunities to reduce cost and improve the system’s capability by adding or replacing modules with new technologies as they become available.

SSL-TM supports development and demonstration of advanced technologies. Crew feedback and results from testing, experimentation, operations, and sustainment will support system refinement and development of future systems.

The application of SSL-TM technology provides commanders increased decision space and response options. The SSL-TM program will accelerate development of lasers to rapidly deliver affordable prototype capabilities.

What this research will accomplish:

- Conduct tests against representative threat Unmanned Aerial Vehicles, small boats and sensors
- Collect feedback from operators
- Develop operational concepts for directed energy
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).
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
For the Fiscal Year Ended September 30, 2019
( $ in thousands)

<table>
<thead>
<tr>
<th>Major Category*</th>
<th>FY18 PB-61 Amounts</th>
<th>Adjustments**</th>
<th>FY19 Totals**</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Aircraft</td>
<td>$ 477,287</td>
<td>$ 92,036</td>
<td>$ 569,323</td>
</tr>
<tr>
<td>2. Electronics and Communications Systems</td>
<td>182</td>
<td>5,002</td>
<td>5,184</td>
</tr>
<tr>
<td>3. Missiles</td>
<td>96,183</td>
<td>(69,833)</td>
<td>26,350</td>
</tr>
<tr>
<td>4. Ships</td>
<td>220,869</td>
<td>304,701</td>
<td>525,570</td>
</tr>
<tr>
<td>5. Ordnance Weapons and Munitions</td>
<td>44,774</td>
<td>(28,963)</td>
<td>15,811</td>
</tr>
<tr>
<td>6. All Other Items Not Identified Above</td>
<td>11,417</td>
<td>2,904</td>
<td>14,321</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 850,712</td>
<td>$ 305,847</td>
<td>$ 1,156,559</td>
</tr>
</tbody>
</table>

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.
**FY19 values are estimates based on data submitted for BES-21

Equipment 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 2019 are included in the data. The Department of Navy has not changed prior year policies.

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, 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, 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 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.
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, P-3 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.

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.

Ships

Fleet Type Commanders provide deferred ship maintenance data. Data is collected from the Current Ships’ Maintenance Plan 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.

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.

All Other Items Not Identified Above

This category comprises deferred maintenance for software, arresting gear, lighting and surfacing equipment, and external fuel transfer module. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.
**US Navy General Fund**

Statement of Disaggregated Budgetary Resources

For the Fiscal Year Ended September 30, 2019

($ in thousands)

<table>
<thead>
<tr>
<th></th>
<th>Research, Development, Test &amp; Evaluation</th>
<th>Procurement</th>
<th>Military Personnel</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Budgetary Resources:</strong></td>
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<td></td>
</tr>
<tr>
<td>Unobligated Balance from Prior Year, net (discretionary and mandatory)</td>
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<td>Appropriations (discretionary and mandatory)</td>
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<tr>
<td>Spending Authority from Offsetting Collections (discretionary and mandatory)</td>
<td>325,035</td>
<td>246,025</td>
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<tr>
<td><strong>Total Budgetary Resources</strong></td>
<td>21,582,248</td>
<td>94,696,170</td>
<td>35,283,740</td>
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<tr>
<td><strong>Status of Budgetary Resources:</strong></td>
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<tr>
<td>New Obligations and Upward Adjustments (total)</td>
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<td><strong>Unobligated Balance, End of Year:</strong></td>
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<tr>
<td>Apportioned, Unexpired Accounts</td>
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<td>Unexpired Unobligated Balance, End of Y ear</td>
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<td>Expired Unobligated Balances, End of Y ear</td>
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<td>33,937,002</td>
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<td>Distributed Offsetting Receipts</td>
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<td>-</td>
<td>-</td>
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<tr>
<td><strong>Agency Outlays, Net (discretionary and mandatory)</strong></td>
<td>$17,727,865</td>
<td>$45,945,998</td>
<td>$33,937,002</td>
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</tbody>
</table>

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, 2019
($ in thousands)

<table>
<thead>
<tr>
<th>Unaudited</th>
<th>Family Housing &amp; Military Construction</th>
<th>Operations, Readiness &amp; Support</th>
<th>2019 Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

**Budgetary Resources:**

- **Unobligated Balance from Prior Year, net (discretionary and mandatory)**
  - $3,575,897
  - $4,943,280
  - $48,688,347
- **Appropriations (discretionary and mandatory)**
  - 3,338,297
  - 55,328,579
  - 169,051,374
- **Spending Authority from Offsetting Collections (discretionary and mandatory)**
  - 217,835
  - 4,236,652
  - 5,462,977

**Total Budgetary Resources**

- 7,132,029
- 64,508,511
- 223,202,698

**Status of Budgetary Resources:**

- **New Obligations and Upward Adjustments (total)**
  - 3,180,018
  - 61,821,810
  - 180,531,329

**Unobligated Balance, End of Year:**

- **Apportioned, Unexpired Accounts**
  - 3,796,957
  - 927,794
  - 39,450,475
- **Exempt from Apportionment, Unexpired Accounts**
  - -
  - 45,228
  - 45,228
- **Unexpired Unobligated Balance, End of Y ear**
  - 3,796,957
  - 973,022
  - 39,495,703
- **Expired Unobligated Balances, End of Y ear**
  - 155,054
  - 1,713,679
  - 3,175,666

**Unobligated Balance, End of Year (total)**

- 3,952,011
- 2,686,701
- 42,671,369

**Total Budgetary Resources**

- $7,132,029
- $64,508,511
- $223,202,698

**Outlays, Net**

- 1,579,355
- 54,872,175
- 154,062,395

**Distributed Offsetting Receipts**

- -
- (158,496)
- (158,496)

**Agency Outlays, Net (discretionary and mandatory)**

- $1,579,355
- $54,713,679
- $153,903,899

The accompanying notes are an integral part of these statements.
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.
### TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT

<table>
<thead>
<tr>
<th>Areas of Material Weaknesses</th>
<th>Beginning Balance</th>
<th>New</th>
<th>Recategorized</th>
<th>Resolved</th>
<th>Reassessed</th>
<th>Consolidated</th>
<th>Ending Balance</th>
<th>General Fund</th>
<th>Working Capital Fund</th>
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**TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES**

The DON Financial Reporting Material Weaknesses and Corrective Actions

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### Areas of Material Weaknesses

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### Financial Management Systems Material Weaknesses and Corrective Actions

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### Effectiveness of Internal Controls over Financial Systems (FMFIA § 4 and FFMIA)

- Statement of Assurance: Controls are not in place to provide Reasonable Assurance

### Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)

<table>
<thead>
<tr>
<th>Agency</th>
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<tr>
<td>1 Federal Financial Management System Requirements</td>
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<td>2 Applicable Federal Accounting Standards</td>
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<td>3. USSGL at Transaction Level</td>
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## General Funds

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<th>Account</th>
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<tr>
<td>017X0513</td>
<td>Ship Modernization, Operations and Sustainment Fund, Navy</td>
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<td>Family Housing, Navy and Marine Corps</td>
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<td>Environmental Restoration, Navy</td>
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<td>017X1000</td>
<td>Medicare-Eligible Retiree Health Fund Contribution, Navy</td>
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<td>017X1001</td>
<td>Medicare-Eligible Retiree Health Fund Contribution, Marine Corps</td>
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<td>017X1105</td>
<td>Military Personnel, Marine Corps</td>
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<tr>
<td>017X1166</td>
<td>Operation and Maintenance, Marine Corps</td>
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<tr>
<td>017X1205</td>
<td>Military Construction, Navy and Marine Corps</td>
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<tr>
<td>017X1206</td>
<td>Military Construction – Recovery Act, Navy and Marine Corps</td>
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<td>017X1253</td>
<td>Military Construction, Naval Reserve</td>
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<td>017X1256</td>
<td>Payments to Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy</td>
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<td>017X1319</td>
<td>Research, Development, Test, and Evaluation, Navy</td>
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<td>Reserve Personnel, Navy</td>
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<td>Military Personnel, Navy</td>
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<td>017X1506</td>
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<td>Weapons Procurement, Navy</td>
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<td>Procurement of Ammunition, Navy and Marine Corps</td>
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## Revolving Funds

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## Special Funds

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<td>Wildlife Conservation, etc., Military Reservations, Navy</td>
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<td>Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy</td>
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<td>017X5562</td>
<td>Ford Island Improvement Account</td>
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<td>Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)</td>
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<td>017X6002</td>
<td>Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)</td>
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<td>017X6025</td>
<td>Pay of the Navy, Deposit Fund (T)</td>
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<td>017X6026</td>
<td>Pay of the Marine Corps, Deposit Fund (T)</td>
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<td>017X6228</td>
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## Trust Funds

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<td>Ships Stores Profits, Navy</td>
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<tr>
<td>017X8733</td>
<td>United States Naval Academy General Gift Fund</td>
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</table>
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
NAVAL INSPECTOR GENERAL


We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the U.S. Navy General Fund Financial Statements and related notes as of and for the fiscal years ended September 30, 2019, and 2018. The contract required EY to provide a report on internal control over financial reporting and compliance with laws and other matters, and to report on whether the Navy's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). 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. EY's Independent Auditor's Reports are 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 FY 2019 and FY 2018 Financial Statements and related notes.
EY’s separate report, “Internal Control Over Financial Reporting,” discusses 17 material weaknesses related to the Navy General Fund.* Specifically, EY’s report describes the following material weaknesses:

- The Navy did not have adequate policies and procedures over financial reporting to identify, detect, and correct inaccurate and incomplete balances in the general ledger.

- The Navy was unable to reconcile the Fund Balance with Treasury ending balances from the general ledger systems to the U.S. Treasury.

- The Navy did not have adequate policies, procedures, internal controls, and supporting documentation over the acquisition, disposal, tracking, and inventory for Government Property in Custody of Contractors.

- The Navy did not have adequate policies, procedures, internal controls, and supporting documentation to support the balance and reporting of the Operating Materials and Supplies–Remainder account.

- The Navy’s policies and procedures over its end-to-end ordnance process did not address financial reporting risks for the Operating Materials and Supplies–Ordnance account.

- The Navy did not have adequate policies, procedures, internal controls, and supporting documentation for substantiating the existence, completeness, and presentation and disclosure related to utility assets.

- The Navy did not have adequate policies, procedures, internal controls, and supporting documentation, which prevented Navy from substantiating the balance and presentation of the General Equipment–Remainder account.

- The Navy did not adequately document policies and procedures over Property, Plant, and Equipment Construction-in-Progress or effectively design key controls to ensure appropriate processing and recording of Construction-in-Progress transactions.

* 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.
• The Navy did not have adequate policies, procedures, internal controls, and supporting documentation to substantiate the balances and presentation of the Expenses and Accounts Payable accounts.

• The Navy’s policies, procedures, and internal controls were not effective for monitoring and validating Undelivered Orders for obligated balances.

• The Navy was unable to substantiate the Contingent Legal Liabilities and did not have adequate policies and procedures to identify, detect, and correct inaccurate balances in the general ledger.

• The Navy did not have policies, procedures, internal controls, and supporting documentation to substantiate the balances and presentation of the Revenue and Unfilled Customer Orders accounts.

• The Navy did not have sufficient policies and procedures to accurately identify, detect, and correct inaccurate balances in the general ledger for Environmental Disposal Liabilities.

• The Navy did not have an effective Managers’ Internal Control program, which impacts its ability to identify and address significant risks for key business processes. The Navy did not fully implement internal controls, including the documentation of policies and procedures that describe Navy’s environment related to end-to-end business processes, roles, and responsibilities, monitoring of service providers, risks, and controls.

• The Navy information systems environment had weaknesses in access controls and segregation of duties, including, but not limited to, incomplete and inaccurate user population, inconsistent user access provisioning and termination processes, and inconsistent periodic review of user access.

• The Navy information systems environment had weaknesses in configuration management, including, but not limited to, inconsistent authorization, testing, approval, logging, and monitoring of changes; incomplete or inaccurate population of system changes; and ineffective segregation of duties within the change management process.

• The Navy information systems environment had weaknesses in interface processing control, including, but not limited to, insecure transmission of data and inability to determine data transfer completeness, timeliness, and accuracy.
EY's additional report, "Compliance and Other Matters," discusses two instances of noncompliance with applicable laws and regulations. Specifically, EY's report describes instances where the Navy's financial management systems did not comply with the FFMIA, and evidence was not provided to ensure that the Navy General Fund meets the requirements of the Federal Managers' Financial Integrity Act.

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY's representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the Navy General Fund FY 2019 and FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control over financial reporting, or conclusions on whether the Navy's financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached reports, dated November 8, 2019, and the conclusions expressed within the reports.

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

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

Attachments:
As stated
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,
2019, and the related consolidated Statements of Net Costs, Changes in Net Position, and the
combined Statement of Budgetary Resources for the year ended September 30, 2019, 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 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, and 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.
19-03, Audit Requirements for Federal Financial Statements. Because of the matter 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 related to
accounting issues for the Department of Defense and the Federal government. The effect on the
financial statements amounts involved is not currently determinable by the Navy and could be
material.
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 a whole for the year ended September 30, 2019.

Disclaimer of Opinion

Because of the significance of the matter 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 require that the Management’s Discussion and Analysis, Required Supplementary Stewardship Information and the 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 because of the significance of the matter 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 basic 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 basic financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.
Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we also have issued our reports dated November 8, 2019 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, 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 on 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.

November 8, 2019
Report of Independent Auditors on Internal Control Over Financial Reporting
Based on an Audit of 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, 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. 19-03, 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, 2019, 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, 2019. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of the work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the fiscal year ended September 30, 2019, and the related notes to the financial statements.

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) to determine 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 limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-03. We did not test 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 ensuring efficient operations.

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.

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, therefore, material weaknesses or significant
deficiencies may exist that have not been identified. As described below, we did identify certain deficiencies in internal control that we consider to be material weaknesses and a significant deficiency.

**Material Weaknesses**

**I. Financial Reporting**

The financial reporting process lacks 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 balance 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, 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 inadequate 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 (OM&S-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, or Trident Missiles, and consists of assets that are consumed as part of a major end item. Lack of adequate controls over the lifecycle 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 (OM&S-O) 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, as well as inadequate oversight and monitoring of ordnance held by third parties, prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to OM&S-O are further described in Appendix A.

VI. Property, Plant, and Equipment: Utilities

Property, Plant, and Equipment (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. The Navy has not developed or implemented a consistent methodology for the measurement, composition, and recordation of utility assets across the organization. This prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to utilities are further described in Appendix A.

VII. Property, Plant, and Equipment: General Equipment Remainder

PP&E General Equipment-Remainder (GE-R) are assets other than vessels, aircraft, and satellites and are primarily composed of equipment used in research, development, and maintenance. The Navy has failed to implement effective policies and procedures over GE-R and lacks controls to adequately record the lifecycle of GE-R (i.e., receipt, acceptance, maintenance, issuance, and disposal) within an approved Accountable Property System of Record (APSR). This prevents the Navy from substantiating the reported balance 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, and Equipment: 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 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, accrued
environmental restoration and asset closure. The EDL process lacks sufficient and appropriate policies and procedures 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.

X. Contingent Legal Liabilities

Contingent legal liabilities include accrued contingent liabilities pertaining to legal cases where the Office of General Counsel or the Office of Judge Advocate General considers an adverse decision probable and the amount of the loss measurable. The contingent legal liabilities process lacks sufficient and appropriate policies and procedures to report and record reasonable estimates, which impact the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Contingent Legal Liabilities are further described in Appendix A.

XI. 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 balance 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.

XII. 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 balance 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.

XIII. Budget Execution & 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. The Navy’s Undelivered Orders (UDO) represents the amount of goods and services ordered which have not been received. Lack of adequate policies, procedures, internal controls and related 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 UDO Balances are further described in Appendix A.
XIV. 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.

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

Access controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. We identified access control and Segregation of Duties (SoD) 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.

XVI. Financial Information Systems – Configuration Management

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematic control changes to that configuration during the system’s life cycle. We identified configuration management 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.

XVII. 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. We identified interface processing 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 Interface Processing are further described in Appendix A.

Significant Deficiency

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 and are further described in Appendix B.
The Navy’s Response to Findings

The Navy’s response to the findings identified in our engagement to audit, as described above, is included in the accompanying letter dated November 8, 2019. The Navy’s response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result 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 performed 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, 2019
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 the Federal Managers’ Financial Integrity Act of 1982 (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 Controls (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’s 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:

Budget Submitting Offices Financial Reporting Process
- Budget Submitting Offices (BSOs) do not have adequate procedures, including internal controls, to properly reconcile their general ledgers to trial balances submitted to the Navy’s financial reporting service provider, the Defense Finance and Accounting Service (DFAS). In addition, the 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 the ERP. This has led to recording JVs that are incomplete, inaccurate, or non-compliant with Treasury Financial Manual (TFM) requirements.

Office of Financial Operations Financial Reporting Process
- The FMO lacks appropriate oversight and controls related to the JV preparation and review, financial reporting compilation and presentation, and the close process. Currently, the controls in place are not designed effectively, and are missing comprehensive reviews over the financial statements and related disclosures. In addition, the Navy lacks appropriate
controls over the preparation and review of recurring and non-recurring JVs, including related reconciliations. For example, in the third quarter, three non-recurring JVs were recorded to reclassify Property Plant & Equipment (PP&E) items to the Inventory and Related Property line. These entries were incorrect, resulting in a $1.8 billion understatement.

3. **Lack of Oversight of Financial Reporting Service Provider.** The Navy lacks appropriate oversight of DFAS related to the 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 US Treasury Financial Manual (TFM) and the review of the support 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 the fourth quarter was $38 billion.

**Data Processing**
- Monitoring controls over data processing actions taken by DFAS impacting the financial statements are inadequate. Management relies on DFAS to process financial information through Defense Departmental Reporting System Budgetary (DDRS-B) and Defense Departmental Reporting System Audited Financial Statement (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. In addition, exclusions (automated and manual) of feeder file activity by DFAS from the financial statements are not reviewed by management for validity and impact to the financial statements. The Navy relies on DFAS for the review of excluded transactions and final determination of the appropriateness and resolution of these exclusions. However, DFAS does not have adequate controls in place to ensure that the entire population of excluded transactions is adequately reviewed.

**Complementary User Entity Controls**
- Complementary User Entity Controls (CUECs) are controls that users of the service organization (the Navy) should have in place to supplement the service organization’s (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:

**Federal Accounting Standards Advisory Board (FASAB) Standards**
- As noted on 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 20 Reconciliation of Net Cost to Net Outlays. In addition, as presented, the Note includes an $800 million unsupported difference.

**Treasury United States Standard General Ledger (USSGL)**
- The Navy is not in compliance with Treasury’s United States Standard General Ledger (USSGL) at the transaction level as required by the Federal Financial Management Improvement Act of 1996 (FFMIA). Examples of significant processes that are not recorded in compliance with the USSGL include: budget execution, revenue, and unfilled customer orders.

**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 lifecycle 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.

Budget Submitting Offices Financial Reporting Process
- Design and implement policies and procedures governing the assessment and documentation of variances identified during the monthly Trial Balance (TB) reconciliation process which includes, but is not limited to, 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 BSO JVs to identify and correct instances where JVs do not comply with TFM posting logic.

Office of Financial Operations Financial Reporting Process
- 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 (DCM).
- Design policies and procedures which are compliant with required regulations.
- Periodically (at least annually) evaluate and update Standard Operating Procedures (SOPs) to ensure that the procedures described are the procedures performed.
- Implement monitoring controls over DFAS.
- Periodically (quarterly) update Delegations of Authority (DOAs) to reflect personnel changes.


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 detail only 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.

• In conjunction with DFAS, coordinate with the Office of Secretary of Defense (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.

• 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 the Navy system generated entries.

Data Processing

• Work with DFAS to develop and implement procedures to verify that excluded Lines of Accounting (LOAs)/General Ledger Account Codes (GLACs) are appropriate.

• 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.

Complimentary User Entity Controls

• Evaluate the current System and Organization Controls (SOC) report and CUECs to determine if they are appropriate to cover the end-to-end business process.

• Design and implement internal controls that address the CUECs identified in the DFAS SOC1 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) No. 54, Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment will have on these policies when the guidance goes into effect.

• Work with OSD to finalize an approach for accounting and reporting assets related to the JSF.

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. 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 agency’s, as well as the government-wide receipt and disbursement data. Treasury Financial Manual Chapter 5100, Section 5120 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 Accounting 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.

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

   Unsupported and Incomplete Transactions
   • Field Level General Ledger (FLGL) accounting systems do not contain complete and accurate disbursement and collection transaction level data. Transaction level data is overlaid through the recording of unsupported system generated adjustments, which limits management’s ability to analyze transactions and support transaction level testing.

   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.
Recommendations

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

1. **Lack of or Inadequate Documentation of FBwT Accounting Policies and Procedures, including Controls.**
   - Complete a PCM that documents the end-to-end process for the entire lifecycle 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 review and sign off on the updated PCM to validate that the PCM is complete and accurate.

2. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.**
   - Disbursements and collections should be accurately recorded in the general ledger system and financially reported from the general ledger system. In addition:
     - Reconcile the general ledger system to Treasury balances.
     - Eliminate the overlay of transaction level data through the elimination of cross disbursements and process disbursements by having the general ledger system interface directly with Treasury.
   - Implement a single reconciliation tool that supports the Navy’s initiative to utilize Treasury Direct Disbursing from the general ledger systems.

III. **Government Property in the Custody of Contractors**

Government property held in the custody of contractors includes government furnished equipment, 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, it 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 misstatements on the financial statements.

1. **Lack of or Inadequate Accounting 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. In addition, the Navy does not promptly record dispositions or losses of property...
in the custody of contractors and its policy fails to address the timely receipt and acceptance of contractor-acquired property.

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. Specifically, the Navy lacks oversight to validate the existence, completeness, accuracy, valuation, and related reporting of Trident assets due to the following control weaknesses:

   • Vendors are not required to provide listings of components held and the Navy does not perform comprehensive physical inventories of components held by contractors.
   • The Navy lacks understanding of the data provided by the contractor that is used to compile the component listing.
   • 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.

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

   • In some cases, the Navy relies on contractors who do not have access to government systems to report all changes to the quantity, condition, and physical location of ordnance assets in their custody using a manual process, resulting 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. During our audit, we noted differences in on hand quantity in 87.5% of 16 National Item Identification Number (NIINs) sampled, with a projected error value of $292 million, at contractor sites not using the Navy system of record.

4. **Inappropriate Reliance on Third Parties for General Equipment – Remainder (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 Accounting Policies and Procedures, including Controls and Related Documentation.**
   - 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).

2. **Inappropriate Reliance on Third Parties for Tridents**
   - Develop and require the use of a standard set of contract clauses that require contractors to provide complete and accurate 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.

3. **Inappropriate Reliance on Third Parties for Ordnance**
   - Expand the best practice of having direct input by contractors into the Navy’s systems by contractors holding ordnance, as this functionality already exists and is required in some, but not all, contracts.

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 property officers who will be responsible for property in the custody of contractors.
   - Require timely updates to property records for all property in the custody of contractors.
IV. Inventory and Related Property: Operating Materials & Supplies Remainder

Operating Materials & Supplies (OM & S) 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, Uninstalled Aircraft Engines, 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 lifecycle 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. 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 Accounting 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. In addition, 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 Property Plant & Equipment (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 BSO’s 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.

3. Lack of Policies and Procedures, including Internal Controls over OM & S-R Valuation and Accounting Methodology. The Navy lacks policies and procedures for valuation of OM & S-R, including valuation of excess, obsolete, unserviceable (EOU), and held for repair
items. In addition, an evaluation process does not exist to determine if previous waivers granted to the BSOs to operate under the purchase method of accounting are applicable and/or appropriate.

**Recommendations**

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

1. **Lack of or Inadequate Documentation of, OM & S-R Accounting Policies and Procedures, including Controls**
   - Implement policies that require consistent application and compliance with GAAP, Navy, and DoD policies and procedures related to OM & S-R asset management, accounting, and reporting.
   - 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**
   - Develop and implement comprehensive policies and procedures to substantiate existence and completeness to include developing a listing of approved systems.
   - 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.
   - Design policies and procedures to ensure OM & S-R balances are classified and presented appropriately in the financial statements.
   - 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.
   - Develop a uniform use of condition codes and ensure this is consistently utilized across all BSOs.

3. **Lack of Policies and Procedures, including Internal Controls over OM & S-R Valuation and Accounting Methodology**
   - Establish and implement policies and procedures to value all OM & S-R assets in accordance with SFFAS 48 and SFFAS 3.
   - Evaluate all BSOs utilizing the purchase method to ensure appropriateness and compliance with Navy policy and procedures.
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 or Inadequate Documentation of Ordnance Accounting Policies and Procedures, including Controls. The end-to-end processes, procedures, and key controls for significant portions of the ordnance end-to-end controls processes are not accurately or completely documented. For example, specific ordnance processes and procedures for Army-held, Contractor-held, procuring BSOs, Naval Sea Systems Command (NAVSEA) and Naval Air Systems Command (NAVAIR), have not been documented.

2. Lack of Sufficient Oversight and Monitoring of Ordnance Held by Third Parties. The Navy cannot identify a complete and accurate population of its ordnance assets held by third parties. Specifically, we noted the following issues during our testing:

**Ordnance Held by Army**
- The Navy does not reconcile the amount reported as Army-held ordnance in its system to the on-hand quantities Army is reporting in their system. The reconciliation procedures are not designed to ensure accurate, timely, and consistent execution to accurately report the Navy-owned ordnance held by the Army.

**Ordnance Held by Contractors**
- The Navy does not effectively oversee and monitor ordnance held by contractors. We noted the following:
  - **Periodic Inventories.** Regular periodic inventories are not required to be performed by contractors and controls do not exist to validate that the ordnance transactions recorded by contractors are appropriate for the related business event. For example, assets discovered during a contractor’s wall-to-wall inventory count were recorded as a receipt rather than as an adjustment and items that could not be located were recorded as an issuance. This results in Navy’s inability to determine if an investigation has occurred or if one is required when contractors incorrectly record items that were potentially lost as normal course of business transactions rather than adjustments.
  - **Recording of Transactions.** Procedures do not exist to determine if transactions recorded by contractors are timely and accurate. Specifically, physical receipt and issuance of assets occurring in previous fiscal years were not recorded until the current fiscal year. This issue was noted for 44% of 71 NIINs tested. In addition, 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.

3. **Inadequate or Lack of Controls over Financial Reporting of Ordnance.** The Navy lacks adequate financial reporting controls over ordnance assets. We noted the following control weaknesses impacting the ordnance balance reported on the balance sheet:

   **In-Transit Reconciliations**
   - The reconciliation of in-transit transactions (e.g., ordnance issuance and corresponding receipt transactions do not match) is not designed to ensure accurate and timely financial reporting, and therefore, these types of ordnance transactions are either not captured on the financial statements or are captured on the financial statements erroneously.

   **Out of Balance Errors**
   - Controls for reviewing and resolving discrepancies between the ordnance system of record and sub-systems are inadequate. Procedures are not in place to validate that errors identified by the error review process are resolved and properly recorded in the quarterly and year-end reports including financial statements.

   **Annual Pricing Update**
   - The annual price update policies and procedures, performed by the Naval Supply Systems Command (NAVSUP), are not designed to ensure complete, accurate, and consistent application of procedures by the program offices. Additionally, there is no set dollar threshold for variances to be researched and resolved. For example, the ordnance value increased by over $6 billion from the end of the prior year to the first quarter of the current year and management was unable to provide support for the change in the balance.

   **Support for Ending Balances**
   - Inputs used to calculate the ordnance gross ending balance are unsupported and cannot be tied back to transactional level detail. Additionally, there is no established threshold to investigate anomalies in the transactional level data. For example, there was a $6 billion-dollar ordnance fluctuation from the end of the prior year to the first quarter of the current year that the Navy was unable to support.

4. **Lack of Policies and Procedures, Including Internal Controls to Effectively Implement Accounting Standards.** There is a lack of policies and procedures, including internal controls to implement accounting standards, causing inaccurate presentation of OM & S on the balance sheet and in the related footnote disclosure. Specifically, ordnance has not been revalued using one of the acceptable valuation methodologies set forth by FASAB SFFAS 3 or SFFAS 48. In addition, the Navy does not record an allowance for “Held for Repair” assets. Lastly, management is unable to provide adequate support for its current recording of EOU ordnance at a net realizable value (NRV) of zero.
Recommendations

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

1. Lack of or Inadequate Documentation of Ordnance Accounting Policies and Procedures, including Controls
   - Update the PCM for the ordnance process that includes a complete and accurate end-to-end process for the entire life cycle of ordnance, including the sub-processes for ordnance held by others, specific sub-processes for each BSO, and the related key controls currently in place.

2. Lack of Sufficient Oversight and Monitoring of Ordnance Held by Third Parties
   - **Ordnance Held by Army**
     - Design and appropriately document procedures to ensure the accurate, timely, and consistent execution of the reconciliation of the Army’s records to the Navy’s records.
   - **Ordnance Held by Contractors**
     - Develop and implement a process for periodic inventory counts at contractor facilities.
     - 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.
     - Expand the Navy’s best practice of having direct input by contractors into the Navy’s system by contractors holding the Navy’s ordnance, as this functionality already exists, and the requirement is included in some, but not all, contracts.
     - 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.

3. Inadequate or Lack of Controls over Financial Reporting of Ordnance
   - **In-Transit Reconciliations**
     - Revise the current policies and procedures to require all unmatched in-transit transactions are cleared by the end of each quarter.
     - Perform an analysis to determine the impact to the Inventory and Related Property line item on the balance sheet of those assets that remain in-transit at the financial reporting deadlines.
Out-of-Balance Errors

• Correct system discrepancies prior to financial reporting.
• Assess the impact of discrepancies that cannot be corrected prior to financial reporting and determine if a top side adjustment is necessary.

Annual Pricing Update

• Design procedures to ensure the consistent application of the annual price update.
• 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.

Support for Ending Balances

• 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;
  - There is an established threshold to investigate anomalies in the data that can be supported.

4. Lack of Policies and Procedures, Including Internal Controls to Effectively Implement Accounting Standards

• Prior to implementing and applying the valuation methodologies set forth by SFFAS 3 and SFFAS 48, the Navy should:
  - Decide what 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.

VI. 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). Commander, Navy Installations Command (CNIC) oversees the Naval Facilities and Engineering Command (NAVFAC), which manages and financially reports real property assets recorded within the system, known as the internet Navy Facilities Asset Data Store (INFADS). 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. Lack of adequate procedures over the utility process can lead to misstatements in the financial statements and an inability to produce accurate information and data to effectively manage the utilities process.

The Navy does not have adequate policies and procedures, including internal controls, or related documentation over its utility assets which has led to inadequate accounting of these assets. Specifically, management has not developed and implemented a consistent methodology for the measurement, composition and recordation of utility assets across the organization. For example, utility plants of the same category on an installation are recorded in INFADS using different bases of measurement. In addition, child asset listings supporting the measurement of parent utility assets are incomplete and inaccurate, and include child assets that are inactive, non-existent, or duplicative of other child assets.

**Recommendations**

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

- Establish and implement policies and procedures to ensure consistent methodology for the measurement, composition and recordation of utility assets across the organization.
- 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.

**VII. Property Plant & Equipment - General Equipment - Remainder**

The Navy’s PP&E GE-R are assets other than vessels, aircraft, and satellites and are primarily composed of equipment used in research, development, and maintenance. The Navy has not implemented effective policies and procedures over GE-R and lacks controls to record the lifecycle of GE-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) within an approved system. 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 Accounting 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 and 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. 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. 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, capital equipment is not recorded within the system, and therefore, not presented on the financial statements.

3. **Lack of Policies and Procedures, Including Internal Controls to Effectively Implement Accounting Standards.** There is a lack of policies, 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 No. 50 to establish opening balances and SFFAS No. 6 to value assets on a “go forward basis” has 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 Navy’s financial statements and notes.

**Recommendations**

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

1. **Lack of or Inadequate Documentation of GE-R Accounting 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 completion of 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 General Equipment 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 PP&E balance and the related footnote.

• Consolidate all GE-R into a single Navy 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 performing financial reporting.

VIII. **Property Plant & Equipment Construction in Progress**

The Navy’s construction in progress (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 prevent full implementation of SFFAS 50 which requires management to “make 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.** The design and implementation of controls over the recording of Real Property CIP are inadequate or ineffective. Specifically, controls are not in place to record CIP assets completely and accurately, as projects funded by appropriations other than Military Construction (MILCON) are not recorded. For balances prior to FY14, the Navy is unable to distinguish between CIP and completed Real Property assets. In addition, current controls are inadequate (e.g., reconciliations) to ensure that all CIP is properly released when buildings are placed in service and to prevent double counting of CIP with finished assets.

2. **Lack of Controls over General Equipment CIP.** Ineffective controls exist related to CIP for vessels and aircraft. The Navy’s method for calculating CIP for major asset classes does not incorporate Research & Development (R&D) costs that should be capitalized, nor does it include overhead costs that are directly related to asset construction. These costs are required to be recorded under SFFAS 6.

**Recommendations**

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

1. **Lack of Controls Over Real Property**
   - Revise the existing Real Property procedures to include all life cycle events for Real Property CIP assets to completely and accurately record assets in INFADs in a timely manner.
   - Perform an 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 and overhead allocations.

**IX. Environmental and Disposal Liabilities**

Environmental and Disposal Liabilities (EDL) includes the estimated costs associated with cleanup or disposal of military equipment/programs, base realignment and closure (BRAC), accrued environmental restoration (ERN), and other environmental liabilities (OEL). In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that enable the agency to provide reasonable assurances over obligations and costs. NAVSEA, NAVAIR, and
NAVFAC lack adequate procedures 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. **Lack of or Inadequate Documentation of EDL Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the EDL process are not accurately or completely documented, including controls over the Spent Nuclear Fuel (SNF) EDL process. The methodology for calculating disposal costs is not appropriately documented, which is a key factor in the determination of nuclear and conventional vessel EDL estimates. Lastly, a process does not exist for the documentation of EDL estimates for aircraft, and therefore, an EDL estimate is not calculated appropriately.

2. **Lack of Effectively Designed Controls in the EDL Process.** Controls are not designed adequately to verify the completeness and accuracy of system generated reports or data, including inputs and key assumptions used in calculating the EDL estimate for nuclear vessels, conventional vessels, and SNF. In addition, adequate controls do not exist over the use of ERN estimation modeling tools or OELs that are added or removed after the conclusion of normal estimating activities.

3. **Lack of Complete and Accurate Data used in EDL Process.** The estimates for OEL, BRAC and ERN are calculated using underlying system data that has known completeness and accuracy issues.

**Recommendations**

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

1. **Lack of or Inadequate Documentation of EDL Accounting Policies and Procedures, including Controls**
   - Complete the PCM that documents the end-to-end process for the aircraft and SNF EDL. The PCM should include all key controls, process owners, data interfaces, accounting entries and EDL Federal regulations followed.
   - Design and implement procedures including internal controls related to the calculation and reporting of EDL for aircraft. EDL procedures should account for material changes due to inflation or deflation and changes in regulations, plans and/or technology related to the disposal of aircraft.
   - Design and implement policies and procedures related to the technical review and approval of the EDL estimation methodology inputs and assumptions for conventional and nuclear vessels.

2. **Lack of Effectively Designed Controls in the EDL Process**
• Develop and implement policies, procedures and controls that address completeness and accuracy of system generated reports, data, key inputs and assumptions used in calculation of EDL estimates.

• Implement controls over use of cost models including analysis of outputs to historical information.

• Develop and implement a review control, including specific review criteria, to validate the completeness and accuracy of the OEL roll-forward procedures.

3. **Lack of Complete and Accurate Data used in EDL Process**

• Implement and design policies, procedures and controls over the completeness, accuracy and validity of data used in EDL calculations.

**X. Contingent Legal Liabilities**

Contingent legal liabilities 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 SFFAS 4 & 5 as amended by SFFAS 12, management is responsible for reporting and/or disclosing liabilities related to ongoing legal cases. The Navy has failed to design and implement effective controls over the recording and disclosure of contingent legal liabilities. Specifically, review controls do not exist to validate that liability amounts recorded and disclosed agree to the case information tracked and monitored by OGC and OJAG, and that amounts paid are not presented on the financial statements as contingent liabilities. In addition, the current methodology is insufficient for determining the range of loss for cases reported and disclosed in the financial statements. Therefore, the Navy is unable to substantiate the balance and disclosure as of September 30, 2019.

**Recommendations**

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

• In order to determine an appropriate range of loss for reporting purposes, OGC and the OJAGs should analyze their case listings and stratify cases by quantitative and qualitative risk factors, including, but not limited to:
  - Cases in which loss is probable
  - Cases that are above a set materiality threshold
  - Cases that are similar in nature and have history of loss
  - Cases that are similar in nature and in aggregate are below a set materiality threshold

• For those cases that are individually material or assessed as probable, OGC and OJAGs should provide a range of loss for each case.

• For all other cases, develop a methodology to assess risk of loss by groups of similar cases.
OGC and the OJAGs should perform sufficient quality assurance review and analysis using historical payment data to validate the potential range of loss. FMO should implement a review control over information received from OGC and the OJAGs.

Document and communicate the newly developed/identified controls to all relevant stakeholders for implementation across the Navy.

X1. Expenses and Accounts Payable

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), Military Standard Requisitioning and Issue Procedures (MILSTRIP), Transportation of People (TOP), Transportation of Things (TOT), and Reimbursable Work Order (RWO) - 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 procedures over its end-to-end expense processes do not address financial reporting risks, leading to inaccuracies in amounts reported within the financial statements. Specifically, expenses and AP were not posted in a timely manner for the CVP, MILSTRIP, TOP, TOT and MILSTRIP, and the Navy was unable to provide receipt and acceptance support for CVP and TOT. In addition, the Navy has not completely recorded liabilities related to government purchase cards, and AP accruals are insufficient and lack precision.

Recommendations

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

- Assess the system interfaces to determine whether expenses and payables are able to post automatically and develop or fix those interfaces as appropriate.
- Manually post payables which 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.

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

• 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 GLACs affecting CIP, OM & S, Operating Expense, or any other accounts for the AP accrual, as appropriate.

XII. Revenue and Unfilled Customer Orders

The Navy’s 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 has led to the following control weaknesses:

1. Lack of or Inadequate Documentation of RWO-P Process Accounting Policies and Procedures, including Controls. The end-to-end processes, procedures, general ledger accounting systems, and related control activities over the RWO-P process is 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 (intra-TAFS) 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. The controls are not effectively designed over the RWO-P process. Specifically, the Navy 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 review controls for billing files, and corrected variances prior to certification by their service provider, DFAS and.
• Designed adequate procedures around RWO-P close-out. Specifically, Unfilled Customer Orders are not closed 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 in the period in which the services or goods were 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 errors 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 Process Accounting 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. In addition:
     - 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, 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 are 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 regarding 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 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.

XIII. **Budget Execution & 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. The Navy’s Undelivered Orders (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 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 undelivered orders, do not address financial reporting and budget management risks leading to inaccuracies 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. Specifically, there is no enterprise wide policy and related procedures for recording bulk
obligation estimates. Estimates are not reviewed and/or adjusted as execution data becomes available, leading to the potential loss of resources as unneeded funding cannot be reprogrammed. Additionally, the estimates do not have adequate analysis to support their recording.

2. **Lack of or Inadequate Budget Execution Procedures.** Procedures outlining the appropriate use of reimbursable agreements or 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 in both Navy ERP and legacy systems.

   **Dormant 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 120 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 does not effectively reconcile budget authority reflected within its general ledger systems, including legacy systems, against the Program Budget Information System (PBIS). PBIS reflects budget authority granted to the Navy by Congress. The Navy does not make corrections based on the identified variances and cannot support many of the variances, leading to inaccuracies in its general ledger. This increases the risk of non-compliance with the Anti-deficiency Act.

**Recommendations**

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

1. **Lack of, or Inadequate Documentation Budget Execution Process Accounting 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 lifecycle, including the initiation, recording, processing, and reporting of transactions:
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.
- Implement a Navy-wide policy requiring obligation estimates be recorded and documented.
- 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.
- Eliminate the PBIS overlay by accurately recording and managing budget authority directly in the general ledger system.
- Implement monitoring controls over the authority recorded and distributed in the general ledger system.

XIV. 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 Controls. FMFIA requires federal entities to establish internal controls in accordance with the GAO’s Standards for Internal Control in the Federal Government (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:
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 design of entity level controls and lack of proper end-to-end documentation of key business processes including internal controls.

**Lack of Appropriate Intra-Navy Coordination**
- According to the GAO Green Book, organizational structure contributes to the design, implementation and operating effectiveness of the overall internal control environment. As part of establishing an organizational structure, management considers how units interact in order to fulfill their overall responsibilities. The GAO Green Book further states that management establishes reporting lines within an organizational structure so that units can communicate the quality information necessary for each unit to fulfill its overall responsibilities. The Navy lacks appropriate coordination between the financial and IT elements of both their A-123 and remediation programs. This lack of coordination prevents the Navy from effectively implementing management oversight, IT controls and overall governance. For example, the Navy has failed to integrate its financial management and IT components’ remediation efforts, which may prevent the Navy from fully implementing an effective A-123 or Manager’s Internal Control Program (MICP). Inadequate coordination between financial and IT in the execution of its MICP program prevents the Navy from addressing critical financial reporting issues such as general ledger systems that do not have appropriately designed posting logic to ensure transactions entered by users or interfaced into the system impact the correct general ledger accounts.

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.

**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 behalf of the Navy. 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 the 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 and IT remediation efforts to achieve a more efficient and effective program.
• Develop, document and maintain supporting documentation as a part of the A-123 program and for the 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.

Lack of Appropriate Intra-Navy Coordination
• FMO should develop and implement a unified remediation plan that takes into consideration the necessary remediation efforts and timelines for both the IT and financial management components associated with the material weaknesses and control deficiencies in its end-to-end business processes to align the Navy Office of Financial Policy and Systems (FMP) remediation efforts appropriately.
• Develop an IT governance structure to establish roles, requirements, policies, and procedures for system decommissions/conversions and any other system changes that could have an impact to financial reporting objectives.
• FMO should develop, document, and disseminate enterprise-wide guidance for the identification of financially significant transactions relating to financial reporting, to include roles, responsibilities, and required levels of approval from the FMO and other relevant financial management stakeholders.

2. Lack of Risk Assessments
• Policy needs 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/reperformed.
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 custody and develop the appropriate policies and procedures to implement the actions necessary for consistent and effective oversight and periodic 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 to focus on implementing a robust internal control environment and information security program that is designed and operating effectively to mitigate key financial audit risks. Consequently, a prioritized, risk-driven effort, is still necessary to remediate deficiencies in the areas of access controls, Segregation of Duties (SoD), configuration management and interfaces. 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. The following table outlines the number of deficiencies identified across the 17 systems in scope.

<table>
<thead>
<tr>
<th>System Type</th>
<th>Security Management</th>
<th>Access Controls/Segregation of Duties</th>
<th>Configuration Management</th>
<th>Interface Processing</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Ledger Systems</td>
<td>14</td>
<td>76</td>
<td>40</td>
<td>77</td>
<td>207</td>
</tr>
<tr>
<td>Feeder and Operational Systems</td>
<td>37</td>
<td>196</td>
<td>150</td>
<td>104</td>
<td>487</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>51</strong></td>
<td><strong>272</strong></td>
<td><strong>190</strong></td>
<td><strong>181</strong></td>
<td><strong>694</strong></td>
</tr>
</tbody>
</table>

*Observation Tracker and NFR Tracker*
Based on the results outlined above, we noted the following:

- 92% of all control deficiencies identified across all system types map to high-risk control domains (i.e., access controls, segregation of duties, configuration management and interface processing)
  - 39% of control deficiencies are a result of Access Control/Segregation of Duties deficiencies
  - 27% of control deficiencies are a result of Configuration Management deficiencies
  - 26% of control deficiencies are a result of Interface Processing deficiencies

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.

XV. Access Controls/Segregation of Duties

Access controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. When properly implemented, access controls can help ensure 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 this was not provided, to include source and level of access granted.
- Definition of financially significant transactions and resources has not been performed and/or lacks financial oversight.
- User access provisioning; to include initial access provisioning, modification and removal were not performed in accordance with defined requirements, timelines and with sufficient
detail to confirm access currently granted in the system was commensurate with access approved and required for the users’ business function.

- User 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 information was not protected against unauthorized access and modification and was not retained for the audit period.
- Definition and control of security violations and monitoring, to include required follow on actions and removal of access, was inconsistent.

An effective control environment guards against a particular user having incompatible functions within a system. SoD controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations without detection and thereby conducting unauthorized actions or gaining unauthorized access to assets or records.

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 is not considered when provisioning user access.
- SoD matrices or equivalents were not consistently documented, inclusive of all functional roles and/or not mapped effectively to the system access associated with the functional roles.
- Assignment of conflicting roles during the access provisioning process could not be prevented, and for known conflicts where SoD concerns were identified, there was a lack of documentation for business rationale and subsequent monitoring of a user’s activity.
- Multiple systems had a significant number of administrator users (i.e., database administrators, developers) able to complete an entire functional process by inputting, processing, and approving transactions.

Recommendations

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

- Systematically generate population of users and incorporate completeness and accuracy procedures into review controls to confirm a holistic evaluation of the user base. Implement monitoring and review controls for users with elevated access privileges.
• Define financially significant transactions and resources and obtain approval from the appropriate level of IT and Financial oversight.

• 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 roles and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.

• Evaluate cross-application SoD to identify potential conflicts for users accessing multiple systems.

• Conduct appropriate analysis to confirm functional user access is tied to the appropriate logical permissions within the systems and confirm SoD is enforced.

• Re-enforce/disseminate guidance as it relates to defining required security violation monitoring procedures and establish governance around the frequency for which security violations should be escalated, to whom, and management’s required actions.

XVI. Configuration Management

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematically controls changes to that configuration during the system’s life cycle. By implementing configuration management controls, the Navy can ensure that 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 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, direct data changes, configurable settings within the application and changes to interfaces.

• Logging and monitoring controls have not been implemented to identify unintentional or unauthorized changes made to the application, database, interface and data.

• Lack of a segregated environment; developers have access to the production environment. Additionally, access to source code is not properly controlled.

• Configuration changes are not properly reviewed, approved, and documented.
• There is no management review on third party providers, who perform many aspects of the configuration management functions for the relevant applications to ensure compliance with the currently approved configuration management process.

• Inadequate governance and requirements during system conversion/consolidation activities resulted in critical financial reporting discrepancies and risks to the financial statement.

Recommendations

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

• Identify complete and accurate populations of configuration changes in order to monitor changes and determine only authorized and approved changes are being applied to production.

• Segregate access between development and production environments.

• Restrict access to source code and document authorization and business need for those that require this access to perform their job roles and responsibilities.

• Establish controls to monitor third party support organizations associated with the configuration management of the Navy’s applications. Establish audit logging capabilities in order to monitor changes to the application, database, interface and data to ensure they are authorized.

• 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.

XVII. Interface Processing

Interface controls consist of those controls over 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 population of interfaces, systematically generated or systematically validated, could not be provided to support the complete and accurate processing of the Navy’s transactions.

• Edit and validation checks are not consistently implemented across financially significant interfaces to prevent the processing of duplicate or inaccurate data.
• File-level reconciliations are not being performed between source and target systems to ensure completeness and accuracy of processing.

• Logs of interface processing activities are not retained to support subsequent auditing and monitoring; error reporting for failed interface processing activities has not been implemented in some systems.

• Interface files are not protected from unauthorized access and modification prior to processing through the use of secure transmission mechanisms.

• Remediation of identified errors in interface processing are not completed in accordance with defined requirements, timelines and with sufficient detail to confirm remediation.

Recommendations

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

• Conduct an appropriate analysis and implement procedures to confirm that the population of interfaces is complete and accurate.

• Implement stronger systemic checks for completeness and accuracy of interface file processing, to include tracking and logging procedures and protection from unauthorized access.

• Conduct an appropriate analysis of a complete and accurate population of edit checks and validations to then determine which are financially significant within the interface process. After this analysis, determine if the interface files are being subject to appropriate validation and edit checks and that they are operating as designed.

• Implement controls to confirm that the information received or sent from a target to source application is complete, accurate and consistently received.

• Test system interfaces in an end-to-end manner for the Navy to gain reasonable assurance that system consolidation efforts will retain desired/intended functionality.

• Implement consistent controls to 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 and utilities. Commander, Navy Installations Command (CNIC) oversees the Naval Facilities and Engineering Command (NAVFAC), which manages and financially reports real property assets recorded within the Accountable Property System of Record (APSR), internet Navy Facilities Asset Data Store (iNFADS). In accordance with 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.

During fiscal year (FY) 2019, the Navy executed an entity-wide, wall-to-wall of their Real Property enterprise. As a result of that effort, the error rates identified decreased to less than one half of one percent for existence and completeness of buildings and structures. However, as noted below, the Navy has not yet implemented controls over the lifecycle 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 Accounting Policies and Procedures, including Ineffectively Designed 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. This includes documentation of specific internal controls in place over acquisition and disposals. 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. In addition, during the current FY, the Navy did not consistently execute controls over additions, transfers, and disposals of Real Property.

Recommendations

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

1. Lack of, or Inadequate Documentation of Real Property Accounting Policies and Procedures, including Ineffectively Designed 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.

2. **Inadequate Financial Reporting Controls Over Real Property.**
   
   • Implement policies and procedures to ensure the revised process is consistent with field level operations.
Report of Independent Auditors on Compliance and Other Matters
Based on an Audit of 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, 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. 19-03, 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, 2019, and the related consolidated Statements of Net Costs, 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, 2019. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2019 and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 19-03, including 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 to audit, and accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Navy.

The results of our tests of compliance with laws, regulations and contracts described in the preceding paragraph disclosed instances of noncompliance and other matters that are required to be reported under Government Auditing Standards and OMB Bulletin No. 19-03, as described below. In addition, 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.
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 Fiscal Year (FY) 2019 Navy Statement of Assurance, the Navy self-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 confirmed this material weakness as part of the Financial Information Systems material weakness, contained in the Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards (Report on Internal Control), 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 2019 Navy Statement of Assurance and Note 1 to the financial statements, the Navy self-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, which was included in our Report on Internal Control.

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

As referenced in the FY 2019 Navy Statement of Assurance, the Navy self-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, which was included in our Report on Internal Control.
FMFIA

Federal Managers’ Financial Integrity Act of 1982 (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 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 yet 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.

The Navy’s Response to Findings

Our Report on Internal Control dated November 8, 2019 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 with FFMIA and FMFIA and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from the Navy’s management responsible for addressing the noncompliance are provided in the accompanying letter dated November 8, 2019. The Navy’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 result 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 performed 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, 2019
Ernst & Young, LLP  
(Attention: Mr. John F. Short, Partner)  
1775 Tysons Boulevard  
Tysons, VA 22102

Dear Mr. Short:

The Department of the Navy (DON) reviewed the Auditors’ Report prepared by Ernst & Young, LLP for the audit of the DON General Fund. We appreciate the recommendations from the auditors and we look forward to our continued engagement to improve financial management in our Department. We acknowledge and concur with the material weaknesses and the disclaimer of the opinion.

We continue to get tremendous value from these annual audits, as we use the audits to drive improvements into our programs. These audits identify opportunities to retire legacy processes and systems, improve the quality of information on count and condition of mission critical assets, and improve visibility over how we spend our resources. This will enable us to save and reinvest hundreds of millions of dollars for readiness and lethality.

During Fiscal Year (FY) 2019, we focused our remediation efforts on specific areas based on their impact on operations and on our ability to obtain a clean opinion. We determined that we could not resolve all of the issues identified in the FY 2018 audit report, and that we would be best served to focus our resources on specific priorities that would yield near and long term positive outcomes. The priority areas include:

- Systems Consolidation — consolidate all accounting systems into one general ledger and reduce feeder system footprint.
- Financial Reporting & Fund Balance with Treasury (FBwT) Reconciliation — re-engineer financial statement compilation process, standardize FBwT reconciliation and produce auditable trial balance.
- Inventory and Operating Materials and Supplies — standardize processes and implement process controls to improve accuracy and facilitate audit.
- Real Property — standardize processes and implement process controls to improve accuracy and facilitate audit.
- Budgetary Reform — standardize processes and implement controls over budgetary transactions (direct and reimbursable).
- Information Technology General Controls — the Department will leverage new technology and retire legacy systems to enhance system security.

This year we achieved two major accomplishments:

- We completed an inventory of real property assets at our installations and corrected all discrepancies between our books and what exists in the field. We will continue to work the remaining deficiencies in this area but we are confident that we can sustain proper accountability of our real property assets.
- We modernized our DON Enterprise Resource Planning (ERP) system by making several changes to improve performance, shifting from an Oracle database to a high-performance analytic appliance database, and migrating to a high-performance analytic cloud-based platform 10 months ahead of schedule, in what is likely the largest ERP cloud migration in North American history. With nearly $70B flowing into the U.S. economy annually through Navy ERP, the new cloud platform will provide faster and more capable performance for the 72,000 ERP users across six Navy commands who play a role in managing more than half of the Navy’s finances. We also continued to make progress in the consolidation of general ledger systems by shutting down a legacy general ledger system and continuing the migration of all other systems to Standard Accounting, Budgeting, and Reporting System (SABRS) and the DON ERP system.

We recognize that correcting these long-standing issues will take a few years and we will continue to work our remediation with a sense of urgency. As we move into next year, we will focus on establishing a clean baseline for our inventory and operating materials and supplies. I am confident that our U.S. Navy will rise to the occasion and we will get this done.

Thank you again for your report; we look forward to our continued partnership.

Sincerely,

Thomas W. Harker
The FY 2019 DON WCF principal statements and related notes are presented in the format prescribed by OMB A-136 Revised, 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 ending September 30, 2019, and are not presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2018.

The following statements comprise the DON WCF principal statements:

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

The accompanying notes should be considered an integral part of the principal statements.
### US Department of the Navy Working Capital Fund

#### Consolidated Balance Sheet

As of September 30, 2019

($ in thousands)

<table>
<thead>
<tr>
<th>ASSETS (Note 2):</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intragovernmental:</strong></td>
<td></td>
</tr>
<tr>
<td>Fund Balance with Treasury (Note 3)</td>
<td>$1,495,023</td>
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<tr>
<td>Accounts Receivable (Note 4)</td>
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<tr>
<td><strong>Total Intragovernmental Assets</strong></td>
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<tr>
<td>Accounts Receivable, Net (Note 4)</td>
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<td>Inventory and Related Property, Net (Note 5)</td>
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<td>General Property, Plant and Equipment, Net (Note 6)</td>
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<tr>
<td>Other (Note 7)</td>
<td>872,425</td>
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<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>$47,709,040</td>
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<thead>
<tr>
<th>LIABILITIES (Note 8):</th>
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<tbody>
<tr>
<td><strong>Intragovernmental:</strong></td>
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<tr>
<td>Accounts Payable</td>
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<td>Other (Note 11)</td>
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<td><strong>Total Intragovernmental Liabilities</strong></td>
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<td>Federal Employee and Veteran Benefits (Note 9)</td>
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<td>Environmental and Disposal Liabilities (Note 10)</td>
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<td>Accrued Funded Payroll and Benefits</td>
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<td>Other (Note 11)</td>
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<tr>
<td>Unexpended Appropriations - Other Funds</td>
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<tr>
<td>Cumulative Results of Operations - Other Funds</td>
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<td><strong>TOTAL NET POSITION</strong></td>
<td>42,472,720</td>
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</table>

**TOTAL LIABILITIES AND NET POSITION**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td><strong>$</strong></td>
<td>$47,709,040</td>
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</table>

The accompanying notes are an integral part of these statements.
US Department of the Navy Working Capital Fund
Consolidated Statement of Net Cost
For the Fiscal Year Ended September 30, 2019
($ in thousands)

<table>
<thead>
<tr>
<th>GROSS PROGRAM COSTS:</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Cost:</td>
<td></td>
</tr>
<tr>
<td>Operations, Readiness &amp; Support</td>
<td>$ 38,484,797</td>
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<tr>
<td>Less: Earned Revenue</td>
<td>(37,716,820)</td>
</tr>
<tr>
<td><strong>NET COST OF OPERATIONS</strong></td>
<td>$ 767,977</td>
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The accompanying notes are an integral part of these statements.
US Department of the Navy Working Capital Fund
Consolidated Statement of Changes in Net Position
For the Fiscal Year Ended September 30, 2019
($ in thousands)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
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<tbody>
<tr>
<td><strong>Unaudited 2019</strong></td>
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</tr>
<tr>
<td><strong>Unexpended Appropriations:</strong></td>
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<td>Beginning Balances</td>
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<tr>
<td><strong>Budgetary Financing Sources:</strong></td>
<td></td>
</tr>
<tr>
<td>Appropriations Used</td>
<td>(3,351)</td>
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<tr>
<td><strong>Total Budgetary Financing Sources</strong></td>
<td>(3,351)</td>
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<tr>
<td><strong>Total Unexpended Appropriations</strong></td>
<td>7,666</td>
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<tr>
<td><strong>Cumulative Results from Operations:</strong></td>
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<td>Beginning Balances</td>
<td>35,652,709</td>
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<tr>
<td><strong>Beginning Balances, as Adjusted</strong></td>
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<tr>
<td><strong>Budgetary Financing Sources:</strong></td>
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<td>Appropriations Used</td>
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<tr>
<td>Non-exchange Revenue</td>
<td>1,142</td>
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<tr>
<td><strong>Other Financing Sources (Non-Exchange):</strong></td>
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<tr>
<td>Transfers In/Out without Reimbursement</td>
<td>1,269,217</td>
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<tr>
<td>Imputed Financing</td>
<td>698,598</td>
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<tr>
<td>Other</td>
<td>5,608,013</td>
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<tr>
<td><strong>Total Financing Sources</strong></td>
<td>7,580,322</td>
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<tr>
<td>Net Cost of Operations (Note 17)</td>
<td>767,977</td>
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<tr>
<td><strong>Net Change</strong></td>
<td>6,812,345</td>
</tr>
<tr>
<td><strong>Cumulative Results of Operations</strong></td>
<td>42,465,054</td>
</tr>
<tr>
<td><strong>Net Position</strong></td>
<td>$42,472,720</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these statements.
# Combined Statement of Budgetary Resources

## For the Fiscal Year Ended September 30, 2019

### ($ in thousands)

#### Unaudited 2019

<table>
<thead>
<tr>
<th>BUDGETARY RESOURCES:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unobligated Balance from Prior Year, net (discretionary and mandatory)</td>
<td>$3,784,902</td>
</tr>
<tr>
<td>Contract Authority (discretionary and mandatory)</td>
<td>12,555,723</td>
</tr>
<tr>
<td>Spending Authority from Offsetting Collections (discretionary and mandatory)</td>
<td>23,996,264</td>
</tr>
<tr>
<td><strong>TOTAL BUDGETARY RESOURCES</strong></td>
<td><strong>$40,336,889</strong></td>
</tr>
</tbody>
</table>

#### STATUS OF BUDGETARY RESOURCES:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Obligations and Upward Adjustments (total)</td>
<td>$37,852,660</td>
</tr>
<tr>
<td>Unobligated Balance, End of Year:</td>
<td></td>
</tr>
<tr>
<td>Apportioned, Unexpired Accounts</td>
<td>2,348,161</td>
</tr>
<tr>
<td>Exempt from Apportionment, Unexpired Accounts</td>
<td>1,696</td>
</tr>
<tr>
<td>Unapportioned, unexpired accounts</td>
<td>134,372</td>
</tr>
<tr>
<td>Unexpired Unobligated Balance, End of Year</td>
<td>2,484,229</td>
</tr>
<tr>
<td>Unobligated Balance, End of Year (total)</td>
<td>2,484,229</td>
</tr>
<tr>
<td><strong>TOTAL BUDGETARY RESOURCES</strong></td>
<td><strong>$40,336,889</strong></td>
</tr>
</tbody>
</table>

#### OUTLAYS, NET:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outlays, Net (total) (discretionary and mandatory)</td>
<td>1,028,101</td>
</tr>
<tr>
<td><strong>AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)</strong></td>
<td><strong>$1,028,101</strong></td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these statements.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.A. Mission of the Reporting Entity

The DON financial results of operations are presented within two AFRs: one that presents both the USN GF and the DON WCF and one that presents the USMC GF. This section of the AFR specifically applies to the DON WCF, as a result, it does not disclose information related to the USN GF.

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.

Refer to the MD&A Section – “Mission and Organization” for further information.

1.B. Basis of Accounting and Presentation

These financial statements reflect both proprietary and budgetary accounting transactions and have been prepared to report non-comparative consolidated financial position, results of operations, the changes in the financial position, and the combined budgetary resources of the DON WCF. 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, and the form and content for entity financial statements specified by OMB A-136 Revised.

The DON WCF is unable to implement all elements of U.S. GAAP, OMB A-136 Revised, 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 nonfinancial 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 and supporting trial balances 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, FECA Liabilities, and E&DL. 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 at the consolidated DON WCF level. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated level.

Specifically, the DON WCF is not in compliance with the following authoritative accounting guidance:

SFFAC 7, “Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording”

SFFAS 3, “Accounting for Inventory and Related Property”


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 12, “Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government”

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 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 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 areas are presented in the DoD AFR on behalf of the USN.

Accounting standards require all reporting entities to disclose that accounting standards allow certain presentation disclosures to be modified, if needed, to prevent the disclosure of classified information.

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 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.

1.D. Use of Estimates

Preparation of the financial statements 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. As a result, actual results may differ from those estimates. Significant estimates and assumptions include, but are not limited to, plant replacement values for real property, general equipment including depreciation, OM&S, E&DL, AFDA, Accounts Payable, and Contingent Legal Liabilities.

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.

Significant assumptions used by the DON WCF in making accounting estimates are reasonable and supportable except for estimates related to contingent legal liabilities and environmental liabilities.
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 five business areas: Depot Maintenance, Research and Development, Transportation, Base Support, 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.
- **Base Support** activities recognize revenue at the time service is 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. Due to these limitations, the DON WCF is not compliant with SFFAS 7.

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 17, "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 DON WCF operations and is therefore reported in the SCNP as a financing source.

1.F. Recognition of Expenses

The DON WCF performs data calls to obtain and record financial amounts, including expenses, in its financial accounting system, 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. Estimates are made for major items, such as payroll expenses, Accounts Payable, environmental liabilities, FECA liabilities, Contingent Legal Liabilities, and unbilled revenue.

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

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 consolidated financial statements to prevent the overstatement for business with itself. 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.
The DON WCF can reconcile balances pertaining to investments in federal securities, borrowings from the Treasury and the Federal Financing Bank, FECA transactions with DOL, and benefit program transactions with the OPM. The DON WCF continues to implement process and system improvements to reconcile intragovernmental transactions with all federal agencies.

1.H. Funds with the Treasury

The DON WCF’s monetary resources are maintained in Treasury accounts. The DON WCF generally does not maintain cash in commercial bank accounts. The disbursing offices of DFAS, DON WCF, other military departments, and State’s 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 addition, DFAS and the 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’s WCF FBWT is reviewed and adjusted at the field General Ledger level prior to month-end close based on FBWT reconciliation reports. In addition, FBWT is reviewed and adjusted at the Department level within the DoD’s 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.I. 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 depending on 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.

The DON WCF does not recognize an allowance for estimated uncollectible amounts from other federal agencies. Claims for Accounts Receivable against other federal agencies are resolved in accordance with Treasury dispute resolution procedures.

1.J. Inventory and Related Property

The DON WCF categorizes Inventory and Related Property as inventory and OM&S. Due to long standing business process and financial system deficiencies, the DON WCF is unable to make an unreserved assertion for inventory and OM&S opening balances accounted for in legacy systems. The DON WCF accounts for OM&S using a combination of the consumption method and purchase method.

Supply management inventory is tangible personal property that is held for sale available and purchased for resale, held for repair, EOU, and work in process (WIP). Inventory WIP balances include (1) costs related to the production or servicing of items, including direct material, labor, and applied overhead; (2) the value of finished products or completed services yet to be placed in service; and (3) munitions in production and depot maintenance work with associated costs incurred in the delivery of maintenance services. The DON WCF assigns inventory to categories based upon condition of the inventory item; and in the case of raw material and WIP, based upon stage of fabrication. Due to business process and system limitations, the DON WCF does not currently report accurate values related to WIP.

The DON WCF values available and purchased for sale inventory using the LAC or MAC methods. The DON WCF values held for repair inventory at the price of a serviceable item, less estimated repair costs, using the direct method. As 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.

The DON WCF identifies related property as OM&S categorized as operating material and supplies held for use, held for repair and EOU. 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. However, some OM&S is valued using LAC. The LAC method is used for OM&S accounted for in the DON WCF legacy logistics (feeder) systems or APSRs that were designed specifically for material management rather than accounting purposes. The DON WCF is in the process of resolving these weaknesses and transitioning to the MAC method.

*Refer to Note 5, “Inventory and Related Property, Net” for additional information.*

### 1.K. General Property, Plant, and Equipment

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.

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 thresholds. 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.

The DON WCF uses several capitalization thresholds for its GPP&E. For all general fund assets acquired or developed after June 30, 2013, the DON WCF uses a $1.0 million threshold for general equipment and $250 thousand for real property and IUS. 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.

When it is in the best interest of the government, the DON WCF provides government property to contractors to complete contract work. The DON WCF owns such property and either provides it to the contractor or it is purchased directly by the contractor from the government based on contract terms. The FAR requires the DON WCF to maintain information on all property furnished to contractors in the DON WCF property systems. The Navy reports such property when the value of contractor-procured GPP&E meets or exceeds the DON WCF capitalization thresholds. In addition, federal accounting standards require that this contractor held property be reported on the DON WCF balance sheet. The DON WCF 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.

### 1.L. Advances and Prepayments

When making payments in advance of the receipt 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. Advances and prepayments received are recorded as liabilities. The DON WCF has not implemented this policy due to noncompliance with the FFMIA.
1.M. Other Assets

Other assets include military and 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.

Civilian pay advances are payments advanced to full-time DON WCF civilians intended to finance unusual employee expenses associated with overseas 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. Contingencies and Other Liabilities

The DON WCF is party to various administrative proceedings, legal actions, and claims. The DON WCF recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

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

*Refer to Note 12, “Commitments and Contingencies” for further information.*

Other liabilities also arise as a result of anticipated disposal costs for the DON WCF’s assets.

*Refer to Note 11, “Other Liabilities” for further information.*

1.O. Accrued Leave

The DON WCF reports 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. Any portions of the accrued leave for which funding is not available, is recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.P. 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.Q. 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 undistributed, there is a possibility both supported
and unsupported adjustments may have been made to 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.R. Federal Employee and Veteran Benefits**

For financial reporting purposes, the DON WCF’s actuarial liability for worker’s compensation benefits is developed by DOL and provided to the DON WCF 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 DON WCF does not record any liabilities or obligations for pensions or healthcare retirement benefits.

**1.S. 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

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intragovernmental:</strong></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$ 4,336</td>
</tr>
<tr>
<td><strong>Non-Federal:</strong></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$ 3,775</td>
</tr>
<tr>
<td><strong>Total Non-entity Assets</strong></td>
<td>$ 8,111</td>
</tr>
<tr>
<td><strong>Total Entity Assets</strong></td>
<td>$ 47,700,929</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$ 47,709,040</td>
</tr>
</tbody>
</table>

Non-entity Assets are held by the USN are not available to the USN.

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

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unobligated Balance:</strong></td>
<td></td>
</tr>
<tr>
<td>Available</td>
<td>$ 2,349,857</td>
</tr>
<tr>
<td>Unavailable</td>
<td>134,372</td>
</tr>
<tr>
<td><strong>Total Unobligated Balance</strong></td>
<td>$ 2,484,229</td>
</tr>
<tr>
<td><strong>Obligated Balance not yet Disbursed:</strong></td>
<td>20,021,248</td>
</tr>
<tr>
<td><strong>Non-FBWT Budgetary Accounts:</strong></td>
<td></td>
</tr>
<tr>
<td>Unfilled Customer Orders without Advance</td>
<td>(13,050,741)</td>
</tr>
<tr>
<td>Contract Authority</td>
<td>(6,802,081)</td>
</tr>
<tr>
<td>Receivables and Other</td>
<td>(1,157,632)</td>
</tr>
<tr>
<td><strong>Total Non-FBWT Budgetary Accounts</strong></td>
<td>(21,010,454)</td>
</tr>
<tr>
<td><strong>Total Fund Balance with Treasury</strong></td>
<td>$ 1,495,023</td>
</tr>
</tbody>
</table>
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 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 $543 million in undistributed disbursements and $223 million in undistributed collections as of September 30, 2019.

### NOTE 4. ACCOUNTS RECEIVABLE, NET

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Gross Amount Due</th>
<th>Allowance For Estimated</th>
<th>Accounts Receivable, Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intragovernmental Receivables</td>
<td>$1,139,164</td>
<td>$</td>
<td>$1,139,164</td>
</tr>
<tr>
<td>Non-Federal Receivables (From the Public)</td>
<td>94,193</td>
<td>$(47,773)</td>
<td>46,420</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,233,357</strong></td>
<td><strong>$(47,773)</strong></td>
<td><strong>$1,185,584</strong></td>
</tr>
</tbody>
</table>

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 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.

Refer to Note 1.I, “Accounts Receivable” for further information.

The DON WCF’s gross amount due for Non-federal Receivables (From the Public) for FY 2019 includes criminal restitution orders of $3.2 million monitored by DFAS, of which $0.3 million is determined to be collectible. Restitution receivables and associated payments are pursued by the courts handling those cases. Receivables are established 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 WCF is only authorized to write off or close accounts with approval from the Department of Justice.

Due to limitations of financial and nonfinancial management processes and systems that support the financial statements, the DON WCF is unable to separately identify USN GF and DON WCF criminal restitution receivables.
NOTE 5. INVENTORY AND RELATED PROPERTY, NET

The DON WCF inventory consists of funded and reported materials held for sale or as inventory stock, under the DON WCF.

All 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 for reserve for future sale, held for repair, work in process, 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.

Held in for reserve for future sale inventory consists of additional consumable and repairable items held in reserve for future sale as it is not readily available for immediate sale.

### Inventory and Related Property, Net

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inventory, Net</strong></td>
<td>$ 38,219,886</td>
</tr>
<tr>
<td><strong>Operating Material &amp; Supplies, Net</strong></td>
<td>231,012</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 38,450,898</td>
</tr>
</tbody>
</table>

### Inventory Net:

<table>
<thead>
<tr>
<th>Inventory Categories</th>
<th>Gross Value</th>
<th>Revaluation Allowance</th>
<th>Net</th>
<th>Valuation Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available and Purchased for Resale</td>
<td>$ 20,137,966</td>
<td>(580) $</td>
<td>$ 20,137,386</td>
<td>LAC, MAC</td>
</tr>
<tr>
<td>Held in for Reserve for Future Sale</td>
<td>917,689</td>
<td>-</td>
<td>917,689</td>
<td>LAC, MAC</td>
</tr>
<tr>
<td>Held for Repair</td>
<td>17,166,727</td>
<td>(34,463)</td>
<td>17,132,264</td>
<td>LAC, MAC</td>
</tr>
<tr>
<td>Work-in Process</td>
<td>32,547</td>
<td>-</td>
<td>32,547</td>
<td>MAC</td>
</tr>
<tr>
<td>Excess, Obsolete, and Unserviceable</td>
<td>2,790</td>
<td>(2,790)</td>
<td>-</td>
<td>NRV</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 38,257,719</td>
<td>(37,833) $</td>
<td>$ 38,219,886</td>
<td></td>
</tr>
</tbody>
</table>

**Legend for Valuation Methods:**

- LAC = Latest Acquisition Cost
- NRV = Net Realizable Value
- MAC = Moving Average Cost

The DON WCF inventory consists of funded and reported materials held for sale or as inventory stock, under the DON WCF. All USN inventory held for sale is funded and reported on the DON WCF financial statements.
Held for repair inventory consists of damaged materiel that requires repair to make it usable.

Work-in-Process 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.

With the category of held for repair, the inventory items here are initially presented at purchase value (gross value). This value is used to reconcile inventory listings and related reports. The internally calculated revaluation allowance is then factored to bring the inventory to its net cost. Revaluation allowances usually arise from destroyed goods, missing goods, or a decrease in the market value of goods.

As a result of business process and system limitations, the revaluation allowance is recorded to eliminate unreconciled balances between the USN APSRs and logistics feeder systems.

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

<table>
<thead>
<tr>
<th>OM&amp;S Categories:</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of September 30 ($ in thousands)</td>
<td>Gross Value</td>
</tr>
<tr>
<td>Held for Use</td>
<td>$ 230,348</td>
</tr>
<tr>
<td>Held in Reserve for Future Use</td>
<td>632</td>
</tr>
<tr>
<td>Held for Repair</td>
<td>32</td>
</tr>
<tr>
<td>Total</td>
<td>$ 231,012</td>
</tr>
</tbody>
</table>

Legend for Valuation Methods:
MAC = Moving Average Cost

The DON WCF OM&S consists of tangible personal property in support of general maintenance on Navy facilities such as paint, screws, bolts, etc. The DON WCF OM&S is classified in the following categories based on purpose or condition: held for use, held in reserve for future use, and held for repair.

Held for use consists of all other serviceable (ready for issue) material. OM&S held for future use are items not readily available in the market and there is a more than a remote chance that it will be needed for future use.

Held in reserve for future use consists of damaged material, accounted for in the physical inventory, that is more economical to repair than to dispose.

Held for Repair consists of damaged or unserviceable material, accounted for in the physical inventory, that is more
There are no known restrictions on the use of OM&S.

**NOTE 6. GENERAL PROPERTY, PLANT, AND EQUIPMENT, NET**

<table>
<thead>
<tr>
<th>Major Asset Classes</th>
<th>Depreciation/Amortization Method</th>
<th>Service Life</th>
<th>Acquisition Value</th>
<th>(Accumulated Depreciation / Amortization)</th>
<th>Net Book Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buildings, Structures, Linear Structure</td>
<td>S/L</td>
<td>35, 40 or 45</td>
<td>$17,905,417</td>
<td>$(15,045,649)</td>
<td>$2,859,768</td>
</tr>
<tr>
<td>Utilities</td>
<td>S/L</td>
<td>35 or 40</td>
<td>$11,954,404</td>
<td>$(10,046,668)</td>
<td>$1,907,736</td>
</tr>
<tr>
<td>Software</td>
<td>S/L</td>
<td>2-5 or 10</td>
<td>$169,090</td>
<td>$(128,877)</td>
<td>40,213</td>
</tr>
<tr>
<td>General Equipment</td>
<td>S/L</td>
<td>Various</td>
<td>$2,822,005</td>
<td>$(2,263,686)</td>
<td>558,319</td>
</tr>
<tr>
<td>Construction-in-Progress</td>
<td>N/A</td>
<td>N/A</td>
<td>$311,335</td>
<td>-</td>
<td>$311,335</td>
</tr>
<tr>
<td>Other</td>
<td>M</td>
<td>M</td>
<td>$646,217</td>
<td>$(618,478)</td>
<td>$27,739</td>
</tr>
</tbody>
</table>

**Total General PP&E**

$33,808,468 $(28,103,358) $5,705,110

**Legend for Depreciation/Amortization Method:**

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

The DON WCF’s GPP&E is comprised of unique asset lifecycle-based categories consisting of: real property (buildings, structures, linear structures and utilities); IUS; General Equipment; and CIP (real property and general equipment). Other GPP&E consists of assets awaiting disposal.

**NOTE 7. OTHER ASSETS**

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding Contract Financing Payments</td>
<td>$715,851</td>
</tr>
<tr>
<td>Advances and Prepayments</td>
<td>$154,917</td>
</tr>
<tr>
<td>Other Assets (With the Public)</td>
<td>$1,657</td>
</tr>
<tr>
<td><strong>Total Non-Federal Other Assets</strong></td>
<td><strong>$872,425</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$872,425</strong></td>
</tr>
</tbody>
</table>

Non-Federal 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. Non-Federal 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.

Non-Federal Other Assets (With the Public) consists of prepayments made to vendors and travel advances made to employees.

**NOTE 8. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES**

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intragovernmental:</strong></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>$ 119,024</td>
</tr>
<tr>
<td><strong>Total Intragovernmental</strong></td>
<td>$ 119,024</td>
</tr>
<tr>
<td>Federal Employee and Veteran Benefits</td>
<td>627,822</td>
</tr>
<tr>
<td>Environmental and Disposal Liabilities</td>
<td>334,043</td>
</tr>
<tr>
<td>Other</td>
<td>666</td>
</tr>
<tr>
<td><strong>Total Liabilities Not Covered by Budgetary Resources</strong></td>
<td>$ 1,081,555</td>
</tr>
<tr>
<td><strong>Total Liabilities Covered by Budgetary Resources</strong></td>
<td>$ 4,154,765</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>$ 5,236,320</td>
</tr>
</tbody>
</table>

Intragovernmental Other 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.

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

*Refer to Note 10, "Environmental and Disposal Liabilities," for additional information.*

Liabilities not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided to cover the liabilities. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through congressional appropriations or earnings of the entity.

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.Q, “Undistributed Disbursements and Collections” for additional information.

NOTE 9. FEDERAL EMPLOYEE AND VETERAN BENEFITS

<table>
<thead>
<tr>
<th>Other Benefits:</th>
<th>Liabilities</th>
<th>Unfunded Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>FECA</td>
<td>$ 627,822</td>
<td>$ 627,822</td>
</tr>
</tbody>
</table>

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 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 Department level.

**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 2019 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 2.61% was assumed for year one and years thereafter. An interest rate for medical benefits of 2.35% was assumed for year one and years thereafter.

NOTE 10. ENVIRONMENTAL AND DISPOSAL LIABILITIES

<table>
<thead>
<tr>
<th>Other Accrued Environmental Liabilities - Non-BRAC:</th>
<th>Liabilities</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental Closure Requirements</td>
<td>$ 189,970</td>
<td></td>
</tr>
<tr>
<td>Asbestos</td>
<td>143,225</td>
<td></td>
</tr>
<tr>
<td>Non-Military Equipment</td>
<td>848</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 334,043</strong></td>
<td></td>
</tr>
</tbody>
</table>
The USN reports the estimated environmental clean-up or disposal costs for hazardous waste associated with future closure of GPP&E assets. Such costs are categorized as environmental corrective action, closure of facilities, remediation of operational range contamination, asbestos abatement, and disposal of non-military equipment. The remaining environmental liabilities are reported under the USN GF Financial Statements.

**Applicable Laws and Regulations for Cleanup Requirements**

The following is a list of significant laws that affect the DON WCF’s conduct of environmental policy and regulations:

- 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
- CERCLA
- Medical Waste Tracking Act
- Toxic Substances Control Act
- National Environmental Policy Act of 1969
- Medical Waste Tracking Act of 1988
- SFFAS 6: Accounting for Property, Plans, and Equipment, DoD FMR, Volume 6B, Chapter 10, Notes to the Financial Statements
- Federal Financial Accounting TR 10, Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment
- Federal Financial Accounting TR 11, Implementation Guidance on Cleanup Costs Associated with Equipment

**Other Accrued Environmental Liabilities – Non-BRAC**

The OEL segment prepares accounting estimates for the unique clean-up costs that will be incurred when DON WCF GPP&E assets are decommissioned. The estimate is only prepared for those assets determined to have unique 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, asbestos, and lead, 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 DON WCF facilities, when such costs are not eligible for funding from DERP.

The DON WCF’s estimated recognized environmental cleanup cost for GPP&E totaled $334.0 million as of September 30, 2019. For closure sites, non-military equipment 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 DON WCF’s unrecognized environmental cleanup cost for GPP&E totaled $67.6 million as of September 30, 2019.

For FY 2019, due to estimation uncertainties there is a possibility that environmental liabilities could increase to approximately $160.3 million – of which $151.9 million is attributable to uncertainty concerning asbestos abatement. The remaining increased costs related to sites for which limited environmental information was available, these sites will be reevaluated in FY 2020.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

When the environmental cost estimates are completed, the USN complies with accounting standards to assign cost to the current operating period through amortization.

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. As of September 30, 2019, there are no changes to the environmental liability estimates due to inflation, deflation, changes in laws, regulations, agreements with regulatory agencies, and advances in technology. The USN is not aware of any pending changes, but the liability can change in the future due to changes in laws and regulations, inflation, deflation, changes in agreements with regulatory agencies, and advances in technology.

For FY 2019, there is a possibility that environmental liabilities could increase to approximately $160.3 million – of which $151.9 million is attributable to uncertainty concerning asbestos abatement. The remaining increased costs related to sites for which limited environmental information was available, these sites will be reevaluated in FY 2020.

NOTE 11. OTHER LIABILITIES

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Non-CURRENT</th>
<th>CURRENT</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Intragovernmental:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances from Others</td>
<td>$</td>
<td>-</td>
<td>$ 165,715</td>
</tr>
<tr>
<td>FECA Reimbursement to the Dept. of Labor</td>
<td>65,135</td>
<td>53,889</td>
<td>119,024</td>
</tr>
<tr>
<td>Custodial Liabilities</td>
<td>-</td>
<td>8,110</td>
<td>8,110</td>
</tr>
<tr>
<td>Employer Contribution and Payroll Taxes</td>
<td>-</td>
<td>73,538</td>
<td>73,538</td>
</tr>
<tr>
<td><strong>Total Intragovernmental</strong></td>
<td>$ 65,135</td>
<td>$ 301,252</td>
<td>$ 366,387</td>
</tr>
<tr>
<td><strong>Non-Federal:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances from Others</td>
<td>$</td>
<td>-</td>
<td>$ 414,531</td>
</tr>
<tr>
<td>Deposit Funds and Suspense Accounts</td>
<td>-</td>
<td>2,550</td>
<td>2,550</td>
</tr>
<tr>
<td>Contract Holdbacks</td>
<td>-</td>
<td>118,567</td>
<td>118,567</td>
</tr>
<tr>
<td>Employer Contribution and Payroll Taxes Payable</td>
<td>-</td>
<td>6,355</td>
<td>6,355</td>
</tr>
<tr>
<td>Contingent Liabilities</td>
<td>666</td>
<td>-</td>
<td>666</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>-</td>
<td>1,181</td>
<td>1,181</td>
</tr>
<tr>
<td><strong>Total Non-Federal Other Liabilities</strong></td>
<td>$ 666</td>
<td>$ 543,184</td>
<td>$ 543,850</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 65,801</td>
<td>$ 844,436</td>
<td>$ 910,237</td>
</tr>
</tbody>
</table>
**Intragovernmental Advances from Others** represent liabilities for collections received to cover future expenses or acquisition of assets.

**Intragovernmental FECA Reimbursement to the Dept of Labor** represents the liability chargeback amount for payments made by DOL on the behalf of the DON WCF.

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

**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 and 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.

**Non-Federal Other Liabilities** are attributed to improperly recorded 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**

The DON WCF is a party in various administrative proceedings, legal actions, and claims for environmental damage, equal opportunity matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON WCF accrues contingent legal liabilities for legal actions where OGC considers an adverse decision probable and the amount of the loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Treasury Judgment Fund.

Additional information about the DON WCF contingent legal liabilities can be found in Note 11, "Other Liabilities."

The OGC and OJAG conduct reviews of litigation and claims threatened or asserted involving DON WCF 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, remote, and reasonably possible.

As of September 30, 2019, the DON WCF has four cases with an estimated potential loss of $0.7 million that are assessed as probable for an adverse decision. The DON WCF has 243 cases assessed as reasonably possible with an aggregated estimated potential loss of $54.9 million.

In addition to legal cases managed by the OGC and OJAG, OCHR manages EEOC cases presented against the DON WCF. EEOC case liability is not included in the contingent legal liability calculation amount, as the maximum exposure of these cases, individually and collectively, are not significant.

After the period ended September 30, 2019, but before the issuance of this AFR, the DON WCF performed a review of known cases to identify any updates to the cases existed as of September 30, 2019. These updates arise from additional information received based on the progression of legal proceedings for existing cases, including additional claims added to those cases. The changes identified do not have material effects on the contingent legal liability balances recorded or disclosed.

The DON WCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolutions, which may result in a future outflow of budgetary resources. Currently, the DON WCF’s automated system processes have limited capability to capture these potential liabilities; therefore, the amounts reported may not fairly present DON WCF’s commitments and contingencies.
NOTE 13. EXCHANGE REVENUES

As of September 30 ($ in thousands) | Unaudited 2019
--- | ---
Intragovernmental Costs | 6,661,387
Nonfederal Costs | 31,823,410
Total Cost | 38,484,797

Intragovernmental Revenue | (29,062,002)
Nonfederal Revenue | (8,654,818)
Total Intragovernmental Revenue | (37,716,820)

Total Net Cost | 767,977

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 non-federal gross costs balance within NERP overstates the costs of goods sold amounts related to assets returned by customers due to system limitations.

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 component reporting entity] 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. AVAILABLE CONTRACT AUTHORITY

Contract authority represents authority that permits 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, 2019, there is $40.3 billion in total budgetary resources including $12.6 billion in contract authority.

NOTE 15. UNDELIVERED ORDERS AT THE END OF THE PERIOD

As of September 30 ($ in thousands) | Unaudited 2019
--- | ---
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period | $ 17,267,924

The SBR includes intra-entity transactions as the statement is presented on a combined basis.

Permanent, Indefinite Appropriations

NDSF is operated under statutory authority, 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 United States 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. There were no transfers in or out of NDSF during the fiscal year.

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.
**Undelivered Orders – Intragovernmental and Non-federal**

As outlined in OMB A-136 Revised, undelivered orders are to be presented as intragovernmental and non-federal. For FY 2019, the USN adopted a methodology to estimate intragovernmental and non-federal undelivered orders based on the total federal and non-federal designation for Accounts Payable, prepaid advances and prepayments.

**NOTE 16. 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 17. RECONCILIATION OF NET COST TO NET OUTLAYS**

<table>
<thead>
<tr>
<th>As of September 30 ($ in thousands)</th>
<th>Unaudited 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Intragovernmental</td>
</tr>
<tr>
<td>Net Cost of Operations (SNC)</td>
<td>$(22,400,615)</td>
</tr>
<tr>
<td>Components of Net Cost That Are Not Part of Net Outlays:</td>
<td></td>
</tr>
<tr>
<td>Property, plant, and equipment depreciation</td>
<td>-</td>
</tr>
<tr>
<td>Property, plant, and equipment disposal &amp; revaluation</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>(507,726)</td>
</tr>
<tr>
<td>Increase/(decrease) in assets:</td>
<td></td>
</tr>
<tr>
<td>Account Receivable</td>
<td>41,161</td>
</tr>
<tr>
<td>Other assets</td>
<td>(5,392)</td>
</tr>
<tr>
<td>(Increase)/decrease in liabilities:</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>(53,538)</td>
</tr>
<tr>
<td>Salaries and benefits</td>
<td>(9,825)</td>
</tr>
<tr>
<td>Environmental and disposal liabilities</td>
<td>-</td>
</tr>
<tr>
<td>Other Liabilities (Unfunded Leave, Unfunded FECA, Actuarial FECA)</td>
<td>2,381</td>
</tr>
<tr>
<td>Other Financing Sources:</td>
<td></td>
</tr>
<tr>
<td>Federal employee retirement benefit costs paid by OPM and Imputed to the agency</td>
<td>(698,598)</td>
</tr>
<tr>
<td>Total Components of Net Cost That Are Not Part of Net Outlays</td>
<td>(1,231,537)</td>
</tr>
<tr>
<td>Components of Net Outlays That Are Not Part of Net Cost:</td>
<td></td>
</tr>
<tr>
<td>Acquisition of capital assets</td>
<td>(11)</td>
</tr>
<tr>
<td>Acquisition of inventory</td>
<td>19,110</td>
</tr>
<tr>
<td>Other</td>
<td>(22,485)</td>
</tr>
<tr>
<td>Total Components of Net Outlays That Are Not Part of Net Cost</td>
<td>(3,386)</td>
</tr>
<tr>
<td>Net Outlays</td>
<td>(23,635,538)</td>
</tr>
<tr>
<td>Agency Outlays, Net, Statement of Budgetary Resources</td>
<td></td>
</tr>
<tr>
<td>Reconciling Difference</td>
<td>(1,028,101)</td>
</tr>
</tbody>
</table>

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 below 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 some financial system limitations, there is an $1.5 billion difference between net cost and net outlays. This difference is primarily attributable to processes relating to purchasing Inventory and OM&S.
DEPARTMENT OF THE NAVY WORKING CAPITAL FUND
REQUIRED SUPPLEMENTARY INFORMATION

The DON WCF real property deferred maintenance and repair information for fiscal year ended September 30, 2019 is reported with the USN GF deferred maintenance and repair. Refer to USN GF Required Supplementary Information.
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Refer to the USN GF Other Information for the DON WCF:

- Appropriations, Funds and Accounts Included in the Principal Statements
- Summary of Financial Statement Audit and Management Assurances

Crewmembers watch as an EA-6B Prowler assigned to the Black Ravens of Electronic Attack Squadron One Three Five (VAQ-135) comes in for an arrested landing on the flight deck of USS Nimitz (CVN 68). (U.S. Navy photo by Airman Angel G. Hilbrands)
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
NAVAL INSPECTOR GENERAL

SUBJECT: Transmittal of the Independent Auditor’s Reports on the U.S. Department of
the Navy Working Capital Fund Financial Statements and Related Notes
for FY 2019 and 2018 (Project No. D2019-D000FS 0084.000,
Report No. DODIG-2020-012)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY)
to audit the Department of the Navy (DON) Working Capital Fund Financial Statements
and related notes as of and for the fiscal years ended September 30, 2019, and 2018.
The contract required EY to provide a report on internal control over financial
reporting and compliance with laws and other matters, and to report on whether the
DON’s financial management systems did not substantially comply with the
requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).
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. EY’s Independent
Auditor’s Reports are 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 2019 and FY 2018 Financial Statements and
related notes.
EY’s separate report, “Internal Control Over Financial Reporting,” discusses 13 material weaknesses related to the DON’s Working Capital Fund.* Specifically, EY’s report describes the following material weaknesses:

- The DON did not have adequate policies and procedures over financial reporting to identify, detect, and correct inaccurate balances in the general ledger.

- The DON did not have policies, procedures, internal controls, and supporting documentation that allowed the DON to substantiate its Fund Balance with Treasury balances and was unable to reconcile the Fund Balance with Treasury ending balance from the general ledger systems to the U.S. Treasury.

- The DON did not have adequate policies, procedures, internal controls, and supporting documentation to support the balance and reporting of its inventory.

- The DON did not have adequate policies, procedures, internal controls, and supporting documentation for substantiating the existence, completeness, and presentation and disclosure related to utility assets.

- The DON did not have adequate policies, procedures, internal controls, and supporting documentation which prevented DON from substantiating the balance and presentation of the General Equipment–Remainder account.

- The DON did not have adequate policies, procedures, internal controls, and supporting documentation to substantiate the balances and presentation of its Revenue, Accounts Receivable, and Unfilled Customer Orders accounts.

- The DON did not have adequate policies, procedures, internal controls, and supporting documentation to substantiate the balances and presentation of the Expenses and Accounts Payable accounts.

- The DON’s policies, procedures, and internal controls were not effective for monitoring and validating Undelivered Orders for obligated balances.

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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.
• The DON’s Contract Authority process policies, procedures, internal controls, and supporting documentation were not effective to identify, detect, and correct inaccurate balances recorded in the general ledger.

• The DON did not have an effective oversight and monitoring program, which impacts its ability to appropriately identify and address significant risks for key business processes. The DON did not fully implement appropriate internal controls, including the documentation of policies and procedures that describe DON Working Capital Fund’s environment related to end-to-end business processes, roles and responsibilities, monitoring of service providers, risks, and controls.

• The DON information systems environment had weaknesses in access control and segregation of duties, including, but not limited to, lack of complete and accurate user populations, inconsistent user access provisioning and termination processes, and inconsistent periodic review of user access.

• The DON information systems environment had weaknesses in configuration management, including, but not limited to, inconsistent authorization, testing, approval, logging, and monitoring of changes; incomplete or inaccurate population of system changes; and ineffective segregation of duties within the change management process.

• The DON information systems environment had weaknesses in interface processing control, including, but not limited to, insecure transmission of data and inability to determine data transfer completeness, timeliness, and accuracy.

EY’s additional report, “Compliance and Other Matters,” discusses two instances of noncompliance with applicable laws and regulations. Specifically, EY’s report describes instances where the DON’s financial management systems did not comply with the requirements of the FFMIA, and evidence was not provided to ensure that the DON Working Capital Fund met the requirements of the Federal Managers’ Financial Integrity Act.

In connection with the contract, we reviewed EY’s reports and related documentation and discussed them with EY’s representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the DON’s Working Capital Fund FY 2019 and FY 2018 Financial Statements and related notes, conclusions about the
effectiveness of internal control over financial reporting, or conclusions on whether the DON’s financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached reports, dated November 8, 2019, and the conclusions expressed within the reports.

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

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

Attachments:
As stated
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, 2019, and the related consolidated Statements of Net Costs, Changes in Net Position, and the combined Statement of Budgetary Resources for the year ended September 30, 2019, 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 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, and 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. 19-03, Audit Requirements for Federal Financial Statements. Because of the matter 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 related to accounting issues for the Department of Defense and the Federal government. The effect on the financial statements 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 a whole for the year ended September 30, 2019.

Disclaimer of Opinion
Because of the significance of the matter 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 require that the Management’s Discussion and Analysis and the 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 because of the significance of the matter 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 basic 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 basic financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.
Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we also have issued our reports dated November 8, 2019 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, 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 on 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, 2019
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) to determine 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 the DON’s internal control. Accordingly, we do not express an opinion on the effectiveness of the DON’s internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-03. We did not test 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 ensuring efficient operations.

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.
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. As described below, we did identify certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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 adequate controls over the FBwT process, including reconciliations with Treasury, prevents the DON from substantiating the reported balance 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 policies and procedures over the DON 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: Utilities

Property, Plant, & Equipment (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. The DON has not developed or implemented a consistent methodology for the measurement, composition, and recordation of utility assets across the organization. This prevents the DON from substantiating the reported balance on the financial statements and notes. The combination of these
deficiencies results in a material weakness. The matters related to Utilities are further described in Appendix A.

V. Property, Plant, & Equipment: General Equipment Remainder

PP&E 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.

VI. 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.

VII. 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 Department of Defense and federal agencies, and the public. The DON determines revenue through their 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 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.

VIII. Contract Authority

Contract authority is a type of budget authority, authorized by Congress, that permits the DON to incur obligations in advance of an appropriation, offsetting collections or receipts. The contract authority process lacks sufficient and appropriate policies, procedures, and internal controls to identify, detect and correct inaccurate and incomplete balances recorded in the general ledger. The combination of these deficiencies results in a material weakness. The matters related to Contract Authority are further described in Appendix A.
IX. **Budget Execution and Undelivered Orders**

Budget Execution represents the use of funds from the time the funds are received through the outlay and reporting of those funds. Undelivered Orders (UDO) represent the amount of goods or 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, prevent 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 the UDOs are further described in Appendix A.

X. **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 and monitoring processes and insufficient risk assessment. 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.

XI. **Financial Information Systems - Access Controls/Segregation of Duties**

Access controls include those controls related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. We identified access control and segregation of duties (SoD) 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.

XII. **Financial Information Systems - Configuration Management**

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematic control changes to that configuration during the system’s life cycle. We identified configuration management 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.

XIII. **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. We identified interface processing 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 Interface Processing are further described in Appendix A.

**Significant Deficiencies**

I. **Property, Plant, & Equipment: Real Property**

Real Property includes land, buildings, and structures. The DON 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 DON to continue to assert to the existence and completeness of its Real Property. The combination of these matters results in a significant deficiency. The matters related to Real Property are further described in Appendix B.

II. **Property, Plant, & Equipment: 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 DON 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 DON from substantiating the recorded balances on the financial statements and notes. The combination of these deficiencies results in a significant deficiency. The matters related to CIP are further described in Appendix B.

**The DON’s Response to Findings**

The DON’s response to the findings identified in our engagement to audit, as described above, is included in the accompanying letter dated November 8, 2019. The DON’s response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and the result 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 performed in accordance with Government Auditing Standards in considering the entity’s internal control. Accordingly, this communication is not suitable for any other purpose.

November 8, 2019
Appendix A – Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the Department of the Navy’s (DON) ability to produce reliable financial statements, accompanying notes, and related disclosures. In accordance with the Federal Managers’ Financial Integrity Act of 1982 (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’s 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.

**Budget Submitting Offices Financial Reporting Process**
- The Budget Submitting Offices (BSO) do not have adequate procedures, including internal controls, to properly reconcile their general ledgers to trial balances (TB) submitted to the DON’s financial reporting service provider, Defense Finance and Accounting Service (DFAS). 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. This has led to recording JVs that are incomplete, inaccurate, or non-compliant with Treasury Financial Manual (TFM) requirements.

- FMO lacks appropriate oversight and controls related to JV preparation and review, financial reporting compilation and presentation, and the close process. Currently, the
controls in place are not designed effectively, missing comprehensive reviews over the financial statements, accompanying footnotes, and related disclosures.

3. **Lack of Oversight of Financial Reporting Service Provider.** The DON lacks appropriate oversight of DFAS related to the execution of financial reporting controls and does not have adequate monitoring controls in place to evaluate actions taken by DFAS. Specifically, we noted the following control weaknesses:

**Journal Vouchers (JVs)**
- FMO does not have adequately designed monitoring controls over manual and system generated JVs initiated and recorded by DFAS. Specifically, the review process is not comprehensive and fails to include attributes such as completeness of the JV, compliance with the TFM, and the review of the support 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 at Q4 was $9 billion.

**Data Processing**
- Monitoring controls over data processing actions taken by DFAS impacting the financial statements are inadequate. Management relies on DFAS to process financial information through 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 TBs. In addition, exclusions (automated and manual) of feeder file activity by DFAS from the financial statements are not reviewed by management for validity and impact to the financial statements. The DON relies on DFAS for the review of these excluded transactions and final determination of the appropriateness and resolution of these exclusions. However, DFAS does not have adequate controls in place to ensure that the entire population of excluded transactions is adequately reviewed.

**Complementary User Entity Controls**
- Complementary User Entity Controls (CUECs) are controls that users of the service organization (DON) should have in place to supplement the service organization’s (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 noted 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 OMB Circular A-136, Financial Reporting Requirements, including requirements for the financial statements and related disclosures. For example, activities included in Note 16, Reconciliation of Net Cost to Net Outlays, are not classified appropriately. Also, as presented, the note includes a $1.5 billion unsupported difference.

**Treasury United States Standard General Ledger (USSGL)**
- The DON is not in compliance with Treasury’s United States Standard General Ledger (USSGL) at the transaction level as required by the Federal Financial Management Improvement Act of 1996 (FFMIA). Examples of significant processes that are not recorded in compliance with the USSGL include: Budget Execution and Undelivered Orders, Revenue, Accounts Receivable, Unfilled Customer Orders, and Inventory.

**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**
Budget Submitting Offices 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: 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 BSO JVs to identify and correct instances where JVs do not comply with TFM posting logic.

Office of Financial Operations Financial Reporting Process

- 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 the DDRS Data Collection Module (DCM).

- 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.

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 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 detail only obtained from DDRS-B and DDRS-AFS. Transactional level support should be provided by the DON.

- 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.

• Implement monitoring controls over DFAS

Trading Partner Eliminations
• In conjunction with DFAS coordinate with the Office of the Secretary of Defense 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 DON trading partners and develop a process for resolving differences at the document level.

Data Processing
• Work with DFAS to develop and implement procedures to verify that excluded Lines of Accounting/General Ledger Account Codes are appropriate.

• 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.

Complementary User Entity Controls
• Evaluate the current System and Organization Control (SOC) 1 report and 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.
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 5120 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 on 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 has led to the following internal control deficiencies:

1. Lack of or Inadequate Documentation of FBwT Accounting 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. Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury. The FBwT reconciliation is not adequately designed:

   Unsupported Journal Vouchers
   • The reconciliation does not include the 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.

   Aged Unreconciled Transactions
   • The DON is unable to research and resolve differences at the transaction level between its books and activity reported by Treasury. As of September 30, 2019, there are $867 million of aged unreconciled transactions impacting the financial statements that are not due to timing differences.

   Suspense Accounts
   • The DON does not have procedures in place to timely identify, research, and resolve expenditure and receipt amounts in Treasury suspense accounts. In addition, the DON cannot isolate the amount in Treasury expenditure and receipt suspense accounts that are specific to the DON.
Recommendations

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

1. **Lack of or Inadequate Documentation of FBwT Accounting 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, 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. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury**
   - Disbursements and collections should be 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**

Inventory is comprised of consumable spare parts, repair parts, and repairable items. As of September 30, 2019, inventory is located across over 1,300 sites within and outside of the United States and is comprised of approximately 500,000 unique items—identified through National Item Identification Numbers (NIINs). The Naval Supply Systems Command (NAVSUP) provides program and inventory management for WCF Supply Management (SM) - Inventory and is the only entity that has financial reporting responsibility for WCF SM - Inventory. Inventory is held in DON-managed warehouses (including ships), Marine Corps Logistic Command (LOGCOM) warehouses, and third-party managed warehouses operated by the Defense Logistics Agency (DLA) and contractors. The DON reports the status of inventory using the Navy ERP system, which is the system of record for NAVSUP inventory. LOGCOM reports the status of the DON inventory held in its warehouses using the Stock Control System. 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 procedures 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 procedures, including oversight, over the DON Inventory process have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of Inventory Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the inventory process are not accurately or 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).

2. **Inadequate Policies, Procedures and Related Controls Over Inventory Physical Counts.** 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 requires an annual inventory of all items held at DON-managed sites, but the process is ineffective and lacks appropriate management oversight. NAVSUP also failed to appropriately design, implement, and document policies and procedures for the physical count of inventories. In addition, the frequency of the physical counts varies across DON managed sites. The lack of adequate procedures, including controls over the physical count of inventory has led to errors within the system. For example, during our testing of existence and completeness of inventory, quantity variances were observed in 49.8% of 207 NIINs sampled for existence testing (in the system, not in the warehouse) and 30.5% of 420 NIINs sampled for completeness testing (in the warehouse, not in the system). These error rates were calculated consistently with the methodology the DON uses to calculate inventory accuracy rates, as outlined in the NAVSUP Publication 723 Inventory Integrity Standards. NAVSUP was unable to perform adequate analysis to resolve variances noted between quantities recorded in Navy ERP and the quantities we observed.

3. **Policies, Procedures and Related Controls Over Accountability of Inventory Held at DON Managed Sites are Inadequate or Do Not Exist.** Given the control weaknesses noted below, the DON is unable to substantiate the existence, completeness, and condition of its inventory:

   **Receipt and Issuance**
   - There is a lack of policies, procedures and controls to ensure that inventory receipts and issuances are recorded in an accurate and timely manner in the inventory feeder systems and Navy ERP. Specifically, we noted untimely recording of transactions related to receipts and issuances of inventory for 30.4% of our sample of 207 NIINs.
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 misstatements 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.

Virtual Plants
- NAVSUP lacks 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.

Stock in Transit
- NAVSUP failed to substantiate inventory items that were recorded as Stock in Transit (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 in Navy ERP. NAVSUP also failed to properly create, utilize, and retain appropriate documentation to support the existence of SIT and monitor SIT to ensure it is cleared in a timely manner. For example, one plant had multiple items remaining in SIT that had been open since 2011 and 2012. Research was performed, and it was determined that these assets were no longer in transit (lost, canceled, or previously receipted) and should no longer have been recorded as in transit. The lack of adequate controls led to errors in 12.6% of our total sample of 207 NIINs, with a projected error value of $859 million.

4. Lack of Sufficient Oversight and Monitoring of Inventory Held by Third Parties. NAVSUP failed to effectively design controls over inventory transactions reported by third-party custodians to the DON. As a result, the DON’s inventory records are not complete, accurate or reliable.

Inventory Held by DLA
- DLA sends transactional data to Navy ERP related to movement of DON WCF inventory quantity via DLA’s Distribution Standard System (DSS). The DON does not perform a reconciliation of 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. To reconcile the two systems, NAVSUP records an unsupported JV in Navy ERP to match DSS. As of September 30, 2019, the unsupported JV amounted to more than $13 billion.
Inventory Held by Contractors

- NAVSUP failed to appropriately design, implement, and document policies and procedures including controls related to the accountability of inventory at contractor sites. These inadequate inventory practices have led to pervasive errors in the recording of inventories held by contractors. For example, our tests noted errors for 67% of 51 NIINs sampled for existence with a projected error value of over $1.28 billion. In addition, we noted errors in 56% of 176 NIINs tested for completeness.

5. **Inadequate or Lack of Controls over Financial Reporting of Inventory.** Management lacks processes and procedures to ensure that inventory balances are reconciled between the systems and the TB for both NAVSUP and LOGCOM managed inventory. This results in unsupported JVs in the amounts of $84.4 million and $254 million, respectively, to agree system balances to the financial statement balance as of September 30, 2019.

6. **Lack of Controls, Policies, and Procedures to Effectively Implement Accounting Standards.** Management lacks 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 revalued using one of the acceptable valuation methodologies set forth by FASAB Statement of Federal Financial Accounting Standards (SFFAS) 3 or SFFAS 48.

Recommendations

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

1. **Lack of or Inadequate Documentation of Inventory Accounting Policies and Procedures, including Controls**

   - 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, 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.

2. **Inadequate Policies, Procedures and Related Controls Over Inventory Physical Counts**

   - Design and implement inventory count controls related to the DON for which the following objectives are met:
     - Add a requirement to the inventory processes designed for DON-operated sites whereby all 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. Additionally, design and implement a management review control to monitor compliance with inventory count policies and procedures.

- Design and implement an overarching inventory count program using a risk-based statistical sampling approach whereby the DON executes counts on inventory items selected throughout the year that allows them to better monitor their DON-operated warehouses.

3. Policies, Procedures and Related Controls Over Accountability of Inventory Held at DON Managed Sites are Inadequate or Do Not Exist

Receipt and Issuance/Asset Condition/Virtual Plants
- Develop and implement comprehensive policies and procedures to substantiate existence and completeness to include the following:
  - Design and 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 and procedures to ensure documentation supporting the various inventory transactions are reconciled, matched for accuracy, and maintained.
  - Design and implement a management review control over DON managed warehouses to monitor compliance with the DON’s internal inventory policies and procedures such as the NAVSUP Publication 723 Inventory Integrity Standards.
  - 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.

Stock in Transit
- 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.
4. **Lack of Sufficient Oversight and Monitoring of Inventory Held by Third Parties**

**Inventory Held by DLA**
- Design policies and procedures to validate the completeness and accuracy of inventory transactions recorded by DLA to include the following:
  - Design and implement an adequate 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 the 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.

**Inventory Held by Contractors**
- Design and implement a management review program in which NAVSUP monitors 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.
  - Incorporate standard practice inventory management policies, procedures, and metrics into all contracts. Ensure these policies and procedures are implemented consistently across all contractor managed warehouses.
  - Adequately staff and manage warehouses by personnel possessing the requisite skillset.
  - Consider the applicability of using SOC reports, or contractually mandated contractor management assertions for the most significant contractors to support contractor-held inventory and ensure the accuracy of inventory reports and the financial statements.

5. **Inadequate or Lack of Controls over Financial Reporting of Inventory**
- Design policies and procedures to validate the completeness and accuracy of inventory transactions recorded by NAVSUP and LOGCOM to include the following:
- Design and 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 and should be performed prior to LOGCOM Navy ERP implementation.

- 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).

6. Lack of Controls, Policies, and Procedures to Effectively Implement Accounting Standards

   • 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 sufficient description of the process, as well as the proposed application of SFFAS 48.
     - Establish and 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.

IV. Property, Plant, & Equipment - Utilities

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).

Commander, Navy Installations Command oversees the Naval Facilities Engineering Command, which manages and financially reports utilities assets recorded within the system of record, the internet Navy Facilities Asset Data Store (iNFADS). In accordance with FM FIA, management is responsible for establishing and maintaining effective controls to achieve proper accountability for property and other assets for which the agency is responsible. Lack of adequate procedures over the utilities process can lead to misstatements on the financial statements and an inability to produce accurate information and data to effectively manage utilities.
There is a lack of adequate documentation of policies and procedures, including internal controls, which has led to inadequate accounting for utility assets. Specifically, management has not developed and implemented a consistent methodology for the measurement, composition, and recordation of utility assets across the organization. For example, utility plants of the same category on an installation are recorded in iNFADS using different bases of measurement. In addition, child asset listings supporting the measurement of parent utility assets are incomplete and inaccurate, and include child assets that are inactive, non-existent, or duplicative of other child assets.

**Recommendations**

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

- Establish and implement policies and procedures to ensure consistent methodology for the measurement, composition and recordation of utility assets across the organization.
- Establish and implement policies and procedures to enable the DON to track and accurately maintain records of child utility assets associated to a single parent utility record in iNFADS.

**V. Property, Plant, & Equipment - General Equipment Remainder**

General Equipment Remainder (GE-R) is primarily comprised of equipment used in research, development, and maintenance. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability of property and other assets. The DON 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 Accounting 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. This includes 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 financial transactions 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 system’s 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, capital equipment is not recorded within the system, and therefore not presented on the financial statements.

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 conditions identified above:

1. **Lack of or Inadequate Documentation of GE-R Accounting 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 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 GAAP.

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 that variances identified are investigated and resolved prior to preparation and reporting of the financial statements and related footnotes.

VI. **Expenses and Accounts Payable**

Accounts Payable (AP) represents the amount owed to third parties by the DON for goods and services received and 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 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 procedures over its end-to-end expense processes do not address financial reporting risks, leading to inaccuracies in amounts reported within the financial statements. Specifically, expenses were not posted in a timely manner for the TOT, MILSTRIP, and CVP processes and the DON was unable to provide receipt and acceptance support for TOT, CVP, and RWO-G selected transactions. In addition, the DON is unable to record AP intragovernmental transactions in an accurate, complete, and timely manner and lacks procedures to monitor outstanding AP. Lastly, 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:

- 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.
- 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.

VII. Revenue, Accounts Receivable, and Unfilled Customer Orders

Revenue, Accounts Receivable (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 has 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 Process Accounting 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 (TAFS) transactions, which have resulted in misstatements on the financial statements, and recording and monitoring (including segregation of duties) of reimbursements the DON receives from the DoD Foreign Military Sales (FMS) program.

3. **Lack of Effectively Designed Controls in the RWO-P Process.** The controls are not effectively designed over the RWO-P process. 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, Unfilled Customer Orders 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 the period in which the services or goods were 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 addition, advance payments are incorrectly recorded due to posting logic issues and documentation to support recorded transactions was 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 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 Process Accounting 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-P:
  - Implement non-automated review procedures to ensure the validity of FMS RWO-P 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 are included on the reimbursable documentation and entered into the general ledger systems. Additionally, implement appropriate monitoring over the execution of the agreements including the billings, collections 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 is 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 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:
  - 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.

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 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.

VIII. Contract Authority

Contract authority is a type of budget authority, authorized by Congress, that permits the DON to incur obligations in advance of an appropriation, offsetting collections or receipts. Contract Authority is part of the Fund Receipt and Distribution process (FRD). In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that budget authority, including contract authority, applicable to the agency operations is properly recorded and accounted for to permit the preparation of reliable financial reports. There is a lack of controls over the recording of contract authority. For example, not all BSOs record contract authority within the Field-Level General Ledger (FLGL) accounting systems. Instead, some BSOs track funding manually through excel spreadsheets. They rely on manual reconciliations between their FLGL and Annual Cost Authority (ACA) letters to ensure adequate contract authority funding is available. However, the DON failed to perform these reconciliations which led to funding being over-distributed from FMB to the BSOs, due to a failure to record two ACA letters that rescinded funding from the BSOs. The lack of controls has led to significant unreconciled variances reported in the financial statements, Standard Form-133, and Annual Operating Budget issued by the DoD.

Recommendations

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

• Ensure all BSOs are recording contract authority directly in the general ledger system.
• Develop and implement policies, procedures, and controls around receipt and distribution of contract authority.
• Provide training that aligns to updated policies, procedures and control. Specifically, employees who complete control activities within the FRD process cycle should be cognizant of and trained on the required procedures.

IX. 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. Undelivered Orders (UDO) 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 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 recognition and reporting of UDOs, do not address financial reporting and budget management risks leading to misstatements in amounts reported within the financial statements as detailed below:

1. Lack of or Inadequate Budget Execution Accounting Policies and Procedures, including Controls and Related Documentation. 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 procedure 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.

2. Lack of or Inadequate Budget Execution Procedures. Procedures outlining the appropriate use of reimbursable agreements and the identification and elimination of intra-TAFS 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 in both Navy ERP and legacy systems.

Dormant Obligations
• Management 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 120 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.

Recommendations

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

1. **Lack of or Inadequate Documentation of Budget Execution Process Accounting 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.

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, including:
     - 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.
   - Implement a DON-wide policy requiring obligation estimates be recorded and documented for all purchase orders.
   - Evaluate existing policies and procedures over the UDO process to ensure that the appropriate procedures are in place for the timely de-obligation of funds.

X. **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 Controls. 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 design of entity level controls and lack of proper end-to-end documentation of key business processes including internal controls.

   **Lack of Appropriate Intra-DON Coordination**
   - According to the GAO Green Book, organizational structure contributes to the design, implementation and operating effectiveness of the overall internal control environment. As part of establishing an organizational structure, management considers how units interact in order to fulfill their overall responsibilities. Management establishes reporting lines within an organizational structure so that units can communicate the quality information necessary for each unit to fulfill its overall responsibilities. The DON lacks appropriate coordination between the financial and Information Technology (IT) elements of both their A-123 and remediation programs. This lack of coordination prevents the DON from effectively implementing management oversight, IT controls, and overall governance. For example, the DON has failed to integrate its financial management and IT components’ remediation efforts, which may prevent the DON from fully implementing an effective A-123 or Manager’s Internal Control Program (MICP). Inadequate coordination between financial and IT in the execution of its MICP prevents the DON from addressing critical financial reporting issues such as general ledger systems that do not have appropriately designed posting logic to ensure transactions entered by users or interfaced into the system impact the correct general ledger accounts.

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 the 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 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.

**Lack of Appropriate Intra-DON Coordination**

- FMO should develop and implement a unified remediation plan that takes into consideration the necessary remediation efforts and timelines for both the IT and financial management components associated with the material weaknesses and control deficiencies in its end-to-end business processes to align the Office of Financial Policy and Systems’ remediation efforts appropriately.
- Develop an IT governance structure to establish roles, requirements, policies, and procedures for system decommissions/conversions and any other system changes that could have an impact to financial reporting objectives.
- FMO should develop, document, and disseminate enterprise-wide guidance for the identification of financially significant transactions relating to financial reporting, to include roles, responsibilities, and required levels of approval from FMO and other relevant financial management stakeholders.

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 management review control 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 to focus on implementing a robust internal control environment and information security program that is designed and operating effectively to mitigate key financial audit risks. Consequently, a prioritized, risk-driven effort is still necessary to remediate deficiencies in the areas of access controls, Segregation of Duties (SoD), configuration management and interfaces. 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. The following table outlines the number of deficiencies identified across the 21 systems in scope for the WCF:

<table>
<thead>
<tr>
<th>System Type</th>
<th>FY 19 Financially Significant Systems - IT Internal Controls Deficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Security Management</td>
</tr>
<tr>
<td>General Ledger Systems</td>
<td>29</td>
</tr>
<tr>
<td>Feeder and Operational Systems</td>
<td>46</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>75</strong></td>
</tr>
</tbody>
</table>

Based on the results outlined above, we noted the following:

- 92% of all control deficiencies identified across all system types map to high-risk control domains (i.e., access controls, SoD, configuration management and interface processing)
  - 40% of control deficiencies are a result of Access Control/SoD deficiencies
- 27% of control deficiencies are a result of Configuration Management deficiencies
- 25% of control deficiencies are a result of Interface Processing deficiencies

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:

- Access controls/Segregation of Duties
- Configuration management
- Interface processing

Each of the IT material weaknesses are discussed further below.

XI. Access Controls/Segregation of Duties

Access controls include those controls related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. When properly implemented, access controls can help ensure 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 this was not provided, to include source and level of access granted.
- Definition of financially significant transactions and resources has not been performed and/or lacks financial oversight.
- User access provisioning to include initial access provisioning, modification and removal were not performed in accordance with defined requirements, timelines and with sufficient detail to confirm access currently granted in the system was commensurate with access approved and required for the user’s business function.
- User access recertification/periodic user access reviews were not performed to consistently evaluate both the need for access and the level of access provisioned.
- Monitoring sensitive user activities, including activities of privileged users, were not documented, not being performed, or not configured appropriately within systems.
Audit logging information was not protected against unauthorized access and modification as well as not being retained for the audit period.

Definition and control of security violations and monitoring, to include required follow on actions and removal of access, was inconsistent.

An effective control environment guards against a particular user having incompatible functions within a system. SoD controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations without detection and thereby conducting unauthorized actions or gaining unauthorized access to assets or records.

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 is not considered when provisioning user access.
- SoD matrices or equivalent were not consistently documented, inclusive of all functional roles and/or not mapped effectively to the system access associated with the functional roles.
- Assigning of conflicting roles during the access provisioning process could not be prevented, and for known conflicts where SoD concerns were identified, there was a lack of documentation for business rationale and subsequent monitoring of a user’s activity.
- Multiple systems had a significant number of administrator users (i.e., database administrators, developers) able to complete an entire functional process by inputting, processing, and approving transactions.

Recommendations

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

- Systematically generate population of users and incorporate completeness and accuracy procedures into review controls to confirm a holistic evaluation of the user base. Implement monitoring and review controls for users with elevated access privileges.
- Define transactions and resources that are financially significant and obtain approval from the appropriate level of IT and Financial oversight.
- 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 roles and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.
• Evaluate cross-application SoD to identify potential conflicts for users accessing multiple systems.

• Conduct appropriate analysis to confirm functional user access is tied to the appropriate logical permissions within the systems and confirm SoD is enforced.

• Re-enforce/disseminate guidance as it relates to defining required security violation monitoring procedures and establish governance around the frequency for which security violations should be escalated, to whom, and management’s required actions.

XII. Configuration Management

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematically controls changes to that configuration during the system’s life cycle. By implementing configuration management controls, the DON can ensure that 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 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, direct data changes, configurable settings within the application and changes to interfaces.

• Logging and monitoring controls have not been implemented to identify unintentional or unauthorized changes made to the application, database, interface and data.

• Environment is not segregated; developers have access to the production environment. Additionally, access to source code is not properly controlled.

• Configuration changes are not properly reviewed, approved, and documented.

• There is no management review or monitoring of third-party providers, who perform many aspects of the configuration management functions for the relevant applications, to ensure compliance with the currently approved configuration management process.

• Inadequate governance and requirements during system conversion/consolidation activities resulted in critical financial reporting discrepancies and risks to the financial statement.
Recommendations

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

- Identify complete and accurate populations of configuration changes in order to monitor changes and determine only authorized and approved changes are being applied to production.
- Segregate access between development and production environments.
- Restrict access to source code and document authorization and business need for those that require this access to perform their job roles and responsibilities.
- Establish controls to monitor third party support organizations associated with the configuration management of the DON applications.
- Establish audit logging capabilities in order to monitor changes to the application, database, interface and data to ensure they are authorized.
- 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.

XIII. Interface Processing

Interface controls consist of those controls over 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 population of interfaces, systematically generated or systematically validated, could not be provided to support the complete and accurate processing of the DON transactions.
- Edit and validation checks are not consistently implemented across financially significant interfaces to prevent the processing of duplicate or inaccurate data.
- File-level reconciliations are not being performed between source and target systems to ensure completeness and accuracy of processing.
- Logs of interface processing activities are not retained to support subsequent auditing and monitoring; error reporting for failed interface processing activities has not been implemented in some systems.
• Interface files are not protected from unauthorized access and modification prior to processing through the use of secure transmission mechanisms.

• Remediation of identified errors in interface processing are not completed in accordance with defined requirements, timelines and with sufficient detail to confirm remediation.

Recommendations

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

• Conduct an appropriate analysis and implement procedures to confirm that the population of interfaces is complete and accurate.

• Implement stronger systemic checks for completeness and accuracy of interface file processing, to include tracking and logging procedures and protection from unauthorized access.

• Conduct an appropriate analysis of a complete and accurate population of edit checks and validations to then determine which are financially significant within the interface process. After this analysis, determine if the interface files are being subject to appropriate validation and edit checks and that they are operating as designed.

• Implement controls to confirm that the information received or sent from a target to source application is complete, accurate and consistently received.

• Test system interfaces in an end-to-end manner for the DON to gain reasonable assurance that system consolidation efforts will retain desired/intended functionality.

• Implement consistent controls to 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 Department of the Navy’s (DON) Real Property consists of land, buildings, and structures, the latter of which is segmented into linear and non-linear structures. Commander, Navy Installations Command oversees the Naval Facilities Engineering Command, which manages and financially reports Real Property assets recorded within the system of record, the 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.

During fiscal year (FY) 2019, the DON executed an entity wide wall-to-wall inventory of their Real Property enterprise. As a result of that effort, the error rates identified decreased to less than one half of one percent for existence and completeness of buildings and structures. However, as noted below, the DON has not yet implemented 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 Accounting Policies and Procedures, including Ineffectively Designed Controls. The DON’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. This includes documentation of specific internal controls in place over acquisition and disposals. 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 DON failed to design or implement effective controls over the Real Property process. Specifically, the DON has not adequately designed internal controls to ensure Real Property data is accurately or timely recorded in iNFADS. In addition, during the current FY, the DON did not consistently execute controls over additions, transfers, and disposals of Real Property.
Recommendations

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

1. **Lack of or Inadequate Documentation of Real Property Accounting Policies and Procedures, including Ineffectively Designed 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.

   • Implement policies and procedures to ensure the revised PCM is consistent with field level operations.

   • Design and implement policies and procedures to ensure that controls are adequately designed to detect material misstatements in its Real Property process and the performance of review controls are adequately documented and supported by evidential matter.

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

   • Design and implement policies, procedures, and internal controls to ensure Real Property is correctly reconciled and recorded in a timely manner across all DON installations.

II. **Property, Plant, & Equipment - Construction in Progress**

The DON’s Construction in Progress (CIP) reflects the resources expended to construct Property, Plant, & Equipment that have not been placed in service as of the end of the fiscal year. In accordance with Statements of Federal Financial Accounting Standards (SFFAS) 6, management is responsible for capitalizing the cost of acquiring assets as those costs are incurred and recorded as CIP. Effective controls over the recording of CIP do not exist. Specifically, controls to ensure CIP assets are completely and accurately reported have not been implemented, and therefore the DON is unable to support the CIP balance. In addition, adequate controls (e.g., reconciliations) to ensure that all CIP is properly relieved when buildings are placed in service do not exist. The lack of controls over CIP prevent full implementation of SFFAS 50 which requires management to “make an unreserved assertion” that its balances comply with SFFAS 6 prospectively and comply with SFFAS 50 retroactively.

Recommendations

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

• Revise the existing CIP procedures to ensure that life cycle events for CIP assets are completely and accurately recorded in a timely manner.
• Perform an analysis of the current CIP projects reported in the financial statements to validate the accuracy and completeness of the current balance and determine whether an adjustment is necessary to accurately state the CIP balance.
Report of Independent Auditors on Compliance and Other Matters
Based on an Audit of 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, 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. 19-03, 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, 2019, and the related
consolidated Statements of Net Cost, 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, 2019. That report states that because of matters
described in the Basis for Disclaimer of Opinion paragraph, the scope of the work was not
sufficient to enable us to express, and we do not express, an opinion on the financial statements as
of and for the fiscal year ended September 30, 2019 and the related notes to the financial
statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its
compliance with certain provisions of laws, regulations and contracts noncompliance with which
could have a direct and material effect on the determination of financial statement amounts, and
certain other laws and regulations specified in OMB Bulletin No. 19-03, including 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 to audit, and accordingly, we do not express such an opinion. We
limited our tests of compliance of these provisions, and we did not test compliance with all laws
and regulations applicable to the DON.

The results of our tests of compliance with laws, regulations and contracts described in the
preceding paragraph disclosed instances of noncompliance and other matters that are required to
be reported under Government Auditing Standards and OMB Bulletin No. 19-03, as described
below. In addition, 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.
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 Fiscal Year (FY) 2019 Navy Statement of Assurance, the DON self-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 confirmed this material weakness as part of the Financial Information Systems material weakness, contained in the Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards (Report on Internal Control), 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 2019 Navy Statement of Assurance and Note 1 to the financial statements, the DON self-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, which was included in our Report on Internal Control.

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

As referenced in the FY 2019 Navy Statement of Assurance, the DON self-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, which was included in our Report on Internal Control.
FMFIA

Federal Managers’ Financial Integrity Act of 1982 (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 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 yet 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.

The DON’s Response to Findings

Our Report on Internal Control dated November 8, 2019, 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 with FFMIA and FMFIA and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from the DON’s management responsible for addressing the noncompliance are provided in the accompanying letter dated November 8, 2019. The DON’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 result 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 performed in accordance with Government Auditing Standards in considering the entity’s compliance. Accordingly, this communication is not suitable for any other purpose.

November 8, 2019
Ernst & Young, LLP
(Attention: Mr. John F. Short, Partner)
1775 Tysons Boulevard
Tysons, VA 22102

Dear Mr. Short:

The Department of the Navy (DON) reviewed the Auditors’ Report prepared by Ernst & Young, LLP for the audit of the DON Working Capital Fund. We appreciate the recommendations from the auditors and we look forward to our continued engagement to improve financial management in our Department. We acknowledge and concur with the material weaknesses and the disclaimer of the opinion.

We continue to get tremendous value from these annual audits, as we use the audits to drive improvements into our programs. These audits identify opportunities to retire legacy processes and systems, improve the quality of information on count and condition of mission critical assets, and improve viability over how we spend our resources. This will enable us to save and reinvest hundreds of millions of dollars for readiness and lethality.

During Fiscal Year (FY) 2019, we focused our remediation efforts on specific areas based on their impact on operations and on our ability to obtain a clean opinion. We determined that we could not resolve all of the issues identified in the FY 2018 audit report, and that we would be best served to focus our resources on specific priorities that would yield near and long term positive outcomes. The priority areas include:

- Systems Consolidation – consolidate all accounting systems into one general ledger and reduce feeder system footprint.
- Financial Reporting and Fund Balance with Treasury (FBwT) Reconciliation – re-engineer financial statement compilation process, standardize FBwT reconciliation and produce auditable trial balance.
- Inventory and Operating Materials and Supplies – standardize processes and implement process controls to improve accuracy and facilitate audit.
- Real Property – standardize processes and implement process controls to improve accuracy and facilitate audit.
- Budgetary Reform – standardize processes and implement controls over budgetary transactions (direct and reimbursable).
- Information Technology General Controls – the Department will leverage new technology and retire legacy systems to enhance system security.

This year we achieved two major accomplishments:

- We completed an inventory of real property assets at our installations and corrected all discrepancies between our books and what exists in the field. We will continue to work the remaining deficiencies in this area but we are confident that we can sustain proper accountability of our real property assets.
• We modernized our DON Enterprise Resource Planning (ERP) system by making several changes to improve performance, shifting from an Oracle database to a high-performance analytic appliance database, and migrating to a high performance analytic cloud-based platform 10 months ahead of schedule, in what is likely the largest ERP cloud migration in North American history. With nearly $70B flowing into the U.S. economy annually through Navy ERP, the new cloud platform will provide faster and more capable performance for the 72,000 ERP users across six Navy commands who play a role in managing more than half of the Navy’s finances. We also continued to make progress in the consolidation of general ledger systems by shutting down a legacy general ledger system and continuing the migration of all other systems to Standard Accounting, Budgeting, and Reporting System (SABRS) and the DON ERP system.

We recognize that correcting these long-standing issues will take a few years and we will continue to work our remediation with a sense of urgency. As we move into next year, we will focus on establishing a clean baseline for our inventory and operating materials and supplies. I am confident that our Department will rise to the occasion and we will get this done.

Thank you again for your report; we look forward to our continued partnership.

Sincerely,

Thomas W. Harker
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1. Mediterranean MEDITERRANEAN SEA (April 24, 2019) The Nimitz-class aircraft carrier USS Abraham Lincoln (CVN 72) sails behind the Spanish navy Ivaro de Bazan-class frigate ESPS Mendez Nuñez (F 104) during a photo exercise.

2. RED SEA (April 19, 2019) Aviation Electrician’s Mate 1st Class Ryan Liesse, right, from Stoughton, Wisconsin, and Aviation Electrician’s Mate 2nd Class Myles Stewart, from Tacoma, Washington, look at schematics for aircraft wiring on an E/A-18G Growler, assigned to Electronic Attack Squadron (VAQ) 133, in the hangar bay aboard the aircraft carrier USS John C. Stennis (CVN 74) in the Red Sea, April 19, 2019.


4. ATLANTIC OCEAN (May 10, 2019) Fire Controlman 1st Class Alexander Perez, from Houston, Texas, fires the phalanx close-in weapons system from a local control station aboard the Arleigh Burke-class guided-missile destroyer USS Carney (DDG 64) during Formidable Shield 19, May 10, 2019.

5. A UH-1Y Venom with the 22nd Marine Expeditionary Unit takes off from the flight deck during flight operations aboard the USS Kearsarge, Dec 28, 2018.

6. GULF OF OMAN (June 15, 2019) Boatswain’s Mate Seaman Heather Montgomery, from Tuscaloosa, Ala., uses the shipboard binoculars while standing lookout watch aboard the Arleigh Burke-class guided-missile destroyer USS Mason (DDG 87).
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