UNITED STATES DEPARTMENT OF DEFENSE

AGENCY FINANCIAL REPORT

FISCAL YEAR 2017

FINANCIAL SECTION

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MESSAGE FROM THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER

November 15, 2017

On behalf of the Department of Defense (DoD), it is my privilege to present the fiscal year (FY) 2017 financial statements. The financial statements and the accompanying notes are one of the key means for the Department to communicate the results of its accountability and stewardship to the President, the Congress, and the American public over the taxpayer dollars entrusted to it.

The Department is fully committed to upholding the trust of the American public by improving its ability to transparently and accurately report the operating results of the Department's unique and complex mission. Since Congress passed the Chief Financial Officers Act of 1990, which required the 24 largest federal agencies to undergo annual financial statement audits, the Department has been the only large federal agency that has not been able to meet the requirement. Thanks to the dedicated efforts of the Service members, the DoD civilian workforce, and the Defense financial management community, the Department will accomplish this goal in FY 2018 when the first full financial statement audit of the Department begins.

The audit will not be easy – the Department is immense in size and its operations are varied and complex. However, size and complexity are not a reason to delay the audit but rather a reason to begin. Conducting the audit will improve public confidence in our fiscal stewardship as well as directly support the Department's strategic priority of improving and transforming business processes. To that end, our significant accomplishments include:

- The processes and systems are in place to allow an auditor to scope and perform audit procedures over the universe of transactions; Fund Balance with Treasury; journal vouchers; Environmental and Disposal Liabilities; and the existence, completeness, rights and obligations and valuation of assets;
- A notice of findings and recommendations (NFR) tracking database was implemented to manage all auditor-issued NFRs, assign responsibility to the relevant organization or command, and track Department progress on remediation; and
- The Defense Information Systems Agency Working Capital Fund received its first unmodified audit opinion of its full financial statements and seven (7) other agencies maintained unmodified audit opinions – (1) the U.S. Army Corps of Engineers Civil Works, (2) the Defense Commissary Agency, (3) the Defense Contract Audit Agency, (4) the Defense Finance and Accounting Service, (5) Defense Health Agency Contract Resource Management, (6) the Military Retirement Fund, and (7) the DoD Office of Inspector General.

Our work is made more complicated by the Department's demanding mission and the difficulty of regularly operating under a continuing resolution and the Budget Control Act caps. The Department's regulatory compliance workload has increased in FY 2017 as we must begin to demonstrate our progress towards compliance with two new financial management-related requirements: the Fraud Reduction and Data Analytics Act of 2015 and the Grants Oversight and New Efficiency Act of 2016.

Our ability to fully implement the requirements of these and other regulations, including the ability to make necessary business process and system changes, depends on sufficient and stable funding.

Similarly, the Department requires resources in order to fully remediate its identified material weaknesses in areas such as financial reporting compilation, financial management systems, Real Property Assets, and Inventory. We have established and are working to implement corrective action plans for each of the Department's identified weaknesses, with many targeted for correction within the next several fiscal years. Undergoing audit in FY 2018 and beyond will help us in this effort by providing actionable feedback to help guide and improve our corrective action efforts.

The Department's continued financial process improvement over the years is a testament to the commitment of leadership and the hard work of our financial and functional communities. I have the fullest confidence in all of the people of the Department as we work together towards improving the efficiency and effectiveness of our operations and financial reporting.

David L. Norquist
Under Secretary of Defense (Comptroller)/
Chief Financial Officer

PRINCIPAL FINANCIAL STATEMENTS AND NOTES

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of title 31 U.S. Code, *section 3515(b)*. The statements are prepared from accounting records of the Department in accordance with Office of Management and Budget *(OMB) Circular No. A-136* and, to the extent possible, U.S. Generally Accepted Accounting Principles (GAAP). The statements, in addition to other financial and accounting reports, are used to monitor and control budgetary resources, which are prepared from the same records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

The financial statements of the Department include four principal statements listed in the table below.

The financial statements reflect the aggregate financial position of the Department and include both the proprietary (Federal accounting standards) and budgetary resources of the Department. The Department is large and complex with an asset base of $2.6 trillion, and approximately 1.3 million personnel in the active component, more than 809,000 personnel serving in the National Guard and Reserve forces, and about 750,000 civilians employees on installations in every state and around the world.

Four Principal Financial Statements

Statement	What Information It Provides
Balance Sheet	Reflects the Department's financial position as of the statement date (September 30, 2017). The assets are the amount of future economic benefits owned or managed by the Department. The liabilities are amounts owed by the Department. The net position is the difference between the assets and liabilities.
Statement of Net Cost	Shows separately the components of the net cost of the Department's operations for the period. Net cost is equal to the gross cost incurred by the Department less any exchange revenue earned from its activities.
Statement of Changes in Net Position	Presents the sum of the cumulative results of operations since inception and unexpended appropriations provided to the Department that remain unused at the end of the fiscal year. The statement focuses on how the net cost of operations is financed. The resulting financial position represents the difference between assets and liabilities as shown on the consolidated balance sheet.
Statement of Budgetary Resources	Provides information about how budgetary resources were made available as well as their status at the end of the period. It is the only financial statement exclusively derived from the Department's budgetary general ledger in accordance with budgetary accounting rules. The Statement of Budgetary Resources is the only principal financial statement prepared on a combined versus consolidated basis. As such, all intra-entity transactions are included in the balances reported in the statement.

Department of Defense Consolidated Balance Sheet Agency Wide		*Dollars in Millions*
As of September 30, 2017 and 2016	2017 Consolidated	2016 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 501,620.4	$ 474,289.0
Investments (Note 4)	991,733.9	910,567.9
Accounts Receivable (Note 5)	2,055.0	1,907.6
Other Assets (Note 6)	927.2	1,253.4
Total Intragovernmental Assets	**$ 1,496,336.5**	**$ 1,388,017.9**
Cash and Other Monetary Assets (Note 7)	1,119.7	1,152.3
Accounts Receivable, Net (Note 5)	5,244.1	6,920.1
Loans Receivable (Note 8)	1,644.2	1,603.9
Inventory and Related Property, Net (Note 9)	266,760.5	255,289.9
General Property, Plant and Equipment, Net (Note 10)	761,707.8	711,717.2
Investments (Note 4)	3,511.6	3,521.7
Other Assets (Note 6)	29,390.0	35,130.6
TOTAL ASSETS	**$ 2,565,714.4**	**$ 2,403,353.6**
Stewardship Property, Plant & Equipment (Note 10)		
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,573.8	$ 1,922.4
Debt (Note 13)	1,630.8	1,630.7
Other Liabilities (Note 15)	7,017.8	8,083.6
Total Intragovernmental Liabilities	**$ 10,222.4**	**$ 11,636.7**
Accounts Payable (Note 12)	26,426.8	18,263.6
Loan Guarantee Liability (Note 8)	65.2	70.9
Military Retirement and Other Federal Employment Benefits (Note 17)	2,356,869.6	2,297,837.3
Environmental and Disposal Liabilities (Note 14)	68,318.1	62,670.3
Other Liabilities (Note 15)	36,071.9	32,421.6
TOTAL LIABILITIES	**$ 2,497,974.0**	**$ 2,422,900.4**
Commitments & Contingencies (Note 16)		
NET POSITION		
Unexpended Appropriations – Other Funds	$ 457,849.4	$ 450,026.1
Cumulative Results of Operations – Funds From Dedicated Collections (Note 23)	16,149.7	15,493.7
Cumulative Results of Operations – Other Funds	(406,258.7)	(485,066.6)
TOTAL NET POSITION	**$ 67,740.4**	**$ (19,546.8)**
TOTAL LIABILITIES AND NET POSITION	**$ 2,565,714.4**	**$ 2,403,353.6**

The accompanying notes are an integral part of these financial statements.

Department of Defense Consolidated Statement of Net Cost Agency Wide		*Dollars in Millions*
For the Years Ended September 30, 2017 and 2016	**2017 Consolidated**	**2016 Consolidated**
Program Costs		
Gross Costs	**$ 728,117.7**	**$ 730,745.2**
Military Retirement Benefits	96,630.1	102,514.8
Civil Works	9,168.2	9,876.8
Military Personnel	139,512.6	138,720.9
Operations, Readiness & Support	302,022.8	285,650.9
Procurement	85,881.3	107,864.2
Research, Development, Test & Evaluation	84,380.8	73,771.0
Family Housing & Military Construction	10,521.9	12,346.6
(Less: Earned Revenue)	(114,295.5)	(83,528.9)
Net Cost before Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	**$ 613,822.2**	**$ 647,216.3**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	24,069.0	(57,582.7)
Net Cost of Operations (Note 18)	**$ 637,891.2**	**$ 589,633.6**

The accompanying notes are an integral part of these financial statements.

Department of Defense Consolidated Statement of Changes in Net Position Agency Wide		*Dollars in Millions*
For the Years Ended September 30, 2017 and 2016	**2017 Consolidated**	**2016 Consolidated**
Cumulative Results Of Operations		
Beginning Balances (Includes Funds from Dedicated Collections of $15,493.7 in FY 2017 and $14,674.7 in FY 2016 – See Notes 19 and 23)	**$ (469,572.9)**	**$ (609,246.1)**
Prior Period Adjustments:		
Changes in accounting principles (+/-)	37,345.0	(1,498.9)
Corrections of errors (+/-)	0.0	31,383.3
Beginning balances, as adjusted (Includes Funds from Dedicated Collections of $15,493.7 in FY 2017 and $14,674.7 in FY 2016– See Notes 19 and 23)	**(432,227.9)**	**(579,361.7)**
Budgetary Financing Sources:		
Other adjustments (rescissions, etc.)	612.5	9.0
Appropriations used	680,590.0	685,350.9
Nonexchange revenue	1,460.8	1,738.4
Donations and forfeitures of cash and cash equivalents	179.1	246.8
Transfers in/out without reimbursement	1,286.4	1,251.5
Other	(2,543.8)	(6,134.5)
Other Financing Sources		
Donations and forfeitures of property	2.4	1.8
Transfers in/out without reimbursement	139.7	94.1
Imputed financing	3,673.9	4,573.4
Other	(5,390.9)	12,291.0
Total Financing Sources	**$ 680,010.1**	**$ 699,422.4**
Less: Net Cost of Operations	637,891.2	589,633.6
Net Change	**$ 42,118.9**	**$ 109,788.8**
Cumulative Results of Operations (Includes Funds from Dedicated Collections of $16,149.7 in FY 2017 and $15,493.7 in FY 2016 – See Notes 19 and 23)	**$ (390,109.0)**	**$ (469,572.9)**

Unexpended Appropriations		
Beginning Balances (Includes Funds from Dedicated Collections of $0.0 in FY 2017 and $0.0 in FY 2016 – See Notes 19 and 23)	**$ 450,026.1**	**$ 474,792.9**
Budgetary Financing Sources:		
Appropriations received	710,705.3	683,343.5
Appropriations transferred in/out	487.7	289.4
Other adjustments	(22,779.7)	(23,048.8)
Appropriations used	(680,590.0)	(685,350.9)
Total Budgetary Financing Sources (Includes Funds from Dedicated Collections of $0.0 in FY 2017 and $0.0 in FY 2016 – See Note 23)	**$ 7,823.3**	**$ (24,766.8)**
Unexpended Appropriations (Includes Funds from Dedicated Collections of $0.0 in FY 2017 and $0.0 in FY 2016 – See Notes 19 and 23)	**$ 457,849.4**	**$ 450,026.1**
Net Position	**$ 67,740.4**	**$ (19,546.8)**

The accompanying notes are an integral part of these financial statements.

Department of Defense Combined Statement of Budgetary Resources **Agency Wide** **For the Years Ended September 30, 2017 and 2016** **Page 1 of 2** *Dollars in Millions*	**Budgetary Financing Accounts**		**Non-Budgetary Financing Accounts**	
	2017 Combined	**2016 Combined**	**2017 Combined**	**2016 Combined**
Budgetary Resources				
Unobligated balance, brought forward, October 1	$ 155,556.4	$ 149,462.3	$ 79.7	$ 66.6
Adjustment to unobligated balance brought forward, Oct 1 (+or-)	0.0	2,083.9	0.0	0.0
Unobligated balance, brought forward, October 1, as adjusted	$ 155,556.4	$ 151,546.2	$ 79.7	$ 66.6
Recoveries of prior year unpaid obligations	49,713.3	50,516.5	0.0	0.0
Other changes in unobligated balance	(24,285.7)	(21,673.4)	0.0	0.0
Unobligated balance from prior year budget authority, net	**180,984.0**	**180,389.3**	**79.7**	**66.6**
Appropriations (discretionary and mandatory)	776,981.7	745,655.2	0.0	0.0
Borrowing authority (discretionary and mandatory)	0.0	0.0	58.1	27.0
Contract authority (discretionary and mandatory)	76,540.2	69,749.9	0.0	0.0
Spending authority from offsetting collections (discretionary and mandatory)	105,705.9	105,509.3	76.6	74.7
Total Budgetary Resources	**$ 1,140,211.8**	**$ 1,101,303.7**	**$ 214.4**	**$ 168.3**

Status of Budgetary Resources				
New obligations and upward adjustments (total)	$ 981,481.5	$ 945,747.3	$ 129.4	$ 88.6
Unobligated balance, end of year:				
Apportioned, unexpired accounts	116,449.6	108,698.3	0.0	0.0
Exempt from Apportionment, unexpired accounts	6,759.2	6,437.7	0.0	0.0
Unapportioned unexpired accounts	1,910.5	3,321.0	85.0	79.7
Unexpired unobligated balance, end of year	125,119.3	118,457.0	85.0	79.7
Expired unobligated balance, end of year	33,611.0	37,099.4	0.0	0.0
Unobligated balance, end of year (total)	**$ 158,730.3**	**$ 155,556.4**	**$ 85.0**	**$ 79.7**
Total Budgetary Resources	**$ 1,140,211.8**	**$ 1,101,303.7**	**$ 214.4**	**$ 168.3**

Change in Obligated Balance				
Unpaid obligations:				
Unpaid obligations, brought forward, October 1	$ 406,769.4	$ 407,118.1	$ 284.2	$ 410.5
New obligations and upward adjustments	981,481.5	945,747.3	129.4	88.6
Outlays (Gross)	(899,834.4)	(895,579.5)	(185.6)	(214.9)
Recoveries of prior year unpaid obligations	(49,713.3)	(50,516.5)	0.0	0.0
Unpaid obligations, end of year	**438,703.2**	**406,769.4**	**228.0**	**284.2**
Uncollected payments:				
Uncollected payments, Federal sources, brought forward, October 1	(74,181.3)	(72,850.2)	(58.9)	(72.4)
Change in uncollected payments, Federal sources	(4,307.2)	(1,331.1)	5.9	13.5
Uncollected payments, Federal sources, end of year	**(78,488.5)**	**(74,181.3)**	**(53.0)**	**(58.9)**
Memorandum (non-add) Entries:				
Obligated balance, start of year	**$ 332,588.1**	**$ 334,267.9**	**$ 225.3**	**$ 338.1**
Obligated balance, end of year	**$ 360,214.7**	**$ 332,588.1**	**$ 175.0**	**$ 225.3**

The accompanying notes are an integral part of these financial statements.

Department of Defense Combined Statement of Budgetary Resources **Agency Wide** **For the Years Ended September 30, 2017 and 2016** **Page 2 of 2** *Dollars in Millions*	**Budgetary Financing Accounts**		**Non-Budgetary Financing Accounts**	
	2017 Combined	**2016 Combined**	**2017 Combined**	**2016 Combined**
Budgetary Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	$ 959,227.8	$ 920,914.4	$ 134.7	$ 101.7
Actual offsetting collections (discretionary and mandatory)	(167,915.5)	(167,332.7)	(190.6)	(105.4)
Change in uncollected customer payments from Federal sources (discretionary and mandatory)	(4,307.2)	(1,331.1)	5.9	13.5
Recoveries of prior year paid obligations (discretionary and mandatory)	2,766.9	1,548.3	0.0	0.0
Budget Authority, net (discretionary and mandatory)	**$ 789,772.0**	**$ 753,798.9**	**$ (50.0)**	**$ 9.8**
Outlays, gross (discretionary and mandatory)	$ 899,834.4	$ 895,579.5	$ 185.6	$ 214.9
Actual offsetting collections (discretionary and mandatory)	(167,915.5)	(167,332.7)	(190.6)	(105.4)
Outlays, net (discretionary and mandatory)	**731,918.9**	**728,246.8**	**(5.0)**	**109.5**
Distributed offsetting receipts	(97,963.0)	(92,078.2)	0.0	0.0
Agency Outlays, net (discretionary and mandatory)	**$ 633,955.9**	**$ 636,168.6**	**$ (5.0)**	**$ 109.5**

The accompanying notes are an integral part of these financial statements.

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NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of DoD, as required by the *Chief Financial Officers Act of 1990*, expanded by the *Government Management Reform Act of 1994*, and other appropriate legislation. The financial statements have been prepared from the books and records of the Department in accordance with, to the extent possible, U.S. GAAP promulgated by the Federal Accounting Standards Advisory Board; the *OMB Circular No. A-136*, "Financial Reporting Requirements"; and the DoD Financial Management Regulation *(FMR)*. The accompanying financial statements account for all resources for which the Department is responsible unless otherwise noted. Information relative to classified assets, programs, and operations is excluded from the statements or otherwise aggregated and reported in such a manner that it is not discernible.

The Department is not yet fully compliant with all elements of U.S. GAAP and OMB Circular No. A-136, due to limitations of financial and nonfinancial management processes and systems supporting the financial statements. The Department derives reported values and information for major asset and liability categories largely from nonfinancial systems, such as inventory and logistics systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of federal appropriations rather than preparing financial statements in accordance with U.S. GAAP. The Department continues to implement process and system improvements addressing these limitations.

The Department has material weaknesses from internal assessments: (1) Fund Balance with Treasury, (2) Financial Reporting Compilation, (3) Health Care Liabilities, (4) Military Pay, (5) Contracts/Vendor Pay, (6) Reimbursable Work Orders (Budgetary), (7) Transportation of Things, (8) Equipment Assets, (9) Real Property Assets, (10) Environmental Liabilities, (11) Inventory, (12) Operating Materials & Supplies, and (13) Military Standard Requisitioning and Issue Procedures.

1.B. Mission of the Reporting Entity

The Department was established by the *National Security Act of 1947*. The Department provides the military forces needed to deter war and protect the security of our country. Since the creation of America's first army in 1775, the Department and predecessor organizations have evolved into a global presence with a worldwide infrastructure dedicated to defending the United States by deterring and defeating aggression and coercion in critical regions.

The Department includes the Military Departments and the Defense Agencies. The Military Departments consist of the Army, the Navy (of which the Marine Corps is a component), and the Air Force. The Defense Agencies provide support services commonly used throughout the Department.

1.C. Appropriations and Funds

The Department receives appropriations and funds as general, working capital (revolving), trust, and special funds. The Department uses these appropriations and funds to execute its missions and subsequently report on resource usage.

General funds are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, and military construction.

Working Capital Funds (WCF) received funding to establish an initial corpus through an appropriation or a transfer of resources from existing appropriations or funds. The corpus finances operations and transactions flowing through the fund. Each WCF obtains the goods and services sold to customers on a reimbursable basis and maintains the corpus. Reimbursable receipts fund future operations and generally are available in their entirety for use without further congressional action. At various times, Congress provides additional appropriations to supplement the WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute. Special fund accounts are used to record government receipts reserved for a specific purpose. Certain trust and special funds may be designated funds from dedicated collections. Funds from dedicated collections are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. The Department is required to separately account for and report on the receipt, use and retention of revenues and other financing sources for funds from dedicated collections.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. They are not Department funds, and as such, are not available for the Department's operations. The Department is acting as an agent or custodian for funds awaiting distribution.

The Department is a party to allocation transfers with other federal agencies as a transferring (parent) entity or receiving (child) entity. An allocation transfer is an entity's legal delegation of authority to obligate budget authority and outlay funds on its behalf. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity. Exceptions to this general rule apply to specific funds for which OMB has directed that all activity be reported in the financial statements of the child entity. These exceptions include U.S. Treasury Managed Trust Funds, Executive Office of the President (EOP), and all other funds specifically designated by OMB.

The Department receives allocation transfers from the following agencies: Departments of Agriculture, Interior, Energy, and Transportation; the Appalachian Regional Commission; and the Federal Highway Administration.

Additionally, the Department also receives allocation transfers from certain funds meeting the OMB exception and all related activity is included in the Department's financial statements. These funds include South Dakota Terrestrial Wildlife Habitat Restoration, Inland Waterways and Harbor Maintenance. The Department receives allocation transfers for the Security Assistance programs meeting the OMB exceptions for EOP funds. These funds are reported separately from the DoD financial statements based on an agreement with OMB. (See Appendix A for information regarding Security Assistance programs.)

As a parent entity, the Department reports in these financial statements funds allocated to the Departments of Transportation and Agriculture.

1.D. Basis of Accounting

Due to the limitations of various systems, and the sensitive nature of Departmental activities, the Department is not fully compliant with U.S. GAAP for the accrual method of accounting.

The Department's financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the Military Services and Defense Agencies and their sub-entities. The underlying data is largely derived from budgetary transactions (obligations, disbursements, and collections), from nonfinancial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities. Some of the sub-entity level trial balances may reflect known abnormal balances resulting largely from business and system processes. An abnormal balance occurs when the general ledger account balance reported is opposite of its normal balance, as it is defined by the United States Standard General Ledger (USSGL) *"Accounts and Definitions"* guidance in the U.S. Treasury Financial Manual. At the consolidated level these abnormal balances may not be evident. 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.

The Department is continuing the actions required to bring financial and nonfinancial feeder systems and processes into compliance with U.S. GAAP. One such action is the current revision of accounting systems to record transactions based on the U.S. Standard General Ledger (USSGL). Until all of the Department's financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by U.S. GAAP, there will be instances when the Department's financial data is derived from budgetary transactions or data from nonfinancial feeder systems.

1.E. Revenues and Other Financing Sources

The Department receives congressional appropriations as financing sources for general funds, and on occasion, will also receive congressional appropriations for WCFs. These funds either expire annually, some on a multi-year basis, or do not expire. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The Department recognizes revenue as a result of costs incurred for goods and services provided to other federal agencies and the public. Full-cost pricing is the Department's standard policy for services provided as required by *OMB Circular No. A-25, "User Charges."* The Department recognizes revenue when earned within the constraints of its current system capabilities. In some instances, revenue is recognized when bills are issued.

Depot Maintenance and Ordnance WCF activities recognize revenue according to the percentage of completion method. Supply Management WCF activities recognize revenue from the sale of inventory items.

The Department does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and Note 21, Reconciliation of Net Cost of Operations to Budget. 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 a port.

In compliance with Statement of Federal Financial Accounting Standards *(SFFAS) 7*, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting", the Department recognizes nonexchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not directly receive value in return.

1.F. Recognition of Expenses

For financial reporting purposes, the Department's policy requires the recognition of operating expenses in the period incurred. 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, and expenses related to unbilled revenue. In the case of Operating Materiel and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. The Department has issued guidance under which Federal entities may expense OM&S using the purchases method of accounting rather than the consumption method. Under the consumption method, OM&S would be expensed when consumed. However, in some instances, expenditures for capital and other long-term assets may be recognized as operating expenses. The Department continues to implement process and system improvements to address these limitations.

1.G. Accounting for Intragovernmental Activities

Accounting standards require an entity to eliminate intra-entity activity and balances from consolidated financial statements to prevent overstatement for business with itself. However, the Department cannot accurately identify intragovernmental transactions by customer because the Department's systems do not track buyer and seller data at the transaction level. Generally, seller entities within the Department 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 Department seller side balances and are then eliminated. The Department is implementing replacement systems and a standard financial information structure incorporating the necessary elements to enable the Department to correctly report, reconcile, and eliminate intragovernmental balances.

The Treasury Financial Manual, Part 2, *Chapter 4700*, Agency Reporting Requirements for the Financial Report of the United States Government, provides guidance for reporting and reconciling intragovernmental balances. The Department is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees' Compensation Act transactions with the Department of Labor, and benefit program transactions with the Office of Personnel Management. The Department is taking actions to fully reconcile intragovernmental transactions with all federal agencies.

Imputed financing represents the cost paid on behalf of the Department by another Federal entity. The Department recognizes imputed costs for (1) employee pension, post retirement health, and life insurance benefits; (2) post employment benefits for terminated and inactive employees to include unemployment and workers compensation under the Federal Employees' Compensation Act; and (3) losses in litigation proceedings.

The Department's proportionate share of public debt and related expenses of the Federal Government is not included. The Federal Government does not apportion debt and related costs to federal agencies. The Department's financial statements do not report public debt, interest, or source of public financing, whether from issuance of debt or tax revenues.

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

1.H. Transactions with Foreign Governments and International Organizations

Each year, the Department sells defense articles and services to foreign governments and international organizations under the provisions of the *Arms Export Control Act of 1976*. Under the provisions of the Act, the Department has authority to sell defense articles and service to foreign countries and international organizations generally at no profit or loss to the Federal Government. Payment in U.S. dollars is required in advance.

1.I. Funds with the U.S. Treasury

The Department's monetary resources are maintained in U.S. Treasury accounts and are often referred to as "Fund Balance with Treasury". The disbursing offices of Defense Finance and Accounting Service (DFAS), the Military Departments, the U.S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the Department's cash collections, disbursements, and adjustments worldwide. Each disbursing station reports to the U.S. Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS and the USACE Finance Center report to the U.S. Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The U.S. Treasury records these transactions to the applicable Fund Balance with Treasury (FBWT) account. On a monthly basis, the Department's FBWT is reviewed and adjusted, as required, to agree with the U.S. Treasury accounts.

1.J. Cash and Other Monetary Assets

Cash is the total of cash resources under the control of the Department including coins, 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 foreign currency exchanged for U.S. dollars and foreign currency received as payment for goods or services. Foreign currencies are held in foreign currency fund accounts. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

The majority of cash and all 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 Department conducts a significant portion of operations overseas. Congress established a special account to handle the gains and losses from foreign currency transactions for five 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 gains and losses are calculated as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The Department does not separately identify foreign currency fluctuation transactions.

1.K. Accounts Receivable

Accounts receivable from other federal entities or the public include: accounts receivable, claims receivable, and refunds receivable. Allowances for uncollectible accounts due from the public are based upon an analysis of collection experience. The Department does not recognize an allowance for estimated uncollectible amounts from other federal agencies, as receivables from other federal agencies are considered to be inherently collectible. Claims for accounts receivable from other federal agencies are to be resolved between the agencies in compliance with the business rules published in Appendix 10, “Intragovernmental Transaction Guide,” of Treasury Financial Manual, Part 2, *Chapter 4700*.

The Department has fuel exchange agreements with foreign countries. These agreements allow the Department to periodically offset the accounts receivable by the amount the Department owes to the same foreign country.

1.L. Direct Loans and Loan Guarantees

The Department operates a direct loan and loan guarantee program authorized by the National Defense Authorization Act *(NDAA) for FY 1996*. The Act includes a series of authorities allowing the Department to work with the private sector to renovate military housing. The Department's goals are to obtain private capital to leverage government dollars, make efficient use of limited resources, and use a variety of private sector approaches to build and renovate military housing faster and at a lower cost to the American taxpayers.

The Act also provides the Department with a variety of authorities to obtain private sector financing and expertise to improve military housing. The Department uses these authorities individually or in combination. They include guarantees (both loan and rental), conveyance/leasing of existing property and facilities, differential lease payments, investments (both limited partnerships and stock/bond ownership), and direct loans.

The *NDAA for FY 2005* provided permanent authorities to the Military Housing Privatization Initiative (MHPI). The Department administers the Foreign Military Financing program on behalf of the EOP. This program is authorized by sections 23 and 24 of the Arms Export Control Act of 1976, as amended, and provides loans to help countries purchase U.S. produced weapons, defense equipment, services, or military training. The direct loans and loan guarantees related to Foreign Military Sales are not included in these financial statements, per Department's agreement with OMB; this information is provided separately as other information.

1.M. Inventories and Related Property

The Department values approximately 98 percent of resale inventory using the moving average cost method. Additionally, the Department reports the remaining 2 percent of resale inventories at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. The Department, when applicable, will continue to implement the adoption of *SFFAS 48*, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials", permitting alternative methods in establishing opening balances.

The Department manages only military or government-specific materiel under normal conditions. Materiel is a unique term that relates to military force management, and includes items such as ships, tanks, self propelled weapons, aircraft, etc., and related spares, repair parts, and support equipment. Items commonly used in and available from the commercial sector are not managed in the Department's materiel management activities. Operational cycles are irregular and the military risks associated with stock-out positions have no commercial parallel. The Department holds materiel based on military need and support for contingencies.

Related property includes OM&S and stockpile materiel. The OM&S, including munitions not held for sale, are valued at standard purchase price. The Department uses both the consumption method and the purchase method of accounting for OM&S. Centrally managed and stored items, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, the Department uses the purchases method. Under this method, materiel and supplies are expensed when purchased. This is a material weakness for the Department and long term system corrections are in process. Once the proper systems are in place, these items will be accounted for under the consumption method of accounting.

Many high-dollar items, such as aircraft engines, are categorized as OM&S rather than general equipment. The Department determined the recurring high dollar-value of OM&S in need of repair is material to the financial statements and requires a separate reporting category.

The Military Services recognize excess, obsolete, and unserviceable inventory and OM&S at a net realizable value of zero, pending development of an effective means of valuing such materiel.

Inventory available and purchased for resale includes consumable spare and repair parts, and repairable items owned and managed by the Department. This inventory is retained to support military or national contingencies. Inventory held for repair is damaged inventory requiring repair to make it suitable for sale. Often, it is more economical to repair these items rather than to procure them. The Department often relies on weapon systems and machinery no longer in production. As a result, the Department supports a process encouraging the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force. Work in process 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.

<u>1.N. Investments in U.S. Treasury Securities</u>

The Department reports investments in U.S. 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 yielding similar results. The Department'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 Department invests in nonmarketable market-based U.S. Treasury securities issued to federal agencies by Treasury's Bureau of the Fiscal Service. These securities are not traded on any financial exchange but are priced consistently with publically traded U.S. Treasury securities.

The Department's net investments are held by various trust and special funds. These funds include the Military Retirement Fund; Medicare-Eligible Retiree Health Care Fund; Support for U.S. Relocation to Guam Activities; donations (gift funds); and Treasury managed trust funds reported by USACE including the South Dakota Terrestrial Habitat Restoration, Inland Waterways, and Harbor Maintenance Trust Fund accounts.

Other investments represent joint ventures with private developers constructing or improving military housing on behalf of the Department under the authority of MHPI, authorized by section 2801 of the NDAA for FY 1996. These investments do not require market value disclosure. The Department's potential losses on these ventures are limited to the amounts invested.

1.O. General Property, Plant and Equipment

In some instances, the Department uses the estimated historical cost for valuing equipment. To establish a baseline, the Department accumulated information relating to program funding and associated equipment, equipment useful life, program acquisitions, and disposals. The equipment baseline was updated using expenditure, acquisition, and disposal information. The Department, when applicable, will continue to implement the adoption of *SFFAS 50*, "Establishing Opening Balances for General Property, Plant, and Equipment", permitting alternative methods in establishing opening balances.

The USACE Civil Works General Property, Plant, and Equipment (PP&E) is capitalized at acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost exceeds $25 thousand. The exception is buildings and structures related to hydropower projects, which are capitalized regardless of cost.

In addition, the Departments of the Air Force and Navy General Funds capitalize General Equipment acquisitions that are $1 million and greater. The remainder of the Department's General PP&E capitalization threshold is $250 thousand. These capitalization thresholds apply to asset acquisitions and modifications/improvements placed into service after September 30, 2013. General PP&E assets acquired prior to October 1, 2013, were capitalized at prior thresholds ($100 thousand for equipment and $20 thousand for real property).

With the exception of USACE Civil Works, General PP&E assets are capitalized at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds the Department's capitalization threshold. The Department capitalizes improvements to existing General PP&E assets if the improvements equal or exceed the capitalization threshold and extend the useful life or increase the size, efficiency, or capacity of the asset. The Department depreciates all General PP&E, other than land, on a straight-line basis.

When it is in the best interest of the government, the Department provides government property to contractors to complete contract work. The Department either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E meets or exceeds the Department's capitalization threshold, federal accounting standards require it be reported on the Department's Balance Sheet.

The Department developed policy and a reporting process for contractors with government furnished equipment providing appropriate General PP&E information for financial statement reporting. The Department requires entities maintain, in their property systems, information on all property furnished to contractors. These actions are structured to capture and report the information necessary for compliance with federal accounting standards. The Department has not fully implemented this policy primarily due to system limitations.

1.P. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, the Department's policy is to record advances or prepayments in compliance with U.S. GAAP. As such, payments made in advance of the receipt of goods and services should be reported as an asset on the Balance Sheet. The Department's policy is to expense and/or properly classify assets when the related goods and services are received. The Department has not fully implemented this policy primarily due to system limitations.

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease), and the value equals or exceeds the current capitalization threshold, the Department records the applicable asset as though purchased, with an offsetting liability, and subsequently records depreciation of the asset. The Department records the asset and liability at the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The Department, as the lessee, receives the use and possession of leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all the benefits and risks of ownership. Payments for operating leases are expensed over the lease term.

Office space leases entered into by the Department comprise the largest value of operating leases and are based on costs gathered from existing leases, General Services Administration bills, and interservice support agreements.

1.R. Other Assets

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on the Department's Balance Sheet.

The Department conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden to contractors from long-term contracts, the Department may provide financing payments. Contract financing payments are defined in the *Federal Acquisition Regulation, Part 32*, as authorized disbursements to a contractor prior to acceptance of supplies or services by the Government. 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 cost, and interim payments under certain cost-reimbursement contracts. It is the Department's policy to record certain contract financing payments as other assets. The Department has not fully implemented this policy primarily due to system limitations.

Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion. The *Defense Federal Acquisition Regulation Supplement* authorizes progress payments based on a percentage or stage of completion 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.

1.S. Contingencies and Other Liabilities

The *SFFAS 5*, "Accounting for Liabilities of the Federal Government," as amended by *SFFAS 12*, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances involving an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The Department 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 Department'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.

Other liabilities also arise as a result of anticipated disposal costs for the Department's assets. Consistent with *SFFAS 6*, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Based on the Department's policy, consistent with SFFAS 6, nonenvironmental disposal liabilities are recognized when management decides to dispose of an asset. In addition, the Department recognizes nonenvironmental disposal liabilities for nuclear-powered military equipment when placed into service. These amounts are not easily distinguishable and are developed in conjunction with environmental disposal costs.

1.T. Accrued Leave

The Department reports liabilities for military leave and accrued compensatory and annual leave for civilians. Sick leave for civilians is expensed when taken. The liabilities are based on current pay rates.

1.U. Net Position

Net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

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

1.V. Treaties for Use of Foreign Bases

The Department has the use of land, buildings, and other overseas facilities obtained through various international treaties and agreements negotiated by the Department of State. The Department purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. Treaty terms generally allow the Department 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 nonretrievable capital assets. The settlement due to the United States or host nation is negotiated and takes into account the value of capital investments and may be offset by the environmental cleanup cost, if applicable.

1.W. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to specific obligations, payables, or receivables in the source systems and those reported by U.S. Treasury.

Supported disbursements and collections have corroborating documentation for the summary level adjustments made to accounts payable and receivable. Unsupported disbursements and collections do not have supporting documentation for the transaction and most likely would not meet audit scrutiny. Both supported and unsupported adjustments may have been made to the Department's accounts payable and receivable trial balances prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the Department generally cannot determine whether undistributed disbursements and collections should be applied to federal or nonfederal accounts payable/receivable at the time accounting reports are prepared. Accordingly, the Department's policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of distributed federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements and collections are also applied to reduce accounts payable and receivable accordingly.

1.X. Fiduciary Activities

Fiduciary cash and other assets are not assets of the Department and are not recognized on the Balance Sheet. Fiduciary activities are reported on the financial statement note schedules.

1.Y. Military Retirement and Other Federal Employment Benefits

The Department applies *SFFAS 33*, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates," in selecting the discount rate and valuation date used in estimating actuarial liabilities. In addition, gains and losses from changes in long-term assumptions used to estimate the actuarial liability are presented separately on the Statement of Net Cost. Refer to Note 17, Military Retirement and Other Federal Employment Benefits and Note 18, General Disclosures Related to the Statement of Net Cost, for additional information.

The jump master passes final direction to Marines with the 15th Marine Expeditionary Unit Maritime Raid Force before conducting a night jump during Realistic Urban Terrain training at Twentynine Palms, March 6, 2017. RUT is a land-based exercise that provides an opportunity to integrate unique skills and develop the MEU's collective proficiency in challenging and unfamiliar environments. The 15th MEU's rapid ability to mobilize people and equipment makes the amphibious force uniquely postured to respond to any mission at a moment's notice.

Photo by Cpl. Timothy Valero

Note 2. Nonentity Assets

Nonentity Assets *As of September 30*	2017	2016
Dollars in Millions		
Intragovernmental Assets		
Fund Balance with Treasury	$ 2,895.1	$ 2,216.7
Accounts Receivable	55.8	54.1
Total Intragovernmental Assets	**$ 2,950.9**	**$ 2,270.8**
Non-Federal Assets		
Cash and Other Monetary Assets	$ 946.2	$ 1,063.5
Accounts Receivable	2,338.9	3,080.2
Other Assets	0.0	0.0
Total Non-Federal Assets	**$ 3,285.1**	**$ 4,143.7**
Total Nonentity Assets	**$ 6,236.0**	**$ 6,414.5**
Total Entity Assets	**$ 2,559,478.4**	**$ 2,396,939.1**
Total Assets	**$ 2,565,714.4**	**$ 2,403,353.6**

Nonentity assets are not available for use in the Department's normal operations. The Department has stewardship accountability and reporting responsibility for nonentity assets.

Abnormal Balance

In FY 2017, Total Entity Assets includes a $7.2 million abnormal balance in USSGL 159100, Other Related Property. In FY 2016 the abnormal balance was $5.4 million. The issue has been identified and the Department is in the process of correcting in FY 2018.

Other Disclosures

Intragovernmental Fund Balance with Treasury (FBWT) consists primarily of deposit funds and receipt accounts. Deposit funds represent amounts held temporarily until paid to the appropriate party. Receipt accounts represent amounts collected on behalf of the U.S. Treasury General Fund.

Non-Federal Cash and Other Monetary Assets consist primarily of cash held by Disbursing Officers to carry out payment, collection, and foreign currency exchanges.

Non-Federal Accounts Receivable consists of amounts associated with canceled year appropriations, and interest, fines and penalties due on debt. Generally, the Department cannot use the collections and must remit them to the U.S. Treasury.

NOTE 3. FUND BALANCE WITH TREASURY

Fund Balance with Treasury		*Dollars in Millions*
As of September 30	**2017**	**2016**
Fund Balance		
Appropriated Funds	$ 481,302.8	$ 457,587.2
Revolving Funds	13,132.2	10,065.0
Trust Funds	3,082.3	3,304.7
Special Funds	1,477.2	1,368.9
Other Fund Types	2,625.9	1,963.2
Total Fund Balance	**$ 501,620.4**	**$ 474,289.0**
Fund Balance Per Treasury Versus Agency		
Fund Balance per Treasury	$ 501,987.0	$ 474,480.0
Less: Fund Balance per Agency	(501,620.4)	(474,289.0)
Reconciling Amount	**$ 366.6**	**$ 191.0**

Other Fund Types primarily consist of deposit funds and receipt accounts. These funds represent receipts held temporarily for distribution to another fund or entity or held as an agent for others.

In FY 2017 the Department shows a reconciling net difference of $366.6 million with the U.S. Treasury between the Department's financial statement records and Treasury. This includes net allocation transfers of $288.8 million as well as fiduciary activities of $77.8 million. In FY 2016 the Department's reconciling net difference was $191.0 million and consisted of allocation transfers of $108.0 million, fiduciary activities of $80.1 million, and other reconciling items of $2.9 million. The Department received allocation transfers as the "child entity." As "parent entity," the Department issued allocation transfers to other Federal Government agencies for execution on behalf of the Department. For additional information, refer to Note 1, Significant Accounting Policies, Section 1C. Additionally, Fiduciary Activities are not reported in FBWT in accordance with SFFAS 31, *"Accounting for Fiduciary Activities."*

Beginning in FY 2017, the Department is disclosing the amount of undistributed collection and disbursement adjustments. The amount reported in Fund Balance per Agency includes undistributed collection adjustments of $2.7 billion, $2.3 billion are unsupported. Undistributed disbursement adjustments totaled $2.9 billion, $968.2 million are unsupported.

Status of Fund Balance with Treasury		*Dollars in Millions*
As of September 30	**2017**	**2016**
Unobligated Balances		
Available	$ 123,203.5	$ 115,130.6
Unavailable	924,233.1	846,765.2
Total Unobligated Balance	**1,047,436.6**	**961,895.8**
Obligated Balance not yet Disbursed	**438,931.2**	**407,053.7**
Non-Budgetary FBWT	**2,956.1**	**2,809.4**
Non-FBWT Budgetary Accounts	**(987,703.5)**	**(897,469.9)**
Total Fund Balance	**$ 501,620.4**	**$ 474,289.0**

Other Disclosures

The Status of FBWT, as presented in the table above, reflects the budgetary resources to support FBWT and is a reconciliation between budgetary and proprietary accounts. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursements against current or future obligations.

Unobligated Balance is classified as available or unavailable and represents the cumulative amount of budgetary authority set aside to cover future obligations. The unavailable balance consists primarily of funds invested in U.S. Treasury securities and are temporarily precluded from obligation by law. Certain unobligated balances are restricted for future use and are not apportioned for current use. Unobligated balances for trust fund accounts are restricted for use by public laws establishing the funds.

Obligated Balance not yet Disbursed represents funds obligated for goods and services but not paid.

Non-Budgetary FBWT includes accounts without budgetary authority, such as deposit funds, unavailable receipt accounts, clearing accounts, and nonentity FBWT.

Non-FBWT Budgetary Accounts reduce the Status of FBWT and consist of investments in U.S. Treasury securities, unfilled customer orders without advance, contract and borrowing authority, and receivables.

Members of U.S. Pacific Fleet Band's Pipeline roll through a Jazz standard during a concert at Universiti Malaysia Sarawak as part of a music exchange during Pacific Partnership 2017 Kuching, Malaysia, April 17. Pacific Partnership is the largest annual multilateral humanitarian assistance and disaster relief preparedness mission conducted in the Indo-Asia-Pacific and aims to enhance regional coordination in areas such as medical readiness and preparedness for manmade and natural disasters.

Photo by Mass Communication Specialist 1st Class Micah Blechner

NOTE 4. INVESTMENTS AND RELATED INTEREST

Investments and Related Interest					*Dollars in Millions*
	2017				
As of September 30	Cost	Amortization Method	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities					
Nonmarketable, Market-Based					
Military Retirement Fund	$ 755,224.4	See Below	$ (31,092.9)	$ 724,131.5	$ 779,882.2
Medicare-Eligible Retiree Health Care Fund	262,142.0	See Below	(13,604.4)	248,537.6	280,882.8
US Army Corps of Engineers	9,257.2	See Below	(67.3)	9,189.9	9,184.1
Other Funds	2,619.5	See Below	(114.8)	2,504.7	2,530.4
Total Nonmarketable, Market-Based	**$ 1,029,243.1**		**$ (44,879.4)**	**$ 984,363.7**	**$ 1,072,479.5**
Accrued Interest	7,370.2		0.0	7,370.2	7,370.3
Total Intragovernmental Securities	**$ 1,036,613.3**		**$ (44,879.4)**	**$ 991,733.9**	**$ 1,079,849.8**
Other Investments					
Total Other Investments	**$ 3,511.6**	**See Below**	**$ 0.0**	**$ 3,511.6**	**N/A**
Amortization Method Used: Effective Interest					

Investments and Related Interest					*Dollars in Millions*
	2016				
As of September 30	Cost	Amortization Method	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Intragovernmental Securities					
Nonmarketable, Market-Based					
Military Retirement Fund	$ 684,211.3	See Below	$ (29,836.4)	$ 654,374.9	$ 754,114.1
Medicare-Eligible Retiree Health Care Fund	250,500.2	See Below	(12,839.8)	237,660.4	284,553.0
US Army Corps of Engineers	8,928.9	See Below	(60.9)	8,868.0	8,894.7
Other Funds	2,430.1	See Below	(135.1)	2,295.0	2,360.7
Total Nonmarketable, Market-Based	**$ 946,070.5**		**$ (42,872.2)**	**$ 903,198.3**	**$ 1,049,922.5**
Accrued Interest	7,369.6		0.0	7,369.6	7,369.6
Total Intragovernmental Securities	**$ 953,440.1**		**$ (42,872.2)**	**$ 910,567.9**	**$ 1,057,292.1**
Other Investments					
Total Other Investments	**$ 3,521.7**	**See Below**	**$ 0.0**	**$ 3,521.7**	**N/A**
Amortization Method Used: Effective Interest					

The Department invests primarily in non-marketable, market-based U.S. Treasury securities. The value of these securities fluctuates in tandem with the selling price of the equivalent marketable security. Securities are purchased with the intent to hold until maturity; thus, balances are not adjusted to market value.

The U.S. Treasury securities are issued to authorized funds and are an asset to the Department and a liability to the U.S. Treasury. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with these funds. Cash generated is deposited in the U.S. Treasury and used for general Government purposes. Since the Department and the U.S. Treasury are both part of the Federal Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements.

The U.S. Treasury securities provide the Department with authority to access funds to make future benefit payments or other expenditures. When the Department requires redemption of securities to make expenditures, the Federal Government will meet the requirement by using accumulated cash balances, raising taxes or other receipts, borrowing from the public or repaying less debt, or curtailing other expenditures. The Federal Government uses the same method to finance all other expenditures.

In FY 2017, Other Funds primarily consists of $1.2 billion in investments of the Support for U.S. Relocation to Guam Activities Trust Fund and $1.1 billion in investments of the DoD Education Benefits Trust Fund. In FY 2016 Other Funds primarily consisted of $1.3 billion in investments of the DoD Education Benefits Trust Fund and $778.2 million in investments of the Support for U.S. Relocation to Guam Activities Trust Fund.

Other Investments consists of Military Housing Privatization Initiative limited partnerships. The Department invests in nongovernmental entities involved in the acquisition or construction of family housing and supporting facilities at Army, Air Force, Navy, and Marine Corps installations. The Department provides cash, land, or facilities as equity, but has no management role. A limited partnership arrangement operates purely as a private business and does not require Market Value Disclosure.

NOTE 5. ACCOUNTS RECEIVABLE

Accounts Receivable			*Dollars in Millions*
	2017		
As of September 30	**Gross Amount Due**	**Allowance for Estimated Uncollectibles**	**Accounts Receivable, Net**
Intragovernmental Receivables	$ 2,055.0	N/A	$ 2,055.0
Non-Federal Receivables (From the Public)	6,061.9	(817.8)	5,244.1
Total Accounts Receivable	**$** 8,116.9	**$** (817.8)	**$** 7,299.1

Accounts Receivable			*Dollars in Millions*
	2016		
As of September 30	**Gross Amount Due**	**Allowance for Estimated Uncollectibles**	**Accounts Receivable, Net**
Intragovernmental Receivables	$ 1,907.6	N/A	$ 1,907.6
Non-Federal Receivables (From the Public)	7,278.9	(358.8)	6,920.1
Total Accounts Receivable	**$** 9,186.5	**$** (358.8)	**$** 8,827.7

Accounts receivable represent the Department's claim for payment from other entities. The Department only recognizes an allowance for uncollectible amounts from the public. Allowances for uncollectible accounts due from the public are based on an analysis of collection experience. Claims with other Federal agencies are resolved in accordance with the Intragovernmental Business Rules.

Note 6. Other Assets

Other Assets		*Dollars in Millions*
As of September 30	**2017**	**2016**
Intragovernmental Other Assets		
Advances and Prepayments	$ 798.6	$ 1,116.0
Other Assets	128.6	137.4
Total Intragovernmental Other Assets	**$ 927.2**	**$ 1,253.4**
Non-Federal Other Assets		
Outstanding Contract Financing Payments	$ 25,397.3	$ 31,560.8
Advances and Prepayments	3,980.0	3,556.9
Other Assets (With the Public)	12.7	12.9
Total Non-Federal Other Assets	**$ 29,390.0**	**$ 35,130.6**
Total Other Assets	**$ 30,317.2**	**$ 36,384.0**

Contract terms and conditions for certain types of contract financing payments convey rights to the Department, 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 should not be misconstrued to mean that ownership of contractors' work has transferred to the Department. The Department does not have the right to take the work, except as provided for in contract clauses related to termination or acceptance. The Department is not obligated to make payment to contractors until delivery and acceptance.

Intragovernmental Other Assets are largely related to the Department's right to approximately 6.4 million barrels of crude oil, net book value of $123.3 million, held by the Department of Energy. The value for this asset remains unchanged from FY 2016.

The Other Assets (With the Public) balance includes liquidated damages, asset donations, and assets awaiting disposal.

In FY 2017, Outstanding Contract Financing Payments includes $20.0 billion in contract financing payments and an additional $5.4 billion in estimated future payments to contractors upon delivery and government acceptance. In FY 2016 Outstanding Contract Financing Payments included $26.2 billion in contract financing payments and an additional $5.4 billion in estimated future payments to contractors upon delivery and government acceptance. The Department is currently implementing the requirements for properly reporting Contract Financing Payments and Construction in Progress in accordance with existing internal guidance. Refer to Note 15, Other Liabilities, for additional details.

NOTE 7. CASH AND OTHER MONETARY ASSETS

Cash and Other Monetary Assets		*Dollars in Millions*
As of September 30	**2017**	**2016**
Cash	$ 462.7	$ 384.2
Foreign Currency	657.0	768.1
Total Cash, Foreign Currency, and Other Monetary Assets	**$ 1,119.7**	**$ 1,152.3**

The majority of Cash and all Foreign Currency represent nonentity assets and are restricted and unavailable to fund the Department's mission. In FY 2017, cash includes unrestricted entity assets of $172.3 million comprised of undeposited collections and other cash. In FY 2016, cash included unrestricted entity assets of $87.2 million comprised of undeposited collections and other cash.

A U.S. Army Ranger fast ropes out of a UH-60 Black Hawk helicopter during the Best Ranger Competition 2017 in Fort Benning, Ga., April 7, 2017. The 34th annual David E. Grange Jr. Best Ranger Competition 2017 is a three-day event consisting of challenges to test competitor's physical, mental, and technical capabilities.

Photo by Staff Sgt. Marianique Santos

NOTE 8. DIRECT LOAN AND LOAN GUARANTEES

The Department operates loan guarantee programs for MHPI.

The *Federal Credit Reform Act of 1990* governs all new and amended direct loan obligations and loan guarantee commitments made after FY 1991.

Direct loans are reported at the net present value (NPV) of the following projected cash flows:

- Loan disbursements;
- Repayments of principal; and
- Payments of interest and other payments over the life of the loan after adjusting for estimated defaults, prepayments, fees, penalties, and other recoveries.

Loan guarantee liabilities are reported at the NPV. The cost of the loan guarantee is the NPV of the following estimated projected cash flows:

- Payments by the Department to cover defaults and delinquencies, interest subsidies, or other payments; offset by payments to the Department including origination and other fees, penalties, and recoveries.

Military Housing Privatization Initiative

The MHPI includes both direct loan and loan guarantee programs. The programs are authorized by section 2801 of the *National Defense Authorization Act for FY 1996* and includes a series of authorities allowing the Department to work with the private sector to renovate and build military family housing. The MHPI accelerates the construction of new housing built to market standards and obtains private sector capital to leverage government funds. The Department provides protection to private sector partners against specific risks, such as base closure or member deployment.

Summary of Direct Loans and Loan Guarantees		*Dollars in Millions*
As of September 30	**2017**	**2016**
Loans Receivable		
Direct Loans:		
Military Housing Privatization Initiative	$ 1,644.2	$ 1,603.9
Total Direct Loans	**$ 1,644.2**	**$ 1,603.9**
Total Loans Receivable	**$ 1,644.2**	**$ 1,603.9**
Loan Guarantee Liability		
Military Housing Privatization Initiative	$ 65.2	$ 70.9
Total Loan Guarantee Liability	**$ 65.2**	**$ 70.9**

Direct Loans Obligated		*Dollars in Millions*
As of September 30	**2017**	**2016**
Direct Loans Obligated After FY 1991 (Present Value Method):		
Military Housing Privatization Initiative		
Loans Receivable Gross	$ 1,704.6	$ 1,667.4
Allowance for Subsidy Cost (Present Value)	(60.4)	(63.5)
Value of Assets Related to Direct Loans, Net	**1,644.2**	**1,603.9**
Total Direct Loans Receivable	**$ 1,644.2**	**$ 1,603.9**

Direct Loans Receivable does not represent proceeds the Department would expect to receive from selling the loans, and includes interest receivable. Interest receivable is calculated using the interest earned method.

Total Amount of Direct Loans Disbursed		*Dollars in Millions*
As of September 30	**2017**	**2016**
Direct Loan Programs		
Military Housing Privatization Initiative	$ 56.3	$ 126.3
Total	**$ 56.3**	**$ 126.3**

Subsidy Expense for Direct Loan by Program					*Dollars in Millions*
2017	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
New Direct Loans Disbursed					
Military Housing Privatization Initiative	$ 1.0	$ 11.8	$ 0.0	$ 0.0	$ 12.8
Total	**$ 1.0**	**$ 11.8**	**$ 0.0**	**$ 0.0**	**$ 12.8**

2016	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
New Direct Loans Disbursed					
Military Housing Privatization Initiative	$ (2.4)	$ 15.9	$ 0.0	$ 0.0	$ 13.5
Total	**$ (2.4)**	**$ 15.9**	**$ 0.0**	**$ 0.0**	**$ 13.5**

2017	Modifications	Interest Rate Reestimates	Technical Reestimates	Total
Direct Loan Modifications and Reestimates				
Military Housing Privatization Initiative	$ 0.0	$ 6.1	$ (20.3)	$ (14.2)
Total	**$ 0.0**	**$ 6.1**	**$ (20.3)**	**$ (14.2)**

2016	Modifications	Interest Rate Reestimates	Technical Reestimates	Total
Direct Loan Modifications and Reestimates				
Military Housing Privatization Initiative	$ 0.0	$ 19.4	$ 6.6	$ 26.0
Total	**$ 0.0**	**$ 19.4**	**$ 6.6**	**$ 26.0**

	2017	2016
Total Direct Loan Subsidy Expense:		
Military Housing Privatization Initiative	$ (1.4)	$ 39.5
Total	**$ (1.4)**	**$ 39.5**

Subsidy Rates for Direct Loan by Program					
As of September 30, 2017	Interest Differential	Defaults	Fees	Other	Total
Budget Subsidy Rates for Direct Loans					
Military Housing Privatization Initiative	0.0%	0.0%	0.0%	0.0%	0.0%

Subsidy rates pertain to loan agreements contracted during the current fiscal year. There were no new loan agreements.

These rates cannot be applied to direct loans disbursed during the current reporting year to yield the subsidy expense. Subsidy expense for new loans disbursed in the current year results from disbursements of loans from current and prior year loan agreements. Subsidy expense reported in the current year also includes reestimates.

Schedule for Reconciling Subsidy Cost Allowance Balances for Post-FY 1991 Direct Loans		*Dollars in Millions*	
As of September 30	**2017**		**2016**
Beginning Balance, Changes, and Ending Balance:			
Beginning Balance of the Subsidy Cost Allowance	**$**	**63.5**	**$**	**31.2**
Add: Subsidy Expense for Direct Loans Disbursed during the Reporting Years by Component				
Interest Rate Differential Costs		1.0		(2.4)
Default Costs (Net of Recoveries)		11.8		15.9
Total of the above Subsidy Expense Components	**$**	**12.8**	**$**	**13.5**
Adjustments				
Subsidy Allowance Amortization		(1.7)		(7.2)
Total of the above Adjustment Components	**$**	**(1.7)**	**$**	**(7.2)**
Ending Balance of the Subsidy Cost Allowance before Reestimates	**$**	**74.6**	**$**	**37.5**
Add or Subtract Subsidy Reestimates by Component				
Interest Rate Reestimates	$	6.1	$	19.4
Technical/Default Reestimate		(20.3)		6.6
Total of the above Reestimate Components		**(14.2)**		**26.0**
Ending Balance of the Subsidy Cost Allowance	**$**	**60.4**	**$**	**63.5**

Guaranteed Loans Outstanding		*Dollars in Millions*		
As of September 30	**Outstanding Principal of Guaranteed Loans, Face Value**		**Amount of Outstanding Principal Guaranteed**	
2017				
Guaranteed Loans Outstanding				
Military Housing Privatization Initiative	$	1,074.2	$	1,074.2
Total	**$**	**1,074.2**	**$**	**1,074.2**
2016				
Guaranteed Loans Outstanding				
Military Housing Privatization Initiative	$	958.9	$	958.9
Total	**$**	**958.9**	**$**	**958.9**
2017				
New Guaranteed Loans Disbursed				
Military Housing Privatization Initiative	$	115.3	$	115.3
Total	**$**	**115.3**	**$**	**115.3**
2016				
New Guaranteed Loans Disbursed				
Military Housing Privatization Initiative	$	84.2	$	84.2
Total	**$**	**84.2**	**$**	**84.2**

Liabilities for Loan Guarantees	*Dollars in Millions*	
As of September 30	**2017**	**2016**
Liabilities for Loan Guarantee from Post- FY 1991 (Present Value)		
Military Housing Privatization Initiative	$ 65.2	$ 70.9
Total Loan Guarantee Liability (Post-FY 1991)	**$ 65.2**	**$ 70.9**
Total Loan Guarantee Liability	**$ 65.2**	**$ 70.9**

Subsidy Expense for Loan Guarantees by Program
As of September 30 *Dollars in Millions*

2017	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
New Loan Guarantees Disbursed					
Military Housing Privatization Initiative	$ 0.0	$ 12.0	$ 0.0	$ 0.0	$ 12.0
Total	**$ 0.0**	**$ 12.0**	**$ 0.0**	**$ 0.0**	**$ 12.0**

2016	**Interest Differential**	**Defaults**	**Fees**	**Other**	**Total**
New Loan Guarantees Disbursed					
Military Housing Privatization Initiative	$ 0.0	$ 12.0	$ 0.0	$ 0.0	$ 12.0
Total	**$ 0.0**	**$ 12.0**	**$ 0.0**	**$ 0.0**	**$ 12.0**

2017	**Modifications**	**Interest Rate Reestimates**	**Technical Reestimates**	**Total Reestimates**	**Total**
Modifications and Reestimates					
Military Housing Privatization Initiative	$ 0.0	$ (3.3)	$ (16.5)	$ (19.8)	$ (19.8)
Total	**$ 0.0**	**$ (3.3)**	**$ (16.5)**	**$ (19.8)**	**$ (19.8)**

2016	**Modifications**	**Interest Rate Reestimates**	**Technical Reestimates**	**Total Reestimates**	**Total**
Modifications and Reestimates					
Military Housing Privatization Initiative	$ 0.0	$ (2.0)	$ (7.7)	$ (9.7)	$ (9.7)
Total	**$ 0.0**	**$ (2.0)**	**$ (7.7)**	**$ (9.7)**	**$ (9.7)**

	2017	**2016**
Total Loan Guarantee		
Military Housing Privatization Initiative	$ (7.8)	$ 2.3
Total	**$ (7.8)**	**$ 2.3**

Subsidy Rates for Loan Guarantees by Program					
As of September 30, 2017	**Interest Supplements**	**Defaults**	**Fees and other Collections**	**Other**	**Total**
Budget Subsidy Rates for Loan Guarantees					
Military Housing Privatization Initiative	0.0%	0.0%	0.0%	0.0%	0.0%

Subsidy rates pertain to loan agreements contracted during the current fiscal year. There were no new loan agreements.

These rates cannot be applied to loan guarantees agreed to during the current reporting year to yield the subsidy expense. Subsidy expense reported in the current year also includes reestimates.

Schedule for Reconciling Loan Guarantee Liability Balances for Post-FY 1991 Loan Guarantees		*Dollars in Millions*
As of September 30	**2017**	**2016**
Beginning Balance, Changes, and Ending Balance		
Beginning Balance of the Loan Guarantee Liability	**$ 70.9**	**$ 66.5**
Add: Subsidy Expense for Guaranteed Loans Disbursed during the Reporting Years by Component		
Default Costs (Net of Recoveries)	12.0	12.0
Total of the above Subsidy Expense Components	**$ 12.0**	**$ 12.0**
Adjustments		
Interest Accumulation on the Liability Balance	2.1	2.1
Total of the above Adjustments	**$ 2.1**	**$ 2.1**
Ending Balance of the Loan Guarantee Liability before Reestimates	**$ 85.0**	**$ 80.6**
Add or Subtract Subsidy Reestimates by Component		
Interest Rate Reestimate	$ (3.3)	$ (2.0)
Technical/Default Reestimate	(16.5)	(7.7)
Total of the above Reestimate Components	**$ (19.8)**	**$ (9.7)**
Ending Balance of the Loan Guarantee Liability	**$ 65.2**	**$ 70.9**

Administrative Expenses

Administrative Expenses are limited to separately identified expenses for administering pre-FY 1992 and post-FY 1991 Direct Loans and Loan Guarantee Programs.

NOTE 9. INVENTORY AND RELATED PROPERTY

Inventory and Related Property				*Dollars in Millions*
As of September 30		**2017**		**2016**
Inventory, Net	$	94,904.0	$	94,832.4
Operating Materiel & Supplies, Net		171,049.9		159,304.7
Stockpile Materiel, Net		806.6		1,152.8
Total Inventory and Related Property	**$**	**266,760.5**	**$**	**255,289.9**

Inventory, Net							*Dollars in Millions*
	2017						**Valuation Method**
As of September 30	**Inventory, Gross Value**		**Revaluation Allowance**		**Inventory, Net**		
Inventory Categories							
Available and Purchased for Resale	$	61,251.2	$	(49.2)	$	61,202.0	MAC, LAC
Held for Repair		35,051.3		(4,473.4)		30,577.9	MAC, LAC
Excess, Obsolete, and Unserviceable		869.3		(388.6)		480.7	NRV
Raw Materiel		1,083.4		0.0		1,083.4	MAC, LAC
Work in Process		1,560.0		0.0		1,560.0	MAC
Total Inventory, Net	**$**	**99,815.2**	**$**	**(4,911.2)**	**$**	**94,904.0**	
Legend for Valuation Methods:							
LAC = Latest Acquisition Cost, adjusted for holding gains and losses					MAC = Moving Average Cost		
					NRV = Net Realizable Value		

Inventory, Net							*Dollars in Millions*
	2016						**Valuation Method**
As of September 30	**Inventory, Gross Value**		**Revaluation Allowance**		**Inventory, Net**		
Inventory Categories							
Available and Purchased for Resale	$	61,871.8	$	50.3	$	61,922.1	MAC, LAC
Held for Repair		33,765.6		(3,646.6)		30,119.0	MAC, LAC
Excess, Obsolete, and Unserviceable		1,087.2		(646.1)		441.1	NRV
Raw Materiel		1,188.4		0.0		1,188.4	MAC, LAC
Work in Process		1,161.8		0.0		1,161.8	AC
Total Inventory, Net	**$**	**99,074.8**	**$**	**(4,242.4)**	**$**	**94,832.4**	
Legend for Valuation Methods:							
LAC = Latest Acquisition Cost, adjusted for holding gains and losses					MAC = Moving Average Cost		
AC = Actual Cost					NRV = Net Realizable Value		

Abnormal Balance

FY 2017 Inventory Available and Purchased for Resale includes a $7.2 million abnormal balance in USSGL 159100, Other Related Property. In FY 2016 the abnormal balance was $5.4 million. The issue has been identified and the Department is in the process of correcting in FY 2018.

Inventory Restrictions

The following are the categories of inventory which are subject to restrictions on use, sale, or disposition:

- War reserve materiel valued at $2.6 billion in FY 2017 ($2.5 billion in FY 2016);
- Defense Commissary Agency inventory valued at $365.8 million in FY 2017 ($404.0 million in FY 2016), consisting of grocery, meat, and produce items, limited for resale to authorized commissary patrons; and
- Dispositions pending litigation or negotiation valued at $ 134.3 million in FY 2017 ($119.1 million in FY 2016).

There are no known restrictions on inventory disposition related to environmental or other liabilities.

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, and fuels held for sale. Inventory is tangible personal property such as:

- Raw materials to be consumed in the production of goods for sale or in the provision of service for a fee.
- Work in process awaiting completion.
- Finished goods held for sale, or held for repair and eventual sale.

The Department assigns inventory items to a category based on asset type and condition.

Items awaiting sale, disposal, or reuse are valued at $480.7 million in FY 2017 and $441.1 million in FY 2016.

Operating Materiel and Supplies, Net				*Dollars in Millions*
	2017			**Valuation Method**
As of September 30	**OM&S, Gross Value**	**Revaluation Allowance**	**OM&S, Net**	
OM&S Categories				
Held for Use	$ 140,300.4	$ 0.0	$ 140,300.4	LAC, MAC
Held for Repair	30,749.5	0.0	30,749.5	LAC, MAC
Excess, Obsolete, and Unserviceable	2,458.3	(2,458.3)	0.0	NRV
Total OM&S	**$ 173,508.2**	**$ (2,458.3)**	**$ 171,049.9**	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost, adjusted for holding gains and losses NRV = Net Realizable Value
MAC = Moving Average Cost

Operating Materiel and Supplies, Net				*Dollars in Millions*
	2016			**Valuation Method**
As of September 30	**OM&S, Gross Value**	**Revaluation Allowance**	**OM&S, Net**	
OM&S Categories				
Held for Use	$ 104,985.0	$ 25.3	$ 105,010.3	LAC, MAC
Held for Repair	54,294.4	0.0	54,294.4	LAC, MAC
Excess, Obsolete, and Unserviceable	2,149.6	(2,149.6)	0.0	NRV
Total OM&S	**$ 161,429.0**	**$ (2,124.3)**	**$ 159,304.7**	

Legend for Valuation Methods:
LAC = Latest Acquisition Cost, adjusted for holding gains and losses   NRV = Net Realizable Value
MAC = Moving Average Cost

OM&S Restrictions

Some munitions included in OM&S are restricted due to condition. Restricted munitions are considered obsolete or unserviceable when they cannot meet performance requirements. However, obsolete and unserviceable OM&S may be used in emergency combat situations when no other suitable munitions are immediately available.

General Composition of OM&S

OM&S include spare and repair parts, ammunition, tactical missiles, aircraft configuration pods, and centrally managed aircraft engines held for consumption. The Department assigns OM&S items to a category based on asset type and condition.

Other Disclosures

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards *(SFFAS) 48*, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials" permitting alternative methods in establishing opening balances. SFFAS 48 is effective for periods beginning after September 30, 2016 with early implementation allowed. Some activities within the Department used the deemed cost measures from this standard for FY 2016; additional components used the deemed cost measures from the standard in FY 2017 using a combination of standard price (selling price), latest acquisition cost, estimated historical cost, and historical cost as the basis for valuation.

Stockpile Materiel, Net				*Dollars in Millions*
	2017			
As of September 30	Stockpile, Materiel Amount	Allowance for Gains (Losses)	Stockpile, Materiel, Net	Valuation Method
Stockpile Materiel Categories				
Held for Sale	$ 19.6	$ 0.0	$ 19.6	AC, LCM
Held for Reserve for Future Sale	787.0	0.0	787.0	AC, LCM
Total Stockpile Materiel	**$ 806.6**	**$ 0.0**	**$ 806.6**	
Legend for Valuation Methods:				
AC = Actual Cost			LCM = Lower of Cost or Market	

Stockpile Materiel, Net				*Dollars in Millions*
	2016			
As of September 30	Stockpile, Materiel Amount	Allowance for Gains (Losses)	Stockpile, Materiel, Net	Valuation Method
Stockpile Materiel Categories				
Held for Sale	$ 4.2	$ 0.0	$ 4.2	AC, LCM
Held for Reserve for Future Sale	1,148.6	0.0	1,148.6	AC, LCM
Total Stockpile Materiel	**$ 1,152.8**	**$ 0.0**	**$ 1,152.8**	
Legend for Valuation Methods:				
AC = Actual Cost			LCM = Lower of Cost or Market	

Stockpile Materiel Restrictions

Materiel held by the National Defense Stockpile (NDS) is restricted unless released by congressional action and made available for sale on the open market. Stockpile materiel may not be disposed except for: (1) necessary upgrading, refining, or processing; (2) necessary rotation to prevent deterioration; (3) determination as excess with potential financial loss if retained; or (4) authorization by law.

Before selling any materiel, Congress must enact specific enabling legislation (e.g., the National Defense Authorization Act). When authorized to offer materiel for sale, NDS reclassifies from Materiel Held in Reserve to Materiel Held for Sale.

General Composition of Stockpile Materiel

Due to statutory requirements, the Department holds strategic and critical stockpile materiel for use in national defense, conservation, or national emergencies. The estimated market price of stockpile materiel as of September 30, 2017, is $1.1 billion ($1.2 billion in FY 2016).

NOTE 10. GENERAL PP&E, NET

General PP&E, Net					*Dollars in Millions*
	2017				
As of September 30	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 10,615.4	N/A	$ 10,615.4
Buildings, Structures, and Facilities	S/L	35, 40 or 45[1]	407,135.0	(248,252.3)	158,882.7
Leasehold Improvements	S/L	Lease term	560.2	(293.2)	267.0
Software	S/L	2 – 5 or 10	9,069.5	(4,787.3)	4,282.2
General Equipment	S/L	Various	1,103,474.6	(637,223.7)	466,250.9
Assets Under Capital Lease	S/L	Lease term	353.7	(242.7)	111.0
Construction-in-Progress	N/A	N/A	109,992.1	N/A	109,992.1
Other	N/A	N/A	11,306.8	(0.3)	11,306.5
Total General PP&E			**$ 1,652,507.3**	**$ (890,799.5)**	**$ 761,707.8**

[1] *Based on a periodic reevaluation of useful lives, DoD management adjusted the Estimated Useful Lives of Buildings, Structures, and Facilities as follows: 45 years (Buildings), 35 Years (Structures), and 40 Years (Linear Structures).*

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

General PP&E, Net					*Dollars in Millions*
	2016				
As of September 30	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ 10,658.7	N/A	$ 10,658.7
Buildings, Structures, and Facilities	S/L	20 or 40	384,144.7	(230,145.3)	153,999.4
Leasehold Improvements	S/L	Lease term	584.9	(265.3)	319.6
Software	S/L	2 – 5 or 10	9,464.5	(6,043.5)	3,421.0
General Equipment	S/L	5 or 10	1,054,528.7	(639,666.1)	414,862.6
Assets Under Capital Lease	S/L	Lease term	353.7	(226.0)	127.7
Construction-in-Progress	N/A	N/A	118,089.1	N/A	118,089.1
Other	N/A	N/A	10,250.1	(11.0)	10,239.1
Total General PP&E			**$ 1,588,074.4**	**$ (876,357.2)**	**$ 711,717.2**

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

Assets Under Capital Lease *As of September 30*	*Dollars in Millions* **2017**	**2016**
Entity as Lessee, Assets Under Capital Lease		
Land and Buildings	$ 0.7	$ 0.7
Equipment	353.0	353.0
Accumulated Amortization	(242.7)	(226.0)
Total Capital Leases	**$ 111.0**	**$ 127.7**

Other Disclosures

The Department has use of overseas land, buildings, and other facilities obtained through international treaties and agreements negotiated by the Department of State. Treaty covenants restrict the Department's use and disposal of real property (land and buildings) located outside the United States.

The Department does not have acquisition value for all General Property, Plant, and Equipment (PP&E) and uses several cost methodologies to provide General PP&E values for financial statement reporting purposes. The Federal Accounting Standards Advisory Board issued *SFFAS 50*, "Establishing Opening Balances for General Property, Plant and Equipment" permitting alternative methods in establishing opening balances for General PP&E. Some activities in the Department used the alternative valuation methods from this standard for FY 2016; additional components used the alternative valuation methods under the standard in FY 2017 using historical records such as expenditure data, contracts, budget information, and engineering documentation as the method of valuation. Extensive efforts are underway resulting in changes in asset values to include the exclusion of land and land rights from opening balances in FY 2018.

Other General PP&E includes Real Property held in Caretaker Status. Caretaker Status is defined as the Department's property being held awaiting disposition, sale, or transfer.

Heritage Assets and Stewardship Land

The Department's policy is to preserve its heritage assets including items of historical, cultural, educational, or artistic importance. The Department, with minor exceptions, uses the buildings and stewardship land in its daily activities and includes the buildings on the Balance Sheet as multi-use heritage assets.

Heritage assets within the Department consist of buildings and structures, archeological sites, and museum collections. The Department defines these as follows:

- Buildings and Structures are listed, or eligible for listing, on the National Register of Historic Places, including multi-use heritage assets.
- Archeological Sites are listed, or eligible for listing, on the National Register of Historic Places in accordance with Section 110 of the *National Historic Preservation Act*.
- Museum Collection Items are considered unique due to historical, natural, cultural, educational, artistic, technical, or architectural significance.

The Department is unable to identify which of the heritage assets and stewardship land were added through donation or devise due to limitations of the Department's systems.

Differences in heritage assets quantities between the previously reported FY 2016 ending and the FY 2017 beginning unit counts reported in the table below resulted from periodic reviews.

Heritage Assets					
Categories	**Measure Quantity**	**Beginning Balance**	**Additions**	**Deletions**	**Ending Balance**
Buildings and Structures	Each	51,772	564	391	51,945
Archeological Sites	Each	31,319	701	703	31,317
Museum Collection Items (Objects, not including fine art)	Each	1,245,099	22,406	14,012	1,253,493
Museum Collection Items (Objects, fine art)	Each	96,348	811	209	96,950

Stewardship land includes both land and land rights owned by the Department, but not acquired for, or in connection with, items of General PP&E. All land provided to the Department from the public domain at no cost, regardless of its use, is classified as Stewardship Land.

Stewardship land is categorized and reported in acres based on the predominant use of the land. The three categories of Stewardship land held in public trust are: State Owned Land, Withdrawn Public Land, and Public Land. The other categories of Stewardship land are not held in public trust.

The Department's stewardship land consists mainly of mission essential land. Differences in the stewardship land quantities between the previously reported FY 2016 ending and the FY 2017 beginning unit counts reported in the table below resulted from periodic reviews.

Stewardship Land					*Acres in Thousands*
Facility Code	**Predominant Land Use Categories**	**Beginning Balance**	**Additions**	**Deletions**	**Ending Balance**
9110	Government Owned Land	6,542	0	1	6,541
9111	State Owned Land	6	0	1	5
9120	Withdrawn Public Land	15,455	1	227	15,229
9130	Licensed and Permitted Land	945	3	0	948
9140	Public Land	16	0	0	16
9210	Land Easement	378	1	0	379
9220	In-leased Land	124	0	1	123
9230	Foreign Land	297	1	0	298
	Grand Total				**23,539**
	Total – All Other Lands				**8,289**
	Total – Stewardship Lands				**15,250**

NOTE 11. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Liabilities Not Covered by Budgetary Resources	*Dollars in Millions*	
As of September 30	**2017**	**2016**
Intragovernmental Liabilities Not Covered by Budgetary Resources		
Accounts Payable	0.0	0.1
Debt	0.8	1.0
Other Liabilities	1,875.0	1,929.9
Total Intragovernmental Liabilities Not Covered by Budgetary Resources	**$ 1,875.8**	**$ 1,931.0**
Non-Federal Liabilities Not Covered by Budgetary Resources		
Accounts Payable	$ 1,150.2	$ 762.2
Military Retirement and Other Federal Employment Benefits	1,477,502.2	1,500,390.0
Environmental and Disposal Liabilities	65,032.9	59,466.8
Other Liabilities	14,971.8	12,439.6
Total Non-Federal Liabilities Not Covered by Budgetary Resources	**$ 1,558,657.1**	**$ 1,573,058.6**
Total Liabilities Not Covered by Budgetary Resources	**$ 1,560,532.9**	**$ 1,574,989.6**
Total Liabilities Covered by Budgetary Resources	**$ 937,441.1**	**$ 847,910.8**
Total Liabilities	**$ 2,497,974.0**	**$ 2,422,900.4**

Liabilities Not Covered by Budgetary Resources includes liabilities requiring congressional action before budgetary resources can be provided.

Non-Federal Accounts Payable primarily represents liabilities in canceled appropriations, when paid, will be disbursed using current year funds.

Debt consists primarily of borrowing from the U.S. Treasury for capital improvements to the Washington Aqueduct Project expected to be completed by 2023. The related reimbursement to the Department from Arlington County and Falls Church, Virginia, is recorded as non-Federal accounts receivable.

Environmental and Disposal Liabilities represents the Department's liability for existing and anticipated environmental clean-up and disposal. Refer to Note 14, Environmental and Disposal Liabilities, for additional details.

Intragovernmental Other Liabilities consists primarily of unfunded liabilities for Federal Employees Compensation Act, Judgment Fund, and Unemployment Insurance.

Non-Federal Other Liabilities consists primarily of unfunded annual leave, contingent liabilities, and expected expenditures for disposal of conventional munitions.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current fiscal year. In FY 2017, these liabilities primarily consist of $913.6 billion in pension liabilities and $556.2 billion in health benefit liabilities. In FY 2016, the Department reported $906.1 billion in pension liabilities and $586.5 billion in health benefit liabilities. Refer to Note 17, Military Retirement and Other Federal Employment Benefits, for additional details.

NOTE 12. ACCOUNTS PAYABLE

Accounts Payable			*Dollars in Millions*
	2017		
As of September 30	**Accounts Payable**	**Interest, Penalties, and Administrative Fees**	**Total**
Intragovernmental Payables	$ 1,573.8	N/A	$ 1,573.8
Non-Federal Payables (To the Public)	26,402.8	24.0	26,426.8
Total Accounts Payable	**$ 27,976.6**	**$ 24.0**	**$ 28,000.6**

Accounts Payable			*Dollars in Millions*
	2016		
As of September 30	**Accounts Payable**	**Interest, Penalties, and Administrative Fees**	**Total**
Intragovernmental Payables	$ 1,922.4	N/A	$ 1,922.4
Non-Federal Payables (To the Public)	18,239.7	23.9	18,263.6
Total Accounts Payable	**$ 20,162.1**	**$ 23.9**	**$ 20,186.0**

Other Disclosures

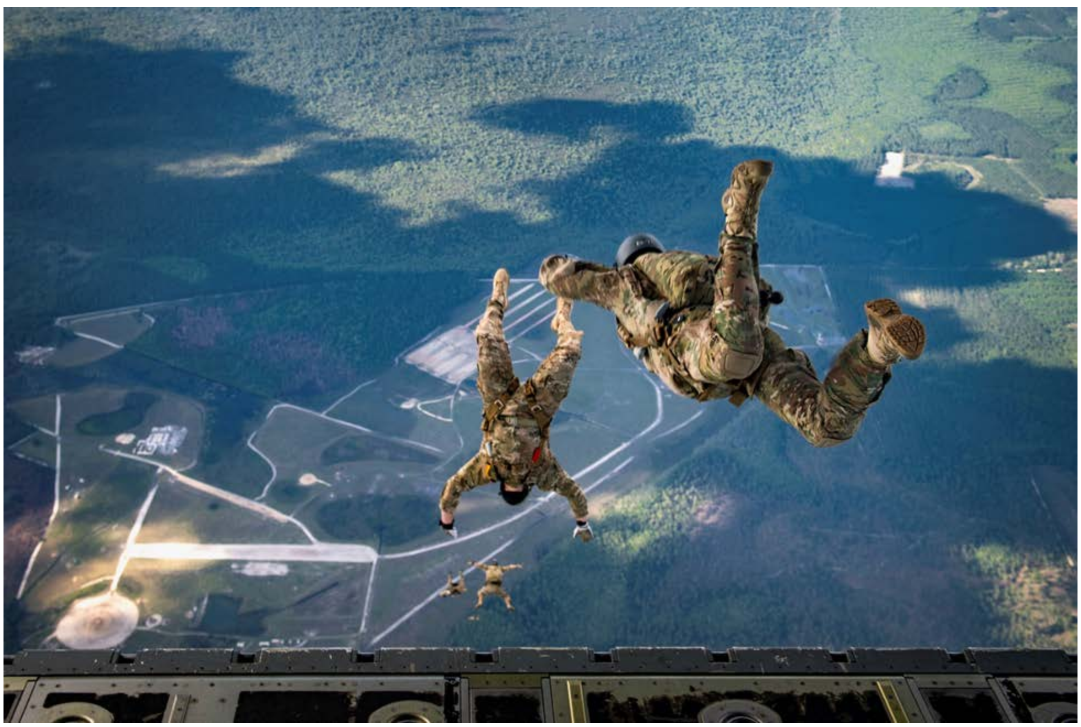
Accounts Payable include amounts owed to Federal and non-Federal entities for goods and services received by the Department. Buyer-side accounts payable are adjusted to agree with interagency seller-side accounts receivable by: (1) reclassifying amounts between Federal and non-Federal accounts payable, (2) accruing additional accounts payable and expenses, and (3) applying both supported and unsupported undistributed disbursements at the reporting entity level.

NOTE 13. DEBT

Debt			*Dollars in Millions*
	2017		
As of September 30	**Beginning Balance**	**Net Borrowing**	**Ending Balance**
Agency Debt (Intragovernmental)			
Debt to the Treasury	$ 1,630.7	$ 0.1	$ 1,630.8
Total Agency Debt	**$ 1,630.7**	**$ 0.1**	**$ 1,630.8**

Debt			*Dollars in Millions*
	2016		
As of September 30	**Beginning Balance**	**Net Borrowing**	**Ending Balance**
Agency Debt (Intragovernmental)			
Debt to the Treasury	$ 1,508.6	$ 122.1	$ 1,630.7
Total Agency Debt	**$ 1,508.6**	**$ 122.1**	**$ 1,630.7**

The Department's debt consists of interest and principal payments due to the U.S. Treasury. The Department borrows funds from the U.S. Treasury for MHPI and the Washington Aqueduct Capital Improvements Project. See Note 8 for more information pertaining to the Departments Direct Loan and Loan Guarantee programs related to MHPI.



U.S. Air Force Pararescuemen with the 38th Rescue Squadron jump from the back of an HC-130J Combat King II aircraft over Moody Air Force Base, Georgia, April 13, 2017. Pararescuemen are qualified experts in Airborne and Military Free Fall operations, to include high-altitude, low opening techniques.

Photo by Staff Sgt. Ryan Callaghan

NOTE 14. ENVIRONMENTAL AND DISPOSAL LIABILITIES

Environmental and Disposal Liabilities		*Dollars in Millions*
As of September 30	**2017**	**2016**
Environmental Liabilities–Non-Federal		
Accrued Environmental Restoration Liabilities		
Active Installations – Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 13,063.8	$ 12,422.2
Active Installations – Military Munitions Response Program (MMRP)	3,354.3	3,677.4
Formerly Used Defense Sites – IRP & BD/DR	2,967.8	3,019.4
Formerly Used Defense Sites – MMRP	7,968.3	7,699.4
Other Accrued Environmental Liabilities – Non-BRAC		
Environmental Corrective Action	$ 917.9	$ 829.5
Environmental Closure Requirements	3,916.7	4,203.7
Environmental Response at Operational – Ranges	76.1	62.4
Asbestos	4,510.4	2,014.6
Non-Military Equipment	5.5	0.4
Other	1,786.5	2,220.7
Base Realignment and Closure Installations (BRAC)		
Installation Restoration Program	$ 3,732.9	$ 3,664.0
Military Munitions Response Program	713.5	730.5
Environmental Corrective Action/Closure Requirements	251.6	201.3
Asbestos	9.7	14.2
Environmental Disposal for Military Equipment/Weapons Programs		
Nuclear Powered Military Equipment/Spent Nuclear Fuel	$ 15,807.0	$ 14,562.2
Non-Nuclear Powered Military Equipment	137.0	0.0
Other Weapons Systems	354.6	202.4
Chemical Weapons Disposal Program		
Chemical Demilitarization – Chemical Materials Agency (CMA)	$ 2,671.4	$ 2,658.0
CAMD Demilitarization – Assembled Chemical Weapons Alternatives (ACWA)	6,073.1	4,488.0
Total Environmental Liabilities	**$ 68,318.1**	**$ 62,670.3**

Other Accrued Environmental Liabilities, Non-Base Realignment and Closure (Non-BRAC), Other consists primarily of Formerly Utilized Sites Remedial Action Program (FUSRAP) remediation of radiological contamination. The FUSRAP is a shared program between the Department and the Department of Energy's U.S. Atomic Energy and Weapons Program.

The unrecognized portion of the estimated total cleanup costs associated with disposal of General Property, Plant, and Equipment (PP&E) is being reevaluated.

Types of Environmental Liabilities and Disposal Liabilities Identified

The Department has cleanup requirements for the Defense Environmental Restoration Program (DERP) for active installations, BRAC installations, and Formerly Used Defense Sites. The Department has additional cleanup requirements for active installations not covered by DERP, weapon systems programs, and chemical weapons disposal programs. The weapons systems program consists of chemical weapons disposal, nuclear powered aircraft carriers, nuclear powered submarines, and other nuclear ships. All cleanup efforts are performed in coordination with regulatory agencies, other responsible parties, and current property owners.

Applicable Laws and Regulations for Cleanup Requirements

The Department is required to clean up contamination from past waste disposal practices, leaks, spills, and other activity resulting in public health or environmental risk. The Department accomplishes this effort in coordination with regulatory agencies and, if applicable, other responsible parties and current property owners. The Department is also required to recognize closure and post-closure costs for its General PP&E and environmental corrective action costs for current operations. Each of the Department's major reporting entities is responsible for tracking and reporting all required environmental information related to environmental restoration costs, other accrued environmental costs, disposal costs of weapon systems, and environmental costs related to BRAC actions.

The Department follows the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (*CERCLA*), Superfund Amendments and Reauthorization Act of 1986 (*SARA*), Resource Conservation and Recovery Act of 1976 (*RCRA*) or other applicable federal or state laws to clean up contamination. The CERCLA and RCRA require the Department to clean up contamination in coordination with regulatory agencies, current owners of property damaged by the Department, and third parties with partial responsibility for environmental restoration. Failure to comply with agreements and legal mandates puts the Department at risk of incurring fines and penalties.

Laws concerning cleanup requirements for nuclear-powered naval vessels govern the Department's environmental policy and regulations. The *Atomic Energy Act of 1954*, as amended, assures the proper management of source, special nuclear, and byproduct materiel. The Department coordinates nuclear power actions with the Department of Energy. The *Nuclear Waste Policy Act of 1982* requires owners and generators of high-level nuclear waste and spent nuclear fuel to pay their share of the cost of the program. The *Low-Level Radioactive Waste Policy Amendments Act of 1985* provides for the safe and efficient management of low-level radioactive waste.

The Chemical Weapons Disposal Program is based on the National Defense Authorization Act *(NDAA) for FY 1986* directing the Department to destroy the unitary chemical stockpile in accordance with the Chemical Weapons Convention Treaty.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

The Department uses engineering estimates and independently validated models to project environmental costs. The models include the Remedial Action Cost Engineering Requirements application and the Normalization of Data System. The Department validates the models in accordance with *DoD Instruction 5000.61*, "DoD Modeling and Simulation Verification, Validation, and Accreditation," and estimates liabilities based on data received during preliminary assessment and site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

Once the environmental cost estimates are complete, the Department complies with accounting standards to charge costs to current operating periods. The Department expensed cleanup costs for General PP&E placed into service prior to October 1, 1997, unless costs are to be recovered through user charges. As costs are recovered, the Department expenses cleanup costs associated with the asset life that has passed since the General PP&E was placed into service. The Department systematically recognizes the remaining cost over the life of the assets.

For General PP&E placed into service after September 30, 1997, the Department expenses associated environmental costs using two methods: physical capacity for operating landfills and life expectancy in years for all other assets. The Department expenses the full cost to clean up contamination for Stewardship PP&E when the asset is placed into service.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, or Applicable Laws and Regulations

The Department revised estimates resulting from previously unknown contaminants, re-estimation based on different assumptions, and other changes in project scope. Although the Department is unaware of pending changes, environmental liabilities are subject to changes in laws and regulations, agreements with regulatory agencies, and advances in technology.

Uncertainty Regarding the Accounting Estimates Used to Calculate the Reported Environmental Liabilities

Accounting estimates for environmental liabilities use reasonable judgments and assumptions based on available information. Actual results may materially vary if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels differing from estimate parameters.

The Department is responsible for environmental restoration and corrective action for buried chemical munitions and agents; however, it is unable to provide a reasonable estimate because the extent of the buried chemical munitions and agents is unknown. The Department also cannot provide a complete estimate for FUSRAP. The Department has ongoing studies and will update its estimate as additional information is identified. In addition, the Department is in the process of evaluating completeness of its environmental liabilities.

The Department may incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The Department is unable to provide a reasonable estimate because the extent of required restoration is unknown.

U.S. Army Sgt. Tyler Brady, with the 372nd Engineer Company, flattens gravel for the foundation at the St. Matthews School during exercise Beyond the Horizon 2017, in Pamona, Belize, May 1, 2017. Beyond the Horizon is a U.S. Southern Command-sponsored, Army South-led exercise designed to provide humanitarian and engineering services to communities in need, demonstrating U.S. support for Belize.

Photo by Spc. Gary Silverman

NOTE 15. OTHER LIABILITIES

Other Liabilities						*Dollars in Millions*
	2017					
As of September 30	**Current Liability**		**Noncurrent Liability**		**Total**	
Intragovernmental						
Advances from Others	$	1,418.0	$	0.0	$	1,418.0
Deposit Funds and Suspense Account Liabilities		(141.4)		0.0		(141.4)
Disbursing Officer Cash		1,009.2		0.0		1,009.2
Judgment Fund Liabilities		562.1		0.0		562.1
FECA Reimbursement to the Department of Labor		518.2		620.6		1,138.8
Custodial Liabilities		191.1		2,119.3		2,310.4
Employer Contribution and Payroll Taxes Payable		519.7		0.0		519.7
Other Liabilities		201.0		0.0		201.0
Total Intragovernmental Other	**$**	**4,277.9**	**$**	**2,739.9**	**$**	**7,017.8**
Non-Federal						
Accrued Funded Payroll and Benefits	$	5,961.9	$	0.0	$	5,961.9
Advances from Others		5,149.8		11.0		5,160.8
Deposit Funds and Suspense Accounts		3,007.5		0.0		3,007.5
Nonenvironmental Disposal Liabilities						
Military Equipment (Nonnuclear)		1,136.7		58.5		1,195.2
Excess/Obsolete Structures		0.0		0.0		0.0
Conventional Munitions Disposal		0.0		6.0		6.0
Accrued Unfunded Annual Leave		10,433.7		0.0		10,433.7
Capital Lease Liability		0.0		0.0		0.0
Contract Holdbacks		540.2		6.2		546.4
Employer Contribution and Payroll Taxes Payable		629.9		0.0		629.9
Contingent Liabilities		619.5		8,215.1		8,834.6
Other Liabilities		295.9		0.0		295.9
Total Non-Federal Other Liabilities	**$**	**27,775.1**	**$**	**8,296.8**	**$**	**36,071.9**
Total Other Liabilities	**$**	**32,053.0**	**$**	**11,036.7**	**$**	**43,089.7**

Other Liabilities			*Dollars in Millions*
	2016		
As of September 30	**Current Liability**	**Noncurrent Liability**	**Total**
Intragovernmental			
Advances from Others	$ 800.6	$ 0.0	$ 800.6
Deposit Funds and Suspense Account Liabilities	497.4	0.0	497.4
Disbursing Officer Cash	1,128.0	0.0	1,128.0
Judgment Fund Liabilities	530.4	0.0	530.4
FECA Reimbursement to the Department of Labor	538.5	662.1	1,200.6
Custodial Liabilities	916.3	2,138.7	3,055.0
Employer Contribution and Payroll Taxes Payable	658.8	0.0	658.8
Other Liabilities	212.8	0.0	212.8
Total Intragovernmental Other	**$ 5,282.8**	**$ 2,800.8**	**$ 8,083.6**
Non-Federal			
Accrued Funded Payroll and Benefits	$ 5,813.0	$ 0.0	$ 5,813.0
Advances from Others	4,953.8	2.1	4,955.9
Deposit Funds and Suspense Accounts	2,223.8	0.0	2,223.8
Nonenvironmental Disposal Liabilities			
Military Equipment (Nonnuclear)	154.7	47.0	201.7
Excess/Obsolete Structures	0.0	0.0	0.0
Conventional Munitions Disposal	0.0	6.0	6.0
Accrued Unfunded Annual Leave	10,242.4	0.0	10,242.4
Capital Lease Liability	0.0	0.0	0.0
Contract Holdbacks	783.3	0.8	784.1
Employer Contribution and Payroll Taxes Payable	529.6	0.0	529.6
Contingent Liabilities	313.2	7,121.4	7,434.6
Other Liabilities	230.5	0.0	230.5
Total Non-Federal Other Liabilities	**$ 25,244.3**	**$ 7,177.3**	**$ 32,421.6**
Total Other Liabilities	**$ 30,527.1**	**$ 9,978.1**	**$ 40,505.2**

Other Disclosures

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

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.

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

Custodial Liabilities represents liabilities for collections reported as non-exchange revenues where the Department is acting on behalf of another Federal entity.

Intragovernmental Other Liabilities primarily consists of unemployment compensation liabilities.

Nonfederal Other Liabilities primarily consist of estimated costs for services provided; accrued liabilities for inventory owned and managed on behalf of foreign governments; and undistributed international tariff receipts.

The Department currently has no capital lease liability. However, the Department is part of an arrangement for Indefeasible Right of Use agreements allowing the Department access to portions of fiber optic, undersea cables. These agreements called for an upfront payment which cannot be refunded. Therefore, there are no future minimum lease payments. However, there are payments due annually for maintenance expenses. If the Department discontinues the agreement in accordance with the contract terms, it would no longer be responsible for future annual maintenance expenses.

Contingent Liabilities in both FYs 2016 and 2017 include $5.4 billion related to contracts authorizing progress payments based on cost as defined in the *Federal Acquisition Regulation (FAR).* In accordance with contract terms, specific rights to contractors' work vests with the Federal Government when a specific type of contract financing payment is made. This action protects taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as rights of ownership. The Department is under no obligation to pay contractors amounts in excess of progress payments until delivery and government acceptance. Due to the probability the contractors will complete their efforts and deliver satisfactory products, and because the amount of contractor costs incurred but yet unpaid are estimable, the Department has recognized a contingent liability for the estimated unpaid costs that are considered conditional for payment pending delivery and government acceptance.

Total contingent liabilities for progress payments based on cost represent the difference between the estimated costs incurred to date by contractors and amounts authorized to be paid under progress payments based on cost provisions within the FAR. Estimated contractor-incurred costs are calculated by dividing the cumulative unliquidated progress payments based on cost by the contract-authorized progress payment rate. The balance of unliquidated progress payments based on cost is deducted from the estimated total contractor-incurred costs to determine the contingency amount.

NOTE 16. COMMITMENTS AND CONTINGENCIES

Legal Contingencies

The Department is a party in various administrative proceedings and legal actions related to claims for environmental damage, equal opportunity matters, and contractual bid protests. The Department has accrued contingent liabilities for legal actions where the Office of General Counsel (OGC) considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury Judgment Fund. The Department reports contingent liabilities in Note 15, Other Liabilities.

The Department reports 43 legal actions with individual claims greater than the Department's FY 2017 materiality threshold of $152.3 million. These actions total approximately $1.5 trillion. Of this amount, the OGC classified claims totaling approximately $1.3 billion as "probable," $5.8 billion as "reasonably possible," $100.0 billion as "remote," and $1.4 trillion as "unable to determine the probability of loss." The Department also has 119 actions at approximately $6.6 billion above the individual Components' thresholds, but below the Department's materiality threshold.

Other Commitments and Contingencies

The Department is a party in numerous individual contracts containing clauses, such as price escalation, award fee payments, or dispute resolution, potentially resulting in a future outflow of budgetary resources. Currently, the Department's automated system processes have limited capability to capture these potential liabilities; therefore, the amounts reported may not fairly present the Department's commitments and contingencies. Contingencies considered both measurable and probable have been recognized as liabilities. Refer to Note 15, Other Liabilities, for additional details.

NOTE 17. MILITARY RETIREMENT AND OTHER FEDERAL EMPLOYMENT BENEFITS

Military Retirement and Other Federal Employment Benefits			*Dollars in Millions*
	2017		
As of September 30	Liabilities	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Pension and Health Actuarial Benefits			
Military Retirement Pensions	$ 1,567,689.2	$ (654,078.5)	$ 913,610.7
Military Pre Medicare-Eligible Retiree Health Benefits	252,512.9	0.0	252,512.9
Military Medicare-Eligible Retiree Health Benefits	526,986.1	(223,306.2)	303,679.9
Total Pension and Health Actuarial Benefits	**$ 2,347,188.2**	**$ (877,384.7)**	**$ 1,469,803.5**
Other Benefits			
FECA	$ 5,936.0	$ 0.0	$ 5,936.0
Voluntary Separation Incentive Programs	321.5	(130.4)	191.1
DoD Education Benefits Fund	998.7	(998.7)	0.0
Other	2,425.2	(853.6)	1,571.6
Total Other Benefits	**$ 9,681.4**	**$ (1,982.7)**	**$ 7,698.7**
Total Military Retirement and Other Federal Employment Benefits	**$ 2,356,869.6**	**$ (879,367.4)**	**$ 1,477,502.2**

Actuarial Cost Method Used: Aggregate Entry-Age Method
Assumptions: Effective Interest
Market Value of Investments in Market-based and Marketable Securities: $1.1 trillion

Military Retirement and Other Federal Employment Benefits					*Dollars in Millions*
	2017				
As of September 30	**Military Retirement Pensions**	**Military Pre-Medicare Eligible Retiree Health Benefits**	**Military Medicare-Eligible Retiree Health Benefits**	**Voluntary Separation Incentive Programs**	**DoD Education Benefits Fund**
Beginning Actuarial Liability	**$ 1,490,292.5**	**$ 239,734.7**	**$ 557,806.2**	**$ 380.4**	**$ 1,215.9**
Normal Cost	27,428.0	9,384.3	11,152.7	0.0	144.4
Interest Cost	57,530.9	9,751.5	22,546.3	8.6	40.7
Plan Amendments	(858.2)	0.0	0.0	0.0	0.0
Experience Losses (Gains)	(1,610.8)	(6,274.1)	(14,310.7)	(1.8)	(81.3)
Other Factors	0.0	0.0	0.0	0.0	0.0
Subtotal: Expenses before Losses (Gains) from Actuarial Assumption Changes	**82,489.9**	**12,861.7**	**19,388.3**	**6.8**	**103.8**
Actuarial (Gain)/Loss due to:					
Changes in Trend Assumptions	0.0	1,109.1	(53,632.9)	0.0	0.0
Changes in Assumptions Other than Trend	52,910.5	9,575.9	14,134.1	4.9	(32.6)
Subtotal: Losses (Gains) from Actuarial Assumption Changes	**52,910.5**	**10,685.0**	**(39,498.8)**	**4.9**	**(32.6)**
Total Expenses	**135,400.4**	**23,546.7**	**(20,110.5)**	**11.7**	**71.2**
Less Benefit Outlays	58,003.7	10,768.5	10,709.6	70.6	288.4
Total Changes in Actuarial Liability	**$ 77,396.7**	**$ 12,778.2**	**$ (30,820.1)**	**$ (58.9)**	**$ (217.2)**
Ending Actuarial Liability	**$ 1,567,689.2**	**$ 252,512.9**	**$ 526,986.1**	**$ 321.5**	**$ 998.7**

Military Retirement and Other Federal Employment Benefits						*Dollars in Millions*
	2016					
As of September 30		**Liabilities**		**(Less: Assets Available to Pay Benefits)**		**Unfunded Liabilities**
Pension and Health Actuarial Benefits						
Military Retirement Pensions	$	1,490,292.5	$	(584,180.9)	$	906,111.6
Military Pre Medicare-Eligible Retiree Health Benefits		239,734.7		0.0		239,734.7
Military Medicare-Eligible Retiree Health Benefits		557,806.2		(210,970.9)		346,835.3
Total Pension and Health Actuarial Benefits	**$**	**2,287,833.4**	**$**	**(795,151.8)**	**$**	**1,492,681.6**
Other Actuarial Benefits						
FECA	$	5,931.9	$	0.0	$	5,931.9
Voluntary Separation Incentive Programs		380.4		(153.3)		227.1
DoD Education Benefits Fund		1,215.9		(1,215.9)		0.0
Other		2,475.7		(926.3)		1,549.4
Total Other Actuarial Benefits	**$**	**10,003.9**	**$**	**(2,295.5)**	**$**	**7,708.4**
Total Military Retirement and Other Federal Employment Benefits	**$**	**2,297,837.3**	**$**	**(797,447.3)**	**$**	**1,500,390.0**
Actuarial Cost Method Used: Aggregate Entry-Age Method *Assumptions: Effective Interest* *Market Value of Investments in Market-based and Marketable Securities: $1.0 trillion*						

Military Retirement and Other Federal Employment Benefits					*Dollars in Millions*
	2016				
As of September 30	**Military Retirement Pensions**	**Military Pre-Medicare Eligible Retiree Health Benefits**	**Military Medicare-Eligible Retiree Health Benefits**	**Voluntary Separation Incentive Programs**	**DoD Education Benefits Fund**
Beginning Actuarial Liability	**$ 1,558,518.6**	**$ 220,876.2**	**$ 508,194.0**	**$ 453.1**	**$ 1,137.3**
Normal Cost	31,243.9	8,709.5	10,690.2	0.0	102.3
Interest Cost	63,367.2	9,208.4	21,074.3	11.5	37.9
Plan Amendments	(18,677.2)	(657.3)	(5,184.3)	0.0	(31.1)
Experience Losses (Gains)	(25,452.1)	11,118.0	29,782.8	(7.6)	(31.0)
Other Factors	0.0	0.0	0.0	0.0	241.6
Subtotal: Expenses before Losses (Gains) from Actuarial Assumption Changes	**50,481.8**	**28,378.6**	**56,363.0**	**3.9**	**319.7**
Actuarial (Gain)/Loss due to:					
Changes in Trend Assumptions	0.0	1,057.2	(9,522.1)	0.0	0.0
Changes in Assumptions Other than Trend	(61,248.7)	(497.4)	12,623.0	5.2	0.0
Subtotal: Losses (Gains) from Actuarial Assumption Changes	**(61,248.7)**	**559.8**	**3,100.9**	**5.2**	**0.0**
Total Expenses	**(10,766.9)**	**28,938.4**	**59,463.9**	**9.1**	**319.7**
Less Benefit Outlays	57,459.2	10,079.9	9,851.7	81.8	241.1
Total Changes in Actuarial Liability	**$ (68,226.1)**	**$ 18,858.5**	**$ 49,612.2**	**$ (72.7)**	**$ 78.6**
Ending Actuarial Liability	**$ 1,490,292.5**	**$ 239,734.7**	**$ 557,806.2**	**$ 380.4**	**$ 1,215.9**

The Department complies with Statement of Federal Financial Accounting Standards *(SFFAS) 33*, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates." The standard requires the separate presentation of gains and losses from changes in long-term assumptions used to estimate liabilities associated with pensions, other retirement and postemployment benefits. SFFAS 33 also provides a standard for selecting the discount rate and valuation date used in estimating these liabilities.

Military Retirement Pensions

The Military Retirement Fund is a defined benefit plan authorized by the National Defense Authorization Act *(NDAA) for FY 1984* to provide funds used to pay annuities and pensions to retired military personnel and their survivors. The DoD Board of Actuaries approves the long-term economic assumptions for inflation, salary, and interest. The actuaries calculate the actuarial liabilities annually using economic assumptions and actual experience (e.g., mortality and retirement rates). The Blended Retirement System (BRS) is a new retirement benefit merging aspects of both a defined benefit annuity with a defined contribution account, through the Thrift Savings Plan (TSP). Military personnel with a start date on or after January 1, 2018 are automatically enrolled in BRS. Although all members serving as of December 31, 2017 are grandfathered under the existing retirement system, Active Duty, National Guard and Reserve personnel meeting established criteria may opt into BRS during calendar year 2018. Retiring members are given the option to receive a portion of their retired pay annuity in the form of a lump sum distribution.

The actuaries used the following assumptions to calculate the FY 2017 roll-forward amount:

Military Retirement Pensions	Inflation	Salary	Interest
Fiscal Year 2017	0.3% (actual)	2.1% (actual)	3.9%
Fiscal Year 2018	2.0% (estimated)	2.1% (estimated)	3.7%
Long Term	1.7%	2.1%	3.7%
Actuarial Cost Method Used: Aggregate Entry-Age Normal Method *Market Value of Investments in Market-Based and Marketable Securities: $785.0 billion* *Assumed Interest Rate: 3.7%*			

Historically, the initial unfunded liability of the program was amortized over a 50-year period. Effective FY 2008, the initial unfunded liability is amortized over a 42-year period to ensure annual payments cover interest on the unfunded actuarial liability, with the last payment expected October 1, 2025. All subsequent gains and losses experienced by the system are amortized over a 30-year period.

Military Retirement Health Benefits (MRHB)

The MRHB are post-retirement benefits the Department provides to non-Medicare-eligible military retirees and other eligible beneficiaries through private sector health care providers and the Department's medical treatment facilities. The actuaries calculate actuarial liabilities annually using assumptions and actual experience. For the FY 2017 actuarial liability calculation, actuaries used the following assumptions:

MRHB Medical Trend	FY 2016 – FY 2017	Ultimate Rate FY 2041
Non-Medicare Inpatient (Direct Care)	4.45%	4.20%
Non-Medicare Outpatient (Direct Care)	6.00%	4.20%
Non-Medicare Prescriptions (Direct Care)	5.80%	4.20%
Non-Medicare Inpatient (Purchased Care)	1.95%	4.20%
Non-Medicare Outpatient (Purchased Care)	3.30%	4.20%
Non-Medicare Prescriptions (Purchased Care)	3.91%	4.20%
U.S. Family Health Plan (USFHP) (Purchased Care)	4.03%	4.20%
Actuarial Cost Method Used: Aggregate Entry-Age Normal Method *Assumed Interest Rate: 3.8%*		

Medicare-Eligible Retiree Health Care Fund (MERHCF) Benefits

In accordance with National Defense Authorization Act *(NDAA) for FY 2001*, MERHCF accumulates funds to finance the health care program liabilities of Medicare-eligible retirees for all the Uniformed Services and specific Medicare-eligible beneficiaries. The DoD Board of Actuaries approves the long-term assumptions for medical trends and interest. The actuaries calculate the actuarial liabilities annually using actual experience (e.g., mortality and retirement rates, direct care costs, purchased care). The actuaries used the following assumptions to calculate the FY 2017 roll-forward amount:

MERHCF Benefits – Medical Trend	FY 2016 – FY 2017	Ultimate Rate FY 2041
Medicare Inpatient (Direct Care)	2.00%	4.20%
Medicare Outpatient (Direct Care)	4.00%	4.20%
Medicare Prescriptions (Direct Care)	4.00%	4.20%
Medicare Inpatient (Purchased Care)	1.00%	4.20%
Medicare Outpatient (Purchased Care)	3.00%	4.20%
Medicare Prescriptions (Purchased Care)	3.42%	4.20%
Medicare USFHP (Purchased Care)	2.56%	4.20%
Actuarial Cost Method Used: Aggregate Entry-Age Normal Method *Market Value of Investments in Market-Based and Marketable Securities: $283.1 billion* *Assumed Interest Rate: 3.8%*		

The FY 2017 MERHCF liability includes Medicare liabilities for all Uniformed Services. The $527.0 billion liability includes $514.5 billion for the Department, $11.1 billion for the Coast Guard, $1.3 billion for the Public Health Service, and $83.3 million for National Oceanic and Atmospheric Administration (NOAA). The FY 2016 $557.8 billion liability included $544.6 billion for the Department, $11.7 billion for the Coast Guard, $1.4 billion for the Public Health Service, and $87.0 million for NOAA. The FY 2017 contributions from each of the Uniformed Services were $7.0 billion from the Department, $175.5 million from the Coast Guard, $27.9 million from the Public Health Service, and $1.4 million from NOAA. The FY 2016 contributions from each of the Uniformed Services were $6.6 billion from the Department, $169.0 million from the Coast Guard, $26.0 million from the Public Health Service, and $1.0 million from NOAA.

Federal Employees Compensation Act (FECA)

The Department of Labor (DOL) annually determines the liability for future workers' compensation benefits including the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred-but-not-reported claims. The liability is determined using historical benefit payment patterns related to a specific incurred period to predict the final payment related to that period. 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 2.7 percent was assumed for year one and 2.7 percent for year two and thereafter. An interest rate for medical benefits of 2.2 percent was assumed for year one and 2.2 percent for year two and thereafter.

The DOL calculates this liability using wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIM). The actual rates for these factors for charge back year (CBY) 2017 were also used to adjust the methodology's historical payments to current year constant dollars. The compensation COLAs and CPIMs used in the projections for various charge back years were as follows:

Federal Employees Compensation Act (FECA)		
CBY	**COLA**	**CPIM**
2018	1.22%	3.20%
2019	1.35%	3.52%
2020	1.59%	3.80%
2021	1.99%	3.99%
2022+	2.26%	3.91%

To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Changes in the liability from last year's analysis to this year's analysis were also examined by agency, with any significant differences by agency inspected in greater detail. DOL concluded that the model has been stable and has accurately projected the actual payments by agency.

DoD Education Benefits Fund (EBF)

The EBF was established by National Defense Authorization Act *(NDAA) for FY 1985* to recruit and retain military members and aid in the readjustment of military members to civilian life. The actuaries calculate the actuarial liability annually based on the assumed interest rate of 3.5 percent as approved by the DoD Board of Actuaries.

The Market Value of Investments in Market-based and Marketable Securities: $1.1 billion.

Voluntary Separation Incentive (VSI) Program

The VSI Program was established by National Defense Authorization Act *(NDAA) for FYs 1992 and 1993* to reduce the number of military personnel on active duty. The DoD Board of Actuaries approved the assumed annual interest rate of 2.1 percent used to calculate the actuarial liability. Since VSI is no longer offered, the actuarial liability calculated annually is expected to continue to decrease with benefit outlays and increase with interest cost.

The Market Value of Investments in Market-based and Marketable Securities: $138.6 million.

Other Federal Employment Benefits

Other Federal Employment Benefits primarily consists of an estimated liability for incurred-but-not-reported medical claims not processed prior to fiscal year-end and accrued pensions and annuities.

U.S. Marine Corps Recruits from Platoon 4045, N. Co., 4th Battalion, Recruit Training Regiment, practice sighting in on the range at Marine Corps Recruit Depot Parris Island, S.C., Oct. 24, 2016.Qualifying with the M16-A4 Service Rifle teaches recruits to understand the weapon system in order to keep with the concept “Every Marine a Rifleman”.

Photo by Lance Cpl. Sarah Stegall

NOTE 18. GENERAL DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Costs and Exchange Revenue by Program		*Dollars in Millions*		
As of September 30		**2017**		**2016**
Military Retirement Benefits				
Gross Cost				
Intragovernmental Cost	$	3.8	$	3.6
Non-Federal Cost	$	96,626.3	$	102,511.2
Total Cost	**$**	**96,630.1**	**$**	**102,514.8**
Earned Revenue				
Intragovernmental Revenue	$	(29,360.3)	$	(21,837.1)
Non-Federal Revenue	$	0.0	$	0.0
Total Revenue	**$**	**(29,360.3)**	**$**	**(21,837.1)**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	$	13,411.6	$	(58,147.7)
Total Net Cost	**$**	**80,681.4**	**$**	**22,530.0**
Civil Works				
Gross Cost				
Intragovernmental Cost	$	1,442.6	$	1,507.1
Non-Federal Cost	$	7,725.6	$	8,369.7
Total Cost	**$**	**9,168.2**	**$**	**9,876.8**
Earned Revenue				
Intragovernmental Revenue	$	(946.2)	$	(930.1)
Non-Federal Revenue	$	(645.7)	$	(599.4)
Total Revenue	**$**	**(1,591.9)**	**$**	**(1,529.5)**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	$	0.0	$	0.0
Total Net Cost	**$**	**7,576.3**	**$**	**8,347.3**
Military Personnel				
Gross Cost				
Intragovernmental Cost	$	38,440.3	$	52,639.3
Non-Federal Cost	$	101,072.3	$	86,081.6
Total Cost	**$**	**139,512.6**	**$**	**138,720.9**
Earned Revenue				
Intragovernmental Revenue	$	(1,256.3)	$	(1,227.9)
Non-Federal Revenue	$	(37.7)	$	(43.1)
Total Revenue	**$**	**(1,294.0)**	**$**	**(1,271.0)**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	$	0.0	$	0.0
Total Net Cost	**$**	**138,218.6**	**$**	**137,449.9**
Operations, Readiness & Support				
Gross Cost				
Intragovernmental Cost	$	(58,574.8)	$	(59,942.9)
Non-Federal Cost	$	360,597.6	$	345,593.8
Total Cost	**$**	**302,022.8**	**$**	**285,650.9**

Costs and Exchange Revenue by Program		*Dollars in Millions*		
As of September 30		**2017**		**2016**
Earned Revenue				
Intragovernmental Revenue	$	10,635.1	$	10,346.6
Non-Federal Revenue	$	(68,445.8)	$	(51,949.2)
Total Revenue	**$**	**(57,810.7)**	**$**	**(41,602.6)**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	$	10,657.4	$	565.0
Total Net Cost	**$**	**254,869.5**	**$**	**244,613.3**
Procurement				
Gross Cost				
Intragovernmental Cost	$	35,413.2	$	24,284.4
Non-Federal Cost	$	50,468.1	$	83,579.8
Total Cost	**$**	**85,881.3**	**$**	**107,864.2**
Earned Revenue				
Intragovernmental Revenue	$	(2,594.4)	$	(2,252.0)
Non-Federal Revenue	$	(7,908.7)	$	(1,629.5)
Total Revenue	**$**	**(10,503.1)**	**$**	**(3,881.5)**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	$	0.0	$	0.0
Total Net Cost	**$**	**75,378.2**	**$**	**103,982.7**
Research, Development, Test & Evaluation				
Gross Cost				
Intragovernmental Cost	$	18,398.3	$	16,802.2
Non-Federal Cost	$	65,982.5	$	56,968.8
Total Cost	**$**	**84,380.8**	**$**	**73,771.0**
Earned Revenue				
Intragovernmental Revenue	$	(8,331.6)	$	(7,649.5)
Non-Federal Revenue	$	(270.4)	$	(255.6)
Total Revenue	**$**	**(8,602.0)**	**$**	**(7,905.1)**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	$	0.0	$	0.0
Total Net Cost	**$**	**75,778.8**	**$**	**65,865.9**
Family Housing & Military Construction				
Gross Cost				
Intragovernmental Cost	$	591.0	$	647.1
Non-Federal Cost	$	9,930.9	$	11,699.5
Total Cost	**$**	**10,521.9**	**$**	**12,346.6**
Earned Revenue				
Intragovernmental Revenue	$	(5,028.3)	$	(4,910.6)
Non-Federal Revenue	$	(105.2)	$	(591.5)
Total Revenue	**$**	**(5,133.5)**	**$**	**(5,502.1)**
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	$	0.0	$	0.0
Total Net Cost	**$**	**5,388.4**	**$**	**6,844.5**

Costs and Exchange Revenue by Source		*Dollars in Millions*		
As of September 30		**2017**		**2016**
Total Gross Cost				
Intragovernmental Cost	$	35,714.4	$	35,940.8
Non-Federal Cost	$	692,403.3	$	694,804.4
Total Cost	**$**	**728,117.7**	**$**	**730,745.2**
Total Earned Revenue				
Intragovernmental Revenue	$	(36,882.0)	$	(28,460.6)
Non-Federal Revenue	$	(77,413.5)	$	(55,068.3)
Total Revenue	**$**	**(114,295.5)**	**$**	**(83,528.9)**
Total Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits for the Deparment	$	24,069.0	$	(57,582.7)
Costs Not Assigned to Programs	$	0.0	$	0.0
(Less: Earned Revenues) Not Attributed to Programs	$	0.0	$	0.0
Total Net Cost	**$**	**637,891.2**	**$**	**589,633.6**

The Statement of Net Cost (SNC) represents the net cost of programs and organizations of the Department supported by appropriations or other means. 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 Department's current processes and systems capture costs based on appropriation groups as presented in the schedule above. The lower level costs for major programs are not presented as required by the Government Performance and Results Act of 1993 (*GPRA*). The Department is in the process of reviewing available data and developing a cost reporting methodology required by Statement of Federal Financial Accounting Standards *(SFFAS) 4*, "Managerial Cost Accounting Standards and Concepts," amended by *SFFAS 30*, "Inter-Entity Cost Implementation."

Intragovernmental costs and revenues represent transactions between two reporting entities within the Federal Government. Non-Federal costs and revenues are exchange transactions between the reporting entity and a non-Federal entity.

Buyer side expenses are adjusted to agree with internal seller side revenues. Expenses are generally adjusted by reclassifying amounts between Federal and non-Federal expenses. Intradepartmental revenues and expenses are then eliminated.

The information presented on the SNC is compiled from many financial systems and sources. Newer financial systems record costs based on business events (e.g., receipt of goods or services), while many older financial systems record costs based upon financial transactions (e.g., invoices). In addition, some costs (e.g., actuarial) are derived from non-financial systems.

Abnormal Balances

An abnormal balance occurs when the general ledger account balance reported is opposite of its normal balance, as it is defined by the United States Standard General Ledger (USSGL) "Accounts and Definitions" guidance in the U.S. Treasury Financial Manual. Operations, Readiness & Support Intragovernmental Gross Cost and Earned Revenue on the SNC have abnormal balances of $58.6 billion and $10.6 billion, respectively in FY 2017, and abnormal balances of $59.9 billion and $10.3 billion, respectively in FY 2016. The current business practice is to report most eliminations in this program group resulting in the abnormal balance presentation.

Net Cost of Operations reported on the Statement of Changes in Net Position includes an abnormal balance of $67.9 million in USSGL 711000, Gains on Disposition of Assets – Other. The abnormal balance is attributable to reversal of an FY 2016 erroneous entry to record Property Plant, and Equipment, that was subsequently determined to be fully depreciated.

Other Disclosures

The Department's military retirement and postemployment costs are reported in accordance with *SFFAS 33*, "Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates." The standard requires the separate presentation of gains and losses from changes in long term assumptions used to estimate liabilities associated with pensions, other retirement benefits, and other postemployment benefits on the SNC.

FY 2017 Nonfederal Cost and Nonfederal Revenue include a $30.2 billion increase due to a change in accounting for inventory valuation. Prior to FY 2017, one component recorded the net of inventory gains and losses as costs; FY 2017 gains and losses are reported separately as revenues and costs.

Note 19. Disclosures Related to the Statement of Changes in Net Position

Abnormal Balances

Budgetary Financing Sources, Other Adjustments on the Statement of Changes in Net Position includes an abnormal balance of $612.5 million in USSGL 591900, Revenue and Other Financing Sources – Collections. The balance was created from incomplete data conversion corrected during the pre-closing process.

Net Cost of Operations reported on the Statement of Changes in Net Position includes an abnormal balance of $67.9 million in USSGL 711000, Gains on Disposition of Assets – Other. The abnormal balance is attributable to reversal of an FY 2016 erroneous entry to record Property Plant, and Equipment, that was subsequently determined to be fully depreciated.

Other Disclosures

The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards *(SFFAS) 48*, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials" and *SFFAS 50*, "Establishing Opening Balances for General Property, Plant and Equipment." These standards permit alternative methods in establishing opening balances and are effective for periods beginning after September 30, 2016 with early implementation allowed. Some activities within the Department used the principles of these standards for FY 2016; additional components used the principles of these standards in FY 2017.

During FY 2017, the Department increased the beginning Cumulative Results of Operation by $37.3 billion through a prior period adjustment, from an FY 2016 ending balance of ($469.5) billion to an FY 2017 adjusted beginning balance of ($432.2) billion. The Department increased the ending balance of Operating Materiel and Supplies by $24.4 billion, and increased the ending balance of General Property, Plant and Equipment by $12.9 billion. During FY 2016, the Department decreased the beginning Cumulative Results of Operations by $1.5 billion, decreased the ending balance of General PP&E by $2.2 billion, and increased the ending balance of Stockpile Materials by $0.7 billion.

In FY 2016, the Department increased the beginning Cumulative Results of Operations and General Equipment Construction in Progress by $31.4 billion to correct an error in valuation.

Reconciliation Differences

When complying with the Office of Management and Budget and U.S. Treasury guidance, Appropriations reported on the Statement of Budgetary Resources will exceed Appropriations Received on the Statement of Changes in Net Position. A reconciliation of these amounts is presented in the table below.

Period Ended September 30, 2017 Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations Received on the Statement of Changes in Net Position	*Dollars in Billions*	
	Total	
Appropriations, Statement of Budgetary Resources	$	777.0
Less: Appropriations Received, Statement of Changes in Net Position		(710.7)
Total Reconciling Amount	**$**	**66.3**
Items Reported as Reductions to Appropriations, Statement of Budgetary Resources		
Permanent and Temporary Reductions	**$**	**(87.6)**
Miscellaneous items		**0.8**
Items Reported in Net Cost of Operations, Statement of Changes in Net Position		
Trust and Special Fund Receipts	**$**	**153.1**
Total Reconciling Items	**$**	**66.3**

Period Ended September 30, 2016 Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations Received on the Statement of Changes in Net Position	*Dollars in Billions*	
	Total	
Appropriations, Statement of Budgetary Resources	$	745.7
Less: Appropriations Received, Statement of Changes in Net Position		(683.3)
Total Reconciling Amount	**$**	**62.4**
Items Reported as Reductions to Appropriations, Statement of Budgetary Resources		
Permanent and Temporary Reductions	**$**	**(79.5)**
Miscellaneous items		**0.8**
Items Reported in Net Cost of Operations, Statement of Changes in Net Position		
Trust and Special Fund Receipts	**$**	**141.2**
Total Reconciling Items	**$**	**62.4**

FY 2017 and FY 2016 Funds from Dedicated Collections are presented on a combined basis. The following tables summarize the elimination of intradepartmental activity between Funds from Dedicated Collections and all Other Fund types to arrive at the consolidated net position totals as presented on the Balance Sheet.

Period Ended September, 2017 Reconciliation of Combined Dedicated Collections and Other Funds to Consolidated Dedicated Collections and Other Funds			*Dollars in Millions*
Consolidating Net Position	Combined	Consolidating Eliminations	Consolidated
Unexpended Appropriations – Dedicated Collections	$ 0.0	$ 0.0	$ 0.0
Unexpended Appropriations – Other Funds	457,849.4	0.0	457,849.4
Cumulative Results of Operations – Dedicated Collections	14,618.9	(1,530.8)	16,149.7
Cumulative Results of Operations – Other Funds	(404,727.9)	1,530.8	(406,258.7)
Total Net Position	**$ 67,740.4**	**$ 0.0**	**$ 67,740.4**

Period Ended September, 2016 Reconciliation of Combined Dedicated Collections and Other Funds to Consolidated Dedicated Collections and Other Funds			*Dollars in Millions*
Consolidating Net Position	Combined	Consolidating Eliminations	Consolidated
Unexpended Appropriations – Dedicated Collections	$ 0.0	$ 0.0	$ 0.0
Unexpended Appropriations – Other Funds	450,026.1	0.0	450,026.1
Cumulative Results of Operations – Dedicated Collections	13,938.6	(1,555.1)	15,493.7
Cumulative Results of Operations – Other Funds	(483,511.5)	1,555.1	(485,066.6)
Total Net Position	**$ (19,546.8)**	**$ 0.0**	**$ (19,546.8)**

NOTE 20. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

Disclosures Related to the Statement of Budgetary Resources		*Dollars in Millions*
As of September 30	**2017**	**2016**
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 417,855.6	$ 401,966.2

Reconciliation Differences

When complying with the Office of Management and Budget and U.S. Treasury guidance, the FY 2017 Appropriations reported on the Statement of Budgetary Resources (SBR) exceed Appropriations Received on the Statement of Changes in Net Position by $66.3 billion and $62.4 billion in FY 2016. Reference Note 19, Disclosures Related to the Statement of Changes in Net Position, for additional details.

Differences exist between the amounts reported on the SBR and on the Budget of the U.S. Government (the Budget). The FY 2019 Budget will display the FY 2017 actual values and is expected to be published in February 2018. The FY 2018 Budget contains the actual values for FY 2016 reporting.

Reconciliation of Combined SBR to President's Budget				*Dollars in Billions*
	Fiscal Year 2016 Actual			
As of September 30	**Budgetary Resources**	**Obligations Incurred**	**Distributed Offsetting Receipts**	**Agency Outlays, Net**
Combined SBR – Budgetary and Non-Budgetary Financing Accounts	**$ 1,101.5**	**$ 945.8**	**$ 92.1**	**$ 728.4**
Differences:				
Adjustments to SBR	0.2[1]	0.2[1]	0.0	(0.1)[1]
Other	(0.1)[2]	(0.1)[2]	(0.1)	0.0
Budget of the U.S. Government	**$ 1,101.6**[3]	**$ 945.9**	**$ 92.0**	**$ 728.3**

1. *The $0.2 billion difference reported above for Budgetary Resources and New Obligations and Upward Adjustments and the $(0.1) billion difference for Agency Outlays, Net are primarily due to late adjustments to the SBR not reported in the Governmentwide Treasury Account Symbol Adjusted Trial Balance System which flows to the Office of Management and Budget MAX website.*
2. *The $(0.1) billion difference reported above for Budgetary Resources and New Obligations and Upward Adjustments is primarily due to different reporting requirements on the SBR versus the Budget and other differences requiring research.*
3. *The source of the Budgetary Resources figure was the DoD SBR to SF133 Reconciliation Summary on the Office of Management and Budget MAX website, as it represents the official 2016 budget.*

Permanent Indefinite Appropriations

The Department of Defense received the following permanent indefinite appropriations:

Department of the Army General Gift Fund (10 USC 2601(C)(1))
Department of the Navy General Gift Fund (10 USC 2601(C)(2))
Department of the Air Force General Gift Fund (10 USC 2601(C)(3))
Department of Defense General Gift Fund (10 USC 2601)
Disposal of Department of Defense Real Property (40 USC 485(h)(2)(A)(B))
Lease of Department of Defense Real Property (40 USC 485(h)(2)(A)(B))
Foreign National Employees Separation Pay Account, Defense (10 USC 1581)
United States Naval Academy Gift and Museum Fund (10 USC 6973-4)
Ship Stores Profits, Navy (10 USC 7220, 31 USC 1321)
Burdensharing Contributions (10 USC 2350j)
Forest Program (10 USC 2665)
Medicare-Eligible Retiree Health Care Fund (10 USC 1111)
Military Retirement Fund (10 USC 1461)
Education Benefits Fund (10 USC 2006)
Host Nation Support for U.S. Relocation Activities (10 USC 2350k)
Hydraulic Mining Debris Reservoir (33 USC 683)
Maintenance and Operation of Dams and Other Improvements of Navigable Waters (16 USC 810(a))
Payments to States (33 USC 701c-3)
Wildlife Conservation (16 USC 670-670(f))
Ainsworth Bequest (31 USC 1321)
DoD Family Housing Improvement Fund (10 USC 2883 (a))
DoD Military Unaccompanied Housing Improvement Fund (10 USC 2883 (a))
Voluntary Separation Incentive Fund (10 USC 1175(h))
Rivers & Harbors Contributed Funds (33 USC 560, 701h)
Concurrent Receipt Accrual Payments to the Military Retirement Fund (10 USC 1466(b)(1))
Rocky Mountain Arsenal, Restoration (100 Statute, 4003 SEC 1367)
Homeowners Assistance Fund (10 USC 4551-4555; 42 USC 3374(d); Public Law 111-5)
Payments to Military Retirement Fund, Defense (10 USC, 1466)
Payment to Department of Defense Medicare-Eligible Retiree Health Care Fund (10 USC 1116(a))
Medicare-Eligible Retiree Health Fund Contribution, Navy (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, Marine Corps (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, Army (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Army (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, National Guard Personnel, Army (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, Air Force (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Air Force (10 USC 1116)
Medicare-Eligible Retiree Health Fund Contribution, National Guard Personnel, Air Force (10 USC 1116)
Department of Defense Vietnam War Commemoration Fund, Defense (PL 110-181, 122 Stat. 141 (Sec. 598))

The preceding permanent indefinite appropriations cover a wide variety of purposes to help the Department accomplish its missions. These purposes primarily include: (1) military retirees' health care benefits, retirement and survivor pay, and education benefits for veterans; (2) wildlife habitat restoration and water resources maintenance; (3) relocation of armed forces within a host nation; (4) separation payments for foreign nationals; and (5) upkeep of libraries and museums.

Apportionment Categories for New Obligations and Upward Adjustments (Total)

Apportionment categories are determined in accordance with the guidance provided in Office of Management and Budget *(OMB) Circular No. A-11*, "Preparation, Submission and Execution of the Budget." Category A relates to appropriations for a specific period of time (e.g., Military Personnel appropriation), and Category B relates to appropriations for a specific project (e.g., Military Construction appropriation). The Department reported the following amounts of new obligations and upward adjustments (total):

Period Ended September 30, 2017				*Dollars in Billions*
	Apportionment Category A	**Apportionment Category B**	**Exempt From Apportionment**	**Total**
Obligations Incurred – Direct	$ 409.1	$ 237.9	$ 153.0	$ 800.0
Obligations Incurred – Reimbursable	16.2	157.0	8.4	181.6
Total Obligations Incurred:	**$ 425.3**	**$ 394.9**	**$ 161.4**	**$ 981.6**

Period Ended September 30, 2016				*Dollars in Billions*
	Apportionment Category A	**Apportionment Category B**	**Exempt From Apportionment**	**Total**
Obligations Incurred – Direct	$ 396.1	$ 227.9	$ 148.8	$ 772.8
Obligations Incurred – Reimbursable	15.5	149.5	8.0	173.0
Total Obligations Incurred:	**$ 411.6**	**$ 377.4**	**$ 156.8**	**$ 945.8**

Legal Arrangements Affecting the Use of Unobligated Balances

A portion of the Department's unobligated balances represent trust fund receipts collected in the current fiscal year exceeding the amount needed to pay benefits or other valid obligations. These receipts are temporarily precluded from obligation by law due to a benefit formula or other limitation. The receipts, however, are assets of the funds and are available for obligation in the future. The Department operates within the constraints of fiscal law and has no additional legal arrangements affecting the use of unobligated balances.

Other Disclosures

In compliance with OMB guidance, $119.0 billion of FY 2017 General Fund appropriations received by the Department are also recognized on the SBR as appropriations received for trust and special funds and $115.5 billion in FY 2016. OMB guidance requires duplicate reporting on the SBR of the Military Services' contributions and U.S. Treasury's payments to the Military Retirement Trust Fund and Medicare-Eligible Retiree Health Care Fund.

The SBR includes intra-entity transactions because the statements are presented as combined.

The Department utilizes borrowing authority for the Military Housing Privatization Initiative. Borrowing authority is used in compliance with *OMB Circular No. A-129*, "Policies for Federal Credit Programs and Non-Tax Receivables."

In FY 2017 the Department received additional funding of $82.8 billion to cover obligations incurred above baseline operations in support of contingency operations and $58.6 billion in FY 2016.

U.S. Army Maj. Gen. Duane A Gamble, center, the commander of the 21st Theater Sustainment Command, participates in improvise explosive device training with U.S. Soldiers, assigned to the 702nd Explosive Ordnance Disposal (EOD) Company, 16th Sustainment Brigade, during exercise Vanguard Proof at Pocek Range in Postonja, Slovenia, March 22, 2017. Vanguard Proof is a combined U.S. and Slovenian tactical military exercise designed to strengthen military relationships and increase readiness for both nations.

Photo by Paolo Bovo

NOTE 21. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

Reconciliation of Net Cost of Operations to Budget		*Dollars in Millions*
As of September 30	**2017**	**2016**
Resources Used to Finance Activities		
Budgetary Resources Obligated:		
Obligations incurred	$ 981,610.9	$ 945,835.9
Less: Spending authority from offsetting collections and recoveries (-)	(222,120.7)	(219,272.4)
Obligations net of offsetting collections and recoveries	**$ 759,490.2**	**$ 726,563.5**
Less: Distributed Offsetting receipts (-)	(97,963.0)	(92,078.2)
Net obligations	**$ 661,527.2**	**$ 634,485.3**
Other Resources:		
Donations and forfeitures of property	$ 2.4	$ 1.8
Transfers in/out without reimbursement (+/-)	139.7	94.1
Imputed financing from costs absorbed by others	3,673.9	4,573.4
Other (+/-)	(5,390.9)	12,291.0
Net other resources used to finance activities	**$ (1,574.9)**	**$ 16,960.3**
Total resources used to finance activities	**$ 659,952.3**	**$ 651,445.6**
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:		
Undelivered Orders (-)	$ (15,889.4)	$ 30,209.2
Unfilled Customer Orders	3,327.5	1,738.6
Resources that fund expenses recognized in prior Periods (-)	(31,928.9)	(71,848.0)
Budgetary offsetting collections and receipts that do not affect Net Cost of Operations	559.3	929.9
Resources that finance the acquisition of assets (-)	(106,271.6)	(110,735.2)
Other resources or adjustments to net obligated resources that do not affect Net Cost of Operations:		
Less: Trust or Special Fund Receipts Related to exchange in the Entity's Budget (-)	(255.7)	(297.2)
Other (+/-)	5,384.0	(12,398.7)
Total resources used to finance items not part of the Net Cost of Operations	**$ (145,074.8)**	**$ (162,401.4)**
Total resources used to finance the Net Cost of Operations	**$ 514,877.5**	**$ 489,044.2**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability	$ 244.5	$ 59.0
Increase in environmental and disposal liability	1,644.9	2,320.7
Upward/Downward reestimates of credit subsidy expense (+/-)	(8.7)	40.3
Increase in exchange revenue receivable from the public (-)	(16.9)	371.8
Other (+/-)	97,606.6	71,644.3
Total components of Net Cost of Operations that will Require or Generate Resources in future periods	**$ 99,470.4**	**$ 74,436.1**
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 14,885.1	$ 34,741.5
Revaluation of assets or liabilities (+/-)	2,170.2	(1,860.9)

Reconciliation of Net Cost of Operations to Budget *As of September 30*	*Dollars in Millions* **2017**	**2016**
Other (+/-)		
Trust Fund Exchange Revenue	(51,990.0)	(47,295.0)
Cost of Goods Sold	63,126.6	59,210.3
Operating Materiel and Supplies Used	39,100.3	51,872.9
Other	(43,748.9)	(70,515.5)
Total Components of Net Cost of Operations that will not Require or Generate Resources	**$ 23,543.3**	**$ 26,153.3**
Total components of Net Cost of Operations that will not Require or Generate Resources in the current period	**$ 123,013.7**	**$ 100,589.4**
Net Cost of Operations	**$ 637,891.2**	**$ 589,633.6**

The Reconciliation of Net Cost of Operations to Budget reconciles the cost reflected on the Statement of Net Cost to the budgetary information on the Statement of Budgetary Resources. This is accomplished by aligning budgetary obligations and non-budgetary resources available with the cost of the Department's operations.

Abnormal Balances

The FY 2017 Revaluation of assets or liabilities (+/-) includes an abnormal balance of $67.9 million in USSGL 711000, Gains on Disposition of Assets - Other due to the reversal of a gain erroneously recorded in FY 2016. This account balance will close to zero at the end of this fiscal year.

The FY 2017 Resources that finance the acquisition of assets includes an abnormal balance of $10.1 million in USSGL 880400, Purchases of Assets – Other. The Department is currently researching and anticipates correction in FY 2018.

Other Disclosures

Due to the Department's financial systems limitations, budgetary data does not agree with proprietary expenses and capitalized assets. This difference is a previously identified deficiency.

The following adjustments (absolute value) were made to balance the Reconciliation of Net Cost of Operations to Budget:

Adjustment to Reconcile Net Cost of Operations to Budget *As of September 30*	*Dollars in millions* **2017**	**2016**
Resources that Finance the Acquisition of Assets	$ 5,286.9	$ 8,380.6
Revaluation of Assets or Liabilities	$ 2,763.7	$ 1,804.1
Other Components not Requiring or Generating Resources	$ 1,950.2	$ 8,386.2
Total Amount	**$ 10,000.8**	**$ 18,570.9**

The following Reconciliation of Net Cost of Operations to Budget lines are presented as combined instead of consolidated as intra-agency budgetary transactions are not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Other Resources, Other primarily consists of non-exchange gains and losses to revalue assets, as well as reconcile the proprietary and budgetary amounts.

Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations, Other primarily consists of non-exchange gains and losses to revalue assets, as well as reconcile the proprietary and budgetary amounts.

Components Requiring or Generating Resources in Future Period, Other consists primarily of future funded expenses.

Components not Requiring or Generating Resources, Other primarily consists of cost capitalization offsets, applied overhead, and other expenses not requiring budgetary resources.

NOTE 22. DISCLOSURES RELATED TO INCIDENTAL CUSTODIAL COLLECTIONS

In FY 2017 The Department collected $1.5 million of incidental custodial revenues generated primarily from forfeitures of unclaimed money and property and $5.5 million in FY 2016. These funds are not available for use by the Department. At the end of each fiscal year, the accounts are closed and the balances are relinquished to the U.S. Treasury.

Airmen camouflage themselves during sniper training, Feb. 1, 2017, at Moody Air Force Base, Ga. Airmen had to prove they could neutralize a target without giving away their position. Airmen had two hours to crawl to a secluded spot, identify a target on a clipboard and fire their weapon without giving away their position.

Photo by Airman 1st Class Janiqua P. Robinson

NOTE 23. FUNDS FROM DEDICATED COLLECTIONS

Funds from Dedicated Collections ***(Combined)***				*Dollars in Millions*
	2017			
As of September 30	**Harbor Maintenance Trust Fund**	**Rivers and Harbors Contributed and Advance Fund**	**Other Funds**	**Total Funds from Dedicated Collections**
Balance Sheet				
Assets				
Fund Balance with Treasury	$ 118.7	$ 1,279.5	$ 2,087.2	$ 3,485.4
Investments	9,095.3	0.0	1,279.3	10,374.6
Accounts and Interest Receivable	509.2	6.4	9.5	525.1
Other Assets	597.4	288.5	742.1	1,628.0
Total Assets	**$ 10,320.6**	**$ 1,574.4**	**$ 4,118.1**	**$ 16,013.1**
Liabilities and Net Position				
Accounts Payable and Other Liabilities	6.1	1,324.5	63.6	1,394.2
Total Liabilities	**$ 6.1**	**$ 1,324.5**	**$ 63.6**	**$ 1,394.2**
Cumulative Results of Operations	$ 10,314.5	$ 249.9	$ 4,054.5	$ 14,618.9
Total Liabilities and Net Position	**$ 10,320.6**	**$ 1,574.4**	**$ 4,118.1**	**$ 16,013.1**
Statement of Net Cost				
Program Costs	$ 64.8	$ 318.7	$ 1,079.3	$ 1,462.8
Less Earned Revenue	0.0	(439.5)	(282.9)	(722.4)
Net Program Costs	64.8	(120.8)	796.4	740.4
Net Cost of Operations	**$ 64.8**	**$ (120.8)**	**$ 796.4**	**$ 740.4**
Statement of Changes in Net Position				
Net Position Beginning of the Period	$ 9,972.2	$ 232.9	$ 3,733.5	$ 13,938.6
Net Cost of Operations	(64.8)	120.8	(796.4)	(740.4)
Budgetary Financing Sources	407.1	0.0	1,023.3	1,430.4
Other Financing Sources	0.0	(103.8)	94.1	(9.7)
Change in Net Position	**$ 342.3**	**$ 17.0**	**$ 321.0**	**$ 680.3**
Net Position End of Period	**$ 10,314.5**	**$ 249.9**	**$ 4,054.5**	**$ 14,618.9**

Funds from Dedicated Collections ***(Combined)***								*Dollars in Millions*
	2016							
As of September 30	**Harbor Maintenance Trust Fund**		**Rivers and Harbors Contributed and Advance Fund**		**Other Funds**		**Total Funds from Dedicated Collections**	
Balance Sheet								
Assets								
Fund Balance with Treasury	$	112.1	$	1,264.6	$	2,147.0	$	3,523.7
Investments		8,773.3		0.0		864.1		9,637.4
Accounts and Interest Receivable		492.4		0.6		7.6		500.6
Other Assets		600.5		260.8		777.4		1,638.7
Total Assets	**$**	**9,978.3**	**$**	**1,526.0**	**$**	**3,796.1**	**$**	**15,300.4**
Liabilities and Net Position								
Accounts Payable and Other Liabilities		6.1		1,293.1		62.6		1,361.8
Total Liabilities	**$**	**6.1**	**$**	**1,293.1**	**$**	**62.6**	**$**	**1,361.8**
Cumulative Results of Operations	$	9,972.2	$	232.9	$	3,733.5	$	13,938.6
Total Liabilities and Net Position	**$**	**9,978.3**	**$**	**1,526.0**	**$**	**3,796.1**	**$**	**15,300.4**
Statement of Net Cost								
Program Costs	$	86.3	$	162.9	$	1,244.9	$	1,494.1
Less Earned Revenue		0.0		(428.5)		(277.0)		(705.5)
Net Program Costs		86.3		(265.6)		967.9		788.6
Net Cost of Operations	**$**	**86.3**	**$**	**(265.6)**	**$**	**967.9**	**$**	**788.6**
Statement of Changes in Net Position								
Net Position Beginning of the Period	$	9,897.9	$	(14.2)	$	3,339.5	$	13,223.2
Net Cost of Operations		(86.3)		265.6		(967.9)		(788.6)
Budgetary Financing Sources		160.6		0.0		1,311.4		1,472.0
Other Financing Sources		0.0		(18.5)		50.5		32.0
Change in Net Position	**$**	**74.3**	**$**	**247.1**	**$**	**394.0**	**$**	**715.4**
Net Position End of Period	**$**	**9,972.2**	**$**	**232.9**	**$**	**3,733.5**	**$**	**13,938.6**

The Statement of Federal Financial Accounting Standards *(SFFAS) 43*, "Funds from Dedicated Collections: Amending SFFAS 27, Identifying and Reporting Earmarked Funds," requires disclosure of Funds from Dedicated Collections separate from All Other Funds on the Balance Sheet. Funds must meet three criteria to be classified as funds from dedicated collections: (1) a statute committing the use of specifically-identified revenues provided by non-Federal sources for designated purposes; (2) explicit authority to retain the revenues; and (3) a requirement to separately account and report on the revenues. The Department's funds from dedicated collections are either special or trust funds and use both receipt and expenditure accounts to report activity to U.S. Treasury. There has been no legislation significantly altering the purposes of the funds.

The Total column is shown as combined and relates only to Funds from Dedicated Collections. The net position amounts in the Total column will not equal the amounts reported as Funds from Dedicated Collections on the Balance Sheet, as the Balance Sheet reflects consolidated Funds from Dedicated Collections. Reference Note 19, Disclosures Related to the Statement of Changes in Net Position, for additional details.

The Department has the following Funds from Dedicated Collections:

Harbor Maintenance Trust Fund, title 26 U.S. Code, *section 9505*. The United States Army Corps of Engineers (USACE) Civil Works mission is funded by the Energy and Water Development Appropriations Act. The *Water Resources Development Act of 1986* covers a portion of USACE operations and maintenance costs for deep draft navigation. The Harbor Maintenance Trust Fund is available for making expenditures to carry out the functions specified in the Act and for the payment of all administrative expenses incurred by the U.S. Treasury, USACE, and the Department of Commerce. Taxes collected from imports, domestics, passengers, and foreign trade are deposited into the Trust Fund. The Bureau of the Fiscal Service manages and invests for the Trust Fund.

Rivers and Harbors Contributed and Advance Funds, title 33 U.S. Code, *sections 701h, 702f, and 703*. Whenever any state or political subdivision offers to advance funds for a flood control project authorized by law, the Secretary of the Army may accept such funds and expend them in the immediate performance of such work. The funding is used to construct, improve, and maintain levees, water outlets, flood control, debris removal, rectification and enlargement of river channels, etc. in the course of flood control and river and harbor maintenance.

Other Funds from Dedicated Collections

Special Recreation Use Fees, title 16 U.S. Code, *section 460I-6a note*. The USACE charges and collects Special Recreation Use Fees at campgrounds located at lakes and reservoirs under their jurisdiction. Allowable fees include daily use fees, admission fees, recreational fees, annual pass fees, and other permit type fees. Receipts cover operation and maintenance of recreational sites.

Hydraulic Mining in California, Debris, title 33 U.S. Code, *section 683*. Operators of hydraulic mines allowing debris to flow to a body restrained by a dam or other work erected by the California Debris Commission are required to pay an annual tax as determined by the Commission. The USACE collects taxes and expends funds under the direction of the Department of the Army. Funds repay advances by the Federal Government or other agencies for construction, restraining works, settling reservoirs, and maintenance.

Payments to States, Flood Control Act of 1954, title 33 U.S. Code, *section 701c-3*. The USACE collects receipts for the leasing of lands acquired by the U.S. for flood control, navigation, and allied purposes (including the development of hydroelectric power). Funds received are appropriated and made available for use in the following fiscal year with seventy-five percent of funds provided to the state where the property is located. States may expend the funds for the benefit of public schools and public roads of the counties where the property is located, or for defraying county government expenses.

Maintenance and Operation of Dams and Other Improvements of Navigable Waters, title 16 U.S. Code, *sections 803(f) and 810*. The Federal Energy Regulatory Commission (FERC) assesses charges against licensees when a reservoir or other improvement is constructed by the U.S. All proceeds from Indian reservations are credited to the Indians of the reservations. All other proceeds arising from licenses, except those established by the FERC for administrative reimbursement, are paid to the U.S. Treasury and allocated for specific uses. The Department of the Army is allocated fifty percent of charges from all licenses, except licenses for the occupancy and use of public lands and national forests. These funds are deposited in a special fund and used for maintenance, operation, and improvement of dams and other navigation structures owned by the U.S., or in construction, maintenance, or operation of headwater, or other improvements to navigable waters of the U.S.

Fund for Non-Federal Use of Disposal Facilities (for dredged material), title 33 U.S. Code *section 2326*. Non-Federal interests may use dredged material disposal facilities under the jurisdiction of, or managed by, the Secretary of the Army if the Secretary determines use will not reduce the availability of the facility for project purposes. Fees may be imposed to recover capital, operation, and maintenance costs of the disposal facility from which the fees were collected.

Coastal Wetlands Restoration Trust Fund and Coastal Wetlands Planning, Protection, and Restoration Act, title 16 U.S. Code, *sections 3951-3956*. The USACE, Environmental Protection Agency, and Fish and Wildlife Service are authorized to work with the State of Louisiana to achieve a goal of "no net loss of wetlands" in coastal Louisiana. The USACE is also responsible for allocating funds. Federal contributions are 75 percent of project costs or 85 percent if the state has an approved Coastal Wetlands Conservation Plan. This Trust Fund receives funding from the Sport Fish Restoration and Boating Trust Fund

Inland Waterways Trust Fund, title 26 U.S. Code, *section 9506*. Excise taxes from the public are used by USACE for navigation, construction, and rehabilitation projects on inland waterways. The BFS manages and invests for the Trust Fund.

Defense Commissary Agency Surcharge Trust Fund, title 10 U.S. Code, *section 2685*. Surcharge on sales of commissary goods finance the Commissary System operating expenses and capital purchases, precluded by law from being paid with appropriated funds. Revenue is generated through a five percent surcharge applied to each sale. These funds finance commissary-related information technology investments, equipment, advance design modifications to prior year construction projects, and maintenance and repair of facilities and equipment.

NOTE 24. FIDUCIARY ACTIVITIES

Schedule of Fiduciary Activity		*Dollars in Millions*
As of September 30	**2017**	**2016**
Fiduciary net assets, beginning of year	**$ 80.1**	**$ 80.9**
Contributions	73.5	90.4
Investment earnings	0.3	0.3
Distributions to and on behalf of beneficiaries	(76.1)	(91.5)
Increase/(Decrease) in fiduciary net assets	**(2.3)**	**(0.8)**
Fiduciary net assets, end of period	**$ 77.8**	**$ 80.1**

Schedule of Fiduciary Net Assets		*Dollars in Millions*
As of September 30	**2017**	**2016**
Fiduciary Assets		
Cash and cash equivalents	$ 77.8	$ 80.1
Total Fiduciary Net Assets	**$ 77.8**	**$ 80.1**

Fiduciary activities exist when the Department has collected, received, held, or made disposition of assets on behalf of an individual or non-Federal entity. Fiduciary assets are not recognized on the Balance Sheet.

Public Law 89-538 authorized the Department, through the Savings Deposit Program, to collect voluntary contributions from members of the Armed Forces serving in designated areas. These contributions and earned interest are deposited in the U.S. Treasury on behalf of the members.

NOTE 25. OTHER DISCLOSURES

Other Disclosures				*Dollars in Millions*
	2017 – Asset Category			
As of September 30	**Land and Buildings**	**Equipment**	**Other**	**Total**
Entity as Lessee – Operating Leases				
Future Payments Due				
Fiscal Year 2018	$ 732.5	$ 8.8	$ 78.1	$ 819.4
Fiscal Year 2019	531.1	8.5	70.4	610.0
Fiscal Year 2020	530.2	7.7	66.9	604.8
Fiscal Year 2021	532.2	7.6	63.4	603.2
Fiscal Year 2022	506.8	7.4	63.5	577.7
After 5 Years	952.9	4.8	45.1	1,002.8
Total Future Lease Payments Due	**$ 3,785.7**	**$ 44.8**	**$ 387.4**	**$ 4,217.9**

Operating leases do not transfer the benefits and risks of ownership as compared to capital leases. Payments are expensed over the life of the lease. Future year cost projections use the Consumer Price Index. Office space is the largest component of land and building leases. Other leases are primarily commercial leases with the general public and include automobile leases.

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

Federal financial reporting requires the Department to report on its stewardship over certain resources that cannot be measured in traditional financial reports. These resources do not meet the criteria for assets and liabilities required to be reported in the financial statements, but are important to understand the operations and financial condition of the Department at the date of the financial statements and in subsequent periods.

The Department's stewardship investments are comprised of, and are measured in terms of, expenditures for: (1) Nonfederal Physical Property (federally-financed, but not federally owned) and (2) federally-financed Research and Development (R&D). Information on additional reporting requirements for Nonfederal Physical Property and R&D follows.

NON-FEDERAL PHYSICAL PROPERTY

The Nonfederal Physical Property investments support the purchase, construction, or major renovation of physical property owned by state and local governments. In addition, Nonfederal Physical Property investments include federally-owned physical property transferred to state and local governments. The Department participates in cost-sharing agreements with nonfederal sponsors which are governed under numerous Water Resources Development Acts. The Department's transferred assets include expenditures supporting the design, build, and construction services/management for the missions of commercial navigation, flood/storm damage reduction, hydropower, regulatory, environmental, recreation and water supply.

Non-Federal Physical Property
Department of Defense Consolidated – Non-Federal Physical Property

Yearly Investments in State and Local Governments
For Fiscal Years 2013 through 2017 *Dollars in Millions*

Categories	2017	2016	2015	2014	2013
Transferred Assets:					
National Defense Mission Related	$ 1,011.4	$ 1,265.2	$ 1,307.2	$ 1,113.2	$ 1,376.8
Funded Assets:					
National Defense Mission Related	$ 15.5	$ 17.2	$ 12.7	$ 12.4	$ 11.8
Total	**$ 1,026.9**	**$ 1,282.4**	**$ 1,319.9**	**$ 1,125.6**	**$ 1,388.6**

INVESTMENTS IN RESEARCH AND DEVELOPMENT

Investment values included in this report are based on R&D expenditures. The R&D programs are classified in the following categories: Basic Research, Applied Research, and Development. The amounts reported in the Investments in R&D table show outlays from FY 2013 – FY 2017 for all DoD Components. The definition for each type of R&D Category and Subcategories are explained below.

Basic Research is the systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

Applied Research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is the practical application of such knowledge or understanding for the purpose of meeting a recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs are scientific studies, investigations, research papers, hardware components, software codes, or limited construction of a weapon system component, to include non-system-specific development efforts. Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development consists of the five stages defined in the Investments in R&D table.

Advanced Technology Development is the systematic use of the knowledge or understanding gained from research and directed toward proof of concept and feasibility rather than directed toward the development of hardware for service use. It employs demonstration activities intended to test a technology or method.

Advanced Component Development and Prototypes evaluates integrated technologies in an operating environment as realistic as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components and complete weapon systems ready for operational and developmental testing and field use.

System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapons systems finalized for complete operational and developmental testing.

Research, Development, Test, and Evaluation Management Support bolsters installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operation and maintenance of test aircraft and ships, and studies and analyses furthering the Research and Development program.

Operational Systems Development finances projects, programs, or upgrades in engineering and manufacturing development stages which have received approval for production, including production funds that have been budgeted in subsequent fiscal years.

Investments in Research and Development (R&D) **Department of Defense Consolidated** *Yearly Investments in Research and Development* *For the Current and Four Preceding Fiscal Years*					*Dollars in Millions*
Categories	**2017**	**2016**	**2015**	**2014**	**2013**
Basic Research	**$ 1,960.3**	**$ 2,106.8**	**$ 1,958.0**	**$ 1,948.2**	**$ 1,841.5**
Applied Research	6,988.6	6,307.5	5,744.7	5,500.6	5,477.4
Development					
Advanced Technology Development	5,736.5	5,525.8	5,007.6	5,253.3	4,898.3
Advanced Component Development and Prototypes	13,965.7	12,517.9	11,954.9	10,947.0	12,464.8
System Development and Demonstration	11,487.3	11,037.7	10,733.8	11,459.7	12,524.6
Research, Development, Test and Evaluation Management Support	5,189.3	5,335.5	5,163.3	5,262.5	4,906.5
Operational Systems Development	21,611.1	20,428.8	20,441.9	20,334.3	21,180.9
Totals:	**$ 66,938.8**	**$ 63,260.0**	**$ 61,004.2**	**$ 60,705.6**	**$ 63,294.0**

The U.S. Air Force's 45th Space Wing supported NASA's successful launch of Orbital ATK's Cygnus spacecraft aboard a United Launch Alliance Atlas V rocket from Space Launch Complex 41 here April 18 at 11:11 a.m. ET.

REQUIRED SUPPLEMENTARY INFORMATION

This section includes the deferred maintenance and repairs information and Statement of Disaggregated Budgetary Resources in accordance with Statement of Federal Financial Accounting Standards *(SFFAS) 42*, "Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32."

REAL PROPERTY DEFERRED MAINTENANCE AND REPAIRS

Real Property Deferred Maintenance and Repairs
As of September 30, 2016 *Dollars in Millions*

Property Type	FY 2017		
	1. Plant Replacement Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage
1. Category 1	$ 1,133,177.7	$ 101,482.3	9%
2. Category 2	$ 85,997.0	$ 10,536.6	12%
3. Category 3	$ 22,227.8	$ 4,756.0	21%
Total	**$ 1,241,402.5**	**$ 116,774.9**	**9%**

Property Type	FY 2016		
	1. Plant Replacement Value	2. Required Work (Deferred Maintenance & Repair)	3. Percentage
1. Category 1	$ 1,094,166.9	$ 116,366.5	11%
2. Category 2	$ 77,488.1	$ 12,552.8	16%
3. Category 3	$ 33,389.9	$ 6,278.7	19%
Total	**$ 1,205,044.9**	**$ 135,198.0**	**11%**

Maintenance and repairs are activities directed toward keeping real property assets in an acceptable condition. Activities include preventive maintenance; replacement of parts, systems, or components; and other activities needed to preserve or maintain the asset. Maintenance and repairs, as distinguished from capital improvements, exclude activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use.

Deferred Maintenance and Repairs (DM&R) are maintenance and repairs that were not performed when they should have been or were scheduled to be and which are put off or delayed for a future period. DM&R are identified through condition assessment surveys in accordance with the September 10, 2013 Under Secretary of Defense for Acquisition Technology and Logistics policy memorandum, "*Standardizing Facility Condition Assessments*." The real property record is the data source for obtaining the total deferred maintenance and repairs for the Agency Financial Report. Facility Categories are as follows:

- 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 multi-use Heritage Assets.

As of the end of FY 2017, the Department estimates facility maintenance cost of more than $116.8 billion for facilities with replacement cost of $1.2 trillion. The totals include $2 billion in civil works related maintenance needs under the USACE with replacement cost of more than $267.1 billion. The decrease in the Department's estimate from FY 2016 is primarily attributable to the Navy's implementation of the Facility Condition Index (FCI) to determine DM&R.

Maintenance and Repair Policies

The Department is migrating to the Sustainment Management System (SMS), to perform a cyclical assessment of real property facilities and assign a facility condition index, which considers an asset's key life-cycle attributes such as age and material.

Maintenance and Repair Prioritization and Acceptable Condition Standards

The Department considers mission, health and safety, and quality of life when assigning priority to maintenance needs and assessing whether a facility is in acceptable condition. Generally, an asset is considered acceptable when it is in good condition with an assigned FCI off 90 percent or above.

Deferred Maintenance and Repair Exclusions

The deferred maintenance and repair information presented relates to all DoD facilities and is not restricted to capitalized assets.

EQUIPMENT DEFERRED MAINTENANCE AND REPAIRS

Equipment Deferred Maintenance and Repairs *For Fiscal Year Ended September 30* *in Millions*		*Dollars*
Major Categories	**2017**	**2016**
1. Aircraft	$ 1,003.6	$ 407.3
2. Automotive Equipment	432.7	385.6
3. Combat Vehicles	258.8	190.1
4. Construction Equipment	5.7	10.8
5. Electronics and Communications Systems	351.3	30.7
6. Missiles	127.7	82.6
7. Ships	249.4	301.7
8. Ordnance Weapons and Munitions	50.2	42.1
9. All Other Items Not Identified to above Categories	298.4	278.8
Total	**$ 2,777.8**	**$ 1,729.7**

Maintenance and Repair Policies

Depot maintenance requirements for equipment are developed during the annual budget process and updated based on work completion, shifts in priorities, work stoppages, or additional requirements. Not all unfunded depot maintenance requirements are deferred. Supporting the Planning Programming and Budgeting Execution (PPBE) system, the Military Services all have fairly detailed and methodical processes for determining their depot maintenance requirements. During this process, and as more information becomes available, depot requirements are adjusted and refined, and the amount of funding determined, based on Military Service priorities and assessment of risk.

Eventually, Service depot maintenance requirements and funding amounts are included in the baseline budget. In the year of execution, the Military Services may take steps to either mitigate, or exacerbate the levels of deferred maintenance depending upon the availability of resources and Service priorities. The Military Services may take steps to mitigate deferred maintenance through the reprogramming of resources from cancelled programs, or from those of a lesser priority, or utilize supplemental funding. The Military Services may also cancel requirements, direct maintenance be performed at the field-level, or even reduce force structure and reprogram those O&M funds.

Maintenance and Repair Prioritization and Acceptable Condition Standards

The Department prioritizes maintenance and repair requirements based on mission and health and safety. In addition emerging requirements and real world events drive review and reprioritization of maintenance and repair requirements. The Department employs risk-based methodologies in determining acceptable levels of equipment operational risk.

Deferred Maintenance and Repair Exclusions

The deferred maintenance and repair information presented relates to all DoD equipment and is not restricted to capitalized assets.

Significant Changes in Deferred Maintenance and Repair

The Department's deferred maintenance and repair work for equipment, platforms, and weapon systems increased by $1.0 billion during FY 2017. A large portion of the increase was driven by aircraft maintenance deferrals. Other areas with significant increases were individual and soldier equipment items and electronic and communications systems maintenance. Newly fielded digital technologies that did not exist in previous years also contributed to the increase.

Lt. j.g. Brandon Rivera, assigned to Underwater Construction Team (UCT) 1, dives on a plane wreck during diver-qualification training off the coast of Naval Station Guantanamo Bay, Feb. 15, 2017. UCT 1 provides a capability for construction, inspection, repair and maintenance of ocean facilities in support of Naval operations.

Photo by Mass Communication Specialist 2nd Class Sean Furey

Statement of Disaggregated Budgetary Resources *For the Years Ended September 30* *Dollars in Millions*	**2017**							
	Military Personnel	**Procurement**	**Research, Development, Test and Evaluation**	**Family Housing/ Military Construction**	**Military Retirement Benefits**	**Civil Works**	**Operations, Readiness & Support**	**2017 Combined**
Budgetary Resources								
Unobligated balance, brought forward, October 1	$ 4,210.3	$ 61,733.3	$ 15,290.9	$ 14,894.8	$ 0.0	$ 9,911.8	$ 49,515.3	$ 155,556.4
Adjustment to unobligated balance brought forward, Oct 1 (+ or -)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unobligated balance brought forward, Oct 1, as adjusted	4,210.3	61,733.3	15,290.9	14,894.8	0.0	9,911.8	49,515.3	155,556.4
Recoveries of prior year unpaid obligations	5,098.8	7,138.6	4,495.6	1,391.1	0.0	331.2	31,258.0	49,713.3
Other changes in unobligated balance	(2,072.1)	(2,768.6)	78.9	(757.0)	0.0	6.9	(18,773.8)	(24,285.7)
Unobligated balance from prior year budget authority, net	7,237.0	66,103.3	19,865.4	15,528.9	0.0	10,249.9	61,999.5	180,984.0
Appropriations (discretionary and mandatory)	139,378.1	124,108.8	75,852.3	6,818.8	67,652.2	7,625.7	355,545.8	776,981.7
Contract Authority (discretionary and mandatory)	0.0	0.0	0.0	0.0	0.0	0.0	76,540.2	76,540.2
Spending Authority from offsetting collections (discretionary and mandatory)	1,288.5	3,379.7	9,618.1	4,988.0	0.0	11,929.8	74,501.8	105,705.9
Total Budgetary Resources	**$ 147,903.6**	**$ 193,591.8**	**$ 105,335.8**	**$ 27,335.7**	**$ 67,652.2**	**$ 29,805.4**	**$ 568,587.3**	**$ 1,140,211.8**
Status of Budgetary Resources:								
New obligations and upward adjustments (total)	144,236.1	132,572.2	86,162.6	12,995.8	67,652.2	18,261.3	519,601.3	981,481.5
Unobligated balance, end of year:								
Apportioned, unexpired accounts	356.2	57,701.9	16,576.9	12,695.8	0.0	9,738.3	19,380.5	116,449.6
Exempt from Apportionment, unexpired accounts	0.0	0.0	0.0	0.0	0.0	1,800.6	4,958.6	6,759.2
Unapportioned, unexpired accounts	0.0	(422.4)	9.6	206.7	0.0	0.1	2,116.5	1,910.5
Unexpired unobligated balance, end of year	356.2	57,279.5	16,586.5	12,902.5	0.0	11,539.0	26,455.6	125,119.3
Expired unobligated balance, end of year	3,311.3	3,740.1	2,586.7	1,437.4	0.0	5.1	22,530.4	33,611.0
Unobligated balance, end of year	**$ 3,667.5**	**$ 61,019.6**	**$ 19,173.2**	**$ 14,339.9**	**$ 0.0**	**$ 11,544.1**	**$ 48,986.0**	**$ 158,730.3**
Total Budgetary Resources	**$ 147,903.6**	**$ 193,591.8**	**$ 105,335.8**	**$ 27,335.7**	**$ 67,652.2**	**$ 29,805.4**	**$ 568,587.3**	**$ 1,140,211.8**

Statement of Disaggregated Budgetary Resources *For the Years Ended September 30* *Dollars in Millions*	2017							
	Military Personnel	Procurement	Research, Development, Test and Evaluation	Family Housing/ Military Construction	Military Retirement Benefits	Civil Works	Operations, Readiness & Support	2017 Combined
Change in Obligated Balance								
Unpaid obligations								
Unpaid obligations, brought forward, October 1 (Gross)	$ 8,558.3	$ 140,403.4	$ 47,240.8	$ 18,666.4	$ 736.4	$ 7,492.6	$ 183,671.5	$ 406,769.4
New obligations and upward adjustments	144,236.1	132,570.7	86,162.6	12,995.8	67,652.2	18,261.3	519,602.8	981,481.5
Outlays (gross)	(139,270.5)	(108,187.2)	(79,519.1)	(11,082.3)	(67,676.3)	(18,010.7)	(476,088.3)	(899,834.4)
Recoveries of prior year unpaid obligations	(5,098.8)	(7,138.6)	(4,495.5)	(1,391.1)	0.0	(331.2)	(31,258.1)	(49,713.3)
Unpaid Obligations, end of year	**8,425.1**	**157,648.3**	**49,388.8**	**19,188.8**	**712.3**	**7,412.0**	**195,927.9**	**438,703.2**
Uncollected Payments								
Uncollected customer payments from Federal Sources, brought forward	(263.2)	(3,708.8)	(5,976.1)	(8,567.3)	0.0	(1,766.5)	(53,899.4)	(74,181.3)
Change in uncollected payments, Federal sources	(9.7)	(5.2)	(425.3)	(199.8)	0.0	(901.6)	(2,765.6)	(4,307.2)
Uncollected payments, Federal sources, end of year	**(272.9)**	**(3,714.0)**	**(6,401.4)**	**(8,767.1)**	**0.0**	**(2,668.1)**	**(56,665.0)**	**(78,488.5)**
Memorandum (non-add) entries:								
Obligated balance, start of year	**$ 8,295.1**	**$ 136,694.6**	**$ 41,264.7**	**$ 10,099.1**	**$ 736.4**	**$ 5,726.1**	**$ 129,772.1**	**$ 332,588.1**
Obligated balance, end of year	**$ 8,152.2**	**$ 153,934.3**	**$ 42,987.4**	**$ 10,421.6**	**$ 712.3**	**$ 4,743.9**	**$ 139,263.0**	**$ 360,214.7**
Budget Authority and Outlays, Net:								
Budget Authority, gross (discretionary and mandatory)	$ 140,666.6	$ 127,488.5	$ 85,470.4	$ 11,806.8	$ 67,652.2	$ 19,555.5	$ 506,587.8	$ 959,227.8
Actual offsetting collections (discretionary and mandatory)	(1,334.1)	(3,843.3)	(10,189.8)	(4,809.6)	0.0	(10,923.2)	(136,815.5)	(167,915.5)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)	(9.7)	(5.2)	(425.3)	(199.8)	0.0	(901.6)	(2,765.6)	(4,307.2)
Recoveries of prior year paid obligations (discretionary and mandatory)	55.3	468.8	997.0	21.6	0.0	6.8	1,217.4	2,766.9
Budget authority, net (discretionary and mandatory)	**$ 139,378.1**	**$ 124,108.8**	**$ 75,852.3**	**$ 6,819.0**	**$ 67,652.2**	**$ 7,737.5**	**$ 368,224.1**	**$ 789,772.0**
Outlays, gross (discretionary and mandatory)	$ 139,270.5	$ 108,187.2	$ 79,519.1	$ 11,082.3	$ 67,676.3	$ 18,010.7	$ 476,088.3	$ 899,834.4
Actual offsetting collections (discretionary and mandatory)	(1,334.1)	(3,843.3)	(10,189.8)	(4,809.6)	0.0	(10,923.2)	(136,815.5)	(167,915.5)
Outlays, net (discretionary and mandatory)	**137,936.4**	**104,343.9**	**69,329.3**	**6,272.7**	**67,676.3**	**7,087.5**	**339,272.8**	**731,918.9**
Distributed offsetting receipts	0.0	0.0	(0.5)	0.0	(96,285.9)	(649.2)	(1,027.4)	(97,963.0)
Agency outlays, net (discretionary and mandatory)	**$ 137,936.4**	**$ 104,343.9**	**$ 69,328.8**	**$ 6,272.7**	**$ (28,609.6)**	**$ 6,438.3**	**$ 338,245.4**	**$ 633,955.9**

Statement of Disaggregated Budgetary Resources	**2016**							
For the Years Ended September 30 *Dollars in Millions*	**Military Personnel**	**Procurement**	**Research, Development, Test and Evaluation**	**Family Housing/ Military Construction**	**Military Retirement Benefits**	**Civil Works**	**Operations, Readiness & Support**	**2016 Combined**
Budgetary Resources								
Unobligated balance, brought forward, October 1	$ 4,481.7	$ 56,162.6	$ 15,375.6	$ 13,952.7	$ 0.0	$ 10,034.7	$ 49,455.0	$ 149,462.3
Adjustment to unobligated balance brought forward, Oct 1 (+ or -)	0.0	0.0	0.0	0.0	0.0	0.0	2,083.9	2,083.9
Unobligated balance brought forward, Oct 1, as adjusted	4,481.7	56,162.6	15,375.6	13,952.7	0.0	10,034.7	51,538.9	151,546.2
Recoveries of prior year unpaid obligations	5,919.8	6,715.2	3,107.3	2,110.0	0.0	287.4	32,376.8	50,516.5
Other changes in unobligated balance	(1,384.9)	(1,260.5)	(1,202.1)	(37.4)	0.0	9.5	(17,798.0)	(21,673.4)
Unobligated balance from prior year budget authority, net	**9,016.6**	**61,617.3**	**17,280.8**	**16,025.3**	**0.0**	**10,331.6**	**66,117.7**	**180,389.3**
Appropriations (discretionary and mandatory)	138,576.0	118,487.6	71,284.1	6,764.8	66,964.2	6,551.6	337,026.9	745,655.2
Contract Authority (discretionary and mandatory)	0.0	0.0	0.0	0.0	0.0	0.0	69,749.9	69,749.9
Spending Authority from offsetting collections (discretionary and mandatory)	1,253.8	3,695.5	8,543.2	5,250.1	0.0	11,447.6	75,319.1	105,509.3
Total Budgetary Resources	**$ 148,846.4**	**$ 183,800.4**	**$ 97,108.1**	**$ 28,040.2**	**$ 66,964.2**	**$ 28,330.8**	**$ 548,213.6**	**$ 1,101,303.7**
Status of Budgetary Resources:								
New obligations and upward adjustments (total)	144,636.1	122,067.1	81,817.2	13,145.4	66,964.2	18,419.0	498,698.3	945,747.3
Unobligated balance, end of year:								
Apportioned, unexpired accounts	459.8	57,517.1	12,658.5	12,501.3	0.0	8,281.3	17,280.3	108,698.3
Exempt from Apportionment, unexpired accounts	0.0	0.0	0.0	0.0	0.0	1,626.9	4,810.8	6,437.7
Unapportioned, unexpired accounts	0.0	77.2	294.0	294.0	0.0	0.0	2,655.8	3,321.0
Unexpired unobligated balance, end of year	459.8	57,594.3	12,952.5	12,795.3	0.0	9,908.2	24,746.9	118,457.0
Expired unobligated balance, end of year	3,750.5	4,139.0	2,338.4	2,099.5	0.0	3.6	24,768.4	37,099.4
Unobligated balance, end of year	**$ 4,210.3**	**$ 61,733.3**	**$ 15,290.9**	**$ 14,894.8**	**$ 0.0**	**$ 9,911.8**	**$ 49,515.3**	**$ 155,556.4**
Total Budgetary Resources	**$ 148,846.4**	**$ 183,800.4**	**$ 97,108.1**	**$ 28,040.2**	**$ 66,964.2**	**$ 28,330.8**	**$ 548,213.6**	**$ 1,101,303.7**

Statement of Budgetary Resources *For the Years Ended September 30* *Dollars in Millions*	**2016**							
	Military Personnel	**Procurement**	**Research, Development, Test and Evaluation**	**Family Housing/ Military Construction**	**Military Retirement Benefits**	**Civil Works**	**Operations, Readiness & Support**	**2016 Combined**
Change in Obligated Balance								
Unpaid obligations								
Unpaid obligations, brought forward, October 1 (Gross)	$ 12,049.8	$ 130,935.9	$ 43,235.8	$ 19,433.3	$ 5,126.8	$ 7,593.7	$ 188,742.8	$ 407,118.1
New 0bligations and upward adjustments	144,636.1	122,067.1	81,817.2	13,145.4	66,964.2	18,419.0	498,698.3	945,747.3
Outlays (gross)	(142,207.8)	(105,884.4)	(74,704.9)	(11,802.3)	(71,354.6)	(18,232.7)	(471,392.8)	(895,579.5)
Recoveries of prior year unpaid obligations	(5,919.8)	(6,715.2)	(3,107.3)	(2,110.0)	0.0	(287.4)	(32,376.8)	(50,516.5)
Unpaid Obligations, end of year	**8,558.3**	**140,403.4**	**47,240.8**	**18,666.4**	**736.4**	**7,492.6**	**183,671.5**	**406,769.4**
Uncollected Payments								
Uncollected customer payments from Federal Sources, end of year	(172.4)	(3,769.0)	(5,760.5)	(8,848.6)	0.0	(1,647.8)	(52,651.9)	(72,850.2)
Change in uncollected payments, Federal sources	(90.8)	60.2	(215.6)	281.3	0.0	(118.7)	(1,247.5)	(1,331.1)
Uncollected payments, Federal sources, end of year	**(263.2)**	**(3,708.8)**	**(5,976.1)**	**(8,567.3)**	**0.0**	**(1,766.5)**	**(53,899.4)**	**(74,181.3)**
Memorandum (non-add) entries:								
Obligated balance, start of year	**$ 11,877.4**	**$ 128,166.9**	**$ 37,475.2**	**$ 10,584.7**	**$ 5,126.8**	**$ 5,945.9**	**$ 136,090.9**	**$ 334,267.9**
Obligated balance, end of year	**$ 8,295.1**	**$ 136.694.6**	**$ 41,264.7**	**$ 10,099.1**	**$ 736.4**	**$ 5,726.1**	**$ 129,772.1**	**$ 332,588.1**
Budget Authority and Outlays, Net:								
Budget Authority, gross (discretionary and mandatory)	$ 139,829.8	$ 122,183.1	$ 79,827.3	$ 12,014.9	$ 66,964.2	$ 17,999.2	$ 482,095.9	$ 920,914.4
Actual offsetting collections (discretionary and mandatory)	(1,172.7)	(4,148.0)	(8,522.8)	(5,571.3)	0.0	(11,227.3)	(136,690.6)	(167,332.7)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)	(90.8)	60.2	(215.6)	281.3	0.0	(118.7)	(1,247.5)	(1,331.1)
Recoveries of prior year paid obligations (discretionary and mandatory)	9.8	390.7	195.2	39.9	0.0	9.5	903.2	1,548.3
Budget authority, net (discretionary and mandatory)	**$ 138,576.1**	**$ 118,486.0**	**$ 71,284.1**	**$ 6,764.8**	**$ 66,964.2**	**$ 6,662.7**	**$ 345,061.0**	**$ 753,798.9**
Outlays, gross (discretionary and mandatory)	$ 142,207.8	$ 105,884.4	$ 74,704.9	$ 11,802.3	$ 71,354.6	$ 18,232.7	$ 471,392.8	$ 895,579.5
Actual offsetting collections (discretionary and mandatory)	(1,172.7)	(4,148.0)	(8,522.8)	(5,571.3)	0.0	(11,227.3)	(136,690.6)	(167,332.7)
Outlays, net (discretionary and mandatory)	**141,035.1**	**101,736.4**	**66,182.1**	**6,231.0**	**71,354.6**	**7,005.4**	**334,702.2**	**728,246.8**
Distributed offsetting receipts	0.0	(0.2)	0.0	0.0	(89,920.3)	(614.7)	(1,543.0)	(92,078.2)
Agency outlays, net (discretionary and mandatory)	**$ 141,035.1**	**$ 101,736.2**	**$ 66,182.1**	**$ 6,231.0**	**$ (18,565.7)**	**$ 6,390.7**	**$ 333,159.2**	**$ 636,168.6**

Statement of Disaggregated Budgetary Resources ***For the Years ended September 30*** *Dollars in Millions*	**Non-Budgetary**		
	Other	**2017 Combined**	**2016 Combined**
Budgetary Resources			
Unobligated balance, brought forward, October 1	$ 79.7	$ 79.7	$ 66.6
Borrowing Authority (discretionary and mandatory)	58.1	58.1	27.0
Spending Authority from offsetting collections (discretionary and mandatory)	76.6	76.6	74.7
Total Budgetary Resources	**$ 214.4**	**$ 214.4**	**$ 168.3**
Status of Budgetary Resources:			
New obligations and upward adjustments (total)	$ 129.4	$ 129.4	$ 88.6
Unobligated balance, end of year:			
Unapportioned unexpired accounts	85.0	85.0	79.7
Unexpired unobligated, end of year	**85.0**	**85.0**	**79.7**
Expired unobligated, end of year	0.0	0.0	0.0
Unobligated balance, end of year (total)	**$ 85.0**	**$ 85.0**	**$ 79.7**
Total Budgetary Resources	**$ 214.4**	**$ 214.4**	**$ 168.3**

Statement of Disaggregated Budgetary Resources ***For the Years ended September 30*** *Dollars in Millions*	**Non Budgetary**		
	Other	**2017 Combined**	**2016 Combined**
Change in Obligated Balance			
Unpaid obligations:			
Unpaid obligations, brought forward, October 1 (gross)	$ 284.2	$ 284.2	$ 410.5
New obligations and upward adjustments	129.4	129.4	88.6
Outlays (gross)	(185.6)	(185.6)	(214.9)
Unpaid obligations, end of year	**228.0**	**228.0**	**284.2**
Uncollected payments:			
Uncollected payments, Federal sources, brought forward, October 1	(58.9)	(58.9)	(72.4)
Change in uncollected customer payments, Federal sources	5.9	5.9	13.5
Uncollected payments, Federal sources, end of year	**(53.0)**	**(53.0)**	**(58.9)**
Memorandum (non-add) entries:			
Obligated balance, start of year (net)	**$ 225.3**	**$ 225.3**	**$ 338.1**
Obligated balance, end of year (net)	**$ 175.0**	**$ 175.0**	**$ 225.3**
Budget Authority and Outlays, Net:			
Budget Authority, gross (discretionary and mandatory)	134.7	134.7	101.7
Actual offsetting collections (discretionary and mandatory)	(190.6)	(190.6)	(105.4)
Change in uncollected customer payments from Federal Sources (discretionary and mandatory)	5.9	5.9	13.5
Recoveries of prior year obligations (discretionary and mandatory)	0.0	0.0	0.0
Budget authority, net (discretionary and mandatory)	**$ (50.0)**	**$ (50.0)**	**$ 9.8**
Outlays, gross (discretionary and mandatory)	185.6	185.6	214.9
Actual offsetting collections (discretionary and mandatory)	(190.6)	(190.6)	(105.4)
Outlays, net (discretionary and mandatory)	**(5.0)**	**(5.0)**	**109.5**
Agency outlays, net (discretionary and mandatory)	**$ (5.0)**	**$ (5.0)**	**$ 109.5**

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

November 15, 2017

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/
CHIEF FINANCIAL OFFICER, DOD

SUBJECT: Independent Auditor's Report on the Department of Defense FY 2017 and FY 2016 Basic Financial Statements (Report No. DODIG-2018-030)

We are providing the subject report to be published in the Department of Defense FY 2017 Agency Financial Report in conjunction with the Department of Defense FY 2017 and FY 2016 Basic Financial Statements. The report includes our disclaimer of opinion on the basic financial statements and our required Report on Internal Control Over Financial Reporting and Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements. We are issuing our disclaimer of opinion to accompany the Department of Defense FY 2017 and FY 2016 Basic Financial Statements and, therefore, this audit report should not be disseminated separately from those statements.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 or (DSN) 329-5945.

Lorin T. Venable

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

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

November 15, 2017

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER)/
CHIEF FINANCIAL OFFICER, DOD

SUBJECT: Independent Auditor's Report on the Department of Defense FY 2017 and FY 2016 Basic Financial Statements (Project No. D2017-D000FE-0124.000, Report No. DODIG-2018-030)

Report on the Basic Financial Statements

Public Law 101-576, "Chief Financial Officers Act of 1990," requires the DoD Inspector General to audit the accompanying DoD Agency-Wide consolidated balance sheet as of September 30, 2017, and September 30, 2016, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and notes to the basic statements (basic financial statements).

Management's Responsibility for the Annual Financial Statements

DoD management is responsible for the annual financial statements. Specifically, management is responsible for: (1) preparing financial statements that conform with accounting principles generally accepted in the United States of America (GAAP); (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that they met broad control objectives of Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982" (FMFIA); (3) ensuring that the DoD's financial management systems substantially comply with Public Law 104-208, "Federal Financial Management Improvement Act of 1996" (FFMIA) requirements; and (4) complying with applicable laws and regulations.

Auditor's Responsibility

Our responsibility is to express an opinion on the basic financial statements based on conducting the audit in accordance with generally accepted government auditing standards (GAGAS) and the Office of Management and Budget (OMB) Bulletin No. 17-03, "Audit Requirements for Federal Financial Statements," September 29, 2017. However, based on the matters described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Section 1008(d) of the FY 2002 National Defense Authorization Act limits the DoD Inspector General to performing only those audit procedures required by GAGAS that are consistent with the representations made by management. DoD management asserted to us that DoD FY 2017 and FY 2016 Basic Financial Statements would not substantially conform to GAAP and that DoD financial management and feeder systems were unable to adequately support material amounts on the basic financial statements as of September 30, 2017. We considered this scope limitation in forming our conclusions on the basic financial statements. Accordingly, we did not perform all the auditing procedures required by GAGAS and OMB Bulletin No. 17-03 to determine whether material amounts on the basic financial statements were presented fairly.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we could not obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the DoD FY 2017 and FY 2016 Basic Financial Statements. Thus, the basic financial statements may have undetected misstatements that are both material and pervasive.

Other Information in the Annual Financial Statements

We performed our audit to form an opinion on the basic financial statements as a whole. DoD management presented the Management’s Discussion and Analysis, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Information for additional analysis as part of the annual financial statements. These elements are not required parts of the basic financial statements. Therefore, we do not express an opinion or provide any assurance on the information. We reviewed the other information for inconsistencies with the audited basic financial statements. Based on our limited review, we did not find any material inconsistencies between the information and the basic financial statements and applicable sections of OMB Circular No. A-136 (Revised), “Financial Reporting Requirements,” August 15, 2017, and DoD Regulation 7000.14-R, “Financial Management Regulation,” volume 6b, “Form and Content of the Department of Defense Audited Financial Statements.”

Report on Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

We limited our audit to determining compliance with provisions of applicable laws and regulations, contracts, and grant agreements that have a direct and material effect on the basic financial statements and compliance with OMB regulations and audit requirements for financial reporting. DoD management represented that instances of noncompliance identified in prior audits continue to exist; therefore, we did not determine whether the DoD complied with all applicable laws and regulations, contracts, and grant agreements related to financial reporting. It was not our objective to provide an opinion on compliance with certain provisions of laws and regulations, contracts, and grant agreements and, accordingly, we do not express such an opinion.

See the Attachment for additional details on internal control and compliance with legal and other regulatory requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, who provided technical comments which we have incorporated as appropriate.

This report will be made publicly available under section 8M, paragraph (b)(1)(A) of the Inspector General Act of 1978. However, this report is intended solely for the information and use of Congress; the OMB; the U.S. Government Accountability Office; the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD; DoD management; and the DoD Office of Inspector General. This report is not intended for, nor should it be used by, any other audience.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 or (DSN) 329-5945.

Lorin T. Venable

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

Attachment:
As stated

Report on Internal Control Over Financial Reporting

Internal Control Compliance

In planning our audit, we considered the DoD's internal control over financial reporting. We did this to determine our procedures for auditing the basic financial statements appropriate to the circumstances and for expressing our opinion on the basic financial statements, but not for expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on internal control over financial reporting.

Management Responsibilities

Management is responsible for implementing and maintaining effective internal controls to include providing reasonable assurance that DoD personnel recorded, processed, and summarized accounting data properly; met the requirements of applicable laws and regulations; and safeguarded assets against misappropriation and abuse.

Auditor's Responsibilities

Our purpose was not to express an opinion on internal controls over financial reporting, and we do not do so. However, the following material weaknesses continue to exist and could adversely affect the DoD's financial operations.

Previously Identified Material Weaknesses

Management acknowledged that previously identified material weaknesses continued to exist. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the DoD's financial statements will not be prevented, or detected and corrected, on a timely basis. The following material weaknesses continue to exist.

Financial Management Systems. Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, "Objectives of Federal Financial Reporting," requires financial management system controls that are adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and recorded in accordance with Federal accounting standards. SFFAC No. 1 also requires that financial management system controls ensure assets are properly safeguarded to deter fraud, waste, and abuse and that performance measurement information is adequately supported.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, acknowledged that DoD financial management and feeder systems do not substantially comply with Federal financial management system requirements. The DoD financial management and feeder systems were not designed to adequately support various material amounts on the basic financial statements. These systemic deficiencies in financial management and feeder systems and inadequate DoD business processes prevent the DoD from collecting and reporting financial and performance information that is accurate, reliable, and timely.

Fund Balance With Treasury. Statement of Federal Financial Accounting Standards (SFFAS) No. 1, "Accounting for Selected Assets and Liabilities;" the Treasury Financial Manual; and DoD Regulation 7000.14-R, "DoD Financial Management Regulation," require the DoD to reconcile its Fund Balance with Treasury accounts and explain any discrepancies between the accounts and Treasury's records to ensure the integrity and accuracy of its internal and Governmentwide financial report data. However, the DoD acknowledged that it has ineffective processes and controls for reconciling the DoD's Fund Balance with Treasury accounts. The ineffective processes and controls result in differences between the DoD and U.S. Treasury recorded balances for Fund Balance with Treasury that cannot be resolved in a timely manner, as required by SFFAS No. 1, the TFM, and DoD Regulation 7000.14-R.

Accounts Receivable. According to SFFAS No. 1, Federal entities should recognize a receivable when they establish a claim to cash or other assets against other entities, based on either legal provisions or goods and services provided. The DoD acknowledged that it was unable to accurately record, report, collect, and reconcile intragovernmental accounts receivable.

Inventory. SFFAS No. 3, "Accounting for Inventory and Related Property," requires the DoD to use historical cost, the latest acquisition cost (adjusted for holding gains and losses), or any other valuation method that reasonably approximates historical cost. However, the DoD acknowledged that it lacks controls to provide assurance that inventory recorded in the financial statements exists and is complete. In addition, the DoD acknowledged that it lacks clear audit trails to trace transactions from source documentation to the reported total dollar values on the inventory line items on the financial statements. As a result, the DoD cannot accurately determine historical costs of its inventory and, therefore, fails to comply with SFFAS No. 3.

Operating Materials and Supplies. SFFAS No. 3 states that Operating Materials and Supplies generally must be expensed when the items are consumed. The DoD acknowledged that significant amounts of Operating Materials and Supplies were expensed when purchased, instead of when consumed. In addition, the DoD does not maintain historical cost data and, therefore, inventory values cannot be reported as required by GAAP.

General Property, Plant, and Equipment. SFFAS No. 6, "Accounting for Property, Plant, and Equipment," requires the DoD to record General Property, Plant, and Equipment (General PP&E) at acquisition cost, capitalize improvement costs, and recognize depreciation expense. However, the DoD acknowledged that it does not have acquisition value for all General PP&E and uses several cost methodologies to provide General PP&E values for financial statement reporting purposes. In addition, the DoD acknowledged that reported values and information for major asset and liability categories are derived from nonfinancial systems, such as inventory and logistics systems, and these systems were not designed to prepare financial statements in accordance with GAAP.

Government Property in Possession of Contractors. SFFAS No. 6 requires that property and equipment in the possession of a contractor, acquired on behalf of the Government (in other words, the Government will ultimately hold title) for use in accomplishing a contract, be considered Government property. Such property should be accounted for based on the nature of the item, regardless of who has possession.
The DoD acknowledged that it was unable to comply with these requirements for Government Property in Possession of Contractors. As a result, the value of DoD property and material in the possession of contractors was not reliably reported.

Accounts Payable. According to SFFAS No. 5, "Accounting for Liabilities of the Federal Government," an entity recognizes a liability when one party receives goods or services in return for a promise to provide money or other resources in the future. The DoD acknowledged that it did not meet accounting standards for the financial reporting of public accounts payable. The DoD cannot support its accounts payable balances because it lacks standard procedures for recording, reporting, and reconciling the amounts between the financial, accounting, and reporting systems.

Environmental Liabilities. The DoD acknowledged that its internal controls for reporting environmental liabilities did not provide reasonable assurance that cleanup costs for all of its ongoing, closed, and disposal operations were identified, consistently estimated, and appropriately reported. In addition, guidance and audit trails for estimating environmental liabilities were insufficient, and the inventory of ranges and operational activities was incomplete. The DoD also acknowledged that it is uncertain of the accuracy of the accounting estimates used to calculate the reported environmental liabilities.

Statement of Net Costs. SFFAC No. 2, "Entity and Display," states that the main purpose of the Statement of Net Costs is to provide an understanding of the net costs of each organization and each program. In addition, the Statement of Net Cost provides gross and net cost information that can be related to the amounts of outputs and outcomes for the programs and organization. The DoD acknowledged that the information presented on the Statement of Net Costs is compiled from many financial systems and sources. Newer financial systems record costs based on business events (e.g., receipt of goods or services), while many older financial systems record costs based upon financial transactions (e.g., invoices). In addition, some costs (e.g., actuarial) are derived from non-financial systems. In addition, the oD acknowledged that the current processes and systems capture costs based on appropriation groups and lower level costs for major programs are not presented as required by the Government Performance and Results Act of 1993 and SFFAC No. 2. However, the DoD stated that it is reviewing data and developing a cost reporting methodology as required by SFFAS 4, as amended by SFFAS 30.

Intragovernmental Eliminations. The DoD disclosed that it could not accurately identify its intragovernmental transactions by customer because its systems do not track the buyer and seller data needed to match related transactions. In addition, the DoD was unable to fully reconcile intragovernmental transactions with all Federal partners. The DoD acknowledged that its inability to reconcile most intragovernmental transactions resulted in adjustments that cannot be fully supported.

Accounting Entries. The DoD acknowledged that it continued to enter significant unsupported and erroneous accounting entries in its financial management systems because of system controls and process weaknesses. In addition, the DoD did not always record account entries in accordance with GAAP. The unsupported accounting entries present a material uncertainty regarding the reliability of the financial statements.

Reconciliation of Net Cost of Operations to Budget. SFFAS No. 7, "Accounting for Revenue and Other Financing Sources," requires a reconciliation of proprietary and budgetary information to assist users in understanding the relationship between the net cost of operations and the budgetary resources obligated by the entity during the period. The DoD acknowledged that due to system limitations, budgetary data does not agree with proprietary expenses and capitalized assets. The DoD made a $10 billion adjustment to reconcile Net Cost of Operations to Budget in FY 2017.

These financial management control deficiencies may cause inaccurate management information. As a result, DoD management decisions based in whole or in part on this information may be adversely affected. Financial information reported by the DoD may also contain misstatements resulting from these deficiencies. Internal control work we conducted as part of our prior audits would not necessarily disclose all material weaknesses and significant deficiencies. We did not identify material weaknesses that were not reported in the DoD's FMFIA report.

Report on Compliance with Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

U.S. generally accepted government auditing standards and OMB guidance requires auditors to report on entities' compliance with selected provisions of laws and regulations, contracts, and grant agreements. Management is responsible for compliance with existing laws, regulations, contracts, and grant agreements related to financial reporting. Management has also acknowledged to us that previously reported instances of noncompliance continue to exist. Therefore, we limited our work to determining compliance with selected provisions of the applicable laws, regulations, contracts, and grant agreements. Other noncompliance may have occurred and not been detected, and the results of our limited procedures may not be sufficient for other purposes. Our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements.

Antideficiency Act

Section 1341, title 31, United States Code (31. U.S.C. §1341 [1990]) limits the DoD and its agents to making or authorizing expenditures or obligations that do not exceed the available appropriations or funds. Additionally, the DoD or its agents may not contract or obligate for the payment of money before an appropriation is made available for that contract or obligation unless otherwise authorized by law. As stated in 31 U.S.C §1517 (2004), the DoD and its agents are prohibited from making or authorizing expenditures of obligations exceeding an apportionment or the amount permitted by prescribed regulations. According to 31 U.S.C. §1351 (2004), if an officer or employee of an executive agency violates the Antideficiency Act (ADA), the head of the agency must immediately report to the President and Congress all relevant facts and a statement of actions taken. During FY 2017, the DoD reported 6 ADA violations within 17 completed cases.

DoD Regulation 7000.14-R, "Financial Management Regulation," volume 14, chapter 7, "Antideficiency Act Report," establishes time-frames for identifying and reporting ADA violations. The regulation states that the formal investigation and reporting on ADA violations should take no more than 15 months. Of the 15 potential ADA violation investigations, 11 have been open for more than 15 months.

Compliance With FFMIA Requirements

The FFMIA requires the DoD to establish and maintain financial management systems that comply substantially with the Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. For areas in which an agency is not in compliance, OMB Circular No. A-136 requires the agency to identify remediation activities planned or underway to bring the systems into substantial compliance with the FFMIA. However, the DoD reported in the Financial Improvement and Audit Readiness Plan Status Report, May 2017, that information technology systems and documentation are the most pervasive challenges to audit readiness. The DoD has hundreds of financial and feeder systems affecting the financial statements. It is nearly impossible to ensure data are completely and accurately feeding between these various systems. Furthermore, the DoD still relies on legacy systems designed and implemented in the 1960s. These legacy systems lack the basic capabilities required to successfully undergo audit. The DoD has stated that it is accelerating legacy systems migration to Enterprise Resource Planning (ERP) systems in an effort to automate internal controls and better support audits. However, the DoD relies on legacy business practices and manual work-arounds such as corrections in the form of journal vouchers, in order to meet various accountability and reporting requirements.

For FY 2017, the DoD did not substantially comply with the FFMIA. The Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, acknowledged to us that DoD financial management and feeder systems could not provide adequate evidence supporting various material amounts on the financial statements, and that previously identified material weaknesses continue. The financial management and feeder systems did not substantially comply with the Federal financial management systems requirements, Federal accounting standards, or the U.S. Standard General Ledger at the transaction level as of September 30, 2017. Therefore, based on the representation of the DoD, we did not substantiate whether the DoD complied with the FFMIA and OMB implementation guidance.

Recommendations

This report does not include recommendations to correct the material weaknesses nd instances of noncompliance with laws and regulations because previous audit reports contained recommendations for corrective actions and current audit projects will include appropriate recommendations.

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