FY 2018

Financial Section

Face of Defense: Extended Family Trains Together at Fort Lee

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Message from the Under Secretary of Defense (Comptroller)/ Chief Financial Officer

November 15, 2018

It is my privilege to join the Secretary of Defense in presenting the Department of Defense financial statements for Fiscal Year (FY) 2018, which are an integral part of our Agency Financial Report (AFR). The objective of the financial statements and accompanying information contained in the Financial Section of the AFR is to provide a comprehensive view of the financial activities undertaken in support of the Department's mission to deter war and protect national security.

In FY 2018, the Department underwent its first full-scope financial statement audit. As anticipated, our independent auditor, the Department of Defense Office of Inspector General, issued a Disclaimer of Opinion as the result of the audit. Though we were unable to achieve a clean (unmodified) opinion, the audit provides us with a powerful additional method to identify accounting and financial reporting issues as well as their root causes, target and develop corrective actions, prioritize business process reforms, and verify the proper remediation of audit findings.

To assist in driving change, we have established a Department-wide database tool for use in capturing, prioritizing, and assigning responsibility for auditor findings and the related corrective action plans. The wide visibility and use of this tool across the Department will reduce duplication of efforts, facilitate the sharing of lessons learned and best practices, and help maintain accountability. The tool will also help us to track the number of auditor findings closed, which will be the benchmark used to measure our progress towards achieving a clean audit opinion.

I want to thank the civilian employees and Military Service members of our financial and functional communities for their hard work and dedication in addressing audit findings, seeking opportunities for greater efficiency, and improving our business processes. The progress we achieved to date and will achieve going forward would not be possible without their efforts. We look forward to working through future audits as we improve the quality and reliability of our financial information, as well as the efficiency and effectiveness of our operations.

David L. Norquist

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PRINCIPAL FINANCIAL STATEMENTS AND NOTES

The principal financial statements are prepared to report the financial position and results of operations of the Department of Defense (DoD or the Department), pursuant to the requirements of title 31, United States Code, section 3515(b) (*31 U.S.C. § 3515(b)*). The statements are prepared from the accounting records of the Department in accordance with the formats prescribed by Office of Management and Budget (*OMB*) *Circular No. A-136* and, to the extent possible, with U.S. Generally Accepted Accounting Principles for federal entities as prescribed by the Federal Accounting Standards Advisory Board (*FASAB*). The statements, in addition to supporting financial reports, are used to monitor and control budgetary resources. The statements should be read with the realization that they are for a component of the U.S. Government.

The principal financial statements of the Department include the four financial statements described in Table 1.

Table 1. Principal Financial Statements

Statement	Information Provided
Balance Sheet	Reflects the Department's financial position as of the statement date (September 30, 2018). The assets reflect the amount of future economic benefits owned or managed by the Department. The liabilities reflect amounts owed by the Department. The net position is the difference between the assets and liabilities.
Statement of Net Cost	Shows, by major program, 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 unexpended appropriations provided to the Department that remain unused at the end of the fiscal year and the cumulative results of the Department's operations since inception. The statement focuses on how the Department's 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, rather than consolidated, basis. As such, all intra-entity transactions are included in the balances reported on the statement.

Department of Defense Agencywide
Consolidated Balance Sheet
As of September 30, 2018 and 2017
($ in millions)

	2018 (Unaudited)	2017 (Unaudited)
Assets (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	$ 580,213.8	$ 501,620.4
Investments (Note 4)	1,091,764.4	991,733.9
Accounts Receivable (Note 5)	1,951.6	2,055.0
Other Assets (Note 6)	961.5	927.2
Total Intragovernmental Assets	1,674,891.3	1,496,336.5
Cash and Other Monetary Assets (Note 7)	968.0	1,119.7
Accounts Receivable, Net (Note 5)	5,694.1	5,244.1
Inventory and Related Property, Net (Note 9)	275,678.4	266,760.5
Loans Receivable (Note 8)	1,697.4	1,644.2
General Property, Plant and Equipment, Net (Note 10)	758,829.1	761,707.8
Investments (Note 4)	3,511.6	3,511.6
Other Assets (Note 6)	28,374.4	29,390.0
Total Assets	$ 2,749,644.3	$ 2,565,714.4
Stewardship Property, Plant and Equipment (Note 10)		
Liabilities (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	$ 1,914.1	$ 1,573.8
Debt (Note 13)	1,685.7	1,630.8
Other Liabilities (Note 15 & 16)	7,403.7	7,017.8
Total Intragovernmental Liabilities	11,003.5	10,222.4
Accounts Payable (Note 12)	29,222.8	26,426.8
Loan Guarantee Liability (Note 8)	58.4	65.2
Military Retirement and Other Federal Employment Benefits (Note 17)	2,415,346.8	2,356,869.6
Environmental and Disposal Liabilities (Note 14)	70,411.4	68,318.1
Other Liabilities (Note 15 and Note 16)	38,074.9	36,071.9
Total Liabilities	2,564,117.8	2,497,974.0
Commitments and Contingencies (Note 16)		
Net Position (Consolidated Totals)		
Unexpended Appropriations - Dedicated Collections (Note 23)	-	-
Unexpended Appropriations - Other Funds	529,746.6	457,849.4
Cumulative Results of Operations - Dedicated Collections (Note 23)	16,778.4	16,149.7
Cumulative Results of Operations - Other Funds	(360,998.5)	(406,258.7)
Total Net Position	185,526.5	67,740.4
Total Liabilities and Net Position	$ 2,749,644.3	$ 2,565,714.4

The accompanying notes are an integral part of these statements.

Department of Defense Agencywide
Consolidated Statement of Net Cost
For the Years Ended September 30, 2018 and 2017
($ in millions)

	2018 (Unaudited)	2017 (Unaudited)
Gross Program Costs:		
Military Retirement Benefits	$ 104,973.1	$ 96,630.1
Civil Works	12,603.8	9,168.2
Military Personnel	145,255.3	139,512.6
Operations, Readiness & Support	259,653.5	302,022.8
Procurement	112,506.4	85,881.3
Research, Development, Test & Evaluation	88,386.3	84,380.8
Family Housing & Military Construction	11,714.5	10,521.9
Total Gross Program Costs	735,092.9	728,117.7
Less: Earned Revenue	(90,456.3)	(114,295.5)
Net Program Costs Before Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	644,636.6	613,822.2
Losses/(Gains) from Actuarial Assumption Changes for Military Retirement Benefits	16,735.0	24,069.0
Net Cost of Operations	$ 661,371.6	$ 637,891.2

The accompanying notes are an integral part of these statements.

Department of Defense Agencywide
Consolidated Statement of Changes in Net Position
For the Years Ended September 30, 2018 and 2017
($ in millions)

	2018 (Unaudited)	2017 (Unaudited)
Unexpended Appropriations		
Beginning Balance	$ 457,849.4	$ 450,026.1
Prior Period Adjustments:		
Changes in Accounting Principles	-	-
Corrections of Errors	-	-
Beginning Balance, as adjusted (Includes Funds from Dedicated Collections of $0.0 in FY 2018 and $0.0 in FY 2017) - (Note 23)	457,849.4	450,026.1
Budgetary Financing Sources:		
Appropriations Received	794,788.0	710,705.3
Appropriations Transferred In/Out	221.8	487.7
Other Adjustments	(20,876.0)	(22,779.7)
Appropriations Used	(702,236.6)	(680,590.0)
Total Budgetary Financing Sources (Includes Funds from Dedicated Collections of $0.0 in FY 2018 and $0.0 in FY 2017) - (Note 23)	71,897.2	7,823.3
Total Unexpended Appropriations (Includes Funds from Dedicated Collections of $0.0 in FY 2018 and $0.0 in FY 2017) - (Note 23)	529,746.6	457,849.4
Cumulative Results of Operations		
Beginning Balance	(390,109.0)	(469,572.9)
Prior Period Adjustments:		
Changes in Accounting Principles	(2,461.7)	37,345.0
Corrections of Errors	-	-
Beginning Balance, as adjusted (Includes Funds from Dedicated Collections of $16,149.7 in FY 2018 and $15,493.7 in FY 2017) - (Note 23)	(392,570.7)	(432,227.9)
Budgetary Financing Sources:		
Other Adjustments	(734.2)	612.5
Appropriations Used	702,236.6	680,590.0
Nonexchange Revenue	2,223.5	1,460.8
Donations and Forfeitures of Cash and Cash Equivalents	480.3	179.1
Transfers In/Out Without Reimbursement	1,325.0	1,286.4
Other	(3,490.4)	(2,543.8)
Other Financing Sources (Nonexchange):		
Donations and Forfeitures of Property	19.8	2.4
Transfers In/Out Without Reimbursement	23.8	139.7
Imputed Financing	5,309.1	3,673.9
Other	2,328.7	(5,390.9)
Total Financing Sources (Includes Funds from Dedicated Collections of $2,010.0 in FY 2018 and $1,251.4 in FY 2017) - (Note 23)	709,722.2	680,010.1
Net Cost of Operations (Includes Funds from Dedicated Collections of $1,381.3 in FY 2018 and $595.4 in FY 2017) - (Note 23)	661,371.6	637,891.2
Net Change	48,350.6	42,118.9
Cumulative Results of Operations (Includes Funds from Dedicated Collections of $16,778.4 in FY 2018 and $16,149.7 in FY 2017) - (Note 23)	(344,220.1)	(390,109.0)
Net Position	$ 185,526.5	$ 67,740.4

The accompanying notes are an integral part of these statements.

Department of Defense Agencywide
Combined Statement of Budgetary Resources
For the Years Ended September 30, 2018 and 2017
($ in millions)

	2018 (Unaudited)		2017 (Unaudited)	
	Budgetary	Non-Budgetary Credit Reform Financing Account	Budgetary	Non-Budgetary Credit Reform Financing Account
Budgetary Resources				
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory)	$ 181,008.2	$ 85.1	$ 180,984.0	$ 79.7
Appropriations (Discretionary and Mandatory)	863,583.0	-	776,981.7	-
Borrowing Authority (Discretionary and Mandatory)	-	55.4	-	58.1
Contract Authority (Discretionary and Mandatory)	88,428.1	-	76,540.2	-
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	119,413.9	61.6	105,705.9	76.6
Total Budgetary Resources	$ 1,252,433.2	$ 202.1	$ 1,140,211.8	$ 214.4
Memorandum (Non-Add) Entries				
Net Adjustments to Unobligated Balances Brought Forward, Oct 1	$ 22,300.3	$ -	$ 25,361.8	$ -
Status of Budgetary Resources				
New Obligations and Upward Adjustments (Total)	$ 1,054,209.3	$ 133.1	$ 981,481.5	$ 129.4
Unobligated Balance, End of Year:				
Apportioned, Unexpired Accounts	165,702.9	-	116,449.6	-
Exempt from Apportionment, Unexpired Accounts	2,875.6	-	6,759.2	-
Unapportioned, Unexpired Accounts	1,933.2	69.0	1,910.5	85.0
Unexpired Unobligated Balance, End of Year	170,511.7	69.0	125,119.3	85.0
Expired Unobligated Balance, End of Year	27,712.2	-	33,611.0	-
Unobligated Balance, End of Year (Total)	198,223.9	69.0	158,730.3	85.0
Total Budgetary Resources	$ 1,252,433.2	$ 202.1	$ 1,140,211.8	$ 214.4
Outlays, Net				
Outlays, Net (Total) (Discretionary and Mandatory)	$ 763,216.0	$ 71.2	$ 731,918.9	$ (5.0)
Distributed Offsetting Receipts (-)	(101,973.1)	-	(97,963.0)	-
Agency Outlays, Net (Discretionary and Mandatory)	$ 661,242.9	$ 71.2	$ 633,955.9	$ (5.0)

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

Note 1. Significant Accounting Policies

A. Mission of the Reporting Entity

The Department was established by the *National Security Act of 1947*. The enduring mission of the Department is to provide 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 its predecessor organizations have evolved into a global presence with a worldwide infrastructure dedicated to defending the United States (U.S.) by deterring and defeating aggression and coercion in critical regions.

The Department includes the Office of the Secretary of Defense (*OSD*), Joint Chiefs of Staff (*JCS*), DoD Office of the Inspector General (*DoD OIG*), Military Departments, Defense Agencies, DoD Field Activities, and Combatant Commands, which are considered, and may be referred to as, DoD Components. The Military Departments consist of the Departments of the *Army*, the *Navy* (of which the *Marine Corps* is a component), and the *Air Force*.

B. Basis of Presentation

The financial statements have been prepared to report the financial position and results of DoD operations, as required by the *Chief Financial Officers Act of 1990*, as amended and expanded by the *Government Management Reform Act of 1994* and other applicable legislation. The financial statements have been prepared from statements from the accounting records of the Department in accordance with the formats prescribed by OMB *Circular No. A-136* and, to the extent possible, with U.S. Generally Accepted Accounting Principles (GAAP) for federal entities as prescribed by the Federal Accounting Standards Advisory Board (*FASAB*). The financial statements account for all resources for which the Department is responsible, unless otherwise noted. Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed to prevent the disclosure of classified information.

The Department is unable to fully comply with all elements of U.S. GAAP and OMB Circular No. A-136 due to the limitations of financial and non-financial processes and systems that support the financial statements. The Department derives reported values and information for major asset and liability categories largely from non-financial 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.

In accordance with FASAB Statement of Federal Financial Accounting Standards *(SFFAS) 47*, the Department is disclosing its relationships with Department-sponsored Federally Funded Research and Development Centers and DoD Nonappropriated Fund Instrumentalities. This disclosure is available at Note 26, *Disclosure Entities and Related Parties*.

C. Use of Estimates

The Department's management makes assumptions and reasonable estimates in the preparation of financial statements based on current conditions which may affect the reported amounts. Actual results could differ materially from the estimated amounts. Significant estimates include such items as environmental liabilities, year-end accruals of accounts payable, and actuarial liabilities related to workers' compensation.

D. Appropriations and Funds

Appropriated Fund Types

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, operations and maintenance, research and development, procurement, and military construction.

Working capital funds (WCF) receive 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; are required by statute to be used for designated activities, benefits, or purposes; and remain available over time. In accordance with *SFFAS 27*, as amended by *SFFAS 43*, the Department separately accounts for and reports on the receipt, use, and retention of revenues and other financing sources for Funds from Dedicated Collections in Note 23, *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 DoD 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.

Nonappropriated Funds

The Department's nonappropriated fund instrumentalities (NAFIs) are fiscal entities supported in whole or in part by nonappropriated funds (NAFs). Generally, NAFs are generated from sales and user fees. The Department's NAFIs are established by DoD policy, controlled by the Department, and governed by sections of *title 10, U.S.C.*. NAFIs, primarily consisting of the Military Services' exchanges and morale, welfare, and recreation (*MWR*) entities, are intended to enhance the quality of life for members of the Uniformed Services, retired members, and dependents of such members, and to support military readiness, recruitment, and retention.

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

Allocation Transfers

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. 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.

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.

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

E. Basis of Accounting

The Department's financial statements and supporting trial balances are compiled from the underlying financial data and trial balances of the DoD Components and their sub-entities. The underlying data is largely derived from budgetary transactions (e.g., obligations, disbursements, and collections), from non-financial feeder systems, and accruals made for major items such as payroll expenses, accounts payable, and environmental liabilities.

The Department presents the Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position on a consolidated basis, which is the summation of the DoD Components less the eliminations of intradepartmental activity. The Statement of Budgetary Resources is presented on a combined basis, which is the summation of the DoD Components. The financial transactions are recorded on a proprietary accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recognized when incurred, without regard to the timing of receipt or payment of cash. Under the budgetary basis, the legal commitment or obligation of funds is recognized in advance of the proprietary accruals and in compliance with legal requirements and controls over the use of federal funds.

The Department's continued effort towards full compliance with U.S. GAAP for the accrual method of accounting is encumbered by various systems limitations and the sensitive nature of Departmental activities.

F. 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, 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*. In some instances, revenue is recognized when invoices 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 non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost. The U.S. has cost sharing agreements with countries, through mutual or reciprocal defense agreements, where U.S. troops are stationed or where the U.S. Fleet is in a port.

In accordance with *SFFAS 7*, 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.

G. Recognition of Expenses

For financial reporting purposes, the Department's policy requires the recognition of operating expenses in the period incurred. Estimates are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue.

In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. The Department has issued guidance under which DoD Components may expense OM&S using the purchase method of accounting rather than the consumption method if certain operational and other criteria, as applicable, are met, as set forth under U.S. GAAP. Under the consumption method, OM&S would be expensed when consumed.

H. Accounting for Intragovernmental and Intergovernmental Activities

Treasury Financial Manual, Volume I, Part 2, *Chapter 4700*, provides guidance for reporting and reconciling intragovernmental balances. Accounting standards require an entity to eliminate intra-entity activity and balances from consolidated financial statements to prevent overstatement caused by the inclusion of business activity between entity components. 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. 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.

Imputed financing represents the cost paid on behalf of the Department by another federal entity. In accordance with *SFFAS 55* (which rescinded *SFFAS 4*, *SFFAS 30*, and Interpretation of Federal Financial Accounting Standards *(Interpretation) 6*), the Department recognizes imputed costs only for business-type activities and other costs specifically required by OMB, including (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 (*FECA*); 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 sources 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 Department of the Treasury (*Treasury*) does not allocate such costs to the Department.

I. Transactions with Foreign Governments and International Organizations

The Department is implementing the administration's foreign policy objectives under the provisions of the *Arms Export Control Act of 1976* by selling U.S. Government-approved defense articles and services to foreign partners and international organizations. The cost of administering these sales must occur at no cost to the Federal Government. Payment in U.S. dollars is required in advance for each sale.

J. Funds with the Department of the Treasury

The Department's monetary resources of collections and disbursements are maintained in Treasury accounts. The disbursing offices of 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 Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits.

In addition, DFAS and the USACE Finance Center report to the Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The Treasury records these transactions to the applicable Fund Balance with Treasury account.

K. 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 currency is valued using the Treasury prevailing rate of exchange.

The majority of cash and all foreign currency is classified as "non-entity" 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 its 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 operations and maintenance, and (5) family housing construction. The gains and losses are calculated as the difference 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.

L. 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 factors such as aging of accounts receivable, debtor's ability to pay, and payment history. 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 accordance with the business rules published in Appendix 10 of Treasury Financial Manual, Volume I, 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.

M. 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*, which 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 taxpayers.

The NDAA for FY 1996 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).

N. Inventories and Related Property

The Department values approximately 99 percent of resale inventory using the moving average cost method. Additionally, the Department reports the remaining one 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 adopt *SFFAS 48*, which permits 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; 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. OM&S, including munitions not held for sale, are valued using various methods including moving average cost, standard price, historical cost, replacement price, and direct method. 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. Under this method, materiel and supplies are expensed when consumed. 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, see Note 9, *Inventory and Related Property*.

Excess, obsolete, and unserviceable (EOU) inventory and OM&S is recognized at net realizable value through the use of an allowance account. For EOU transferred to the Defense Logistics Agency (*DLA*) *Disposition Services*, the net realizable value will generally be zero. The net realizable value of EOU disposed of through a *Qualified Recycling Program* or by other means other than a transfer to DLA is estimated based on prior disposal proceeds for comparable EOU, buyer quotes, or other reasonable means.

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 readiness for a lethal joint force.

Inventory 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.

O. Investments in Treasury Securities

The Department reports investments in Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments using the effective interest rate method or another method 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 non-marketable, market-based 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 publicly traded 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 the *NDAA for FY 2005*.

P. General Property, Plant and Equipment

The Department generally records General Property, Plant and Equipment (PP&E) at the estimated historical cost. However, when applicable, the Department will continue to adopt *SFFAS 50*, which permits alternative methods in establishing opening balances. The opening balance asset valuations were established using expenditure, acquisition, and disposal information. Land and land rights recognized in the prior year for certain DoD Components are excluded from General PP&E opening balances in FY 2018.

General PP&E assets are capitalized when an asset has a useful life of two or more years and when the acquisition costs equal or exceed the relevant capitalization threshold. The costs of modifications/improvements to existing General PP&E assets are capitalized if they (1) extend the asset's useful life or increase the asset's size or capacity and (2) equal or exceed the relevant capitalization threshold. The capitalization threshold for General PP&E assets is $250 thousand for real property and General Equipment, with the following exceptions:

- The capitalization threshold for Department of the Navy General Fund and Department of the Air Force General Fund general equipment assets is $1 million;
- The capitalization threshold for *USACE Civil Works* General PP&E assets, other than buildings and structures related to hydropower projects, is $25 thousand; and
- USACE Civil Works buildings and structures related to hydropower projects are capitalized regardless of cost.

Except for those related to USACE Civil Works, these capitalization thresholds apply to General PP&E 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 general equipment and $20 thousand for real property). The Department depreciates all General PP&E assets, other than land, on a straight-line basis.

The Department provides government property to contractors to complete contract work, for which the contractors assume the responsibility for asset control and accountability. 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 assets meet or exceed the relevant capitalization threshold, federal accounting standards require it to be reported on the Department's Balance Sheet.

Q. Advances and Prepayments

Payments made in advance of the receipt of goods and services are reported as an asset on the Balance Sheet. The Department expenses and properly classifies assets when the related goods and services are received.

R. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease substantially transfers all the benefits and risks of ownership to the Department (a capital lease) and the value equals or exceeds the relevant capitalization threshold, the Department records the applicable asset as though purchased, with an offsetting liability, and records depreciation on the asset. The Department records the asset and liability at the lesser of the present value of the rental and other minimum 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 (e.g., real estate or equipment) from a lessor in exchange for payments of funds.

An operating lease does not substantially transfer all the benefits and risks of ownership to the Department. Payments for operating leases are expensed over the lease term. Office space leases entered into by the Department are the largest component of operating leases.

S. 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. The Department may provide financing payments to contractors to alleviate the potential financial burden from long-term contracts. Contract financing payments are defined in the Federal Acquisition Regulation (*FAR*), *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.

The Defense Federal Acquisition Regulation Supplement (*DFARS*) 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. 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.

T. Contingencies and Other Liabilities

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.

When conditions for liability recognition on the financial statements are not met, there may still be a requirement for disclosure in the notes to the financial statements if 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.

The Department is evaluating treaties and other international agreements that may give rise to contingent liabilities and that should be recognized and disclosed in accordance with *SFFAS 5* as amended by *SFFAS 12*.

Other liabilities also arise as a result of anticipated disposal costs for the Department's assets. Consistent with *SFFAS 6*, recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Based on the Department's policy, and in accordance with *SFFAS 5*, non-environmental disposal liabilities are recognized when management decides to dispose of an asset. In addition, the Department recognizes non-environmental 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.

U. 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. Under general funds, military leave and civilian annual leave liabilities are typically recorded as unfunded until the leave is taken or otherwise becomes due and payable; under working capital funds, leave is funded as earned.

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 irretrievable 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 environmental cleanup costs, if applicable.

W. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the Department of cash and other assets in which non-federal individuals or entities have an ownership interest that the Department must uphold. Fiduciary cash and other assets are not assets of the Department and are not recognized on the Balance Sheet. Fiduciary activities are reported in Note 24, *Fiduciary Activities*.

X. Military Retirement and Other Federal Employment Benefits

The Department applies *SFFAS 33* 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.

Y. Subsequent Events

Subsequent events have been evaluated from the balance sheet date through November 15, 2018, which is the date the financial statements were available to be issued. Management is in the process of assessing the financial impact of Hurricane Michael, which occurred during the month of October 2018.

Note 2. Non-Entity Assets

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

Table 2. Non-Entity Assets

As of September 30 ($ in millions)	2018	2017
Intragovernmental Assets		
Fund Balance with Treasury	$ 2,849.2	$ 2,895.1
Accounts Receivable	0.5	55.8
Total Intragovernmental Assets	2,849.7	2,950.9
Non-Federal Assets		
Cash and Other Monetary Assets	856.3	946.2
Accounts Receivable	2,205.7	2,338.9
Total Non-Federal Assets	3,062.0	3,285.1
Total Non-Entity Assets	5,911.7	6,236.0
Total Entity Assets	2,743,732.6	2,559,478.4
Total Assets	$ 2,749,644.3	$ 2,565,714.4

Intragovernmental Assets

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 Treasury General Fund.

Accounts Receivable are primarily amounts necessary to cover surcharge liabilities to be collected on behalf of others. In FY 2018, the Department improved its business practices for capturing Military Housing Privatization Initiative-related intragovernmental activity between business units. This improvement resulted in more accurate reporting of Intragovernmental Accounts Receivable for FY 2018; the Intragovernmental Accounts Receivable amount for FY 2017 is overstated.

Non-Federal Assets

Cash and Other Monetary Assets consist primarily of cash held by disbursing officers to carry out payment, collection, and foreign currency exchanges.

Accounts Receivable consists of amounts associated with canceled year appropriations, and interest, fines, and penalties due on debt. Generally, the Department cannot use the proceeds and must remit them to the Treasury unless permitted by law.

Note 3. Fund Balance with Treasury

The Treasury records cash receipts and disbursements on the Department's behalf; funds are available only for the purposes for which they were appropriated. The Department's Fund Balances with Treasury consist of appropriation accounts, revolving funds, trust accounts, special funds and other fund types.

Table 3. Status of Fund Balance with Treasury

As of September 30 ($ in millions)	2018	2017
Unobligated Balance		
Available	$ 168,578.4	$ 123,203.5
Unavailable	1,009,258.6	924,233.1
Obligated Balance Not Yet Disbursed	500,397.7	438,931.2
Non-Budgetary FBWT	3,325.9	2,956.1
Non-FBWT Budgetary Accounts	(1,101,346.8)	(987,703.5)
Total FBWT	$ 580,213.8	$ 501,620.4

The Status of FBWT, as presented in Table 3, reflects the reconciliation between the budgetary resources supporting FBWT (largely consisting of Unobligated Balance and Obligated Balance Not Yet Disbursed) and those resources provided by other means. The Total FBWT reported on the Balance Sheet reflects 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 available balance consists primarily of the unexpired, unobligated balance that has been apportioned and available for new obligations. The unavailable balance consists primarily of funds invested in 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 Non-Entity FBWT.

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

Total FBWT does not include funds held as a result of allocation transfers received from other federal agencies and fiduciary activities. The Department received allocation transfers from other federal agencies for execution on their behalf in the amount of $399.2 million in FY 2018 and $288.8 million in FY 2017. In addition, the Department held cash and cash equivalents for fiduciary activities in the amount of $77.9 million in FY 2018 and $77.8 million in FY 2017; these amounts are not reported in FBWT in accordance with *SFFAS 31*.

The FBWT reported in the financial statements has been adjusted to reflect the Department's balance as reported by Treasury. The difference between FBWT in the Department's general ledgers and FBWT reflected in the Treasury accounts is attributable to transactions that have not been posted to the individual detailed accounts in the DoD Components' general ledgers as a result of timing differences or the inability to obtain valid accounting information prior to the issuance of the financial statements. When research is completed, these transactions will be recorded in the appropriate individual detailed accounts in the DoD Components' general ledger accounts.

Note 4. Investments and Related Interest

Table 4. Investments and Related Interest

As of September 30 ($ in millions)	2018				
	Cost	Amortization Method	Amortized (Premium) / Discount	**Investments, Net**	Market Value Disclosure
Intragovernmental Securities					
Non-Marketable, Market-Based					
Military Retirement Fund	$ 842,584.2	Eff. Int.	$ (34,499.7)	$ 808,084.5	$ 831,172.6
Medicare Eligible Retiree Health Care Fund	278,981.1	Eff. Int.	(15,090.3)	263,890.8	284,354.3
U.S. Army Corps of Engineers	9,364.2	Eff. Int.	(37.5)	9,326.7	9,294.2
Other Funds	2,663.4	Eff. Int.	(78.2)	2,585.2	2,564.7
Total Non-Marketable, Market-Based	1,133,592.9		(49,705.7)	1,083,887.2	1,127,385.8
Accrued Interest	7,877.2	Eff. Int.	N/A	7,877.2	7,877.2
Total Intragovernmental Securities	1,141,470.1		(49,705.7)	1,091,764.4	1,135,263.0
Other Investments	$ 3,511.6		$ -	$ 3,511.6	N/A

Legend for Amortization Methods: Eff. Int. = Effective Interest Method

As of September 30 ($ in millions)	2017				
	Cost	Amortization Method	Amortized (Premium) / Discount	**Investments, Net**	Market Value Disclosure
Intragovernmental Securities					
Non-Marketable, Market-Based					
Military Retirement Fund	$ 755,224.4	Eff. Int.	$ (31,092.9)	$ 724,131.5	$ 779,882.2
Medicare Eligible Retiree Health Care Fund	262,142.0	Eff. Int.	(13,604.4)	248,537.6	280,882.8
U.S. Army Corps of Engineers	9,257.2	Eff. Int.	(67.3)	9,189.9	9,184.1
Other Funds	2,619.5	Eff. Int.	(114.8)	2,504.7	2,530.4
Total Non-Marketable, Market-Based	1,029,243.1		(44,879.4)	984,363.7	1,072,479.5
Accrued Interest	7,370.2	Eff. Int.	N/A	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	$ 3,511.6		$ -	$ 3,511.6	N/A

Legend for Amortization Methods: Eff. Int. = Effective Interest Method

The Department invests primarily in non-marketable, market-based 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 Treasury securities are issued to authorized funds and are an asset to the Department and a liability to the Treasury. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with these funds. Cash generated (e.g., from bond dividends, proceeds from bond sales, and proceeds from sureties reaching maturity) is deposited in the Treasury and used for general Government purposes. Since the Department and the 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. Government-wide financial statements.

The 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 of its other expenditures.

The U.S. Army Corps of Engineers balance in Intragovernmental Securities consists primarily of $9.1 billion and $9.0 billion in Harbor Maintenance and Related Funds for FY 2018 and FY 2017, respectively.

In FY 2018, Other Funds consists primarily of $1.3 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 2017, Other Funds consists primarily 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.

Other Investments consists of Military Housing Privatization Initiative limited partnerships. The Department invests in non-governmental 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, Net

Table 5. Accounts Receivable

As of September 30 ($ in millions)	2018 Gross Amount Due	2018 Allowance for Estimated Uncollectibles	2018 Accounts Receivable, Net
Intragovernmental Receivables	$ 1,951.6	N/A	$ 1,951.6
Non-Federal Receivables (From the Public)	6,474.0	(779.9)	5,694.1
Total Accounts Receivable	$ 8,425.6	$ (779.9)	$ 7,645.7

As of September 30 ($ in millions)	2017 Gross Amount Due	2017 Allowance for Estimated Uncollectibles	2017 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 represent the Department's claim for payment from other entities. Claims with other federal agencies are resolved in accordance with the business rules published in Appendix 10 of Treasury Financial Manual, Volume I, Part 2, *Chapter 4700*. The Department only recognizes an allowance for uncollectible amounts from the public. Allowances for uncollectible accounts are based on an estimation methodology using three years of historical collection data and is calculated on consolidated receivable balances.

The gross amount due for Non-Federal Receivables (From the Public) for FY 2018 includes criminal restitution orders of $1.1 billion. Restitution receivables and associated payments are pursued by the courts handling those cases. The Department establishes the receivables based on the court documents received and posts payments received through the courts. Since the allowance for estimated uncollectible amounts is calculated for non-federal receivables at a summary level, the exact amount of allowance related to the criminal restitution orders cannot be determined. At two years delinquent, criminal restitution receivables are considered 100 percent uncollectible; however, the Department is only authorized to write off or close accounts with approval from the Department of Justice.

Note 6. Other Assets

Table 6. Other Assets

As of September 30 ($ in millions)		2018		2017
Intragovernmental Other Assets				
Advances and Prepayments	$	838.1	$	798.6
Other Assets		123.4		128.6
Total Intragovernmental Other Assets		961.5		927.2
Non-Federal Other Assets				
Outstanding Contract Financing Payments		26,016.6		25,397.3
Advances and Prepayments		2,316.3		3,980.0
Other Assets (With the Public)		41.5		12.7
Total Non-Federal Other Assets		28,374.4		29,390.0
Total Other Assets	$	29,335.9	$	30,317.2

Intragovernmental Other Assets

Advances and Prepayments are amounts advanced or prepaid to other federal agencies.

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 in FY 2018 and FY 2017), held by the Department of Energy. In accordance with the *Department of Defense Appropriations Act of 1993*, these assets are maintained as a *Strategic Petroleum Reserve* for national defense purposes.

Non-Federal Other Assets

In FY 2018, Outstanding Contract Financing Payments includes $21.7 billion in contract financing payments and an additional $4.3 billion in payments of estimated future amounts due to contractors upon delivery and government acceptance. In comparison, FY 2017 Outstanding Contract Financing Payments included $20.0 billion in contract financing payments and an additional $5.4 billion in payments of estimated future amounts due to contractors upon delivery and government acceptance. The Contract Financing Payment asset is related to the Contingent Liabilities reported in Note 15, *Other Liabilities*.

Advances and Prepayments are contract financing payments related to contract terms and conditions that 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. These rights do not transfer ownership of contractors' work 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.

In FY 2018, Other Assets (With the Public) consisted primarily of General PP&E permanently removed but awaiting disposal. In FY 2017, Other Assets (With the Public) consisted of General PP&E permanently awaiting disposal; liquidated damages used to compensate the Department for untimely delivery or for nonperformance of contracts; and asset donations received through voluntary non-reciprocal transfer, such as gifts of capital assets.

Note 7. Cash and Other Monetary Assets

Table 7. Cash and Other Monetary Assets

As of September 30 ($ in millions)	2018	2017
Cash	$ 444.2	$ 462.7
Foreign Currency	523.8	657.0
Total Cash and Other Monetary Assets	$ 968.0	$ 1,119.7

The majority of Cash and Foreign Currency represent non-entity assets and are restricted and unavailable to fund the Department's mission. In FY 2018 and FY 2017, cash includes unrestricted entity assets of $108.9 million and $172.3 million, respectively, comprised of undeposited collections and other cash.

Note 8. Direct Loans and Loan Guarantees

Military Housing Privatization Initiative

The Department operates loan guarantee programs for MHPI. The MHPI includes both direct loan and loan guarantee programs. The programs are authorized by the *NDAA for FY 2005*, which 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.

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

Loans Receivable

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.

Table 8A. Direct Loans Obligated After FY 1991

As of September 30 ($ in millions)	2018	2017
Military Housing Privatization Initiative		
Loans Receivable Gross	$ 1,759.6	$ 1,704.6
Allowance for Subsidy Cost (Present Value)	(62.2)	(60.4)
Value of Assets Related to Direct Loans, Net	$ 1,697.4	$ 1,644.2
Total Loans Receivable	$ 1,697.4	$ 1,644.2

Total Loans Receivable does not represent proceeds the Department would expect to receive from selling the loans. Interest is calculated using the interest earned method.

Table 8B. Total Amount of Direct Loans Disbursed

As of September 30 ($ in millions)	2018	2017
Military Housing Privatization Initiative	$ 75.8	$ 56.3

Table 8C. Subsidy Expense for New Direct Loans Disbursed

As of September 30 ($ in millions)	2018				
	Interest Differential	Defaults	Fees and Other Collections	Other	Total
Military Housing Privatization Initiative	$ 8.8	$ 9.0	$ -	$ -	$ 17.8

As of September 30 ($ in millions)	2017				
	Interest Differential	Defaults	Fees and Other Collections	Other	Total
Military Housing Privatization Initiative	$ 1.0	$ 11.8	$ -	$ -	$ 12.8

Table 8D. Direct Loan Modifications and Reestimates

As of September 30 ($ in millions)	2018			
	Total Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Military Housing Privatization Initiative	$ -	$ (5.0)	$ (7.4)	$ (12.4)

As of September 30 ($ in millions)	2017			
	Total Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Military Housing Privatization Initiative	$ -	$ 6.1	$ (20.3)	$ (14.2)

Table 8E. Total Direct Loan Subsidy Expense

As of September 30 ($ in millions)	2018	2017
Military Housing Privatization Initiative	$ 5.4	$ (1.4)

Table 8F. Budget Subsidy Rates for Direct Loans for the Current Year

As of September 30 ($ in millions)	2018				
	Interest Differential	Defaults	Fees and Other Collections	Other	Total
Military Housing Privatization Initiative	0%	0%	0%	0%	0%

Subsidy rates pertain to loan agreements contracted during the current fiscal year. There were no new loan agreements in FY 2018 and FY 2017; disbursements and expenses relate to agreements existing at the beginning of the respective fiscal years.

The rates in Table 8F 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 year (when applicable) and prior year loan agreements. Subsidy expense reported in the current year also includes reestimates.

Table 8G. Schedule for Reconciling Subsidy Cost Allowance Balances

For the years ended September 30 ($ in millions)	2018	2017
Beginning Balance of the Subsidy Cost Allowance	$ 60.4	$ 63.5
Add: Subsidy Expense for Direct Loans Disbursed		
During the Reporting Years by Component:		
Interest Rate Differential Costs	8.8	1.0
Default Costs (Net of Recoveries)	9.0	11.8
Total of the Above Subsidy Expense Components	17.8	12.8
Adjustments:		
Subsidy Allowance Amortization	(3.6)	(1.7)
Ending Balance of the Subsidy Cost Allowance Before Reestimates	74.6	74.6
Add or Subtract Subsidy Reestimates by Component:		
Interest Rate Reestimates	(5.0)	6.1
Technical/Default Reestimates	(7.4)	(20.3)
Total of the Above Reestimates Components	(12.4)	(14.2)
Ending Balance of the Subsidy Cost Allowance	$ 62.2	$ 60.4

Loan Guarantee Liability

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

There were no defaulted loan guarantees in FY 2018 or FY 2017.

Table 8H. Guaranteed Loans Outstanding

As of September 30 ($ in millions)	2018		2017	
	Outstanding Principal, Face Value	Amount of Outstanding Principal Guaranteed	Outstanding Principal, Face Value	Amount of Outstanding Principal Guaranteed
Military Housing Privatization Initiative	$ 1,008.8	$ 1,008.8	$ 1,074.2	$ 1,074.2

Table 8I. New Guaranteed Loans Disbursed

As of September 30 ($ in millions)	2018 Outstanding Principal, Face Value	2018 Amount of Outstanding Principal Guaranteed	2017 Outstanding Principal, Face Value	2017 Amount of Outstanding Principal Guaranteed
Military Housing Privatization Initiative	$ 52.9	$ 52.9	$ 115.3	$ 115.3

Table 8J. Liability for Loan Guarantees

As of September 30 ($ in millions)	2018	2017
Military Housing Privatization Initiative	$ 58.4	$ 65.2
Total Loan Guarantee Liability	$ 58.4	$ 65.2

Table 8K. Subsidy Expense for New Loan Guarantees

As of September 30 ($ in millions)	2018 Interest Supplements	Defaults	Fees and Other Collections	Other	Total
Military Housing Privatization Initiative	$ -	$ 2.0	$ -	$ -	$ 2.0

As of September 30 ($ in millions)	2017 Interest Supplements	Defaults	Fees and Other Collections	Other	Total
Military Housing Privatization Initiative	$ -	$ 12.0	$ -	$ -	$ 12.0

Table 8L. Guaranteed Loan Modifications and Reestimates

As of September 30 ($ in millions)	2018 Total Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Military Housing Privatization Initiative	$ -	$ (2.1)	$ (8.5)	$ (10.6)

As of September 30 ($ in millions)	2017 Total Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Military Housing Privatization Initiative	$ -	$ (3.3)	$ (16.5)	$ (19.8)

Table 8M. Total Loan Guarantee Subsidy Expense

As of September 30 ($ in millions)	2018	2017
Military Housing Privatization Initiative	$ (8.6)	$ (7.8)

Table 8N. Budget Subsidy Rates for Loan Guarantees for the Current Year

As of September 30 ($ in millions)	2018				
	Interest Supplements	Defaults	Fees and Other Collections	Other	Total
Military Housing Privatization Initiative	0%	0%	0%	0%	0%

Subsidy rates pertain to loan agreements contracted during the current fiscal year. There were no new loan agreements in FY 2018 and FY 2017; disbursements and expenses relate to agreements existing at the beginning of the respective fiscal years.

These rates cannot be applied to loan guarantees disbursed during the current reporting year to yield the subsidy expense. Subsidy expense reported in the current year also includes reestimates. The subsidy expense for new loan guarantees reported in the current year results from both current year (when applicable) and prior year agreements.

Table 8O. Schedule for Reconciling Loan Guarantee Liability Balances

For the years ended September 30 ($ in millions)	2018	2017
Beginning Balance of the Loan Guarantee Liability	$ 65.2	$ 70.9
Add: Subsidy Expense for Guaranteed Loans Disbursed During the Reporting Years by Component:		
Default Costs (Net of Recoveries)	2.0	12.0
Adjustments:		
Interest Accumulation on the Liability Balance	1.8	2.1
Ending Balance of the Loan Guarantee Liability Before Reestimates	69.0	85.0
Add or Subtract Subsidy Reestimates by Component:		
Interest Rate Reestimates	(2.1)	(3.3)
Technical/Default Reestimates	(8.5)	(16.5)
Total of the Above Reestimate Components	(10.6)	(19.8)
Ending Balance of the Loan Guarantee Liability	$ 58.4	$ 65.2

Note 9. Inventory and Related Property

Table 9A. Inventory and Related Property

As of September 30 ($ in millions)	2018	2017
Inventory, Net	$ 103,772.5	$ 94,904.0
Operating Materials & Supplies, Net	171,087.6	171,049.9
Stockpile Materiel, Net	818.3	806.6
Total Inventory and Related Property, Net	$ 275,678.4	$ 266,760.5

Inventory

Table 9B. Inventory Categories

As of September 30 ($ in millions)	2018			
	Inventory, Gross Value	Revaluation Allowance	**Inventory, Net**	Valuation Method
Held for Sale	$ 66,309.9	$ 62.2	$ 66,372.1	LAC, MAC
Held in Reserve for Future Sale	1,156.1	-	1,156.1	LAC, MAC
Held for Repair	37,668.8	(5,068.9)	32,599.9	LAC, MAC
Raw Material	1,171.8	-	1,171.8	MAC,LAC
Work-in-Process	2,106.4	-	2,106.4	MAC
Excess, Obsolete and Unserviceable	809.2	(443.0)	366.2	NRV
Total	$ 109,222.2	$ (5,449.7)	$ 103,772.5	

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

As of September 30 ($ in millions)	2017			
	Inventory, Gross Value	Revaluation Allowance	**Inventory, Net**	Valuation Method
Held for Sale	$ 61,251.2	$ (49.2)	$ 61,202.0	LAC, MAC
Held in Reserve for Future Sale	-	-	-	LAC, MAC
Held for Repair	35,051.3	(4,473.4)	30,577.9	LAC, MAC
Raw Material	1,083.4	-	1,083.4	MAC,LAC
Work-in-Process	1,560.0	-	1,560.0	MAC
Excess, Obsolete and Unserviceable	869.3	(388.6)	480.7	NRV
Total	$ 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

General Composition of Inventory

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, the value of inventory used in the production process, finished goods held for sale, and goods held for repair and eventual sale. Inventory includes spare and repair parts, clothing and textiles, and fuels held for sale. The Department assigns inventory items to a category based on asset type and condition.

Inventory Restrictions

The following types of inventory are subject to restrictions on use, sale, or disposition:

- Inventories maintained as war reserve materiel in accordance with *DoD Instruction 3110.06* with a recorded value of $2.5 billion in FY 2018 ($2.6 billion in FY 2017), consisting of stocks such as bulk petroleum, subsistence items, and other goods managed and positioned to reduce reaction time in response to contingencies and to sustain military forces;
- Defense Commissary Agency inventory with a recorded value of $386.4 million in FY 2018 ($365.8 million in FY 2017), consisting of grocery, meat, and produce items, limited for resale to authorized commissary patrons; and
- Dispositions pending litigation or negotiation (related to issues including inventory condition, pricing disputes, and product specifications) with a recorded value of $129.6 million in FY 2018 ($134.3 million in FY 2017).

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

Operating Materials & Supplies

Table 9C. OM&S Categories

As of September 30 ($ in millions)	2018 OM&S, Gross Value	Revaluation Allowance	**OM&S, Net**	Valuation Method
Held for Use	$ 121,061.8	$ -	$ 121,061.8	DM, HC, MAC, RP, SP
Held in Reserve for Future Use	13,562.7	-	13,562.7	DM, HC, MAC, RP, SP
Held for Repair	31,996.8	-	31,996.8	DM, HC, MAC, RP, SP
In Development	4,466.3	-	4,466.3	DM, HC, MAC, RP, SP
Excess, Obsolete and Unserviceable	2,933.4	(2,933.4)	-	NRV
Total	$ 174,021.0	$ (2,933.4)	$ 171,087.6	

Legend for Valuation Methods:
DM = Direct Method *HC = Historical Cost* *MAC = Moving Average Cost*
NRV = Net Realizable Value *RP = Replacement Price* *SP = Standard Price*

As of September 30 ($ in millions)	2017 OM&S, Gross Value	Revaluation Allowance	**OM&S, Net**	Valuation Method
Held for Use	$ 130,343.1	$ -	$ 130,343.1	LAC, MAC
Held in Reserve for Future Use	9,957.3	-	9,957.3	LAC, MAC
Held for Repair	30,749.5	-	30,749.5	LAC, MAC
In Development	-	-	-	LAC, MAC
Excess, Obsolete and Unserviceable	2,458.3	(2,458.3)	-	NRV
Total	$ 173,508.2	$ (2,458.3)	$ 171,049.9	

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

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.

OM&S Restrictions

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

Other Disclosures

The FASAB issued *SFFAS 48*, permitting alternative methods in establishing opening balances, effective for periods beginning after September 30, 2016 with early implementation allowed. Some DoD Components used the deemed cost measures from this standard for FY 2016; additional DoD 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 actual historical cost as the basis for valuation.

The Department identified assets previously reported as OM&S Held for Repair and reclassified the assets as OM&S Held for Use during Quarter 4, FY 2017. This correction, along with other adjustments (including a prior period adjustment recorded in FY 2017 of $24.4 billion to the noted OM&S balances), resulted in a decrease to OM&S Held for Repair of $30.3 billion and an increase to OM&S Held for Use of $55.0 billion at that time.

Effective FY 2018, certain assets previously reported under General Equipment Construction-in-Progress are now reported as OM&S In Development.

Stockpile Materiel

Table 9D. Stockpile Materiel Categories

As of September 30 ($ in millions)	2018 Stockpile Materiel Gross Value	2018 Allowance for Gains (Losses)	2018 **Stockpile Materiel, Net**	Valuation Method
Held for Sale	$ 32.1	$ -	$ 32.1	AC, LCM
Held in Reserve for Future Sale	786.2	-	786.2	AC, LCM
Total	$ 818.3	$ -	$ 818.3	

Legend for Valuation Methods:
AC = Actual Cost *LCM = Lower of Cost or Market*

As of September 30 ($ in millions)	2017 Stockpile Materiel Gross Value	2017 Allowance for Gains (Losses)	2017 **Stockpile Materiel, Net**	Valuation Method
Held for Sale	$ 19.6	$ -	$ 19.6	AC, LCM
Held in Reserve for Future Sale	787.0	-	787.0	AC, LCM
Total	$ 806.6	$ -	$ 806.6	

Legend for Valuation Methods:
AC = Actual Cost *LCM = Lower of Cost or Market*

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, 2018, is $1.3 billion ($1.1 billion in FY 2017).

Stockpile Materiel Restrictions

Materiel held by the National Defense Stockpile 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, the National Defense Stockpile reclassifies the materiel from Held in Reserve to Held for Sale.

Note 10. General PP&E, Net

Table 10A. Major General PP&E Asset Classes

As of September 30 ($ in millions)	2018 Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation / Amortization)	**Net Book Value**
Land	N/A	N/A	$ 9,076.7	N/A	$ 9,076.7
Buildings, Structures, and Facilities	S/L	35, 40, or 45 *	432,389.3	(265,377.3)	167,012.0
Leasehold Improvements	S/L	Lease Term	551.2	(292.6)	258.6
Software	S/L	2 - 5 or 10	9,940.2	(5,053.2)	4,887.0
General Equipment	S/L	Various	1,134,083.5	(660,634.5)	473,449.0
Assets Under Capital Lease	S/L	Lease Term	353.7	(257.5)	96.2
Construction in Progress	N/A	N/A	103,695.4	N/A	103,695.4
Other	N/A	N/A	12,477.3	(12,123.1)	354.2
Total General PP&E			$ 1,702,567.3	$ (943,738.2)	$ 758,829.1

** Estimated useful service life is 35 years for structures, 40 years for linear structures, and 45 years for buildings*

Legend for Depreciation/Amortization Methods: S/L = Straight Line Method

As of September 30 ($ in millions)	2017 Depreciation / Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation / Amortization)	**Net Book Value**
Land	N/A	N/A	$ 10,615.4	N/A	$ 10,615.4
Buildings, Structures, and Facilities	S/L	35, 40, or 45 *	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

** Estimated useful service life is 35 years for structures, 40 years for linear structures, and 45 years for buildings*

Legend for Depreciation/Amortization Methods: S/L = Straight Line Method

The Department's General PP&E consists primarily of buildings and structures, furniture and fixtures, equipment, vehicles, internal use software, and land.

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 uses several cost methodologies to provide General PP&E values for financial statement reporting purposes. The FASAB issued *SFFAS 50*, permitting alternative methods in establishing opening balances for General PP&E, effective for periods beginning after September 30, 2016. Some DoD Components used the alternative valuation methods from this standard based on historical records such as expenditure data, contracts, budget information, and engineering documentation. Land and land rights recognized in the prior year for certain DoD Components are excluded from General PP&E opening balances in FY 2018, as permitted under SFFAS 50. The total acreage of land and land rights excluded in this manner was 20,926,485 as of September 30, 2018. See Note 19, *Disclosures Related to the Statement of Changes in Net Position*, for additional details about the Department's implementation of SFFAS 50.

Other General PP&E includes Real Property held in Caretaker Status. Caretaker Status is defined as the Department's property, such as Base Realignment and Closure assets, awaiting further disposition, sale, or transfer to another entity.

Heritage Assets and Stewardship Land

SFFAS 29 provides guidance on accounting and note disclosures for Heritage Assets and Stewardship Land. The Department's policy is to preserve its heritage assets, which are items of historical, cultural, educational, or artistic importance.

As the Department's mission to provide the military forces needed to deter war and protect the security of our country has been executed, the Department has become a large scale owner of historic buildings, structures, historical artifacts, art, stewardship land, and other cultural resources. Protection of these elements of the nation's heritage assets and stewardship land is an essential part of the Department's mission.

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

Heritage assets within the Department consist of buildings and structures, archeological sites, and museum collections. The Department defines these as follows in accordance with the National Historic Preservation Act:

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

The Department continues to progress towards identifying heritage assets and stewardship land added through donation or devise (e.g., a clause in a will leaving real estate to the Department). Differences in heritage asset quantities between the FY 2017 ending unit counts and the FY 2018 beginning unit counts resulted from periodic reviews.

Table 10B. Heritage Assets

For the year ended September 30, 2018 (physical unit count)	Beginning Balance	Additions	(Deletions)	Ending Balance
Categories:				
Buildings and Structures	45,314	1,467	(3,515)	43,266
Archeological Sites	25,385	350	(12,583)	13,152
Museum Collection Items (Objects, Not Including Fine Art)	1,255,279	11,798	(2,774)	1,264,303
Museum Collection Items (Objects, Fine Art)	96,960	390	(123)	97,227

Stewardship land represents 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.

The Department uses Stewardship Land for military bases, installations, training ranges, or other military mission related functions.

Stewardship land is categorized and reported in acres based on the predominant use of the land.

Table 10C. Stewardship Land

For the year ended September 30, 2018
(acres in thousands)

Facility Code	Facility Title	Beginning Balance	Additions	(Deletions)	Ending Balance
9110	Government Owned Land	1,561	11	-	1,572
9111	State Owned Land	-	-	-	-
9120	Withdrawn Public Land	8,825	90	(652)	8,263
9140	Public Land	5	-	(4)	1
Total Stewardship Lands		10,391	101	(656)	9,836

The four categories of Stewardship land– Government Owned Land; State Owned Land; Withdrawn Public Land (not available for settlement, sale, location, or entry); and Public Land (held by local governments) – are held in public trust.

The Department's methods of acquisition and withdrawal of stewardship land are as follows:

- Acquiring additional land through donation or withdrawals from public domain,
- Identifying missing land records,
- Disposing of Base Realignment and Closure (BRAC) sites or transferring land to another DoD Component,
- Identifying cemeteries and historical facilities,
- Disposing of BRAC property or excess installations, and
- Privatizing residential community initiatives programs.

Assets Under Capital Lease

Table 10D. Assets Under Capital Lease

As of September 30 ($ in millions)	2018	2017
Land and Buildings	$ 0.7	$ 0.7
Equipment	353.0	353.0
Accumulated Amortization	(257.5)	(242.7)
Total Assets Under Capital Lease	$ 96.2	$ 111.0

The Department is reporting capital lease equipment and related amortization related to an arrangement for Indefeasible Right of Use agreements, allowing the Department access to portions of fiber optic, undersea cables. In addition, the Department has a 50 year agreement for use of property in which no future lease payments are due; however, improvements made to the property as a tenant are reported as a capital asset.

Note 11. Liabilities Not Covered by Budgetary Resources

Table 11. Liabilities Not Covered by Budgetary Resources

As of September 30 ($ in millions)	2018	2017
Intragovernmental Liabilities		
Accounts Payable	$ -	$ -
Debt	0.6	0.8
Other	1,762.8	1,875.0
Total Intragovernmental Liabilities	1,763.4	1,875.8
Non-Federal Liabilities		
Accounts Payable	1,467.7	1,150.2
Military Retirement and Other Federal Employee Benefits	1,440,808.5	1,477,502.2
Environmental and Disposal Liabilities	67,100.1	65,032.9
Other Liabilities	13,454.8	14,971.8
Total Non-Federal Liabilities	1,522,831.1	1,558,657.1
Total Liabilities Not Covered by Budgetary Resources	1,524,594.5	1,560,532.9
Total Liabilities Covered by Budgetary Resources	1,039,523.3	937,441.1
Total Liabilities Not Requiring Budgetary Resources	-	-
Total Liabilities	$ 2,564,117.8	$ 2,497,974.0

Intragovernmental Liabilities

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

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

Non-Federal Liabilities

Accounts Payable primarily represents liabilities in canceled appropriations, which if paid, will be disbursed using current year funds.

Military Retirement and Other Federal Employment Benefits consists of various employee actuarial liabilities not due and payable during the current fiscal year. In FY 2018, these liabilities primarily consist of $886.0 billion in pension liabilities and $547.4 billion in health benefit liabilities. In FY 2017, the Department reported $913.6 billion in pension liabilities and $556.2 billion in health benefit liabilities. Refer to Note 17, *Military Retirement and Other Federal Employment Benefits*, for additional details.

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.

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

Total Liabilities

Budgetary resources include (1) new budget authority, (2) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, (3) spending authority from offsetting collections, and (4) recoveries of unexpired budget authority through downward adjustments of prior year obligations. Additionally, liabilities are covered by budgetary resources if they are to be funded by permanent indefinite appropriations, provided that the resources may be apportioned by OMB without further action by Congress and without contingency having to be met first.

- Liabilities Not Covered by Budgetary Resources require congressional action before budgetary resources can be provided.
- Liabilities Not Requiring Budgetary Resources have not in the past and will not in the future require the use of budgetary resources.

Note 12. Accounts Payable

Table 12. Accounts Payable

As of September 30 ($ in millions)	2018 Accounts Payable	Interest, Penalties, and Administrative Fees	Accounts Payable, Net
Intragovernmental Payables	$ 1,914.1	N/A	$ 1,914.1
Non-Federal Payables (To the Public)	29,221.7	1.1	29,222.8
Total Accounts Payable	$ 31,135.8	$ 1.1	$ 31,136.9

As of September 30 ($ in millions)	2017 Accounts Payable	Interest, Penalties, and Administrative Fees	Accounts Payable, Net
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 include amounts owed to federal and non-federal entities for goods and services received by the Department.

Note 13. Debt

Table 13. Debt

($ in millions)	2017 Beginning Balance	2017 Net Borrowing	2017 Ending Balance	2018 Net Borrowing	2018 Ending Balance
Agency Debt (Intragovernmental)					
Debt to Treasury	$ 1,630.7	$ 0.1	$ 1,630.8	$ 54.9	$ 1,685.7
Total Debt	$ 1,630.7	$ 0.1	$ 1,630.8	$ 54.9	$ 1,685.7

The Department's debt consists of interest and principal payments due to the Treasury. The Department borrows funds from the Treasury for the Military Housing Privatization Initiative and the Washington Aqueduct Capital Improvements Project. See Note 8, *Direct Loan and Loan Guarantees*, for more information pertaining to MHPI.

Note 14. Environmental and Disposal Liabilities

Table 14. Environmental and Disposal Liabilities

As of September 30 ($ in millions)	2018	2017
Accrued Environmental Restoration Liabilities		
Active Installations - Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 13,621.0	$ 13,063.8
Active Installations - Military Munitions Response Program (MMRP)	3,476.6	3,354.3
Formerly Used Defense Sites - IRP and BD/DR	2,942.1	2,967.8
Formerly Used Defense Sites - MMRP	7,683.0	7,968.3
Other Accrued Environmental Liabilities - Non-BRAC		
Environmental Corrective Action	1,902.3	917.9
Environmental Closure Requirements	4,089.8	3,916.7
Environmental Response at Operational Ranges	92.4	76.1
Asbestos	3,972.2	4,510.4
Non-Military Equipment	24.4	5.5
Other	2,078.9	1,786.5
BRAC Installations		
IRP	4,381.7	3,732.9
MMRP	766.0	713.5
Environmental Corrective Action/Closure Requirements	240.7	251.6
Asbestos	10.1	9.7
Environmental Disposal for Military Equipment/Weapons Program		
Nuclear Powered Military Equipment/Spent Nuclear Fuel	16,439.6	15,807.0
Non-Nuclear Powered Military Equipment	126.1	137.0
Other Weapon Systems	383.7	354.6
Chemical Weapons Disposal Program		
Chemical Demilitarization - Chemical Materials Agency	2,576.8	2,671.4
Chemical Demilitarization - Assembled Chemical Weapons Alternatives (ACWA)	5,604.0	6,073.1
Total Environmental and Disposal Liabilities	$ 70,411.4	$ 68,318.1

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, as applicable.

Other Accrued Environmental Liabilities, 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.

Sources 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 (*CERCLA*), Superfund Amendments and Reauthorization Act of 1986 (*SARA*), Resource Conservation and Recovery Act (*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 for these vessels. 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*, as amended, 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*, as amended, provides for the safe and efficient management of low-level radioactive waste.

The Chemical Weapons Disposal Program is based on the *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 (*RACER*) application and the Normalization of Data System. The Department validates the models in accordance with *DoD Instruction 5000.61* 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 and/or future 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 – (1) physical capacity for operating landfills and (2) life expectancy in years for all other assets. The Department expenses the full cost to clean up contamination for Heritage Assets and Stewardship Land and certain other General PP&E when the asset is placed into service.

The unrecognized portion of the estimated total cleanup costs associated with disposal of General PP&E as of September 30, 2018 was $4.8 billion; this amount was unknown as of September 30, 2017.

Nature and Possible Changes in Estimated Cleanup Costs

Environmental liabilities are subject to changes in laws and regulations, agreements with regulatory agencies, and advances in technology. The Department is unaware of pending changes affecting its estimated cleanup costs.

The Department revised estimates resulting from previously unknown contaminants, re-estimation based on different assumptions, and other changes in project scope.

Uncertainty Regarding Accounting Estimates

The accounting estimates used to calculate the reported 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, a reasonable estimate is indeterminable because the extent of the buried chemical munitions and agents is unknown.

The Department has ongoing studies for FUSRAP and will update its estimate as additional information is identified.

The Department may incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The Department continues its efforts to reasonably estimate required restoration costs.

Asbestos-Related Cleanup Costs:

The Department maintains structures and facilities that may contain asbestos material in the construction or renovation. At this time, the Department is working towards assessing a reasonable estimate for the total cleanup costs related to asbestos.

Note 15. Other Liabilities

Table 15. Other Liabilities

As of September 30 ($ in millions)	2018 Current Liability	2018 Non-Current Liability	2018 Total
Intragovernmental			
Advances from Others	$ 1,739.8	$ -	$ 1,739.8
Deposit Funds and Suspense Account Liabilities	242.0	-	242.0
Disbursing Officer Cash	867.6	-	867.6
Judgment Fund Liabilities	573.8	-	573.8
FECA Reimbursement to the Department of Labor	485.5	604.0	1,089.5
Custodial Liabilities	183.6	2,065.3	2,248.9
Employer Contributions and Payroll Taxes Payable	536.2	-	536.2
Other Liabilities	105.9	-	105.9
Total Intragovernmental Other Liabilities	4,734.4	2,669.3	7,403.7
Non-Federal			
Accrued Funded Payroll and Benefits	10,146.3	-	10,146.3
Advances from Others	5,696.5	(2.0)	5,694.5
Deposit Funds and Suspense Accounts	2,986.8	-	2,986.8
Non-Environmental Disposal Liabilities			
Military Equipment (Non-Nuclear)	1,166.6	60.5	1,227.1
Conventional Munitions Disposal	-	6.0	6.0
Accrued Unfunded Annual Leave	10,589.6	-	10,589.6
Capital Lease Liability	-	-	-
Contract Holdbacks	534.9	27.4	562.3
Employer Contribution and Payroll Taxes Payable	586.8	-	586.8
Contingent Liabilities	695.6	5,347.6	6,043.2
Other Liabilities	232.3	-	232.3
Total Non-Federal Other Liabilities	32,635.4	5,439.5	38,074.9
Total Other Liabilities	$ 37,369.8	$ 8,108.8	$ 45,478.6

As of September 30 ($ in millions)	2017 Current Liability	Non-Current Liability	Total
Intragovernmental			
Advances from Others	$ 1,418.0	$ -	$ 1,418.0
Deposit Funds and Suspense Account Liabilities	(141.4)	-	(141.4)
Disbursing Officer Cash	1,009.2	-	1,009.2
Judgment Fund Liabilities	562.1	-	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 Contributions and Payroll Taxes Payable	519.7	-	519.7
Other Liabilities	201.0	-	201.0
Total Intragovernmental Other Liabilities	4,277.9	2,739.9	7,017.8
Non-Federal			
Accrued Funded Payroll and Benefits	5,961.9	-	5,961.9
Advances from Others	5,149.8	11.0	5,160.8
Deposit Funds and Suspense Accounts	3,007.5	-	3,007.5
Non-Environmental Disposal Liabilities			
Military Equipment (Non-Nuclear)	1,136.7	58.5	1,195.2
Conventional Munitions Disposal	-	6.0	6.0
Accrued Unfunded Annual Leave	10,433.7	-	10,433.7
Capital Lease Liability	-	-	-
Contract Holdbacks	540.2	6.2	546.4
Employer Contribution and Payroll Taxes Payable	629.9	-	629.9
Contingent Liabilities	619.5	8,215.1	8,834.6
Other Liabilities	295.9	-	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

Intragovernmental Other Liabilities

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 Officers 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; and similar notes advanced from the Treasury under various authorities. Disbursing Officers Cash is non-entity, restricted cash.

For information on Judgement Fund Liabilities, see Note 16, *Commitments and Contingencies*.

Federal Employees' Compensation Act (*FECA*) Reimbursement to the Department of Labor represents liabilities for billed amounts payable in FY 2018 and FY 2019 and unbilled amounts, including both incurred and an estimated accrual. Refer to Note 17, *Military Retirement and Other Federal Employment Benefits*, for the estimated FECA actuarial liability.

Custodial Liabilities represents liabilities for collections reported as nonexchange revenues where the Department is acting on behalf of another federal entity.

Employer Contributions and Payroll Taxes Payable represents the employer portion of payroll taxes and benefit contributions for health benefits, retirement, life insurance and voluntary separation incentive payments.

Other Liabilities primarily consists of unemployment compensation liabilities.

Non-Federal Other Liabilities

In FY 2018, Advances from Others includes an abnormal balance for the non-current portion of the liability. The Department is currently researching and working to resolve this.

Military Equipment (Non-Nuclear) is a part of the Non-Environmental Disposal liability related to the final disposition of equipment, munitions, and other national defense weapon systems that are considered non-nuclear. Disposal measurements involve the use of cost estimates that consider the anticipated level of effort required to dispose of the item.

The Department currently has no capital lease liability, but it is reporting capital lease assets. 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. There are no future minimum lease payments, therefore no liability is required. However, payments are due annually for operating and 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. In addition, the Department has a 50 year agreement for use of property in which no future lease payments are due; however, improvements made to the property as a tenant are reported as a capital asset. Refer to Note 10, *General PP&E, Net*, for additional information on Assets under Capital Lease.

Contract Holdbacks are amounts earned by contractors or suppliers during the production period but not yet paid to the contractor/supplier to ensure future performance.

Contingent Liabilities in FY 2018 and FY 2017 include $4.3 billion and $5.4 billion, respectively, 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. The Department has recognized a contingent liability for the estimated unpaid costs that are considered conditional for payment pending 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.

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.

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

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 material legal actions which the DoD Office of General Counsel (*DoD OGC*) considers an adverse decision probable and the amount of loss is measurable. Claims below the DoD consolidated materiality threshold but above the individual DoD Components' materiality threshold have the potential to be material in the aggregate; however, at this time in the judgement of the DoD OGC, those amounts are not included as contingent liabilities. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Treasury *Judgment Fund*. The Department records contingent liabilities in Note 15, *Other Liabilities*.

Table 16. Summary of Legal Contingent Liabilities

As of September 30 ($ in millions)	2018 Dollars	2018 Number of Legal Actions	2017 Dollars	2017 Number of Legal Actions
DoD Consolidated Materiality Threshold	$ 160.4		$ 152.3	
Total Claims Exceeding Materiality Threshold:				
Probable	$ 935.1	4	$ 1,256.5	4
Reasonably Possible	12,237.7	8	5,829.0	3
Unable to Determine Possibility of Loss *	3,193,826.0	22	1,365,416.9	30
Remote	2,058,255.0	8	99,965.6	6
Total Claims Exceeding Materiality Threshold	$ 5,265,253.8	42	$ 1,472,468.0	43
Total Claims Above DoD Component Materiality Threshold, But Below the DoD Consolidated Materiality Threshold	$ 7,144.1	108	$ 6,598.6	119

* *Cases in which legal counsel is unable to express an opinion concerning the outcome should be considered as "Reasonably Possible" for financial reporting disclosure purposes.*

Other Commitments and Contingencies

The Department is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, potentially resulting in a future outflow of budgetary resources. Contingencies considered both measurable and probable have been recognized as liabilities. Refer to Note 15, *Other Liabilities*, for additional details. In addition, the Department may have contingencies arising from treaties and other international agreements. Presently, the Department has limited capability to capture these potential liabilities.

In FY 2018, the Department has $1.5 billion in obligations related to canceled appropriations for which it has a contractual commitment for payment ($1.5 billion in FY 2017), $950.4 million for contractual arrangements related to loan guarantees ($1,009.0 million in FY 2017), and $5.2 billion related to non-cancelable operating leases which may require future financial obligations ($4.2 billion in FY 2017). See Note 8, *Direct Loan and Loan Guarantees*, and Note 25, *Other Disclosures*, for additional information.

Note 17. Military Retirement and Other Federal Employment Benefits

The Department complies with *SFFAS 33*, which 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.

Table 17A. Military Retirement and Other Federal Employment Benefits Liability

As of September 30	2018		
($ in millions)	Liabilities	(Assets Available to Pay Benefits)	Unfunded Liabilities
Pension and Health Benefits			
Military Retirement Pensions	$ 1,616,398.1	$ (730,405.6)	$ 885,992.5
Military Pre Medicare-Eligible Retiree Health Benefits	249,694.0	-	249,694.0
Military Medicare-Eligible Retiree Health Benefits	535,318.1	(237,646.7)	297,671.4
Total Pension and Health Benefits	2,401,410.2	(968,052.3)	1,433,357.9
Other Benefits			
FECA	5,858.0	-	5,858.0
Voluntary Separation Incentive Programs	270.9	(108.6)	162.3
DoD Education Benefits Fund	921.7	(921.7)	-
Other	6,886.0	(5,455.7)	1,430.3
Total Other Benefits	13,936.6	(6,486.0)	7,450.6
Total Military Retirement and Other Federal Employment Benefits	$ 2,415,346.8	$ (974,538.3)	$ 1,440,808.5

Actuarial Cost Method Used for Pension and Health Benefits: Aggregate Entry-Age Normal Method
Market Value of Investments in Non-Marketable, Market Based Securities included in Assets Available to Pay Benefits: $1.1 trillion

As of September 30 ($ in millions)	2017 Liabilities	2017 (Assets Available to Pay Benefits)	2017 Unfunded Liabilities
Pension and Health Benefits			
Military Retirement Pensions	$ 1,567,689.2	$ (654,078.5)	$ 913,610.7
Military Pre Medicare-Eligible Retiree Health Benefits	252,512.9	-	252,512.9
Military Medicare-Eligible Retiree Health Benefits	526,986.1	(223,306.2)	303,679.9
Total Pension and Health Benefits	2,347,188.2	(877,384.7)	1,469,803.5
Other Benefits			
FECA	5,936.0	-	5,936.0
Voluntary Separation Incentive Programs	321.5	(130.4)	191.1
DoD Education Benefits Fund	998.7	(998.7)	-
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 for Pension and Health Benefits: Aggregate Entry-Age Normal Method
Market Value of Investments in Non-Marketable, Market Based Securities included in Assets Available to Pay Benefits: $1.1 trillion

Table 17B. Reconciliation of Beginning and Ending Liability Balances for Military Retirement and Other Federal Employment Benefits

For the year ended September 30 ($ in millions)	2018 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	$ 1,567,689.2	$ 252,512.9	$ 526,986.1	$ 321.5	$ 998.7
Expense:					
Normal Cost	29,673.5	10,135.7	10,498.3	-	138.8
Interest on the Liability Balance	57,466.1	9,772.8	20,223.9	6.1	33.6
Plan Amendments	8,932.0	(2,678.3)	(18,195.0)	-	-
Experience Losses (Gains)	9,610.0	(8,729.9)	(8,492.0)	3.0	6.9
Other Factors	-	-	-	-	-
Expenses Before Losses (Gains) from Actuarial Assumption Changes	105,681.6	8,500.3	4,035.2	9.1	179.3
Actuarial Losses (Gains) due to:					
Changes in Trend Assumptions	-	(3,805.0)	(6,598.1)	-	-
Changes in Assumptions Other Than Trend	2,069.7	3,525.9	21,547.6	1.9	(7.0)
Losses (Gains) from Actuarial Assumption Changes	2,069.7	(279.1)	14,949.5	1.9	(7.0)
Total Expenses	107,751.3	8,221.2	18,984.7	11.0	172.3
Less: Benefit Outlays	59,042.4	11,040.1	10,652.7	61.6	249.3
Total Changes in Actuarial Liability	48,708.9	(2,818.9)	8,332.0	(50.6)	(77.0)
Ending Actuarial Liability	$ 1,616,398.1	$ 249,694.0	$ 535,318.1	$ 270.9	$ 921.7

For the year ended September 30 ($ in millions)	2017				
	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
Expense:					
Normal Cost	27,428.0	9,384.3	11,152.7	-	144.4
Interest on the Liability Balance	57,530.9	9,751.5	22,546.3	8.6	40.7
Plan Amendments	(858.2)	-	-	-	-
Experience Losses (Gains)	(1,610.8)	(6,274.1)	(14,310.7)	(1.8)	(81.3)
Other Factors	-	-	-	-	-
Expenses Before Losses (Gains) from Actuarial Assumption Changes	82,489.9	12,861.7	19,388.3	6.8	103.8
Actuarial Losses (Gains) due to:					
Changes in Trend Assumptions	-	1,109.1	(53,632.9)	-	-
Changes in Assumptions Other Than Trend	52,910.5	9,575.9	14,134.1	4.9	(32.6)
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

Pension and Health Benefits

Military Retirement Pensions

The Military Retirement Fund is a defined benefit plan authorized by the *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 assumptions listed in Table 17C to calculate the FY 2018 actuarial liability.

Table 17C. Actuarial Assumptions for Military Retirement Pension Liability

Projection Year	Inflation (COLA)		Salary		Interest
FY 2018	2.0%	(actual)	2.4%	(actual)	3.7%
FY 2019	2.8%	(estimated)	2.6%	(estimated)	3.5%
Long Term	1.5%		2.0%		3.5%

Actuarial Cost Method Used: Aggregate Entry-Age Normal Method
Market Value of Investments in Market-Based and Marketable Securities: $786.9 billion
Assumed Interest Rate: 3.5%

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 2018 actuarial liability calculation, actuaries used the assumptions listed in Table 17D.

Table 17D. Actuarial Assumptions for MRHB Liability

MRHB Medical Trend	FY 2017 - FY 2018	Ultimate Rate FY 2042
Non-Medicare Inpatient (Direct Care)	4.45%	4.00%
Non-Medicare Outpatient (Direct Care)	6.00%	4.00%
Non-Medicare Prescriptions (Direct Care)	6.00%	4.00%
Non-Medicare Inpatient (Purchased Care)	1.95%	4.00%
Non-Medicare Outpatient (Purchased Care)	3.30%	4.00%
Non-Medicare Prescriptions (Purchased Care)	3.28%	4.00%
U.S. Family Health Plan (USFHP) (Purchased Care)	3.95%	4.00%

Actuarial Cost Method Used: Aggregate Entry-Age Normal Method
Assumed Interest Rate: 3.6%

Medicare-Eligible Retiree Health Care Fund (MERHCF) Benefits

In accordance with *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 Department 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 assumptions listed in Table 17E to calculate the FY 2018 actuarial liability.

Table 17E. Actuarial Assumptions for MERHCF Liability

MERHCF Benefits - Medical Trend	FY 2017 - FY 2018	Ultimate Rate FY 2042
Medicare Inpatient (Direct Care)	2.50%	4.00%
Medicare Outpatient (Direct Care)	4.00%	4.00%
Medicare Prescriptions (Direct Care)	3.80%	4.00%
Medicare Inpatient (Purchased Care)	1.00%	4.00%
Medicare Outpatient (Purchased Care)	3.00%	4.00%
Medicare Prescriptions (Purchased Care)	3.12%	4.00%
Medicare USFHP (Purchased Care)	2.52%	4.00%

Actuarial Cost Method Used: Aggregate Entry-Age Normal Method
Market Value of Investments in Market-Based and Marketable Securities: $286.7 billion
Assumed Interest Rate: 3.6%

The FY 2018 MERHCF liability includes Medicare liabilities for all Uniformed Services. The $535.3 billion liability includes $522.5 billion for the Department, $11.4 billion for the Coast Guard, $1.3 billion for the Public Health Service, and $0.1 billion for the National Oceanic and Atmospheric Administration (NOAA). The FY 2017 $527.0 billion liability included $514.5 billion for the Department, $11.1 billion for the Coast Guard, $1.3 billion for the Public Health Service, and $0.1 billion for NOAA.

The FY 2018 contributions from each of the Uniformed Services were $8.1 billion from the Department, $204.1 million from the Coast Guard, $32.0 million from the Public Health Service, and $1.6 million from 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.

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 Treasury's Yield Curve for Treasury Nominal Coupon Issues (*TNC Yield Curve*) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.72% was assumed for year one and years thereafter. An interest rate for medical benefits of 2.38% was assumed for year one and years 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) 2018 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 are provided in Table 17F.

Table 17F. Actuarial Assumptions for FECA Liability

CBY	COLA	CPIM
2019	1.31%	3.21%
2020	1.51%	3.48%
2021	1.89%	3.68%
2022	2.16%	3.71%
2023+	2.21%	4.09%

To test the reliability of the model discussed, 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.

Voluntary Separation Incentive (VSI) Program

The *VSI Program* was established by *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 1.9% 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 is $137.8 million for FY 2018 and $138.6 million for FY 2017.

DoD Education Benefits Fund (EBF)

The EBF was established by *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 3.25% as approved by the DoD Board of Actuaries.

The Market Value of Investments in Market-based and Marketable Securities is $1.1 billion for both FY 2018 and FY 2017.

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 related to certain life insurance and pension plans.

Note 18. General Disclosures Related to the Statement of Net Cost

Table 18. Costs and Exchange Revenue by Major Program

For the years ended September 30 ($ in millions)	2018	2017
Military Retirement Benefits		
Gross Cost	$ 104,973.1	$ 96,630.1
Less: Earned Revenues	(41,456.8)	(29,360.3)
Losses (Gains) from Actuarial Assumption Changes for Militray Retirement Benefits	17,019.2	13,411.6
Net Program Costs	80,535.5	80,681.4
Civil Works		
Gross Cost	12,603.8	9,168.2
Less: Earned Revenues	(4,816.2)	(1,591.9)
Losses (Gains) from Actuarial Assumption Changes for Militray Retirement Benefits	-	-
Net Program Costs	7,787.6	7,576.3
Military Personnel		
Gross Cost	145,255.3	139,512.6
Less: Earned Revenues	(1,349.3)	(1,294.0)
Losses (Gains) from Actuarial Assumption Changes for Militray Retirement Benefits	-	-
Net Program Costs	143,906.0	138,218.6
Operations, Readiness & Support		
Gross Cost	259,653.5	302,022.8
Less: Earned Revenues	(24,396.2)	(57,810.7)
Losses (Gains) from Actuarial Assumption Changes for Militray Retirement Benefits	(284.2)	10,657.4
Net Program Costs	234,973.1	254,869.5
Procurement		
Gross Cost	112,506.4	85,881.3
Less: Earned Revenues	(7,297.4)	(10,503.1)
Losses (Gains) from Actuarial Assumption Changes for Militray Retirement Benefits	-	-
Net Program Costs	105,209.0	75,378.2
Research, Development, Test & Evaluation		
Gross Cost	88,386.3	84,380.8
Less: Earned Revenues	(9,905.5)	(8,602.0)
Losses (Gains) from Actuarial Assumption Changes for Militray Retirement Benefits	-	-
Net Program Costs	78,480.8	75,778.8
Family Housing & Military Construction		
Gross Cost	11,714.5	10,521.9
Less: Earned Revenues	(1,234.9)	(5,133.5)
Losses (Gains) from Actuarial Assumption Changes for Militray Retirement Benefits	-	-
Net Program Costs	10,479.6	5,388.4
Total Net Cost	$ 661,371.6	$ 637,891.2

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 Table 18. 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 *SFFAS 4*, as amended by *SFFAS 55*.

The Department's military retirement and postemployment costs are reported in accordance with *SFFAS 33*. As required by the standard, the Department separately presents on the SNC gains and losses from changes in long term assumptions used to estimate liabilities associated with pensions, other retirement benefits, and other postemployment benefits.

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

Cumulative Results of Operations – Prior Period Adjustments

The FASAB issued *SFFAS 48* and *SFFAS 50*, which permit alternative methods in establishing opening balances and are effective for periods beginning after September 30, 2016 with early implementation allowed. Some DoD Components used the principles of these standards for FY 2017; additional DoD Components used the principles of these standards in FY 2018.

During FY 2018, the Department decreased the beginning Cumulative Results of Operation by $2.5 billion through prior period adjustments, General PP&E for land and buildings. As a result, the FY 2017 ending balance of $390.1 billion adjusted to an FY 2018 beginning balance of $392.6 billion. This entry also adjusted downward the ending balance of General PP&E by $2.5 billion.

During FY 2017, the Department increased the beginning Cumulative Results of Operations by $37.3 billion through prior period adjustments, from an FY 2016 ending balance of $469.5 billion to an FY 2017 beginning balance of $432.2 billion. The Department increased the ending balance of Operating Materiel and Supplies by $24.4 billion and of General PP&E by $12.9 billion.

Reconciliation Differences

Statement of Budgetary Resources to the Statement of Changes in Net Position

Appropriations (Discretionary and Mandatory) reported on the Statement of Budgetary Resources exceed Appropriations Received on the Statement of Changes in Net Position by $68.8 billion in FY 2018 and $66.3 billion in FY 2017. A reconciliation of these amounts is presented in Table 19A.

Table 19A. Reconciliation of Appropriations on the Statement of Budgetary Resources to Appropriations Received on the Statement of Changes in Net Position

For the year ended September 30 ($ in millions)	2018	2017
Appropriations, Statement of Budgetary Resources (SBR)	$ 863.6	$ 777.0
Permanent and Temporary Reductions	95.8	87.6
Trust and Special Fund Receipts	(164.2)	(153.1)
Miscellaneous Items	(0.4)	(0.8)
Total Difference	(68.8)	(66.3)
Appropriations Received, Statement of Changes in Net Position	$ 794.8	$ 710.7

Permanent and Temporary Reductions primarily includes the amount of prior year balances and current year budget authority permanently reduced by enacted legislation; receipts upon collection not immediately available for obligation, but awaiting legislation; and authority currently unavailable, awaiting specific legal requirements to be met.

Miscellaneous Items primarily includes the current year authority transfers in, authority made available from receipt or appropriation balances previously precluded from obligation, non-allocation transfers of invested balances, re-estimated loan subsidy appropriation, and current year authority transfers out.

Funds from Dedicated Collections Information to the Balance Sheet and Statement of Changes in Net Position

Funds from Dedicated Collections information is presented on a combined basis in Note 23, *Funds from Dedicated Collections*. Table 19B summarizes the elimination of intradepartmental activity between Funds from Dedicated Collections and all Other Fund types to arrive at the consolidated Net Position amounts presented on the DoD Agencywide Balance Sheet and Statement of Changes in Net Position.

Table 19B. Reconciliation of Combined Unexpended Appropriations and Cumulative Results of Operations to Consolidated Unexpended Appropriations and Cumulative Results of Operations

As of September 30 ($ in millions)	2018 Combined	 Consolidating Eliminations	 Consolidated
Unexpended Appropriations - Dedicated Collections	$ -	$ -	$ -
Unexpended Appropriations - Other Funds	529,746.6	-	529,746.6
Cumulative Results of Operations - Dedicated Collections	14,614.6	(2,163.8)	16,778.4
Cumulative Results of Operations - Other Funds	(358,834.7)	2,163.8	(360,998.5)
Total Net Position	$ 185,526.5	$ -	$ 185,526.5

As of September 30 ($ in millions)	2017 Combined	 Consolidating Eliminations	 Consolidated
Unexpended Appropriations - Dedicated Collections	$ -	$ -	$ -
Unexpended Appropriations - Other Funds	457,849.4	-	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	$ -	$ 67,740.4

Note 20. Disclosures Related to the Statement of Budgetary Resources

The Statement of Budgetary Resources is presented on a combined basis in accordance with OMB *Circular No. A-136*; thus, intra-entity transactions have not been eliminated from the amounts presented. This presentation differs from that of the other principal financial statements, which are presented on a consolidated basis.

Budgetary Resources Obligated for Undelivered Orders

Table 20A. Budgetary Resources Obligated for Undelivered Orders at the End of the Period

As of September 30 ($ in millions)	2018	2017
Intragovernmental		
Unpaid	$ 120,202.7	*
Prepaid / Advanced	3,285.7	*
Total Intragovernmental	123,488.4	*
Non-Federal		
Unpaid	319,795.6	*
Prepaid / Advanced	23,988.3	*
Total Non-Federal	343,783.9	*
Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 467,272.3	$ 417,855.6

** FY 2017 presentation not required*

The breakout of total Budgetary Resources Obligated for Undelivered Orders at the End of the Period between (1) Intragovernmental and Non-Federal and (2) paid and unpaid amounts is a new presentation requirement for FY 2018; the FY 2017 presentation is not required in accordance with OMB Circular No. A-136.

Available Borrowing / Contract Authority

Table 20B. Available Borrowing / Contract Authority at the End of the Period

As of September 30 ($ in millions)	2018	2017
Available Borrowing and Contract Authority, End of the Period	$ -	$ -

The Department utilizes borrowing authority for the Military Housing Privatization Initiative. Borrowing authority is used in compliance with OMB *Circular No. A-129*. There was no remaining borrowing authority available at the end of the period for FY 2018 or FY 2017.

Apportionment Categories for New Obligations and Upward Adjustments

Table 20C. Apportionment Categories of New Obligations and Upward Adjustments, Budgetary and Non-Budgetary Credit Reform Financing Account

As of September 30 ($ in billions)	2018 Apportionment Category A	Apportionment Category B	Exempt from Apportionment	Total
Direct	$ 424.1	$ 268.0	$ 156.6	$ 848.7
Reimbursable	27.7	177.9	-	205.6
New Obligations and Upward Adjustments	$ 451.8	$ 445.9	$ 156.6	$ 1,054.3

As of September 30 ($ in billions)	2017 Apportionment Category A	Apportionment Category B	Exempt from Apportionment	Total
Direct	$ 409.1	$ 237.9	$ 153.0	$ 800.0
Reimbursable	16.2	157.0	8.4	181.6
New Obligations and Upward Adjustments	$ 425.3	$ 394.9	$ 161.4	$ 981.6

Apportionment 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).

Permanent Indefinite Appropriations

The following 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.

The Department received the following permanent indefinite appropriations in FY 2018 and FY 2017:

Department of the Army General Gift Fund (*10 U.S.C. §2601(c)(1)*)

Department of the Navy General Gift Fund (*10 U.S.C. §2601(c)(2)*)

Department of the Air Force General Gift Fund (*10 U.S.C. §2601(c)(3)*)

Department of Defense General Gift Fund (*10 U.S.C. §2601*)

Disposal of Department of Defense Real Property (*40 U.S.C. §572(b)(5)(A)*)

Lease of Department of Defense Real Property (*40 U.S.C. §485(h)*)

Foreign National Employees Separation Pay Account, Defense (*10 U.S.C. §1581*)

United States Naval Academy Gift and Museum Fund (*10 U.S.C. §§6973*, *6974*)

Ship Stores Profits, Navy (*10 U.S.C §7220*, *31 U.S.C. §1321*)

Burdensharing Contributions (*10 U.S.C. §2350j*)

Forest Program (*10 U.S.C. §2665*)

Medicare-Eligible Retiree Health Care Fund (*10 U.S.C. §1111*)

Military Retirement Fund (*10 U.S.C. §1461*)

Education Benefits Fund (*10 U.S.C. §2006*)

Host Nation Support for U.S. Relocation Activities (*10 U.S.C. §2350k*)

Hydraulic Mining Debris Reservoir (*33 U.S.C. §683*)

Maintenance and Operation of Dams and Other Improvements of Navigable Waters (*16 U.S.C. §810(a)*)

Payments to States (*33 U.S.C. §701c-3*)

Wildlife Conservation (*16 U.S.C. §§670-670f*)

Ainsworth Bequest (*31 U.S.C. §1321*)

DoD Family Housing Improvement Fund (*10 U.S.C. §2883(a)*)

DoD Military Unaccompanied Housing Improvement Fund (*10 U.S.C. §2883(a)*)

Voluntary Separation Incentive Fund (*10 U.S.C. §1175(h)*)

Rivers & Harbors Contributed Funds (*33 U.S.C. §§560*, *701h*)

Concurrent Receipt Accrual Payments to the Military Retirement Fund (*10 U.S.C. §1466(b)(1)*)

Rocky Mountain Arsenal, Restoration (United States Statutes at Large, Volume 100, page 4003, section 1367 (*100 Stat. 4003 §1367*))

Homeowners Assistance Fund (*42 U.S.C. §3374(d)*, *Public Law 111-5*)

Payments to Military Retirement Fund, Defense (*10 U.S.C. §1466*)

Payment to Department of Defense Medicare-Eligible Retiree Health Care Fund (*10 U.S.C. §1116(a)*)

Medicare-Eligible Retiree Health Fund Contribution, Navy (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, Marine Corps (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, Army (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Army (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, National Guard Personnel, Army (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, Air Force (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Air Force (*10 U.S.C. §1116*)

Medicare-Eligible Retiree Health Fund Contribution, National Guard Personnel, Air Force (*10 U.S.C. §1116*)

Department of Defense Vietnam War Commemoration Fund, Defense (*Public Law 110-181*, *122 Stat. 141 §598*)

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.

Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the U.S. Government

Table 20D presents a reconciliation between the budgetary resources, obligations incurred, distributed offsetting receipts, and net outlays in the FY 2017 column on the Combined Statement of Budgetary Resources (SBR) to the actual amounts for FY 2017 from the "Analytical Perspectives – Federal Budget by Agency and Account" and "Appendix – Detailed Budget Estimates by Agency" sections of the FY 2019 President's Budget. The FY 2020 Budget will display the FY 2018 actual values and is expected to be published in February 2019 at *https://www.whitehouse.gov/omb/budget*.

Table 20D. Explanation of Differences Between the SBR and the Budget of the U.S. Government

For the year ended September 30 ($ in billions)	FY 2017 Actual			
	Budgetary Resources	New Obligations & Upward Adjustments	Distributed Offsetting Receipts	Net Outlays
Combined Statement of Budgetary Resources	$ 1,140.4	$ 981.6	$ 98.0	$ 731.9
Expired Accounts that are Excluded from the Budget of the U.S. Government	(53.9)	(20.3)	-	-
Adjustments to the SBR	(0.1) *	(0.1) *	-	-
Permanent Reporting Differences	(0.1) **	(0.1) **	-	-
Other	-	-	-	(0.1)
Budget of the U.S. Government	$ 1,086.3	$ 961.1	$ 98.0	$ 731.8

* *The $(0.1) billion difference reported for Budgetary Resources and New Obligations and Upward Adjustments is due to a FY 2017 adjustment to the SBR which had been reported on the Budget of the U.S. Government in the prior year.*

** *The $(0.1) billion difference reported for Budgetary Resources and New Obligations and Upward Adjustements is due to different reporting requirements on the SBR versus the Budget of the U.S. Government.*

Other Disclosures

In compliance with OMB guidance, $123.0 billion of FY 2018 and $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. This duplicate reporting on the SBR relates to amounts from the Military Services' contributions and Treasury's payments to the Military Retirement Trust Fund and Medicare-Eligible Retiree Health Care Fund.

The Department received additional funding of $65.9 billion in FY 2018 and $82.8 billion in FY 2017 to cover obligations incurred above baseline operations in support of contingency operations.

Note 21. Reconciliation of Net Cost of Operations to Budget

The Reconciliation of Net Cost of Operations to Budget reconciles the cost (proprietary) 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.

Table 21. Reconciliation of Net Cost of Operations to Budget

For the years ended September 30 ($ in millions)	2018	2017
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	$ 1,054,342.4	$ 981,610.9
Less: Spending Authority from Offsetting Collections and Recoveries (-)	(240,985.5)	(222,120.7)
Obligations Net of Offsetting Collections and Recoveries	813,356.9	759,490.2
Less: Offsetting Receipts (-)	(101,973.1)	(97,963.0)
Net Obligations	711,383.8	661,527.2
Other Resources		
Donations and Foreitures of Property	19.8	2.4
Transfers In/Out Without Reimbursement (+/-)	23.8	139.7
Imputed Financing from Costs Absorbed by Others	5,309.1	3,673.9
Other (+/-)	2,328.7	(5,390.9)
Net Other Resources	7,681.4	(1,574.9)
Total Resources Used to Finance Activities	719,065.2	659,952.3
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 (-)	(49,416.7)	(15,889.4)
Unfilled Customer Orders	12,444.6	3,327.5
Resources That Fund Expenses Recognized in Prior Periods (-)	(24,039.3)	(31,928.9)
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations	2,021.4	559.3
Resources that Finance the Acquisition of Assets (-)	(108,594.2)	(106,271.6)
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 (-)	(220.2)	(255.7)
Other (+/-)	(2,918.4)	5,384.0
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(170,722.8)	(145,074.8)
Total Resources Used to Finance the Net Cost of Operations	548,342.4	514,877.5

Table 21. Reconciliation of Net Cost of Operations to Budget (continued)

For the years ended September 30 ($ in millions)	2018	2017
Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	1,154.9	244.5
Increase in Environmental and Disposal Liability	1,677.2	1,644.9
Upward/Downward Reestimates of Credit Subsidy (+/-)	(50.9)	(8.7)
Increase in Exchange Revenue Receivable from the Public (-)	(195.3)	(16.9)
Other (+/-)	75,916.6	97,606.6
Total Components Requiring or Generating Resources in Future Periods	78,502.5	99,470.4
Components that Will Not Require or Generate Resources		
Depreciation and Amortization	54,021.6	14,885.1
Reevaluation of Assets or Liabilities (+/-)	1,754.3	2,170.2
Other (+/-)		
Trust Fund Exchange Revenue	(65,225.4)	(51,990.0)
Cost of Goods Sold	70,045.1	63,126.6
Operating Materials and Supplies Used	31,350.5	39,100.3
Other	(57,419.4)	(43,748.9)
Total Components that Will Not Require or Generate Resources	34,526.7	23,543.3
Total Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period	113,029.2	123,013.7
Net Cost of Operations	$ 661,371.6	$ 637,891.2

Resources Used to Finance Other Activities, Other Resources, Other primarily consists of nonexchange gains and losses to revalue assets, as well as reconcile the proprietary and budgetary amounts.

Resources Used to Finance Items Not Part of the Net Cost of Operations, Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations, Other primarily consists of nonexchange gains and losses to revalue assets, as well as reconcile the proprietary and budgetary amounts.

Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period, Components Requiring or Generating Resources in Future Periods, Other consists primarily of future funded expenses.

Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period, Components that Will Not Require or Generate Resources, Other primarily consists of cost capitalization offsets and other expenses not requiring budgetary resources.

Note 22. Disclosures Related to Incidental Custodial Collections

In FY 2018 and FY 2017, the Department collected $11.8 million and $1.5 million, respectively, of incidental custodial revenues generated primarily from forfeitures of unclaimed money and property. These funds are not available for use by the Department; the accounts are closed and relinquished to the Treasury at the end of the fiscal year.

Note 23. Funds from Dedicated Collections

The Department's Funds from Dedicated Collections are financed by specifically identified revenues and other financing sources provided by non-federal sources. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes and must be accounted for separately from the Department's general revenues. There has been no legislation in FY 2018 or FY 2017 which has significantly altered the purposes of the Department's Funds from Dedicated Collections.

The disclosures in this note are made in accordance with *SFFAS 27*, as amended by *SFFAS 43*.

Table 23A. Combined Balance Sheet – Funds from Dedicated Collections

As of September 30 ($ in millions)	2018			
	Harbor Maintenance and Related Funds	Rivers and Harbors Contributed and Advance Fund	Other Funds	Combined Total
Assets				
Fund Balance with Treasury	$ 297.4	$ 1,598.2	$ 2,172.6	$ 4,068.2
Investments	9,231.6	-	1,391.8	10,623.4
Accounts and Interest Receivable	504.1	6.5	6.9	517.5
Other Assets	133.5	296.3	719.0	1,148.8
Total Assets	$ 10,166.6	$ 1,901.0	$ 4,290.3	$ 16,357.9
Liabilities and Net Position				
Accounts Payable and Other Liabilities	$ 26.2	$ 1,645.0	$ 72.1	$ 1,743.3
Total Liabilities	26.2	1,645.0	72.1	1,743.3
Unexpended Appropriations	-	-	-	-
Cumulative Results of Operations	10,140.4	256.0	4,218.2	14,614.6
Total Liabilities and Net Position	$ 10,166.6	$ 1,901.0	$ 4,290.3	$ 16,357.9

As of September 30 ($ in millions)	2017			
	Harbor Maintenance and Related Funds	Rivers and Harbors Contributed and Advance Fund	Other Funds	Combined Total
Assets				
Fund Balance with Treasury	$ 118.7	$ 1,279.5	$ 2,087.2	$ 3,485.4
Investments	9,095.3	-	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
Unexpended Appropriations	-	-	-	-
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

Table 23B. Combined Statement of Net Cost – Funds from Dedicated Collections

For the year ended September 30 ($ in millions)	2018 Harbor Maintenance and Related Funds	2018 Rivers and Harbors Contributed and Advance Fund	2018 Other Funds	2018 Combined Total
Gross Program Costs	$ 85.6	$ 316.5	$ 1,811.3	$ 2,213.4
Less: Earned Revenues	-	(400.5)	(308.8)	(709.3)
Net Cost of Operations	$ 85.6	$ (84.0)	$ 1,502.5	$ 1,504.1

For the year ended September 30 ($ in millions)	2017 Harbor Maintenance and Related Funds	2017 Rivers and Harbors Contributed and Advance Fund	2017 Other Funds	2017 Combined Total
Gross Program Costs	$ 64.8	$ 318.7	$ 1,079.3	$ 1,462.8
Less: Earned Revenues	-	(439.5)	(282.9)	(722.4)
Net Cost of Operations	$ 64.8	$ (120.8)	$ 796.4	$ 740.4

Table 23C. Combined Statement of Changes in Net Position – Funds from Dedicated Collections

For the year ended September 30 ($ in millions)	2018 Harbor Maintenance and Related Funds	2018 Rivers and Harbors Contributed and Advance Fund	2018 Other Funds	2018 Combined Total
Net Position, Beginning of Period	$ 10,314.5	$ 249.9	$ 4,054.5	$ 14,618.9
Budgetary Financing Sources	373.4	-	1,584.5	1,957.9
Other Financing Sources	(461.9)	(77.9)	81.7	(458.1)
Less: Net Cost of Operations	85.6	(84.0)	1,502.5	1,504.1
Change in Net Position	(174.1)	6.1	163.7	(4.3)
Net Position, End of Period	$ 10,140.4	$ 256.0	$ 4,218.2	$ 14,614.6

For the year ended September 30 ($ in millions)	2017 Harbor Maintenance and Related Funds	2017 Rivers and Harbors Contributed and Advance Fund	2017 Other Funds	2017 Combined Total
Net Position, Beginning of Period	$ 9,972.2	$ 232.9	$ 3,733.5	$ 13,938.6
Budgetary Financing Sources	407.1	-	1,023.3	1,430.4
Other Financing Sources	-	(103.8)	94.1	(9.7)
Less: Net Cost of Operations	64.8	(120.8)	796.4	740.4
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

Tables 23A, 23B, and 23C are presented on a combined basis and relate solely to Funds from Dedicated Collections. The Net Position amounts related to Funds from Dedicated Collections reflected on Tables 23A and 23C will not equal those reflected on the DoD Agencywide Balance Sheet and Statement of Changes in Net Position, as those statements are presented on a consolidated basis. Refer to Note 19, *Disclosures Related to the Statement of Changes in Net Position*, for additional information on reconciling the combined Funds from Dedicated Collections Net Position amounts to the consolidated Funds from Dedicated Collections Net Position amounts.

Purpose, Source of Revenue, and Authority for Funds from Dedicated Collections

Harbor Maintenance and Related Funds

Harbor Maintenance Trust Fund (*26 U.S.C. §9505*) – The United States Army Corps of Engineers *(USACE) Civil Works* mission is funded by the Energy and Water Development Appropriations Acts. 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 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.

Coastal Wetlands Restoration Trust Fund and Coastal Wetlands Planning, Protection, and Restoration Act (*16 U.S.C. §§3951-3956*) – 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. 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 (*26 U.S.C. §9506*) – Excise taxes from the public are used by USACE for navigation, construction, and rehabilitation projects on inland waterways. The Bureau of the Fiscal Service manages and invests for the Trust Fund.

Rivers and Harbors Contributed and Advance Funds

Rivers and Harbors Contributed and Advance Funds (*33 U.S.C. §§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 (executed by USACE) 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, enlargement of river channels, and similar work, in the course of flood control and river and harbor maintenance.

Other Funds from Dedicated Collections

Other funds from dedicated collection have been aggregated in accordance with *SFFAS 43*.

Special Recreation Use Fees (*16 U.S.C. §§460l-6a* and *6812(e)(1)*) – 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 (*33 U.S.C. §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. 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 (*33 U.S.C. §701c-3*) – 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 75 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 (*16 U.S.C. §§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 Treasury and allocated for specific uses. The Department of the Army is allocated 50 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) (*33 U.S.C. §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.

Defense Commissary Agency Surcharge Trust Fund (*10 U.S.C. §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

Table 24A. Schedule of Fiduciary Activity

For the years ended September 30 ($ in millions)	2018	2017
Fiduciary Net Assets, Beginning of Year	$ 77.8	$ 80.1
Fiduciary Revenues	-	-
Contributions	42.5	73.5
Investment Earnings	0.3	0.3
Gain (Loss) on Disposition of Investments, Net	-	-
Administrative and Other Expenses	-	-
Distibutions To and On Behalf Of Beneficiaries	(42.7)	(76.1)
Increase / (Decrease) in Fiduciary Net Assets	0.1	(2.3)
Fiduciary Net Assets, End of Year	$ 77.9	$ 77.8

Table 24B. Schedule of Fiduciary Net Assets

As of September 30 ($ in millions)	2018	2017
Cash and Cash Equivalents	$ 77.9	$ 77.8
Less: Liabilities	-	-
Total Fiduciary Net Assets	$ 77.9	$ 77.8

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 (*SDP*), to collect voluntary contributions from members of the Armed Forces serving in designated areas, up to $10,000 per deployment per member. These contributions and earned interest (10% per year, paid quarterly) are deposited in the Treasury on behalf of the members and kept as a separate fund. Military members have access to SDP statements for viewing deposits and other activity. Funds are returned to a military member upon request after leaving the designated area; however, at 120 days if a request is not made, the funds are returned to the member via direct deposit by the Department. Funds in excess of $10,000 may be withdrawn quarterly. Otherwise, while in the designated area, a withdrawal of deposit may only be made in limited situations.

Note 25. Other Disclosures

Table 25. Future Payments Due for Non-Cancelable Operating Leases

As of September 30 ($ in millions)	2018			
	Asset Category			
	Land and Buildings	Equipment	Other	Total
Intragovernmental				
Fiscal Year				
2019	$ 711.0	$ 3.2	$ 110.6	$ 824.8
2020	499.4	3.2	106.4	609.0
2021	500.5	3.2	107.2	610.9
2022	500.1	2.5	109.1	611.7
2023	486.2	2.6	14.2	503.0
After 5 Years	1,147.1	6.4	25.4	1,178.9
Total Intragovernmental Future Lease Payments	3,844.3	21.1	472.9	4,338.3
Non-Federal				
Fiscal Year				
2019	220.4	0.8	18.2	239.4
2020	181.2	0.7	18.4	200.3
2021	148.8	0.5	18.2	167.5
2022	96.6	0.2	18.4	115.2
2023	61.0	0.1	18.7	79.8
After 5 Years	70.6	0.1	22.7	93.4
Total Non-Federal Future Lease Payments	778.6	2.4	114.6	895.6
Total Future Lease Payments	$ 4,622.9	$ 23.5	$ 587.5	$ 5,233.9

The future lease payments due presented on Table 25 are for non-cancelable operating leases only. Unlike capital leases, operating leases do not transfer the benefits and risks of ownership; rather, payments for operating leases 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.

Note 26. Disclosure Entities and Related Parties

In accordance with *SFFAS 47*, the Department is disclosing its relationship with its Department-sponsored DoD Nonappropriated Fund Instrumentalities (NAFIs) and Federally Funded Research and Development Centers (FFRDCs). The financial position and results of operations of NAFIs and FFRDCs are not reported in the DoD consolidated financial statements.

The Department has a special relationship with NAFIs, which are fiscal entities supported in whole or in part by nonappropriated funds (NAFs). For the most part, NAFs are generated from sales and user fees. NAFIs are established by Department policy, controlled by the Military Departments, and governed by sections of *title 10, United States Code*. NAFIs, consisting primarily of the Military Services exchanges and morale, welfare, and recreation (*MWR*) entities, are intended to enhance the quality of life of members of the uniformed services, retired members, and dependents of such members, and to support military readiness, recruitment, and retention.

The Under Secretary of Defense for Personnel and Readiness (*USD(P&R)*) exercises overall policy direction for and oversight of DoD NAF activities. The Under Secretary of Defense (Comptroller)/Chief Financial Officer (*USD(C)/CFO*) and the Defense Finance and Accounting Service (*DFAS*), in coordination with the USD(P&R), are responsible for NAF accounting policy. DoD policy requires DoD Components to appoint advisory groups for NAFIs. The advisory group ensures that the NAFI is responsive to authorized patrons and to the purposes for which the NAFI was created. Additionally, the NAFIs are subject to the Department's policy requirements for financial reporting to USD(P&R) and financial audits conducted by independent public accounting firms.

Similarly, the Department maintains long-term contractual relationships with the parent organizations of ten Department-sponsored FFRDCs to meet research or development needs that cannot be met as effectively by existing government or contractor resources. There are three categories of FFRDCs that provide support to the Department – (1) research and development laboratories, (2) systems engineering and integration centers, and (3) study and analysis centers. All DoD funding for FFRDC work is provided through the Department's contract with the parent organization that operates each FFRDC. Federal Acquisition Regulation *(FAR) Part 35.017* provides federal policy for the establishment and use of FFRDCs.

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

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

The Department has not identified any related party relationships that meet the disclosure requirements of SFFAS 47.

Required Supplementary Stewardship Information

The stewardship objective of federal financial reporting requires the Department to report on its stewardship of certain resources entrusted to it and on certain responsibilities assumed by it that cannot be reflected in traditional financial measures. These resources and responsibilities do not meet the criteria for assets and liabilities but are important to understanding the operations and financial condition of the Department.

Costs of stewardship-type resources are treated as expenses in the year the costs are incurred. However, the costs and associated resources are intended to provide long-term benefits to the public.

The Department's stewardship investments are measured by expensed for (1) federally-financed, but not federally owned physical property (Non-Federal Physical Property) and (2) federally-financed Research and Development (R&D).

Non-Federal Physical Property

Table RSSI-1. Non-Federal Physical Property Investments

As of September 30 ($ in millions)	2018	2017	2016	2015	2014
Transferred Assets					
National Defense Mission Related	$ 1,162.4	$ 1,011.4	$ 1,265.2	$ 1,307.2	$ 1,113.2
Funded Assets					
National Defense Mission Related	16.4	15.5	17.2	12.7	12.4
Total Non-Federal Phsical Property Investments	$ 1,178.8	$ 1,026.9	$ 1,282.4	$ 1,319.9	$ 1,125.6

The Non-Federal Physical Property investments support the purchase, construction, or major renovation of physical property owned by state and local governments. In addition, Non-Federal Physical Property investments include federally-owned physical property transferred to state and local governments. The Department participates in cost-sharing agreements with non-federal 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.

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 Table RSSI-2 present the expenditures from FY 2014 to FY 2018 for all DoD Components.

Table RSSI-2. Investments in Research and Developments

As of September 30 ($ in millions)	2018	2017	2016	2015	2014
Basic Research	$ 2,321.1	$ 1,960.3	$ 2,106.8	$ 1,958.0	$ 1,948.2
Applied Research	6,393.6	6,988.6	6,307.5	5,744.7	5,500.6
Development					
Advanced Technology Development	5,862.9	5,736.5	5,525.8	5,007.6	5,253.3
Advanced Component Development and Prototypes	16,243.7	13,965.7	12,517.9	11,954.9	10,947.0
System Development and Demonstration	13,241.3	11,487.3	11,037.7	10,733.8	11,459.7
Research, Development, Test and Evaluation Management Support	6,882.3	5,189.3	5,335.5	5,163.3	5,262.5
Operational Systems Development	24,776.1	21,611.1	20,428.8	20,441.9	20,334.3
Total	$ 75,721.0	$ 66,938.8	$ 63,260.0	$ 61,004.2	$ 60,705.6

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 knowledge or better 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:

- 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 funding 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.

Required Supplementary Information

This section provides the deferred maintenance and repairs disclosures, required in accordance with *SFFAS 42*, and the Combining Statement of Budgetary Resources, which disaggregates the information aggregated for presentation on the DoD Agencywide Combined Statement of Budgetary Resources.

Real Property Deferred Maintenance and Repairs

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 needed or were scheduled to be and are 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 reported total deferred maintenance and repairs. Facility Categories are:

- 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; and
- Category 3: Buildings, Structures, and Linear Structures that are excess to requirements or planned for replacement or disposal, including multi-use Heritage Assets.

Table RSI-1. Real Property Deferred Maintenance and Repairs (excluding Military Family Housing)

As of September 30 ($ in millions)	2018		
	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage
Property Type			
Category 1	$ 1,122,340.6	$ 95,815.9	9%
Category 2	94,998.7	10,903.7	11%
Category 3	18,301.0	4,097.0	22%
Total	$ 1,235,640.3	$ 110,816.6	9%

As of September 30 ($ in millions)	2017		
	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage
Property Type			
Category 1	$ 1,111,711.7	$ 100,054.3	9%
Category 2	85,461.0	10,420.6	12%
Category 3	21,899.8	4,701.0	21%
Total	$ 1,219,072.5	$ 115,175.9	9%

Table RSI-2. Real Property Deferred Maintenance and Repairs (Military Family Housing only)

As of September 30 ($ in millions)	2018		
	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage
Property Type			
Category 1	$ 24,560.0	$ 1,451.0	6%
Category 2	531.0	123.0	23%
Category 3	383.0	111.0	29%
Total	$ 25,474.0	$ 1,685.0	7%

As of September 30 ($ in millions)	2017		
	Plant Replacement Value	Required Work (Deferred Maintenance & Repair)	Percentage
Property Type			
Category 1	$ 21,466.0	$ 1,428.0	7%
Category 2	536.0	116.0	22%
Category 3	328.0	55.0	17%
Total	$ 22,330.0	$ 1,599.0	7%

As of the end of FY 2018, the Department estimates deferred facility maintenance cost of more than $112.5 billion for facilities with replacement cost of $1.3 trillion. The totals include $2.2 billion in USACE Civil Works-related maintenance needs with replacement cost of more than $267.1 billion.

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 (FCI), 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 of 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

Table RSI-3. Equipment Deferred Maintenance and Repairs

As of September 30 ($ in millions)	2018	2017
Major Categories		
Aircraft	$ 583.7	$ 1,003.6
Automotive Equipment	47.3	432.7
Combat Vehicles	372.6	258.8
Construction Equipment	8.7	5.7
Electronics and Communications Systems	113.9	351.3
Missiles	123.9	127.7
Ships	221.2	249.4
Ordnance Weapons and Munitions	65.8	50.2
Other Items Not Identified Above	74.3	298.4
Total	$ 1,611.4	$ 2,777.8

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. In support of the Planning, Programming, Budgeting, and Execution (PPBE) process, each Military Service has 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 is determined, based on Military Service priorities and assessment of risk.

Ultimately, Military 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 Military 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 operation and maintenance 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 decreased by $1.2 billion during FY 2018. The decrease was driven by the United States Special Operations Command (*USSOCOM*) paying for all maintenance and repairs during the current fiscal year; therefore it did not have to defer maintenance and repair work.

Combining Statement of Budgetary Resources

Table RSI-4. Combining Statement of Budgetary Resources (Budgetary)

For the year ended September 30 ($ in millions)	2018							
	Military Personnel	Procurement	Research, Development, Test & Evaluation	Family Housing & Military Contstuction	Military Retirement Benefits	Civil Works	Operations, Readiness & Support	Combined
Budgetary Resources								
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory)	$ 6,518.2	$ 66,143.6	$ 20,602.4	$ 14,586.2	$ -	$ 11,986.6	$ 61,171.2	$ 181,008.2
Appropriations (Discretionary and Mandatory)	144,017.0	147,080.9	93,807.9	10,241.0	69,065.7	25,087.7	374,282.8	863,583.0
Borrowing Authority (Discretionary and Mandatory)	-	-	-	-	-	-	-	-
Contract Authority (Discretionary and Mandatory)	-	-	-	-	-	-	88,428.1	88,428.1
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	1,385.9	3,771.0	11,324.3	6,201.2	-	20,516.2	76,215.3	119,413.9
Total Budgetary Resources	$ 151,921.1	$ 216,995.5	$ 125,734.6	$ 31,028.4	$ 69,065.7	$ 57,590.5	$ 600,097.4	$1,252,433.2
Memorandum (Non-Add) Entries								
Net Adjustments to Unobligated Balances Brought Forward, Oct 1	$ 2,777.7	$ 5,318.7	$ 1,427.8	$ 245.9	$ -	$ 442.5	$ 12,087.7	$ 22,300.3
Status of Budgetary Resources								
New Obligations and Upward Adjustments (Total)	$ 148,779.7	$ 140,398.4	$ 101,647.5	$ 13,553.1	$ 69,065.7	$ 26,937.2	$ 553,827.7	$1,054,209.3
Unobligated Balance, End of Year:								
Apportioned, Unexpired Accounts	228.8	73,423.7	22,497.8	16,427.8	-	30,618.9	22,505.9	165,702.9
Exempt from Apportionment, Unexpired Accounts	-	-	-	-	-	(894.3)	3,769.9	2,875.6
Unapportioned, Unexpired Accounts	-	14.9	11.3	0.9	-	921.6	984.5	1,933.2
Unexpired Unobligated Balance, End of Year	228.8	73,438.6	22,509.1	16,428.7	-	30,646.2	27,260.3	170,511.7
Expired Unobligated Balance, End of Year	2,912.6	3,158.5	1,578.0	1,046.6	-	7.1	19,009.4	27,712.2
Unobligated Balance, End of Year (Total)	3,141.4	76,597.1	24,087.1	17,475.3	-	30,653.3	46,269.7	198,223.9
Total Budgetary Resources	$ 151,921.1	$ 216,995.5	$ 125,734.6	$ 31,028.4	$ 69,065.7	$ 57,590.5	$ 600,097.4	$1,252,433.2
Outlays, Net								
Outlays, Net (Total) (Discretionary and Mandatory)	$ 138,990.3	$ 111,904.0	$ 78,315.2	$ 6,338.1	$ 64,541.9	$ 5,932.9	$ 357,193.6	$ 763,216.0
Distributed Offsetting Receipts (-)	-	-	(7.8)	-	(98,904.2)	(860.2)	(2,200.9)	(101,973.1)
Agency Outlays, Net (Discretionary and Mandatory)	$ 138,990.3	$ 111,904.0	$ 78,307.4	$ 6,338.1	$ (34,362.3)	$ 5,072.7	$ 354,992.7	$ 661,242.9

For the year ended September 30 ($ in millions)	2017							
	Military Personnel	Procurement	Research, Development, Test & Evaluation	Family Housing & Military Contstuction	Military Retirement Benefits	Civil Works	Operations, Readiness & Support	Combined
Budgetary Resources								
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory)	$ 7,237.0	$ 66,103.3	$ 19,865.4	$ 15,528.9	$ -	$ 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
Borrowing Authority (Discretionary and Mandatory)	-	-	-	-	-	-	-	-
Contract Authority (Discretionary and Mandatory)	-	-	-	-	-	-	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	-	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
Memorandum (Non-Add) Entries								
Net Adjustments to Unobligated Balances Brought Forward, Oct 1	$ 3,026.3	$ 4,351.5	$ 4,199.9	$ 778.6	$ -	$ 337.9	$ 12,667.6	$ 25,361.8
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	-	9,738.3	19,380.5	116,449.6
Exempt from Apportionment, Unexpired Accounts	-	-	-	-	-	1,800.6	4,958.6	6,759.2
Unapportioned, Unexpired Accounts	-	(422.4)	9.6	206.7	-	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	-	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	-	5.1	22,530.4	33,611.0
Unobligated Balance, End of Year (Total)	3,667.5	61,019.6	19,173.2	14,339.9	-	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
Outlays, Net								
Outlays, Net (Total) (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 (-)	-	-	(0.5)	-	(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

Table RSI-5. Combining Statement of Budgetary Resources (Non-Budgetary Credit Reform Financing Account)

For the year ended September 30 ($ in millions)	2018 Operations, Readiness & Support	2018 Combined	2017 Operations, Readiness & Support	2017 Combined
Budgetary Resources				
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory)	$ 85.1	$ 85.1	$ 79.7	$ 79.7
Appropriations (Discretionary and Mandatory)	-	-	-	-
Borrowing Authority (Discretionary and Mandatory)	55.4	55.4	58.1	58.1
Contract Authority (Discretionary and Mandatory)	-	-	-	-
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	61.6	61.6	76.6	76.6
Total Budgetary Resources	202.1	202.1	214.4	214.4
Memorandum (Non-Add) Entries				
Net Adjustments to Unobligated Balances Brought Forward, Oct 1	-	-	-	-
Status of Budgetary Resources				
New Obligations and Upward Adjustments (Total)	133.1	133.1	129.4	129.4
Unobligated Balance, End of Year:				
Apportioned, Unexpired Accounts	-	-	-	-
Exempt from Apportionment, Unexpired Accounts	-	-	-	-
Unapportioned, Unexpired Accounts	69.0	69.0	85.0	85.0
Unexpired Unobligated Balance, End of Year	69.0	69.0	85.0	85.0
Expired Unobligated Balance, End of Year	-	-	-	-
Unobligated Balance, End of Year (Total)	69.0	69.0	85.0	85.0
Total Budgetary Resources	202.1	202.1	214.4	214.4
Outlays, Net				
Outlays, Net (Total) (Discretionary and Mandatory)	71.2	71.2	(5.0)	(5.0)
Distributed Offsetting Receipts (-)	-	-	-	-
Agency Outlays, Net (Discretionary and Mandatory)	$ 71.2	$ 71.2	$ (5.0)	$ (5.0)

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

November 15, 2018

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

SUBJECT: Independent Auditor's Report on the Department of Defense FY 2018 and FY 2017 Basic Financial Statements (Project No. D2018-D000FE-0063.000, Report No. DODIG-2019-017)

We are providing the subject report to be published in the Department of Defense FY 2018 Agency Financial Report in conjunction with the Department of Defense FY 2018 and FY 2017 Basic Financial Statements provided to us in draft on November 14, 2018. The report includes our disclaimer of opinion on the basic financial statements and our required Reports 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 2018 and FY 2017 Basic Financial Statements; 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.

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, 2018

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

SUBJECT: Independent Auditor's Report on the Department of Defense FY 2018 and FY 2017 Basic Financial Statements (Project No. D2018-D000FE-0063.000, Report No. DODIG-2019-017)

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, 2018, and September 30, 2017, 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 financial statements (referred to as financial statements in this report).

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 the control 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 our audit. We conducted the audit in accordance with generally accepted government auditing standards (GAGAS) and the Office of Management and Budget (OMB) Bulletin No. 19-01, "Audit Requirements for Federal Financial Statements," October 4, 2018. However, because of the matters described in the "Basis for Disclaimer of Opinion" section below, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Management's Assertion

The National Defense Authorization Act for FY 2014 required the DoD to assert to audit readiness and to undergo its first full financial statement audit in 2018.[1] On September 27, 2017, Secretary of Defense James N. Mattis and Under Secretary of Defense (Comptroller)/Chief Financial Officer David L. Norquist notified the DoD Office of Inspector General that the DoD's financial statements were ready for audit. They asserted that "the DoD has the following capabilities (i.e., processes and systems) in place that allow an auditor to scope and perform an audit of full financial statements, that results in actionable feedback on:

- Universe of Transactions – The DoD can provide detailed accounting transactions for material financial statement line items;

- Fund balance with Treasury – The DoD can provide processes to reconcile fund balance with the Department of the Treasury;

- Journal vouchers – The DoD can provide a list of material journal vouchers and support;

- Existence, completeness, and rights and obligations and valuation of assets – The DoD can provide asset populations and has applied alternative valuation methods to certain asset categories; and

- Environmental and disposal liabilities for real property and general equipment – The DoD has identified and valued its liabilities."

[1] Public Law 113-66, "National Defense Authorization Act for Fiscal Year 2014," December 26, 2013.

Basis for Disclaimer of Opinion

OMB Bulletin No. 19-01 identifies reporting entities required to undergo financial statement audits. Auditors conducting the audits of these entities issued disclaimers of opinion on the following DoD Component financial statements.

- Department of the Army General Fund
- Department of the Navy General Fund
- Department of the Air Force General Fund
- U.S. Marine Corps General Fund
- Department of the Army Working Capital Fund
- Department of the Navy Working Capital Fund
- Department of the Air Force Working Capital Fund

In addition to the required reporting entities, the auditors also issued disclaimers of opinion on the Component financial statements for the Defense Health Program, Defense Logistics Agency, U.S. Transportation Command, and U.S. Special Operations Command.

When combined, these reporting entities are material to the DoD financial statements. As a result, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

We performed limited audit procedures at the Agency-Wide level and compiled the work from the audits of the DoD Components to identify material weaknesses in internal control over financial reporting that affected the DoD as a whole. We also compiled material weaknesses that DoD Components identified within their Statements of Assurance. These material weaknesses limit the DoD's ability to produce reliable financial statements. The underlying material weaknesses in internal control contributed to our disclaimer of opinion on the financial statements.

We considered the disclaimers of opinion on the DoD Component financial statements a scope limitation in forming our conclusions on the Agency-Wide Basic Financial Statements. Accordingly, we did not perform all the auditing procedures required by

GAGAS and OMB Bulletin No. 19-01 to determine whether material amounts on the financial statements were presented fairly. Therefore, our work may not identify all issues that could affect the financial statements.

Disclaimer of Opinion

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

Emphasis of Matter

In this first year audit of the Agency-Wide Basic Financial Statements, DoD management did not provide a completed Agency Financial Report until after the close of business on November 14, 2018, which limited our ability to complete a thorough review of the annual financial statements. However, during our review of the draft Agency Financial Report, we noted a material inconsistency between the basic financial statements and applicable sections of OMB Circular No. A-136 (Revised), "Financial Reporting Requirements," July 30, 2018. Specifically, Note 3 and Note 16 were not presented in accordance with OMB Circular No. A-136. We did not modify our disclaimer report on the FY 2018 Basic Financial Statements with respect to this matter.

Other Matter

DoD management referenced information on websites or other forms of interactive data outside the DoD Agency Financial Report, this information is not required. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

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. However, based on our limited review, we did not find any material inconsistencies between the information and applicable sections of OMB Circular No. A-136.

Reports on Internal Control Over Financial Reporting and Compliance With Applicable Provisions of Laws, Regulations, Contracts, and Grant Agreements

In accordance with Government Auditing Standards, we also have included our consideration of DoD's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of the reports is described in the Attachment. The reports are an integral part of our audit in accordance with Government Auditing Standards in considering DoD's internal control over financial reporting and compliance.

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. We compiled the results from the audits of the DoD Components to determine whether the DoD complied with provisions of applicable laws and regulations, contracts, and grant agreements.

However, it was not our objective to provide an opinion on internal control or compliance with certain provisions of laws and regulations, contracts, and grant agreements. 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 officials at the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. The officials provided technical comments that 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 Government Accountability Office; the Under Secretary of Defense (Comptroller)/Chief Financial Officer; DoD management; and the DoD Office of Inspector General. This report is not intended for, nor should it be used to, any other audience.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 (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 appropriate procedures for auditing the basic financial statements 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

DoD management is responsible for implementing and maintaining effective internal controls, including 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

The purpose of our audit was not to express an opinion on internal controls over financial reporting, and we do not express such an opinion. However, we identified the following material weaknesses by compiling the results from the audits of the DoD Components, performing limited audit procedures at the Agency-Wide level and reviewing the DoD Components' Statements of Assurance. These material weaknesses could adversely affect the DoD's financial operations.

Identified Material Weaknesses

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, in a timely manner. We identified the following 20 material weaknesses.

Financial Management Systems and Information Technology. The FMFIA requires financial management systems to provide reasonable assurances that: obligations and costs are in compliance with applicable law; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for to permit the preparation of reliable financial reports. The FFMIA requires Government agencies to incorporate accounting standards and reporting objectives established for the Government into their financial management systems. In addition, it requires that financial management systems have controls to support financial management. However, the DoD had multiple material financial management systems that did not comply with Federal management system requirements. In addition, the DoD Components did not implement internal controls over their information technology environment that adequately deter fraud, waste, and abuse. These systemic deficiencies in financial management systems and inadequate internal controls prevent the DoD from collecting and reporting financial and performance information that is accurate, reliable, and timely.

Universe of Transactions. OMB Bulletin No. 19-01 states that internal control over financial reporting includes ensuring that transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements. However, the DoD Components were unable to validate the completeness of the universe of transactions underlying their financial statements. Without a complete universe of transactions, the DoD Components cannot perform reconciliations of their financial statement line items. Therefore, auditors may not detect errors within the financial statements.

Financial Statement Compilation. OMB Circular No. A-123 states that management is responsible for developing and maintaining effective internal control to ensure the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. However, at least three DoD Component financial statements were not compiled correctly into the Agency-Wide Basic Financial Statements. The DoD lacked sufficient processes and internal controls to ensure that complete and accurate Component financial statements, including related note disclosures, were prepared prior to the compilation of the Agency-Wide Basic Financial Report. The lack of sufficient processes at the Agency-Wide level increased the risk of material misstatements on the Agency-Wide Basic Financial Statements.

Fund Balance With Treasury. For FY 2018, the DoD reported a Fund Balance With Treasury (FBWT) balance of $580 billion. Statement of Federal Financial Accounting Standards (SFFAS) No. 1, "Accounting for Selected Assets and Liabilities," and the Treasury Financial Manual (TFM), chapter 5100, require the DoD to reconcile its FBWT and explain any discrepancies between its balances and the Department of the Treasury's records. However, the DoD Components have ineffective processes and controls for reconciling their FBWT. The ineffective processes and controls resulted in unreconciled differences between the DoD and Treasury recorded balances that materially affect the financial statements.

Accounts Receivable. For FY 2018, the DoD reported an Accounts Receivable balance of $5.7 billion. SFFAS No. 1 states that a receivable should be recognized when a Federal entity establishes a claim to cash or other assets against other entities. However, the DoD Components did not have proper controls to record, report, test, or reconcile transactions that should be labeled as a receivable. Failure to establish proper controls to support and document accounts receivable transactions could prevent the recording of receivables or result in recording receivables in the incorrect period or for the incorrect amount, which could result in a material misstatement on the financial statements.

Operating Materials & Supplies. For FY 2018, the DoD reported an Operating Materials and Supplies (OM&S) gross value of $184 billion. SFFAS No. 3, "Accounting for Inventory and Related Property," requires the DoD to value its OM&S at historical costs or any method approximating historical cost. However, SFFAS No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials," permits a reporting entity that cannot value its opening balance in accordance with SFFAS No. 3 to apply an alternative valuation method in establishing opening balances for OM&S. The DoD Components were unable to report OM&S in accordance with SFFAS No. 3 because the systems they used did not maintain historical cost data. In addition, the DoD Components did not implement a process to accurately value all OM&S opening balances in accordance with SFFAS No. 48. Therefore, the DoD OM&S balances may be materially misstated on the financial statements.

Inventory and Related Property. For FY 2018, the DoD reported an Inventory and Related Property net balance of $282 billion. SFFAS No. 3 requires the DoD to use historical cost, the latest acquisition cost, or any other valuation method that reasonably approximates historical cost for valuing Inventory. However, the DoD Components lacked the systems and controls necessary to provide assurance over the existence, completeness, and the valuation of Inventory and Related Property recorded in the financial statements. In addition, the DoD has not established policies and procedures to properly manage or account for inventory held by other DoD Components and Government contractors. Therefore, Inventory and Related Property reported on the financial statements may be materially misstated.

General Property, Plant, and Equipment. For FY 2018, the DoD reported a General Property, Plant, and Equipment (PP&E) balance of $759 billion. SFFAS No. 6, "Accounting for Property, Plant, and Equipment," requires the DoD to record General PP&E at acquisition cost. However, the DoD worked with the Federal Accounting Standards Advisory Board (FASAB) to develop an alternative method for establishing a baseline, or starting value of its General PP&E at the time it was acquired. Although the DoD has established a formula that will be used by all DoD Components to value their General PP&E, the FASAB has made it clear that the alternative method for valuing assets is a one-time exception to the established standards. Despite the flexibilities allowed by the FASAB, the DoD had several deficiencies affecting its valuation of its General PP&E. These deficiencies include the inability of the DoD to record General PP&E at acquisition or historical cost, substantiate the existence and completeness of its assets, and assign or determine the value for all real property and general equipment assets. Because the DoD could not accurately account for its assets or value its General PP&E, the DoD is at risk of materially misstating its General PP&E on its financial statements.

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 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 lacked policies, procedures, controls, and supporting documentation for the acquisition, disposal, tracking, and inventory processes of Government property in the possession of contractors, which prevented the DoD from substantiating the existence and completeness of this property. As a result, the financial statements may be incomplete or inaccurate and could be materially misstated.

Accounts Payable. For FY 2018, the DoD reported an Accounts Payable balance of $29 billion. SFFAS No. 1 states that Accounts Payable are "amounts owed by a Federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities." However, the DoD Components had a combination of deficiencies that resulted in unsupported Accounts Payable balances. In addition, the DoD Components did not have the financial management system capabilities to properly record Accounts Payable transactions. Therefore, the Accounts Payable balances on the financial statements may be materially misstated.

Environmental and Disposal Liabilities. For FY 2018, the DoD reported an Environmental and Disposal Liabilities balance of $70 billion. Federal Accounting Standards Advisory Board, Federal Financial Accounting and Auditing Technical Release 2, "Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government," states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable.

The DoD lacked formal policies, procedures, and supporting documentation to substantiate the completeness and valuation of its Environmental and Disposal Liabilities. As a result, Environmental and Disposal Liabilities reported on the financial statements may be materially misstated.

Legal Contingencies. SFFAS No. 5, "Accounting for Liabilities of the Federal Government," defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to a possible gain or loss to an entity. Additionally, TFM, volume 1, part 2, chapter 4700, states that significant entities must submit a Legal Representation Letter (LRL) summarizing and evaluating legal actions against the entity and categorizing them as having a probable, reasonably possible, remote, or "unable to determine" chance of a negative outcome. The TFM also states that agencies should avoid excessive use of the term "unable to determine" in assessing the likelihood of loss. In addition, it states that, if agencies categorized a case as "unable to determine," they should provide a note disclosure that includes the information they evaluated which led to their assessment. If a note disclosure is not provided, the agency should provide justification for why a disclosure is not necessary. The Agency-Wide Consolidated LRL included 150 cases, totaling $5.27 trillion. Of the 150 cases, 97 cases, totaling $3.2 trillion, were categorized as "unable to determine." The DoD did not disclose what information was evaluated to categorize these cases as "unable to determine" or provide a justification for why a disclosure was not necessary. Due to the DoD's noncompliance with the TFM, the DoD was unable to substantiate the presentation and disclosure of the legal contingencies balance on the financial statements.

Beginning Balances. SFFAS No. 48 states that beginning balances are account balances that exist at the beginning of the reporting period and are based upon the closing balances of the prior period. These balances reflect the effects of transactions that occurred and accounting policies applied in the prior period. At least six reporting entities do not have the historical data to support beginning balances on their financial statements or the ability to reconcile beginning balances to closing balances at the end of the reporting period. Without a supported beginning balance, the auditors cannot confirm the completeness and accuracy of the amounts reported on the financial statements.

Journal Vouchers. The FMFIA requires that obligations and costs comply with applicable laws. FMFIA also requires that revenues and expenditures be properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over the assets. Adequate supporting documentation is necessary to demonstrate compliance with the FMFIA requirements. The DoD recorded 1,232 journal vouchers that it categorized as unsupported, totaling more than $175 billion, that directly affected the financial statements. In addition, multiple DoD Components posted journal vouchers to the accounting systems before management performed adequate reviews. The lack of adequate supporting documentation and management reviews at the Component level directly increased the risk of material misstatements on both the Components' financial statements and the Agency-Wide Basic Financial Statements.

Intragovernmental Eliminations. The TFM, volume 1, part 2, chapter 4700, requires agencies to maintain accurate information and supporting documentation on intragovernmental transactions to facilitate the reconciliation and elimination of these transactions during the financial statement preparation process. However, DoD Components could not accurately identify, provide supporting documentation, or fully reconcile their intragovernmental transactions. Additionally, DoD Components eliminated transactions based on data that may not have been accurate. The inability to confirm that the transaction data supporting the intragovernmental eliminations was accurate may have resulted in a material misstatement to the amounts reported on the financial statements.

Statement of Net Cost. SFFAC No. 2, "Entity and Display," states that the Statement of Net Cost should present the amounts paid, the consumption of other assets, and the incurrence of liabilities as a result of rendering services, delivering or producing goods, or carrying out other operating activities. OMB Bulletin No. 19-01 requires that the Statement of Net Cost be included in the Basic Financial Statements and it requires that financial statements be presented in accordance with GAAP. However, at least three reporting entities did not accumulate cost information and record transactions in compliance with GAAP for the Statement of Net Cost. Therefore, DoD management does not have reliable financial information to effectively manage and understand the net costs of its organizations and programs, resulting in a potential material misstatement on the Statement of Net Cost.

Reconciliation of Net Cost of Operations to Budget. SFFAS No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," requires a reconciliation of proprietary and budgetary data. At least three reporting entities were unable to perform the required reconciliation. This negatively affects management's and users' understanding of the relationship between the net cost of operations and the budgetary resources obligated. In addition, variances between proprietary and budgetary data may not be identified and resolved, resulting in possible misstatements to amounts reported on the financial statements.

Budgetary Resources. SFFAS No. 7 states that the budget is the Government's primary financial planning and control tool. For this reason, the following material budgetary information should be presented by reporting entities for which financing comes wholly or partially from the budget: total budgetary resources available to the reporting entity during the period, the status of those resources (including "obligations incurred"), and outlays. At least three reporting entities could not accurately determine their total budgetary resources available during the period and the status of those resources. Therefore, the DoD Components are unable to use their Statement of Budgetary Resources to monitor the status of their available funds, and, as a result, the DoD is at greater risk of potential violations of the Antideficiency Act.

Entity Level Controls. The Government Accountability Office Green Book, "Standards for Internal Control in the Federal Government," September 2014, present the internal control standards for federal agencies for both program and financial management. The Green Book states that entity-level controls are controls that have a pervasive effect on an entity's internal control system and may pertain to multiple components. Entity-level controls may include controls related to the entity's risk assessment process, control environment, service organizations, and management override. However, multiple DoD Components do not have sufficient entity level controls to establish an internal control system that will produce reliable financial reporting. The lack of sufficient controls at the Component level directly increased the risk of material misstatements on both the Components' financial statements and the Agency-Wide Basic Financial Statements.

Oversight and Monitoring. OMB Circular No. A-123 defines management's responsibility for internal control. Additionally, it states that agency management is responsible for taking timely and effective action to correct deficiencies and ensuring that corrective action plans are developed for all material weaknesses. However, some DoD Components have not developed corrective action plans for all material weaknesses. Without effective oversight and monitoring, the Components' material weaknesses will continue to affect the DoD's ability to provide reasonable assurance that internal controls over financial reporting are effective.

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

Generally accepted government auditing standards and OMB guidance require 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. We compiled the results from the audits of the DoD Components and determined that the DoD was not compliant with all laws, regulations, contracts, and grant agreements that could have a direct and material effect on the financial statements. Specifically, the DoD did not comply with the Antideficiency Act (ADA), FFMIA, FMFIA, the Federal Information Security Modernization Act, and the Debt Collection Improvement Act. However, our objective was not to, and we do not, express an opinion on compliance with applicable laws, regulations, contracts, and grant agreements. Additionally, because of the significance of the matters described in "Basis for Disclaimer of Opinion," we performed limited procedures that may not have detected all instances of noncompliance. The following instances of noncompliance impacted material DoD Components.

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 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 2018, the DoD reported six ADA violations within four completed cases.

DoD Regulation 7000.14-R, "Financial Management Regulation," volume 14, chapter 7, "Antideficiency Act Report," establishes timeframes 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. One potential ADA violation investigation within a case has 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.

For FY 2018, the DoD did not substantially comply with the FFMIA. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer represented that the controls in place to support reliable financial reporting were not effective to provide reasonable assurance. They represented that their 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, 2018. In addition, the auditors of the DoD Components identified that the DoD Components did not substantially comply with the FFMIA.

Compliance With FMFIA Requirements

The FMFIA requires the DoD to perform ongoing evaluations and reports on the adequacy of its systems of internal accounting and administrative control. OMB Circular No. A-123, which implemented FMFIA, states that management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.

For FY 2018, the DoD did not substantially comply with the FMFIA. The Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer represented that the DoD's internal control over financial reporting was not effective because of the material weaknesses reported in the FY 2018 Agency Financial Report. In addition, the auditors of the DoD Components identified that the DoD Components did not substantially comply with the FMFIA.

Recommendations

This report does not include recommendations to correct the material weaknesses and instances of noncompliance with laws and regulations. Component auditors provided recommendations to the DoD Components. We will review all Component auditor recommendations to determine if an Agency-Wide recommendation is appropriate.

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