Defense Logistics Agency

FISCAL YEAR 2018
(Unaudited)

Agency Financial Report

General Fund

DEFENSE LOGISTICS AGENCY GENERAL FUND AGENCY FINANCIAL REPORT

DEFENSE LOGISTICS AGENCY
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Message from the Director

On behalf of the Defense Logistics Agency (DLA), I present the Fiscal Year (FY) 2018 Agency Financial Report. This report provides an overview of our programs, accomplishments, challenges, and management's accountability for the resources entrusted to us by the American Public and our partner agencies. DLA is fully committed to upholding that trust by improving its ability to provide transparency and report accurately the operating results of the DLA's complex and important mission.

DLA, as the nation's combat logistics support agency, has a proud history of supporting the Warfighter, providing effective logistics support to the operating forces of our Military Services at the lowest possible cost to the taxpayer. As we continue to improve our performance, we can devote more resources to our Military Services to accomplish their critical missions to defend the nation. To accomplish our goals of delivering world-class support to the Warfighter and of continued accountability, the Agency has emphasized their resources on seven Lines of Effort:

- ***Warfighter First:*** *Strengthen Service and Combatant Command Readiness and Lethality*
- ***Global Posture:*** *Prepared for Immediate Action*
- ***Strong Partnerships:*** *Leverage the Joint Logistics Enterprise, Interagency, Industry, and Partner and Allied Nations*
- ***Whole of Government:*** *Support to the Nation*
- ***Always Accountable:*** *Assured Supply Chain, Financial and Process Excellence*
- ***People and Culture:*** *The heart of everything we do. If you take care of your people, the mission will happen*
- ***Enterprise Enablers:*** *Technology, Innovation, and Data Management*

Our Independent Public Accounting firm issued a Disclaimer of Opinion on DLA's 2018 General Fund (GF). DLA conducted its assessment of the effectiveness over internal controls in accordance with the OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the assessment, DLA management was unable to provide assurance that the internal controls were operating effectively. The related material weaknesses are the impediments to obtaining an unqualified audit opinion, and positive assurance over internal controls.

DLA has made improvements on the path to correct our material weaknesses. We are committed towards achieving auditability and are actively remediating open audit findings and internal control weaknesses. DLA will develop a comprehensive management strategy to address DLA material weaknesses, including organizational capabilities, underlying business processes, accounting challenges, and non-compliant financial systems. DLA is preparing comprehensive corrective action plans to address internal control weaknesses and audit findings.

I am confident in our abilities to meet the challenges with accountability, while continuing to be the standard-bearer for joint logistics and acquisitions. With our agile and professional workforce as our solid foundation, we will continue to be the Nation's best combat logistics support Agency.

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Homecoming Joy ~ Navy Petty Officer 1st Class Kial Hartwell hugs his children during a homecoming ceremony for the USS O'Kane at Joint Base Pearl Harbor-Hickam, Hawaii

Management's Discussion and Analysis (Unaudited)

The ***Management's Discussion and Analysis (Unaudited)*** is required supplementary information to the General Fund financial statements and provides a brief, high-level overview of the Defense Logistics Agency.

The ***Mission and Organizational Structure*** section describes the Defense Logistics Agency's organization, its missions and goals, and provides an overview of our Defense Logistics Agency Commands.

The ***Performance Goals, Objectives, and Results*** section provides a summary of the General Fund's mission, goals, objectives, results, and future initiatives to strengthen the General Fund efforts in supporting the Department of Defense objectives and missions.

The ***Analysis of Financial Statements and Stewardship Information*** section provides a summary of General Fund financial data explaining the major sources and uses of funds and provides a quick look at our Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and Limitations of Financial Statements.

The ***Analysis of Systems, Controls, and Legal Compliance*** section provides the Director's Assurance Statement related to the Federal Managers' Financial Integrity Act and the Federal Financial Management Improvement Act. This section also describes the General Fund efforts to address our financial management systems to ensure compliance with applicable accounting principles, standards, and requirements, and with internal control standards.

Mission and Organizational Structure

The Defense Logistics Agency (DLA) reports to the Office of the Under Secretary of Defense (OUSD) for Acquisition and Sustainment through the Assistant Secretary for Defense Sustainment. DLA provides support around the clock and around the world to meet the needs of America's Armed Forces and other designated customers in times of peace, national emergency, and war. America's national defense strategy depends on DLA's support to feed, clothe, fuel, medicate, treat, and sustain U.S. and many allied nations' troops. DLA supports Department of Defense (DoD) objectives and missions with involvement in the full range of military operations from participation with multi-national forces engaged in large-scale combat operations, weapons and spares provisions, peacekeeping efforts, and emergency support to humanitarian assistance.

DLA's Mission, Vision, and Values

Mission	Vision	Values
Sustain Warfighter readiness and lethality by delivering proactive global logistics in peace and war.	We are the Nation's Combat Logistics Support Agency …Global, Agile, and Innovative; Focused on the Warfighter First!	Leadership, Professionalism, and Technical Knowledge through Dedication to Duty, Integrity, Ethics, Honor, Courage, and Loyalty.

DLA General Fund (GF) employs approximately 450 civilian personnel, whose labor is paid from the GF.

DLA chose to produce an Agency Financial Report (AFR) for DLA's GF. The DoD produces an Annual Performance Report (APR) for all its components (including DLA GF) and will include its Fiscal Year (FY) 2018 APR with its Congressional Budget Justification. All information within this report pertains to DLA's GF unless specifically stated otherwise.

The following "Who's Who in DLA" chart represents DLA leadership agency directors, J / D Code Organizational heads, and Major Subordinate Command (MSC) heads. The J and D Codes are function codes used in DoD to identify the type of work performed within DLA.

Figure 1, DLA Organizational Chart

Defense Logistics Agency – Enterprise J/D Codes

DLA HUMAN RESOURCES (J1) provides the full range of human resource services, both policy and operational, for DLA's civilian and active duty military employees. DLA Human Resources recruits, hires, trains, and sustains a mission-ready workforce for DLA and our Human Resources customers, using world class policies, processes, programs, and tools.

DLA LOGISTICS OPERATIONS (J3) is responsible for the end-to-end supply chain management of DLA's supply chains, providing logistics and materiel process management policy, guidance, and oversight. J3 integrates strategic, operational, and tactical perspectives, as well as command and control functions for contingency operations and logistics supply chain planning. J3 maximizes the readiness and logistics combat power by leveraging enterprise solutions to support DLA's global customer base.

DLA INFORMATION OPERATIONS (J6) as DLA's knowledge broker, providing comprehensive, best practice Information Technology (IT) support to the DoD/DLA Logistics Business Community, resulting in quality customer support, efficient and economical computing; data management; electronic business; telecommunication services; key management, and secure voice systems for DoD, DLA and geographically separated operating locations. The Director of Information Operations also serves as DLA's Chief Information Officer (CIO). J6 also manages DLA's Research and Development (R&D) IT program.

DLA ACQUISITION (J7) is responsible for planning, organizing, directing, and managing the procurement and contract administration functions for DLA acquisition in support of both internal operations and other supported activities. The Director of DLA Acquisition also serves as the Agency's Component Acquisition Executive. DLA Acquisition provides oversight of DLA Contracting Services Office.

DLA FINANCE (J8) is responsible for obtaining and allocating resources; analyzing execution; and providing fiscal guidance and advice to support the Agency, its business areas, and its Major Subordinate Commands (MSCs) in accomplishing DLA's mission. DLA Finance prepares the AFRs and guides DLA in its Audit Remediation efforts. The Director of Finance also serves as DLA's Chief Financial Officer (CFO).

DLA JOINT RESERVE FORCE (J9) provides DLA with trained, ready, and available reservists from the Army, Air Force, Navy, and Marine Corps for worldwide contingency operations and support of ongoing operations, surge requirements, and logistics planning.

DLA OFFICE OF SMALL BUSINESS PROGRAMS (DB) provides small business advocacy and promotes small business utilization to strengthen the competency, capability, and commitment of the industrial base that fulfills DLA's mission as the Nation's combat logistics support Agency. The DLA Office of Small Business Programs is responsible for implementation of the Procurement Technical Assistance Program (PTAP) to expand the number of businesses capable of participating in contracts with the DoD, other Federal agencies, state and local governments, and government prime contractors.

DLA GENERAL COUNSEL (DG) delivers professional, candid, and independent legal advice and services to DLA.

DLA COMMAND CHAPLAIN (DH) serves as the program manager for religious support logistics. This office provides the DLA Director and the staff a clear picture of workforce morale as affected by religion, ensuring the free exercise of religion to support the Warfighter, and the employees in the workplace at DLA.

DLA INSTALLATION MANAGEMENT (DM) provides enterprise-wide agency policy, program, and worldwide operational support in environmental management; safety and occupational health; installation management; public safety; forms and policy management; and morale, welfare, and recreation for DLA.

DLA EQUAL EMPLOYMENT OPPORTUNITY AND DIVERSITY OFFICE (DO) provides DLA senior leadership, staff and subordinate commands enterprise wide respondent and subject matter expertise on all EEO Compliance oversight, Affirmative Employment and Diversity and Inclusion.

DLA PUBLIC AFFAIRS (DP) provides public affairs support, communication strategy development, and engagement guidance to the DLA senior leadership, staff, and subordinate commands. The DLA Public Affairs office develops and administers internal news and information; manages DLA's online web presence (www.dla.mil); interacts with external media; serves as DLA official spokesperson; manages DLA social media and public engagement policies; and develops programs that communicate DLA's role as a combat support agency that adds value to the Defense Department, Military Services, Combatant Commands, and the American people.

DLA TRANSFORMATION (DT) manages DLA's strategic plan, executive governance forums, and the agency-wide deployment of Enterprise Process Management, Continuous Process Improvement, Enterprise Organizational Alignment, and Enterprise Policy Management programs.

DLA OFFICE OF THE INSPECTOR GENERAL (OIG) coordinates and synchronizes U.S. Government Accountability Office (GAO) and Department of Defense Office of the Inspector General (DoDIG) audits with all DLA components; tracking, monitoring, and assessing the implementation of audit corrective actions and communicating completion results. They sustain strategic engagement with the Defense Counsel on Integrity and Efficiency and their subcommittees, as well as relationships with DoDIG Criminal Investigative Services, Military Criminal Investigation Services, and other law enforcement agencies. DLA OIG also conducts administrative investigations and crime vulnerability assessments that align with agency risks and strategic goals. The DLA OIG internal audit plan is derived from the DLA's Enterprise Risk Management (ERM) efforts, and also encompasses external audit projects derived from GAO's high risk list.

Performance Goals, Objectives, and Results

DLA's core mission and vision, critical imperatives, goal-oriented objectives, and forward looking initiatives to strengthen DLA's efforts in sustaining Warfighter readiness and lethality and our Nation's responsiveness are shown in the key Lines of Effort (LOE) below.

Figure 2, Lines of Efforts and Objectives

The performance Goals, Objectives, and Results section encompasses mission activities that are financed with DLA General Funds. DLA's GF uses annual appropriated funding to support specific LOEs and objectives as determined annually by the Director. For FY2018, DLA requested and received specific appropriations to support key initiatives that have the Director's emphasis per DLA's Strategic Plan, specifically the Warfighter First, Strong Partnerships, and Always Accountable LOEs.

LOE #1: Warfighter First

DLA's number one priority is sustaining the full range of military operations in an increasingly complex global environment while delivering innovative and responsive solutions to Warfighters First, DoD components, and our other valued customers. DLA continues to provide world-class support and strategies aligned with DoD priorities, operational readiness concerns, and weapon system product support with a solid understanding of the impact to our Warfighters and a targeted solutions-based response.

LOE #2: Strong Partnerships
DLA's mission requires close collaboration and strong relationships with critical stakeholders, such as the Joint Logistics Enterprise, other government partners, suppliers, and our allies.

LOE #3: Always Accountable
Trust and confidence in DLA is born from ethical behavior, reliability, and transparency. Cost-consciousness, auditability, innovation, risk assessment and mitigation, and sound business processes are the foundation of this trust. DLA holds partners and suppliers to these same high standards.

General Fund Funding Sources

Congress appropriates the GF and grants authority to the Office of the Secretary of Defense (OSD) and its Components to obligate those funds to support mission requirements. The GF includes five appropriation categories: Operations and Maintenance, Research, Development, Test and Evaluation (RDT&E), Military Construction (MILCON), Procurement Defense-Wide, and Family Housing. The appropriation categories and their respective programs, which support Warfighter First, Strong Partnerships, and Always Accountable LOEs, are described below.

1) **Operations and Maintenance** received $391.0 million in funding for FY2018. The Operations and Maintenance (O&M) program manages the sustainment of ongoing mission support initiatives. DLA's O&M program has realized significant accomplishments in the following operational areas:

   - **Contingency Logistics**: The Contingency Logistics (CL) program supports military unique (DoD Mandated) tasks, such as readiness support, that a commercial distribution company does not experience. CL helps to keep the DLA's prices competitive with those of the private sector, which do not include overhead for DoD unique costs. The CL program issued funds that supported depot storage costs for War Reserve Materiel (WRM) ration items, commercial storage bills related to contingency items for war effort, storage to ensure readiness, and Command and Control costs necessary to sustain operations and exercise support.

   - **DLA Mapping**: DLA serves as the DoD Integrated Materiel Manager and Distributor of maps. In this capacity, DLA provides a unified, world-wide tailored distribution system for all geospatial products. The DLA Mapping program issued O&M resources to support three mapping organizations that provide the free-issue of map items, charts and publications to various Federal and disaster relief organizations. The three mapping organizations worked closely with DoD units and authorized agencies to support crisis and contingency operations and to maintain selected planning and reserve operational stocks. The DLA Mapping program is currently working to define DLA – Europe/Africa and any other DLA MSC support requirements to DLA Logistics Operations for Combatant Commander Operational Plan and with the Integrated Consumable Item Support (ICIS) system Program Management Office (PMO) and other key players to validate ICIS requirements for inclusion in the FY 2021 Program Budget Review (PBR).

- **Procurement Technical Assistance Program:** The purpose of the PTAP is to enhance the industrial base, improve local economies, and generate employment by assisting businesses in obtaining and performing under contracts with DoD as well as other Federal agencies and state and local governments. The PTAP issued awards and provided oversight to support Procurement Technical Assistance Centers (PTAC), at least one in every state. In FY2018, PTACs provided assistance via one-on-one counseling or during group training held at events nationwide. PTAC assistance contributed to their clients earning local, state, and Federal government contract awards.

- **Warstopper:** DLA's Warstopper program is the recognized leader in the Agency for Industrial Base expertise, and provides studies and analyses to eliminate Warfighter risk, identify Defense Industrial Base issues, and to provide acquisition and risk mitigation solutions. During FY2018, DLA's Warstopper program completed five level two studies: assessing surge risk for Personal Protective Equipment; Nerve Agent Antidote Auto-injector (NAAA) industrial analysis; Subsistence Freight Consolidation Market Intelligence report; Plywood Sector analysis; and a fleet study of Transparent Armor delamination. The Program also completed four level one risk assessments: DoD Titanium market; Beryllium; Impact of Sequestration Federal Procurement Data System (FPDS) Analysis; and a Carbon Fiber analysis. The Warstopper program also mitigated Warfighter risk through its core mission of making industrial base investments to preserve critical industrial/DoD capabilities, particularly those which would have otherwise diminished or severely affected mission readiness.

  In FY2018, the Warstopper program committed funds to support industrial base investments and analyses including several impactful new investments spanning DLA supply chains. Notable new investments supported:

  - Aerospace Energy supporting rocket propellants industrial capability for DoD and National Aeronautics and Space Administration (NASA)
  - Industrial base capability/extending the life of the F107 cruise missile engine
  - Development of a repeatable program to quickly fulfill Warfighter requirements for long lead time vehicle repairable parts while creating business case for Original Equipment Manufacturers (OEMs) to maintain readiness

  Ongoing multi-year investments also continued supporting Medical readiness, specialty metal buffers, Subsistence readiness, Energy contingency funding, and industrial base IT solutions. The Program elevated the Industrial Capabilities Program's (ICP) Sustainment Readiness Criteria tool with new features such as integrating High Visibility Risk Indicators, providing deeper risk analysis capabilities for industrial specialists and supporting a thorough process for assessing commodity risk.

  Forward-Looking: In FY2019, the Warstopper program will maintain its effective history of identifying, assessing, and mitigating industrial base and weapon system risks. High dollar/High impact investments in Aerospace Energy, Medical Readiness, and DLA Energy Contingency are set to continue, comprising approximately half of the Program's planned budget. Potential new investments planned for include funding a Title III effort for a modern NAAA production facility, revitalizing nuclear missile industrial capability, and funding surge availability of unmanned aerial drones for delivery of emergency supplies. On-going multi-year investments are planned to exercise option years including: specialty metal buffers; Tungsten-Rhenium buffers, NOMEX fiber, and various Subsistence rations. Building upon the OEM Readiness Partnership efforts from FY2018, the Program seeks to use this repeatable methodology to drive strategic sourcing efforts in Class IX category of supplies, Expendable Parts. Additionally, new analyses and industrial base studies are planned to explore and provide solutions to some of the DoD's most pressing industrial base commodity challenges.

- **FMWR:** The Family and Morale, Welfare and Recreation (FMWR) program utilizes O&M funding to provide an array of quality of life programs that further improve the resiliency of the DLA workforce. In FY2018, FMWR received O&M funding to deliver our programs. FY2018 represents the first year of an annual cost avoidance due to in-sourcing three previously contracted Child Development Centers.

- **DAI:** The Defense Agencies Initiative (DAI) program is a financial management system of nine integrated business processes that provides real-time, web-based accessed capabilities for financial managers, auditors, and other DoD employees who make financial business decisions in support of the Warfighter. The DAI PMO supports DoD Business Enterprise Architecture (BEA) business processes and operational activities. The DAI program demonstrated operational agility by moving large groups of personnel rapidly to support the mission by bringing in Defense Activity for Non-Traditional Education Support (DANTES) and transferring out both the Defense Health Agency and Uniformed Services University for the Health Sciences to support departmental realignment, as well as supporting new users at the Defense Information Systems Agency (DISA). The DAI program also enhanced reporting mechanisms to be more responsive to diverse customers, and sustained automated integrated internal controls within a commercial governance, risk and compliance module for enhanced auditability. The DAI program demonstrated a focus on mission by communicating constantly with the customer base through an Annual Stakeholders Day, twice-monthly Agency Updates, regular User Groups, Communities of Practice, and posting online resources hosted on DoD Enterprise Portal Service.

  Forward-Looking: In FY2019, the DAI PMO will continue to sustain financial operations across Defense Agencies directly for mission readiness. This includes Compliance and Configuration Management Services that provide maintenance and enhancement (cybersecurity and policy update) support for current and future releases of the DAI Enterprise Solutions. The DAI PMO will also perform developmental, operational, and Cybersecurity Testing with independent third parties under OUSD(C) oversight. The DAI PMO provides the infrastructure to support system performance, capacity planning, and sustainment activities focused on providing stability, supportability, high availability, and maintainability of the DAI application. There are also DISA hosting costs and required maintenance licenses resulting in the system being available to support the FY2019 user base. The DAI PMO conducts regression testing for all Oracle and operating system patches. The DAI team operates a complex communication interface operation supporting transactions through the end-to-end process with Federal, DoD, and commercial trading partners largely leveraging Global Exchange (GEX) services.

2) **RDT&E**: The Research, Development, Test and Evaluation Program received $355.8 million in FY2018. DLA's goal is to deliver innovative and responsive solutions to the Warfighters and our other valued customers. DLA's RDT&E program has realized significant accomplishments in the following areas:

- **Additive Manufacturing –** One of DLA's top priorities, the Additive Manufacturing (AM) program partnered with the Military Services, Academia, and Industry to further develop how to integrate AM technology into DoD supply chain processes through common Technical Data Packages, as well as conduct pilot programs for select AM parts. AM provides the capability to source hard-to-procure parts and reduces lead-times for parts procurement.

- **Advanced Microcircuit Emulation –** The Advanced Microcircuit Emulation **(**AME) program successfully developed, validated and qualified a new Advanced Schottky transistor-transistor logic manufacturing capability, which can produce a wide variety of previously discontinued digital logic chips. This unique manufacturing capability has transitioned to full-scale production at SRI International and is available to redesign and produce hundreds of part types to help mitigate the readiness and cost impact of microcircuit obsolescence. The AME program also successfully demonstrated the use of third party field-programmable gate array (FPGA) reverse engineering in the emulation design flow as part of the program's approach to supporting legacy FPGAs.

- **Castings –** In FY2018, the DLA Casting program finalized work on the Casting Solutions for Readiness (CSR) program. The CSR program focused on meeting the military's evolving requirements in a more cost and time efficient manner through improved manufacturing processes and materials within the foundry industry. For example, the Welding of High Strength Steels project developed heat treatment methods to re-establish mechanical properties of the heat affected zone of welded high strength steels and is estimated to produce savings over the next 10 years. Another project, Modeling of Steel Casting Performance-Dimensions and Distortion, developed properties and modeling algorithms to reliably predict dimensions and distortions for steel and mold materials and is estimated to produce savings.

- **Battery Network –** The Battery Network (BATTNET) program leveraged new manufacturing capability in advanced technology lead-acid batteries to replace flooded lead-acid batteries still used in military systems. Application of this technology provides improvement in energy capacity; improvement in battery life; safety improvements for the Warfighter; decreased maintenance costs; and increased shelf life. The BATTNET program also leveraged new manufacturing technology to develop and qualify low cost, domestic lithium-ion cells for the Conformal Wearable Battery, providing an improvement in energy capacity and a decrease in battery cost.

- **Weapon Systems Sustainment –** A top DLA initiative for FY2018, the Weapon System Sustainment (WSS) program leads the RDT&E effort for assuring supply chain integrity through its Counterfeit Risk Reduction program. During FY2018, the program expanded its scope to include a Vendor Network Mapping Capability to include all information and communications technology parts due to a National Defense Authorization Act (NDAA) requirement. Additionally, the program tested a proof concept for a web-based vendor trace data collection capability. The efforts and accomplishments of the program improve the visibility, detection, and prevention of supply chain vulnerabilities, assuring quality, safe parts for the Warfighter weapon systems.

- **Military Unique Sustainment Technology –** The Military Unique Sustainment Technology (MUST) program developed and validated a process of using instrumental measurement of solid colors and compliance with color shade requirements across different instrument brands used by fabric manufacturers. Manufacturers, the U.S. Army, and the DLA Troop Support Product Test Center actively participated in the validation effort leading to implementation. Instrumental color measurement is critical to moving towards digital data modernization for a knowledge-based approach. It will communicate accurate shade requirements throughout the supply chain, resulting in a higher quality product and reduction in costs of production and rejected material lots.

- **Subsistence Network: Optimize Combat Ration Inspection Costs -** During FY2018, the Subsistence Network (SUBNET) project established a baseline for the combat ration inspection process, optimized inspection protocols, and implemented and verified the effectiveness of new protocols. The project identified inefficiencies and reduced costs and duplication of tests, improving the combat ration inspection process. Inspection cost optimization strategies were identified that are more cost effective than the current methods without sacrificing the quality of rations. These improvements will result in annual cost savings.

- **Small Business Innovation Research –** The Small Business Innovation Research (SBIR) program focused most FY2018 resources on the Nuclear Enterprise Support Office (NESO) effort. Through the SBIR Program, we are enabling small businesses to enter the realm of Reverse Engineering and Manufacturing. The identified legacy parts are no longer available from the original source, and in several cases, are identified as non-procurable, and/or the quantities required do not support a traditional business model. The Technical Data developed has produced not only several new parts manufacturers, but also identified areas for improvement in the supply system National Stock Number (NSN) linkages. SBIR is establishing new partnerships with DLA and service component supply chains and the small business industrial base. This improves Warfighter readiness, fosters small business growth, and realizes present and future cost savings.

3) **MILCON**: The MILCON program received $303.7 million in FY2018. This program provides for major construction to replace or renovate DoD Fuels, Distribution, and Inventory Control Point facilities around the world. Due to long lead times associated with planning MILCON projects (environmental assessments, international agreements, surveys, permits etc.), OUSD(C) does not use financial benchmarks for execution success. As DLA's MILCON funds are issued to the U.S. Army Corps of Engineers (USACE) and U.S. Naval Facilities Engineering Command (NAVFAC) for execution, DLA does not have control over how quickly the Execution Agents move out on our projects. A better indicator of success is how quickly the DLA GF issues funds to the Execution Agents.

   In FY2018, the DLA GF completed projects in Richmond, Virginia for the DLA Aviation Operations Facility Phase I, and in Guam for the Andersen Air Force Base Upgrade Fuel Pipeline. All projects were authorized and appropriated for by Congress.

4) **Procurement Defense-Wide** The Procurement Defense-Wide (PDW) program received $3.0 million of funding in FY2018. Funding supported (1) the replacement of agency-owned and commercially leased passenger carrying motor vehicles at DLA overseas locations not available from the General Services Administration (GSA), (2) Warstoppers' Program procurement requirements for the purchase of fully automated metrology equipment for wafer test and inspection of emulated microcircuits, and (3) OSD Contingency Operations logistic support activities.

5) **Family Housing Operations and Maintenance** received $1.0 million of funding in FY2018. Funding supported units at New Cumberland, Pennsylvania for (1) management, (2) utility costs and (3) replacement of household appliances/furniture and cyclical maintenance requirements such as painting, and window and carpet replacement.

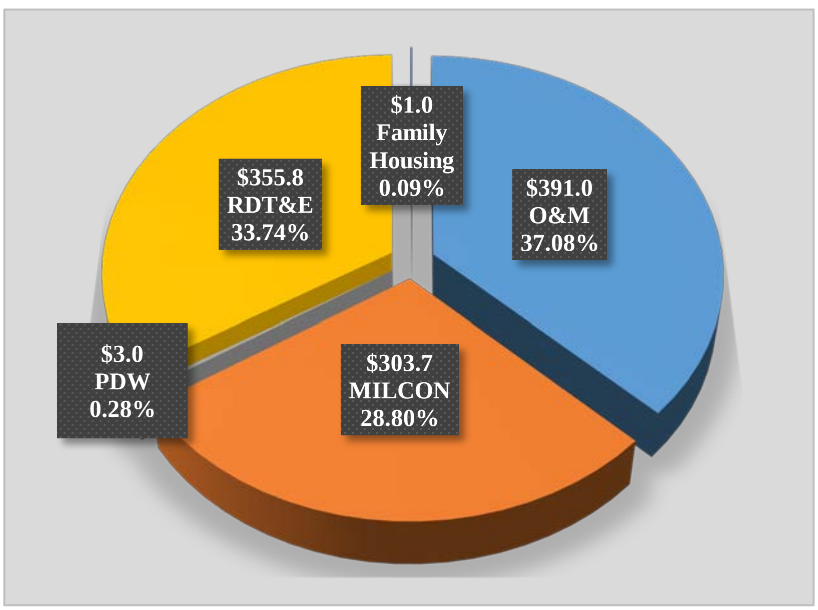


Figure 3, Distribution of General Fund Appropriations in FY2018 (in $ millions)

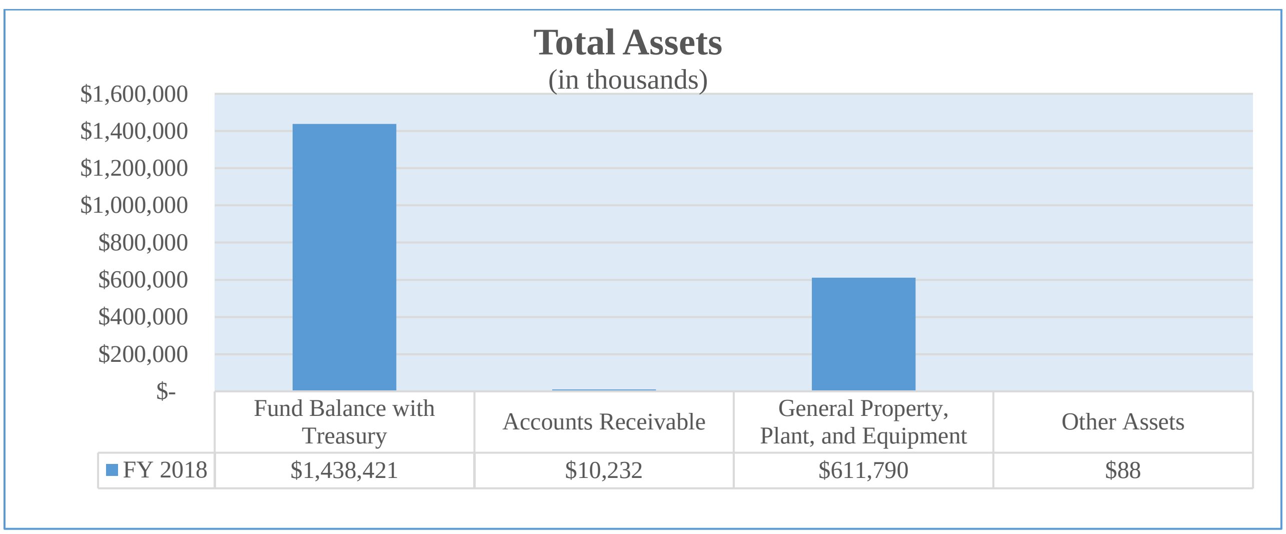
Analysis of Financial Statements and Stewardship Information

The Financial Statements presented in this AFR relate solely to DLA’s GF. The Financial Statements for the Working Capital Fund (WCF) and the Transaction Fund (TF) are located in their respective AFRs. The DLA’s budgetary resources were approximately $1.6 billion for FY2018. DLA prepares its Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position on an accrual basis; meaning that economic events are recorded as they occur, regardless of when cash is received or disbursed. These financial statements provide the results of our operations and financial position, including long-term commitments and obligations. Budgetary accounting principles require recognition of the obligation of funds according to legal requirements, which in many cases occurs prior to the occurrence of a transaction under the accrual basis. The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds, and are reported in the Combined Statement of Budgetary Resources.

Balance Sheet

The Balance Sheet presents the resources owned or managed by DLA that have future economic benefits (assets) and the amounts owed by DLA that will require future payments (liabilities). The difference between DLA’s assets and liabilities is the residual amount retained by DLA (net position) that is available for future programs and capital investments.

Assets – What We Own and Manage

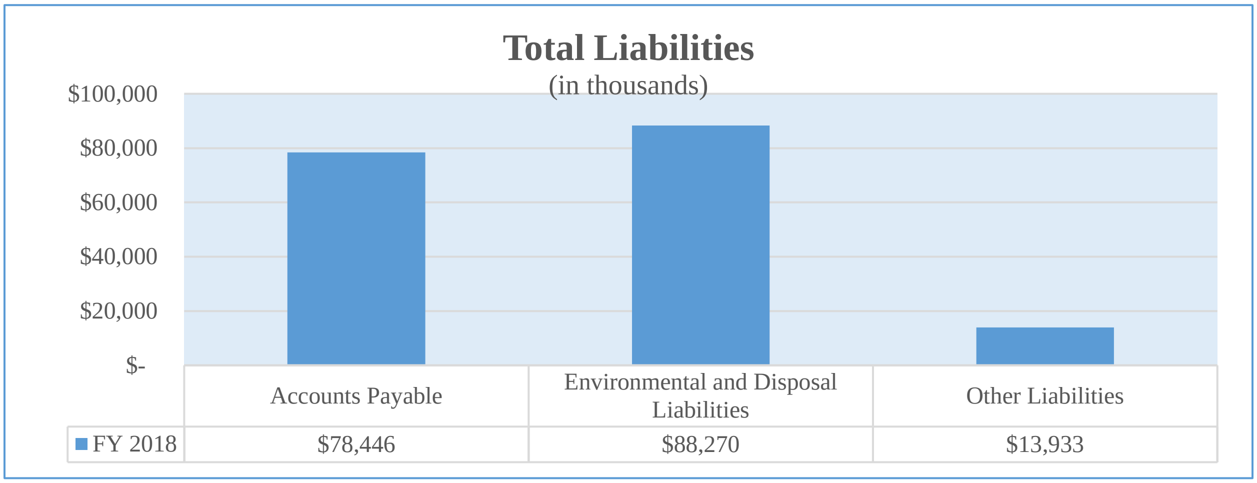


Assets represent amounts owned or managed by DLA that can be used to accomplish its mission. As of September 30, 2018, the GF had $2.1 billion in assets.

Fund Balance with Treasury (FBwT) is the GF’s largest asset, comprises 69.8% of total assets. FBwT balances are primarily appropriated funds remaining at the end of the fiscal year.

General Property, Plant, and Equipment (PP&E), is the second largest asset, comprising 29.7% of total assets. The major items in this category include internal use software (IUS) under development and Construction in Progress (CIP).

Liabilities – What We Owe



As of September 30, 2018, the GF reported approximately $180.6 million in total liabilities.

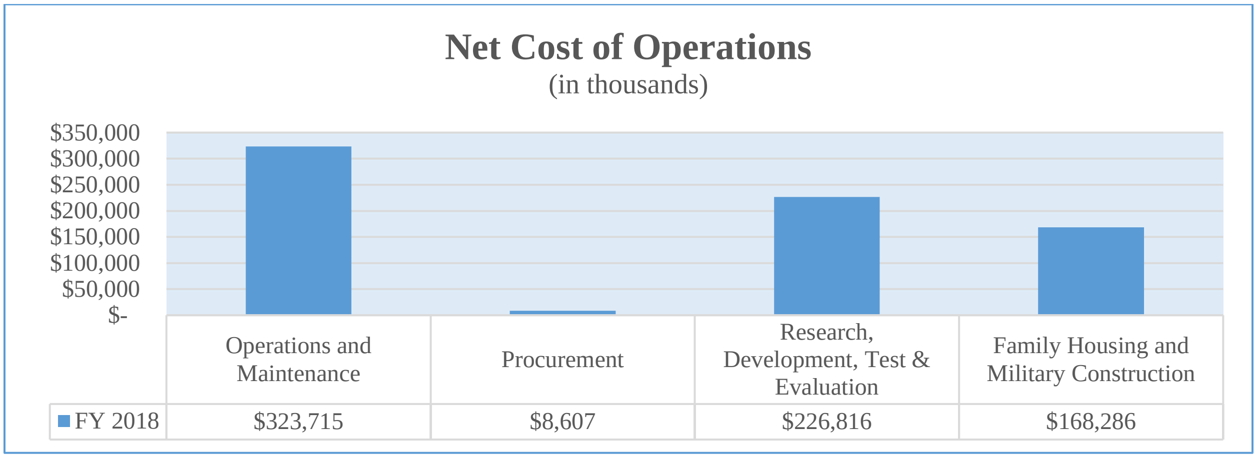
DLA's largest liability is for *Environmental and Disposal Liabilities*, representing 48.9% of total liabilities. It is comprised of environmental cleanup costs associated with restoration of environmental sites. These environmental sites may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, clean closure of assets, and post-closure costs related to the Agency's operations that result in hazardous waste.

Accounts Payable represents 43.4% of total liabilities.

Other liabilities, comprising of 7.7% of the GF's liabilities, includes amounts due for *Other Federal Employment Benefits* and *Other Liabilities*.

Statement of Net Cost

The Statement of Net Cost (SNC) of operations before gains and losses represents the difference between the costs incurred and revenue earned by GF programs. The GF SNC reports the four major program or appropriation categories: Operations and Maintenance; Research, Development, Test & Evaluation; Procurement; and Family Housing and Military Construction. The major appropriation categories are represented below:

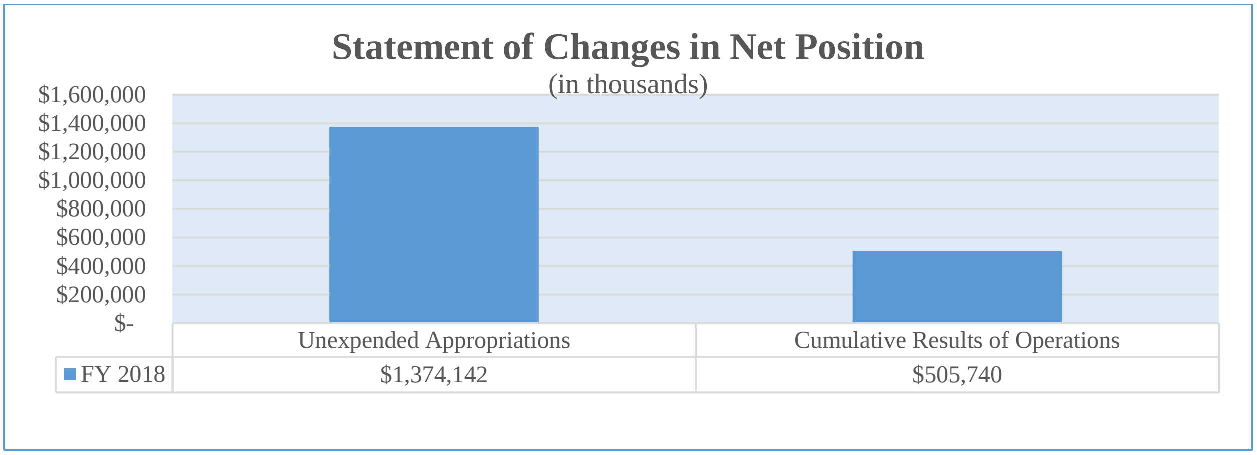


Operations and Maintenance represents 44.5% of DLA's net cost of operations and includes: Administration and Service-Wide Activities (DoD programs, DoD EBS, and HQ DLA programs) and Environmental Programs. These programs are associated with DLA logistics mission as well as programs assigned to DLA from the DoD for budget administration purposes. RDT&E represents 31.2% of total net costs and includes: development of major upgrades that increase the performance of existing systems, the purchase of test articles, and the developmental testing and/or initial operational test and evaluation prior to system acceptance. The remaining appropriations, Procurement, and Family Housing and Military Construction, represent 24.3% of total net costs.

During FY2018, the GF earned approximately $48.4 million in exchange revenue. Exchange revenue arises from transactions in which DLA provides goods and services to the public of another government entity for a price.

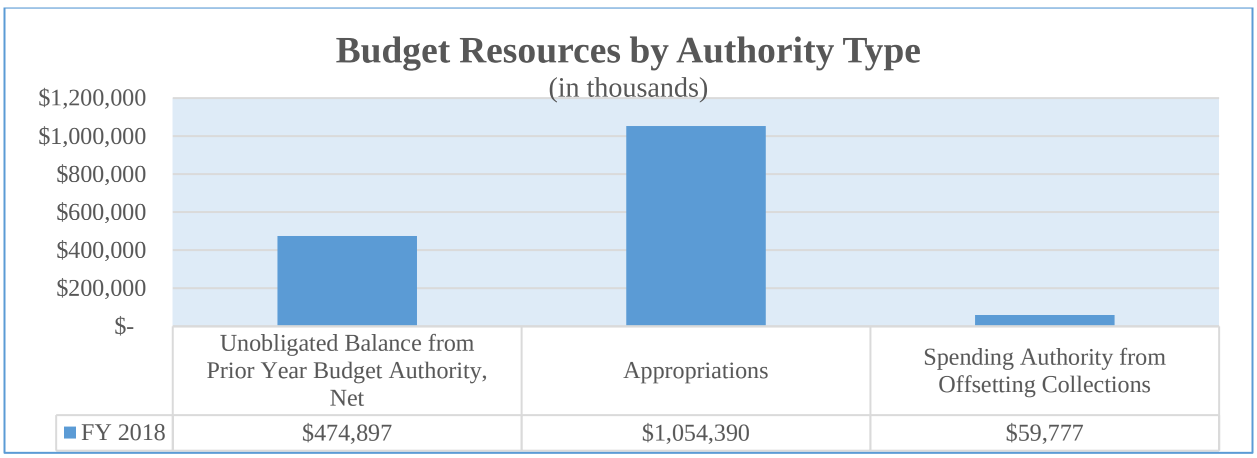
Statement of Changes in Net Position

The Statement of Changes in Net Position (SCNP) consists of Unexpended Appropriations and Cumulative Results of Operations, which represent the accumulation of revenue, expenses, budgetary, and other financing sources since inception. The SCNP presents changes to the DLA GF's net position during the year. Financing sources increase net position and include, but are not limited to, appropriations. The net costs discussed in the section above as well as transfers to other agencies decrease net position. Total net position is $1.9 billion.



Combined Statement of Budgetary Resources

The Combined Statement of Budgetary Resources (SBR) provides information on the status of the approximately $1.6 billion in budgetary resources available to DLA during FY2018.



The authority was derived from $474.9 million in *Unobligated Balance from Prior Year Budget Authority*, *Net Appropriations* of $1.1 billion and $59.8 million in *Spending Authority from Offsetting Collections*.

As of September 30, 2018, $561.9 million of the $1.6 billion was not yet obligated. The $436.1 million represents apportioned funds available for future use, and $125.7 million in expired and unobligated funds. Of the total budget authority available, DLA incurred a total of $901.9 million in obligations from salaries and benefits, purchase orders placed, contracts awarded, or similar transactions.

Limitations of Financial Statements

The principal financial statements were prepared to report the financial position and results of operations of the DLA GF, pursuant to the requirements of 31 U.S.C. 3515(b). The statements were prepared from DLA's books and records in accordance with Federal Generally Accepted Accounting Principles (GAAP) and the formats prescribed by OMB. The statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. Government.

To the extent possible, the financial statements were prepared in accordance with Federal accounting standards and the formats prescribed by OMB. At times, DLA is unable to implement all elements of the standards due to financial management systems limitations. DLA continues to implement system improvements to address these limitations.

DLA and the Defense Finance and Accounting Service (DFAS) prepared the FY2018 DLA GF financial statements from available automated finance, accounting, and feeder systems (such as acquisition, logistics, and personnel systems) and manual processes. Due to system deficiencies, there are limitations in collecting the data needed to prepare financial statements that comply with Federal standards. To prepare the financial statements, DFAS made numerous adjustments during the compilation process in an attempt to overcome these deficiencies.

DLA has several corrective actions underway intended to improve the underlying systems, business processes, and internal controls.

The DLA GF is unable to fully prepare the financial statements in conformity with U.S. GAAP. This is due to financial and nonfinancial management system limitations, as well as limitations on the underlying processes that support these statements. These systems are designed to maintain accountability over assets, liabilities, and budgetary resources. They are not designed to prepare financial statements in accordance with U.S. GAAP. DLA continues to take actions to bring its financial and nonfinancial systems and processes into compliance with U.S. GAAP and other Federal regulations. DLA continues to implement interim mitigation processes to address known limitations; additionally, DLA is remediating deficiencies to the financial statement preparation process. DLA has identified non-U.S. GAAP accounting practices or policies; therefore, has not presented comparative financial statements as a result of the U.S. GAAP departures.

Analysis of Systems, Controls, and Legal Compliance

DLA management is responsible for establishing, maintaining, and assessing internal controls to provide reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 (31 USC 3512, Sections 2 and 4) and the Federal Financial Management Improvement Act (FFMIA) of 1996 (Pub. L. 104-208), as prescribed by the GAO Green Book, *Standards for Internal Control in the Federal Government*, are met.

In FY 2014, the GAO revised the Green Book effective beginning FY 2016 and for the FMFIA reports covering that year. The Green Book provides managers the criteria for an effective internal control system, organized around internal control components, principles, and attributes.

OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, as amended, emphasizes the integration of risk management and internal controls within existing business practices across an agency. DLA continues to implement improvements to internal controls to strive for compliance with all applicable laws and regulations.

Management Assurances

The following section provides an overview of DLA's Management's Assurances related to FY2018.

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD
FORT BELVOIR, VIRGINIA 22060-6221

AUG 2 3 2018

MEMORANDUM FOR SECRETARY OF DEFENSE

THROUGH: UNDER SECRETARY OF DEFENSE (ACQUISITION AND SUSTAINMENT)

SUBJECT: Annual Statement of Assurance (SOA) Required Under the Federal Managers' Financial Integrity Act (FMFIA) for Fiscal Year (FY) 2018 General Fund

As Director, I recognize DLA is responsible for managing risks and maintaining effective internal control to meet the objectives of Sections 2 and 4 of the FMFIA of 1982. DLA conducted its assessment of risk and internal control in accordance with the OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* and the Green Book, GAO-14-704G, Standards for Internal Control in the Federal Government. Based on the results of the assessment (see attachments), DLA is unable to provide assurance that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2018.

DLA conducted its assessment of the effectiveness of internal controls over operations in accordance with OMB Circular No. A-123, the GAO Green Book, and the FMFIA. The *"Internal Control Evaluation"* section provides specific information on how DLA conducted this assessment. Based on the results of the assessment, DLA is unable to provide assurance that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2018.

DLA conducted its assessment of the effectiveness of internal controls over reporting (including internal and external financial reporting) in accordance with OMB Circular No. A-123, Appendix A. The *"Internal Control Evaluation"* section provides specific information on how DLA conducted this assessment. Based on the results of the assessment, DLA is unable to provide assurance that internal controls over operations, reporting (including internal and external reporting), and compliance were operating effectively as of September 30, 2018.

DLA also conducted an internal review of the effectiveness of the internal controls over the integrated financial management systems in accordance with Federal Financial Management Improvement Act (FFMIA) of 1996 (Public Law 104-208) and OMB Circular No. A-123, Appendix D. The *"Internal Control Evaluation"* section provides specific information on how DLA conducted this assessment. Based on the results of this assessment, DLA is unable to provide assurance that the internal controls over the financial systems are in compliance with the FFMIA and OMB Circular No. A-123, Appendix D, as of September 30, 2018.

Point of contact is Billie Sue Goff and can be reached at (571) 767-7736 or email: billie.goff@dla.mil.

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

cc:
Office of the Under Secretary of Defense (Comptroller)
Office of the Chief Management Officer

Federal Financial Management Improvement Act

As mandated by FFMIA and OMB Circular A-123 Appendix D, *Compliance with the Federal Financial Management Improvement Act of 1996*, Federal agencies subject to the CFO Act must provide, as part of their annual assurance statement, an assessment of whether the agency has substantially complied with the three FFMIA Section 803(a) requirements.

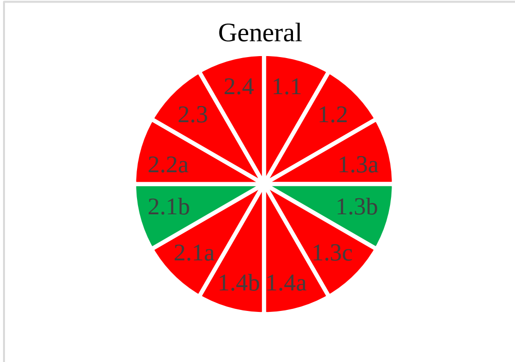
- Federal Financial Management System Requirements (FFMSRs),
- Applicable Federal accounting standards, and
- The U.S. Standard General Ledger (USSGL) at the transaction level.

OMB Circular A-123, Appendix D provides a framework to assist with determining compliance with FFMIA. The FFMIA compliance determination framework includes a series of Federal financial management goals and associated compliance indicators that assist the agency head in determining whether the agency has substantially complied with the requirements of FFMIA.

DLA leveraged the OMB Circular A-123 Appendix D compliance determination framework to perform a review of data for each of the FFMIA compliance indicators and associated analysis in order to determine compliance with FFMIA.

OMB Circular A-123 Appendix D Goals	OMB Circular A-123 Appendix D Compliance Indicator
Goal 1.1: Consistently, completely, and accurately record and account for Federal funds, assets, liabilities, revenues, expenditures, and costs.	1.1.a Current / prior year's agency-reported material weaknesses, reportable conditions, or non-conformances, or auditor-reported material weaknesses, or significant deficiencies relating to this goal
Goal 1.2: Provide timely and reliable Federal financial management information to agency program managers.	1.2.a Current / prior year's agency-reported material weaknesses, reportable conditions, or non-conformances
Goal 1.3: Provide timely and reliable Federal financial management information for use by stakeholders external to the agency.	1.3.a Audit opinion on agency financial statements
	1.3.b Unaudited interim agency financial statements submitted to Office of Management and Budget (OMB) within 21 calendar days after the end of the first three quarters of the FY
	1.3.c Agency financial reports submitted to OMB, the Government Accountability Office, and the Congress by November 15

OMB Circular A-123 Appendix D Goals	OMB Circular A-123 Appendix D Compliance Indicator
Goal 1.4: Provide timely and reliable Federal financial management information that can be linked to strategic goals and performance information.	1.4.a Agency costs, as presented in the Statement of Net Costs, in accordance with OMB Circular A-136, are clearly linked to agency strategic goals and are free from agency-reported material weaknesses, reportable conditions, or non-conformances, or auditor-reported material weaknesses or significant deficiencies
	1.4.b Financial and performance information, as presented in the performance section of the Agency Financial Report, is free from agency-reported material weaknesses, reportable conditions, or non-conformances
Goal 2.1: Provide internal controls to restrict Federal obligations and outlays to those authorized by law and within the amount available.	2.1.a Current / prior year's agency-reported material weaknesses, reportable conditions, or non-conformances, or auditor-reported material weaknesses or significant deficiencies relating to this goal
	2.1.b Anti-Deficiency Act (ADA) Violation Report required to be submitted
Goal 2.2: Perform Federal financial management operations effectively within resources available.	2.2.a Current / prior year's instances of non-compliance with laws and regulations related to prompt payments or debts owed to the Federal Government
Goal 2.3: Minimize waste, loss, unauthorized use, or misappropriation of Federal funds, property and other assets within resources available.	2.3.a Current / prior year's agency-reported material weaknesses, reportable conditions, or non-conformances, or auditor-reported material weaknesses or significant deficiencies relating to this goal
Goal 2.4: Minimize Federal financial management security risks to an acceptable level.	2.4.a Federal Information Security Modernization Act (FISMA) or other (for example, National Institute of Standards and Technology-related) significant deficiencies impacting financial management systems in the agency Security Certification and Accreditation of Federal Information Systems



Based on the application of the OMB Circular A-123 Appendix D FFMIA Compliance Determination Framework and associated analysis of relevant FFMIA compliance indicators available at the time of this report, DLA had high risk factors associated with all three FFMIA Section 803(a) requirements. Ten of the twelve indicators for the General Fund were at the high risk level based on the Risk (Or Performance) Level indicated in the OMB Circular A-123 Appendix D FFMIA Compliance Determination Framework.

<u>FFMSRs:</u> Financial reporting objectives did not include timely financial information for reporting on DLA's financial condition as the Agency Financial Reports (AFRs) for FY 2016 and FY 2017 were not completed by November 15. In addition, material weaknesses over internal controls over financial reporting and non-compliance related to financial system security were identified.

<u>Federal Accounting Standards:</u> DLA is unable to implement all elements of the Federal GAAP standards due to financial management system limitations.

<u>USSGL at the Transaction Level:</u> DLA has identified a material weakness in budgetary to proprietary relationships as a result of cumulative differences.

During FY2018, DLA initiated a number of activities to increase the accuracy, reliability, and timeliness of the Agency's financial management information. DLA began operationalizing elements of the Data Profiling and Continuous Monitoring Program (DPCMP) in Data Profiling and Continuous Monitoring Efforts and FFMIA Integration and Sustainment Efforts.

To support the implementation of the DPCMP during FY2018, DLA performed a limited evaluation of the EBS system configuration in relation to the Data Input FFMSRs that represent the ability of the system to capture data that will facilitate compliant transaction processing in accordance with applicable accounting standards. The observations resulting from the EBS configuration evaluation will allow DLA to confirm existing issues and identify additional opportunities to improve compliance with the FFMIA requirements through updates to the EBS configuration.

Executing the Agency's program for FFMIA requires identification, coordination, and integration of all the activities that are related to FFMIA. During FY2018, DLA developed a baseline mapping between the FFMIA compliance objectives reflected in the TFM FFMSRs and DLA's business processes and controls as annotated in Process Cycle Memorandums (PCMs) and Standard

Operating Procedures (SOPs). The baseline mapping provides the basis for understanding the operational processes that contribute to each FFMIA objective. The baseline mapping facilitates analysis of FFMIA compliance indicators and supports the identification of gaps in processes and controls that may impact FFMIA compliance.

Financial Management Systems

DLA Information Operations is the DLA knowledge broker, providing comprehensive, best practice Information Technology support to the DoD/DLA Logistics Business Community, resulting in dynamic information systems, customer support, efficient and economical computing, data management, electronic business, telecommunication services, key management, and secure voice systems for DoD and DLA. DLA Information Operations endeavors to improve the control posture of systems and processes by testing and correcting deficiencies to ensure that DLA's systems are compliant with Federal system security and accounting requirements**.**

DLA Information Operations conducts annual internal reviews of the effectiveness of the DLA internal controls over financial systems. DLA is not able to provide assurance that the internal controls over the financial systems as of September 30, 2018 are in compliance with the FFMIA and OMB Circular A-123.

DLA Information Operations continues to review audit findings from the prior and current financial statement audits, develop corrective action plans, and promptly resolve findings. Deficiencies identified are aligned to the appropriate plans issued for the Enterprise controls to ensure they are addressed in a prompt, consistent and coordinated manner. Systems include:

- Defense Agencies Initiative (DAI)
- Employee Activity Guide for Labor Entry (EAGLE)
- Enterprise Business Systems (EBS)
- Invoice, Receipt Acceptance, and Property Transfer (iRAPT)

Federal Information Security Modernization Act of 2014

Federal Information Security Modernization Act of 2014 (FISMA) provides a framework for ensuring effectiveness of security controls over information resources that support Federal operations and assets, and provides a statutory definition for information security. FISMA requires the head of each agency to "implement policies and procedures to cost-effectively reduce information technology security risks to an acceptable level." DLA-J6 is the accountable entity within DLA to perform FISMA assessments and reporting.

FISMA reporting is conducted on an annual basis and covers all operating environments of DLA's authorized systems and applications, and also requires management to review the compliance of security personnel with their training requirements. The compliance targets of FISMA reviews are tracked and monitored in Cyberscope, an automated tool that is mandated for use across the Federal Government. The CIO monitors and reviews the FISMA results, which are then rolled up at the DoD level for reporting purposes.

Anti-Deficiency Act

The Anti-Deficiency Act (ADA), Title 31 USC 1341, prohibits Federal employees from obligating funds in excess of an appropriation, or before funds are available, or from accepting voluntary services. As required by the ADA, DLA notifies all appropriate authorities of any potential ADA violations. There are no known or potential ADA violations at this time.

DLA GF has funds control policies to monitor and track commitments, expenditures, and obligations to ensure amounts do not exceed available authority, in compliance with the ADA. DLA GF is continuously evaluating the existing processes and controls to identify areas of improvement.

Digital Accountability and Transparency Act of 2014

On May 9, 2014, the President signed the Digital Accountability and Transparency Act of 2014 (DATA Act) into law. The DATA Act is the nation's first legislative mandate for data transparency. It requires the Department of the Treasury and the OMB to transform United States Federal spending from disconnected documents into open, standardized data, and to publish that data online. New requirements starting in January and May of 2017 require the financial community to augment the reporting of awards with expenditure data and balances.

The Department of Defense Activity Address Directory (DoDAAD) is an authoritative data source whose primary function is to provide the automatic addressing functions of the DoD supply chain through the Defense Automatic Addressing System (DAAS) worldwide customers' requisition processing and logistics management process. The primary mission of DLA Transaction Services is to use the DAAS to receive, edit, validate, route, and deliver logistics transactions for the DoD Components and Participating Agencies. While that requirement remains today, its use has evolved far beyond the DoD supply chain. It now serves to enable and facilitate business system transactions for both the DoD and the other Departments of the Federal Government. This affords users with a comprehensive capability and resource for the DoDAAD that appeal to the widest user base of the Federal Government, consistent with the DATA Act.

Through data testing and validation, in FY 2018, DLA continued to improve data quality and ensure timely and accurate data reporting to meet and comply with the DATA Act requirements. DLA initiated a complete review of finance-related data in EBS, as well as data capabilities. This review is to define ownership, roles, and responsibilities for the data owner and applicable governance considerations (i.e. stakeholders, rules, definitions, control mechanism, and accountability measures). Finance data includes: finance interfaces, Intermediate Documents (IDOCs), customer/vendor master, financial hierarchy (Fund, Fund Center, GLAC, Commitment Item), and posting logic. The end result of this is to increase the availability, timeliness, accuracy, visibility and usefulness of DLA financial data as well as to insure standards and processes are in place to achieve and sustain audit opinions.

Forward-Looking Information

The following areas present the greatest insights into how the Agency shapes its programs and responds to challenges posed to DLA TF goals and missions.

An Ever Changing Workforce

DLA is a dynamic organization, and our workforce is our greatest asset. As we look forward, four significant external factors could impact DLA's workforce. DLA must identify and implement strategies to decrease the impact to the workforce.

The changing demographics is the first significant external factor. There are different generations working side-by-side in DLA's workplace. DLA civilians are playing an increasingly more critical role in supporting global DoD missions. These changing demographics will require continued assessments of our current initiatives and new strategies in areas such as recruitment, training and development, work-life balance, and managing personnel in a geographically dispersed environment.

Our economy is the second external factor that influences the Federal government's ability to recruit top talent and retain its workforce. DLA must continue to define ourselves as an employer of choice within the Federal sector. This will require the reinforcement of connecting with DLA's mission and with the reputation for valuing diversity and inclusion.

Emerging technologies is the third external factor that transforms the way the workforce works, plays, and interact with others. It is important to empower the workforce through technology to meet changing mission requirements. It is paramount for DLA to develop innovative Human Capital management strategies to recruit, develop, and sustain a workforce that is technically proficient and agile as they adapt to emerging technologies.

The work environment is the fourth significant external factor to impact the workforce. DLA's success as an organization is largely dependent on our ability to achieve a high-performing, results-driven culture, and to sustain that culture in light of changes to demographics, economics, and technology. Each segment of DLA will be impacted and DLA Human Resources must strategically partner with both leadership and the whole of DLA's workforce to continue DLA's mission. The use of Change Management techniques will assist in decreasing the uncertainty associated with changes as well as mitigate resistance to the changes.

Warfighter First and Always Accountable

DLA provides efficiency and effective solutions to the Nation's Warfighters. DLA, through the GF's appropriations, will continue key initiatives for O&M, RDT&E, MILCON, PDW, and Family Housing in support of the Warfighter First, Strong Partnership, and Always Accountable LOEs. The DLA Director will continue developing programs, as those described in the Performance Goals, Objectives, and Results section, to support the Warfighters in time of war, and improving the readiness and quality of life for our soldiers.

External Threats

DLA faces current and future cyber threats that must be countered in a sustained effort to secure and defend the Agency's critical operational data, network, and business systems by applying key security principles, which include:

- Operations-level Situational Awareness;
- Layered perimeter defenses;
- Least privilege for access to data and IT capabilities; and
- Physical or logical segmentation of networks, services, and applications.

These proactive defensive measures serve to provide assurance to data and mission owners in the confidentiality, integrity, and availability of DLA's networked infrastructure and business system portfolio, thus enabling and informing strategic-level decision-making.

Technology Advancement and Initiatives

DLA Finance is working on two major system initiatives: G-Invoice is a Treasury mandated process to improve the reconciliation and coordination of intra-government payments. Second, the implementation of the DoD standard line of accounting (SLOA) will improve interoperability between DoD business systems and provide better end-to-end funds traceability and eliminations reporting to enable successful audits in DoD.

General Fund is the secondary source of cost and financing for DLA operations.

Financial Section (Unaudited)

The Financial Section (Unaudited) demonstrates our commitment to effective stewardship over the funds DLA receives to carry out its mission, including compliance with relevant financial management legislation. It includes the General Fund **Financial Statements**: Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Combined Statement of Budgetary Resources, as well as the accompanying **Notes to the Financial Statements**. It also includes the **Independent Auditors' Report** on DLA's GF Financial Statements and accompanying Notes, provided by Ernst & Young LLP.

Message from the Chief Financial Officer

NOVEMBER 2018

DLA's Fiscal Year 2018 Agency Financial Report (AFR) offers certain valuable insights into the overall financial operations, accomplishments, and challenges of the DLA, and includes our principal statements of financial accountability to the Department of Defense (DoD). Accountability represents the foundation of stewardship and DLA remains committed to ensuring value, efficiency, and effectiveness in every program. This section of the AFR provides a comprehensive view of DLA's General Fund (GF) financial activities.

DLA received a Disclaimer of Opinion on the Agency's GF financial statements, which means the auditor conducted audit procedures on the statements but was unable to express an opinion on them. Material weaknesses continue to be reported. DLA continues to make strides to correct our material weaknesses, reviewing underlying business processes to provide long-term solutions. The opinion does not overshadow achievements already made, such as interim progress on critical corrective action plans, and ongoing audit training provided to all DLA employees.

In the past year, DLA began Financial Transformation and through continued evolution to excellence, this will endure until DLA achieves an unmodified audit opinion. We have taken a holistic, risk-based look at the maturity of our enterprise, and have identified critical focus areas to address audit impediments. These efforts include initiatives to improve the performance of our accounting, financial operations, and customer service to enhance the value of finance to the Agency's mission and values. Key components of Financial Transformation include remediation of Notice of Findings and Recommendations from financial statement audits, enhancing the reliability of financial statement data, and ensuring the accounting process and related controls document approved policies. For the GF, we have enhanced our controls over Information Technology General Controls.

As I enter my second year as Chief Financial Officer at DLA, I am committed to assisting DLA to reach this goal. We will continue to focus on fixing our critical deficiencies to meet and sustain auditability. Increased confidence in our financial information will ultimately benefit the Warfighter and other key stakeholders. Furthermore, I am going to ensure innovation with the implementation and use of artificial intelligence to reduce manual transactions and to provide enhanced decision-making through building a cost conscious culture in our business. We are confident we have the right team in place to continue our sustained progress toward an unmodified audit opinion, and look forward to working with the DLA community on this shared mission.

Gretchen V Anderson

GRETCHEN V. ANDERSON
Director, DLA Finance
Chief Financial Officer

Introduction

The principal financial statements included in this report are prepared pursuant to the requirements of the Government Management Reform Act of 1994 (Pub. L. 103-356) and the Chief Financial Officers Act of 1990 (Pub. L. 101-576), as amended by the Reports Consolidation Act of 2000 (Pub. L. 106-531), and the DLA Financial Accountability Act of 2004 (Pub. L. 108-330). Other requirements include the OMB Circular No. A-136, as amended. The responsibility for the integrity of the financial information included in these statements rests with the management of DLA. Ernst & Young LLP was engaged to perform the audit of the DLA's GF principal financial statements. The Independent Auditors' Report accompanies the principal financial statements. As discussed in Note 1, DLA has identified non-U.S. GAAP accounting practices or policies; therefore, has not presented comparative financial statements as a result of the U.S. GAAP departures.

The DLA's GF principal financial statements consist of the following:

1. The **Balance Sheet** presents those resources owned or managed by the DLA that represent future economic benefits (assets), amounts owed by DLA that will require payments from those resources or future resources (liabilities), and residual amounts retained by DLA comprising the difference (net position) as of September 30, 2018.

2. The **Statement of Net Cost** presents the net cost of DLA operations for the fiscal year ended September 30, 2018. DLA net cost of operations is the gross cost incurred by DLA less any exchange revenue earned from DLA activities and any gains or losses from assumption changes on pensions, other retirement benefits, and other post-employment benefits.

3. The **Statement of Changes in Net Position** presents the change in the DLA's net position resulting from the net cost of DLA operations, budgetary financing sources, and other financing sources for the fiscal year ended September 30, 2018.

4. The **Combined Statement of Budgetary Resources** presents how and in what amounts budgetary resources were made available to the DLA during fiscal year 2018, the status of these resources at September 30, 2018, the changes in the obligated balance, and outlays of budgetary resources for the fiscal year ended September 30, 2018.

5. The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the financial statements as of and for the fiscal year ended September 30, 2018.

Financial Statements (Unaudited)

Defense Logistics Agency - General Fund
Balance Sheet
As of September 30, 2018
(In Thousands)

		Unaudited 2018
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$	1,438,421
Accounts Receivable		10,231
Total Intragovernmental Assets	**$**	**1,448,652**
Accounts Receivable		1
Other Assets (Note 3)		88
General Property, Plant and Equipment (Note 4)		611,790
TOTAL ASSETS	**$**	**2,060,531**
LIABILITIES		
Intragovernmental:		
Accounts Payable	$	24,970
Other Liabilities (Note 8)		2,236
Total Intragovernmental Liabilities	**$**	**27,206**
Accounts Payable		53,476
Environmental and Disposal Liabilities (Note 7)		88,270
Other Liabilities (Note 8)		7,851
Other Federal Employee Benefits (Note 6)		3,846
TOTAL LIABILITIES (Note 5)	**$**	**180,649**
NET POSITION		
Unexpended Appropriations	$	1,374,142
Cumulative Results of Operations		505,740
TOTAL NET POSITION	**$**	**1,879,882**
TOTAL LIABILITIES AND NET POSITION	**$**	**2,060,531**

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - General Fund
Statement of Net Cost
For the Year Ended September 30, 2018
(In Thousands)

	Unaudited 2018
Program Costs	
Operations and Maintenance	
Gross Cost	$ 343,327
Less Earned Revenue	(19,612)
Net Cost	323,715
Procurement	
Gross Cost	8,607
Less Earned Revenue	-
Net Cost	8,607
Research, Development, Test & Evaluation	
Gross Cost	255,603
Less Earned Revenue	(28,787)
Net Cost	226,816
Family Housing and Military Construction	
Gross Cost	168,286
Less Earned Revenue	-
Net Cost	168,286
Net Cost of Operations	
Total Gross Cost	775,823
Less Earned Revenue	(48,399)
NET COST OF OPERATIONS	**$ 727,424**

The accompanying notes are an integral part of these statements.

Defense Logistic Agency - General Fund
Statement of Changes in Net Position
For the Year Ended September 30, 2018
(In Thousands)

	Unaudited 2018
Unexpended Appropriations	
Beginning Balances	$ 1,222,277
Correction of Errors	5,113
Beginning Balances, as adjusted	1,227,390
Budgetary Financing Sources:	
Appropriations received	1,049,080
Appropriations transferred-in/out	6,563
Other adjustments	(33,733)
Appropriations used	(875,158)
Total Budgetary Financing Sources	146,752
Total Unexpended Appropriations	1,374,142
Cumulative Results of Operations	
Beginning Balances	660,284
Correction of Errors	474,943
Beginning balances, as adjusted	1,135,227
Budgetary Financing Sources:	
Appropriations used	875,158
Other Adjustments	(3,930)
Other Financing Sources:	
Transfers-in/out without reimbursement	(776,420)
Imputed financing from costs absorbed by others	3,129
Total Financing Sources	97,937
Net Cost of Operations	727,424
Net Change	(629,487)
Cumulative Results of Operations	505,740
Net Position	$ 1,879,882

The accompanying notes are an integral part of these statements.

Defense Logistics Agency - General Fund
Combined Statement of Budgetary Resources
For the Year Ended September 30, 2018
(In Thousands)

	Unaudited 2018
BUDGETARY RESOURCES	
Unobligated balance from prior year budget authority, net	$ 474,897
Appropriations	1,054,390
Spending Authority From Offsetting Collections	59,777
TOTAL BUDGETARY RESOURCES	$ 1,589,064
Memorandum (non-add) entries:	
Net adjustments to unobligated balance brought forward, Oct 1	17,110
STATUS OF BUDGETARY RESOURCES	
New Obligations and Upward Adjustments	$ 1,027,209
Unobligated Balance, End of Year:	
Apportioned, Unexpired Accounts	436,112
Expired Unobligated Balance, End of Year	125,743
Total Unobligated Balance, End of Year	561,855
TOTAL BUDGETARY RESOURCES	$ 1,589,064
OUTLAYS, NET	
Outlays, net	$ 901,903
Agency Outlays, Net	$ 901,903

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

Note 1. Summary of Significant Accounting Policies - Unaudited

A. Reporting Entity

Created in 1961, the Defense Logistics Agency (DLA) is a component of the U.S. Department of Defense (DoD) and reports to the Office of the Under Secretary of Defense for Acquisition and Sustainment through the Assistant Secretary of Defense for Sustainment. DLA provides materials and services to components of DoD, including the U.S. Army, Navy, and Air Force. The Defense Finance and Accounting Service (DFAS) provides accounting and transaction processing services.

Congress appropriates General Fund (GF) amounts to DLA, which also grants authority to the Office of the Secretary of Defense (OSD) and its Components to obligate those funds to support mission requirements. The DLA GF receives five appropriations which include Operation and Maintenance (O&M); Family Housing; Research, Development, Test, and Evaluation (RDT&E); Procurement; and Military Construction (see Note 1.D).

B. Basis of Presentation

The accompanying financial statements are prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP) for Federal entities and are presented in the format prescribed by the Office of Management and Budget (OMB) in Circular A-136, *Financial Reporting Requirements*, except as described in the following paragraphs. The financial statements present the financial position, net cost of operations, changes in net position, and combined budgetary resources of the DLA GF, as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994.

The DLA GF financial statements have been prepared from the accounting records of DLA GF, and do not include the DLA Transaction or Working Capital Funds. DLA generates separate financial statements for these funds. Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to present disclosure of classified information.

Interfund transactions and balances among the DLA GF programs (RDT&E, PDW, MILCON, Family Housing, and O&M) have been eliminated from the Balance Sheet, the Statement of Net Cost, and the Statement of Changes in Net Position. The Combined Statement of Budgetary Resources is presented on a combined basis in accordance with OMB Circular A-136; therefore, interfund transactions have not been eliminated from this statement.

On a DOD agency-wide basis, DLA GF adjustments are based on the information provided by the seller/service provider unless a waiver is obtained. A waived entity is a DoD reporting entity believed to have complete, accurate, and supported seller or buyer side data. Currently, DLA GF is a non-waived entity. The elimination adjustments for buyer/seller transactions are based on the buyer's accounts payable and expenses and the seller's accounts receivable and revenue records. DLA GF is unable to resolve the reconciling differences in amounts reported for the buyer/seller transactions reciprocal category with other defense organizations.

The DLA GF financial statements include trial balances of DLA's sub-allottees, which includes: Defense Micro Electronics Activity, United States (U.S.) Transportation Command, U.S. Army Corps of Engineers (USACE), and Naval Facilities Engineering Command (NAVFAC). The sub-allottees level trial balances may reflect known abnormal balances, however, at the aggregate DLA level, these abnormal balances may not be evident.

The DLA GF is unable to fully prepare these financial statements in conformity with U.S. GAAP due to limitations of the financial and nonfinancial management systems and processes that currently support DLA GF financial statements. These systems are designed to maintain accountability over assets, liabilities and budgetary resources, rather than preparing financial statements in accordance with U.S. GAAP. DLA has identified non-U.S. GAAP accounting practices or policies; therefore, has not presented comparative financial statements as a result of the U.S. GAAP departures.

DLA is continuing actions required to bring its financial and nonfinancial systems and processes into compliance with U.S. GAAP. Until all DLA financial and nonfinancial feeder systems and processes are able to collect and report financial information as required by U.S. GAAP, DLA continuous to implement interim mitigation processes to address these limitations. In addition, DLA is remediating deficiencies pertaining to reconciliations and adequacy of the supporting documentation identified through audits and other compliance reporting.

The limitations referenced above cause misstatements in certain financial statement balances and prevent DLA from providing assurance that other balances are presented fairly. DLA identified the following non-GAAP accounting policies and practices, although others may exist that have not been identified.

- Financial Statements – DLA does not present comparative financial statements due to the identification of non-U.S. GAAP accounting practices or policies.

- Accounts Payable – A payment without receipt (Negative Payable) occurs when a payment is made prior to posting of the goods receipt in EBS. This results in an understatement of current year expenses and payables, and an overstatement of undelivered orders. A journal voucher is prepared monthly to properly record the accounting entries.

- Unfilled Customer Orders – DLA does not have the proper policies and procedures to reconcile the Unfilled Customer Orders from the EBS trial balance to the transaction detail.

- Undelivered Orders – DLA does not have the proper policy and procedures to reconcile the Undelivered Orders from the EBS trial balance to the transaction detail.

- Fund Balance With Treasury (FBwT) – DLA is not able to identify its undistributed collections and disbursements because DLA shares a Treasury Index (TI)-97 with Other Defense Organization for Treasury reporting.

- Leases – DLA does not currently report capital and operating leases in its financial statements. DLA initiated an Agency-Wide business event assessment for the financial recognition of capital and operating leases that will continue in FY2019.

- Construction in Progress (CIP) – DLA does not have the proper policies and procedures to identify aged CIP. DLA will continue to perform an analysis over aged CIP balances in FY2019.

- IUS – DLA does not have the proper policies and procedures to identify and capitalize costs related to IUS.

There may be other non-GAAP disclosures in Note 1 of the financial statement that are not disclosed in Note 1.B.

C. Basis of Accounting

U.S. GAAP encompasses accrual transactions. DLA uses the accrual basis of accounting to prepare the Balance Sheet, Statement of Net Cost and Statement of Changes in Net Position. Under the accrual basis, revenues are recognized when earned and expenses are recognized when liabilities are incurred, without regard to receipt or payment of cash. The Combined Statement of Budgetary Resources is prepared using a budgetary basis of accounting and complies with legal requirements on the use of Federal funding.

D. Appropriations and Funds

The DLA GF receives appropriations from the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) in Treasury Index (TI)-97, along with Other Defense Organizations (ODOs). OUSD(C) uses a data element referred to as a 'limit' to differentiate the various ODOs under TI-97. Defense-wide (DW) appropriations sub-allotted to GF include: (1) Operation and Maintenance (O&M) (Treasury Account Symbol (TAS) 97 0100), (2) Procurement Defense-wide (PDW) (TAS 97 0300), and (3) Research, Development, Test and Evaluation (RDT&E) (TAS 97 0400). GF also receives sub-allotments for Military Construction (MILCON) (TAS 97 0500) and Family Housing O&M (TAS 97 0706). The appropriations provide the funding to incur obligations and to pay for goods and services.

DLA GF sub-allots RDT&E and MILCON funding to other DoD organizations, using limits assigned to the TI-97 entities to track funding status a level below the Treasury Account Symbol (TAS) level.

The DLA GF receives the following appropriations and funds to execute its mission and subsequently report on resource usage:

- The O&M appropriation funds Administration and Service-Wide Activities such as DoD programs, DoD Enterprise Business Systems, HQ DLA programs, and Environmental Programs. These programs are associated with DLA logistics mission as well as programs assigned to DLA from the DoD for budget administration purposes. For the DLA GF, DLA functions as either the executive agent responsible for program oversight and policy guidance or the budget administrator responsible for administrative support for these programs.

- The Family Housing appropriation funds the routine operations and maintenance of 124 military family housing units. Routine operation and maintenance includes management costs, utility costs and cyclical maintenance such as painting and renovations. Note: DLA GF received approval to divest these units beginning in FY2017 with anticipated completion scheduled for FY2019.

- The RDT&E appropriation funds the development of major upgrades to increase the performance of existing systems, the purchase of test articles, and the developmental testing and/or initial operational testing and evaluation prior to system acceptance. In addition, the RDT&E appropriation develops, manages, and implements innovative microelectronic solutions to enhance DoD mission capabilities. These capabilities are leveraged to develop low-volume, high mix fabrication processes for state-of-the-art technologies that meet the Department's performance and reliability needs for legacy microelectronics that are unavailable from commercial foundries. RDT&E also helps ensure that advanced logistics concepts and business processes are used to accomplish the agency's mission. The Logistics Research and Development (R&D) program identifies the best commercial business practices and tailors them, as necessary, into the most effective business processes for DLA. Manufacturing Technology R&D program provides the critical link between invention and application. DLA sub-allots RDT&E authority to the Defense Microelectronics Activity (DMEA).

- The Procurement Defense-Wide, appropriation funds mission essential equipment, including automated data processing, telecommunications equipment, and passenger carrying vehicles that afford a high degree of efficiency, effectiveness, and productivity in the accomplishment of DLA's logistics mission.

- The MILCON appropriation funds the construction of facilities that support DLA's mission. These include DoD fuel infrastructure projects, and distribution and disposition facilities. DLA sub-allots MILCON authority to USACE and NAVFAC, which are DLA's primary design and construction agents for the MILCON program.

E. Fund Balance with Treasury

The DLA GF does not maintain cash in commercial bank accounts, but rather in U.S. Treasury Accounts for Defense-wide appropriations.

Treasury Account balances allocated to the DLA GF represent the aggregate amount available for DLA to pay current liabilities and finance authorized purchases, except as restricted by law. Defense Finance and Accounting Service (DFAS) Indianapolis (DFAS-IN) uses suspense accounts for its customers, including DLA, to hold transactions temporarily pending clearance for the correct appropriation. The transactions in suspense accounts include unidentified collections, disbursements, and Intra-Governmental Payment and Collection Transactions at month end. All transactions that remain in suspense accounts at month end are reported on the Suspense Account Report. The disbursing offices of DFAS, USACE, and the Department of State's financial service centers process DLA's cash collections, disbursements, and adjustments.

Undistributed disbursements and collections represent the amounts that are reported to Treasury, but have not yet posted to DLA's general ledger. Undistributed amounts can be a result of timing, invalid line of accounting, and invalid TAS information.

DLA adjusts its FBwT account balance to reflect its portion of the U.S. Treasury's Central Accounting and Reporting System (CARS) Account statement, for its Treasury Account Symbols, using the Cash Management Report (CMR).

The CMR is prepared by DFAS-IN and provides the summary cash position for all Defense Agencies in the TI-97 by fiscal year and appropriation at the limit level.

On a monthly basis, the DFAS-Columbus (CO) uses the CMR to calculate and record adjustments for the undistributed disbursements and collections variance to bring the Financial Statements in agreement with the U.S. Treasury cash balance.

Additionally, the CMR is used to populate accounting transaction events in the Department 97 Reconciliation and Reporting System (DRRT), which compares transactions recorded between the CMR and the accounting system of record, and reports the undistributed disbursements and collections variances.

The DLA GF is not able to reconcile its FBwT ending balances in the general ledger directly to the U.S. Treasury balances. DLA policy is to allocate undistributed disbursements and collections between Federal and non-Federal categories. These categories are based on the percentage of distributed Federal and non-Federal accounts payable and accounts receivable. Adjustments for undistributed disbursements and collections are applied to reduce differences of accounts payable and receivable balances between DLA and Treasury's accounts.

F. Accounts Receivable

Accounts receivable represents amounts due to the DLA GF by other Federal agencies (intragovernmental) and the public (non-Federal). Intragovernmental and public accounts receivable arise from services provided for contracting support, system engineering support, sustainment and upgrades to infrastructure, and financial service support and are considered fully collectible.

G. General Property, Plant and Equipment

The DLA GF Property, Plant & Equipment consists of Internal Use Software (IUS) under development and Construction in Progress (CIP). The accounts are not subject to amortization and depreciation.

The DLA transfers the amounts in the CIP account to the appropriate PP&E account when the assets are placed in service. Additional service costs are transferred at the final acceptance of the assets. Due to noted deficiencies in policy and procedure, DLA is not able to reconcile the recorded CIP balances.

H. Advances and Prepayments

When advances are permitted by law, legislative action, or presidential authorization, it is DLA's policy is to record advances or prepayments. As such, payments made in advance of the receipt of goods and services are reported as Other Assets on the Balance Sheet.

I. Other Assets

Other assets (with the public) include those assets such as civil service employee pay and travel advances not reported elsewhere on the DLA Balance Sheet.

J. Accounts Payable

Accounts Payable includes amounts owed but not yet paid to Federal and non-Federal entities for goods and services received by DLA. DLA GF estimates and records accruals when services and goods are performed or received. The accounts payable methodology is a non-U.S. GAAP accounting practice or policy.

K. Commitments and Contingencies

DLA recognizes Contingent Liabilities in the DLA's Balance Sheet and Statement of Net Costs when they are probable and the loss can be reasonably estimated. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the U.S. Treasury.

DLA does not record an accrual for contingent liabilities if it is not probable and estimable, but does disclose those contingencies that are reasonably possible and considers cases that are unable to be determined to be included in this category. DLA does not disclose or record contingent liabilities where the loss is considered remote. DLA GF does not have any contingent liabilities that are reasonably possible or probable.

L. Liabilities

Liabilities represent amounts of monies or other resources likely to be paid by DLA as a result of a transaction or event that has already occurred. However, liabilities cannot be liquidated without legislation providing resources and legal authority. Liabilities for which an appropriation has not been enacted are, therefore, classified as not covered by budgetary resources (see Note 5).

Unearned revenue received in advance of goods or services that have not been fully rendered are reported as Other Liabilities on the Balance Sheet.

M. Environmental Liabilities

DLA is responsible for accurate reporting of the environmental expense and liabilities for the real property and/or equipment that it records and reports on its financial statements as assets, regardless of ownership. DLA identifies and estimates accrued EL through its annual Cost-to-Complete process. The DLA GF's accrued Environmental Liabilities are comprised of environmental cleanup costs associated with restoration of environmental sites on real property that it does not own but has received appropriated funds to execute and manage. These environmental sites may include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, clean closure of assets, and post-closure costs related to the Agency's operations that result in hazardous waste (see Note 7).

N. Payroll and Annual Leave Accruals

Accrued payroll consists of salaries, wages, and other compensation earned by employees but have not yet been disbursed. The DLA accrues the cost of unused annual leave, including restored leave, compensatory time, and credit hours as earned and reduces the accrual when leave is taken. The liability is estimated for reporting purposes based on historical pay information.

O. Federal Employment Benefit

The Federal Employees' Compensation Act (FECA), administered by the U.S. Department of Labor (DOL), provides disability and medical benefits to covered Federal employees who are injured on the job or have occupational illness. FECA also provides survivor's benefit for employees whose death is attributable to a job-related injury or occupational illness. DOL bills DLA annually as claims are paid, and DLA in turn accrues a liability to recognize the future payments. Payment on these bills is deferred for one year to allow for funding to go through the budget process. In addition, DLA records estimates for the FECA actuarial liability using the DOL's FECA bill.

Similarly, employees that DLA terminates without cause may receive unemployment compensation benefits under the unemployment insurance program also administered by DOL, who bills each agency quarterly for paid claims.

P. Pension Benefits

DLA's civilian employees may participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), depending on when they started working for the Federal government. Additionally, personnel covered by FERS have varying coverage under Social Security. DLA finances only a portion of the civilian pensions. While reporting and funding civilian pensions under CSRS and FERS are the responsibility of the Office of Personnel Management, DLA recognizes an imputed expense for the portion of civilian employee pension's benefit on the Statement of Net Cost. DLA also recognizes corresponding imputed revenue from the civilian employee pension's benefit on the Statement of Changes in Net Position.

Q. Revenues

The DLA GF revenue mainly consists of exchange revenue, which arises when DLA provides services to the public or Federal entities. Revenues from services in the O&M appropriation include support for Continuity of Operations; Law Enforcement Support Office; Morale, Welfare and Recreation; and Defense Travel System Support. Revenues from services in the RDT&E appropriation include support for the Next Generation Resource Management System; Mapping Enterprise Business System; and Defense Information System Security.

R. Net Position

Net position is the residual difference between assets and liabilities and consists of unexpended appropriations and cumulative results of operations.

Unexpended appropriations represent the amounts of budget authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

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

S. Other Financing Sources

The DLA GF receives congressional appropriations as financing sources. These funds either expire annually or on a multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by services provided.

DLA recognizes the costs incurred by the DLA but financed by other entities on behalf of the DLA as imputed financing. DLA GF recognizes the following imputed costs: (1) employee pension, post-retirement health, and life insurance benefits; (2) post-employment benefits for terminated and inactive employees to include workers compensation under the Federal Employees' Compensation Act; and (3) losses in litigation proceedings.

T. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates and assumptions include, but are not limited to, contingent liabilities, judgment fund, environmental liabilities, allowance for doubtful accounts and allowance for inventory held for repair at the date of the financial statements. The actual result from the reported amounts and expenses during the reporting period may differ from these estimates.

Note 2. Fund Balance with Treasury - Unaudited

Fund Balance with Treasury as of September 30, 2018 (in thousands):

	2018
Status of Fund Balance with Treasury	
Unobligated Balance	
Available	$ 436,112
Unavailable	125,743
Obligated Balance not yet Disbursed	$ 876,566
Total	$ 1,438,421

The Status of Fund Balance with Treasury reflects the budgetary resources to support FBwT. It primarily consists of unobligated and obligated balances. The balances reflect the budgetary authority remaining for disbursement against current or future obligations.

Unobligated Balance - available represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations and can be used for future obligations.

Unobligated Balance - unavailable represents the cumulative amount of budgetary authority that cannot be used to cover outstanding obligations

Obligated Balance not yet Disbursed represents funds obligated for goods and services not received, and those received but not paid. The balances also include budgetary resources accounts such as unfilled customer orders.

Non-budgetary FBwT consists of FBwT in unavailable receipt accounts and clearing accounts that do not have budget authority and non-budgetary FBwT, such as non-fiduciary deposit funds. As of September 30, 2018, the DLA GF does not have a balance for Non-Budgetary FBwT.

Note 3. Other Assets - Unaudited

Other Assets as of September 30, 2018 (in thousands):

	2018
Nonfederal Other Assets	
Other Assets (With the Public)	$ 88
Total Nonfederal Other Assets	$ 88
Total Other Assets	$ 88

Note 4. General Property, Plant and Equipment - Unaudited

General Property, Plant and Equipment as of September 30, 2018 (in thousands):

Major Asset Classes	2018	
	Acquisition Value	Net Book Value
Major Asset Classes		
Software under development	$131,834	$131,834
Construction-in-Progress	479,956	479,956
Total General Property, Plant, and Equipment	$611,790	$611,790

DLA Construction in Progress mainly consist of projects from USACE and NAVFAC. In FY2018, DLA began implementing a review process to review the CIP balance reported by the constructions agents to DFAS and make adjustments as applicable. This review process is still under development. The DLA GF does not record PP&E placed in service and transfers completed assets to other funds.

Note 5. Liabilities Not Covered by Budgetary Resources - Unaudited

Liabilities not covered by Budgetary Resources as of September 30, 2018 (in thousands):

	2018
Intragovernmental Liabilities	
Other	$ 1,823
Total Intragovernmental Liabilities	$ 1,823
Non- Federal Liabilities	
Accounts Payable	$ 9,105
Other Federal Employment Benefits	3,846
Environmental and Disposal Liabilities	79,615
Other	4,921
Total Non-Federal Liabilities	$ 97,487
Total Liabilities Not Covered by Budgetary Resources	$ 99,310
Total Liabilities Covered by Budgetary Resources	81,339
Total Liabilities	$ 180,649

Other Information:

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources are available.

Intragovernmental Liabilities, Other consists of the FECA liability and any other unfunded employment related liability.

Non-Federal Liabilities, Other consists of unfunded annual leave owed to civilian employees.

As of September 30, 2018, DLA GF does not have any material balances related to Liabilities Not Requiring Budgetary Resources.

Total Liabilities Covered by Budgetary Resources include $8.7 million of Environmental and Disposal Liabilities.

Note 6. Other Federal Employment Benefits - Unaudited

Other Federal Employment Benefits as of September 30, 2018 (in thousands):

	2018	
	Liabilities	Unfunded Liabilities
Other Benefits		
Federal Employees' Compensation Act	$ 3,846	$ 3,846
Total Other Benefits	$ 3,846	$ 3,846
Total Other Federal Employment Benefits:	$ 3,846	$ 3,846

Actuarial Calculations

The DLA actuarial liability for workers' compensation benefits is developed by the DOL's Office of Worker's Compensation Programs (OWCP) and provided to DLA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual benefit payments are then discounted to the present value using the Office of Management and Budget's (OMB) economic assumptions for 10-year U.S. Treasury notes and bonds. Cost of living adjustments (COLAs) and medical inflation factors are also applied to the calculation of projected future benefits.

Actuarial Cost Method and Assumptions

The liability for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Interest rate assumptions utilized for discounting are as follows:

Year 1: 2.72% and thereafter (wage benefits)
Year 1: 2.38% and thereafter (medical benefits)

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (COLAs) and medical inflation factors (Consumer Price Index Medical (CPIMs)) were applied to the calculation of projected future benefits. The actual rates for these factors for the 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 CBY were as follows:

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

To assess the reliability of the model, an analysis was performed by agency to compare projected payments in the last year to the actual amounts. In addition, changes in the liability between the prior year and current year analyses were examined. Based on the analysis, the model and projected actual payments have been stable.

The cost model used for the estimated actuarial liability is updated only at the end of each fiscal year.

Note 7. Environmental and Disposal Liabilities - Unaudited

Environmental and Disposal Liabilities as of September 30, 2018 (in thousands):

	2018
Environmental Liabilities--Nonfederal	
Accrued Environmental Restoration Liabilities	
Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 88,270
Total Environmental Liabilities	$ 88,270

DLA GF EL is comprised of two primary elements: (1) existing obligations supporting the Defense Environmental Restoration Account (DERA) and Base, Realignment, and Closure (BRAC) funded environmental restoration programs, and (2) anticipated future cost to complete (CTC) environmental restoration requirements at DLA's environmental sites.

In FY2018, DLA utilized Version 11.4 of the Remedial Action Cost Engineering & Requirements (RACER) software to generate the FY2019 CTC estimates of anticipated future costs. Cost estimates were generated for 74 Accrued Environmental Restoration Liabilities Installation Restoration Program (IRP) sites and one BRAC IRP site.

Applicable Laws and Regulations for Cleanup Requirements

The DLA is required to clean up contamination resulting from past waste disposal practices, leaks, spills and other prior activities, which may have created a public health or environmental risk. DLA is required to comply with the following laws and regulations where applicable: The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA); the Superfund Amendments and Reauthorization Act (SARA); the Resource Conservation and Recovery Act (RCRA); the Clean Water Act; and other applicable Federal, State, and local laws and regulations. Required cleanup may at times extend beyond Installation boundaries onto privately owned property or onto sites where DLA is named as a potentially responsible party by a regulatory agency.

Types of Environmental Liabilities and Disposal Liabilities.

DLA is responsible for cleanup requirements of Defense Environmental Restoration Program (DERP) eligible sites managed under Active IRP, Military Munition Response Programs (MMRP), and BRAC IRP. Accrued Environmental Restoration clean-up Liabilities represent the cost to correct past environmental problems that are funded from the Environmental Restoration Accounts in accordance with the Department of Defense Manual (DoDM) 4715.20-Defense Environmental Restoration Program (DERP) Management (March 2012) and the DoD 7000.14-R Financial Management Regulation (FMR) Volume 4, Chapter 13 – Environmental and Disposal Liabilities (April 2018). All clean-up is conducted in coordination with regulatory agencies, other responsible parties, and current property owners.

Types of General Fund Environmental Liabilities include:

- *Active Installations*: EL associated with remedial actions eligible for funding under the DERP. These Remedial Actions may address hazardous substances, pollutants, and contaminants as defined in CERCLA; hazardous waste or hazardous constituents addressed under the RCRA corrective action process or other Federal or state statutes and regulations; and military munitions or Waste Military Munitions (WMM), chemical residues from military munitions, and munitions scrap at locations other than operational ranges associated with an active installation when the environmental restoration activity is incidental to the IRP environmental restoration activity.

- *BRAC Installations*: EL associated with the costs to address environmental cleanup at bases that are realigning or closing as a result of past activities that are a part of DERP.

Methods for Assigning Estimated Total Cleanup Costs to Current Operating
The DLA uses the RACER software to estimate future environmental costs. The RACER Steering Committee ensures that the software is validated, verified, and accredited in accordance with Department of Defense Instruction 5000.61, *DoD Modeling and Simulation Verification, Validation, and Accreditation*. DoD is working with the RACER steering committee and stakeholders to identify improvements to RACER functionality, auditability, and documentation. Additionally, DLA utilizes historical user-defined costs to estimate future environmental costs.

Nature of Estimates and the Disclosure of Information Regarding Possible Changes Due to Inflation, Deflation, Technology, or Applicable Laws and Regulations
The change estimates from the prior year CTC can be primarily attributed to an increase in Active Installations - IRP Environmental Corrective Actions due to additional requirements at DF Richmond and DF Tracy groundwater remediation sites and an increase in Defense and State Memorandum of Agreement (DSMOA) DERA funded program management costs resulting from increased state regulatory involvement. Year-to-year fluctuations in DLA's ELs are expected due to changes in agreements with regulatory agencies, deflation, inflation, and technology. The latest

version of RACER (Version 11.4) was used to prepare the estimates, which reflects a FY2017 cost basis since no RACER version was released in FY2018. As a result, an inflation factor was applied to escalate estimates from FY2017 to a FY2018 cost basis.

Uncertainty Regarding the Accounting Estimates used to calculate the Reported Environmental Liabilities

The cost estimates produced through the CTC process are considered accounting estimates, which require certain judgements and assumptions based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

DLA has instituted extensive controls to ensure that these estimates are accurate and reproducible. Due to the inherent uncertainty involved with environmental contamination and associated remedial actions, RACER, as a parametric cost estimating tool, is used as a preliminary order of magnitude estimate. The stated total liability includes prior year obligations and the estimate of future costs necessary to complete the environmental restoration requirements.

In FY2018, DLA conducted the CTC Roll Forward process bridging the timing gap between the approval and completion of the CTC estimates and September 30, 2018 to determine if any material changes to the CTC estimate occurred during that timeframe. Based on the results of the CTC Roll Forward process, it was determined that there were no material changes to DLA GF EL between the time the original CTC estimates were approved and finalized and September 30, 2018. The Roll Forward process is conducted in accordance with the DLA EL CTC Standard Operating Procedure (SOP), the DoD FMR Volume 4, Chapter 13, *Environmental and Disposal Liabilities* (April 2018), and the OSD memorandum *Strategy for Environmental & Disposal Liabilities Audit Readiness* (September 30, 2015).

Additionally, in FY2018, DLA conducted the EL Site Identification (ID) process that reviews an Environmental Event Repository used to track spills and releases at DLA locations and evaluates each event for Out-Year EL potentiality for use in the annual CTC and EL financial reporting. During the FY2018 Site ID Process, environmental events were identified as Potential Out-Year ELs due to the lack of sufficient information/data or pending additional corrective actions. These sites will be re-evaluated during the next Site ID process to determine if any changes have taken place and sufficient information/data is available to create an estimate of future costs that would be included in the GF EL balance.

Note 8. Other Liabilities - Unaudited

Other Liabilities as of September 30, 2018 (in thousands):

	2018		
	Current Liabilities	**Noncurrent Liabilities**	**Total**
Intragovernmental			
FECA Reimbursement to the Department of Labor	$ 81	$ 363	$ 444
Employer Contribution and Payroll Taxes Payable	414	-	414
Other Liabilities	1,378	-	1,378
Total Intragovernmental Other Liabilities	$ 1,873	$ 363	$ 2,236
Non-Federal			
Accrued Funded Payroll and Benefits	$ 1,592	$ -	$ 1,592
Advances from Others	-	634	634
Accrued Unfunded Annual Leave	4,921	-	4,921
Contract Holdbacks	274	-	274
Employer Contribution and Payroll Taxes Payable	430	-	430
Total Non-Federal Other Liabilities	$ 7,217	$ 634	$ 7,851
Total Other Liabilities	$ 9,090	$ 997	$ 10,087

Note 9. Apportionment Categories of New Obligations and Upward Adjustments: Direct vs. Reimbursable Obligations - Unaudited

New Obligations and Upward Adjustments for the year ended September 30, 2018 (in thousands):

2018	Category A	Category B	Total
Direct New Obligations and Upward Adjustments	$ 397,622	$ 569,793	$ 967,415
Reimbursable New Obligations and Upward Adjustments	$ (9)	$ 59,803	$ 59,794
Total New Obligations and Upward Adjustments	**$ 397,613**	**$ 629,596**	**$ 1,027,209**

Apportionment categories are determined in accordance with the guidance provided in OMB Circular A-11, *Preparation, Submission and Execution of the Budget*. The DLA GF had apportionment categories for obligations incurred in Category A (by time) and Category B (by program, project, or activity) for both Direct and Reimbursable New Obligations for the year ended September 30, 2018. Category A and Category B did not contain obligations exempt from apportionment in FY2018. The table below summarizes the apportionment categories. The summation of the categories is equivalent to the New Obligations and Upward Adjustments Line on the Combined Statement of Budgetary Resources (in thousands).

Note 10. Undelivered Orders - Unaudited

Undelivered Orders as of September 30, 2018 (in thousands):

	2018
Intragovernmental	
Unpaid	$ 291,668
Total Intragovernmental	291,668
Non-Federal	
Unpaid	571,206
Total Non-Federal	571,206
Total Undelivered Orders	$ 862,874

Undelivered Orders represent the amount of goods and/or services ordered to perform DLA's mission objectives, which have not been received. As of September 30, 2018, the DLA GF does not have paid intragovernmental and non-Federal undelivered orders.

Note 11. Reconciliation of Net Cost of Operations to Budget – Unaudited

Reconciliation of Net Cost of Operations to Budget for year ended September 30, 2018 is as follows (in thousands):

		2018
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations incurred	$	1,027,209
Less: Spending authority from offsetting collections and recoveries		(114,550)
Net Obligations		912,659
Other Resources:		
Transfers in/out without reimbursement	$	(776,420)
Imputed financing from costs absorbed by others		3,129
Other Temporary Timing Differences for Prior Period Adjustments for Correction of an Error		481,401
Net other resources used to finance activities		(291,890)
Total resources used to finance activities	$	620,769
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	$	(49,170)
Unfilled Customer Orders		11,372
Resources that fund expenses recognized in prior Periods		(1,190)
Other		295,018
Total resources used to finance items not part of the Net Cost of Operations		256,030
Total resources used to finance the Net Cost of Operations	$	876,799
Components Requiring or Generating Resources in Future Period:		
Increase in annual leave liability		210
Other		2,550
Total Components of Net Cost of Operations that will Require or Generate Resources in future periods		2,760
Components not Requiring or Generating Resources:		
Depreciation and amortization		-
Revaluation of assets or liabilities		59
Other net costs		(152,194)
Total Components of Net Cost of Operations that will not Require or Generate Resources		(152,135)
Total Components of Net Cost of Operations that will not Require or Generate Resources in the current period		(149,375)
Net Cost of Operations	**$**	**727,424**

The Reconciliation of Net Cost of Operations to Budget provides information on the total resources used by DLA, both those received through the budget and those received by other means. It reconciles the budgetary obligations incurred to the net cost of operations for a given reporting period. It articulates and details the relationship between net obligations from budgetary accounting and net cost of operations from proprietary accounting.

Below are the primary business events comprised in the lines titled, "Other":

- *Resources Used to Finance Activities* is comprised of DLA Military Construction (MILCON):
  - NAVFAC and USACE CIP transfers out.
  - Multi-year clean up initiatives performed by NAVFAC in FY2018 for resources used to finance DLA's CIP program. Amounts were recorded directly to the cumulative results of operations and are presented in Other Resources as Other Temporary Timing Differences for Prior Period Adjustments for Correction of an Error.

- *Components Requiring or Generating Resources in Future Period, Other* is comprised of DLA O&M Employer Contributions to Employee Benefit Programs Not Requiring Current- Year Budget Authority (Unobligated), Unemployment-Military Personnel Benefits, and Unemployment Compensation on behalf of the services and DLA.

- *Components not Requiring or Generating Resources, Other is* comprised of:
  - DLA MILCON - Cost Capitalization offset related to NAVFAC CIP.
  - DLA RDT&E - Cost capitalization related to IUS under development, primarily for Defense Agency Initiatives and Electronic Funds Distribution; offset by DoD Enterprise Business System (DEBS) Assets adjustments related to IUS in development.
  - DLA O&M - Cost capitalization related to IUS under development, related to DEBS Assets.

Required Supplementary Information (Unaudited)

This section includes the Combining Statement of Budgetary Resources by major budget accounts.

Combining Statement of Budgetary Resources (Unaudited)

The Combining Statement of Budgetary Resources combines the availability, status, and outlays of the DLA GF's budgetary resources for the fiscal year ended September 30, 2018. The following table provides the Combining Statement of Budgetary Resources disaggregated by GF programs.

Combining Statement of Budgetary Resources (In Thousands)
For the year ended September 30, 2018

	Operations and Maintenance	Procurement	Research, Development, Test & Evaluation	Family Housing	Military Construction	Total
Budgetary Resources:						
Unobligated balance from prior year budget authority, net (discretionary and mandatory)	$ 107,003	$ 10,446	$ 55,215	$ 1,102	$ 301,131	$ 474,897
Appropriations (discretionary and mandatory)	390,985	2,951	355,779	992	303,683	1,054,390
Spending Authority from offsetting collections (discretionary & mandatory)	20,501	-	39,276	-	-	59,777
Total Budgetary Resources	**$ 518,489**	**$ 13,397**	**$ 450,270**	**$ 2,094**	**$ 604,814**	**$ 1,589,064**
Memorandum (non-add) entries:						
Net adjustment to unobligated balance brought forward, Oct 1	$ (3,943)	$ 2,394	$ 16,277	$ 361	$ 2,021	$ 17,110
Status of Budgetary Resources:						
New obligations and upward adjustments (total)	$ 415,828	$ 10,931	$ 408,257	$ 1,100	$ 191,093	$ 1,027,209
Unobligated balance, end of year						
Apportioned, unexpired accour	3,935	259	35,303	-	396,615	436,112
Expired unobligated balance, end of year	98,726	2,207	6,710	994	17,106	125,743
Total unobligated balance, end of year	102,661	2,466	42,013	994	413,721	561,855
Total Budgetary Resources	**$ 518,489**	**$ 13,397**	**$ 450,270**	**$ 2,094**	**$ 604,814**	**$ 1,589,064**
Outlays, net:						
4190 Outlays, net (total) (discretionary and mandatory)	335,460	8,394	275,450	318	282,281	901,903
4210 Agency Outlays, net (discretionary and mandatory)	**$ 335,460**	**$ 8,394**	**$ 275,450**	**$ 318**	**$ 282,281**	**$ 901,903**

Audit Reports

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

November 14, 2018

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER, DOD
DIRECTOR, DEFENSE LOGISTICS AGENCY
INSPECTOR GENERAL, DEFENSE LOGISTICS AGENCY

SUBJECT: Transmittal of the Independent Auditor's Report on the Defense Logistics Agency General Fund Financial Statements and Related Notes for FY 2018 (Project No. D2018-D000FE-0092.000, Report No. DODIG-2019-024)

We contracted with the independent public accounting firm of Ernst & Young, LLC, (EY) to audit the Defense Logistics Agency (DLA) General Fund FY 2018 Financial Statements and related notes as of September 30, 2018, and for the year then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations. The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/President's Council on Integrity and Efficiency, "Financial Audit Manual," July 2008.[1] EY's Independent Auditor's Reports are attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amount within the DLA General Fund financial statements. As a result, EY could not conclude whether the financial statements and related notes were fairly presented in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the DLA General Fund FY 2018 Financial Statements and related notes.

[1] In June 2018, the Government Accountability Office issued an updated Financial Audit Manual. EY updated its audit procedures to be in accordance with the updates issued in the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency, "Financial Audit Manual," June 2018.

EY's separate report on "Internal Control over Financial Reporting" discusses seven material weaknesses related to the DLA's internal controls over financial reporting. Specifically, EY found material weaknesses including: Property, Plant, and Equipment; Fund Balance with Treasury; Accounts Receivable; Accounts Payable; Financial Reporting; Oversight and Monitoring; and Information Systems. EY's additional report on "Compliance and Other Matters" discusses two instances of noncompliance with applicable laws and regulations.

In connection with the contract, we reviewed EY's report and related documentation and discussed the audit results with EY representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we did not express, an opinion on the DLA General Fund FY 2018 Financial Statements and related notes, conclusions about the effectiveness of internal control, conclusions on whether the DLA's financial systems substantially complied with the "Federal Financial Management Improvement Act of 1996," or conclusions on whether the DLA complied with laws and regulations.

EY is responsible for the attached reports, dated November 14, 2018, and the conclusions expressed in these reports. However, our review disclosed no instances in which EY did not comply, in all material respects, with GAGAS.

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

Attachments:
As stated

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Report of Independent Auditors

The Director of the Defense Logistics Agency and
The Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the General Fund of the Defense Logistics Agency ("DLA"), which comprise the balance sheet as of September 30, 2018, and the related statements of net costs, changes in net position, and combined statement of budgetary resources for the year ended September 30, 2018, and the related notes to the financial statements ("financial statements").

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements*. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

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

Basis for Disclaimer of Opinion

DLA continues to have unresolved accounting issues and material weaknesses in internal controls that cause DLA to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on DLA's financial statements as a whole for the year ended September 30, 2018.

Disclaimer of Opinion

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

Other Matters

Required Supplementary Information

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

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise DLA's basic financial statements. The Other Information, as identified on DLA's Agency Financial Report Table of Contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Other Information, as listed in the Table of Contents, has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated November 14, 2018 on our consideration of DLA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering DLA's internal control over financial reporting and compliance.

Ernst & Young LLP

November 14, 2018

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

The Director of the Defense Logistics Agency and
The Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Office of Management and Budget ("OMB") Bullet No. 19-01, *Audit Requirements for Federal Financial Statements*, the financial statements of the General Fund of the Defense Logistics Agency (DLA), which comprise the balance sheet as of September 30, 2018, and the related statements of net cost, changes in net position, and combined statement of budgetary resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated November 14, 2018. That report states that because of matters described in the Basis for Disclaimer Opinion paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2018 and the related notes to the financial statements.

Internal Control over Financial Reporting

In connection with our engagement to audit the financial statements, we considered DLA's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of DLA's internal control. Accordingly, we do not express an opinion on the effectiveness of DLA's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 19-01. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 ("FMFIA"), such as those controls relevant to ensuring efficient operations.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Material Weaknesses

During our audit, we identified the following matters involving internal control over financial reporting and its operation that we consider to be material weaknesses as defined above:

I. Property, Plant, and Equipment (PP&E) – PP&E includes internal use software and construction-in-progress. We found that DLA does not have policies, procedures, and controls to identify the costs associated with the construction of assets in order to properly value the assets and has weaknesses in the processes of maintaining and reconciling PP&E records. Additionally, DLA has not completed an analysis of existence and completeness of PP&E records for which they are the financial reporting organization (FRO). The combination of these findings led us to conclude that there is a material weakness related to PP&E. The matters identified related to PP&E are further described in Appendix A.

II. Fund Balance with Treasury (FBwT) – DLA is unable to reconcile the FBwT ending balances from the general ledger directly to the U.S. Treasury. DLA, in conjunction with DFAS, has implemented the Cash Management Reconciliation (CMR) and Department 97 Report Reconciliation Tool (DRRT) processes as mechanisms to reconcile DLA's general ledger to Treasury. However, these tools have known control deficiencies and reconciling issues within the process. In addition, DLA does not have sufficient policies, procedures or controls in place for the end-to-end FBwT process. These deficiencies supported a conclusion of a material weakness in FBwT. The matters noted are further described in Appendix A.

III. Accounts Receivable (AR) – AR consists of amounts owed to DLA primarily related to providing services to other federal agencies. We found that DLA was unable to adequately support the balances included in the accounts receivable detail, lacks policies and procedures to properly identify valid unfilled customer orders, and had not adequately supported transactions recorded. The combined effect of these weaknesses led us to conclude there is a material weakness related to accounts receivable. The matters identified related to AR are further described in Appendix A.

IV. Accounts Payable (AP) – AP represents the amount owed to third parties by DLA for goods and services received, whether or not an invoice has been received. We found that DLA was unable to adequately support the accounts payable and related budgetary balances, had issues recording obligations and accounts payable in the proper period, and had inadequate accrual methodologies. Additionally, DLA lacked overall policies and procedures, as well as internal controls surrounding the creation and approval of the obligation, the review and recording of invoices, and the payment process. This combination of deficiencies is considered to be a material weakness. The matters identified related to AP are further described in Appendix A.

V. Financial Reporting – DLA's financial statement preparation process lacks sufficient, appropriate reviews to identify inaccurate balances on the face of the financial statements, as well as completeness and accuracy of disclosures. In addition, we found that DLA lacks policies and procedures to validate budgetary account balances and monitor budgetary reporting variances between source systems, resulting in DLA recording unsupported journal vouchers to correct the variances. We considered these deficiencies to be a material weakness. The matters noted are further described in Appendix A.

VI. Oversight and Monitoring – DLA does not have an effective OMB Circular A-123 program, which impacted DLA's ability to appropriately identify and address significant risks for all key business processes. DLA has not implemented appropriate internal controls, including the documentation of policies and procedures that describe DLA's environment related to end-to-end business processes, roles, and responsibilities, and monitoring of service providers, related parties, systems, risks, and controls. DLA's lack of documented controls prevent the consistent execution and proper review of data/reports used in the execution of key controls, as well as appropriate evidence of management review controls. We consider these overall weaknesses in the internal control structure to be a material weakness. The matters noted are further described in Appendix A.

VII. Information Systems – Our assessment of DLA's information technology (IT) controls and the computing environment identified deficiencies which collectively constitute a material weakness in the design and operation of information systems controls over financial data. We reviewed each finding individually, as well as in aggregate. Based on our review, we have identified four areas of deficiency which, when aggregated, result in a material weakness. The deficiencies relate to the following four areas:

- Access controls / user access
- Configuration management / change controls

- Segregation of duties controls
- Security management / governance over implementation of security controls

Refer to Appendix A for additional detail in these four areas.

Significant Deficiencies

During our audit, we also noted the following matters involving internal control over financial reporting and its operation that we consider to be a significant deficiency, as defined above.

I. Environmental liabilities (EL) – Environmental liabilities comprises clean-up costs associated with the restoration of sites on real property that DLA manages. The lack of formal policies, procedures and supporting documentation does not allow for DLA to substantiate the completeness and valuation of its EL. The matters identified related to EL are further described in Appendix B.

DLA's Response to Findings

DLA's response to the findings identified in our engagement, as described above, is included in its letter dated November 14, 2018, which has been included at the end of this report. DLA's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it. The status of prior year instances of deficiencies is presented in Appendix C.

Purpose of this Report

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

Ernst & Young LLP

November 14, 2018

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Appendix A – Material Weaknesses

Property, Plant and Equipment

Property, plant, and equipment (PP&E), comprise internal use software and construction-in-progress (CIP). In this audit of DLA, we found that DLA was not able to adequately support the existence, completeness, rights and obligations, or valuation of its PP&E.

DLA lacks policies, procedures, and controls to verify the existence and completeness of internal use software (IUS) due to:

- DLA does not have documented policies and procedures in place to perform an inventory of IUS assets on a consistent basis. Unlike performing an inventory of physical assets, the existence of IUS is validated by verifying that the software functionalities and/or objects are still in use. DLA policy requires that the inventory is performed on 10% of the population each month. However, DLA does not comply with the policy on a consistent basis.
- DLA has not designed adequate internal controls to identify when assets are completed and should be placed in service. DLA policy states that IUS assets are recorded as in-service PP&E upon the completion of the asset. However, DLA does not have a process in place to ensure that completed assets are placed in service in the correct period.

DLA lacks policies and procedures to review the construction-in-progress (CIP) balance due to:

- Policies and procedures are not in place to ensure that the information reported directly by the construction agent and used for financial reporting is reviewed by DLA, resulting in the potential for a significant number of inactive projects to be reported by the construction agent and recorded in the financial statements. DLA sub-allots funds to construction agents for construction projections which DLA is authorized to perform. The funds are tracked separately by each construction agent and reported to the Defense Finance and Accounting Services (DFAS) directly by each construction agent. These amounts are then reported in DLA's financial statements.

DLA is unable to provide supporting documentation to substantiate construction-in-progress (CIP), including beginning balances:

- Supporting documentation is not available or insufficient to substantiate the CIP assets, including beginning balances.

DLA was unable to substantiate the values assigned to IUS assets are in accordance with Federal Accounting Standards Advisory Board (FASAB) Statements of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software.*

- DLA was unable to substantiate the beginning balances assigned to a significant amount of the IUS. The documentation was not retained or available to determine whether the values recorded were in accordance with SFFAS No. 10.
- DLA was unable to substantiate the in-service date of the IUS assets, which is the basis for the asset amortization. The documentation, such as the evidence demonstrating that the asset was tested and accepted, is not retained or available.

DLA has not appropriately designed controls to adequately detect material misstatements in the financial statements:

- DLA has not designed and implemented sufficiently precise management review controls, including outlining the specific procedure required to evidence that the controls were performed. DLA's control activities include a significant number of management review controls. Management review controls are normally designed to detect and correct errors, whereby the reviewer determines whether information is complete and accurate, accounting is appropriate, and potential errors or misstatements. The internal control activities over PP&E are not sufficiently designed to prevent or detect material misstatements in the financial statements.

DLA lacks policies and procedures to identify and assess lease arrangements and to properly account for lease obligations and disclose lease commitments, in accordance with FASAB SFFAS No. 5, *Accounting for Liabilities of the Government; Capital Leases,* and SFFAS No. 6, *Accounting for Property, Plant, and Equipment.*

- DLA has not completed procedures to identify all of its leasing arrangements, including assessing whether the leasing arrangements should be accounted for as a capital or operating lease.
- The financial statements do not include disclosures for its policy to account for lease arrangements; any operating lease commitments; and future minimum payments due.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:

- Update the IUS process memos and standard operating procedures to adequately describe the policies and procedures in place to inventory IUS assets.

- Design and implement policies and procedures that require for adequate documentation to be maintained that evidences how DLA verifies the asset is still in use and that the listing of the IUS assets is complete.
- Design and implement policies and procedures that ensures the IUS assets are recorded in the appropriate period. This includes reviewing a complete and accurate list of all projects that have successfully completed end user testing and verifying that the projects have been recorded in EBS as active IUS assets.
- In the short-term, DLA should design and implement a review control that allows DS project management personnel to review the amounts reported by the constructions agents in sufficient time for DLA to adjust the amounts reported in their financial statements based on this review.
- In the long-term, DLA should pursue a solution where CIP transactions can be recorded in EBS when they occur.
- Obtain and maintain all supporting documentation (invoices, contracts, project management reports) related to the CIP projects from the construction agents to substantiate the balances recorded for those projects.
- Retain all documentation related to CIP projects in a central repository and organize them for the purposes of determining project status and supporting the value of the projects.
- Design a process where CIP transactions can be recorded in EBS when they occur.
- Design and implement policies and procedures that allow DLA Installation Management Project Management personnel to review, at least quarterly, the status of projects recorded as CIP, invoices, project management reports, and contracts to ensure that all documentation agrees with activity related to the CIP project.
- Design and implement policies and procedures to perform a reconciliation for the construction-in-progress U.S. Standard General Ledger (USSGL) accounts and agree the amounts recorded in EBS to the invoices, project status reports, and other documentation to substantiate the balances as of the financial statement date.
- Design and implement policies and procedures to perform a reconciliation for the USSGL accounts related to providing sub-allotments to its construction agents. This should include the military construction (MILCON) program form (DoD Form 1390) for the fiscal year, the National Defense Authorization Act (NDAA) budget execution, and the receipt of allocated funds from the Office of the Secretary of Defense (OSD) based on the NDAA request.
- For any construction agents that receive independent audits of account balances and transactions facilitated by the construction agents on DLA's behalf, consider how the scope and results of those reports should be incorporated into DLA's policies and procedures.
- Adopt a policy to prospectively capitalize IUS assets, as described in SFFAS No. 50*: Establishing Opening Balances for General Property, Plant, and Equipment.* SFFAS No. 50 permits the exclusion of IUS and IUS under development from the opening balance as of the opening balance date.

- Design and implement policies and procedures to ensure that DLA maintains sufficient supporting documentation to demonstrate that its IUS expenditures are appropriately capitalized, in accordance with SFFAS No. 10.
- EY recommends that DLA undertake the following corrective actions for the conditions noted:
  - Design and implement policies and procedures for the monitoring of completion of IUS assets that DLA is developing for other agencies.
- Design and implement policies and procedures to ensure that the performance of review controls are adequately documented and supported by evidential matter.
- Develop a central repository to retain evidence of control performance and management review.
- Design and implement policies and procedures that include variance thresholds to ensure that the review of significant financial data is precise.
- Design and implement policies and procedures that detail the related documentation and evidential matter to be inspected as part of the review.
- Complete analysis of their leases to determine if DLA has entered into any leasing arrangements that should be accounted for and reported as a capital lease.
  - Design and implement policies and procedures to identify and account for leasing arrangements including whether the leases should be accounted for and reported as capital or operating leases, in accordance with SFFAS No. 6.
  - Develop policies and procedures to review all leasing arrangements to gather the information necessary to prepare and include the required disclosures for capital and operating leases in the financial statements, in accordance with OMB A-136.
  - Consider the impact that SFFAS No. 54, *Leases: An Amendment of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment* will have on these policies when the guidance goes into effect.

Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in DLA's account with Treasury. Through our audit procedures, we identified deficiencies related to DLA's processes of recording and reconciling transactions involving Fund Balance with Treasury.

DLA is unable to reconcile FBwT from general ledger directly to the U.S. Treasury:

- DLA, in conjunction with DFAS, has implemented the Cash Management Reconciliation (CMR) and Department 97 Report Reconciliation Tool (DRRT) processes as mechanisms to attempt to tie EBS to the Treasury. However, the CMR and DRRT processes are not sufficient to produce a complete and accurate reconciliation of DLA's general ledger to U.S. Treasury. There are known differences between CMR and Treasury.

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- DLA lacks policies and procedures to research and resolve differences between Treasury, disbursing system records, and accounting system records within a timely basis. The DRRT report contains transactions that are aged over 60 days, including transactions that are aged over 3 years.
- DLA did not perform the FBwT beginning balance aging analysis required by the Department of Defense (DoD) Financial Management Regulation (FMR).

DLA lacks sufficient policies, procedures, and controls around the end-to-end FBwT process:

- DLA, in conjunction with DFAS, does not have controls to identify FBwT transactions related to DLA and to determine the amounts recorded in suspense accounts. As of June 2018, which is the only data available as of the date of the report, there are currently \$6.5 billion of transactions recorded in suspense across the Department of Defense. DLA, in conjunction with DFAS, is unable to identify which transactions belong to DLA.
- DLA has not finalized the FBwT process narrative or systems flow to document the flow of data through DLA and DFAS systems from the initiation of a transaction to reporting in the financial statements, the key stakeholders within the process, or the flow of data between stakeholders. Additionally, DLA has not identified risks and controls for the end-to-end FBwT process.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Work with DFAS to obtain a system and organization controls report for the CMR performed by the Defense Finance Accounting Service in order to obtain assurance on whether the CMR process is complete and accurate.
- Work with DFAS to obtain a system and organization controls report for the DRRT process performed by the Defense Finance Accounting Service-Columbus in order to determine whether the controls in place are operating effectively.
- Work with DFAS to establish a process, including a key control, for DLA to monitor the status of significantly aged unreconciled transactions in both the CMR and DRRT processes on a frequent basis.
- Design and implement an internal control procedure to reconcile the transactions recorded in EBS to the transactions sent to Secure Payment System (SPS) in order to verify the data was processed correctly.
- Work with DFAS to create an updated policy and procedure for the DRRT process that addresses issues of maintaining sufficient evidential matter to support ongoing remediation efforts on undistributed transactions.

- Develop policies and procedures to establish DLA's involvement in monitoring undistributed funds and assisting DFAS with the research and the clearing process.
- Assign an FBwT point of contact for DLA in order to assist in communications that relate to FBwT such as the DRRT process.
- Work with DFAS to implement a deadline for resolving errors identified as part of the performance of key controls from the FBwT process cycle memorandum (PCM) and maintain documentation of the research performed to resolve the error.
- Work with DFAS to ensure processes are in place to assign, track, age, research, and resolve differences between Treasury, disbursing system records and accounting system records, as prescribed by Treasury, at the voucher level detail on a monthly basis and clear all differences within 60 days, with the exception of budget clearing account differences that have been identified by Treasury as exempt from the 60-day requirement.
- Finalize a standard operating procedure or process cycle narrative that documents the end-to-end process for FBwT, including the initiation, recording, processing, and reporting of FBwT transactions.
- Finalize a standard operating procedure or process cycle narrative that documents the policies and procedures that the Defense Logistics Agency has in place to monitor the CMR and DDRT produced by the Defense Finance and Accounting Services. The standard operating procedure or process cycle narrative should include all key controls, process owners, data interfaces and Federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used for the FBwT process.
- Designate a DLA point of contact responsible for overseeing the FBwT process, understanding the complex process flow as well as key risk points as well as communication with DFAS.
- Establish frequent communication between DFAS and DLA to accurately understand the processes that are performed at each in order to create a comprehensive and cohesive FBwT PCM that accurately reflects the procedures, policies, and internal controls.
- Develop a comprehensive risk assessment that encompasses the risk, policies, and procedures that are performed by DLA and DFAS as part of the Fund Balance with Treasury process, and ensure that the information recorded in the risk assessment is accurate.
- Complete all steps required by the Department of Defense 7000.14-R Financial Management Regulation Volume 4 Chapter 2 Annex 1 to support the fund balance brought forward (i.e. beginning balances).
- Prepare supporting documentation to demonstrate the completion of the steps required by the FMR and demonstrate that the documentation was reviewed and approved.
- Perform regular and recurring reconciliations of the suspense account data and remediate any deficiencies that impact the accuracy of the balances.
- Should develop an estimate using relevant, sufficient, and reliable information to record the consolidated DLA suspense account balances on DLA's financial statements.

- Develop policies, procedures, and internal controls to assist in the research and identification of transactions recorded in suspense to assign them to the appropriate agency and to DLA.
- Establish controls requiring the review of the Treasury Reporting Operations Accountant's reconciliation before submission of the Treasury Tape.
- Establish policies that require variances to be resolved before submission of the Treasury Tape and policies and procedures to address the suspense account transactions within a reasonable time frame to prevent a misstatement.

Accounts Receivable

Accounts receivable (AR) consists of amounts owed to DLA and falls within the scope of DLA's order to cash process. Because of the nature of their services, DLA has a significant volume of transactions in the order to cash process. This balance represents a substantial portion of General Fund (GF) activity that involves receipt of funds by DLA in order to provide services to their ultimate consumers. The volume of these transactions makes it a critical function for DLA to properly record and reconcile these transactions to assure timely appropriate recognition of costs to the end users.

DLA lacks policies and procedures to properly identify valid unfilled customer order (UCO) transactions in EBS:

- DLA is unable to provide the supporting UCO detail that reconciles to EBS. Further, DLA was unable to provide documentation to support the activity in EBS.
- DLA is unable to substantiate the existence and completeness of UCO transactions in EBS due to an interface error between the module and EBS. Additionally, DLA does not have sufficient policies and procedures in place to identify, research, and resolve unreconciled amounts.
- Policies and procedures are not in place to review the validity of significantly aged UCOs. Policies and procedures are not in place to ensure that inconsistencies in UCOs are identified and reviewed and dated orders are investigated.

DLA is unable to substantiate the occurrence and completeness of sales transactions due to:

- DLA is unable to provide supporting documentation that can substantiate revenue recorded occurred and is complete. Supporting documentation consists of screen shots from EBS and other internal financial systems that do not evidence that the sales transaction occurred with a third party.

DLA is unable to substantiate the existence and completeness of their accounts receivable balances due to:

- DLA is unable to provide supporting documentation to substantiate the existence and completeness of accounts receivable balances.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:

- Continue to investigate and attempt to resolve the legacy posting differences between the EBS general ledger and the EBS Sales and Distribution (S&D) module. Create standard operating procedures for the reconciliation of the EBS trial balance and EBS S&D module and associated adjusting JV to ensure properly designed reconciliations are performed in a timely manner.
- Establish and implement the policies and procedures to review the aging of UCO balances. DLA should perform and document procedures to assess the validity of the UCO balances. This assessment should include DLA's policies regarding cancelling invalid orders, management's key assumptions regarding UCOs, and an evaluation of the reasonableness of these key assumptions. These policies and procedures should consider the budgetary and proprietary impact on DLA's GF financial statements.
- Develop a process to timely produce supporting evidential matter for revenue transactions, including, but not limited to sales invoices, shipping documents, contracts, material acknowledgement receipts, and other supporting evidence. Evaluate current policies and procedures against practices within DLA to identify the root cause(s) of conditions. Identify key gaps and inconsistencies in current procedures versus field implementation. Based on the evaluation, perform updates to identified policies, procedures, desk guides, and/or accounting manuals to completely and accurately reflect current key processes as well as provide clarification/updates to areas where differences between policy and implementation are noted.
- Consider providing trainings and implementation guidance on any current and/or new/updated procedures where issues were noted to ensure consistent application of procedures. Consider increasing communication between DLA headquarters and process owners to ensure sufficient, complete documentation is provided as part of documentation requests. After processes have been evaluated and procedures have been updated, as needed, implement and/or strengthen review procedures to ensure key controls are being performed and that there is evidence of the controls. DLA should evaluate individual issues identified in the condition above and perform corrective action, as needed, to ensure identified samples have required supporting documentation.

Accounts Payable

Accounts payable (AP) consists of amounts owed to vendors and falls within the scope of DLA's procure to pay process. Because of the nature of the services, DLA has a significant volume of transactions to procure goods and services to sell to its customers. Through our audit procedures, we determined that DLA was unable to adequately support the accounts payable and related budgetary balances. Further, DLA had issues recording obligations and accounts payable in the proper period, as well as issues with having inadequate accrual methodologies. Additionally, DLA lacked overall policies, procedures, as well as internal controls surrounding the creation and approval of the obligation, the review and recording of invoices, and the payment process.

DLA was unable to adequately support the accounts payable and related budgetary balances:

- DLA is unable to substantiate accounts payable and undelivered orders due to:
    - Supporting documentation was not provided or provided in a timely manner to substantiate the samples tested from the following accounts:
        - Accounts payable
        - Negative payables
        - Undelivered orders, unpaid
        - Upward/downward adjustments of undelivered orders
        - Upward adjustments of delivered orders
    - Goods and/or services received as of year-end were not recorded as an expense/asset and not applied to the undelivered order balance.
    - Upward/downward adjustment related to the prior year were not recorded in the correct period.
- DLA is unable to demonstrate obligations were approved by an authorized official or were approved before the contract was awarded, and is unable to substantiate the validity of recorded good receipts.

DLA does not have policies and procedures to record obligations and liabilities incurred accurately and in the proper period:

- DLA records obligations and liabilities incurred in the incorrect period.
- DLA does not have sufficient internal controls to ensure outbound military interdepartmental purchase requests (MIPR) obligations are created within Enterprise Business System (EBS) in a timely manner.
- DLA does not have a complete and accurate accounts payable accrual policy for outbound MIPR transactions. DLA applied the straight-line method to calculate the accrual amount. DLA did not perform any assessment to determine whether this is an appropriate

methodology. Particularly, for MIPRs that do not have a fixed monthly cost, the straight-line method is not appropriate.

DLA does not adhere to the Treasury Financial Manual USSGL posting logic:

- A general ledger account is inappropriately being used to track accounts payable activities. DLA uses negative payables to track outstanding goods receipt and to prevent inventory from showing as available for distribution when the items are not physically available. The related posting logic is not recording assets or expenses at the appropriate point in time. In addition, an undelivered order, paid is recorded for these transactions, but the proprietary entry for the payment made in advance is not recorded.

DLA does not comply with the Federal Financial Management Improvement Act due to the following:

- Transactions were not recorded at the detailed transaction level. DLA recorded transactions at a summary level for certain budgetary and proprietary accounts. As a result, each EBS summary level record contains multiple individual transactions.
    - Transactions are posted in detail to the Fund Balance with Treasury (FBwT) account, but summarized when posting to the other proprietary and budgetary accounts. A reconciliation is not performed to ensure that all detailed transactions posted to the FBwT agree to the summarized postings and to the corresponding budgetary general ledger accounts.
    - Additionally, budgetary accounts (obligations, expenses, payables) are not tied to the FBwT transactions and are posted in summary within the general ledger.

DLA lacks policies, procedures and controls in the accounts payable process, including the process to create and approve obligations and the process to review, record, and pay invoices due to the following:

- DLA does not ensure that each obligation was approved by an authorized official, nor was the obligation document approved prior to receiving goods or services.
- DLA does not have internal controls, policies, and procedures in place to ensure MIPR information is accurately entered into EBS. There is a risk of misstating the obligation

balance as the purchase order cannot be closed out in timely manner because the delivered date is not accurate.

- DLA does not have adequate controls to ensure invoices were reviewed by authorized personnel.
- DLA does not have adequate policies and procedures to ensure that invoices are paid in a timely manner and interest penalties paid for these late payments to mitigate the risk of noncompliance with the Prompt Payment Act.
- DLA's controls for the proper approval of invoices, receiving reports, and purpose, time, and amount for the following accounts were not operating effectively: accounts payable, negative payables, and expense accounts.
- DLA's control for the government purchase card expenditure approval was not operating effectively, for the following reasons:
    - The Approving/Billing Official (A/BO) has the ability to approve the monthly statement in US Bank Access Online and certify that statement for payment without any secondary review.
    - When the government purchase card holder (GPCH) is not available to reconcile purchase card transactions to the statement, the A/BO has the authority to perform the reconciliation and prepare the form 1901 (Request for Purchase).
    - The A/BO can approve the GPC monthly bill in U.S. Bank Online for payment.

DLA does not have effective internal controls to ensure that unliquidated orders (ULO) are cleared in a timely manner:

- DLA does not have adequate controls to ensure invalid undelivered orders (UDOs) were closed in a timely manner. In our testing, we found purchase orders that were significantly aged, including a purchase order that was open for approximately one (1) year prior to being closed.
- DLA does not have policies and procedures in place to manage stale payables/obligations:
    - A timely review and monitoring is not performed for the following account balances:
        - Negative payables – There is a significant number of aged transactions that may no longer be valid.
        - Undelivered orders (UDO), unpaid – There is a significant volume of UDOs that had no activity.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Evaluate current policies and procedures against practices in the field to identify the root cause(s) of conditions. Identify key gaps and inconsistencies in current procedures versus field implementation.
- Based on the evaluation, perform updates to identified policies, procedures, desk guides, and/or accounting manuals to completely and accurately reflect current key procure to pay processes as well as provide clarification/updates to areas where differences between policy and implementation are noted.
- Consider providing trainings and implementation guidance on any current and/or new/updated procedures where issues were noted to ensure consistent application of procedures including:
    - Ensure procure to pay process owners' document detailed explanation (i.e. cause, impact) for discrepancies or missing documentation.
    - Ensure documentation standards are clear including supporting documentation that is complete, accurate, and prepared timely.
    - Ensure process owners understand key supporting documentation.
- Consider increasing communication between DLA headquarters and process owners to ensure sufficient, complete documentation is provided as part of documentation requests.
- After processes have been evaluated and procedures have been updated, as needed, implement and/or strengthen review procedures to ensure transactions are recorded accurately and timely and process owners can obtain and provide supporting documentation for the transactions.
- Write off residual accounts payable for paid and completed transactions. EY recommends that DLA removes activity from the general ledger detail that were completed in prior years. DLA should monitor the UDO balances and identify stale UDOs for de-obligation. DLA should examine account balances on the balance sheet and statement of budgetary resources to determine the magnitude of aged balances by account.
- Perform an analysis of transactions posted at or near year-end to determine the overall significance of the issue across all general ledger accounts. Based on this analysis, perform corrective action on incorrect transactions, as necessary.
- Implement and/or enhance DLA's year-end process, including key controls, for monitoring potential business events that will need to be entered into the general ledger prior to year-end close.
- Update policies and procedures to document year-end processes for identifying, monitoring and recording transactions prior to financial statement close.
- Discontinue the use of the negative payable account. In addition, DLA should develop, test, and implement a process to ensure that all transactions related to proper recording and reporting for expenses and inventory items are in compliance with the Treasury Financial Manual (TFM) USSGL postings at the transaction level. This would include developing an entity wide standard process and procedure of identifying the financial events that requires the recognition of an account payable based on standard accounting guidance (Ex. Treasury Financial Management Service [FMS] USSGL guidance - Recognition of a Liability). EY

further recommends, that once the new procedures are in place, stakeholders are educated on the new process. EY further recommends that any process, procedure, or policy documentation for accounts payable be updated to reflect the use of the asset or expense accounts instead of the negative payable accounts.

- Implement and maintain financial management systems that comply substantially with Federal Financial Management Systems requirements and the United States Government Standard General Ledger at the transaction level. DLA should establish a process that reconciles the transaction level detail to the summarized postings in each account.
- Update existing internal control documentation to accurately describe the process and identify key internal controls over financial reporting.
- Monitor, review, and validate whether controls are operating effectively on an on-going basis.
- Update existing internal control activities to produce evidence that the control occurred (e.g. signature) after the control is executed.
- Implement limiting the A/BO to one key role of either approving government purchase card (GPC) purchases on DLA form 1901 or approving payments of the GPC monthly bill in U.S. Bank Online. If DLA is unable to properly segregate the duties, DLA should require a secondary reviewer as a mitigating factor to approve the monthly bill or approving the form 1901.
- Perform root-cause analysis to determine the risk areas and develop and implement the following:
    - An accounts payable accrual methodology that adequately considers the nature of the liabilities incurred, data validation to ensure the data used in determining the accrual balance is appropriate, and periodic review to assess whether the established methodology is still valid.
    - Process narratives, policies, and procedures to ensure obligations are recorded in a timely manner.
    - Process narratives and internal controls to ensure liabilities are recorded in the period incurred and costs are accurately recorded; develop and implement processes and internal controls to ensure invoices are reviewed by authorized personnel; and obligations are approved by authorized officials and are approved prior to receiving goods or services.
    - Processes and internal controls to ensure accurate data is captured in the system.
    - Controls to ensure invoices are paid in a timely manner or interest penalty is paid when payments are made late.
    - Processes and internal controls to ensure that:
        - Obligations are recorded accurately to include good receipts are recorded in a timely manner and funds are de-obligated within a reasonable time.
        - Obligations are approved by authorizing official prior to the award, good receipt are fully supported, and appropriate supporting documentation are retained.

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- Perform an analysis of transactions posted at or near year-end to determine the overall significance of cutoff issues related to upward/downward adjustments across all general ledger accounts. Based on this analysis, perform corrective action on incorrect transactions, as necessary.

Financial Reporting

Financial reporting encompasses all aspects of operations affecting DLA's ability to produce reliable financial statements and disclosures. This process starts with establishing an effective governance structure to identify and assess risk and continues with developing a control environment that is effective and efficient to manage identified risks. Through our audit procedures, we identified a number of deficiencies in DLA's processes related to the accumulation and presentation of their financial position and results of operations.

DLA does not have sufficient policies and procedures in place around the implementation and monitoring of the Enterprise Business Systems (EBS):

- DLA is unable to adequately demonstrate that business events are linked to the correct posting logic.
  - In DLA's posting logic reference book, which was manually generated, there are multiple scenarios associated with the same transaction description and SAP T-Code (i.e., EBS document type).
  - In DLA's posting logic reference book, there is no attribute or data field to indicate the type of transaction posting in EBS. Therefore, DLA is unable to crosswalk the reference book to the EBS.
  - DLA is unable to produce a compliant posting logic reference book directly from EBS.
- DLA does not have any monitoring or review controls in place to ensure that EBS posting logic is configured in accordance with the United States Standard General Ledger (USSGL).

DLA does not have sufficient controls in place to validate and monitor that EBS proprietary general ledger accounts agree to budgetary general ledger accounts:

- DLA has known reconciliation issues between budgetary and proprietary tie points. Based on walkthrough procedures performed, EY observed that the DFAS posts an unsupported quarterly journal vouchers (JVs) in Defense Departmental Reporting System (DDRS) to ensure DLA's budgetary accounts reconcile to the proprietary accounts.

DLA does not have sufficient controls in place around the quarterly reconciliation of EBS to the financial statements:

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- DLA does not perform a sufficient monthly or quarterly unadjusted trial balance (UTB) to adjusted trial balance (ATB) reconciliation.
    - DLA uses data pulled out of DDRS as a starting point for the reconciliation instead of using data directly pulled from EBS.
    - DLA lacks controls to validate the completeness and accuracy of the data and reports used to create the reconciliation.
    - Lack of a complete master listing of files used within the reconciliation, including the source system, parameters used to generate the report, etc., and the purpose of each file.
    - Lack of a review to ensure that feeder files and adjustments are valid and agree to supporting documentation.
    - DLA lacks controls to verify that the crosswalk from EBS to DDRS is complete and accurate.
- DLA does not perform the quarterly UTB to ATB reconciliation in a timely manner.
    - DLA does not perform the reconciliation until after the quarter-end as well as fiscal year-end has been closed.
    - Per the standard operating procedures (SOP), DFAS should provide DLA the data files needed for the reconciliation five (5) days after quarter/year-end close. However, the reconciliations are completed approximately two months subsequent to quarter-close.

DLA does not perform a sufficient review of monthly and quarterly adjustments and JVs made by DLA and DFAS:

- DLA does not have a comprehensive listing of adjustments that occur in DDRS including:
    - The source of each file and parameters used to generate JV logs/files.
    - The required files or reports needed from DFAS to support each adjustment as well as the parameters of each file or report.
    - The rationale or business purpose for each adjustment and the evidential matter to support the amounts.
- DLA does not review each type of adjustment and feeder files to determine completeness, accuracy, validity, and impact of information posted to DLA's financial statements.
    - In several cases, prior year adjustments were used in the reconciliation of the DDRS – Budgetary (DDRS-B) unadjusted trial balance (UTB) to the DDRS-B adjusted trial balance (ATB) that did not have evidence of review by DLA.
    - Trial balance input adjustments occurred during the interface of DDRS-B to DDRS – Audited Financial Statements (DDRS-AFS) that were not reviewed by DLA.
- DLA relies on DFAS to make various adjustments that are maintained within DDRS-B versus making the corrective updates within EBS.
    - Within the quarterly reviews, prior year adjustments were used as offsetting entries to the current year adjustments.

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- DLA does not perform a reconciliation in a timely manner to allow for adjustments to be reviewed prior to the generation of the financial statements.
- DLA has not completed the remediation of the trading partner elimination process which was scheduled to be completed in fiscal year (FY) 2018. EY noted the following during FY 2018:
    - Supporting documentation to reconcile the variances between DLA and trading partners is not obtained timely.
    - DLA relies on contractor maintained software tools to determine the balances for trading partners. There is no evidence that DLA assesses the completeness or accuracy of data input or output from this tool.
    - Adjustments made to accounts receivable, accounts payable, revenue, expenses, and undisbursed funds are not appropriately supported.
- DFAS performs quarterly elimination adjustments to DLA's financial statements for both waived and non-waived entities.
    - EY observed that there is not a complete reconciliation at the agreement level to the trading partner adjustments that are being made. Trading partner adjustments are recorded in DDRS-AFS as "top-side" adjustments and are identified as "unsupported" by DFAS.

During EY's review of the third quarter (Q3) FY18 and fourth quarter (Q4) FY18 financial statements and footnote disclosure, we determined that level of review performed was insufficient to detect and correct misstatements in the financial statements and related disclosures:

- Inaccurate balances reported in the financial statements and notes.
    - Line items were not appropriately broken out between federal and non-federal.
    - DLA excluded the funds executed by the United States Army Corps of Engineers through Q3 FY18, which is material to the General Fund financial statements.
    - Supporting documentation did not adequately support the balances recorded in the notes.
    - DLA is unable to fully prepare financial statements in conformity with U.S. generally accepted accounting principles (GAAP) due to limitations of the financial and nonfinancial management systems and processes that currently support the financial statements and described in Note 1 Significant Accounting Policies.
    - DLA does not present comparative financial statements.
- Lack of complete and accurate disclosures.
    - Note 1 Significant Accounting Policies (SAP) did not completely and accurately summarize the accounting principles and methods of applying those principles.
    - Note 1 SAP did not appropriately disclose management's judgments relevant to valuation, recognition, and allocation of assets, liabilities, expenses and revenues.

- Note 1 SAP did not sufficiently describe changes or non-compliance in GAAP reporting.
- DLA currently does not have policies and procedures providing an end-to-end process for identifying contingent legal liabilities.

DLA does not have sufficient controls in place to reconcile budget authority received:

- DLA does not have adequate policies, procedures, and internal controls over the receipt of funding.

DLA does not have a process in place to validate budgetary beginning balances:

- DLA did not perform procedures to verify the accuracy of the beginning balance in general ledger (GL) account 4201, Total Actual Resources Collected.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Evaluate EBS posting logic and evidential matter to ensure system posting logic is configured in compliance with USSGL and DoD Standard Financial Information Structure (SFIS).
- Evaluate EBS system capabilities and provide a system-generated mapping report which ties EBS configured posting logic to EBS transaction codes, movement types, and USSGL/DoD transaction numbers.
- Document clear descriptions of business events and varying circumstances that impact or change the posting logic.
- Document transaction descriptions based on the EBS document type to identify the type of transactions within the EBS universe of transactions.
- Implement monitoring or review controls to ensure EBS transactions are being posted as intended.
- Analyze and investigate the known budgetary to proprietary tie point variances at a business process level to determine the root cause.
- Assess the current policies and procedures around the budgetary to proprietary reconciliations including the design of key controls in the process. DLA should design a control that focuses on addressing the root cause of the variances in order to resolve current underlying issues as well as prevent future variances.
- Evaluate the process for reviewing the budget to proprietary (B2P) tie-points, including who should be performing the review, timing of the review and at what level the review

should occur, in order to ensure variances are being researched and resolved in a timely manner.

- Evaluate the current process for reconciling the UTB to the ATB:
  - Identify areas to create efficiencies through automating the process.
  - Consider other reconciliation options to design a reconciliation that is performed in conjunction with the production of the DDRS-AFS trial balance and not subsequent to the production.
  - Consider the design of the reconciliation and ensure that data is being pulled from the proper sources to ensure completeness and accuracy of data interfaces.
  - Consider documenting the list of reports generated by DFAS and the specific parameters used to generate the reports.
- As a part of the Manager's Internal Control Program (MICP), assess the risks associated with the process to generate the financial statements, including the complexity, extent of manual processes, decentralization, and reliance on third party data. Based on the assessed risks, determine if sufficient policies, procedures and controls are in place to address risks related to the compilation of the financial statements.
- Evaluate the current support agreement with DFAS to determine if the agreement sufficiently documents roles, responsibilities, communications and timelines needed to support DLA's reconciliation requirements.
- Evaluate the policies and procedures in place over the financial reporting process including the specific roles of DLA and DFAS:
  - Document the list of reports generated by DFAS and the specific parameters used to generate the reports.
  - Include a control(s) for reviewing all the files that are used to adjust the ending balances within EBS in the creation of the adjusted trial balances.
  - Document the business need for adjustments and the appropriate evidential matter required to support adjustments.
- Evaluate current quarterly adjustments and prior year adjustments to determine if the adjustments recorded in DDRS-B could be eliminated by making the adjustments within EBS.
- Evaluate the quarterly trading partner adjustments and design controls and a process to perform a reconciliation at the agreement level.
- Implement additional controls for the agreement level reconciliations with DLA trading partners and develop a process for resolving variance at the agreement level in a timely manner.
  - Evaluate system capabilities to include recording and monitoring transactions at the trading partner and agreement level.
- Finalize updated policies and procedures for identifying, researching and reconciling variances between DLA general ledger data and trading partners. Include considerations for:
  - Review of appropriate classification between federal and non-federal.

  - Review impact on both proprietary and budgetary general ledger accounts.
- Work with DFAS and OSD as necessary to continue to resolve issues with trading partners at the department level.
- Evaluate all components of OMB-136 and recent accounting pronouncements and determine if disclosures are complete, accurate and compliant. Incorporate updates to footnotes as necessary.
- Evaluate the supporting documentation being utilized in the review of each footnote and consider developing procedures to:
  - Assess adjustments impacting the footnote disclosures.
  - Review changes between fiscal years and determining the procedures necessary to support the change.
- Re-assess review controls associated with the financial statement review process and consider including:
  - A review of revised OMB-136 requirements to ensure updated guidance is evaluated and incorporated in a timely manner.
  - Other reviews by business process areas to ensure disclosures are complete, accurate, and compliant. These reviews should ensure that footnote disclosure are consistent with business activity occurring throughout the year.
  - Design and document standard operating procedures to ensure that the beginning balance for carry forward budgetary accounts are accurately stated.
- Provide training to ensure timely review and certification of monthly reconciliations.
- Implement validation checks within spreadsheets used to compile the monthly summary reconciliations to ensure grand totals are calculated correctly.
- Update the summary reconciliation to identify variances between the totals obtained from the various source documents used to complete the reconciliation.
- Redesign the summary reconciliation review process to be sufficiently precise and identify formula errors.
- Update the Funds Management PCM to include policies and procedures outlining the timelines to follow up on variances noted in the reconciliation process, including coordination with DFAS to resolve variances on the summary reconciliations when identified.
- Develop policies, procedures, and internal controls to reconcile the Consolidated Appropriations Act, the DD1414 received from Office of the Under Secretary of Defense – Comptroller (OUSD-C), and the funding authorization document (FAD).
- Obtain and retain supporting documentation for changes in the funding that exceed the allowable threshold per the FMR. This includes but is not limited to:
  - Form DD1415/Form DD1416.
  - Evidence of congressional approval for reprogramming from OUSD-C.
- Establish monitoring controls to monitor changes in funding made by OUSD-C.
- Obtain a system and organization control report (SOC-1) on funds management processes and controls in place at OUSD-C that impact DLA's funding.

- Develop and implement internal controls, along with policies, procedures, and end-to-end process cycle memorandums, as appropriate, to identify and estimate contingent liabilities related to litigation. In addition, DLA should include procedures to identify, assess, and disclose unasserted claims.
- An assessment of current checklists used in the financial reporting process to determine if checklists need to include enhanced review procedures.
- Analyze and investigate the known budgetary to proprietary tie point variances related to authority versus appropriations at a business process level to determine the root cause.
- Assess current policies and procedures around the budgetary to proprietary reconciliations including the design of key controls in the process. Design a control that focuses on addressing the root cause of the variances in order to resolve current underlying issues as well as prevent future variances from occurring.

Oversight and Monitoring

Oversight and monitoring relates to DLA's lack of establishment and implementation of a sufficient control environment, enterprise-wide.

DLA lacks a sufficient control environment related to internal controls over financial reporting, including a sufficient A-123 program:

- A sufficient risk assessment, performed at the appropriate level, related to reporting, such as documenting the complexity of programs, accounting estimates, related party transactions and extent of manual processes.
- An evaluation of fraud risks and the approach to implement financial and administrative control activities to mitigate identified material fraud risks.
- A finalized policy or procedure to develop and implement enterprise risk management (ERM) and internal control, including Anti-deficiency Act reporting, that includes the appropriate documentation requirements that are necessary as a part of an effective internal control system.

DLA lacks sufficient policies and procedures around financial and budgetary reporting including:

- Sufficient written policies and procedures do not exist related to management review controls for the financial reporting process. The identified management review controls do not accurately describe the procedures performed to detect or correct an error.
- Policies or procedures are not in place to verify the accuracy and completeness of system generated reports used in the execution of controls.
- DLA's funds management policies and procedures documentation is incomplete and inaccurate:

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- The risks and related controls have not been completed identified and assessed in the budget to execute process.
- Controls over the transfer process do not exist.
- Controls over the Treasury warrant process do not exist.

DLA does not perform sufficient oversight and monitoring of system and organization control reports:

- DLA has not associated each relevant complementary user entity controls (CUECs) to specific DLA controls.
- DLA has not identified specific DLA compensating controls for system and organization controls deemed ineffective in the each applicable SOC 1 report.
- DLA has unresolved control gaps relate both to addressing control issues identified in the SOC report as well as with DLA's CUECs.
- DLA's evaluation was not performed by the subject matter experts (SMEs) in a timely manner. As of the date of this report, the SMEs had not reviewed the evaluation and the controls identified were identified as possible mitigating controls.

Recommendations

EY recommends that DLA consider the following corrective actions related to the conditions described above:

- Continue to design and implement DLA Statement of Assurance (SOA) policy at all levels throughout the organization and emphasize the importance of the Manager's Internal Control Program (MICP) from DLA leadership. This will help bring visibility, education, and support to the program from across the organization.
- Ensure DLA SOA policy includes proper detail and guidance for conducting the risk assessment process, including:
  - All aspects of the risk management process are reviewed at least once a year;
  - Risks themselves are subjected to review with appropriate frequency; and
  - Provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed.
- Identify, document, and communicate MICP roles and responsibilities. Ensure proper groups and personnel are involved at the appropriate levels to produce the most results-based, cost-effective control environment.
- Develop, document and maintain supporting documentation as a part of the MICP and for the Statement of Assurance as evidence that DLA developed management control plans, performed risk assessments, performed ongoing monitoring, developed corrective action plans, and tracked progress towards remediation for each separate fund.

- Provide formal training and guidance, on an annual basis, to those involved in the MICP to ensure roles, responsibilities, and objectives are properly understood, carried out in a timely manner, and executed consistently across the organization.
- Increase the resources dedicated to the A-123 program, as needed, to completely execute all aspects of the program requirements on an on-going basis.
- Utilizing the updated risk assessment, DLA should design and implement a control testing strategy appropriate to address the risks.
- DLA should evaluate the current review controls identified to operate over an entire process:
    - Evaluate single controls to determine if multiple controls actually exist in the process.
    - Evaluate controls to determine if they are designed to appropriately mitigate identified risks.
    - Assess control descriptions to ensure they are documented completely including how the control is applied, who is responsible, how frequently it is performed, and how the control is evidenced.
- Evaluate the current policies and procedures for evaluating information produced by the entity.
    - Foot system generated financial reports.
    - Perform a tie-out of system generated reports to the trial balance.
    - Verify that the parameters used to generate the reports or data are appropriate.
    - Judgmentally select a sample of transactions or balances in the report and validate that the transactions are accurate.
  - Implement a process to identify, monitor, and maintain related parties and material related party transactions. Additionally, management should perform a review of these sales transactions on a regular basis and disclose any material related party transactions in the notes to their financial statements.
  - DLA should develop and maintain internal control documentation relating to the identification of related parties and related party transactions.
  - DLA should analyze if current policies and procedures are sufficient for the process and update if necessary.
    - Ensure that appropriate personnel are involved in the process.
    - Evaluate that proper roles and responsibilities are identified and communicated.
    - Ensure timelines are defined.
  - DLA should determine if controls need to be established for the SOC 1 review process and ensure controls are properly identified, designed, and operating effectively.
  - DLA should associate specific DLA controls to CUECs, as well as system and organization controls, determined to be ineffective.
- Update the Funds Management PCM to accurately reflect all aspects of the end-to-end budget to execute process, including processes and controls performed by DLA and by service providers.

- Design and implement internal controls and procedures to ensure that the performance of review controls are adequately documented and supported by evidential matter, variance thresholds used in the performance of the review are precise, and identify the key related supporting documentation as part of the view.
- Develop a timeline and procedure to continue to update the Funds Management PCM as the processes, internal controls, policies, and individuals performing the control change.

Financial Information Systems

Information systems controls are a critical component of the Federal government's operations to manage the integrity, confidentiality, and reliability of its programs and activities and assist with reducing the risk of errors, fraud or other illegal acts. Information management security, access controls, segregation of duties, and configuration management controls are fundamental to the integrity of financial data and can help manage risks such as unauthorized access, changes to critical data, and preventing compromised data. The nature, size, and complexity of DLA's operations require the agency to administer its programs under a decentralized business model by using numerous geographically dispersed operating locations and complex, extensive information systems.

Our assessment of the Information Technology ("IT") controls and the computing environment identified deficiencies in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate. We have identified four deficiencies which, when aggregated, result in a material weakness related to the oversight and monitoring of internal control.

The deficiencies relate to the following areas:

- Access controls / user access
- Configuration management / change controls
- Segregation of duties controls
- Security management / governance over implementation of security controls

(a) Access controls / user access

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

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

- Access was not restricted to authorized users and was not assigned in accordance with the principle of least privilege.
- Lack of monitoring and auditing security violations and sensitive user activities, including activities of privileged users logs, were not documented, not being performed, or not configured appropriately within systems.
- Lack of enforcement for procedures related to establishing new users, monitoring unused IDs, locked IDs, terminated users, or access re-certifications.
- Lack of policies and procedures for account authorization, provisioning, and termination.

(b) Configuration management / change controls

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematically controls changes to that configuration during the system's life cycle. By implementing configuration management controls, DLA can ensure that only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

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

- Inability to identify all application changes made to production during the audit period.
- Lack of monitoring and recording of changes made to applications by DLA management.
- Users have access privileges, enabling them to bypass the configuration management process and make changes directly to production.

(c) Segregation of duties ("SoD") controls

An effective control environment guards against a particular user having incompatible functions within a system. Segregation of duties controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations and thereby conducting unauthorized actions or gaining unauthorized access to financial management information systems.

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

- DLA management did not identify segregation of duties conflicts that consider both IT and business process roles and activities across DLA-owned applications.
- Application program management has not completely identified sensitive (financial transactions) roles in order to identify and implement appropriate segregation of duties.
- Segregation of duties review within the user provisioning process is not performed consistently across all applications.
- Administrator and super user privileges are not restricted through user groups and permissions. In some cases, users can create and assign roles to themselves, including Defense Information Systems Service (DISA) administrators.
- Business end users have access to roles intended for IT privileged users.

(d) Security Management / governance over implementation of security controls

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management's commitment to addressing security risks. The security management program should establish a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures and controls implement the entity-wide policy. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

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

- System and organization control (SOC) reports are not reviewed, specifically, to assess complementary user entity controls (CUECs). In addition, service level agreements (SLAs) with DISA are not reviewed and updated in a timely manner.
- Lack of application specific access control policies/procedures to consider unique business rules/processes, roles and responsibilities, and technologies.
- Security controls were not assessed or tested within required timeframes.

Recommendations

EY recommends that DLA consider implementing controls to address deficiencies in access controls, configuration management, segregation of duties, and security management procedures to include:

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Access controls / user access / segregation of duties

- Restrict access to authorized users in accordance with least privilege principles. Document and follow procedures related to user account management and segregation of duties.
- Implement stronger security controls and restricting user access to programs and data to the minimum level required by the user's responsibilities, to include encrypting sensitive data.
- Identify sensitive business transactions in application business and privileged roles, segregate these roles and, where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.

Configuration management / change controls

- Identify and monitor applications changes made in the production environment.
- Segregate developers' access to the development and production environments.

Security Management / governance over implementation of security controls

- Implement stronger security controls to improve the security documentation and testing of applications.
- Establish a process to evaluate and incorporate service providers' CUECs into security documentation and the current application control environment.

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Appendix B - Significant Deficiency

Environmental Liabilities

Environmental liabilities (EL) comprise clean-up costs associated with the restoration of sites that DLA manages. Through our audit procedures, we identified deficiencies in internal controls listed below, which, when aggregated, we consider to be a significant deficiency.

DLA is unable to substantiate the cost to complete estimates for environmental liabilities:

- Policies and procedures are not in place that adequately demonstrates the methodology used to derive the estimate was appropriate.
- The supporting documentation does not appropriately substantiate the estimate for the cost to complete the clean-up and restoration.

DLA is unable to substantiate the program management (PM) cost estimates for environmental liabilities:

- Policies and procedures not in place that adequately documents the methodology used to derive the estimate.
- The supporting documentation does not appropriately substantiate the estimate for the program management costs.

DLA has not appropriately designed controls to adequately detect material misstatements in EL:

- Controls are not designed to verify the completeness and accuracy of the system generated reports or data used in executing the control activity. DLA's EL control activities, including deriving the EL estimates, are dependent upon system-generated reports or data produced by information systems.

Recommendations

EY recommends that DLA consider the following corrective actions related to the deficiencies identified above:

- Design and implement policies and procedures to ensure that process for preparing the cost to complete estimate is adequately documented and sufficiently describes the methodology used to derive the estimate.
- DLA should include procedures to verify that the supporting documentation used to derive the estimate properly reconciles to the cost to complete estimate.

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- DLA should adequately document the qualifications of the specialist used in deriving the estimate to ensure and demonstrate that the specialists have the necessary competence, capabilities, and objectivity.
- Design and implement policies and procedures that adequately describe the process for preparing the estimate of the EL PM costs. The description should include sufficient detail for a reviewer to understand the process and evaluate whether the process used is reasonable and consistent with the policy.
- Implement policies and procedures to verify that the system generated reports or data used in the performance of the control is complete and accurate such as:
    - Foot system generated inventory reports;
    - Perform a tie-out of the system generated reports to the trial balance;
    - Verifying that the parameters used to generate the reports or data are appropriate;
    - Judgmentally selecting a sample of transactions or balances in the report and validating that the transactions are accurate.

Appendix C – Status of Prior Year Deficiencies

Area	Type of Deficiency in Fiscal Year 2017	Current Year Status
Property, Plant, and Equipment	Material Weakness	Not Remediated
Fund Balance with Treasury	Material Weakness	Not Remediated
Accounts Payable	Material Weakness	Not Remediated
Financial Reporting	Material Weakness	Not Remediated
Oversight and Monitoring	Material Weakness	Not Remediated
Information Systems	Material Weakness	Not Remediated
Environmental Liabilities	Significant Deficiency	Not Remediated

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

The Director of the Defense Logistics Agency and
The Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget ("OMB") Bulletin No. 19-01, *Audit Requirements for Federal Financial Statements,* the financial statements of the General Fund of the Defense Logistics Agency ("DLA"), which comprise the balance sheet as of September 30, 2018, and the related statements of net cost, changes in net position, and combined statement of budgetary resources for the year ended September 30, 2018, and the related notes to the financial statements, and have issued our report thereon dated November 14, 2018. That report states that because of matters described in the Basis for Disclaimer of Opinion paragraph, the scope of our work was not sufficient to enable us to express and we do not express an opinion on the financial statements as of and for the year ended September 30, 2018 and the related notes to the financial statements.

Compliance and Other Matters

In connection with our engagement to audit the financial statements, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 19-01, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 ("FFMIA") (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to DLA.

The results of our tests of compliance with laws, regulations, contracts and grant agreements described in the preceding paragraph disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-01, and which are described below. In addition, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

FFMIA

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

(a) Federal financial management system requirements

EY identified as part of the Financial Information Systems material weakness, contained in the *Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards* ("Report on Internal Control"), noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with user access, configuration management/change controls, segregation of duties, and security management. These financial system deficiencies prevent DLA from being compliant with federal financial management system requirements and inhibit DLA's ability to prepare complete and accurate financial reporting.

(b) Noncompliance with applicable federal accounting standards

As referenced in Note 1.B. to the financial statements, DLA self-identified that the design of their financial and non-financial systems does not allow DLA to comply with applicable federal accounting standards, including not being able to collect and record financial information as required by U.S. generally accepted accounting principles. EY also identified noncompliance with federal accounting standards during our testing, which was included in our Report on Internal Control.

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

EY also identified noncompliance with USSGL posting logic during our testing, which was included in our Report on Internal Control.

FMFIA

Federal Managers' Financial Integrity Act ("FMFIA") requires ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control.

DLA was not able to provide evidence that they are in compliance with significant aspects of Circular A-123, which implemented FMFIA. DLA provided a FY 2018 Statement of Assurance, however there was not sufficient evidence that each process identified by DLA fully completed an organizational risk assessment, identified relevant risks related to the financial statement assertions, documented the internal control standards as it relates to those assertions, performed internal control testing, and reported and tracked control deficiencies at the control level. Based on the evidence received, EY notes that DLA has an A-123 testing strategy, however DLA is unable to provide evidence that the extent of testing and review performed is sufficient to meet the requirements of FMFIA.

DLA's Response to Findings

Our Report on Internal Control dated November 14, 2018 includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance with FFMIA and FMFIA, and our recommendations to the specific issues presented. Management agrees with the facts as presented and relevant comments from DLA's management responsible for addressing the noncompliance are provided in the accompanying letter dated November 14, 2018. DLA's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Ernst & Young LLP

November 14, 2018

Management's Response to Audit Reports

DEFENSE LOGISTICS AGENCY
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NOV 14 2018

MEMORANDUM FOR DEPARTMENT OF DEFENSE OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Fiscal Year (FY) 2018 Financial Statement Audit – General Fund

Thank you for the opportunity to comment on the Independent Auditors' report on the audit of the Defense Logistics Agency's (DLA) FY 2018 financial statements. We agree with the Independent Public Accountant's (IPA) conclusions for the DLA Financial Statement Audit. This audit has provided us with a valuable and independent view of our current financial operations. We concur with the reported findings as presented by the IPA.

For FY 2018, the engagement with the IPA was a positive partnership that facilitated an effective and efficient audit. The IPA's continual updates to our management team provided on-going insight during the audit. To enhance DLA's process we have stood up an Audit Task Force to oversee and execute the coordination, integration and synchronization of Audit efforts across the Agency. The Audit Task Force will:

- Create Common Operating Picture for Enterprise-wide visibility.
- Address the material weaknesses associated with high priority areas in order to manage and coordinate DLA's financial compliance and audit response functions for accurate and reliable financial statement reporting and operational effectiveness.
- Establish leadership, policy, guidance, and oversight to ensure enduring compliance with Office of Management and Budget Circular A-123.

Overall, we are committed to resolving the material weaknesses and strengthening internal controls around DLA's operations.

I look forward to working collaboratively with the Office of the Inspector General and the IPA to strengthen DLA financial management and internal controls.

DARRELL K. WILLIAMS
Lieutenant General, USA
Director

Defense Secretary James N. Mattis pays his respects to the victims of war and visited the Monument to the Fallen Heroes of World War II in Rio de Janeiro, August 14, 2018.

Other Information (Unaudited)

The ***Other Information (Unaudited)*** section contains information on Management Challenges, Summary of Financial Statement Audit and Management Assurances, Payment Integrity, Fraud Reduction Report, and Grants Oversight and New Efficiency Act Requirements.

Management Challenges

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August 6, 2018

MEMORANDUM FOR LTG DARRELL K. WILLIAMS, DIRECTOR, DLA

SUBJECT: Major Management and Performance Challenges Facing the Defense Logistics Agency General Fund

Although significant progress has been made in the management of the organization and the reduction of challenges facing the organization, the Office of the Inspector General sees five areas where major challenges remain. The five challenge areas are:

a. Nonconforming inventory. Regardless of the manner in which nonconforming inventory is inducted into the system, the potential risks to the warfighter remain the same.

b. Pricing. Market consolidation, long-term contracts, and socioeconomic programs are decreasing the ability of DLA to foster competition and lower prices.

c. Cybersecurity of DLA systems. Reliance on computer operations to conduct daily business exposes the organization to a myriad of new and increasing computer security threats.

d. Evidential matter. As DLA completes our annual full financial statement audit, we have learned that our ability to locate appropriate evidential matter for audit readiness is just as important as appropriately processing the transaction.

e. Knowledge management. DLA needs to move from the reactionary data management mentality to a more proactive ability to appropriately summarize our vast data into useful and actionable knowledge that management can act upon.

These critical business fundamentals are necessary for DLA to achieve an unmodified financial statement position, as well as to provide the best value to the taxpayer and the best support to the warfighter.

WILLIAM A. RIGBY
Inspector General

Summary of Financial Statement Audit and Management Assurances

The Audit Reports on the FY2018 GF financial statements identified material weaknesses for GF. Table 1 below provides a summary of the financial statement audit results for FY2018.

Table 1: FY2018 Summary of the Financial Statement Audit Results

Audit Opinion	Disclaimer				
Restatement	**No**				
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Property, Plant & Equipment	1				1
Fund Balance with Treasury	1				1
Accounts Receivable	-	1			1
Accounts Payable	1				1
Financial Reporting	1				1
Oversight and Monitoring	1				1
Information Systems	1				1
Total Material Weaknesses	6	1	-	-	7

DLA management does not provide assurance on Internal Control over Reporting (ICOR). Management has performed its evaluation, and no assurance is provided based on the cumulative assessment work performed on Financial Reporting, Budgetary Resources, Fund Balance with Treasury (FBwT), Human Resources and Payroll Management, Procurement Management, Property, Plant, and Equipment (PP&E), and Sales Revenue across DLA. DLA management began remediation efforts in FY2018, which will continue in FY2019. New material weaknesses were identified by DLA management as a result of the assessment work performed in FY2018. Table 2 provides those areas where material weaknesses were identified and remediation work continues for DLA.

Effectiveness of Internal Control over Reporting (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consol.	Downgraded to Deficiency	Ending Balance
Financial Reporting - Unresolved variances for key reconciliations	1					1
Financial Reporting - Period-end Close review process requires improvement	1					1
Financial Reporting - Timely compilation of Agency Financial Report and components	1					1
Financial Reporting - The Budgetary to Proprietary reconciliations for the Working Capital Fund (WCF) are not performed on a timely basis and include cumulative differences with incomplete or unsupported explanations	1					1
Financial Reporting – The eliminations issue was identified while performing period-end close procedures	1					1
Procure to Stock – Inventory Reconciliation Framework Design and Implementation	1					1
Acquire to Retire – An effective, consistently applied standardized process is not in place to ensure recorded real property assets are supported by adequate evidential matter for valuation and recording of real property records	1			1		
Acquire to Retire – An effective, consistently applied physical inventory process is not in place to ensure recorded real property assets exist and that real property records are complete	1			1		
Fund Balance with Treasury (FBwT) – DLA is unable to provide sufficient, competent evidential documentation to support undistributed collection items	1			1		
FBwT – DLA is unable to provide sufficient, competent evidential documentation to support undistributed disbursement items	1			1		
FBwT – Standard processes for the FBwT reconciliation process were not fully documented	1			1		

Effectiveness of Internal Control over Reporting (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consol.	Downgraded to Deficiency	Ending Balance
Acquire to Retire - Lack of Management Review for controls related to PP&E.		1				1
Acquire to Retire - Lack of documentation of real property quantity.		1				1
Acquire to Retire - Lack of evidence to support the Rights assertion over real property assets.		1				1
Acquire to Retire - Inconsistent policy for grouping real property and general equipment assets.		1				1
Acquire to Retire - Lack of reconciiation between real property asset listing and the amounts recorded in the financial statements footnotes.		1				1
Acquire to Retire - Inability to provide a listing of additions and deletions for real property or general equipment.		1				1
Procure to Pay - Lack of segregation of duties in the Government Purchase Card process.		1				1
Financial Reporting - Inadequate review of completeness and accuracy of system generated reports and data used in the execution of internal controls in the financial reporting process.		1				1
Financial Reporting - Lack of sufficient review and monitoring of Defense Finance and Accounting Service (DFAS) System and Organization Controls (SOC) 1 report related to Financial Reporting		1				1
FBwT - Lack of complete and accurate Department 97 Report Reconciliation Tool (DRRT) policies and procedures .		1				1
FBwT - Inability to reconcile FBwT.		1				1
Financial Reporting - Insufficient documentation for calculation and posting of allowance for doubtful accounts.		1				1
Total Material Weaknesses	**11**	**12**	**-**	**5**	**-**	**18**

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consol.	Downgraded to Deficiency	Ending Balance
Management of First Article Test Exihibits Checks demonstrates inadeqate Chain of Custody between Initial Production items required to be tested prior to contract award and full rate production, Custody at the Air Force Lab-Tinker AFB and financial payments for item(s) when retained by Service, and DLA distribution role. No Enterprise Policy in place for Air Force driven actions.		1				1
Risk of HAZMAT material not being segregated properly by Hazardous class caused by inadequate knowledge of HAZMAT segregation requirements or inadequate compliant storage space resulting in a potential safety hazard	1				1	
Certain items within Medical Supply Chain are critical for war readiness. However there are cases where the item (e.g. Antidote Treatment Nerve Agent Auto-injector, 2-PAM Atropine, or key ingredients of these items are provided by a sole source	1					1
DLA does not have valid real property agreements establishing DLA rights and obligations for occupying the real property.	1				1	
Controls over the processing of Product Quality Deficiency Reports (PQDRs) were found to be ineffective in DoD Information Assurance Report.	1				1	
Customers are not verifying receipt of material.	1					1
Total Material Weaknesses	**5**	**1**	**-**	**-**	**3**	**3**

Compliance with Federal Financial System Requirements (FMFIA § 4)						
Statement of Assurance	No Assurance					
Non-Compliance	Beginning Balance	New	Resolved	Consolidated	Downgraded to Deficiency	Ending Balance
Security Management: • System Security Plan conformance and completeness across financial systems • Policies and procedures out of date or not approved • Monitoring of service provider and demonstrating evidence of Complementary User Entity Control completion	1					1
Access Controls: • Coverage and details within Account Management Policy – Increase stringency in areas of risk • Financial system Compliance with Account Management Policy – ensure all systems are in alignment to policy • Alignment of Provisioning Tools with Account Management Policy – ensure tools that support account request and approval of user roles. • Clarify Transaction code alignment to role in system – identify business and IT functions within systems that are higher risk or critical to both financial reporting and IT system management	1					1

Compliance with Federal Managers Financial Integrity Act (FMFIA § 4)						
Statement of Assurance	Federal Systems do not comply with Financial Management System requirements					
Non-Compliance	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Segregation of Duties: • Issues with Firefighter roles – ensure Firefighter roles are provisioned only when needed and activity is promptly reviewed to ensure Firefighter roles are provisioned only when needed and activity is promptly reviewed to ensure Fighter use was appropriate • Segregation of Duties in Software Development Life Cycle	1					1
Contingency Planning: • Continuity of Operations Plan (COOP) environment – ensure COOP environment is established and tested regularly	1					1
Total non-compliances	**4**	**-**	**-**	**-**	**-**	**4**

Compliance with Section 803(a) of the Federal Financial Management Improvement Act (FFMIA)		
	Agency	Auditor
1. Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
2. Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
3. U.S. Standard General Ledger (USSGL) at Transaction Level	Lack of compliance noted	Lack of compliance noted

Table 3 below summarizes DLA management's self-identified material weaknesses in internal controls as well as planned corrective actions for the GF. DLA is currently evaluating the outcome of the corrective actions taken so far to determine whether the current corrective action plans (CAPs) will remediate the material weaknesses identified, or if the plans need to be modified to remediate the deficiencies. Based on results of the evaluation, the completion date of the CAPs will be updated accordingly.

Table 3: Corrective Actions

Material Weakness	Corrective Action Summary
Fund Balance with Treasury (FBwT) - Inability to reconcile FBwT	In collaboration with Defense Finance and Accounting Service (DFAS), DLA is developing a FBwT reconciliation process
FBWT - Lack of complete and accurate Department 97 Report Reconciliation Tool (DRRT) policies and procedures	DLA is developing policies and procedures to monitor and correct undistributed funds and to assist DFAS with the research and the clearing process
Financial Reporting - Inadequate review of completeness and accuracy of system generated reports and data used in the execution of internal controls in the financial reporting process	DLA will document a control procedures that documents what should be performed to each system generated reports and data used in the execution of internal controls in the financial reporting process to ensure completeness and accuracy
Financial Reporting - Lack of sufficient review and monitoring of DFAS System and Organization Controls (SOC) 1 report related to Financial Reporting	DLA is implementing sufficient review and monitoring procedures of SOC 1 reports related to financial reporting
Financial Reporting – The Budgetary to Proprietary reconciliation for the General Fund are not performed on a timely basis and include cumulative differences with incomplete or unsupported explanations	DLA performed a root cause analysis to determine the impediments to reconcile budget to proprietary accounts. Currently, the Agency is implementing procedures and providing recommendations to correct the differences noted in the reconciliation and avoid further differences.
Financial Reporting - Period-end Close review process requires improvement	DLA is revising policies and procedures for the Agency Financial Reporting process, including enhancing Management Review Controls over period-end closing procedures
Financial Reporting – The Eliminations issue was identified while performing period-end close procedures	DLA is updating the Trial Balance Management Process Cycle Memorandum (PCM), Financial Reporting policies, and Standard Operating Procedures (SOPs), to ensure complete and accurate financial reporting, including control procedures over eliminations
Financial Reporting - Timely compilation of Agency Financial Report and components	DLA is revising policies and procedures for the Agency Financial Report (AFR) process, including enhancing Management Review Controls over the compilations and drafting of the AFR

Material Weakness	Corrective Action Summary
Financial Reporting - Unresolved variances for key reconciliations	DLA is in process of improving existing reconciliations by training employees on new procedures for identifying root causes and developing the appropriate corrective actions and monitoring the performance of the new processes
Procure to pay - Lack of segregation of duties in the Government Purchase Card (GPC) process	DLA is revising and making updates to the current the GPC management process in order to ensure segregation of duties

The governance structure of DLA integrates a system through which business is directed and controlled by establishing rules and procedures for decision making, setting objectives, and specifying the distribution of rights and responsibilities among different participants within DLA, such as the Executive Board, Alignment Group, Stewardship Committee (SC), program working groups, managers, and stakeholders. In accordance with OMB Circular A-123, management monitors and evaluates risk response and internal controls. The OMB Circular A-123 team consists of the SC, Enterprise Business Cycle Owners (EBCOs), HQ J/D Code Organizations, MSC Directors/Commanders and their sub-organizations. The SC is the governance structure for ERM and Internal Controls and acts in an Audit Committee capacity by aiding the agency Director and Executive Board in fulfilling Agency Financial Stewardship. The SC /Senior Assessment Team (SAT) provides oversight of OMB Circular A-123 activities reported to OUSD(C). Process Cycle Integrators (PCI) for the EBCO coordinates with Assessable Unit Managers and Process Health Leads to ensure proper documentation of business processes that support operational, administrative, system, and financial events to assess controls and improve efficiency in agency mission execution.

To elevate awareness of risk management and establish a risk mitigation strategy, DLA developed a Risk Profile (RP) as the basis for internal control assessments. DLA's approach to controlling risk does not necessarily seek to eliminate the risk, but attempts to reduce risk and monitor its impact on completing mission objectives. The below Enterprise Risk Priority Heat Map includes Enterprise Risks and associated vulnerabilities, as recognized by Senior Leaders. This is conveyed through the Chief Risk Officer for the Agency, the ERM Program Lead, and Risk Managers throughout DLA. DLA's approach to Risk Management is a top-down and bottom-up perspective. The Enterprise Risks fall into eight overarching categories: Support to Operations, IT Management, Inventory Management, Procurement and Acquisition, Financial Management, Human Resources Management, Customer Satisfaction, and Security and Force Protection. The bottom-up perspective is documented in Local Risk Profiles (LRPs), submitted by DLA Assessable Units. LRPs tie Enterprise Risks to local issues. LRPs ascertain the risk driver, category, impact, end-to-end business process, and strategic objectives associated with each risk at the local level.

Enterprise Risk Priority Heat Map

Risk Area	Impact SUM	Likelihood SUM	Appetite SUM
Support to Operations	45	29	15
Customer Satisfaction	21	18	9
Procurement & Acquisition	25	15	13
HR Management	10	23	4
Security & Force Protection	9	9	1
IT Management	21	26	15
Inventory Management	36	25	18
Financial Management	45	24	15

A worst case scenario would be
1) high likelihood of occurrence
2) high impact
3) high level of unpreparedness
should the event occur
(represented by a big bubble)

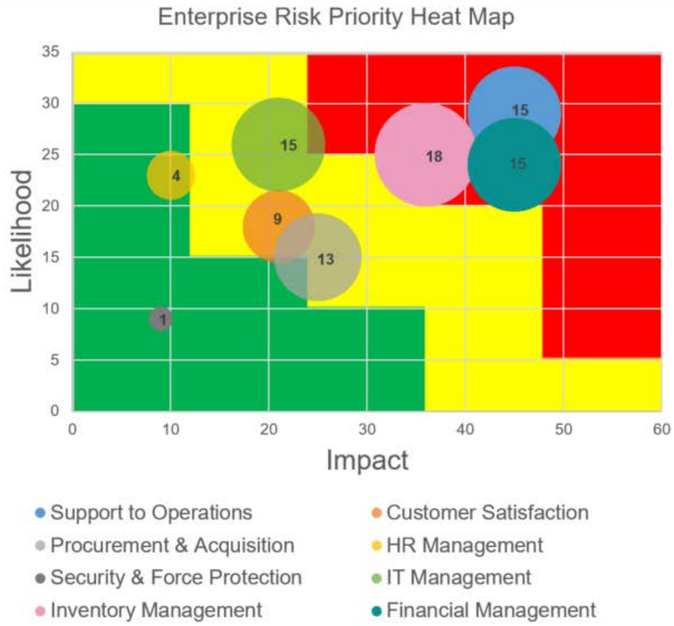

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Figure 4, Enterprise Risk Priority Heat Map

Internal Control over Operations

The prior year's risk profile served as the guide for the operational processes to evaluate in FY2018. DLA utilizes a variety of techniques to evaluate its operational effectiveness, efficiency, and compliance, including management evaluation, self-reporting, and internal and external review. Various avenues of testing highlight risk areas and potential fraud indicators. Highlighted below are test results from the Agency Management Review (AMR) and the Distribution Quality Control and Quality Assessments Results.

The AMR Program, led by DLA Logistics Operations, is the foundation for operational internal control assessments and operational compliance. The AMR Program is a cross-functional evaluation of DLA's compliance with the laws, regulations, policies, and procedures covering operations in selected areas. The AMR Program allows for examination of operationalized activities, as well as observation of processes outside the scope of current policies and procedures, and identification of best practices. Evaluation criteria and tolerance rate were predetermined for each review topic. Scores consist of: pass, pass with comments, fail, or not applicable after completion of the review.

The following table includes areas evaluated in FY2018 as applicable to DLA Logistics Operations mission.

Focus Area	DLA Troop Support	DLA Distribution
Service Management Quality Assurance Plan	Pass	Pass
Service Management customer-Supplier Operations Procedures	Fail	Fail
Customer Relationship Management Program Support	Pass	Pass
Opportunity Management	Pass	NA
Unfilled Customer Orders	Pass	NA
Backorder Management	Fail	NA
Intermediate Document Processing	Pass	NA
Forecast Override	Pass	NA
Logistics Reassignment	Pass	NA
Testing First Article	Pass	NA
Demilitarization	Pass	NA
Demilitarization Training	Pass with comments	NA
Packaging Policy and Procedures	Fail	Pass with comments
Product Quality Deficiency Report Process	Pass with comment	Pass with comment
Price Changes Authorized	Fail	NA
Shelf Life Management	NA	Pass
Transportation Policy	NA	Pass with comments
Physical Inventory	NA	Pass
Supply Discrepancy Reports	NA	Pass

The Quality Control (QC) and Quality Assessment (QA) programs have test plans and test methods developed for areas to be tested. Methods of testing and sampling techniques utilized consist of random sampling (utilizing a random number generator), 100% inspection, direct observation, and re-performance. QC has a minimum sample size of 45 per control per month while QA is generally determined by workload in that area or utilizing a random number generator, or a combination of any of the methods and sampling techniques mentioned. All controls tested were manual controls. In the testing timeframe for the FY2018 Statement of Assurance (SOA) (October 2017 – February 28, 2018) across all Distribution centers, QC samples were tested in the core Distribution process areas of pick, pack and stow. This resulted in a pass rate of 99.5% which is within the established Financial Improvement Audit Remediation (FIAR) tolerance.

Quality Control and Quality Assessment Results

	Pick	Pack	Stow	Total
Samples tested	9,590	8,874	8,620	27,084
Samples passed	9,524	8,832	8,602	26,958
% Pass Rate	99.3%	99.5%	99.8%	99.5%

In the testing timeframe for the FY2018 SOA (October 2017 – February 2018) across all Distribution centers, QA samples were conducted in high-risk areas to include ensuring proper procedures are being followed in areas identified in the FY2018 LRP. These areas include the handling of FMS, Hazardous Material (HAZMAT), Arms, Ammunition and Explosives (AA&E), and Nuclear Weapon Related Materiel (NWRM).

Quality Control and Quality Assessment Results Continued

	Classified	FMS	HAZMAT	AA&E	NWRM	Total Samples	FIAR Tolerance
Sample Size	377	560	517	100	120	1,674	1,674
#Failure	4	-	21	-	-	25	186
%Failure Rate	1.1%	-	4.1%	-	-	1.5%	11.1%

DLA Distribution's QA program adds another layer of testing by measuring process adherence across operational controls as well as high risk areas across the Distribution network. A total failure rate of 1.5% was determined. Although DLA Distribution takes a "no tolerance" stance on these process areas, DLA will continue to monitor and develop new controls that assist in mitigating these risks.

DLA prioritized developing and implementing corrective action plans to remediate Notice of Findings and Recommendations (NFRs) resulting from the FY2017 Financial Statement Audit. Numerous NFRs focused on the inadequacy of business processes and controls as well as lack of associated policy. Consequently, DLA performed limited OMB Circular A-123 testing since corrective action plans were not completed and process improvements were not yet fully institutionalized or applied.

Moving forward into FY2019, DLA will continue to commit time and resources to the financial statement audit as well as the integration of audit efforts and results with each phase of the Enterprise OMB Circular A-123 Program. OMB Circular A-123 management assessments and the financial statement audit assessments are complementary processes and together provide the information needed to support remediation and effectively sustain an auditable control environment.

Internal Control over Reporting

DLA Finance used several factors to determine which processes to review in FY2018, such as establishing materiality to identify significant financial statement line items. In addition, DLA Finance also assessed inherent risk, impact of the risk event to the financial, reputational, and operational aspects of the Agency, risk mitigation strategies, and dates of when the process was last tested. DLA Finance also considered existing deficiencies in each process area to determine whether to test the process in FY2018. This included evaluating NFRs issued by EY during

FY2017, which reported material weaknesses and significant deficiencies in various business processes across the Agency. DLA Finance did not select areas that contained significant issues as indicated by the NFRs or existing deficiencies for testing in FY2018 to allow for remediation efforts and corrective actions to be implemented. Based on the various factors discussed above, DLA Finance selected the below process areas in FY2018 for testing.

FY2018 Process Areas

Process Area	PCM
Hire to Retire	• Employee Record Set-Up and Management • Manage Payroll • Manage Travel Defense Travel System (DTS) Transactions • Federal Employees' Compensation Act (FECA)
Acquire to Retire	• Real Property
Fund Balance with Treasury and Financial Reporting and Reconciliation	• Fund Balance With Treasury • Trial Balance Management
Procure to Pay	• Government Purchase Card

For each of the above process areas, DLA identified specific PCMs and key controls to test. For each key control, performed test of design and test of operating effectiveness procedures to evaluate the controls effectiveness to mitigate the associated financial reporting risk. DLA used a variety of testing methods such as inquiry, observation, inspection and re-performance in the testing. DLA determined the appropriate testing method based on the nature of the control. See the Table below for the summary of control test results.

Summary of Test Results (Note: Control testing was not specific for individual funds)

Control Analysis				
Process Cycle	**PCM Name**	**Test Description**	**Control Type**	**Results**
Fund Balance With Treasury	Fund Balance With Treasury	Internal Control Test of Design and Test of Operating Effectiveness	Automated and Manual	4 controls tested; 4 control failures
Financial Reporting and Reconciliation	Trial Balance Management	Internal Control Test of Design and Test of Operating Effectiveness	Automated and Manual	11 controls tested; 11 control failures
Financial Reporting and Reconciliation	Invoice to Disbursement	Internal Control Test of Design and Test of Operating Effectiveness	Manual	1 control tested; 1 control failure
Financial Reporting and Reconciliation	Billings to Collections	Internal Control Test of Design and Test of Operating Effectiveness	Automated and Manual	4 controls tested; 4 control failures
Procure to Pay	Government Purchase Card	Internal Control Test of Design and Test of Operating Effectiveness	Manual	2 controls tested; 2 control failures
Procure to Pay	Outbound Military Inter-Departmental Purchase Request (MIPR)	Internal Control Test of Design and Test of Operating Effectiveness	Manual	2 controls tested; 2 control failures
Acquire to Retire	Real Property	Internal Control Test of Design and Test of Operating Effectiveness	Automated and Manual	7 controls tested; 4 control failures
Order to Cash	Construction and Equipment	Internal Control Test of Design and Test of Operating Effectiveness	Manual	3 controls tested; 2 control failures

Process Cycle	Process Cycle Memorandum Name	Test Description	Control Type	Results
Order to Cash	Disposition Public Sales	Internal Control Test of Design and Test of Operating Effectiveness	Manual	5 controls tested; 4 control failures
Hire to Retire	Manage Payroll	Internal Control Test of Design and Test of Operating Effectiveness	Automated and Manual	4 controls tested; 0 control failures
Hire to Retire	Federal Employees' Compensation Act	Internal Control Test of Design and Test of Operating Effectiveness	Manual	10 controls tested; 0 control failures
Hire to Retire	Employee Record Set-Up and Management	Internal Control Test of Design and Test of Operating Effectiveness	Automated and Manual	8 controls tested; 0 control failures
Hire to Retire	Manage Travel Defense Travel Systems Transactions	Internal Control Test of Design and Test of Operating Effectiveness	Automated and Manual	4 controls tested; 0 control failures
Total Results				**65 controls tested; 34 control failures**

For the deficiencies identified as part of management's internal control program, DLA GF analyzed the deficiencies to determine the relationship to any existing NFRs issued as part of the FY2017 financial statement audit. DLA Finance completed this analysis to ensure that existing corrective actions already underway would address the newly identified deficiencies. For those deficiencies that did not have a relationship to an existing NFR, DLA GF determined the category of the deficiency by considering whether the control failure would result in a material misstatement to the financial statements. In addition, DLA Finance will develop corrective actions as necessary. DLA Finance also compared open corrective actions reported in the FY2017 Statement of Assurance to the FY2017 NFRs to ensure that the corrective actions developed for these NFRs covered the existing deficiencies. Based on these factors, internal controls over reporting for DLA are not effective to mitigate the risk of a material misstatement to the financial statements.

Payment Integrity

Payment Reporting

The Improper Payments Information Act of 2002 (IPIA) (Pub. L. 107-300), as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA) (Pub. L. 111-204) and Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA); (Pub. L. 112-248), requires agencies to review and assess all programs and activities they administer and identify those determined to be susceptible to significant improper payments, estimate the annual amount of improper payments, and submit those estimates to Congress. In accordance with DoD 7000.14-R Financial Management Regulation (FMR), Volume 4, Chapter 14, *Improper Payments*, DoD components that entitle (i.e. process or compute) payments conduct risk assessments of their payment processes and random post-payment reviews to estimate improper payments. The OUSD(C) Accounting & Finance Policy Directorate (A&FP) compiles the Department-wide results annually as part of DoD's AFR. As DLA's Service Provider, DFAS entitles payments and provides the results of post-payment reviews to OUSD(C) A&FP on behalf of its customers.

The OMB Circular A-123, Appendix D, *Requirements for Payment Integrity Improvement*, also requires agencies to review all programs and activities to determine the risk of making significant improper payments and to perform more in-depth assessments to determine whether those programs meet the criteria for "significant erroneous payments". Although DLA does not currently meet the full requirements of Payment Integrity, DLA will conduct a risk assessment over its programs in FY2019.

Recapture of Improper Payments Reporting

High Dollar Overpayments to Individuals and Entities

DFAS conducts a quarterly post payment review on behalf of its customers for high dollar overpayments. Payments from the EBS, Mechanization of Contract Administration Services (MOCAS), and Computerized Accounts Payable System (CAPS-W) systems were statistically sampled for the period ended June 30, 2018. Based on the results of the review, there were no improper payments identified that resulted in overpayments or underpayments.

System	Sampled Invoices #	Sampled Invoices $
EBS	226	$ 494,497,522
MOCAS*	320	$ 5,142,358,722
CAPS-W*	27	$ 64,347,141
Total	**573**	**$ 5,701,203,385**

**Sampled invoices include other Defense agencies*

Travel Pay

DoD reports improper payment estimates related to the DoD Travel Pay program. DLA conducts a quarterly post payment review of travel vouchers in order to identify and recover improper payments agency wide. The reviews are designed to identify incorrect payment amounts, unauthorized claims, and internal controls over the travel payment process. The DoD goal for the recovery of improper payments is 86% or above. Based on the results of the review for the period ended July 30, 2018, the DLA GF recovery rate was 100%.

Organization	FY18 Total Debt Value	Open Debt Vouchers (cumulative)	Open Due US	Debt Paid	DLA DMM Recovery Rate
DPAS	$ 470	-	$ -	$ 470	100%
Total	**$ 470**	**-**	**$ -**	**$ 470**	**100%**

Fraud Reduction Report

DLA utilized the American Institute of Certified Public Accountants Audit Standard (AU-C) Section 240.04, Consideration of Fraud in a Financial Statement Audit, criteria to identify management's responsibility for fraud risk management. Management is responsible for placing a strong emphasis on fraud prevention and fraud deterrence. This responsibility involves creating a culture of honesty and ethical behavior, reinforced by active oversight by those charged with governance to consider the potential for override of controls or other inappropriate influence. DLA utilized the fraud triangle as a means to begin addressing fraud risk management. The fraud triangle is a model for explaining the factors that cause someone to commit occupational fraud. Together, pressure, perceived opportunity, and rationalization lead to fraudulent behavior.

Fraud Triangle

- **Pressure**
  - Perceived unshareable financial need
  - Unable to solve problem through legitimate means
  - Example: need to meet productivity targets
- **Perceived Opportunity**
  - Ability to carry out misappropriation of cash or assets
  - Position of trust – Low perceived risk of getting caught
  - Critical: able to operate in secrecy
- **Rationalization**
  - Justification of dishonest actions
  - Sense of Entitlement – "I deserve this"
  - Do not see themselves as criminals

Pressure
Motivation or Incentive

Opportunity
Circumstances Exists that provide opportunity

Rationalization
Culture or environment enables

A common approach states the removal of one or more of these components will act as a deterrent to fraudulent activity

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Figure 6, Fraud Triangle

As part of DLA's efforts in establishing an adequate internal control environment and comply with the Fraud Reduction and Data Analytics Act of 2015 (Pub. L. 114-186, 31 USC 3321), DLA has identified and documented administrative and financial internal controls to address fraud risks. Internal controls include both preventive and detective controls. DLA has identified the following internal controls to address fraud risk:

Anti-Fraud Controls

Anti-Fraud Controls	
Preventive	Detective
1. An Independent Audit Committee	1. Dedicated Fraud Department or Team
2. An Anti-Fraud policy	2. Whistleblower Hotline
3. Code of Conduct	3. Surprise Audits
4. Management Review	4. Internal Audits
5. Job Rotation and Mandatory Vacation	5. Rewards for Whistleblowers
6. Formal Fraud Risk Assessment	6. External Audit of Internal Controls over Reporting
7. Proactive Data Monitoring and Analysis	7. External Audit of Financial Statements
8. Fraud Training for Employees	
9. Fraud Training for Managers and Executives	
10. Employee Support Programs	
11. Management Certification of Financial Statements	

DLA has identified five internal control areas where a gap exists and corrective action is needed. These areas are highlighted above and include:

- Establishment of a formal fraud risk assessment policy
- Proactive data monitoring and analysis to identify potential frauds
- Establishing formal fraud training for employees
- Establishing formal fraud training for managers and executives
- Establishing a formal reward program for whistleblowers

These areas will continue to remediate the gaps identified above in FY2019 as DLA makes progress in identifying fraud risk vulnerabilities and establishing strategies and procedures to curb fraud. DLA has the responsibility to develop and maintain effective system of internal control to detect and mitigate the risk of fraud.

Grants Oversight and New Efficiency Act Requirements

The Grants Oversight and New Efficiency (GONE) Act was enacted on January 28, 2016. The Act requires the head of each agency to submit to the Congress a report on Federal grant and cooperative agreement awards which have not yet been closed out and for which the period of performance elapsed for more than two years. Only Federal grants and cooperative agreements are subject to the Act.

In FY2018, DLA made significant efforts to close out expired awards with remaining balances. Closing these awards and de-obligating any remaining balances is a significant internal control over the financial assistance process. DLA is currently in process of closing out the three remaining awards, which are pending invoice approval and payment, correction of a payment error, and processing of a refund check.

The table below summarizes the total number of Federal grant and cooperative agreement awards and the balances for which closeout has not yet occurred but the period of performance has elapsed by more than two years.

CATEGORY	2 - 3 Years	> 3 - 5 Years	> 5 Years
Number of Grants/Cooperative Agreements with Zero Dollar Balances	-	-	-
Number of Grants/Cooperative Agreements with Undisbursed Balances	2	1	-
Total Amount of Undisbursed Balances (in dollars)	$ 129,952	$ 4,414	-

Happiest Hello ~ Air Force Technical Sgt. Matthew Clark hugs his son at the North Dakota Air National Guard base in Fargo, N.D., Jan. 15, 2018, upon returning from a six-month deployment to Southwest Asia. Air National Guard photo by Senior Master Sgt. David H. Lipp

Acronym and Abbreviation List

Acronyms and Abbreviations	
AA&E	Arms, Ammunition, and Explosives
ADA	Anti-Deficiency Act
AFR	Agency Financial Report
AM	Additive Manufacturing
AME	Advanced Microcircuit Emulation
AMR	Agency Management Review
AO	Approving Official
AUM	Accessible Unit Manager
B2P	Budgetary to Proprietary
BATTNET	Battery Network
BEA	Business Enterprise Architecture
BRAC	Base, Realignment, and Closure
CAPS-W	Computerized Accounts Payable System
CARS	Central Accounting and Reporting System
CBY	Charge Back Year
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CFO	Chief Financial Officer
CIO	Chief Information Officer
CIP	Construction in Progress
CL	Contingency Logistics
CMR	Cash Management Report
COLA	Cost of Living Adjustment
CONOPs	Concept of Operations
CPI	Continuous Process Improvement
CPIM	Consumer Price Index Medical
CSR	Casting Solutions for Readiness
CSRS	Civil Service Retirement System
CTC	Cost to Complete
DAAS	Defense Automatic Addressing System
DAI	Defense Agency Initiative
DANTES	Defense Activity for Non-Traditional Education Support
DATA	Digital Accountability and Transparency Act
DEBS	DoD Enterprise Business System
DERA	Defense Environmental Restoration Account
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service

Acronyms and Abbreviations	
DISA	Defense Information Systems Agency
DLA	Defense Logistics Agency
DMEA	Defense Microelectronics Activity
DoD	Department of Defense
DoDAAD	Department of Defense Activity Address Directory
DoDIG	Department of Defense Office of the Inspector General
DoL	Department of Labor
DPCMP	Data Profiling and Continuous Monitoring Program
DDRS	Defense Department Reporting System
DRRT	Department 97 Report Reconciliation Tool
DT	DLA Transformation
DTS	Defense Travel System
EBCO	Enterprise Business Cycle Owner
EBS	Enterprise Business System
EL	Environmental Liabilities
ERM	Enterprise Risk Management
EY	Ernst & Young
FBwT	Fund Balance with Treasury
FDA	Food and Drug Administration
FECA	Federal Employees' Compensation Act
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FFMSR	Federal Financial Management System Requirements
FIAR	Financial Improvement and Audit Remediation
FISMA	Federal Information Security Modernization Act
FMFIA	Federal Managers' Financial Integrity Act
FMR	Financial Management Regulation
FMWR	Family and Morale, Welfare and Recreation
FO	Financial Officer
FPDS	Federal Procurement Data System
FPGA	Field-Programmable Gate Array
FWAM	Fraud, Waste, Abuse, and Mismanagement
FY	Fiscal Year
FYDP	Fiscal Year Defense Plan
GAO	Government Accountability Office
GEX	Global Exchange
GF	General Fund
GO	General Order

Acronyms and Abbreviations	
GONE	Grants Oversight & New Efficiency Act
CPIM	Consumer Price Index Medical
GSA	General Services Administration
HAZMAT	Hazardous Materials
HQ	Headquarters
ICIS	Integrated Consumable Item Support
ICO	Internal Control over Operations
ICOFS	Internal Control over Financial Systems
ICOR	Internal Control Over Reporting
ICP	Industrial Capabilities Program
IG	Inspector General
IPA	Independent Public Accountant
IPERA	Improper Payments Elimination and Recovery Act
IPIA	Improper Payments Information Act
IT	Information Technology
IUS	Internal Use Software
LESO	Law Enforcement Support Office
LOE	Line of Effort
LRP	Local Risk Profile
MATS	Microwave Assisted Thermal Sterilization
MD&A	Management's Discussion and Analysis
MILCON	Military Construction
MIPR	Military Interdepartmental Purchase Request
MMRP	Military Munition Response Program
MOCAS	Mechanization of Contract Administration Services
MSC	Major Subordinate Command
MUST	Military Unique Sustainment Technology
NAAA	Nerve Agent Antidote Auto-injector
NASA	National Aeronautics and Space Administration
NAVFAC	Naval Facilities and Engineering Command
NDAA	National Defense Authorization Act
NESO	Nuclear Enterprise Support Office
NFR	Notice of Findings and Recommendation
NRV	Net Realizable Value
NWRM	Nuclear Weapons Related Materials
NSN	National Stock Number
O&M	Operations and Maintenance
OEM	Original Equipment Manufacturers

Acronyms and Abbreviations	
OIG	Office of the Inspector General
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense
OUSD	Office of the Under Secretary of Defense
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
OWCP	Office of Worker's Compensation Programs
P2P	Procure to Pay
PBR	Program Budget Review
PCI	Process Cycle Integrator
PCM	Process Cycle Memorandum
PDW	Procurement Defense-Wide
PM	Program Manager
PMO	Program Management Office
PP&E	Property, Plant, and Equipment
PPR	Post Payment Review
PTAC	Procurement Technical Assistance Centers
PTAP	Procurement Technical Assistance Program
QA	Quality Assurance
QC	Quality Control
R&D	Research and Development
RACER	Remedial Actions Cost Requirements
RCRA	Reserve Conservation and Recovery Act
RDT&E	Research, Development, Test & Evaluation
ROI	Return on Investment
RP	Risk Profile
SARA	Superfund Amendments & Reauthorization Act
SAT	Senior Assessment Team
SBIR	Small Business Innovation Research
SBR	Statement of Budgetary Resources
SC	Stewardship Committee
SCNP	Statement of Changes in Net Position
SES	Senior Executive Service
SFFAS	Statement of Federal Financial Accounting Standards
SLOA	Standard Line of Accounting
SNC	Statement of Net Cost
SOA	Statement of Assurance
SOC	System and Organization Controls
SOP	Standard Operating Procedures

Acronyms and Abbreviations	
SUBNET	Subsistence Network
TF	Transaction Fund
TFM	Treasury Financial Manual
TOA	Total Obligation Authority
TOAI	Total Obligation Authority Integrator
USACE	US Army Corps of Engineers
U.S. GAAP	United States Generally Accepted Accounting Principles
USSGL	United States Standard General Ledger
WCF	Working Capital Fund
WMM	Waste Military Munitions
WRM	War Reserve Materiel
WSS	Weapon System Sustainment

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The Nation’s Logistics Combat Support Agency