DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Annual Financial Statements Fiscal Year 2003

(Unaudited)

DLA MISSION

To provide best value logistics support to America's Armed Forces, in peace and war . . . around the clock, around the world.

DLA VISION

Right Item, Right Time, Right Place, Right Price. Every Time . . . Best Value Solutions For America's Warfighters.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

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Message from the Director

I'm pleased to present our Fiscal Year 2003 Financial Statements. During the course of the year, we met the challenges of supporting our soldiers, sailors, marines, and airmen in both OPERATION ENDURING FREEDOM and OPERATION IRAQI FREEDOM and positioned ourselves to support the Department of Defense transformation initiative. Collectively, these events led us to the threshold of initiating monumental cultural and structural changes within the Agency — changes that will achieve efficiencies and operational effectiveness to lessen the logistics footprint, but not the capability, safety, or health of our fighting forces. accordingly, I am committed to executing a comprehensive plan that leads to the best structure, business processes, and workforce we can devise to support the warfighter at the least cost.

Because the environments — threat, risk, and theater — are so fluid, we will no longer anticipate an "end state." Our strategic management system plans, consisting of the DLA Strategic Plan, Balanced Score Card, and Enterprise Business Plan, will retain both flexibility and agility as we manage the challenges of an uncertain and ambiguous future. The successful deployment of our enterprise resource planning system in the Non-Energy supply segments of our mission and the underlying cultural and organizational changes are critical events in executing our overall strategy.

KEITH W. LIPPERT
Vice Admiral, SC, USN
Director

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated Management's Discussion & Analysis

For the Fiscal Year Ended
September 30, 2003

Description of the Defense Logistics Agency

The Defense Logistics Agency (DLA) is the logistics combat support agency of the Department of Defense (DoD) and receives its oversight and staff direction from the Deputy Under Secretary of Defense for Logistics and Materiel Readiness. Our primary mission is to provide best value logistics solutions to meet the needs of America's Armed Forces around the clock and around the world in times of peace, national emergency, and war. Execution of the U.S. national defense strategy is dependent on the logistics support provided by DLA — where our reach extends from the home front to the frontlines and from dining facilities to foxholes. We support DoD objectives and missions through our involvement in the full range of military operations, from our participation with multi-national forces engaged in large-scale combat operation, peacekeeping, and humanitarian assistance to the global war on terrorism.

DLA manages more than 4.6 million items and disseminates logistics cataloging information for approximately 6.7 million items that support the DoD, other Federal Agencies, and U.S. international partners. Among the materiel we manage are fuel and repair parts for weapon systems as well as food, clothing, and medical supplies needed to deploy and sustain U.S. Forces. Through our network of supply depots, we receive, issue, and distribute most of these items and through our reutilization and marketing services, we manage DoD programs to reutilize, transfer, donate, or sell surplus and excess materiel, and dispose of hazardous materiel. In addition to these logistics missions, we also administer the DoD document automation and production services.

Our missions have evolved and grown over the past four decades to an extent that if our forces fight with it, wear it, eat it, or burn it as fuel, we probably buy it; warehouse and distribute it; or arrange for its reuse, sale, or disposal after the owner no longer needs it.

Agency Strategic Goals and Strategies

We are actively engaged in the revolution of DoD business affairs, including the significant advances made in the technological sophistication, speed, and mobility of our armed forces. We are constantly adapting to the changing global logistics requirements, including the need to support smaller U.S. Forces as they respond to crises around the world, often in remote regions where roads, airfields, and seaports are primitive, if they exist at all.

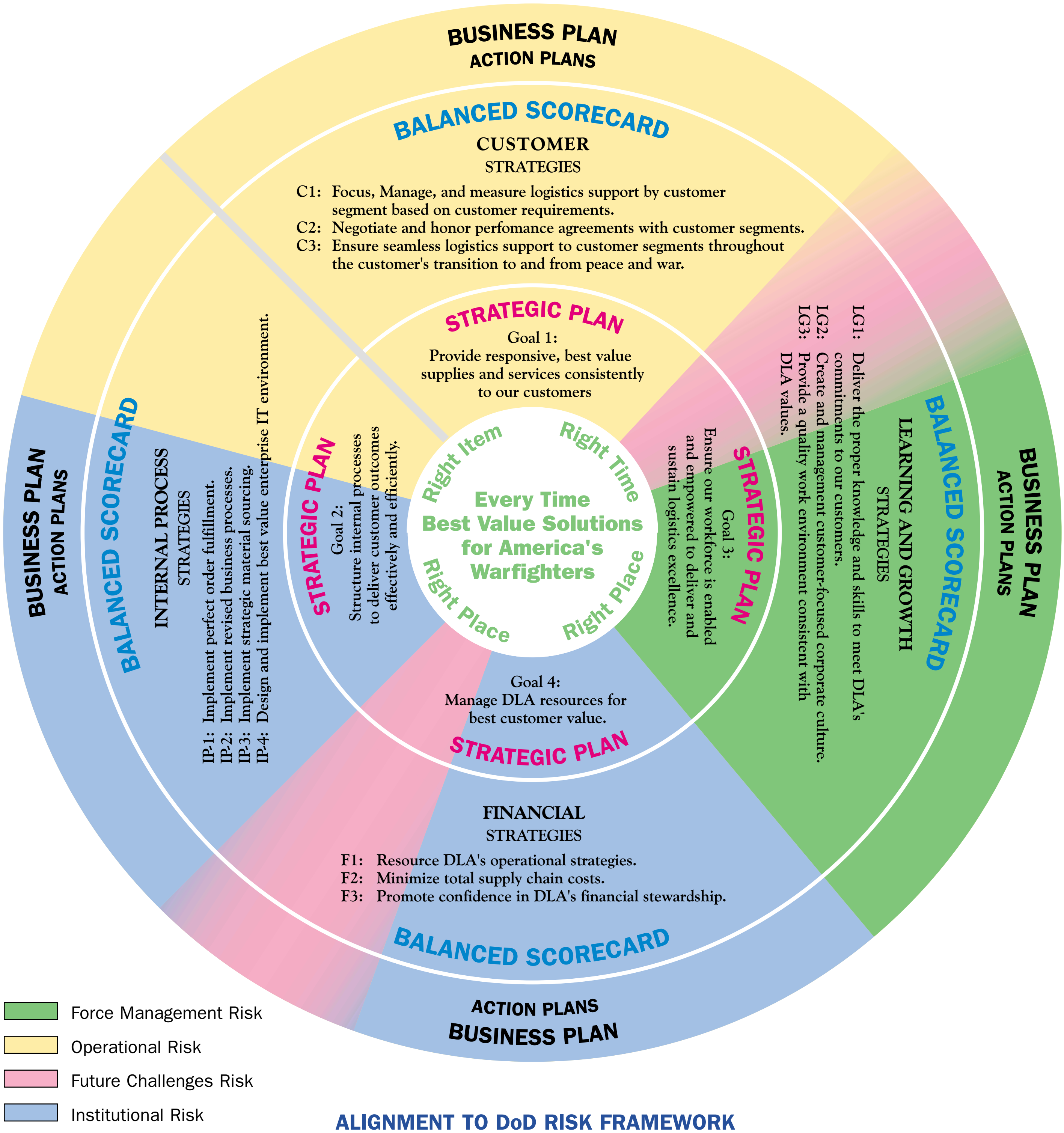
DLA has institutionalized a four-level approach to planning to formalize, align, and integrate a planning and performance measurement process. DLA's Strategic Plan is the top level with its focus on long-term outcomes. The DLA Enterprise Balanced Scorecard (BSC) — our performance plan — is the second level, with an emphasis on identifying the strategies necessary to transform the Agency in the mid-term. The Enterprise Business Plan (EBP) is the third level, highlighting the investments and actions necessary to execute our strategies and realize our objectives and the benefits of specific actions in the near term. The fourth level is performance measurement, analysis, and reporting. This level includes review and analysis of the Agency's performance against the Strategic Plan, BSC, and EBP.

Our Strategic Management System maps and tracks our transformation strategies. During 2003, we revised our BSC and our Strategic Plan to meet current customer transformational needs and aligned both our BSC and Strategic Plan (imbedded with our objectives and strategies) with the DoD Risk Framework/Scorecard. The color-coded alignment wheel, provided below, and an alignment matrix communicates — throughout the Defense community — how DLA's strategies and objectives are cross-mapped to the relevant DoD Scorecard elements.

Our Vision:

Right Item, Right Time, Right Place, Right Price, Every Time…
Best Value Solutions For America's Warfighters.

Defense Logistics Agency Strategic Management System



ALIGNMENT TO DoD RISK FRAMEWORK

At the heart of the alignment graphic is the DLA vision. Concentric circles radiating outward pictorially represent our Strategic Management System — Strategic Plan, Balanced Scorecard, and Business Plan — and demonstrate DLA's support in each of the corresponding DoD scorecard quadrants. The color coded portions align to the DoD Scorecard where green = Force Management Risk, yellow = Operational Risk, rose = Future Challenges Risk, and blue = Institutional Risk. As a DoD logistics provider, DLA closely aligns with the Institutional Risk quadrant, the object of which is to improve DoD processes and efficiencies. In addition, there is an excellent alignment between DLA's Customer Quadrant to the DoD's Operational Risk Quadrant, which defines force readiness objectives. For example, DLA's Customer Relationship Management initiatives are placing teams into theaters during contingencies and forging service-level agreements with mutually collaborated service requirements and measures of performance. Lastly, both our initiatives to perform skills gap assessments of our workforce and the design and implementation of modern information technology systems will lead to meeting Future Challenges Risk Quadrant objectives.

Our Strategic Plan identifies DLA's four strategic goals:

Strategic Goals

- Provide responsive, best-value supplies and services consistently to our customers.
- Structure internal processes to deliver customer outcomes effectively and efficiently.
- Ensure our workforce is enabled and empowered to deliver and sustain logistics excellence.
- Manage DLA resources for best customer value.

We will achieve these strategic goals through a series of integrated enterprise-wide strategies.

Goal 1. Provide responsive, best value supplies and services consistently to our customers.

Strategy 1.1. Focus, manage, and measure logistics support by customer segment based on customer requirements.

Strategy 1.2. Negotiate and honor performance agreements with our customer segments.

Strategy 1.3. Ensure seamless logistics support to customer segments during the customer's transition to and from peace and war.

Goal 2. Structure internal processes to deliver customer outcomes effectively and efficiently.

Strategy 2.1. Implement perfect order fulfillment.

Strategy 2.2. Implement revised business processes.

Strategy 2.3. Implement Strategic Material Sourcing.

Strategy 2.4. Design and implement a best value enterprise information technology (IT) environment.

Goal 3. Ensure our workforce is enabled and empowered to deliver and sustain logistics excellence.

Strategy 3.1. Deliver the proper knowledge and skills to meet DLA's commitments to our customers.

Strategy 3.2. Create and manage a customer-focused corporate culture.

Strategy 3.3. Provide a quality work environment consistent with DLA values.

Goal 4. Manage DLA resources for best customer value.

Strategy 4.1. Resource DLA's operational strategies.

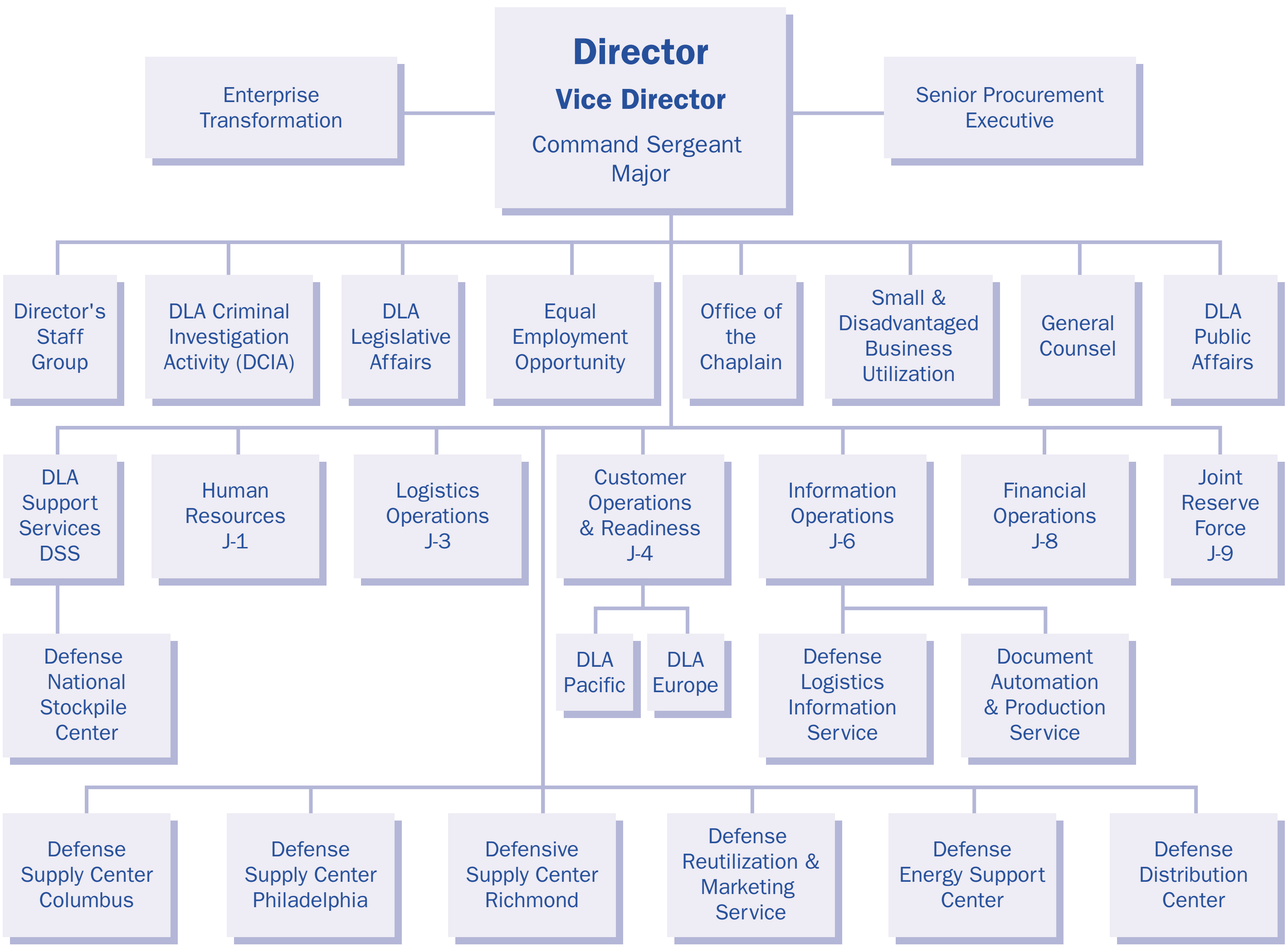
Strategy 4.2. Minimize total supply chain costs.

Strategy 4.3. Promote confidence in DLA's financial stewardship.

Organization

DLA maintains a global presence and accomplishes its mission with approximately 23,200 civilian personnel, 600 active duty personnel and 600 Reserve personnel. Despite our significant mission expansion over the last 40 years, our workforce is now at the smallest level since 1963 and we expect to reduce it even more in the future. Agency leaders are committed to the continuous assessment and transformation of our organizational culture, size, structure, and alignment through enterprise integration and partnering with the private sector. The outcomes of these efforts will enable us to implement an enterprise business model and develop, deploy, and execute an improved set of corporate business processes and strategies. By organizing as a single, integrated business enterprise, we will be in position to focus more efficiently and effectively on supporting the DoD's supply chain, enhancing the Armed Forces' readiness, and providing for the warfighter during contingency operations. We are proactive in our approach to serving those who depend on us for their mission needs, and we constantly meet face-to-face with our customers to determine their requirements and how we can best fulfill them. The establishment of the new headquarters Customer Operations and Readiness directorate in early Fiscal Year (FY) 2004 is a demonstration of this customer-focused commitment.

Our organizational structure is depicted below:



DLA's core functions are directed or supported by:

- Human Resources (J-1) provides a full range of civilian human resources services for the DLA civilian and military workforce. J-1 conducts these services from its customer support offices located in Columbus, OH, and New Cumberland, PA; a centralized military personnel support organization located at HQ DLA in Fort Belvoir, VA; and the DLA Training Center, which provides training support to its workforce - located in Columbus, OH.
- Logistics Operations (J-3) provides focused logistics support to America's Armed Forces. J-3 is responsible for logistics and acquisition policy and supply chain management. J-3 serves as the head of the logistics sector for the entire DoD under the Critical Infrastructure Protection (CIP) Program mandated by the President of the United States. Logistics Operations includes the supply management, distribution, reutilization, and marketing business areas.
- Customer Operations and Readiness (J-4) leads DLA's transformation efforts in customer relations management. J-4 enables readiness and sustainment through deeper insight into the warfighter's requirements; improves warfighter and international support and reduces costs; and expands joint planning and DLA tactics, techniques, and procedures for contingencies. J-4 serves as the head of the logistics sector for the entire DoD under the CIP Program mandated by the President of the United States. (Note: Prior to October 1, 2003, this directorate was an organizational element under J-3).
- Information Operations (J-6) is DLA's knowledge broker, and J-6 is responsible for providing comprehensive, best practice technological support to the DoD/DLA logistics community resulting in the highest quality of information systems, efficient and economical computing, data management, electronic commerce, and telecommunication services. The Director, J-6, is responsible for the development and compliance of IT policy; the development of IT plans and strategies; and the establishment of IT standards, processes, and measurements. The Director, J-6, also serves as the Agency's Chief Information Officer. Information Operations includes oversight of three field activities: the Defense Logistics Information Service, the Defense Automatic Addressing System Center, and the Document Automation and Production Service.
- Financial Operations (J-8) is the Agency's financial management process owner. J-8 is responsible for designing and implementing standard financial processes across the Agency, while determining financial services' resource requirements and performance targets and establishing financial core competency requirements. The Comptroller serves as the Agency's Chief Financial Officer and as the single spokesperson on financial management matters with external organizations.
- Joint Reserve Force (JRF) (J-9) supports DLA with trained, ready, and available reservists in contingency operations, peacetime contributory support, wartime surge support, and planning support. Further, J-9 advises the Director, DLA, on the development and application of JRF support, readiness policies, and programs.
- DLA Support Services (DSS) oversees common corporate/enterprise mission support such as strategic planning, corporate communications, environment and safety, installations, management support, quality of life, command security, protocol and special events, DLA Pacific support, and the DLA Chair, Industrial College of the Armed Forces. DSS also provides operational support to Headquarters, DLA Activity Group Missions.

The Defense-wide Working Capital Fund (DWCF) is the primary source of funds for DLA operations. During FY 03, DLA executed a total budget program of about $28 billion. The four DLA activity groups funded by the DWCF and included in these statements are supply management, distribution, reutilization and marketing, and document automation and production. Each year, DLA either obtains or returns funds to the DWCF and other DoD appropriations.

DLA also receives some direct appropriations (for purposes such as military construction) and manages the National Defense Stockpile Transaction Fund, a separate revolving fund. These funds (and related financial events) are not accounted for in these financial statements.

The following activity groups are financed by customer orders and direct appropriations through the DWCF:

Supply Management: The Supply Management activity group provides customer support through its management of logistics processes. This includes centralized management of logistics catalog information, energy, consumable spare parts, food, pharmaceuticals, medical and surgical supplies, and clothing and textiles. Supply Management operates through three supply centers located in Columbus, OH; Richmond, VA; and Philadelphia, PA; and the Defense Energy Support Center located at Fort Belvoir, VA. The Supply Management activity group is the largest of our business areas. It makes up about 95 percent of the assets, 80 percent of the liabilities, and 90 percent of revenue and costs on the financial statements.

Distribution: The Distribution activity group provides a single, unified materiel distribution system for DoD. In addition to its primary mission of receiving, storing, and issuing materiel worldwide, distribution depots perform other functions that include — but are not limited to — providing refrigerated storage, cylinder refurbishment, tent repair, medical unit assemblies, and set assembly or disassembly. The Distribution activity group is under the control of the Defense Distribution Center in New Cumberland, PA, and includes 22 subordinate distribution centers located throughout the United States, Europe, and the Pacific region.

Reutilization and Marketing: The Reutilization and Marketing activity group supports and coordinates the reuse of excess and surplus property within DoD. Property not reutilized within DoD is available for transfer to other Federal agencies or for donation to authorized non-profit organizations, state governments, and local governments. Property not reused, transferred, or donated is either sold to the public on a competitive basis or disposed of in an environmentally safe manner. A critical part of the Reutilization and Marketing mission is to arrange for the worldwide disposal of hazardous waste and material. The activity group accomplishes its mission from a Headquarters in Battle Creek, MI, and 92 Defense Reutilization and Marketing Offices located on military installations around the world.

Document Automation and Production: The Document Automation and Production Service (DAPS) activity group provides document automation and printing within the DoD. This mission encompasses electronic conversion, retrieval, output, and distribution of digital and hardcopy information. Its focus is on enabling DAPS customers to transition from hardcopy to digital/electronic-based document management. DAPS manages its worldwide mission through its Headquarters in Mechanicsburg, PA, and a network of 184 production facilities.

Defense Logistics Agency Activity Group Principal Locations

1. Defense Supply Center Columbus (DSCC)
2. Defense Supply Center Richmond (DSCR)
3. Defense Supply Center Philadelphia (DSCP)
4. Defense Energy Support Center (DESC)
5. Defense Distribution Center (DDC)
6. Defense Reutilization and Marketing Service (DRMS)
7. Document Automation and Production Service (DAPS)
8. Defense Logistic Agency Headquarters (DLA HQ)

Financial Condition

The financial statements have been prepared to report the financial position and results of operations for the DoD, pursuant to the requirements of the Title 31, United States Code, Section 3515(b).

While the statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by the Office of Management and Budget (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.

To the extent possible, the financial statements have been prepared in accordance with Federal accounting standards. At times, the DoD is unable to implement all elements of the standards due to financial management systems limitations. The DoD continues to implement system improvements to address these limitations. There are other instances when the DoD's application of the accounting standards is different from the auditor's application of the standards. In those situations, the DoD has reviewed the intent of the standard and applied it in a manner that management believes fulfills that intent. The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides resources to do so.

The DWCF was created to establish a cost-based, customer-provider relationship between the military operating forces and the DoD's support organizations. The expected outcome of this relationship is the effective and efficient delivery of goods and support services. The financial structure of the DLA DWCF allows for the identification of the full cost of activity groups, and facilitates performance measures to foster efficiency and productivity improvements. This enables the customer to make economical buying decisions using cost and delivery information in the decision-making process. In response to changing customer demands, DLA evaluates monthly financial reports and makes appropriate adjustments in budget execution during the year to ensure that the activity groups are consistent with budget execution targets and program requirements. Additionally, the financial data is used as a baseline for future budget requests and to establish prices.

The DLA DWCF finished FY 03 with total assets valued at approximately $15.9 billion and liabilities of $3.1 billion from the Consolidated Balance Sheet and a net operating loss of slightly more than $700 million on program costs of approximately $25.2 billion and revenues of approximately $24.5 billion from the Consolidated Statement of Net Cost. This loss is primarily attributed to the increase cost of petroleum, where the market-driven cost exceeded DLA's selling price by almost $1.7 billion. Much of this loss was offset by a $1.0 billion gain in other segments of DLA's businesses that were primarily driven by our support of OPERATIONS IRAQI FREEDOM AND ENDURING FREEDOM.

Systems, Controls, and Legal Compliance

The DLA system of internal accounting and administrative controls, in effect during the Fiscal Year ended September 30, 2003, was evaluated in accordance with the guidance in OMB Circular No. A-123, Management Accountability and Control, dated June 21, 1995, as implemented by DoD Directive 5010.38, Management Control Program, dated August 26, 1996 and DoD Instruction 5010.40, Management Control Program Procedures, dated August 28, 1996. The OMB guidelines were issued by the OMB Director, in consultation with the Comptroller General of the United States, as required by the Federal Managers' Financial Integrity Act of 1982. Included is an evaluation of whether the system of internal accounting and administrative control of DLA is in compliance with the standards prescribed by the Comptroller General.

Systems

For most of its history, DLA performed its complex, worldwide logistics mission with strong command and control lines along multiple business segments and programs. Over time, this led to "stovepipe" organizations that developed their own automated management (Legacy) information systems and accounting processes.

While these business practices worked well to serve the customer, they also produced a fragmented and very complex set of accounting processes and financial systems that often resulted in different accounting methods and systems used to account for essentially the same types of transactions. As part of our logistics transformation initiatives, we will dramatically improve the accuracy, timeliness, and relevance of the financial management data maintained in our logistics systems.

The Defense Finance and Accounting Service (DFAS) prepared the FY 03 DLA financial statements from available automated finance, accounting, and feeder systems (such as acquisition, logistics, and personnel systems) and manual processes. Since most of these automated systems were designed decades before the current Federal accounting standards were developed, it is difficult to collect the data needed to prepare financial statements that comply with Federal standards. Additionally, there is often insufficient documentation available to show how financial transactions are processed through those systems. These factors make it impractical to audit the financial statements and for DLA to demonstrate a high level of internal control and compliance with pertinent financial laws and regulations. Lastly, some data comes from DFAS systems that are not linked with DLA systems and cannot easily pass data among other DFAS systems.

DLA has a multitude of short and long-term efforts designed to fully assess its financial operations and to develop integrated systems and processes that are compliant with Federal system and accounting requirements. Two of our major strategies include:

- An upgrade of the DLA logistics management systems (supply/non-energy) through the Business Systems Modernization (BSM) initiative. BSM is designed to improve business practices and replace aging legacy logistics systems with commercial-off-the-shelf (COTS) enterprise resource planning software that is compliant with Federal Financial Management Improvement Act of 1996 requirements. BSM is expected to reduce costs, eliminate systemic mistakes, and provide the necessary audit trails to demonstrate financial stewardship and pass the scrutiny of financial audits. The initial release Concept Demonstration began processing customer orders on August 1, 2002, using the BSM tools and re-engineered processes for about 170,000 selected items. Functionality, users, and a small number of items will be systematically and incrementally added to the Concept Demonstration enabling it to validate system functionality prior to deploying BSM across DLA. Release 1.1, Battle Dress Uniforms and Defense Integrated Subsistence Management System will go-live in November 2003; Release 1.2, Tents, Flags, Insignia, and Accessories will go live in March 2004; and Release 2 will go live with the remaining functionality in July 2004. Following the Assistant Secretary of Defense for Network Information and Integration approval for a full rate deployment in November 2004, BSM will be deployed across DLA. The Agency plans to bring the balance of its products into the BSM system by 2006.
- The fuel legacy system is also being upgraded to a COTS package, the Fuel Automated System (FAS). FAS is an automated information system designed to support the Defense Energy Support Center (DESC) and the Military Services in performing their respective responsibilities in fuels management and distribution. FAS provides for point of sale data collection, inventory control, financial management, accounting, procurement, and facilities management. An independent verification and validation contractor concurred with the DESC executive management assertion that FAS is compliant with Federal Financial Management Improvement Act requirements. The system is expected to achieve full operational capability by 2007.

Management Controls

The DLA Management Control Program (MCP) is fully developed, and the DLA Headquarters Business Offices and DLA Field Activities continue to make progress in the expanded reporting of control weaknesses and recognizing process improvements to ensure existing internal controls remain in place or are enhanced. Accordingly, Management Control performance standards are part of supervisory/managerial performance plans and the DLA HQ Internal Support Review program requires periodic status updates on weaknesses and concerns addressed by the MCP. The program is managed at DLA HQ with local program managers assigned to each headquarters and field element. The DLA Criminal Investigation Activity works closely with other DLA Field Activities to ensure all objectives are evaluated and weaknesses identified before negative actions occur.

The evaluation of management controls extends to every responsibility and activity undertaken by DLA and is applicable to financial, administrative, and operational controls. Furthermore, the concept of reasonable assurance recognizes that: (1) the cost of management controls should not exceed the benefits that are expected to be derived and (2) the benefits consist of reductions in the risks of failing to achieve the stated objectives. The expected benefits and related costs of control procedures should be addressed using estimates and managerial judgment. Moreover, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, congressional restrictions, and other factors.

Finally, projection of any evaluation of the system to future periods is subject to the risk that procedures may be inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

The objectives of the system of internal accounting and administrative control of DLA are to provide reasonable assurance that:

- Obligations and costs are in compliance with applicable laws.
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
- Revenues and expenditures applicable to Agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial, and statistical reports.
- Accountability over the assets is maintained.

The evaluation was performed in accordance with the guidelines identified above. The results indicate that the system of internal accounting and administrative control of DLA in effect during the fiscal year that ended September 30, 2003, taken as a whole, complies with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved. This position on reasonable assurance is within the limits described in the preceding paragraphs.

Highlights presented in the FY 03 Annual Statement of Assurance demonstrates the progress made toward institutionalizing the DLA MCP.

- The MCP training course (developed in-house) was presented to the MCP local managers at the DLA MCP annual workshop. This training reinforced the training received from U.S. Department of Agriculture Graduate School in 2001 and will be presented to managers throughout DLA during FY 04.
- The DLA intranet website for MCP is continuously updated.
- A formal investigation training module in support of the Financial Liability Investigation of the Property Loss Program is being developed for use by all sites. The estimated completion date is the First Quarter, FY 04. The DLA Distribution Center has developed and distributed a standard operating procedure.
- The Joint Reserve Force (J-9) instituted and updated a standalone MCP. Practices were instituted and improved during FY 03 to ensure proper accountability of human capital management, financial management, government credit cards, government purchase cards, and government-issued equipment.
- Random quarterly reviews of Defense National Stockpile Center (DNSC) sales and acquisition files resulted in a standardized template for the negotiated sales format. The use of this template ensures consistent sales processes and procedures. Further, DNSC instituted reviews of all sales contractors to verify the adequacy of their liquidity and their ability to make payment.

During FY 01 and FY 02, DLA engaged an independent public accounting (IPA) firm to audit the Agency's FY 00 and FY 01 combined and consolidated financial statements. In FY 03, in accordance with the National Defense Authorization Act of 2002, DLA shifted the audit focus and resources to the conduct of auditability assessments in 10 specific areas. Collectively, the audits and assessment resulted in two disclaimers of opinion and reported over 150 system control and auditability deficiencies. By the end of FY 03, more than half of the deficiencies reported were corrected. The remaining unresolved deficiencies are addressed in detailed plans of action and milestones and are scheduled for resolution by the end of FY 06.

DLA's *Financial Transformation Plan* documents the strategies to achieve both auditability (the mid-term goal) and improve financial stewardship (the long-term goal). As such, it communicates these strategies throughout DLA and to our external stakeholders. A major element to the plan's execution is the use of an IPA firm to conduct auditability assessments on the areas that have not yet undergone a review. In the latter part of FY 03, we awarded a long-term contract for the conduct of these assessments and/or the audit of operations funded by the DWCF. As reflected in the plan, DLA intends to achieve the specific mid-term support objectives during the next two years in the following areas:

- Identify auditability impediments associated with our Balance Sheet accounts and other financial statements
- Prioritize and correct the deficiencies and impediments resulting from those assessments
- Build a data repository of accounting records that will support future audits
- Address and implement the changes needed to develop a financial statement compilation process that meets the financial reporting schedule and financial analysis requirements

The plan will be continually updated/revised as progress is made toward these goals or as circumstances warrant.

We made further improvements to the FY 03 financial statements and compilation process by:

- Partnering with our process owners and service providers to produce data call information and statements more timely and with better quality. For example, DLA's and DFAS's collaboration led to enhanced on-line updates into the Defense Departmental Reporting System and a more cohesive joint review and preparation of the footnotes. These efforts led to improved footnote disclosures for personnel cost data, property value information, environmental liabilities, and imputed judgment fund expenses; and the consistent application of accounting principles to DLA's business areas.
- Reconciling accounts payable balances that led to significant reductions in our Document Automation and Production Services (60 percent) and Defense Reutilization and Marketing Services (30 percent) business areas.

Despite these improvements, the financial statements are not yet auditable. Our inability to obtain a favorable audit opinion on our financial statements is included in the Annual Statement of Assurance as a material weakness.

While matters regarding systems, management controls, and legal compliance are addressed in these financial statements, additional detail about management controls are provided in the DLA FY 03 Annual Statement of Assurance.

Other Accompanying Information

Reservists: Among the manpower available to DLA are reservists who are trained logisticians. These reservists — authorized and funded by the Military Services — are used in a variety of capacities in support of peacetime operations, contingencies, and wartime surges. The continuity of operations that these reservists bring to DLA in support of the contingencies was demonstrated with the mobilization of 72 reservists under Partial Mobilization authority to support OPERATION ENDURING FREEDOM. Collectively, these reservists logged more than 26,000 man-days of support to DLA Contingency Support Teams, field activities, and headquarter's missions. Eight additional DLA reservists - providing more than 1,200 man-days of support - were mobilized under the Presidential Recall Authority and were assigned to support the Defense Reutilization and Marketing Service operations in Bosnia and Kosovo. The remaining 556 reservists provided almost 5,400 man-days of support among the various stateside DLA activities. The number of mobilized reservists in FY 03 represented a 24 percent increase over the previous year, while the number of peacetime contributory support man-days increased four-fold.

Joint Chiefs of Staff Combat Support Agency Review Team (CSART): In 2002, the CSART assessed the readiness and responsiveness of DLA's support to the operating forces. While the CSART praised the overall DLA operations, it also reported a number of significant findings and in response, DLA demonstrated commitments by:

- **Increasing the number of DLA Liaison Officers (LNO):** LNOs support the combatant commands in the event of a crisis or contingency when around-the-clock coverage is needed. During FY 03, the Northern Command LNO and Central Command Associate LNO positions were filled. Additionally, a Special Operations Command LNO and Headquarters Associate LNO position were approved. These positions will be filled in FY 04.
- **Reducing medical materiel readiness risk:** The CSART was concerned that an exclusive reliance upon medical prime vendor suppliers increased the risk of not meeting surge requirements for a large-scale contingency. To address this concern, a comprehensive medical readiness assessment was conducted by DLA, the Combatant Commanders, Military Services, Joint Readiness Clinical Advisory Board, and commercial vendors. A simulated medical exercise was not necessary because OPERATIONS ENDURING FREEDOM and IRAQI FREEDOM served as a real life test of commercial-based capabilities under which existing medical prime vendor contracts were rigorously tested. The independent assessment concluded that commercially-based medical support is a strength, not a weakness. Ninety-eight percent of sustainment supplies ordered through the established medical logistics supply chain were immediately available from contracted sources. Commercial manufacturers and distributors were able to meet the demands of these contingencies.
- **Providing weapon system repair parts:** Between FY 00 and FY 03, DLA invested $500 million to bolster its support of customers needing aviation repair parts. With the receipt of more than 70 percent of these repair parts, the supply availability for these items has risen by 27 percentage points (from 54 percent in FY 99 to 81 percent in FY 03).

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Consolidated and Combined Financial Statements

As of and for the Years Ended September 30, 2003, and 2002

UNAUDITED

Consolidated Balance Sheets

As of September 30, 2003 and 2002
(In Thousands)

	2003 Consolidated	2002 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	1,475,360	832,212
Other Assets (Note 4)	720	244
TOTAL INTRAGOVERNMENTAL ASSETS	1,476,080	832,456
Cash and Other Monetary Assets (Note 5)	6,443	4,390
Accounts Receivable (Note 3)	526,941	457,931
Inventory and Related Property (Note 6)	12,166,093	11,535,642
General Property, Plant and Equipment (Note 7)	1,519,683	1,303,793
Other Assets (Note 4)	211,110	224,735
Total Assets	**$ 15,906,350**	**$ 14,358,947**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 169,254	$ 142,959
Other Liabilities (Note 11 and Note 12)	75,064	47,889
Total Intragovernmental Liabilities	244,318	190,848
Accounts Payable (Note 9)	2,236,340	1,648,381
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities (Note 13)	315,843	199,990
Environmental Liabilities (Note 10)	68,796	–
Other Liabilities (Note 11 and Note 12)	282,791	298,152
Total Liabilities	**$ 3,148,088**	**$ 2,337,371**
NET POSITION		
Cumulative Results of Operations	12,758,262	12,021,576
Total Net Position	**$ 12,758,262**	**$ 12,021,576**
TOTAL LIABILITIES AND NET POSITION	**$ 15,906,350**	**$ 14,358,947**

The accompanying notes are an integral part of these statements.

UNAUDITED

Consolidated Statements of Net Cost

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 14.a)	2003 Consolidated	2002 Consolidated
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 2,273,794	$ 1,572,852
Less: Intragovernmental Earned Revenue	(23,426,481)	(19,435,245)
Intragovernmental Net Costs	(21,152,687)	(17,862,393)
Gross Costs With the Public	22,953,606	17,766,343
Less: Earned Revenue From the Public	(1,095,492)	(1,399,248)
Net Costs With the Public	21,858,114	16,367,095
Total Net Cost	**705,427**	**(1,495,298)**
NET COST OF OPERATIONS	**$ 705,427**	**$ (1,495,298)**

The accompanying notes are an integral part of these statements.

Consolidated Statements Changes in Net Position

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 15)	2003 Consolidated	2002 Consolidated
BEGINNING BALANCES	**$ 12,021,576**	**$ 10,867,320**
Budgetary Financing Sources:		
Appropriations used	1,209,000	75,700
Other budgetary financing sources	253,337	4,636
Other Financing Sources:		
Transfers-in/out without reimbursement	(153,465)	(542,298)
Imputed Financing Sources	133,241	120,920
Total Financing Sources	1,442,113	(341,042)
Net Cost of Operations	**705,427**	**(1,495,298)**
ENDING BALANCES	**$ 12,758,262**	**$ 12,021,576**

The accompanying notes are an integral part of these statements.

UNAUDITED

Combined Statements of Budgetary Resources

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 16.a)	**2003 Combined**	**2002 Combined**
BUDGETARY RESOURCES:		
Budget Authority:		
Appropriations received	$ 364,000	$ 75,700
Contract authority	26,861,314	335,738
Net transfers (+/-)	845,000	–
Unobligated balance:		
Beginning of period	840,758	532,016
Net transfers, actual	125,000	–
Spending authority from offsetting collections:		
Earned		
Collected	24,762,064	21,007,872
Receivable from Federal sources	556,771	358,247
Change in unfilled customer orders		
Advance received	(48,432)	(13,994)
Without advance from Federal sources	718,900	226,053
Subtotal	25,989,303	21,578,178
Recoveries of prior year obligations	–	31
Permanently not available	(26,852,598)	(18,095)
Total Budgetary Resources	**$ 28,172,777**	**$ 22,503,568**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 27,963,562	$ 21,662,810
Subtotal	27,963,562	21,662,810
Unobligated balance:		
Apportioned	(13,834)	840,758
Other available	1	–
Unobligated Balances Not Available	223,048	–
Total, Status of Budgetary Resources	**$ 28,172,777**	**$ 22,503,568**

UNAUDITED

Combined Statements of Budgetary Resources (Continued)

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 16.a)	2003 Combined	2002 Combined
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 7,125,765	$ 6,643,099
Obligated Balance, Net — end of period:		
Accounts receivable	(2,048,139)	(1,491,369)
Unfilled customer order from Federal sources	(2,674,133)	(1,955,234)
Undelivered orders	9,689,047	8,313,599
Accounts payable	2,895,820	2,258,769
Outlays:		
Disbursements	25,951,065	20,595,814
Collections	(24,713,632)	(20,993,879)
Subtotal	1,237,433	(398,065)
Net Outlays	**$ 1,237,433**	**$ (398,065)**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Financing

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 17)	2003 Consolidated	2002 Consolidated
RESOURCES USED TO FINANCE ACTIVITIES:		
Budgetary Resources Obligated		
Obligations incurred	$ 27,963,562	$ 21,662,810
Less: Spending authority from offsetting collections and recoveries	(25,989,303)	(21,578,209)
Obligations net of offsetting collections and recoveries	1,974,259	84,601
Net obligations	1,974,259	84,601
Other Resources		
Transfers in/out without reimbursement	(153,465)	2,045
Imputed Financing Sources	133,241	120,920
Net other resources used to finance activities	(20,224)	122,965
Total resources used to finance activities	**1,954,035**	**207,566**

UNAUDITED

Consolidated Statements of Financing (CONTINUED)

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 17)	2003 Consolidated	2002 Consolidated
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	(1,361,565)	(1,194,234)
Unfilled Customer Orders	670,470	212,060
Resources that fund expenses recognized in prior periods	(104)	(54,503)
Resources that finance the acquisition of assets	(1,681,433)	(690,365)
Other	153,466	24
Total resources used to finance items not part of the net cost of operations	(2,219,166)	(1,727,018)
Total resources used to finance the net cost of operations	**(265,131)**	**(1,519,452)**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	(101,213)	8,013
Increase in environmental and disposal liability	68,655	–
Increase in exchange revenue receivable from the public	(1,690)	–
Other	135,665	–
Total components of Net Cost of Operations that will require or generate resources in future periods	101,417	8,013
Components not Requiring or Generating Resources		
Depreciation and amortization	137,022	155,960
Revaluation of assets or liabilities	732,323	(167,993)
Other	(204)	28,174
Total components of Net Cost of Operations that will not require or generate resources	869,141	16,141
Total components of net cost of operations that will not require or generate resources in the current period	**970,558**	**24,154**
Net Cost of Operations	**$ 705,427**	**$ (1,495,298)**

The accompanying notes are an integral part of these statements.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Notes to the Consolidated and Combined Financial Statements

For the Years Ended
September 30, 2003, and 2002

Note 1. Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements have been prepared to report the financial position, net cost, and changes in net position of the Defense Logistics Agency (DLA), together with budgetary resources and a reconciliation of net costs to budgetary obligations that are financed by the Defense-wide Working Capital Fund (DWCF), as required by the Chief Financial Officers Act of 1990 and amended by the Government Management Reform Act of 1994. The financial statements do not include DLA operations funded through direct or general appropriations or the Stockpile, which is a non-working capital revolving fund. The financial statements have been prepared from books and records of DLA in accordance with Office of Management and Budget (OMB) Bulletin No. 01-09, Form and Content of Agency Financial Statements, as amended, and the Department of Defense (DoD) Financial Management Regulation ("DoDFMR") and, to the extent possible, generally accepted accounting principles (GAAP). The DLA's financial statements are in addition to the financial reports also prepared by the DLA pursuant to OMB directives that are used to monitor and control DLA's use of budgetary resources.

DLA is unable to fully implement all elements of GAAP and OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including non-financial feeder systems and processes. Preparing reliable financial statements also depends on the adequacy of the systems and processes used by Defense Finance and Accounting Service (DFAS), which are also not fully compliant with Federal accounting and system requirements. Reported values and information for DLA major asset and liability categories are derived largely from non-financial feeder systems, such as acquisition, property, and logistic systems. Other cost and liability information is derived from 3rd party provider such as imputed costs and liability estimates. These systems were designed to support reporting requirements that focused on asset accountability and funds control rather than supporting preparation of financial statements.

DLA and DFAS continue to implement process and system improvements to address the system and process limitations as they relate to complying with GAAP and OMB Bulletin No. 01-09.

B. Mission of the Reporting Entity

Our primary mission is to provide best value logistics solutions to meet the needs of America's armed forces around-the-clock and around-the-world in times of peace, national emergency, and war. Support begins with joint planning for parts used in new weapons systems, extends through production and contract support, distribution and warehousing, and concludes with the disposal of materiel that is obsolete, worn out, or no longer needed.

DLA provides supply support, technical/logistics services and quality support to all branches of the military. The services it provides fall into the following DWCF activity groups: Supply Management, Distribution, Reutilization and Marketing Service (DRMS), and the Document Automation and Production Service (DAPS). The DWCF includes DLA and other Defense Agencies. The DWCF together with the other four DoD WCFs comprise the Defense-wide WCF.

C. Appropriations and Funds

DLA received its initial working capital through a transfer of resources from existing appropriations or funds and used those capital resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders and other sources. Receipts derived from operations generally are available in their entirety for use without further congressional action.

The DWCF operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision-making process. The DWCF builds on revolving fund principles previously used for industrial and commercial type activities.

The asset accounts on the statements are categorized as either entity or non-entity. Entity assets consist of resources that the Agency has the authority to use or where management is legally obligated to use funds to meet entity obligations. Non-entity accounts are assets that are held by an entity but are not available for use in the operations of the entity.

As part of the DWCF, DLA is provided two forms of budgetary authority: contract authority and anticipated reimbursement authority. DLA's Supply Management, Distribution, and DRMS activities are provided contract authority for both operations and capital programs. DAPS is provided anticipated reimbursement authority for its operations and contract authority for its capital programs. Contract authority allows for the incurring of obligations prior to receipt of customer sales whereas for anticipated reimbursements customer orders are to be received prior to incurring obligations.

D. Basis of Accounting

DLA generally records transactions on an accrual basis of accounting. However, some of the DLA financial and non-financial feeder systems and processes used to prepare the financial statements are not designed to collect and record financial information on an accrual basis. Efforts are underway to determine the actions required to bring all of its financial and non-financial feeder systems and processes into compliance with all elements of GAAP. Until such time that all of the accounting processes and systems are updated to collect and report financial information as required by GAAP, some of DLA's financial data will be based on budgetary transactions (obligations, disbursements, collections), data calls, and non-financial feeder systems.

E. Revenues and Other Financing Sources

Exchange revenue is recognized at the point when rendered services are completed and billed or at the point where inventory items are sold. Certain distribution activity group revenues are recognized based on the actual workload for the period. These revenues may be billed up to 2 months after work is performed. These financial statements include an adjustment to accrue these billings. Revenue is not earned to offset costs incurred by the DRMS activity group's transfer and donation programs.

DLA does not include non-monetary support provided by U.S. Allies for common defense and mutual security in its list of other financing sources that appear in the Statements of Financing. The U.S. has agreements with foreign countries that include either direct or indirect sharing of costs that each country incurs in support of the same general purpose. Examples include countries where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed or where the U.S. fleet is in a port. DoD is reviewing these types of financing and cost reductions in order to establish accounting policies and procedures to identify what, if any, of these costs are appropriate for disclosure in the financial statements in accordance with generally accepted accounting principles. Recognition of support provided by host nations would affect both financing sources and recognition of expenses.

F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because DLA's financial and non-financial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, and environmental liabilities. Expenditures are recognized as expenses in DLA's operations when depreciated in the case of property, plant and equipment or consumed in the case of operating materials and supplies. Net increases or decreases in unexpended appropriations are recognized as a change in the net position. Certain expenses, such as military leave earned but not taken are financed in the period in which payment is made. Operating expenses were adjusted as a result of the elimination of balances between DoD Components. See Note 14.D, Intragovernmental Revenue and Expenses, for disclosure of adjustment amounts.

G. Accounting for Intragovernmental Activities

DLA, as an Agency of the Federal Government, interacts with and is dependent upon the financial activities of the Federal Government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to DLA as though the Agency is a stand-alone entity.

DLA civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while the Military Retirement System (MRS) covers military personnel. Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. DLA funds a portion of the civilian and military pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). DLA recognizes an imputed expense in the Statements of Net Cost for the portion of civilian employee pensions and other retirement benefits funded by the OPM; and recognizes corresponding imputed financing sources in the Statements of Changes in Net Position from the civilian employee pensions and other retirement benefits.

The DoD reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Fund financial statements. The DoD recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization column of the DoD Agency-wide consolidating/combining statements.

To prepare reliable financial statements, transactions occurring between components or activities within DLA must be eliminated. However, DLA as well as other government agencies cannot accurately identify all intragovernmental transactions by customer. DFAS is responsible for eliminating transactions between components or activities of DLA. Since Fiscal Year 1999, seller entities within the DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side departmental accounting offices, and DFAS adjusted the buyer-side records to recognize unrecorded costs and accounts payable. Likewise, DFAS adjusted DLA's records for the seller-side balances it obtained from other DoD activities. Internal DoD intragovernmental balances were then eliminated to the extent possible.

H. Transactions with Foreign Governments and International Organizations

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, the DoD has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or at a loss to the U.S. Government. Customers may be required to make payments in advance.

I. Funds with the U.S. Treasury

The financial resources of the DWCF are maintained in U.S. Treasury accounts. Cash collections, disbursements, transfers, and adjustments are processed worldwide at DFAS, Military Services, General Services Administration, U.S. Army Corps of Engineers, and by the Department of State financial service centers. Each disbursing station prepares monthly reports, which provide information to the U.S. Treasury on check issues, electronic funds transfers, interagency transfers and deposits. Additionally, the DFAS centers submit reports to the Treasury by appropriation, on interagency transfers, collections received, and disbursements issued. The Treasury records this information to the applicable appropriation Fund Balance With Treasury (FBWT) account that they maintain. DLA's funds are maintained at the Treasury within appropriation 97 X 4930.005.

Periodically, the Office of Under Secretary of Defense (Comptroller) (OUSD(C)) authorizes cash transfers between services within the DWCF as well as within different general funds. These transfers are recorded in DLA's FBWT preclosing financial statements. However, since DWCF reporting entities do not maintain FBWT at the DLA or activity level, these amounts are transferred to the component financial statements maintained at the DoD level (97 X 4930.005). These amounts are then included with the other defense agency funds in this appropriation.

J. Foreign Currency

DLA conducts a portion of its operations overseas within the DWCF. Any gains or losses incurred from Foreign Currency Fluctuation are accounted for during the rate development process.

K. Accounts Receivable

Accounts receivable consists of accounts, claims, refunds, and refunds receivable from other Federal entities or from the public. Allowances for uncollectible accounts due from the public are based upon analysis of collection experience by fund type. DoD does not recognize an allowance for uncollectible amounts for intragovernmental accounts receivable because all of the accounts receivable are due from other Federal agencies and are deemed to be fully collectible. For public accounts receivable, DLA primarily uses a percentage method which applies percentages against aged categories excluding contractor claims or any other significant items to determine an estimated allowance for doubtful accounts. Material disclosures are provided in Note 3.

L. Inventories and Related Property

Effective October 1, 2002, Statement of Federal Financial Accounts Standards (SFFAS) Number 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* revised accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). The standard renames National Defense Property, Plant, and Equipment to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades. Likewise, military equipment (previously referred to as National Defense Property, Plant, and Equipment) also includes items which will now be classified as operating materials and supplies.

Implementation of the new accounting principles requires the adjustment of the operating materials and supplies October 1, 2002, balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed and is discussed further in Note 6.b.

DoD inventories are primarily reported at approximate historical cost based on Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The LAC method is used because inventory data is maintained in logistics systems designed for materiel management purposes. These systems provide accountability and visibility over inventory items; however, they do not maintain the historical cost data necessary to comply with the SFFAS No. 3, *Accounting for Inventory and Related Property.* They also cannot directly produce financial transactions using the United States Government Standard General Ledger (USSGL), as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). For the most part, these systems value inventory at LAC and the reported amounts must be adjusted to approximate historic cost. DoD is transitioning to a Moving Average Cost (MAC) methodology for valuing inventory that when fully implemented will allow the DoD to comply with SFFAS No. 3.

DLA also primarily uses the LAC method because its inventory systems were designed for materiel management rather than accounting. DFAS, at the direction of the OUSD(C), uses a formula to estimate the approximate historical cost of DLA inventories. DLA is implementing an integrated Enterprise Resource Planning (ERP) system which will value inventory at MAC. Additional information is in Note 6A.

SFFAS No. 3 distinguishes between “inventory held for sale” and “inventory held in reserve for future sale.” There is no management or valuation difference between the two USSGL accounts. Further, the DoD manages only military or government-specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in the DoD material management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DoD holds material based on military need and support for contingencies. Therefore, DLA does not attempt to account separately for items held for current or future sale.

Related property includes Operating Materials and Supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD uses the consumption method of accounting for OM&S, for the most part, expensing material when it is issued to the end user. Where current systems cannot fully support the consumption method, DLA uses the purchase method i.e., expensed when purchased.

M. General Property, Plant and Equipment

Effective October 1, 2002, Statement of Federal Financial Accounting Standards No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* revises accounting principles for military equipment (previously referred to as National Defense Property, Plant, and Equipment). The standard renames National Defense Property, Plant, and Equipment to military equipment, classifies military equipment as general property, plant, and equipment, and requires the capitalization and depreciation of the cost of military equipment, including the cost of modifications and upgrades.

Implementation of the new accounting principles requires the adjustment of the October 1, 2002, General Property, Plant, and Equipment (General PP&E) balance to recognize the investment, accumulated depreciation, and net book value of military equipment that previously had been expensed.

General PP&E assets are capitalized at cost if the acquisition is $100 thousand or more and has a useful life of 2 or more years. All General PP&E is depreciated on a straight-line basis. For WCF activities, all PP&E used in the performance of their mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E categories. National Defense PP&E, Heritage Assets, and Stewardship Land owned or maintained on a WCF installation are reported in the Required Supplementary Stewardship Information. USC Title 10 prohibits DoD Agencies from owning property; therefore, DoD has expanded the recognition criteria of SFFAS No. 6 to more accurately report the financial position of its member agencies in accordance with DoD regulations. Defense agencies recognize capital assets when they are deemed to be the predominant user of the asset. In those instances where original acquisition cost of General PP&E were not available, estimates have been used. Such estimates are based on either (1) the cost of similar assets at the time of acquisition or (2) the current cost of similar assets discounted for inflation to the time of acquisition.

Prior to Fiscal Year 1996, General PP&E was capitalized if it had an acquisition cost of $15,000, $25,000, and $50,000 for Fiscal Years 1993, 1994, and 1995, respectively, and an estimated useful life of 2 or more years. These assets remain capitalized and reported on the WCF financial statements.

The DLA financial feeder systems and its policies and processing procedures do not adequately account for internal use software costs in accordance with SFFAS No. 10, *Accounting for Internal Use Software*. DLA's financial systems (and component financial feeder systems) do not meet the provisions of SFFAS No. 10 in capturing cost at the appropriate detail level. The financial and financial feeder systems supporting or owned by DLA fall into this category. DLA is participating in the Office OUSD(C) led working group established to address the DLA's inability to comply with the standard.

The OUSD(C) working group is developing standard policies, procedures, and guidelines for capturing the costs of internal use software. When OUSD(C) completes its work and issues guidance, DLA will comply with the provisions promulgated. DLA HQ will subsequently issue policy guidance to its business offices and its field activities. Such guidance may require changes to existing, or DLA emerging systems, and will require manual work around procedures until all systems are capable of capturing the information at the appropriate level. Material disclosures are providedÏ at Note 7.

N. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

O. Leases

Generally, lease payments are for the rental of equipment, space, and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) and the value equals or exceeds the current DoD capitalization threshold, the applicable asset and liability are recorded. The amount recorded is the lesser of the present value of the rental and other lease payments during the lease term, excluding that portion of the payments representing executory costs paid to the lesser or the asset's fair value. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and recorded as expenses as payments are made over the lease terms. DLA currently does not have the necessary policies, procedures, or systems in place to obtain this data.

P. Other Assets

DLA conducts business with commercial contractors under two primary types of contracts — fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that these long-term contracts can cause, DLA provides financing payments. One type of financing payment that DLA makes is based on percentage of the work completed.

In accordance with the SFFAS No. 1, *Accounting for Selected Assets and Liabilities,* such payments are treated as construction in process and are reported on the General PP&E line and in Note 7, General PP&E, Net.

In addition, based on the provision of the Federal Acquisition Regulations, DLA makes financing payments under fixed price contracts that are not based on a percentage of completion. DLA reports these financing payments as advances or prepayments in the "Other Assets" line item because they become a DLA liability only after the contractor delivers the goods in conformance with the contract terms.

If the contractor does not deliver a satisfactory product, DLA is not obligated to reimburse the contractor for its costs, and the contractor is liable to repay DLA for the full amount of the advance.

Q. Contingencies and Other Liabilities

The SFFAS No. 5, *Accounting for Liabilities of the Federal Government,* defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to DLA. The uncertainty will be resolved when one or more future events occur or fail to occur. A contingency is recognized as a liability when it is probable that the future event or events will confirm the loss or the incurrence of a liability for the reporting entity and the amount of loss can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectability of receivables, pending or threatened litigation, possible claims, and assessments. DLA's loss contingencies arising from pending or threatened litigation or claims and assessments occur due to events such as vehicle accidents, property or environmental damages, and contract disputes.

R. Accrued Leave

Civilian annual leave and military leave are accrued as earned, and the accrued amounts are reduced as leave is taken. The balances for annual and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates.

S. Net Position

DLA's net position consists of cumulative results of operations. Net position includes the cumulative amount of transfers in and out of assets without reimbursement. Cumulative results of operations for working capital funds represents the excess of revenues over expenses since the fund inception, transfers of assets in or out without reimbursement since the fund inception, less refunds to customers, and future funding requirements.

Note 2. Nonentity and Entity Assets

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003			2002
	Nonentity	**Entity**	**Total**	**Total**
Intragovernmental Assets				
Accounts Receivable	$ –	$ 1,475,360	$ 1,475,360	$ 832,212
Other Assets	–	720	720	244
Total Intragovernmental Assets	$ –	$ 1,476,080	$ 1,476,080	$ 832,456
Non-Federal Assets				
Cash and Other Monetary Assets	$ 6,443	$ —	$ 6,443	$ 4,390
Accounts Receivable	9,477	517,464	526,941	457,931
Inventory and Related Property	–	12,166,093	12,166,093	11,535,642
General Property, Plant and Equipment	–	1,519,683	1,519,683	1,303,793
Other Assets	–	211,110	211,110	224,735
Total Non-Federal Assets	$ 15,920	$ 14,414,350	$ 14,430,270	$ 13,526,491
TOTAL ASSETS	**$ 15,920**	**$ 15,890,430**	**$ 15,906,350**	**$ 14,358,947**

Cash and Other Monetary Assets: The $6,443 thousand in cash represents bid collections received by the Defense Reutilization & Marketing Service. The collections are received and accounted for in a suspense account. At the time the appropriate bid selection is made, these funds are returned to the bidder(s). For financial statement presentation these bid collections are shown as nonentity assets.

Nonentity Non-Federal Accounts Receivable: The $9,477 thousand includes the interest and penalties that are related to the non-Federal accounts receivable that have been referred to DFAS Debt Management for collection. This amount is nonentity because upon collection the amount will be transferred to Treasury. An offsetting liability has been established to account for this custodial action. This information was not shown in the prior year but has been shown in this year's statements due to a change in practice.

Note 3. Accounts Receivable

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003			2002
	GROSS AMOUNT DUE	ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS	ACCOUNTS RECEIVABLE, NET	ACCOUNTS RECEIVABLE, NET
Intragovernmental Receivables	$ 1,475,360	N/A	$ 1,475,360	$ 832,212
Non-Federal Receivables, Net	532,263	(5,322)	526,941	457,931
TOTAL ACCOUNTS RECEIVABLE	**$ 2,007,623**	**$ (5,322)**	**$ 2,002,301**	**$ 1,290,143**

Allowance Method:

The primary allowance method used for calculating the uncollectible amounts is a percentage method which applies percentages against aged categories excluding contractor claims or any other significant items with the excluded items identified.

Allocation of Undistributed Collections: The difference between collections that are reported on the Cash Management Report, cumulative from inception, and collections reported on the entity general ledger is referred to as undistributed collections. DoD FMR Volume 6B, Chapter 4, requires that undistributed collections are offset against an entity's Federal and Non-Federal accounts receivable balances. Undistributed collections at September 30, 2003, were $106,317 thousand, an increase of $89,004 thousand over the September 30, 2002, amount of $17,313 thousand.

A portion of the undistributed collections cannot be reconciled to known differences, such as unmatched collections or in-transit collections and are considered as unsupported undistributed collections. In accordance with recent guidance from DFAS-Arlington, the accounts receivable are only reduced by the supported portion of the undistributed collections. The unsupported portion has been reclassified from United States Standard General Ledger (USSGL) 1310 — Accounts Receivable (either intra-governmental or non-Federal) to USSGL 2400–Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections (non-Federal). USSGL 2400 (non-Federal) is included in the Other Liabilities With the Public line on the Balance Sheet and is not included in this note. The amount reclassified from USSGL 1310 to USSGL 2400 was $25,385 thousand.

Elimination Adjustments: While DLA's non-stock fund systems capture trading partner data at a transaction level in a manner that facilitates trading partner aggregations, DLA's legacy stock fund systems do not. Allocation of non-interfund intragovernmental trading partner data is based on the percentage of funds recorded at the appropriation level for interfund reimbursement transactions posted on DLA's general ledgers. By design, the interfund system provides appropriations from which DLA's customers pay for the material bought from its inventories. DLA's Enterprise Resource Planning System, Business Systems Modernization (BSM), will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations.

The volume of intragovernmental transactions is so large that after-the-fact reconciliations can not be accomplished with the existing or foreseeable resources. The transaction source data is the sum of WCF reimbursable issues billed and collected through the interfund system for the period. Entity or buyer information is derived from allocations based on a percentage of specific transaction activity as compared to the total activity except where the entity data can be derived directly from the general ledger accounts.

Some of the entity information was not able to be tied to a specific trading partner and resulted in not all intragovernmental receivables being included in the eliminations entries. This remaining balance after elimination entries in intragovernmental receivables was reclassified to non-Federal in order to have the intragovernmental amount on the Government Wide statements adjust to zero. The amount of the adjustment was $38,594 thousand. Total intra-DLA eliminations (eliminations of amounts owed by one DLA activity to another) were $111,755 thousand.

Intragovernmental Receivables Over 180 Days: The DLA's systems that are capable of aging receivables over 180 days (120 days for Supply Management Materiel) have $261,859 thousand of intragovernmental in that category. This aging category has not been adjusted to account for undistributed collections greater than 180 days or elimination adjustments discussed above.

Non-Federal Receivables Over 180 Days: DLA's systems that are capable of aging receivables over 180 days (120 days for Supply Management Materiel) have $104,573 thousand of non-Federal receivables in that category. This aging category has not been adjusted to account for undistributed collections greater than 180 days.

Fluctuations and/or Abnormalities: DLA's accounts receivable balances increased due to support for OPERATIONS IRAQI FREEDOM and ENDURING FREEDOM. One major area of increase was in the Over Ocean Transportation, which accounted for $519,800 thousand of the increase.

Note 4. Other Assets

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003	2002
Intragovernmental Assets		
Advances and Prepayments	$ 720	$ 244
Non-Federal Assets		
Other Assets (With Public)	$ 211,110	$ 224,735
TOTAL OTHER ASSETS	**$ 211,830**	**$ 224,979**

The majority of the Other Assets with the Public, $210,224 is attributable to progress payments made to contractors.

Note 5. Cash and Other Monetary Assets

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003	2002
Cash	$ 6,443	$ 4,390
TOTAL CASH AND OTHER MONETARY ASSETS	**$ 6,443**	**$ 4,390**

Restriction on Cash: The $6,443 thousand in cash represents bid collections received by the Defense Reutilization & Marketing Service still remaining in suspense as of September 30, 2003. In accordance with DoD FMR Volume 11A, Chapter 5, bid deposits are recorded in suspense account X6501. The collections received are accounted for in a suspense account. At the time the appropriate bid selection is made, these funds are either returned to the unsuccessful bidder(s) or transferred to the appropriate account.

Note 6. Inventory and Related Property, Net

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003	2002
Inventory, Net (Note 6.A.)	$ 12,157,521	$ 11,525,134
Operating Materials and Supplies, Net (Note 6.B.)	8,572	10,508
TOTAL	**$ 12,166,093**	**$ 11,535,642**

Note 6.A. Inventory, Net

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003				2002
	Inventory Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method	Inventory, Net
Inventories Categories:					
Available and Purchased for Resale	$ 12,471,229	$ (324,225)	$ 12,147,004	Adjusted LAC/MAC	$ 11,514,112
Held for Repair	10,913	(396)	10,517	Adjusted LAC	11,022
Excess, Obsolete, and Unserviceable	3,022,476	(3,022,476)	–	NRV	–
TOTAL	**$ 15,504,618**	**$ (3,347,097)**	**$ 12,157,521**		**$ 11,525,134**

Legend for Valuation Methods

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

MAC = Moving Average Cost

NRV = Net Realizable Value

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, fuels, medical items, and Meals Ready to Eat (MRE). Inventory is tangible personal property that is:

1. Held for sale or held for repair for eventual sale;
2. In the process of production for sale; or
3. To be consumed in the production of goods for sale or in the provision of services for a fee.

Inventory Categories

Inventory Available and Purchased for Resale includes consumable spare and repair parts and repairable items owned and managed by the DoD. Material Available and Purchased for Resale includes material held based on a managerial determination that it should be retained to support military or national contingencies.

Inventory Held for Repair is damaged inventory that requires repair to make suitable for sale. Many of the inventory items are more economical to repair than to procure. In addition, because the DoD often relies on weapon systems and machinery no longer in production, the DoD supports a process that encourages the repair and rebuilding of certain items. This repair cycle is essential to maintaining a ready, mobile, and armed military force.

(Excess, Obsolete, and Unserviceable (EOU) inventory consists of scrap materials or items that cannot be economically repaired and are awaiting disposal. Potentially reusable material, presented in previous years as EOU is included in "Held for Use" or "Held for Repair" categories according to its condition.

Inventory Valuation

In a July 6, 2001, memo, OUSD(C) prescribed moving average cost as the inventory valuation method to be used within the DoD. OUSD(C) also noted that the DoD's legacy systems were not designed to maintain historical cost valuation for inventory held for sale and operating materials and supplies in compliance with GAAP. Therefore, until the legacy systems are replaced, alternative valuation methods have been authorized for continued use for other functional requirements (e.g. logistics, procurement and budget) as deemed necessary. The alternative valuation methods authorized include LAC and standard price.

In August 2002, DLA launched a new system, BSM which incorporates the moving average cost method. Fuels Automated System (FAS), which is another system under development, uses the transactional First In First Out method. The remaining inventory items reported on the financial statements are derived from legacy logistics systems designed for materiel management rather than accounting. These systems do not maintain the historical cost data necessary to comply with the SFFAS No. 3, *Accounting for Inventory and Related Property.*

Inventories in these legacy systems are valued at LAC, and they approximate historical cost. The LAC method applies the last representative invoice price to all like units held, including units acquired through donation, non-monetary exchange, and returns from end use or reutilization. Generally, LAC is determined by subtracting surcharges that have been applied to the standard cost of an item to arrive at the price most recently paid for the item. In prior years (FY 92-96), gains or losses that resulted from valuation changes for inventory items were immediately recognized and reported in the operating results in the Statements of Net Cost as a cost of goods sold.

The use of LAC requires these amounts be recognized only upon the sale or disposal of material, rather than as the price variance occurs. Therefore, to approximate historical cost, the OUSD(C) inventory model is used to calculate unrealized holding period gains and losses. This allowance account is not under general ledger control of the individual stock fund commodities.

The total Gross Value of "Available and Purchased for Resale" amount is composed of BSM and Legacy elements as follows:

Element	Amount	Valuation Method
BSM	$ 205,080	Moving Average Cost
Legacy	12,266,149	Adjusted LAC
Total (in thousands)	**$ 12,471,229**	

The entire Gross Value amount shown above in "Held for Repair" category is from the Legacy system.

The Gross Value in the EOU account consists of amounts from Supply Management and DRMS as follows:

Supply Management	$ 361
DRMS	$ 3,022,115
Total	**$ 3,022,476**

Note 6.B. Operating Materials and Supplies, Net

DLA's Operating Materials and Supplies (OM&S) are classified as "Held for Use." As of September 30, 2003, the OM&S gross value was $8.6 million as compared to the September 30, 2002, value of $10.5 million.

DAPS Operating Materials and Supplies are composed primarily of paper and toner, as well as CD-ROM disks. DAPS uses an assorted variety of paper, in size, color, and texture/weight. These materials and supplies are consumed in the production of end products for the DAPS customer and continued improvements to the automated production of electronic documents are produced via CD-ROM disks.

OM&S data reported on the financial statements are derived from logistics systems designed for material management purposes. These systems do not maintain the historical cost data necessary to comply with the SFFAS Number 3, *Accounting for Inventory and Related Property.*

In addition, while these logistics systems provide management information on the accountability and visibility over OM&S items, the timeliness at which this information is provided creates issues regarding the completeness and existence of the OM&S quantities used to derive the values reported on the financial statements.

DLA uses the purchase method of accounting for OM&S in situations where it is more cost beneficial than the consumption method. Current financial and logistic systems do not fully support the consumption method. According to Federal accounting standards, the consumption method of accounting should be used to account for OM&S unless (1) the amount of OM&S is not significant, (2) OM&S are in the hands of the end user for use in normal operations, or (3) it is cost-beneficial to expense OM&S when purchased (purchase method). DoD has reached an agreement with OMB, the General Accounting Office (GAO), and the DoD Inspector General (DoDIG) to move to the consumption method of accounting for OM&S in future years. Based on this agreement, DoD, in consultation with its auditors, will (1) develop a framework for conducting cost-benefit analyses for use in determining whether the consumption method is cost beneficial for selected instances of OM&S; (2) develop specific criteria for determining when OM&S amounts are not significant for the purpose of using the consumption method; (3) develop functional requirements for feeder systems to support the consumption method; and (4) identify feeder systems that are used to manage OM&S items and develop plans to revise those systems to support the consumption method.

However, for FY 03, significant portions of DLA's OM&S were reported under the purchase method because the systems could not support the consumption method of accounting.

Note 7. General Property, Plant and Equipment, Net

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003					2002
	Depreciation/ Amortization Method	Service Life	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value	Net Book Value
Major Asset Classes						
Buildings, Structures, Facilities	S/L	20 Or 40	$ 1,891,189	$ (1,159,728)	$ 731,461	$ 671,639
Software	S/L	2-5 Or 10	476,314	(250,584)	225,730	127,293
Equipment	S/L	5 Or 10	598,996	(371,426)	227,570	218,664
Construction-in-Progress	N/A	N/A	334,922	N/A	334,922	286,197
TOTAL GENERAL PP&E			**$ 3,301,421**	**$ (1,781,738)**	**$ 1,519,683**	**$ 1,303,793**

Real Property in the Hands of Contractors: The value of the DLA real property in the possession of contractors is included in the values reported above for the major classes of Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E above the DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. In accordance with an approved strategy with OMB, GAO and DoD IG, the DoD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with generally accepted accounting standards.

Construction-in-Progress: The amount identified above primarily accounts for software development.

Note 8. Liabilities Not Covered and Covered by Budgetary Resources

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003			2002
	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	Total
Intragovernmental Liabilities				
Accounts Payable	$ 169,254	$ –	$ 169,254	$ 142,959
Other	5,973	69,091	75,064	47,889
Total Intragovernmental Liabilities	**$ 175,227**	**$ 69,091**	**$ 244,318**	**$ 190,848**
Non-Federal Liabilities				
Accounts Payable	$ 2,236,340	$ –	$ 2,236,340	$ 1,648,381
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	–	315,843	315,843	199,990
Environmental Liabilities	–	68,796	68,796	–
Other Liabilities	282,791	–	282,791	298,152
Total Non-Federal Liabilities	**$ 2,519,131**	**$ 384,639**	**$ 2,903,770**	**$ 2,146,523**
Total Liabilities	**$ 2,694,358**	**$ 453,730**	**$ 3,148,088**	**$ 2,337,371**

Liabilities Not Covered by Budgetary Resources

Liabilities which are not considered covered by realized budgetary resources as of the balance sheet date. Budgetary resources encompass the following: (1) new budget authority, (2) spending authority from offsetting collections (credited to an appropriation or fund account), (3) recoveries of unexpired budget authority through downward adjustments of prior-year obligations, (4) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior-year balances during the year, and (5) borrowing authority or permanent indefinite appropriations, which have been enacted and signed into law as of the Balance Sheet date provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

Liabilities Covered by Budgetary Resources

Resources incurred by the reporting entity and are covered by realized budget resources as of the Balance Sheet date. Budgetary resources encompass new budgetary authority and other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include: (1) new budget authority, (2) spending authority from offsetting collections (credited to an appropriation or fund account), (3) recoveries of unexpired budgetary authority through downward adjustments of prior year obligations, (4) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and (5) permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet date provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

Intragovernmental Other Liabilities (Amounts in thousands)		2003
Covered by Budgetary Resources		
Accrued Retirement	$	2,626
Accrued Life Insurance		53
Accrued Health Insurance		2,170
Accrued VSIP		1,124
Total Covered by Budgetary Resources	**$**	**5,973**
Not Covered by Budgetary Resources		
Unfunded FECA — current	$	26,320
Unfunded FECA — noncurrent		33,293
Interest and Admin Payable to Treasury		9,478
Total Covered by Budgetary Resources	**$**	**69,091**
TOTAL INTRAGOVERNMENTAL OTHER LIABILITIES	**$**	**75,064**

The increase in Intragovernmental Other Liabilities is due to the recognition of Interest and Admin Payable to the Treasury for $9.5 thousand and change in the Federal Employees Compensation Act (FECA) liability for $19.7 thousand. The FECA liabilities are provided by DFAS.

Non-Federal Other Liabilities (Amounts in thousands)		2003
Advances from Others	$	119,030
Unsupported — Undistributed Collections		25,386
Bid Deposits		6,443
Accrued Payroll/Leave		131,932
TOTAL NON-FEDERAL OTHER LIABILITIES	**$**	**282,791**

The change in Non-Federal Other Liabilities is due to the change in Unfunded Annual Leave. In prior years, the balance of DLA's accrued civilian annual leave was an unfunded liability. This was not in conformance with the DoDFMR which requires WCF activities to fully fund civilian annual leave. Effective FY 03, the accrued leave balance was funded.

Note 9. Accounts Payable

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003			2002
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
Intragovernmental Accounts Payable	$ 169,254	N/A	$ 169,254	$ 142,959
Non-Federal Accounts Payable	2,235,359	981	2,236,340	1,648,381
Total Liabilities	**$ 2,404,613**	**$ 981**	**$ 2,405,594**	**$ 1,791,340**

Intragovernmental accounts payable consists of amounts owed to other Federal agencies for goods or services ordered and received but not yet paid. Interest, penalties, and administrative fees are not applicable to intragovernmental payables. Non-Federal payables (to the Public) are payments to nonfederal government entities.

Undistributed Disbursements: Undistributed disbursements are the difference between disbursements recorded at the detailed level to a specific obligation, payable, or receivable in the activity field records versus those reported by the U.S. Treasury via the reconciled DD 1329 and DD 1400. This should agree with the undistributed amount reported on the accounting reports (SF133/ (M) 1002/ (M) 1307). In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities outstanding accounts payable balance at year-end. Accounts payable were adjusted downward in the amount of $209,486 thousand for these payments.

A portion of the undistributed disbursements cannot be reconciled to known differences, such as unmatched disbursements or intransit disbursements, and are considered as unsupported undistributed disbursements. In accordance with recent guidance from DFAS-Arlington, the accounts payable are only reduced by the supported portion of the undistributed disbursements. The unsupported portion has been reclassified from USSGL 2110 – Accounts Payable (either intragovernmental or non-Federal) to USSGL 2120 – Disbursements in Transit (non-Federal). USSGL 2120 maps to the accounts payable line on both the Balance Sheet and this note. The total amount reclassified was $26,027 thousand.

Intragovernmental Eliminations: For the majority of intra-agency sales, DLA's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, DLA was unable to reconcile intragovernmental accounts payable to the related intragovernmental accounts receivable that generated the payable.

The DoD summary level seller accounts receivable was compared to DLA's accounts payable. Elimination adjustments were made where a match between the seller accounts receivable and the DLA payable was made. Intra-DLA eliminations in the amount of $111,755 thousand were also identified and eliminated in this process. The amount remaining in DLA intragovernmental payables after the elimination process was completed was reclassified to public payables. This reclassification total was $368,850 thousand.

Interest, Penalties, and Administrative Fees: Interest payable was previously captured in the accounts payable number on prior years. However, it is now being presented on a separate line and is no longer grouped in the accounts payable amount.

Note 10. Environmental Liabilities

The Defense Energy Support Center (DESC) recorded $68,796 thousand for environmental cleanup costs under the DLA Defense Working Capital Fund in these statements. No liability was shown for FY 02 because the accrual amount was not available until after the financial statements were finalized. The amount of liability for FY 02 should have been recorded as $35,200 thousand.

The substantial increase in environmental liability over the past fiscal year occurred because the FY 02 estimate did not include all of the DLA facilities reported in FY 03 since the DLA did not have cost-to-complete estimates for all of the facilities at the end of the FY 02 reporting period. The methodology did not change. The FY 02 estimate included only six facilities; the FY 03 estimate included ten facilities. Also, the environmental liability estimate only included DLA/DESC managed Government Owned/Contractor Operated bulk storage facilities. It does not include any Military Service-owned and operated facilities.

DLA recorded environmental cleanup costs funded through the Defense Environmental Restoration Program (DERP) and Base Realignment and Closure (BRAC) in FY 03. This liability, although generated by WCF operations and activities, is recorded on the DLA General Fund financial statements since they administer the DERP and BRAC environmental cleanup programs.

Note 11. Other Liabilities

As of September 30, 2003 and 2002
(Amounts in thousands)

	2003			2002
	Current Liability	Noncurrent Liability	Total	Total
Intragovernmental				
Judgment Fund Liabilities	$ –	$ –	$ —	$ 141
FECA Reimbursement to the Department of Labor	26,320	33,293	59,613	39,800
Other Liabilities	5,974	9,477	15,451	7,948
Total Intragovernmental Other Liabilities	**$ 32,294**	**$ 42,770**	**$ 75,064**	**$ 47,889**
Non-Federal				
Accrued Funded Payroll and Benefits	$ 131,932	$ –	$ 131,932	$ 24,982
Advances from Others	119,031	–	119,031	167,463
Deposit Funds and Suspense Accounts	31,828	–	31,828	4,390
Accrued Unfunded Annual Leave	–	–	–	101,317
Total Non-Federal Other Liabilities	**$ 282,791**	**$ –**	**$ 282,791**	**$ 298,152**
Total Other Liabilities	**$ 315,085**	**$ 42,770**	**$ 357,855**	**$ 346,041**

Deposit Funds and Suspense Accounts: In accordance with year end guidance, the amount of unsupported undistributed collections was reclassified from USSGL 1310 to USSGL 2400 and is included in Non-Federal: Deposit Funds and Suspense Accounts above. The total amount of unsupported undistributed collections included in this line is $25,386 thousand. The remaining $6,443 thousand consists of bid deposits, a $2,153 thousand increase over prior year statement amount.

FECA Reimbursement to the Department of Labor (DoL): FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to either condition. FECA claims are submitted to and approved by DoL. DoL pays the claim holders and prepares a charge back to the applicable agency. The liability represents the charge back amount to the applicable agency. Public Law 93-416, Section 8147 essentially gives agencies 2 years to pay the charge back bill, allowing time for inclusion in their budgets. Therefore, there should be an unfunded liability in the statements for these 2 years, plus an accrual for the current fiscal year. In the current year, a weighted average method is established to allocate the FECA liability. It must be noted that this change in policy has no material impact on the FECA liability balance in comparison to previous years. Any fluctuation in entity balances is solely based upon a true variance in the account.

Note 12. Commitments and Contingencies

DLA currently is reviewing claims and is involved in suits before the United States Court of Federal Claims regarding the use of economic price adjustments clauses in fuels contracts awarded from 1982 through 1999. DLA believes that the basis of the claims and suits is unjustified and that use of the clauses was proper and in accordance with law. The value of claims and cases is approximately $2.94 billion. DLA is not recognizing these as contingent legal liabilities in the financial statements.

Note 13. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

DLA's actuarial liability for workers' compensation benefits is developed by DoL 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 OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. For FY 03, the unfunded actuarial liability amount for FECA increased to $316 thousand in comparison to the amount recorded in FY 02 of $200 thousand due to a correction that was processed during the current fiscal year to correct prior year allocations.

Note 14.A. General Disclosures Related to the Statements of Net Cost

The Consolidated Statements of Net Cost in the Federal Government is unique because its principles are driven on understanding the net cost of programs and/or organizations that the Federal Government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

While DLA generally records sales transactions on an accrual basis as is required by generally accepted accounting principles, its legacy systems do not always capture the related costs of goods sold. DLA is remedying this issue through the implementation of its Enterprise Resource Planning (ERP) system, BSM, and through the replacement of its legacy fuels management system with FAS. These new systems will be compliant with the Federal Financial Management Improvement Act of 1996 which mandated Federal financial management systems comply substantially with Federal financial systems requirements, accounting standards, and the U.S. Standard General Ledger, and they will be able to capture actual costs. However, the information presented on the FY 03 Statements of Net Cost is primarily based on budgetary obligation, disbursements, or collection transactions, as well as information from non-financial feeder systems.

Fluctuations: Significant increases in both revenue and expenses were driven by DLA's support for OPERATIONS ENDURING FREEDOM and IRAQI FREEDOM. Examples of the type of support provided by DLA Commodities are disclosed in Note 16. The $2,200,725 thousand gross change in DLA's Net Cost from ($1,495,298 thousand) in FY 02 to $705,427 thousand in FY 03 was driven by a number of factors as follows:

a) DLA sells petroleum based on a price per barrel that is estimated by OMB as part of the budget process. The ending FY 2003 composite price of petroleum per barrel was $38.34, which was $11.72 per barrel higher than the price included in the FY 03 rates. This resulted in increased fuel expenses of approximately $1,670,000 thousand that were not recovered in the revenue received from customers. The FY 2003 fuel revenue loss was partially offset by $1,100,000 thousand in appropriated funding that is not included as revenue but is identified as a "financing source" on the Statements of Changes in Net Position. In FY 2002, DLA received $75,000 thousand in appropriated funding for the increased fuel expenses associated with OPERATION ENDURING FREEDOM. This accounted for approximately $1,595,000 thousand in increased cost between FY 2002 and FY 03.

b) The way DLA's Aviation Investment Strategy (AIS) program was funded changed in FY 03. In FY 02, the Military Services funded the AIS program via $147,900 thousand in customer orders so the Statements of Net Cost included both AIS revenue and expenses. In FY 03, DLA received a $109,000 thousand in appropriated funding that is not included as revenue, but is identified as a "financing source" on the Statements of Changes in Net Position. The expenses associated with the AIS program are included as part of the Statements of Net Cost. This accounted for approximately $109,000 thousand in increased cost between FY 02 and FY 03.

c) DLA includes a cost recovery rate (i.e. overhead recovery rate) on the materiel it sells. In FY 03, the recovery rates were set lower than those used in FY 02, in order to achieve a planned decrease in revenue of $742,000 thousand based on a set sales volume. However, the non-energy sales volume in FY 03 was significantly higher than planned without a commensurate increase in overhead operating costs.

Note 14.B. Imputed Expenses

As of September 30, 2003 and 2002 (Amounts in thousands)	2003	2002
Civilian Retirement	$ 60,815	$ 49,258
Civilian Health	64,379	68,930
Civilian Life Insurance	211	212
Judgment Fund	7,836	2,520
Total Imputed Expense	**$ 133,241**	**$ 120,920**

Note 14.C. Exchange Revenue

SFFAS No. 7 – Disclosures and Other Accompanying Information Requirements:

Supply Management: Each catalogued item with a national stock number assigned, which is managed by a DoD Inventory Control Point, has a standard price for sales to all authorized customers. Components establish product prices at the lowest practical item level in order to promote cost visibility/management and to motivate cost effective/supplier behavior. At a minimum, prices are established by Federal Supply Class (FSC) or other comparable level at which specific cost allocations can be made. Product pricing levels above the FSC are approved by the Office of the Under Secretary of Defense (Comptroller). The standard sales price becomes effective for billing purposes on the first day of the fiscal year.

Distribution: Consistent with activity based costing techniques, DLA implemented the Net Landed Cost pricing mechanism at the distribution depots. Net Landed Cost pricing structure provides our customers with greater visibility of their distribution costs by commodity, customer, and transactions in order for them to make more informed supply decisions.

Defense Reutilization and Marketing Service: Operating costs are recovered by a combination of proceeds from the sale of surplus personal property to the public, reimbursements from specific customers for work performed, and a Service Level billing paid by the Military Services and DLA Supply Management Activity Groups. DLA developed Transaction Activity Billing to recover mission costs through a process that provides customers (Military Services and DLA) bills based on services and workload for property disposition.

Document Automation and Production Service: Sales prices are published in the DAPS Production Standards and Pricing Manual by revenue process. A revenue process is a discrete process or activity in electronic conversion, retrieval, output, and distribution of digital and hard copy information. Prices are set at a level to recover cost and accumulated operating results. Customer price changes are approved by the Office of the Under Secretary of Defense (Comptroller). The sales price becomes effective for billing on the first day of the fiscal year.

Note 14.D. Intragovernmental Revenue and Expense

Intragovernmental Revenue: While DLA's non-stockfund systems capture trading partner data at a transaction level in a manner that facilitates trading partner aggregations, DLA's legacy stockfund systems do not. Allocation of non-interfund intragovernmental trading partner data is based on the percentage of funds recorded at the appropriation level for interfund reimbursement transactions posted on DLA's general ledgers. By design, the interfund system provides appropriations from which DLA's customers pay for the materiel bought from its inventories. BSM will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliations can not be accomplished with the existing or foreseeable resources. The transaction source data is the sum of DWCF reimbursable issues billed and collected through the interfund system for the period. Entity or buyer information is derived from allocations based on a percentage of specific transaction activity as compared to the total activity except where the entity data can be derived directly from the general ledger accounts. Some of the entity information was not able to be tied to a specific trading partner and resulted in not all intragovernmental revenue being included in the eliminations entries. Any amount remaining after eliminations were completed was reclassified between intragovernmental and public revenue. The amount reclassified from intragovernmental revenue to public revenue was $190,375 thousand.

Intragovernmental Operating Expenses: As discussed in the paragraph above, for the majority of intra-agency sales, DLA's accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, DLA was unable to reconcile intragovernmental operating expenses to the related intragovernmental revenue that generated the payable. In the eliminations process, the DoD summary level seller revenue was compared to DLA's operating expenses. Elimination adjustments were made by the seller based on the amount of revenue shown in their records. Inter-DLA eliminations in the amount of $288,695 thousand were also identified and eliminated in this process. The amount remaining in DLA intragovernmental operating expenses after the elimination process was completed and reclassified to operating expenses with the public. The amount reclassified from intragovernmental to non-Federal operating expense was $845,962 thousand.

DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished with the existing or foreseeable resources.

Note 15. Disclosures Related to the Statements of Changes in Net Position

As of September 30, 2003 and 2002 (Amounts in thousands)	2003 Consolidated	2002 Consolidated
Civilian Retirement	$ 60,815	$ 49,258
Civilian Health	64,379	68,930
Civilian Life Insurance	211	212
Judgment Fund	7,836	2,520
Total Imputed Financing	**$ 133,241**	**$ 120,920**

Imputed Financing: The amounts that DLA remits to OPM for employees covered by the Civilian Service Retirement System, Federal Employees Retirement System, Federal Employees Health Benefit and Federal Employment Group Life Insurance do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employee contributions made by and for them by DFAS. The imputed financing cost factors are provided by OPM to the Office of the Under Secretary of Defense (Personnel and Readiness) (OUSD (P&R)) and DLA. DFAS provides civilian employees base salary and number of employees electing health benefits by reporting entity to the OUSD (P&R). OUSD (P&R) computes and validates the imputed expenses for civilian employees' retirement and other benefits and provides it to the reporting components.

Note 16.A. Disclosures Related to the Statements of Budgetary Resources

As of September 30, 2003 and 2002 (Amounts in thousands)	2003	2002
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	$ 9,899,635	$ 8,538,069
Available Borrowing and Contract Authority at End of the Period	$ 6,765,825	$ 8,301,646

Available Borrowing and Contract Authority at the End of the Period: Available Contract Authority represents the Budgetary Authority for use by the DLA WCF. At the end of the period the remaining balance of Available Contract Authority was $0. The amount shown above represents the cumulative since inception unliquidated realized contract authority as of the end of the fiscal year.

Budget Authority: Appropriations Received, Net Transfers, and Unobligated Balance: Net Transfers Actual. DLA has received a total of $1,334,000 thousand in budget authority as reflected on these three lines. The Aviation Investment Strategy received $109,000 thousand. An additional $125,000 thousand consists of cash that was returned from the Department of the Air Force that DLA had transferred to them in FY 00. The remaining $1,100,000 thousand comes from the Iraqi Freedom Fund

Reprogramming Action, FY03-35 IR (P.L. 108-11), for increased fuel costs in support of military operations in Iraq.

Contract Authority: The amount shown represents the current year Realized Contract Authority. This represents the contract authority invoked and the value of obligations that require customer orders or appropriations to liquidate. This represents a change in the presentation from prior years and brings the presentation into compliance with OMB Circular A-11. In prior years, the contract authority was shown net of the reductions/liquidations of contract authority now shown as Permanently Not Available.

Also, in some prior years' reports, DAPS incorrectly reported anticipated reimbursable authority for operations as if it had been contract authority. This was corrected this year with all previously invoked realized contract authority being shown as liquidated, resulting in an abnormal unobligated balance. This abnormal balance will be corrected during normal DAPS operations.

Spending Authority from Offsetting Collections: Net increase is primarily the result of support to OIF/OEF to include $483,200 thousand increase in clothing and textiles for BDUs, chemical protected gear, body armor, etc; $629,500 thousand increase in medical; $880,900 thousand increase in subsistence for operational and humanitarian rations, dining hall support, etc; $599,500 thousand increase for general and industrial; $648,500 thousand increase for aviation support; $475,900 thousand increase for land and maritime; and $617,700 thousand increase for energy.

Unfilled Customer Orders from Federal Sources: The $718,901 thousand increase in unfilled customer orders is attributable to support for OIF/OEF. The major increases occurred in clothing and textiles, general & industrial, subsistence, and land and maritime. Energy, medical, aviation, distribution, and DAPS had overall reductions to their unfilled customer orders.

Undelivered Orders: The undelivered orders increase of $1,375,448 thousand is attributable to support for OIF/OEF. The fulfillment of these orders will enable DLA to drive down the amount of unfilled customer orders.

Other DLA Disclosures

Correction of Errors: Because some DLA fuel purchases have Federal fuel excise tax added to the price, DLA files for a refund of Federal fuels excise taxes. Before 2002, a part of the entry to account for these refunds was not properly made within the accounting records. The part of the entry that was not made would have cleared the refunds from the other income account and the purchases account. As a result, both income and expense in the Statements of Net Cost were overstated for both 2001 and 2000. However, since both accounts closed to cumulative results of operations, there has been no effect on subsequent years' Balance Sheets or Statements of Net Cost. However, the legacy accounting systems of DLA do not include budgetary accounts and these accounts must be built using the proprietary accounts available. A formula used to build these accounts did not properly include both sides of the entries described above, because the refunds were shown as negative disbursements rather than collections, with the result that budgetary accounts receivable have been overstated by $173,696 thousand since 2001. This amount has been corrected in the current statements with the result that Receivable from Federal Sources is different by that amount from what had been reported on the SF 133 for Fiscal Year 03. The correction of this error will have the effect of showing an additional $173,696 thousand of contract authority being liquidated during the current year.

In addition to the issue above, it was also discovered that a formula used to calculate the Unfilled Customer Orders, without advance included the Unfilled Customer Orders, with advance. The result of this has been the overstating of the beginning balance in the Unfilled Customer Orders, without advance account. Correcting this has resulted in the amount reported Without Advance from Federal Sources being $136,284 thousand different than the amount reported on the SF 133 for September 2003. This correction will have the effect of showing $92,345 thousand less of contract authority being liquidated during the current year than if the error had continued.

The net result of the correction of both errors is that $81,350 thousand more contract authority will be shown as liquidated than if the errors had not been discovered and constitutes a difference between what was shown on the September 2003 SF 133 and the current financial statements.

Note 16.B. Disclosures Related to Problem Disbursements, In-Transit Disbursements, and Suspense/Budget Clearing Accounts

As of September 30, 2003 and 2002 (Amounts in thousands)	2003	2002	(Decrease)/ Increase
Total Problem Disbursements			
Absolute Unmatched Disbursements	$ 30	$ 24	$ 6
Negative Unliquidated Obligations	2	–	2
TOTAL IN-TRANSIT DISBURSEMENTS, NET	**$ (32)**	**$ 5**	**$ (37)**

Absolute value: The sum of the positive values of debit and credit transactions without regard to the sign.

Unmatched Disbursements (UMD): When payments do not match to a corresponding obligation in the accounting system.

Negative Unliquidated Obligations (ULOS): When payments have a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments use available funds for valid receiving reports on delivered goods and services under valid contracts.

In-Transits: The net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity but not yet posted in an accounting system.

Fluctuations: Problem Disbursement Increase and Intransit Disbursement Decrease from FY 02 to FY 03 is attributable to DFAS reporting requirement change. Mechanization of Contract Administration Services intransits that were previously identified as an intransit, now show as a UMD. Also attributable is the addition of the DLA BSM system. For Negative Unliquidated Obligations, $1.2 million was received in the accounting system during the last week of the fiscal year and efficient research and processing time was not available.

Note 17. Disclosures Related to the Statements of Financing

The Statements of Financing reconciles the status of budgetary resources 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 operation from proprietary accounting.

Budgetary data is not in agreement with Proprietary Expenses and Assets Capitalized. Differences between budgetary and proprietary data for Agency-wide are a previously identified deficiency.

The Statements of Financing is presented as combined or combining statements rather than consolidated statements due to intragovernmental transactions not being eliminated. Adjustments in funds that are temporarily not available pursuant to Public Law and those that are permanently not available (included in the "Adjustments" line on the Statements of Budgetary Resources) are not included in "Spending Authority From Offsetting Collections and Adjustments" line on the Statements of Budgetary Resources or on the Statements of Financing.

Other Components Requiring or Generating Resources in the Future: This represents Accrued Unfunded FECA of $19,813 thousand and the Actuarial FECA of $115,852 thousand. Most of this increase occurred because of a prior year error in allocating FECA liabilities between the DLA General Fund and the DLA WCF.

Other Components not Requiring or Generating Resources: This line is comprised of $134.5 thousand in bad debts and $(338.7) thousand in miscellaneous expenses that did not require budgetary resources. The line decreased because the prior year number included a first time accrual of an allowance for uncollectible accounts.

Increase in Annual Leave Liability: This line shows a $101,213 thousand decrease in unfunded annual leave during the fiscal year because DLA funded the entire amount of previously unfunded leave as required by the DoD FMR.

Revaluation of Assets and Liabilities: This line shows a $30,925 thousand proprietary source of resources that arises from recognizing imputed financing equal to the depreciation of MILCON funded assets. There is also an offsetting $763,248 thousand in inventory losses on this line. In prior years, losses from inventory were not shown separately on the Statements of Financing but were included as a part of Resources that finance the acquisition of assets (inventory increase was shown net of inventory losses).

Transfers in/out without reimbursement: This line includes the end-of-fiscal year transfer of the Fund Balance With Treasury balances to component level, a return of a prior year transfer of cash to the Department of the Air Force of $125,000 thousand and a transfer of $78,000 thousand to the Department of the Air Force in the prior year that had not been properly presented in FY 02.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Required Supplementary Stewardship Information

For the Years Ended
September 30, 2003, and 2002

UNAUDITED

Heritage Assets

For the Year Ended September 30, 2003 and 2002

	Measurement Quantity	As of 09/30/02	Additions	As of 09/30/03
Cemeteries & Archeological Sites	Sites	1	–	1
Buildings & Structures	Each	2	–	2

Executive Order 11593 from the United States Department of the Interior, Heritage Conservation and Recreation Service entered Bellwood, Chesterfield County, Virginia, in the National Register. Operated by the Defense Supply Center Richmond (DSCR), the Bellwood home is an early nineteenth century plantation house highlighted by slender columns extending up two stories; it also serves as the DSCR Officer's Club.

The DSCR Officer's Club is in need of some repairs. There is a sustainment project in planning to repair the plumbing system, as well as to provide for lead paint removal. The Department of Historical Resources in Richmond ensures the historical integrity of the property by approving any repairs, major or minor. The Office of Installation Services at DSCR is coordinating the planned sustainment project with conjunction with the Department of Historical Resources to ensure the historical integrity of the property is maintained.

Building 280, Marine Barracks, Pearl Harbor, Hawaii, is a World War II wooden barracks identified as a historic asset. This building is occupied by personnel from the Defense Supply Center Philadelphia — Pacific as a tenant with the financial responsibility for sustainment. The occupied portion of the building has been renovated and is in good repair.

DSCR has established a cemetery to re-inter African-American remains unearthed during the construction of a child development center.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Required Supplementary Information

For the Years Ended
September 30, 2003, and 2002

UNAUDITED

Real Property Deferred Maintenance

As of September 30, 2003 and 2002
(Amounts in thousands)

		FY 2003			
		Annual Sustainment			
Property Type	Restoration as of 9/30/02	Required	Actual	Difference	Restoration as of 9/30/03
Buildings and Structures	$ –	$ 520,110	$ 226,667	$ 293,443	$ –

Annual Deferred Sustainment Trend

Property Type	FY 2001	FY 2002	FY 2003
Buildings and Structures	$ 222,400	$ 218,424	$ 293,443

The total deferred real property maintenance was calculated as the difference between actual FY 03 real property sustainment as reported in the FY 03 DLA President's Budget, $226,667 thousand, less DESC Environmental funds ($38,560 thousand) and DNSC stock funds ($6,246 thousand), and the required FY 03 real property sustainment from the DoD Facility Sustainment Model (FSM), $520,110 thousand. The sustainment value was derived from the FSM version 3.0 for DLA's FY 03 sustainment.

The DoD FSM uses a standard commercial per-square-foot cost factor (for each type of facility) that represents the cost to maintain a facility in good condition. The total Agency sustainment value is calculated by multiplying the total size of each type of facility at a given location by the commercial cost factor. The standard DoD geographic area cost factor for that location then adjusts all the facility costs for a given location.

Comprehensive real property condition information is unavailable as the majority of the facilities (for which the Agency is responsible for sustainment) are not under DLA's operational control, e.g. fuel storage and handling facilities. Condition assessments from the Military Services on these facilities have not been made available to DLA. Management Initiative Decision 909 has tasked DLA with providing a comprehensive facility condition assessment of the DoD fuels infrastructure at Military Service managed installations. However, the assessment funding extends until FY 05 and actual survey results will not be complete before the end of FY 05. The Agency has previously conducted comprehensive condition assessments on some non-fuel facilities only as part of BRAC analyses. Insufficient human and financial resources are available to annually assess Agency facilities and manage the resulting data.

UNAUDITED

Required Supplemental Information — Part A, Intragovernmental Asset Balances

As of September 30, 2003
(In Thousands)

	Treasury Index	Accounts Receivable	Other
Homeland Security	70	$ 16	–
General Accounting Office	5	63	
The Judiciary	10	1	–
Executive Office of the President	11	65	–
Department of Agriculture	12	12,622	–
Department of Commerce	13	324	–
Department of the Interior	14	1,430	–
Department of Justice	15	9,794	–
Department of Labor	16	7,010	–
Navy General Fund	17	219,890	–
United States Postal Service	18	129	–
Department of State	19	3,881	–
Department of Treasury	20	1,757	–
Army General Fund	21	103,781	1
Office of Personnel Management	24	41	–
Federal Communications Commission	27	1	–
Social Security Administration	28	2	–
Nuclear Regulatory Commission	31	2	–
Smithsonian Institution	33	1	–
International Trade Commission	34	1	–
Department of Veterans Affairs	36	1,803	–
General Service Administration	47	14,594	–
National Science Foundation	49	103	–
Air Force General Fund	57	127,158	4
Federal Emergency Management Agency	58	347	–
Tennessee Valley Authority	64	21	–

UNAUDITED

Required Supplemental Information — Part A, Intragovernmental Asset Balances (CONTINUED)

As of September 30, 2003
(In Thousands)

	Treasury Index	Accounts Receivable	Other
United States Information Agency	67	3	–
Environmental Protection Agency	68	6	–
Department of Transportation	69	13,160	–
Agency for International Development	72	18	–
Small Business Administration	73	1	–
Department of Health and Human Services	75	6,416	–
Independent Agencies	76	1,199	–
National Aeronautics & Space Administration	80	5,604	–
Armed Forces Retirement Home	84	496	–
Department of Housing and Urban Development	86	8	–
Department of Energy	89	747	–
Independent Agencies	95	23,162	–
U.S. Army Corps of Engineers	96	6,802	–
Other Defense Organizations General Funds	97	183,196	–
Other Defense Organizations Working Capital Funds	97-4930	87,552	–
Army Working Capital Fund	97-4930.001	394,143	50
Navy Working Capital Fund	97-4930.002	136,585	–
Air Force Working Capital Fund	97-4930.003	111,425	665
Totals		**$ 1,475,360**	**$ 720**

UNAUDITED

Required Supplemental Information — Part B, Intragovernmental Entity Liabilities

As of September 30, 2003
(In Thousands)

	Treasury Index	Accounts Payable	Other
Department of Labor	16	$ –	$ 59,613
Navy General Fund	17	25, 280	–
Department of the Treasury	20	–	9,477
Army General Fund	21	11,200	–
Office of Personnel Management	24	–	5,974
Air Force General Fund	57	7,237	
Other Defense Organizations General Funds	97	659	–
Other Defense Organizations Working Capital Funds	97-4930	105,644	–
Army Working Capital Fund	97-4930.001	2,408	–
Navy Working Capital Fund	97-4930.002	15,561	–
Air Force Working Capital Fund	97-4930.003	1,265	–
Totals		**$ 169,254**	**$ 75,064**

UNAUDITED

Required Supplemental Information – Part C, Intragovernmental Revenue

For the Year Ended September 30, 2003
(In Thousands)

	Treasury Index	Earned Revenue
Homeland Security	70	$ 52
Government Printing Office	4	(2)
General Accounting Office	5	48
The Judiciary	10	(15)
Executive Office of the President	11	985
Department of Agriculture	12	78,953
Department of Commerce	13	2, 536
Department of Interior	14	1,586
Department of Justice	15	27,921
Department of Labor	16	11,070
Navy General Fund	17	3,405,265
United States Postal Service	18	743
Department of State	19	8,033
Department of the Treasury	20	11,823
Army General Fund	21	3,800,607
Office of Personnel Management	24	29
Federal Communications Commission	27	(19)
Social Security Administration	28	27
Nuclear Regulatory Commission	31	37
International Trade Commission	34	1
Department of Veterans Affairs	36	11,263
General Service Administration	47	29,483
National Science Foundation	49	7,484
Air Force General Fund	57	2,724,270
Federal Emergency Management Agency	58	544
Tennessee Valley Authority	64	70

UNAUDITED

Required Supplemental Information – Part C, Intragovernmental Revenue (CONTINUED)

For the Year Ended September 30, 2003
(In Thousands)

	Treasury Index	Earned Revenue
Environmental Protection Agency	68	$ 83
Department of Transportation	69	91,459
Agency of International Development	72	19
Small Business Administration	73	19
Department of Health and Human Services	75	18,852
Independent Agencies	76	18,056
National Aeronautics and Space Administration	80	28,655
Armed Forces Retirement Home	84	1,701
Department of Housing and Urban Development	86	114
Department of Energy	89	5,869
Department of Education	91	4
Federal Meditation and Conciliation Services	93	20
Independent Agencies	95	68,828
U.S. Army Corps of Engineers	96	6,612
Other Defense Organizations General Funds	97	3,073,404
Other Defense Organizations Working Capital Fund	97-4930	1,211,284
Army Working Capital Fund	97-4930.001	1,931,390
Navy Working Capital Fund	97-4930.002	2,816,977
Air Force Working Capital Fund	97-4930.003	4,030,341
Totals		**$ 23,426,481**

UNAUDITED

Required Supplemental Information – Part E, Intragovernmental Nonexchange Revenue

For the Year Ended of September 30, 2003
(In Thousands)

	Treasury Index	Transfers-In	Transfers-Out
US Army Corps of Engineers	96	$ –	$ 6
Air Force Working Capital Fund	97-4930.003	125,000	
Totals		**$ 125,000**	**$ 6**

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Supply Management Overview

Supply Management Activity Group

The Supply Management Activity Group consists of three supply centers, one support center, two service centers and other corporate activities. The supply centers are located at the Defense Supply Center Columbus (DSCC) in Columbus, OH; the Defense Supply Center Richmond (DSCR) in Richmond, VA; and the Defense Supply Center Philadelphia (DSCP) in Philadelphia, PA. Each supply center acts as a lead center for one or more commodities. The Defense Energy Support Center (DESC), which is located at Fort Belvoir, VA, purchases, manages, positions, and sells fuel to the Military Services and provides centralized support to meet the energy needs of the military installations. The Service Centers are the Defense Logistics Information Service and Defense Automatic Addressing Service Center.

The group's mission is to provide materiel and logistics services to support peacetime and combat operations, combat preparedness and humanitarian aid. These include integrated materiel management of more than 3.6 million national stock numbered spare and repair parts supporting over 1,400 weapon systems. Supply Management also provides management of construction and general supplies and troop support items such as food, clothing and textiles, and medical supplies and sold over 142 million barrels of fuel in FY 03. Together, there are more than 9,400 personnel that support this business area generated revenue that totaled about $22.5 billion during FY 03. This is an increase of over $2.9 billion from the previous year.

Mission

The mission of the Supply Management Activity Group is to support its Military Service customers by managing business processes that ensure worldwide logistics support is provided at the right time, to the right place, and consistently at the best value in peacetime, emergency, and wartime scenarios. The support requirements are dynamic, and DLA continues to shift its approach in response to evolving changes in national priorities, requirements of the Military Services, technology, and the commercial marketplace. The primary logistics functions include:

- Supply-chain integration and inventory management;
- Transportation management (shared with the Distribution Activity Group);
- Technical management, which guarantees product quality and proper pricing of materiel;
- Procurement management, ensuring DoD gets the best value;
- Logistics data and information collection, management, and distribution and providing for the integration and availability of this information; and
- Logistics management process and processing of logistics and standard Military Logistics Systems transactions

Strategic Goals

The long-term goals of the Supply Management Activity Group are consistent with the goals contained in the DLA Strategic Plan. These goals will be achieved through a series of supporting strategies and executed by the three supply centers and the energy support center.

The following metric directly supports the DLA Strategic Plan goal to consistently provide responsive services to our customers:

Weapons System Supply Availability by Service: This performance metric measures our capability to ensure that weapon systems supplies are available when needed and that we provide each Service with a minimum level of performance.

The following chart portrays our accomplishment — improvement from FY 00 through FY 03 — relative to the Agency's supply availability goal.

Weapon System Supply Availability				Goal	Actual
Service Branch	FY 00	FY 01	FY 02	FY 03	FY 03
Army	85.3%	88.8%	90.7%	90.2%	88.4%
Air Force	81.5%	81.8%	84.0%	85.0%	86.6%
Navy	84.1%	84.4%	85.9%	86.2%	87.2%
USMC	88.7%	90.3%	91.7%	91.6%	88.2%

The chart below is a quarterly view of our FY 03 Weapons System support. It shows that in the first quarter we were on pace to exceed all of the annual goals. After that quarter, demand from both the Army and the Marine Corps (in support of OPERATION IRAQI FREEDOM) resulted in a slight deterioration of our support to them, while the support to both the Navy and Air Force, which only experienced modest increase in demand, rose to exceed the goals.

Service Branch	1st Qtr FY 03	2nd Qtr FY 03	3rd Qtr FY 03	4th Qtr FY 03	CUM FY 03
Army	90.9%	88.8%	90.7%	90.2%	88.4%
Air Force	81.5%	81.8%	84.0%	85.0%	86.6%
Navy	84.1%	84.4%	85.9%	86.2%	87.2%
USMC	88.7%	90.3%	91.7%	91.6%	88.2%

FY 03 Accomplishments

Support of OPERATIONS ENDURING FREEDOM AND IRAQI FREEDOM. From the end of FY 02 and throughout FY 03, DLA experienced a large increase in the demand for materiel to support the Military Services' needs during OEF and OIF. The increase in demand covered a wide range of items, such as the Joint Services Lightweight Integrated Suit Technology (JSLIST) suits, tents, MREs, pharmaceuticals, water purifiers, concertina wire, sand bags, and repair parts. In order to best support the Military Services' wartime needs, DLA anticipated the Services' requirements and primed the logistics pipeline to allow for procurement, production, and transportation lead-times. As the materiel demands became a reality, DLA worked with both the Deputy Under Secretary of Defense (Logistics and Materiel Readiness) and the OUSD Comptroller to ensure that resources were available in advance of sales. The increase in demand during FY 03 — identified to support OEF and OIF — resulted in an increase in sales at a cost of more than $2.2 billion.

Aviation Investment Strategy Results in Supply Availability Gains. Included in the 3.6 million national stock numbered parts that DLA supports are 1.2 million aviation spare parts. The inventory optimization models DLA uses are configured to maximize customer satisfaction by filling the most orders for the most customers. This configuration more favorably supports the low-cost high-demand items and does not adequately support the aviation parts that are generally expensive with less frequent demand. This resulted in a disproportionately adverse effect on the readiness of the Military Services' aviation weapon systems. The AIS is a 4 year $500 million program to improve the availability of these aviation spare parts and targets these funds to specific support categories: Replenishment Items for Engines, $208.3 million and Non-engines, $291.7 million. The AIS investments in FY 00 ($122.4 million), FY 01 ($142.8 million), FY 02 ($146.2 million), and FY 03 ($88.6 million) are paying off. The supply availability of the AIS items were between 29 percent and 54 percent in the two years prior to the AIS investment, but significant improvement has been achieved with the AIS investment as can be seen in the following chart.

AIS Updated Supply Availability Stats

NOTE: The first two years on each table are pre-AIS baseline years.

FY 00 AIS Investment Items	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
AIS SA (Non-Engine)	29.9%	36.7%	62.4%	73.4%	78.8%	81.6%
AIS SA (Engines)	41.7%	53.4%	70.2%	76.4%	85.5%	87.0%

FY 01 AIS Investment Items	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
AIS SA (Non-Engine)	N/A	41.8%	47.4%	66.2%	77.3%	81.4%
AIS SA (Engines)	N/A	47.3%	52.1%	67.5%	81.7%	86.5%

FY 02 AIS Investment Items	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
AIS SA (Non-Engine)	N/A	N/A	41.0%	38.6%	65.6%	79.1%
AIS SA (Engines)	N/A	N/A	41.5%	43.6%	73.8%	82.6%

FY 03 AIS Investment Items	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
AIS SA (Non-Engine)	N/A	N/A	N/A	47.4%	45.9%	64.7%
AIS SA (Engines)	N/A	N/A	N/A	42.2%	45.7%	66.0%

Strategic Materiel Sourcing (SMS) Program: This program is DLA's successful adoption of best practices for hardware support where over 90 percent of all DLA materiel purchases identified for this program were shifted to long-term contracts. SMS is an umbrella initiative that focuses on stratifying and awarding high demand/sales hardware items through long-term contracts. While SMS targets a relatively small subset (551,000 items) of the total DLA managed hardware items (3.6 million), it is based on those national stock numbered parts that drive the Agency's business (those items that generate 80 percent to 85 percent of sales and demand) and/or have the most potential impact on readiness. During FY 03, we moved 34,000 items to long-term agreements bringing the Agency total to over 128,000. We expect to add an additional 30,000 items to long-term agreements in FY 04.

Strategic Supplier Alliances (SSA): One of the key tools within the SMS umbrella are SSAs. They involve long-term partnerships between DLA and major suppliers that establish collaborative relationships to accomplish mutually compatible goals; e.g., improved forecasting, reduced inventory, quality improvements, and reduced lead-times or other objectives. SSAs involve corporate-wide arrangements that include rationalizing process changes beneficial to both parties. The goal is to strive for two-way communication where all parties, including our customers benefit from the alliance. DLA has realized over $87 million in one-time inventory savings. There are other less quantifiable improvements such as decreased bureaucracy and access to supplier pricing methodologies. During FY 03, DLA established 6 new SSAs bringing the Agency total to 14. We expect to add an additional 12 alliances in FY 04.

Performance Based Agreements. In implementing our Customer Relationship Management (CRM) initiative, DLA finalized several Performance Based Agreements (PBA) with our customers. These agreements formally define DLA performance commitments to a wide range of customers. The FY 03 efforts included support provided through the recently deployed BSM process with the Food Council, U.S. Pacific Fleet, and the Navy Medical Logistics Center. In addition, an overarching PBA with the Navy was also signed in FY 03 and agreements with the Marine Corps, Army, Air Force, Northern Command and Pacific Command, were in formal coordination at fiscal year end. These agreements represent a significant deviation from the practice of providing support based on historical demand patterns to a business practice that uses each customer's forward-looking information to produce collaborative demand plans. These plans will more accurately anticipate the needs of those customers and lead to an increasingly responsive and efficient logistics support capability as the warfighter transitions between peace and war.

Program Performance Measures

Customer Satisfaction Index: This index measures the percentage of customers who responded to mail-out surveys that were either "satisfied" or "very satisfied" with DLA's products and services. The overall satisfaction metric is a composite of how well (as perceived by the customers) the Agency meets customer expectations in each of these areas. During FY 03, DLA Logistics Operations conducted two surveys: October 2002 and June 2003. Each surveyed a different random sample of customers from a population that specifically targeted DLA's non-Energy customers. More than 3,100 responses were received and the results:

	FY 2000	FY 2001	FY 2002	FY 2003
Overall Satisfaction	75.3%	75.7%	78.8%	78.7%

While the Weapon System Supply Availability by service performance metric (covered earlier in this report) details progress made toward meeting customer expectations, the survey segregates customer service factors such as, effective information provided by DLA and responsiveness to calls and inquiries. Because the results of these surveys indicate there is room for improvement in these areas, we will continue to reinforce our focus, as specifically outlined in the DLA Strategic Plan, Balanced Scorecard, and CRM initiative to fully meet customer expectations.

Financial Performance Measures

DLA establishes its prices predicated on three primary factors: (1) its current financial position, as determined by the Accumulated Operating Result (AOR); (2) its projected cash position relative to the stated objective; and (3) the estimated expenses that will be incurred to generate the estimated revenue. It is Agency policy to set prices that achieve an AOR of zero over the long-term and maintain cash balances that preclude an Anti-Deficiency Act violation. In addition, not all costs attributed to the business are recovered by the business - imputed costs, depreciation expenses applied to investments funded from General Fund accounts, and the recording of revenue that is for non-expense items (peacetime inventory augmentation, mobilization inventories, and adjustments to the cash position). The Results section below more fully describes DLA achievement during FY 03.

DLA measures the effectiveness of program budgeting and execution with unit cost performance measures. The following table depicts the Supply Management unit cost results for the fuel commodity and the composite unit cost for the non-energy commodities:

Unit Costs Results	FY 03 Goal	FY 03 Actual
Cost per Barrel of Fuel	$ 37.35	$ 46.28
Non-Energy Cost per Dollar of sales	$ 0.99	$ 1.08

The cost per barrel of fuel includes the acquisition cost of a barrel of petroleum product in addition to operations costs for fuel services, transportation, storage, and overhead. This unit cost ended the year over plan by $8.94 (124%) due to sales that were 10.2 million barrels higher than planned and a refined product cost that was $5.31 per barrel higher than the planned cost of $33.03.

The Non-Energy unit cost was $1.08 which exceeded the plan by $0.09. The actual unit cost was higher than the plan to support OEF/OIF demands with enhanced inventory levels ($371.5 million); and to "lean forward" by procuring assets in anticipation of further OEF/OIF demands and support the Military Services' efforts to reconstitute their inventories ($722.1 million).

Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), was approximately $919 million and is about $355 million greater than the planned net cost of $564 million. The primary causes that led to this increased net cost were the increased market driven cost of petroleum (more than $587 million) and the recognition of $48 million in accrued annual leave expense. These increases in costs were offset by the net effect of OPERATIONS ENDURING FREEDOM and IRAQI FREEDOM, which generated more than $246 million in excess revenue over expenses in our non-Energy business.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Supply Management

Comparative Financial Statements
As of and For the Years Ended September 30, 2003, and 2002

UNAUDITED

Comparative Balance Sheets

As of September 30, 2003 and 2002
(In Thousands)

	2003	2002
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	902,355	723,355
Other Assets (Note 4)	–	239
Total Intragovernmental Assets	902,355	723,594
Accounts Receivable (Note 3)	471,657	443,291
Inventory and Related Property (Note 6)	12,157,521	11,525,134
General Property, Plant and Equipment (Note 7)	844,688	712,842
Other Assets (Note 4)	211,097	224,140
Total Assets	**$ 14,587,318**	**$ 13,629,001**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 323,735	$ 196,921
Other Liabilities (Note 11 and Note 12)	47,569	25,064
Total Intragovernmental Liabilities	371,304	221,985
Accounts Payable (Note 9)	1,641,060	1,386,159
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	188,429	101,080
Environmental Liabilities (Note 10)	68,796	–
Other Liabilities (Note 11 and Note 12)	259,036	219,057
Total Liabilities	**$ 2,528,625**	**$ 1,928,281**
NET POSITION		
Cumulative Results of Operations	12,058,693	11,700,720
Total Net Position	**$ 12,058,693**	**$ 11,700,720**
TOTAL LIABILITIES AND NET POSITION	**$ 14,587,318**	**$ 13,629,001**

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Comparative Statements of Net Cost

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 14.a)

	2003	2002
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 1,966,341	$ 1,801,611
Less: Intragovernmental Earned Revenue	(21,701,243)	(18,240,558)
Intragovernmental Net Costs	(19,734,902)	(16,438,947)
Gross Costs With the Public	21,496,411	16,386,234
Less: Earned Revenue From the Public	(842,537)	(1,356,409)
Net Costs With the Public	20,653,874	15,029,825
Total Net Cost	**918,972**	**(1,409,122)**
NET COST OF OPERATIONS	**$ 918,972**	**$ (1,409,122)**

Comparative Statements Changes in Net Position

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 15)

	2003	2002
BEGINNING BALANCES	**$ 11,700,720**	**$ 10,788,589**
Budgetary Financing Sources:		
Appropriations used	1,209,000	75,300
Other budgetary financing sources	(10,883)	4,636
Other Financing Sources:		
Transfers-in/out without reimbursement	3,865	(643,352)
Imputed Financing Sources	74,963	66,426
Total Financing Sources	1,276,945	(496,990)
Net Cost of Operations	**918,972**	**(1,409,122)**
ENDING BALANCES	**$ 12,058,693**	**$ 11,700,721**

UNAUDITED

Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2003 and 2002
(In thousands) (See Note 16.a)

	2003	2002
BUDGETARY RESOURCES:		
Budget Authority:		
Appropriations received	$ 364,000	$ 75,300
Contract authority	24,595,283	335,738
Net transfers, actual	845,000	–
Unobligated balance:		
Beginning of period	627,542	355,915
Net transfers, actual	125,000	–
Spending authority from offsetting collections:		
Earned		
Collected	22,136,132	18,862,715
Receivable from Federal sources	70,948	304,121
Change in unfilled customer orders		
Advance received	(46,849)	4,922
Without advance from Federal sources	740,827	305,675
Subtotal	22,901,058	19,477,433
Recoveries of prior year obligations		31
Permanently not available	(24,275,876)	75,000
Total Budgetary Resources	**$ 25,182,007**	**$ 20,319,417**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 25,182,006	$ 19,691,875
Subtotal	25,182,006	19,691,875
Unobligated balance:		
Apportioned	–	627,542
Other Available	1	–
Total Status of Budgetary Resources	**$ 25,182,007**	**$ 20,319,417**

UNAUDITED

Comparative Statements of Budgetary Resources (CONTINUED)

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 16.a)	2003	2002
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 6,838,744	$ 6,135,152
Obligated Balance, Net — end of period:		
Accounts receivable	(1,253,069)	(1,182,122)
Unfilled customer order from Federal sources	(2,576,706)	(1,835,880)
Undelivered orders	9,442,476	8,002,588
Accounts payable	2,294,900	1,854,158
Outlays:		
Disbursements	23,301,376	18,378,455
Collections	(22,089,283)	(18,867,637)
Subtotal	1,212,093	(489,182)
Net Outlays	**$ 1,212,093**	**$ (489,182)**

Comparative Statements of Financing

For the Years Ended September 30, 2003 and 2002 (In Thousands) (See Note 17)	2003	2002
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 25,182,006	$ 19,691,875
Less: Spending authority from offsetting collections and recoveries	(22,901,058)	(19,477,464)
Obligations net of offsetting collections and recoveries	2,280,948	214,411
Net obligations	2,280,948	214,411
Other Resources		
Transfers in/out without reimbursement	3,865	2,045
Imputed Financing Sources	74,963	66,426
Net other resources used to finance activities	78,828	68,471
Total resources used to finance activities	**$ 2,359,776**	**$ 282,882**

UNAUDITED

Comparative Statements of Financing (CONTINUED)

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 17)

	2003	2002
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	(1,425,953)	(1,228,108)
Unfilled Customer Orders	693,978	310,598
Resources that fund expenses recognized in prior periods	–	(32,431)
Resources that finance the acquisition of assets	(1,625,665)	(659,238)
Other	3,864	–
Total resources used to finance items not part of the net cost of operations	(2,361,504)	(1,609,179)
Total resources used to finance the net cost of operations	**(1,728)**	**(1,326,297)**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	(64,217)	3,452
Increase in environmental and disposal liability	68,796	–
Other	102,575	–
Total components of Net Cost of Operations that will require or generate resources in future periods	**107,154**	**3,452**
Components not Requiring or Generating Resources		
Depreciation and amortization	56,657	59,363
Revaluation of assets or liabilities	756,979	(171,638)
Other	(90)	25,998
Total components of Net Cost of Operations that will not require or generate resources	813,546	86,277
Total components of net cost of operations that will not require or generate resources in the current period	**920,700**	**82,825**
Net Cost of Operations	**$ 918,972**	**$ (1,409,122)**

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Distribution Overview

Distribution Activity Group

The Distribution Activity Group operates through the Defense Distribution Center (DDC) in New Cumberland, PA, and 22 subordinate distribution centers located throughout the United States, Europe, and in the Pacific region. The group's mission is to manage the receipt, storage, and issue of DoD materiel. It may deliver that materiel to customers co-located on a base or to far-off ships, posts, and repair facilities. The activity group uses contracts with commercial sources to transport items from DLA-owned warehouses direct to customers worldwide. Some distribution centers are highly automated facilities that were specifically designed to provide global support for general commodities. Others fill customer requirements on a regional basis or provide global support for materiel that requires special equipment, facilities, or training. The distribution centers maintain the accountable inventory records and are responsible for preserving about $86 billion (at selling price) in DoD materiel, representing over 4 million items. In addition, they processed over 24.7 million receipt and issue transactions during FY 03, and their business services generated revenues of just less than $2.4 billion. This activity group employs approximately 7,900 civilian and 120 military personnel.

Mission

The mission of the Distribution Activity Group is the global distribution and warehousing of DoD materiel, including weapon systems parts, consumable items (such as medical, clothing, subsistence, electrical, industrial, and general supplies), repairable spare parts, and end-items. It performs this mission by managing materiel and logistics information to enable a seamless, worldwide distribution network that provides effective and efficient support to the Combatant Commanders, Military Services, and others, in Theater and out, during war and peace. The distribution network ensures that America's warfighters receive competitively priced and best value distribution services by providing "around the clock — around the world," world-class service.

Strategic Goals

The strategic goals established by the Distribution Activity Group are consistent with those contained in the DLA Strategic Plan. These goals are achieved through a series of supporting strategies that will:

- Increase our reliability, response time, and value to our customers by continuously improving and reengineering business practices;
- Provide best-value solutions to our customers by continuously evaluating our activities and implementing changes, as necessary, to ensure efficient and effective distribution operations; and
- Reduce under-utilized infrastructure by eliminating unnecessary storage capacity.

FY 03 Accomplishments

Infrastructure Cost Reduction through A-76 Cost Comparisons. In FY 98, we began the process of competing our depots with private industry. The goal of these competitions is to reduce operational costs either by reengineering existing depot business processes or contracting out the distribution functions. Thus far, nine sites have been competed with the Government retaining depot operations at three sites, while the other six were contracted with private industry. The estimated long-term (FY 98 - FY 09) net savings from these nine competitions is in excess of $479 million. During FY 03, two of these competitions resulted in the privatization of the distribution centers located at Hill AFB, Utah, and San Diego, CA. Seven additional sites are currently undergoing study.

Strategic Distribution: During FY 03, DDC reduced its transportation costs through three initiatives. First, it created a more efficient use of dedicated trucks either by establishing new delivery routes (where the Military Service customers had the volume to merit an individual truck) or added new stop-off points on some existing routes (for lower volume customers). On average, dedicated truck shipments are three times less expensive than less-than-truckload shipments and eight times less expensive than small parcel shipments. Second, by positioning a balanced stock on both the East and West Coasts, DDC ensured that assets were more readily available to be efficiently consolidated into each truck. Third, by forward stocking items at the Defense Distribution Depot Germersheim, Germany; the Defense Distribution Depot, Bahrain; and the Defense Depots located in Pearl Harbor and Yokosuka, Japan, DDC was able to lower the over-ocean transportation costs for those items shipped to its Europe, Southwest Asia, and Pacific customers. The forward stocking savings were achieved by shipping materiel into theater by lower cost surface channels in anticipation of the requirement. This avoided the cost of flying the materiel from the U.S. to overseas locations, which on average is $3.96 per pound more expensive, depending on air mode. Added benefits included reduced inventory levels at the customer (retail) level and reduced stress on the strategic air system.

Forward Stocking in Theater: Working in collaboration with the Central Command (CENTCOM), DDC leaned forward before the start of major hostilities in Iraq by anticipating customer requirements and establishing a contractor-run distribution operation in Bahrain. Because of this advanced collaborative planning, 23 barrier and construction items valued at $9.7 million were shipped in 2,415 containers (20 foot) via surface vessel transportation. This mode of transportation avoided the net additional cost of flying more than 1,200 C17 aircraft sorties. More importantly CENTCOM customers had the materiel available when they needed it.

Radio Frequency Identification Tags (RFID). During OPERATION IRAQI FREEDOM, CENTCOM identified a critical requirement to have all shipments coming into theater equipped with Radio Frequency Identification Tags. These tags provided hands-off in-transit visibility of materiel moving through critical transportation nodes throughout the world. The Combatant Commander's staff used the logistics information contained on the RFID tags to facilitate the prioritization and distribution of materiel into and throughout the theater of operations.

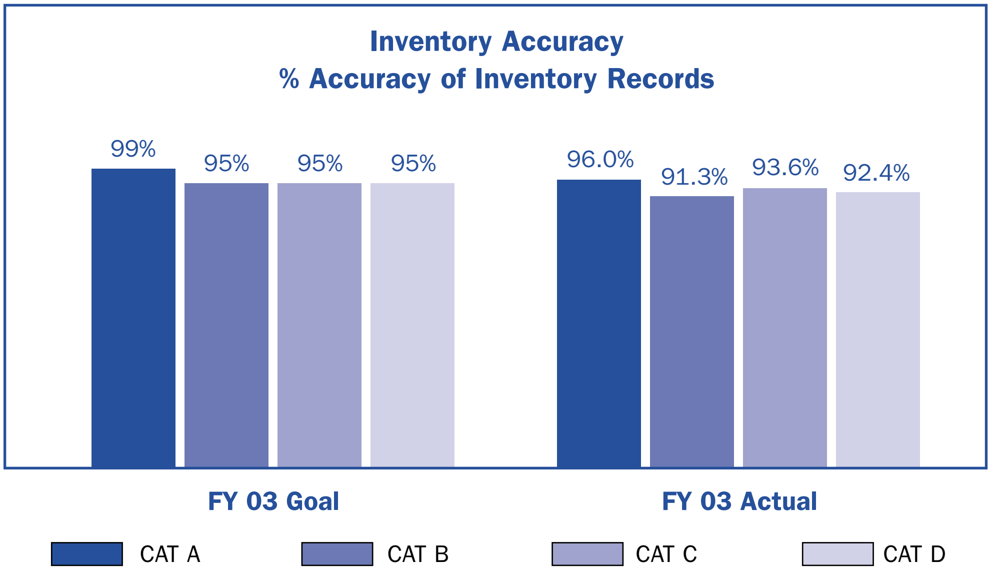
The Defense Supply Center Philadelphia was designated as the central procuring authority for the RFID tags and the Defense Distribution Center was its largest customer. The Defense Distribution Center started out with a requirement for 2,000 tags per month and peaked at 8,000 tags per month.

Program Performance Measures

Inventory Record Accuracy: This performance metric measures the accuracy of inventory records using statistical sampling techniques, which are performed semi-annually. Starting in FY 99, DLA incorporated established DoD stratification and tolerance levels into the inventory sampling methodology. The DoD plan takes into consideration item characteristics such as dollar value and provides a means to focus resources commensurate with the significance of the errors found.

The FY 03 goals for inventory accuracy were: 99 percent for items in the high dollar strata (Category A); and 95 percent for the remaining three strata. Our record accuracy for the high dollar Category (A) was 96.5 percent; Category (B) was 91.3 percent; Category (C) was 93.6 percent; and Category (D) was 92.4 percent.

The reasons we were unable to achieve our goals are due primarily to staff reductions and uncertainty caused by the ongoing and planned public-private competitions.



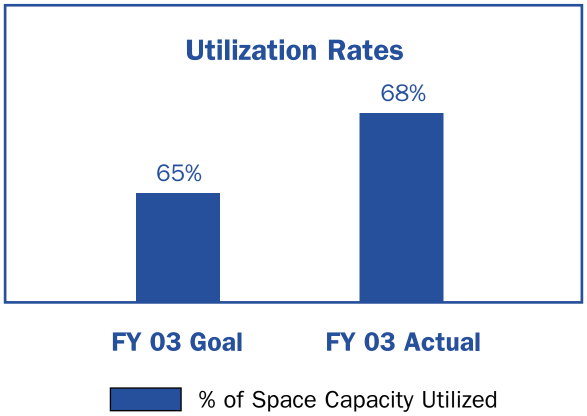
Category A:
Unit Price > $1,000

Category B:
Unit of Issue Not Equal to Each OR
On-Hand Balance > 50 AND
Extended Dollar Value < $50K OR
Activity > 50 per year

Category C:
On-Hand Balance < 50 AND
Date of Last Inventory > 24 Months

Category D:
All Others

Storage Space Utilization: The goal of increasing space utilization ties directly to the goal in the DLA strategic plan to structure internal processes to deliver customer outcomes effectively and efficiently. In an effort to reduce infrastructure costs, we continuously evaluate our storage capacity and occupancy to identify improvements in space utilization and eliminate unnecessary space. This performance goal measures space occupancy. In FY 03, our space utilization rate was 68 percent, which exceeded our goal by 3 percent.



Unit Costs Results	FY 03 Goal	FY 03 Actual
Unit Cost-Total Composite Processing Rate	$ 20.37	$ 17.58
Unit Cost-Covered Storage	$ 2.787	$ 2.415

Financial Performance Measures

We measure the effectiveness of program budgeting and execution with unit cost performance measures. The above table depicts the distribution unit cost results for processing and storage cost rates.

The Unit Cost-Total Composite Processing Rate measures processing costs (direct, indirect, and applied overhead) relative to the number of line items (receipts and issues) processed.

The Unit Cost-Covered Storage measures the costs (direct, indirect, and applied overhead) to provide covered storage to the cubic footage used.

We bettered these goals due to two primary reasons: First, was the increased workload in support of OPERATIONS ENDURING FREEDOM/IRAQI FREEDOM. Receipts and issues increased 2.7 million lines (12.7 percent) over the initial FY 03 estimate. Second, the success of our competition efforts reduced personnel and infrastructure costs more than initially estimated.

Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of revenue over expenses of approximately $112 million. This is an improvement of almost $196 million over the planned net cost of about $84 million and is primarily the result of three factors. First, are the impacts of OPERATIONS IRAQI FREEDOM/ENDURING FREEDOM, where we generated more than $184 million in excess revenue over expenses. The second factor is the acceleration of privatization efforts that reduced cost by almost $40 million. Lastly, was the recognition of more than $22 million in accrued annual leave costs.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Distribution

Comparative Financial Statements
As of and for the Years Ended September 30, 2003, and 2002

UNAUDITED

Comparative Balance Sheets

As of September 30, 2003 and 2002
(In Thousands)

	2003	2002
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	696,983	203,759
Other Assets (Note 4)	–	5
Total Intragovernmental Assets	696,983	203,764
Accounts Receivable (Note 3)	1,020	525
General Property, Plant and Equipment (Note 7)	571,190	478,114
Other Assets (Note 4)	501	457
Total Assets	**$ 1,269,694**	**$ 682,860**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 162,748	$ 125,486
Other Liabilities (Note 11 and Note 12)	18,577	15,980
Total Intragovernmental Liabilities	181,325	141,466
Accounts Payable (Note 9)	197,593	1,036
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	91,327	69,170
Environmental Liabilities (Note 10)	–	–
Other Liabilities (Note 11 and Note 12)	31,393	31,915
Total Liabilities	**$ 501,638**	**$ 243,587**
NET POSITION		
Cumulative Results of Operations	$ 768,056	$ 439,273
Total Net Position	**$ 768,056**	**$ 439,273**
TOTAL LIABILITIES AND NET POSITION	**$ 1,269,694**	**$ 682,860**

UNAUDITED

Comparative Statements of Net Cost

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 14.a)

	2003	2002
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 262,693	$ 622,193
Less: Intragovernmental Earned Revenue	(2,375,833)	(1,461,252)
Intragovernmental Net Costs	(2,113,140)	(839,059)
Gross Costs With the Public	2,002,230	773,699
Less: Earned Revenue From the Public	(1,174)	(2,243)
Net Costs With the Public	2,001,056	771,456
Total Net Cost	**(112,084)**	**(67,603)**
NET COST OF OPERATIONS	**$ (112,084)**	**$ (67,603)**

Comparative Statements Changes in Net Position

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 15)

	2003	2002
BEGINNING BALANCES	**$ 439,273**	**$ 80,114**
Budgetary Financing Sources:		
Appropriations used	–	300
Other budgetary Financing Sources	269,844	–
Other Financing Sources:		
Transfers-in/out without reimbursement	(91,088)	251,343
Imputed Financing Sources	37,943	39,913
Total Financing Sources	216,699	291,556
Net Cost of Operations	**(112,084)**	**(67,603)**
ENDING BALANCES	**$ 768,056**	**$ 439,273**

UNAUDITED

Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 16.a)

	2003	2002
BUDGETARY RESOURCES:		
Budget Authority:		
Appropriations received	$ –	$ 300
Contract authority	2,070,486	–
Unobligated balance:		
Beginning of period	124,157	105,371
Spending authority from offsetting collections:		
Earned		
Collected	1,883,339	1,373,366
Receivable from Federal sources	493,669	90,129
Change in unfilled customer orders		
Without advance from Federal sources	(14,305)	(77,083)
Subtotal	2,362,703	1,386,412
Permanently not available	(2,362,703)	(50,798)
Total Budgetary Resources	**$ 2,194,643**	**$ 1,441,285**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 2,194,643	$ 1,317,128
Subtotal	2,194,643	1,317,128
Unobligated balance:		
Apportioned	–	124,157
Total, Status of Budgetary Resources	**$ 2,194,643**	**$ 1,441,285**

UNAUDITED

Comparative Statements of Budgetary Resources (CONTINUED)

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 16.a)

	2003	2002
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 68,479	$ 259,114
Obligated Balance, Net — end of period:		
Accounts receivable	(697,944)	(204,275)
Unfilled customer order from Federal sources	(80,160)	(94,465)
Undelivered orders	193,910	231,709
Accounts payable	393,071	135,510
Outlays:		
Disbursements	1,974,882	1,494,717
Collections	(1,883,339)	(1,373,366)
Subtotal	91,543	121,351
Net Outlays	**$ 91,543**	**$ 121,351**

Comparative Statements of Financing

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 17)

	2003	2002
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 2,194,643	$ 1,317,128
Less: Spending authority from offsetting collections and recoveries	(2,362,703	(1,386,412)
Obligations net of offsetting collections and recoveries	(168,060)	(69,284)
Net obligations	(168,060)	(69,284)
Other Resources		
Transfers in/out without reimbursement	(91,088)	–
Imputed Financing Sources	37,943	39,913
Net other resources used to finance activities	(53,145)	39,913
Total resources used to finance activities	**$ (221,205)**	**$ (29,371)**

UNAUDITED

Comparative Statements of Financing (CONTINUED)

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 17)

	2003	2002
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	37,840	9,931
Unfilled Customer Orders	(14,305)	(77,083)
Resources that fund expenses recognized in prior periods	–	(15,509)
Resources that finance the acquisition of assets	(46,056)	(24,945)
Other	91,088	–
Total resources used to finance items not part of the net cost of operations	68,567	(107,606)
Total resources used to finance the net cost of operations	**(152,638)**	**(136,977)**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	(25,296)	–
Increase in exchange revenue receivable from the public	(588)	–
Other	25,783	–
Total components of Net Cost of Operations that will require or generate resources in future periods	**(101)**	**–**
Components not Requiring or Generating Resources		
Depreciation and amortization	65,153	69,374
Revaluation of assets or liabilities	(24,498)	–
Total components of Net Cost of Operations that will not require or generate resources	40,655	69,374
Total components of net cost of operations that will not require or generate resources in the current period	**40,554**	**69,374**
Net Cost of Operations	**$ (112,084)**	**$ (67,603)**

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Reutilization and Marketing Overview

Defense Reutilization and Marketing Activity Group

The Defense Reutilization and Marketing Service (DRMS) coordinates the reuse of excess and surplus DoD property. The reutilization of excess materiel by DoD customers reduces the need to purchase new materiel. In FY 03, materiel with an acquisition value of $11.5 billion was turned in to DRMS and $1.1 billion was reutilized within DoD. DRMS also oversees the demilitarization and disposal of the remaining property through transfers, donations, and sales, or its ultimate disposal, as in the case with hazardous waste.

The DRMS headquarters is located in Battle Creek, MI, and its mission is accomplished through 92 Defense Reutilization and Marketing Offices (DRMO) located on military installations throughout the world. DRMOs receive, classify, segregate, demilitarize, account for, and report excess materiel for screening, lot categorization, merchandising, and sale. Using the guidelines for A-76 competition, DRMS issued a request for proposal on May 19, 2003, for the stock, store, and issue function of usable property at 69 Continental United States (CONUS) DRMOs. The current date for receipt of proposals is November 24, 2003.

Mission

DRMS manages the reutilization, transfer, donation, and sale of military personal property, as well as disposal of hazardous waste items no longer needed for national defense. Its mission is to maximize the financial return on the initial equipment investment, conserve valuable natural resources, and protect the environment. The FY 03 mission was performed with approximately 1,600 personnel and generated revenues of almost $343 million.

Strategic Goals

The long-term goals of the Reutilization and Marketing activity group are consistent with the goals contained in the DLA Strategic Plan. These goals are achieved through a series of supporting objectives and initiatives designed to improve and reengineer business practices to ensure efficient, effective, and best-value operational support.

FY 03 Accomplishments

DRMS made significant progress toward its Balanced Scorecard and FY 03 Game Plan objectives:

- Met or exceeded our customers' expectations
- Streamlined and improved processes to deliver the most effective disposal services
- Created an environment to encourage innovative thinking and enabled our workforce to deliver and sustain world-class performance
- Provided disposal services of maximum value

Key mission accomplishments include:

Environmental Stewardship:

- Polychlorinated Biphenyl (PCB) Retrograde. A major accomplishment was the removal of PCBs from Japan with zero safety mishaps. A DRMO PCB Retrograde Team from Port Hueneme, CA, partnered with members of the Naval Base in Ventura County, the Military Traffic Management Command, the California Highway Patrol, and contracted environmental specialist personnel to ensure the safe and environmentally sound transfer of PCBs from Japan to licensed and permitted disposal sites in the U.S. The team successfully offloaded, inspected, and shipped 237 vans and 27 pieces of break bulk containing PCB contaminated electrical equipment. The operation included the coordination of 137 semi-trucks from 3 different companies moving property to 3 disposal sites located in 3 states (Nevada, Kansas, and West Virginia). The California Environmental Protection Agency Department of Toxic Substance Control (DTSC) conducted an inspection that resulted in "No violations of hazardous waste laws, regulations, and requirements." Historically, only 10 percent of DTSCs inspections garner this result.

- OPERATION ENDURING FREEDOM Hazardous Waste (HW) Disposal Support. DRMS awarded a contract — with four option years with a potential aggregate cost of $4.9 million — to provide HW disposal services in Afghanistan, Pakistan, Uzbekistan, Tajikistan, and Kyrgyzstan. In FY 03, hazardous waste generations disposed under this contract totaled 291,466 kilograms. In a related program, DRMS awarded an $800 thousand multi-year option contract to dispose hazardous waste generated by U.S. Forces operating in the Philippines.
- Saudi Arabia Hazardous Waste Removal. DRMS concluded its support of the Prince Sultan Air Force Base closure when the final hazardous waste removal was conducted in August, 2003.

Automation: DRMS continues to promote the web-based Electronic Turn-In Document (ETID) program to optimize the benefits inherent in automated business processes. ETID simplifies the turn-in process by eliminating the need for customers to prepare a hand-scribed/typewritten turn-in document. Its success is demonstrated by its rapid growth: the number of customer sites that used ETID increased more than 240 percent (from 194 customer sites to 466) in FY 03, and the number of ETIDs created in FY 03 was almost four and one-half times the number created in FY 02 (123,463 vs. 27,925).

Program Performance Measures

Reutilization/Transfer/Donation (R/T/D) rate: This indicator represents the aggregate number of line items of the property reutilized, transferred, and donated expressed as a percentage of the total line items disposed. The indicator applies to the available assets that are economically reused, thus preventing concurrent procurement of new assets. It addresses disposal via reutilization by another defense customer, transfer to another Federal Agency, or donation to an eligible state or local government or to a non-profit organization. R/T/D dispositions, as a percentage of total dispositions, indicates compliance with Federal regulations that mandate reuse through these cost avoidance programs as the first priority of disposal. In FY 03, the R/T/D rate exceeded its goal of at least 14 percent of the line items of property available for disposal. DRMS successfully reutilized, transferred, or donated almost 200,000 line items of excess property for an R/T/D rate of slightly less than 20 percent.

- OPERATIONS ENDURING FREEDOM/IRAQI FREEDOM Reutilization: Total reutilization supporting these two contingencies surpassed 2,500 line items with a value of more than $25 million. Examples of the types of items issued in support of these operations include water purification units and an x-ray machine.
- Computers for Learning. DRMS is responsible for overseeing the transfer of computers to schools in support of the Department's Computers for Learning Program. In FY 03, almost 500 schools were approved to participate in the program, and computers worth over $400,000 in acquisition value were transferred.

R/T/D will continue to increase as a percentage of total dispositions by:

- Implementing changes that will improve the information on available property. This includes providing photos on the web and better written descriptions;
- Identifying potential items of interest that may be in batch lots;
- Providing interactive notification lists; and
- Working closely with supply centers to fulfill backorders.

Financial Performance Measures	FY 03 Goal	FY 03 Actual
Cost incurred per line item of useable property received — Receiving	$ 23.458	$ 19.191
Cost incurred per line item — Reutilization/Transfer/Donation (R/T/D)	$ 268.00	$ 201.30
Cost incurred per Pound — Hazardous Waste Disposal	$ 0.203	$ 0.178
Cost incurred per line item — Useable Sales Proceeds	$ 55.89	$ 35.49
Cost incurred per Pound — Recycling / Disposal	$ 0.056	$ 0.036

Financial Performance Measures

We measure the effectiveness of program budgeting and execution with unit cost performance measures. Cost is defined as obligations incurred in support of or attributed to the service performed. DRMS is measured on five unit cost goals: Receiving, Reutilization/Transfer/Donation (R/T/D), Hazardous Waste Disposal, Useable Sales, and Recycling/Disposal. The above table depicts the unit cost results for each category.

In FY 03, DRMS undertook a major initiative to review, analyze, and validate the documents that support its accounting records. The analysis revealed a large number of prior year documents where the financial transactions, in particular the accounts payable, were incomplete. Based on its review, DRMS deobligated (reversed the obligation) approximately $52.8 million.

The Receiving unit cost was lower than planned due to deobligations. If these deobligations had not occurred, then the unit cost would have been $24.736. The adjusted unit cost was above the goal due to changes in the alignment of costs from the plan, offset by higher than planned workload (i.e., receipts of 3.1 million line items vs. the plan of 2.9 million line items).

The R/T/D unit cost was lower than planned due primarily to deobligations. If these deobligations had not occurred, then the unit cost would have been $258.14. This adjusted unit cost was below the goal due to higher than planned workload (i.e., slightly more than 199,000 line items disposed by R/T/D vs. the plan of 172,000). This workload was higher due primarily to the discontinuance of batch-lotting of certain federal supply classes, which gave greater visibility of items available to reutilization customers.

The Hazardous Waste Disposal unit cost was lower than planned due to deobligations. If the deobligations had not occurred, then the unit cost would have been $.216. The adjusted unit cost was above plan due to the cost of transporting (from Japan to stateside) and disposing of 2.5 million pounds of PCB items.

The Useable Sales unit cost was lower than planned due primarily to deobligations. If these deobligations had not occurred, then the unit cost would have been $50.03. The adjusted unit cost was also below the goal due to changes in the alignment of costs from the plan.

The Recycling/Disposal unit cost was lower than planned due primarily to deobligations. If these deobligations had not occurred, then the unit cost would have been $.047. The adjusted unit cost was below the goal due to changes in the alignment of costs from the plan and the processing of almost 7 percent more pounds of scrap than planned (908.9 million pounds vs. the plan of 852.2 million pounds).

Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of revenue over expenses of more than $80 million compared to a planned net cost of ($34.0 million). The decreased net cost is primarily attributed to the cleaning up of accounts payable records that reduced reported expenses by almost $47 million.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Reutilization and Marketing

Comparative Financial Statements
As of and for the Years Ended September 30, 2003, and 2002

UNAUDITED

Comparative Balance Sheets

As of September 30, 2003 and 2002
(In Thousands)

	2003	2002
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	669	1,966
TOTAL INTRAGOVERNMENTAL ASSETS	669	1,966
Cash and Other Monetary Assets (Note 5)	6,443	4,390
Accounts Receivable (Note 3)	13,179	11,736
Inventory and Related Property (Note 6)	–	–
General Property, Plant and Equipment (Note 7)	81,500	92,616
Other Assets (Note 4)	133	39
Total Assets	**$ 101,924**	**$ 110,747**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 62,728	$ 1,575
Other Liabilities (Note 11 and Note 12)	5,850	4,425
Total Intragovernmental Liabilities	68,578	6,000
Accounts Payable (Note 9)	25,180	132,569
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	20,882	19,232
Environmental Liabilities (Note 10)	–	–
Other Liabilities (Note 11 and Note 12)	42,525	41,350
Total Liabilities	**$ 157,165**	**$ 199,151**
NET POSITION		
Cumulative Results of Operations	(55,241)	(88,404)
Total Net Position	**$ (55,241)**	**$ (88,404)**
TOTAL LIABILITIES AND NET POSITION	**$ 101,924**	**$ 110,747**

UNAUDITED

Comparative Statements of Net Cost

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 14.a)

	2003	2002
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 36,425	$ 81,945
Less: Intragovernmental Earned Revenue	(287,414)	(313,538)
Intragovernmental Net Costs	(250,989)	(231,593)
Gross Costs With the Public	225,546	217,946
Less: Earned Revenue From the Public	(55,006)	(37,622)
Net Costs With the Public	170,540	180,324
Total Net Cost	**(80,449)**	**(51,269)**
NET COST OF OPERATIONS	**$ (80,449)**	**$ (51,269)**

Comparative Statements Changes in Net Position

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 15)

	2003	2002
BEGINNING BALANCES	**$ (88,404)**	**$ 10,381**
Budgetary Financing Sources:		
Other budgetary Financing Sources	(5,624)	–
Other Financing Sources:		
Transfers-in/out without reimbursement	(56,810)	(158,579)
Imputed Financing Sources	15,148	8,524
Total Financing Sources	(47,286)	(150,055)
Net Cost of Operations	**(80,449)**	**(51,269)**
ENDING BALANCES	**$ (55,241)**	**$ (88,405)**

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Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 16.a)

	2003	2002
BUDGETARY RESOURCES:		
Budget Authority:		
Contract authority	$ 193,460	–
Unobligated balance:		
Beginning of period	51,057	49,267
Spending authority from offsetting collections:		
Earned		
Collected	344,324	369,860
Receivable from Federal sources	(3,004)	(18,363)
Change in unfilled customer orders		
Advance received	(1,677)	(18,855)
Without advance from Federal sources	(2,121)	1,603
Subtotal	337,522	334,245
Permanently not available	(58,791)	(74,812)
Total Budgetary Resources	**$ 523,248**	**$ 308,700**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 244,517	$ 257,643
Subtotal	244,517	257,643
Unobligated balance:		
Apportioned	55,683	51,057
Unobligated Balances Not Available	223,048	–
Total, Status of Budgetary Resources	**$ 523,248**	**$ 308,700**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 157,374	$ 195,352
Obligated Balance, Net — end of period:		
Accounts receivable	(12,915)	(15,919)
Unfilled customer order from Federal sources	(934)	(3,055)
Undelivered orders	37,406	39,995
Accounts payable	97,584	136,354
Outlays:		
Disbursements	285,876	312,382
Collections	(342,647)	(351,006)
Subtotal	(56,771)	(38,624)
Net Outlays	**$ (56,771)**	**$ (38,624)**

UNAUDITED

Comparative Statements of Financing

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 17)

	2003	2002
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 244,517	$ 257,643
Less: Spending authority from offsetting collections and recoveries	(337,522)	(334,245)
Obligations net of offsetting collections and recoveries	(93,005)	(76,602)
Net obligations	(93,005)	(76,602)
Other Resources		
Transfers in/out without reimbursement	(56,810)	–
Imputed Financing Sources	15,148	8,524
Net other resources used to finance activities	(41,662)	8,524
Total resources used to finance activities	**$ (134,667)**	**$ (68,078)**
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	2,496	13,128
Unfilled Customer Orders	(3,797)	(17,252)
Resources that fund expenses recognized in prior periods	(104)	(4,073)
Resources that finance the acquisition of assets	(6,237)	(1,081)
Other	56,810	24
Total resources used to finance items not part of the net cost of operations	49,168	(9,254)
Total resources used to finance the net cost of operations	**(85,499)**	**(77,332)**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	(7,139)	–
Increase in environmental and disposal liability	(141)	–
Increase in exchange revenue receivable from the public	(1,102)	–
Other	1,818	–
Total components of Net Cost of Operations that will require or generate resources in future periods	**(6,564)**	**–**

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Comparative Statements of Financing (CONTINUED)

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 17)

	2003	2002
Components not Requiring or Generating Resources		
Depreciation and amortization	$ 12,205	$ 24,017
Revaluation of assets or liabilities	(477)	–
Other	(114)	2,046
Total components of Net Cost of Operations that will not require or generate resources	11,614	26,063
Total components of net cost of operations that will not require or generate resources in the current period	**5,050**	**26,063**
Net Cost of Operations	**$ (80,449)**	**$ (51,269)**

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Document Automation and Production Overview

Document Automation and Production Service

The Document Automation and Production Service (DAPS) manages its mission through a headquarters, located in Mechanicsburg, PA, and a world wide network of 184 production facilities. DAPS is responsible for the DoD printing, duplicating, and document automation programs that encompass: value-added conversion, knowledge management, electronic storage and output, and the distribution of hard copy and digital information. All DoD printing requirements, whether produced in-house or procured through the Government Printing Office, are forwarded to DAPS to ensure compliance with DoD directives and the Federal Printing Program. In addition, the Congressional Joint Committee on Printing exercises oversight over all Federal printing, including DAPS in-house capability. During FY 03, DAPS earned more than $393 million in revenue and employed just under 900 people at year-end (a 10 percent end strength reduction from FY 02). Major customers are: Air Force (22.1 percent), Navy (31.1 percent), Army (21.0 percent), Defense Agencies (17.0 percent), and non-DoD customers (8.8 percent).

Mission

The mission of DAPS is to provide best value document automation and management services in support of America's Armed Forces and Federal Agencies, including the capture, management, access, distribution and output of digital and hardcopy information. DAPS provides time sensitive, competitively priced, high quality products and services that are produced in-house or procured from commercial sources. DAPS is the recognized leader in document automation and the customer-preferred provider of automated digital and hardcopy information products and services. Primary focus is placed on the transition from paper to electronic-based document management, which is an integral part of the DoD plan to move into the age of electronic documents and commercial business practices.

Strategic Goals

DAPS is committed to the following goals:

- Serving as a major catalyst in transforming business by revolutionizing document automation services;
- Rapidly utilizing technology for agile and responsive internal business solutions;
- Aggressively pursuing partnerships with government, industry, and suppliers;
- Ensuring the DAPS workforce is enabled to deliver and sustain world-class performance;
- Striving to reduce costs, simplify organizational structure, eliminate unnecessary facilities, and ensure that equipment and personnel are commensurate with the workload; and
- Aligning our processes to focus on improving the quality of our products and services while meeting or exceeding our customers' delivery requirements.

FY 03 Major Accomplishments

Electronic Document Management System (EDMS): DAPS incurred a cost of $3.0 million to add document conversion capabilities at 15 Defense Distribution Center (DDC) depots. This effort completed the implementation of EDMS for all 22 depot locations. The system is important to DDC because it standardizes: document management, work process management, web accessibility, and records management across the DDC enterprise. The EDMS replaces inefficient, non-integrated and costly legacy processes, while it improves inventory accuracy, makes information quickly accessible, and reduces operational costs. EDMS is expected to generate $11.0 million savings in its first 7 years.

Upgraded Electronic Data Access (EDA) System: The Continuity of Operations requirements and the practice of storing and using paper invoices drove DFAS to seek a less costly means of storing contract and voucher information. DoD implemented EDA as an alternative method of retaining this information. EDA is a comprehensive information distribution system that provides DoD with the capability to electronically store and view contract and voucher documents, thus reducing the need to print, mail, file, and manage paper. DAPS' primary efforts were to: collect data from originating sites, convert that data to Portable Document Format (PDF) documents; index according to business rules; and transfer and audit the converted PDF documents and indexes to the Defense Information Systems Agency. DAPS upgrade presents a "Data to Data" solution that will reduce storage from 1.2 terabytes to 300 gigabytes or one fourth the storage requirement. DAPS cost of $1.3 million in FY 03 will generate a total of $2.9 million in savings to DFAS from FY 03 to FY 07.

DAPS Online Interface (DOL): This initiative produced an interface between DAPS Online and the Defense Working Capital Accounting System (DWAS) at a cost of $1.2 million. The interface reduces DWAS input time and cost and enhances information flow to the customer. When fully implemented, DOL will receive jobs, capture keystrokes, and automate billing transactions with the expectation of producing a 50 percent savings in administrative processing time — from 16 minutes to 8 minutes per job — and generate estimated annual savings of $1.1 million.

Implemented the Most Efficient Organization: By implementing its most efficient organization, DAPS anticipates significant savings. The exact amount of savings will be determined by an independent audit during FY 04.

Program Performance Measures

Conversion to Digital Format: This performance metric measures the number of pages converted to digital format during the year. Conversions may be accomplished either in-house or by contract and includes hardcopy to digital, system output to digital, and from one form of digital to another. Actual production of 67.0 million pages exceeded the goal of 59.2 million pages converted and represented an increase of 8 percent from FY 02.

Production Efficiency Factor: This performance metric measures production efficiency in terms of units produced per hour. The units are converted to standard hours earned. Employee time is captured by cost center as hours available. The employee hours available are divided into the hours earned to produce the production efficiency factor shown as a percentage. DAPS production efficiency was 100.4 percent for FY 03, with a goal of 100 percent.

Product Rework: In-house rework percentage is used to measure the quality of delivered products. This performance metric is calculated by dividing revenue lost from orders not accepted by the total in-house production revenue. During FY 03, DAPS achieved a rework percentage of .22 percent to beat our goal of .36 percent.

Unit Cost Results	FY 03 Goal	FY 03 Actual
Unit Cost per In-House Production Unit	.0558	.0493

Financial Performance Measures

In addition to program performance measures, DAPS measures the effectiveness of program budgeting and execution with a unit cost performance measure. It measures the total units produced relative to the total cost to produce those items.

DAPS bettered its unit cost goal because actual in-house costs were lower than planned, $131.1 million versus $143.7 million, while the actual units produced were higher than planned, 2,678.4 million versus 2,575.1 million. The production of In-house units was higher than planned due to the increased operating tempo of the DoD and the customers' requirement that DAPS continue to man and operate facilities that were scheduled to be converted to self-service. The major causes of lower in-house costs were the Army's decision not to transfer the management of printing operations from the Army Corps of Engineers, Seoul to DAPS and the higher than anticipated employee attrition rate.

Results

The Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of revenue over expenses of more than $21 million compared to a planned net cost of almost $-41 million. The increase in net cost is primarily attributed to a reduction in planned revenue (almost $14 million) and the retention of equipment and associated maintenance cost (more than $6 million) that was projected to be saved.

DEFENSE LOGISTICS AGENCY WORKING CAPITAL FUND

Document Automation and Production Service

Comparative Financial Statements
As of and for the Years Ended September 30, 2003, and 2002

UNAUDITED

Comparative Balance Sheets

As of September 30, 2003 and 2002
(In Thousands)

	2003	2002
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury	$ –	$ –
Accounts Receivable (Note 3)	25,702	86,611
TOTAL INTRAGOVERNMENTAL ASSETS	25,702	86,611
Accounts Receivable (Note 3)	2,491	2,379
Inventory and Related Property (Note 6)	8,572	10,508
General Property, Plant and Equipment (Note 7)	22,305	20,221
Other Assets (Note 4)	99	99
Total Assets	**$ 59,169**	**$ 119,818**
LIABILITIES (Note 8)		
Intragovernmental:		
Accounts Payable (Note 9)	$ 94,648	$ 2,456
Other Liabilities (Note 11 and Note 12)	3,068	2,420
Total Intragovernmental Liabilities	97,716	4,876
Accounts Payable (Note 9)	9,657	128,617
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 13)	15,205	10,508
Environmental Liabilities (Note 10)	–	–
Other Liabilities (Note 11 and Note 12)	(50,163)	5,830
Total Liabilities	**$ 72,415**	**$ 149,831**
NET POSITION		
Cumulative Results of Operations	(13,246)	(30,013)
Total Net Position	**$ (13,246)**	**$ (30,013)**
TOTAL LIABILITIES AND NET POSITION	**$ 59,169**	**$ 119,818**

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Comparative Statements of Net Cost

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 14.a)

	2003	2002
PROGRAM COSTS		
Intragovernmental Gross Costs	$ 297,053	$ 28,250
Less: Intragovernmental Earned Revenue	(387,027)	(381,044)
Intragovernmental Net Costs	(89,974)	(352,794)
Gross Costs With the Public	75,362	388,464
Less: Earned Revenue From the Public	(6,400)	(2,974)
Net Costs With the Public	68,962	385,490
Total Net Cost	**(21,012)**	**32,696**
NET COST OF OPERATIONS	**$ (21,012)**	**$ 32,696**

Comparative Statements Changes in Net Position

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 15)

	2003	2002
BEGINNING BALANCES	**$ (30,013)**	**$ (11,764)**
Budgetary Financing Sources:		
Appropriations used	–	100
Other Financing Sources:		
Transfers-in/out without reimbursement	(9,432)	8,290
Imputed Financing Sources	5,187	6,057
Total Financing Sources	(4,245)	14,447
Net Cost of Operations	**(21,012)**	**32,696**
ENDING BALANCES	**$ (13,246)**	**$ (30,013)**

UNAUDITED

Comparative Statements of Budgetary Resources

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 16.a)

	2003	2002
BUDGETARY RESOURCES:		
Budget Authority:		
Appropriations received	$ –	$ 100
Contract authority	2,085	–
Unobligated balance:		
Beginning of period	38,002	21,463
Spending authority from offsetting collections:		
Earned		
Collected	398,269	401,931
Receivable from Federal sources	(4,842)	(17,640)
Change in unfilled customer orders		
Advance received	94	(61)
Without advance from Federal sources	(5,501)	(4,142)
Subtotal	388,020	380,088
Permanently not available	(155,228)	32,515
Total Budgetary Resources	**$ 272,879**	**$ 434,166**
STATUS OF BUDGETARY RESOURCES:		
Obligations incurred:		
Reimbursable	$ 342,396	$ 396,164
Subtotal	342,396	396,164
Unobligated balance:		
Apportioned	(69,517)	38,002
Total, Status of Budgetary Resources	**$ 272,879**	**$ 434,166**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Obligated Balance, Net — beginning of period	$ 61,168	$ 53,481
Obligated Balance, Net — end of period:		
Accounts receivable	(84,211)	(89,053)
Unfilled customer order from Federal sources	(16,333)	(21,834)
Undelivered orders	15,255	39,307
Accounts payable	110,265	132,747
Outlays:		
Disbursements	388,931	410,260
Collections	(398,363)	(401,870)
Subtotal	(9,432)	8,390
Net Outlays	**$ (9,432)**	**$ 8,390**

UNAUDITED

Comparative Statements of Financing

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 17)

	2003	2002
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 342,396	$ 396,164
Less: Spending authority from offsetting collections and recoveries	(388,020)	(380,088)
Obligations net of offsetting collections and recoveries	(45,624)	16,076
Net obligations	(45,624)	16,076
Other Resources		
Transfers in/out without reimbursement	(9,432)	–
Imputed Financing Sources	5,187	6,057
Net other resources used to finance activities	(4,245)	6,057
Total resources used to finance activities	**$ (49,869)**	**$ 22,133**
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	24,052	10,815
Unfilled Customer Orders	(5,406)	(4,203)
Resources that fund expenses recognized in prior periods	–	(2,490)
Resources that finance the acquisition of assets	(3,475)	(5,101)
Other	9,432	–
Total resources used to finance items not part of the net cost of operations	24,603	(979)
Total resources used to finance the net cost of operations	**(25,266)**	**21,154**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	(4,561)	4,561
Other	5,489	–
Total components of Net Cost of Operations that will require or generate resources in future periods	**928**	**4,561**

UNAUDITED

Comparative Statements of Financing (CONTINUED)

For the Years Ended September 30, 2003 and 2002
(In Thousands) (See Note 17)

	2003	2002
Components not Requiring or Generating Resources		
Depreciation and amortization	$ 3,007	$ 3,206
Revaluation of assets or liabilities	319	3,645
Other	–	130
Total components of Net Cost of Operations that will not require or generate resources	3,326	6,981
Total components of net cost of operations that will not require or generate resources in the current period	**4,254**	**11,542**
Net Cost of Operations	**$ (21,012)**	**$ (32,696)**

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